Draft version, not yet officially authorized for quoting.

James Kanali Kwatemba SJ, MA

# Kenya III: Context & History

With contributions by Dr. Jörg Alt SJ, MA, BD

governance

[Wählen Sie das Datum aus]

Draft version, not yet officially authorized for quoting.

## Contents


1 History of Taxation in Kenya .......... 1

1.1 Introduction .......... 3

1.1.1 The Arabs, Portuguese and British in Kenya- Taxation Policy .......... 5

1.2 Structure and Type of Taxes in Pre-independence Kenya .......... 7

1.2.1 Hut and Poll Tax .......... 7

1.2.2 Land Tax .......... 9

1.2.3 Graduated Personal Tax .......... 9

1.2.4 Income tax .......... 10

1.3 Tax Review .......... **Fehler! Textmarke nicht definiert.**

1.3.1 Key challenges of the tax review after independence .......... 13

1.3.2 Observations .......... 12

1.4 The Kenya Revenue Authority .......... **Fehler! Textmarke nicht definiert.**

1.5 Concluding comments .......... 14

2 Bibliography .......... 16

Draft version, not yet officially authorized for quoting.

# 1 Country Information

## 1.1 General overview

Kenya, officially referred to as the Republic of Kenya, is located in the Eastern part of Africa. Covering an area of approximately 581,000 Km², Kenya is located on the equator and has the Indian Ocean lying in the south-east. By 2014, the population of Kenya stood at an estimated 45 million people. The country has a young population with about 73% aged below 30 years. Nairobi, the nation's capital, is the most populous city with over 3 million inhabitants. Mombasa, a tourist city located on the shores of the Indian Ocean, is the second most populated city inhabited by over a million residents. Its currency is the Kenyan Shilling (KES).

Kenya is home to about 42 different ethnic communities. The country's two official languages are English and Swahili which are used in varying degrees for communication. While English is mainly used in commerce, government and schooling, Swahili is commonly spoken in urban and peri-urban areas. Rural communities typically speak their mother tongues.

Having been under British colonial rule, Kenya gained her independence in 1963. It has a multi-party democratic system. The head of state and government is the President. Whereas executive power is exercised by the president and the cabinet, legislative powers are vested in both the national assembly and the senate. The judiciary is independent of the executive and the legislature.

Under the new Constitution of 2010, Kenya has a devolved political administrative system. Political administrative functions are shared between the central government and semi-autonomous regional administrative units referred to as counties. There are 47 counties across Kenya headed by elected governors. Prior to the new constitution, Kenya had a central government with 8 provinces that were subdivided into districts. Provinces were headed by a provincial commissioner appointed by the president.

Kenya's economy is the largest in the eastern and central African region. In fact, it is in Kenya-Nairobi that the Headquarters of the Eastern African Community, a regional political and economic body for eastern Africa countries, is located. Besides being a member of the Eastern African Community, Kenya is also a member of the Common Market for Eastern and Southern Africa (COMESA) as well as the African Union (AU). Kenya is famous for its exotic natural tourist attractions and for world record accomplishments in athletics.

## 1.2 Economy

With a fairly diversified economy, its important sectors are services, agriculture and manufacturing. The services industry, which accounts for about 60% of GDP, is mainly dominated by tourism. Agriculture, including forestry and fishing, contributes to over 20% to the country's GDP. Manufacturing's contribution to the economy is estimated at 14%. Agriculture and tourism are the country's biggest foreign exchange earning sectors. Due to the large inflow of investments, construction and telecommunications sectors are booming.

According to the World Bank Kenya has a population estimated at 46.1 million, which increases by an estimated one million a year. With support of the World Bank Group (WBG), the International Monetary Fund (IMF) and other development partners, Kenya has somehow made significant structural and economic reforms that have contributed to sustained economic growth in the past decade. However, development challenges that include poverty, inequality, climate change, and vulnerability of the economy to internal and external shocks still exist (The World Bank, 2016).

*The World Bank's recent Kenya Economic Update (KEU) of October 2016 projected a 5.9% growth in 2016, rising to 6% in 2017. The key drivers for this growth would be: a vibrant services sector, enhanced construction*, currency stability, low inflation, low fuel prices, a growing middle-class and rising incomes, a surge in remittances, and increased public investment in energy and transportation.

According to the latest Kenya National Bureau of Statistics (KNBS) quarterly report, Kenya's economy expanded by 5.7% in the third quarter of 2016 compared to 5.8% in the same period in 2015. The quarterly report added that the economic growth was spread although most of the sectors of the economy recorded a slowed growth. The tourism and hotel industry, information and communications, and public administration are among the sectors that registered improved growth during the quarter. Inflation was contained within the Central Bank's target to average at 6.3% compared to an average of 6.14% during the same quarter in 2015. The slight increase in inflation was primarily due to increases in the prices of food and beverages during the period under review. Further the amendment of the Banking Act in August 2016 to cap the lending rates to a maximum of 4% above the Central Bank Rate (CBR) resulted in substantial decline of the interest rates during the month of September to 13.84% from 16.75% within the same month of 2015 (The World Bank, 2016). However, the report also notes that Kenya's economy remains vulnerable to domestic risks that could moderate the growth prospects. These include the possibility that investors could defer investment decisions until after the elections, that election-related expenditure could result to a cut back in infrastructure spending, and that security remains a threat, not just in Kenya, but globally. Finally, changes in monetary policy in industrialized countries could trigger volatility in financial markets putting the currency under pressure.

The Kenyan economy is largely driven by the private sector with a significant presence of Multinational entities ("MNEs") in most of the key economic sectors such as Agriculture, Manufacturing and Financial services. Taxation is the single largest source of government revenue with MNEs contribution to tax revenue and gross domestic product ("GDP") in general considered significant; - Although there is no conclusive evidence that MNEs in Kenya are engaged in abusive tax and transfer pricing practices, the inability of the tax authorities to effectively assess the often complex cross border transactions puts the authorities at the mercy of the MNEs and in a position where they may not be able to determine if the tax authority is receiving the right amount of tax from MNEs. Kenya's economy is market-based, with a few state-owned enterprises and a liberalised external trade system. The country is generally perceived as Eastern and Central Africa's hub for financial, communication and transportation services.

While the country is set for further medium-term growth, the report recommends reforming the systemic weaknesses of the country's Public Investment Management (PIM) system, to see stronger growth. PIM is currently characterized by low execution and cost escalation of

infrastructure projects. “There is also urgent need to streamline the process of land acquisition, compensation and resettlement which lead to significant delays and cost escalation in the design and execution of public infrastructure projects adds the report (The World Bank, 2016).

Of interest and perhaps what gives credence to this research are other alternatives to taxation. The report sums up saying Kenya is creating more jobs now, but mainly in the informal sector. As such to increase productivity of jobs in the informal sector, policy interventions could be geared towards increasing access to broad skills beyond formal education, creating linkages between formal and informal firms, and helping small scale firms enter local and global value chains.

**Development Challenges**

Kenya has the potential to be one of Africa’s great success stories from its growing youthful population, a dynamic private sector, a new constitution, and its pivotal role in East Africa. Addressing challenges of poverty, inequality, governance, climate change, low investment and low firm productivity to achieve rapid, sustained growth rates that will transform lives of ordinary citizens, will be a major goal for Kenya. The demand for public services may rise faster than income (the income elasticity for services is greater than one). For instance, urbanization tends to rise with income, and the demand for public services is generally higher in urban areas. At the same time, however, it is usually easier to collect taxes in urbanized areas. More generally, the capacity of a country to collect taxes appears to rise as income levels increase.

# 2 History of Taxation in Kenya

## 2.1 Introduction

Kenya before colonisation was made up of a myriad of tribal based societies all with their own fixed ethnic geographical territory. African society in pre-colonial times can be termed as a communist/socialist society where almost all the properties were communally owned with all members sharing in community wealth. However, in most if not all tribes generally, whatever production took place required that a part of it be remitted to the house of the chief of the tribe and community. This included parts of any harvest whether it was agricultural produce, trading profits or gifts. Both foreign and local traders, especially in ivory and slaves were all required to pay tithes in order to be allowed passage through the territory of a particular tribe. Thus, there was generally no taxation in the form that we understand it today

but there were remittances to the ruler in exchange of which peace was maintained and protection accorded (Waris, 2007)
The tithe levied was never more than affordable and often in cases of famine, the chief of the tribe as well as the more successful farmers would give food to the famine-affected members of the tribe. None died of starvation as long as there was food in the tribe and tithes were paid on the basis of a portion of production, thus applying the principle of 'productivity'.
'Economy', was maintained by the levy of a fixed percentage of produce. Hence a 'simple' system based mainly on voluntary payment resulted in an administratively efficient and fair system. The tithe was remitted to the chief after a harvest usually in form of produce making it both 'convenient' and 'flexible'. Since the payment was in the form of perishable goods, a ruler, would not demand too much as he would only take as much as he himself needed. As far as traders were concerned, this was applied on the basis of the amount of goods being ferried into or out of the tribal territory and was a fixed percentage levied by the warriors of the tribe who took the traders to the king to pay tribute directly. Warris (2007) argues further by stating that there are no recorded instances of traders being kept waiting for days or of payment being refused and thus the principles of efficiency, simplicity by accepting any form of payment including in the goods being traded. The principle of equity was used in the levy of this form of 'passage right' tax; it was usually a fixed amount for passage through land based on the numbers of people or amount of goods. However, inefficiency may have been evidenced by the fact that the entire trading party had to present themselves to the chief or the king and give him his tribute personally. In conclusion, these diverse tribal based tax systems were at best extremely rudimentary, simple and operated at a very small scale.

The following authors, Acemoglu, Johnson and Robinson (2001) have argued that without significant European settlement colonial governments were not necessarily committed to the development of growth-promoting institutions. Instead, near "absolutist" governments imposed extractive institutions to facilitate the exploitation of indigenous labour and natural resources through trade, land appropriation, excessive taxation or outright plunder. As further argued by Frankema Ewout the "revenue imperative" of African colonial governments was a precondition for establishing European hegemony as it not only provided the necessary

resources, but also symbolized the authority and legitimacy of the colonial state (Frankema, 2011).

## 2.2 The Arabs, Portuguese and British in Kenya- Taxation Policy

Although there were trading links between East Africa and other seafaring nations, none really managed to obtain a dominating stronghold of rule. The Arabs came first but were not interested in extending rule beyond the coastal area. They were interested in trading of ivory and slaves but without any apparent need to conquer. They remained along the coastline of East Africa for business expediency to facilitate trade between the hinterland and the Arab traders who came from the Sultanate of Oman (Waris, 2007). The contact of the Arabs and the indigenes at the coastline is important as far as taxation in Kenya is concerned. Most of them remained along the coastline of East Africa for business expediency, to facilitate trade between the hinterland and the Arab traders who mainly came from the Sultanate of Oman (Waris, 2007). The Sultanate applied a system of taxation that was a mixture of Islamic law as well as trade tax in order to maintain their presence at the coast. The locals were taxed using the Islamic law in the form of *zakat*,[1] *jizya*[2], *sadaqa*[3] and *khums*[4] in addition to customs levy, capitation tax (a capitation is a head tax, tax on each individual) as well as harbour fees (Waris, 2007). Customs was charged on all goods taken out of the Sultanate and these included cloves, ivory and beads. It is imperative to know that the taxpayers were divided in two separate tax bases, the citizenry within each Sultanate and the traders. People practicing the Muslim faith were expected to pay the voluntary taxes in a manner deemed fit and the amount they felt adequate without state interference. The Sultanate concentrated on maintaining their coffers by trading levies of capitation tax and customs.

[1] *Zakat* is a form of voluntary single capital tax levied only on Muslims that can never be less than 2.5% on all savings and all cash assets idle for the year.
[2] *Jizya* was a tax imposed on conquered non-Muslims in a Muslim nation under treaties signed between the two communities as a payment in lieu of compulsory military service.
[3] It is given for charitable purposes and is under no control whatsoever, is a source reliant on the charitable feelings of the Muslim giving it.
[4] *Khums* was a tax on assets redeemed by force and was a share of the spoils or war booty.

The principle of simplicity in taxation was later introduced by having a harbour master who ensured that all taxes were paid. In this era, the amount due was a lower percentage of the value of the goods traded. Interestingly there were no allegations of tax evasion and avoidance tabulated in the time of Arab occupation of the coast (Waris, 2007). But with the coming of Portuguese occupation that was notoriously violent and wanted to hold and control the East Coast as it was an important port en route to and from India and the Far East. Their rule was characterized by oppression not only to the native African population but also for the Arabs settlers. There was failure to use equity in the creation and levying of taxes that witnessed riots punctuated with civil disobedience and outright tax evasion and avoidance (Waris, 2007).

By the end of the rule of the Arabs and Portuguese the existing balance of taxation inherited by the British was capitation tax payable per head of slave exported and customs revenue shared equally between the Arabs and Portuguese. The tax base was, however, limited to trader's only. The British originally ruled what is today Kenya and Uganda together forming the East African protectorate and later the East African Colony. British colonial tax policy developed mostly on the grounds that Britain needed to support its own economy by creating foreign markets and sources of raw materials for its industries, thus obtaining maximum gains with minimum input (Waris, 2007). It is important to know that the tax history of Kenya from its commencement is inextricably intertwined with that of its neighbors Uganda and Tanzania due to a common colonial history.

The British colonial tax policy developed during its rule in East Africa on grounds of, firstly, to prop up its own economy by creating foreign markets and sources of raw materials for its industries thus obtain maximum gains with minimum input (Waris, 2007). Secondly, to locate and secure the source of the Nile for protecting British interests in Egypt from that of other European powers of the time which meant securing Lake Victoria and its environs. Thirdly, was the Rhodesian philosophy of conquering Africa from the Cape to Cairo as jewel in the crown of the British to show the world their might? Fourthly, to secure the spice route to Asia and maintain the link with the Indian colony in the wake of the Suez Canal crisis towards the end of the colonial period. Fifthly, it was a deliberate policy to colonize Africa by moving gradually from co-existence to control of territory. Sixthly, to obtain cheap African labour

that had to be forced upon the local Africans by moving them away from subsistence living (Waris, 2007).

Other policies that developed during colonisation included the need to pay for the costs of wars. The colonised world responded by providing soldiers like the African Rifles Division of the British Army as well as having its population taxed. The post-Second World War tax policies were influenced by demands of reconstruction of the war ravaged European economies. Finally taxation was used as the engine of wealth creation and economic prosperity.

With the attainment of independence in the 1960s, in most African states, this was an era of budget deficits, as governments consistently spent much more than they were able to raise from domestic sources despite the relatively high levels of taxation. Problems of existing legislation that arose from different sources such new tax policy choices, changes in the economy, political independence, techniques of tax avoidance and earlier bad choices in policy drafting and administration, meant that the new state adapts to the new realities (Waris, 2007). The policies of economic development also meant economic change and, inevitably, social changes.

## 2.3 Structure and Type of Taxes in Pre-independence Kenya

### 2.3.1 Hut and Poll Tax

The British Crown deliberately began the application of tax law in Kenya through the Hut and Poll tax by completely ignoring tax principles. One of the reasons for the application of this tax was to pull the African population into a capitalist labour market. The tax continued to play a major role in the labour system as a means of indirect coercion as well as a major source of state revenue. The tax weapon had the desired effect in forcing more Africans into wage employment (Waris, 2007). It has to be bone to mind that the hut and poll taxes were crude wealth taxes that only served as a proxy for property rating to rural areas. For instance the wealthier you were the more you paid. This kind of taxation was devoid of well-known taxation principles and key drivers since the motive was colonization and the ill-intended “civilization” drives. At a glance, one may argue that the key drive was to change African social set-up and economic models from communal/socialist to a more capitalist economy (Mutemi, 2015).

Which is why criticism of this tax arose early on: In 1936 many official reports on taxation in Kenya despite being critical of the hut tax failed to suggest a viable solution. The Commission appointed to investigate the allegations of abuse and distress in the collection of various African and non-African direct taxes noted that the system of hut and poll tax was not an equitable system of taxation owing to the individual payments now required instead of the family payments of the past. The recommendations from the Commission were; firstly, that the system of native taxation required amendment by an extension of the system of grading, the reduction of the payment because of extra huts and the raising of taxable age. Secondly, the graduated non-native poll tax and education taxes should be abolished. Thirdly, traders and professional licenses should be modified and levy on official salaries should be reduced by half. In their place, an income tax should be imposed including a basic minimum tax. Finally, that to guard against uncertainty of the yield from the proposed income tax in its early years, and from native hut and poll tax to allow a gradual introduction of the proposed economies (Waris, 2007). The colonial taxation policy rested on the policy of conversion of a territory into a viable economic entity.

Waris (2007) further to explain that another scheme was put under consideration in 1936 that included a native taxation that would consist of two main taxes. A universal poll tax: payable to the government as a contribution towards the general costs of administration, communications, major buildings and scientific research. And a different rate to be assessed and levied by local native councils to cover the cost of all social services. The rate would have to be varied to meet local requirements.

Among some changes that came included in 1952, the three Ordinance governing income tax- The Income Tax Ordinance 1940, The War Taxation (Income Tax) Ordinance 1940 and the War Taxation (Income Tax) (amendment) Ordinance 1941 were combined to what become known as The East African Income Tax (Management) Act 1952. In 1953 the Tea Ordinances of all three East African Countries of Kenya, Uganda and Tanzania were repealed. However, each government (colonial) reserved the power to fix the rates and allowances in each country. The East African Tax department administered the tax, which was under the East African High Commission formed in 1948 (Waris, 2007). Three years later the three separate Income Tax Acts for the East African countries were enacted.

There was no consideration of the principle of equity in the application of tax law as the African communities were being dragged from subsistence, communal system to a monetary and capitalistic economy where they were at best miserable and oppressed. There was no certainty as taxes would exist and be applied at the whims of the colonial government and was liable to rise without reference to the taxpayer. The indigenous African and the Asian settlers had no representation in the Legislative Council until the 1950s. Hence the taxes imposed were created, applied and enforced at the sole behest of the colonial government. Thus, there could never be any certainty on the amount of tax, the types, how they would be applied and for how long.

### 2.3.2 Land Tax

When the Crown Land Bill was presented in 1908, it became the first legislation to propose the levying of a graduated land tax on individual holdings as a sound basis for land policy in East Africa. The Bill among others provided that whenever any individual or corporation held more than 50,000 acres; the land tax would be increased by four times the amount that would otherwise be payable (Waris, 2007). A subsequent proposal that eventually became the Crown Lands Ordinance in 1915 conceded to settlers' demands by deleting the provisions for land taxation. The 1915 Ordinance helped in shaping current land policy throughout the region: It helped the emergence of a land market by legalizing the free transfer and mortgaging of land. It also allowed land leases to be granted for 99 years, and rent reassessments at one percent and two percent of the unimproved value of the land during the 33rd and 66th year respectively. The Land Ordinance Act of 1915 promoted commercial agriculture and urbanization that served as the catalyst for defining individual and private family rights to land in terms that are more exclusive. Waris (2007) argues that the 1915 Land Ordinance failed in one important respect, although occupiers were required to make improvements to the land within a specified period and to maintain such improvements after that, it did not include any provisions against speculative accumulation of land (Waris, 2007).

### 2.3.3 Graduated Personal Tax

The Graduated Personal Tax (GPT) was introduced in 1933. The tax was applied for the first time in 1934 at rates graduated according to the taxpayer's income with certain

amendments. It was assessed on every non-native male or female resident in Kenya. The payment of taxes was to become even more acute with this introduction of the Graduated Personal Tax (GPT). Graduated tax in Kenya was a non-racist tax system meant to apply to all races without discrimination. It was introduced with effect from 1 January 1958 with the enactment of the personal Tax Ordinance of 1957. This system had been proposed way back in 1950. The then Governor had appointed a Commission of Inquiry 'to examine in detail the practicability of introducing a graduated personal tax for Africans upon income, and to consider the method of assessment and the organization required for its estimated cost and to make recommendation. When the committee released its report in 1951, it recommended that the levying of taxes should be done without racial discrimination. This recommendation could not, however, be implemented immediately because of the declaration of emergency in 1952, the difficulty in assessing the rate of payment per taxpayer and the lack of personnel to carry out the exercise. But following the end of the Mau Mau rebellion in 1956, British had become quite sensitive to reforms. For the first time in 1958, tax collection in Kenya was no longer based on race (Isaac, Tarus and Ruth N. Njoroge, 2015).

### 2.3.4 Income tax

It was first introduced in Kenya in 1921, and in 1954, the rates of personal income tax were set at 20 shillings for anyone earning less than £60, for earnings between £ 60-120 charge of 40 shillings and for earnings over £120 a charge of 60 Shillings. In 1956, a Commission of Enquiry into the Administration of Income was established and was chaired by Sir Erick Coates. Soon after independence Kenya had income tax, corporation tax, trade taxes and excise taxes. Value-added taxes were introduced later. During the first decade and a half of independence, the government mainly dealt with taxation as there was a desperate need.

The first post-independence strategy was set out in Kenya's first planning document entitled *Sessional Paper No. 10 of 1965* on African Socialism and its Application to Planning in Kenya (Mutemi, 2015). Its main purpose was to guarantee every citizen full and equal political rights. It was stated specifically that the economic approach

of the government would be dominated with ensuring 'Africanisation' of the economy and public service (Tax Justice Network, 2009). In 1970/1971 the finance ministry changed the policy of cautionary spending and began an expansionary policy. This then resulted to introduction of sales tax in 1973. Again, the oil crisis of 1973 led to an economic shock, leading to a debt problem. Therefore the resulting fiscal reforms were; 20 % withholding tax on nonresident entrepreneurs, capital allowance restricted to rural investment, a new tax on the sale of property, taxes on shares**,** the sale of land and a custom tariff of 10% on a range of previously duty free goods (Tax Justice Network, 2009).

The Kenya government abolished Graduated Personal Tax (GPT) in 1973, the attempt were to make tax payment more equitable and just. This had been necessitated by the fact that GPT was an unfair form of tax since it was more burdensome for the poor than the rich. For instance a millionaire would be paying the same tax as a poor person. Thus, it militated against the principle of least aggregate sacrifice. In addition tax was fixed without considering that most peasants relied on subsistence farming and would not raise sufficient money to pay for their tax. In the words of an economist Sr. William Petty, that which angers men most is to be taxed above their neighbours. Thus it came as a relief when it was replaced by a sales tax in1974 (Isaac, Tarus and Ruth N. Njoroge, 2015). Therefore, taxation in Kenya is influenced by the way the state, peasants and the working class interacted with the market.

But in the contradictory nature of colonialism, taxation helped in the creation of the postmodern colonial state named Kenya. One of the defining characteristics of the colonial situation was that it involved the interaction of a conquering and dominating metropolitan power with an indigenous culture which was exploited economically. The result was an unequal exchange of wealth and power, the East Africa region, even with the demise of colonialism in Kenya in 1963; tax collection continued unabated making the African people feel betrayed.

With the collapse of East African Community (EAC) in 1977, thus the government required money to form corporations and buy out others. When the second oil crisis came in 1979/1980**,** import prices once again deteriorated, leading to reduced availability of domestic

credit and lower returns from agriculture and commerce, causing a large drop in revenue. The Government of Kenya responded by increasing sales taxes from 10% to 15%**,** excise duties from 50% to 59%**,** while Personal Income Tax was actually decreased from 36% to 29% in light of increasing tax competition in East Africa. In 1986, the government wanted to increase tax collection to 24% of GDP by 1999/2000**.** There was a study of the tax system to favour savings and investment and make tax revenue more responsive to changes in GDP. All these changes resulted in an 1987 improvement of exchequer receipts also set out in the tax study in *sessional paper no 1 of 1986* (Tax Justice Network, 2009).

## 2.4 Social welfare provisions

One has to bear in mind that historically during the colonial period, social and welfare services for the natives were almost non-existent. The few that existed and particularly those that one can faintly remember were those intended to safeguard the colonial integrity of the status quo: basic health services and recreational facilities, for instance, were provided in the work camps in order to ensure and maintain a high level of productivity of the labour force. In the same way, education was provided to equip the colonial subjects with basic skills necessary for the public administration of the colonial system and for the smooth running of the colonial extractive economy.

The tax system applied was never created in response to the needs of the people that existed but instead to forcibly convert a subsistence economy into a capitalist one. However, the economy and its responsiveness to the taxation and vice versa were not allowed to balance itself resulting in a sluggish economy. What the tax system did was to introduce an immediate differentiation among the Africans; the fortunate ones had land on which to expand production while the unfortunate had to provide the actual agricultural labour. The colonial government had a continuing interest in sustaining a level of commodity production and trade at least sufficient to provide a tax base to meet the recurrent cost of the local state apparatus (Waris, 2007). Soon after independence, various multitudinous ways and means were sought with the aim of raising government revenue. Among the most important was the re-enactment of the Income Tax Act of 1974, recasting the collection of customs and excise duties, the introduction of Value Added Tax (VAT)

and the establishment of the all-encompassing Kenya Revenue Authority (KRA) in 1995 (Isaac, Tarus and Ruth N. Njoroge, 2015). These measures were intended to harmonize and streamline tax collection to maximize revenue but without hurting the taxpayers.

The first income tax legislation was enacted in 1937. This ordinance remained in effect until 1952 when the Income Tax management Act was enacted. This act laid down the basis of liability, assessment, collection and management. This act was repealed in 1958, and also in 1965. It has, however, undergone a number of administrative and practical changes aimed at making it responsive to the changing needs of the economy. It has since become one of the major sources of government revenue. But a real break was achieved in 1973 by an Act of a parliament, which created an Income Tax Department with the sole responsibility of provision for the charges, assessment and collection of Income Tax. The preceding Act came into effect January 1974 (Isaac, Tarus and Ruth N. Njoroge, 2015). But the biggest problem that faced the collection of income tax was the avoidance and evasion of tax.

## 2.5 Key challenges of the tax review after independence

First, there was no consideration of the principle of equity in the application of tax law as the African communities were being dragged from subsistence, communal system to a monetary and capitalistic economy where they were at best miserable and oppressed. Secondly, in the post-war period, plans for African development were speeded up. When this happened, it was realised that the indigenous population must pay more for the Government expenditure incurred for their 'benefit'. The problem was not only that of transforming "concealed saving potential" into useful investment but also of taxing the African citizens while considering their ability to pay. Thirdly, from the point of view of equity graduated tax is payable by every adult of or above the apparent age of 18 years with no provision for exemption generally for women except for married women. There is no income qualification and no personal allowances with the result that every adult is liable to pay tax at the minimum prescribed scale. There was no logic or reasoning guiding or explaining the absence of allowances and hence it was inherently inequitable. Fourthly, inequality in application of *property tax,* the relative importance of land value taxes as a source of public revenue is

difficult to establish in Africa because only rough estimates exist for a few countries on an aggregate, and on a nationwide basis.

Finally, the native African lived in a subsistence economy and thus a progressive form of taxation regarded as an equitable form of taxation was imposed because it only affected immigrants with cash incomes. To obtain income it thus imposed the hut tax (payable in cash) on all African males who had their own huts, which traditionally included all males who had reached puberty, despite this tax not being equitable. Tax revolts were suppressed with bullets; defaulters had their houses burned down and were imprisoned if caught. Forced labour with low wages were thus viable as the labour force struggled to simply forestall these penalties (Waris, 2007).

## 2.6 Conclusion

Any tax system is a combination of history, experience of the people, politics, economics and the law. No one likes taxes. People do not like to pay them. Governments do not like to impose them. Nevertheless taxes are necessary both to finance desired public spending in a non-inflationary way and also to ensure that the burden of paying for such spending is fairly distributed. While necessary, taxes impose real costs on society. Good tax policy seeks to minimize those costs. Tax policy is not just about economics. Tax policy also reflects political factors, including concerns about fairness and past performance. In Kenya like many other countries, increased economic growth and the disparity between the rich and the poor does influence tax distribution. Finally, regardless of what a particular country may *want* to do with its tax system, or what it *should* do with respect to taxation from one perspective or another, it is always constrained by what it *can* do. Here tax policy choices are influenced by a country's economic structure and its administrative capacity.

Efficiency, equity and administrative feasibility are key criteria in designing and evaluating tax systems. This part provides an overview of the role of taxes in part by focusing on these criteria. The first section examines some considerations in using taxes to raise revenue to fund government operations. The second section reviews issues of economic efficiency and different costs of taxation. Next, fairness concerns are addressed. The fourth section reviews the interaction of tax administration and tax policy. However, as argued in this paper taxation

is founded not only on principles but also on practicality and historicity. There is no element of perpetuity about taxation, only the constant clash of the immediate and semi permanency. From the preceding discourse a state cannot run a democracy well without taxation and a taxation system cannot be run well without democracy. The importance of tax law must be and is tempered as a result with the capabilities of a state and its constitutional and legislative provisions.

In her argument Warris (2007) says taxation is of immense importance to society and is a constant system of trial and error which works in a dynamic society. Indeed tax, like any other legal issue, finds its initial source and authority from the constitution of a country in which it applies. Kenya, like other ex-colonies and developing countries, inherited a system of taxation from the colonizing power. The pattern of taxes found in Kenya depends upon many factors such as its economic structure, its history, and the tax structures found in neighboring countries. More generally, and not surprisingly, trade taxes tend on the whole to be more important in the lower-income group, where they account for 24 percent of tax revenues (Richard M.Bird and Eric M.Zolt, 2003).

From the preceding discussion no single tax structure can possibly meet the requirements of every country. The best system for any country could be determined by taking into account its economic structure, its capacity to administer taxes, its public service needs, and many other factors. Nonetheless, one way to get an idea of what matters in tax policy is to look at what taxes exist around the world.

From the foregoing account it is clear that a number of the societies in Africa/Kenya had some form of taxation going on, based on the kind of economy they had. As earlier stated I would like to credit them as part of the taxation history and not limited only to the Arabs and Europeans. This argument only holds for direct taxation as has been mentioned below. As evidence from research, taxation in Kenya started way before the colonial period era. It was first introduced by the Arabs who arrived in the Kenyan coast around 1498. They came to facilitate trade between the hinterland and the other Arab traders who mainly came from the Sultanate of Oman. The Sultanate of Oman thus occupied and added the coastline of East

Africa into their Governorate based in Malindi, and allowed each of the islands to run their own affairs and collect taxes for the Sultan. Taxpayers were divided into two separate tax bases:-

- *The citizenry within each Sultanate and the traders*: Consisted of a mixture of Arabs, families that resulted from intermarriage and local Africans who had converted to Islam.
- *Traders from other nations:* Were as diverse as India, Europe and Mauritius.

These tax bases were treated in an identical manner as there were fixed rates without exception for all subjects of taxation (Waris, 2007).

Despite determined efforts at tax collection, Kenya remained a dependent colony as it lacked the resources to make it self-sustaining. What was collected in the form of both direct and indirect taxation covered the cost of day-to-day expenditure and little else. A variety of instruments were therefore developed to raise the money needed mainly through direct and indirect taxation (Isaac, Tarus and Ruth N. Njoroge, 2015).Taxation after independence has remained burdensome to the citizen through taxation of consumer goods.

# 3 Bibliography

Acemoglu, D., Johnson, S., Robinson, J. A. (2001). The Colonial Origins of Comparative Development. An imperical Investigation. *American Economic Review*, 1369-1401.

Frankema, E. (2011). "Colonial taxation and government spending in British Africa, 1880-1940: Maximizing revenue or minimizing effort. *Explorations in Economic History*, 136-149.

Frankema, E. (2011, September). Colonial taxation and government spending in British Africa, 1880-1940: Maximising revenue or minimizing effort? *Explorations in Economic History*, pp. 1-38.

Frankema, E. (2011). Colonial taxation and government spending in British Africa, 1880-1940: Maximizing revenue or minimizing effort? *Explorations in Economic History*, 136-149.

Isaac, Tarus and Ruth N. Njoroge. (2015). The Political Economy of Post-Colonial Taxation in Kenya, 1973 - 1995. 59-67.

Mutemi, A. (2015). History of Taxation in Kenya. *Academia UON*, 1-10.

Richard M.Bird and Eric M.Zolt. (2003). *Introduction to Tax Policy Design and Development.* World Bank.

Tax Justice Network. (2009). *Taxation and State Building in Kenya:Enhancing Revenue Capacity to Advance Human Welfare.* Nairobi.: Tax Justice Network Africa.

Waris, A. (2007). Taxation without Principles: A Historical Analysis of the Kenyan Taxation System. *Kenya Law Review*, 262-304.