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# Kenya VI: Tax administration

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**1 Introduction Tax administration in Kenya**

**1.1 Theory and standards of tax administration**

Three ingredients are essential to effective tax administration: the political will to administer the tax system effectively, a clear strategy for achieving this goal and adequate resources for the task. Even the best designed tax system will not be properly implemented unless these three conditions are fulfilled. Most attention is often paid to the resource problem, i.e. the need to have sufficient trained officials, adequate information technology and so on. At the same time: without a sound implementation strategy, even adequate resources will not ensure success, and without sufficient political support, even the best strategy cannot be effectively implemented.

Administering the tax laws of a country should serve the public interest, i.e. it should meet the needs of the government and the people of the country served by the government. A Tax Administration may be responsible for drafting tax legislation. If it is not directly responsible

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for drafting legislation, it should at least be involved in determining the administrability of proposed provisions of the tax law.

The core business of a Tax and Customs Administration usually consists of one or more of the following activities: – assessing, collecting and auditing government-imposed taxes, as well as preventing fraud; – surveillance by customs of goods imported and exported (in order to assess, collect and monitor the various duties linked with import and export, but also to protect the quality of society, i.e. the quality of food, health, cultural inheritance, protection against falsity, etc.); – assessing and collecting social security contributions; and – other assessment and collection activities on behalf of other governmental agencies. An important and critical part of the collection function of Tax Administrations is – finally – enforced tax debt collection. (Matthijs Alink, Victor van Kommer, 2016).

The tax-paying public should be affirmed in its expectation that the organization responsible for administering the country's tax system will administer the tax laws consistently and fairly so that similarly situated taxpayers will be treated equally and consistently under the laws and that, as a result, all taxpayers pay their fair share.

Taxpayers should receive good value for the money spent by the Tax Administration in administering the tax laws, i.e. the Tax Administration should operate as efficiently and cost effectively as possible. In addition to receiving value for their money, the public would expect that the Tax Administration and its employees will be free from any type of corruption or undue influence. The most cost-effective means of collecting taxes is through the voluntary compliance of the public with the tax laws. The more enforcement activities would be necessary, the more expensive the administration of the tax system will be.

In order to encourage taxpayers to comply with their tax-paying responsibilities voluntarily, it is important that the Tax Administration assists them in understanding their responsibilities. This can be done through taxpayer assistance over the telephone, in writing, face to face or by using electronic communication tools such as website technology and e-mail, or through taxpayer education activities.

Also critical to the concept of voluntary compliance is the belief on the part of the tax-paying public that the Tax Administration respects the rights of taxpayers and operates on the principles of integrity and honesty. For there to be confidence in the tax system, people must believe that it is a fair system administered in an even-handed manner. For these reasons, it is important for the Tax administration to provide the proper mix of customer service and fair enforcement of the tax laws. Too much emphasis on raising revenue and less on customer service and taxpayers' rights can lead to a lack of confidence on the part of the public in a Tax Administration's ability to manage its responsibilities properly. Lack of confidence in the Tax Administration which administers the law can also lead to reduced levels of voluntary compliance with the law.

## **1.2 History and priorities of KRA**

From the year 1990 onwards there was a major reorganization and strengthening of the fiscal and tax management divisions with Ministry of Finance especially the treasury. First, was the introduction of a Personal Identification Number (PIN), meaning all taxpayers had to have

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PINs which had to be produced in order to enter into transaction? The system was aimed at bringing more people into the tax net and thereby spreading the tax portfolio. Second, in 1992 the government offered amnesty to all taxpayers who declared their true income or sources of income which they had hidden in the past (Isaac, Tarus and Ruth N. Njoroge, 2015). In seeking to maximise on revenue generation the government created an office for revenue generation.

The Kenya Revenue Authority (KRA) was established by an act of parliament, Chapter 469 of the laws of Kenya, which became effective on 1 July 1995. It was the culmination of a long process of an attempt to streamline tax collection in Kenya. The Kenya Revenue Authority is the principle agency mandated with tax administration. KRA was designed with autonomy (self-governance) enhancing mechanisms, including self-financing mechanisms, a Board of Directors with public and private sector representatives, and sui generis personnel systems. By running on business principles and by being semi-autonomous, KRA was designed to be less vulnerable to political interventions and to have the leverage to recruit, retain, dismiss and promote quality staff by paying salaries above civil service terms. This was intended to motivate staff and reduce corruption.

KRA also feels itself committed to implement the “Vision 2030 revenue administration objectives”, which in the Sixth Corporate Plan is broken down to a “KRA Vision 2018” (Kenya Revenue Authority, 2015a, p. 12f.)

Its four strategic priorities for the Sixth Corporate Plan/Vision 2018 are:

- a) Enhancing revenue mobilisation by broadening the revenue base, enhancing compliance and combating tax evasion and fraud using intelligence and risk based forward looking enforcement,
- b) Strengthening revenue administrative capacity and enhancing transparency and fairness through organisational change and business process optimisation,
- c) Creating a staff establishment that is professional, courteous, accessible and proactive in solving customer problems,
- d) Enabling business by leveraging on technology to achieve full electronic customer service and enhance operational efficiency and service delivery in line with best practice, to achieve high customer satisfaction levels. (Kenya Revenue Authority, 2015a, p. 13f.+44ff.)

Objectives to be realized on that background are:

- To attain a VAT/GDP ratio of **9%**.
- To achieve weighted taxpayer compliance of 65%.
- To attain a minimum active taxpayer base of 4 million.
- To attain 80% customer satisfaction rate.
- To achieve full electronic customer service.
- To become a fully automated Single Revenue Collector.
- Complete implementation of the Enterprise Risk Management framework.
- To achieve enactment of new innovative and enabling income tax framework.
- To achieve six hour average cargo clearance time.
- Become Lead Border Agency with complete electronic control of all goods entering and exiting Kenya.
- Develop sustainable long term funding by among others, unlocking internal resource capacity through innovative approaches. (Kenya Revenue Authority, 2015a, p. 19f.)

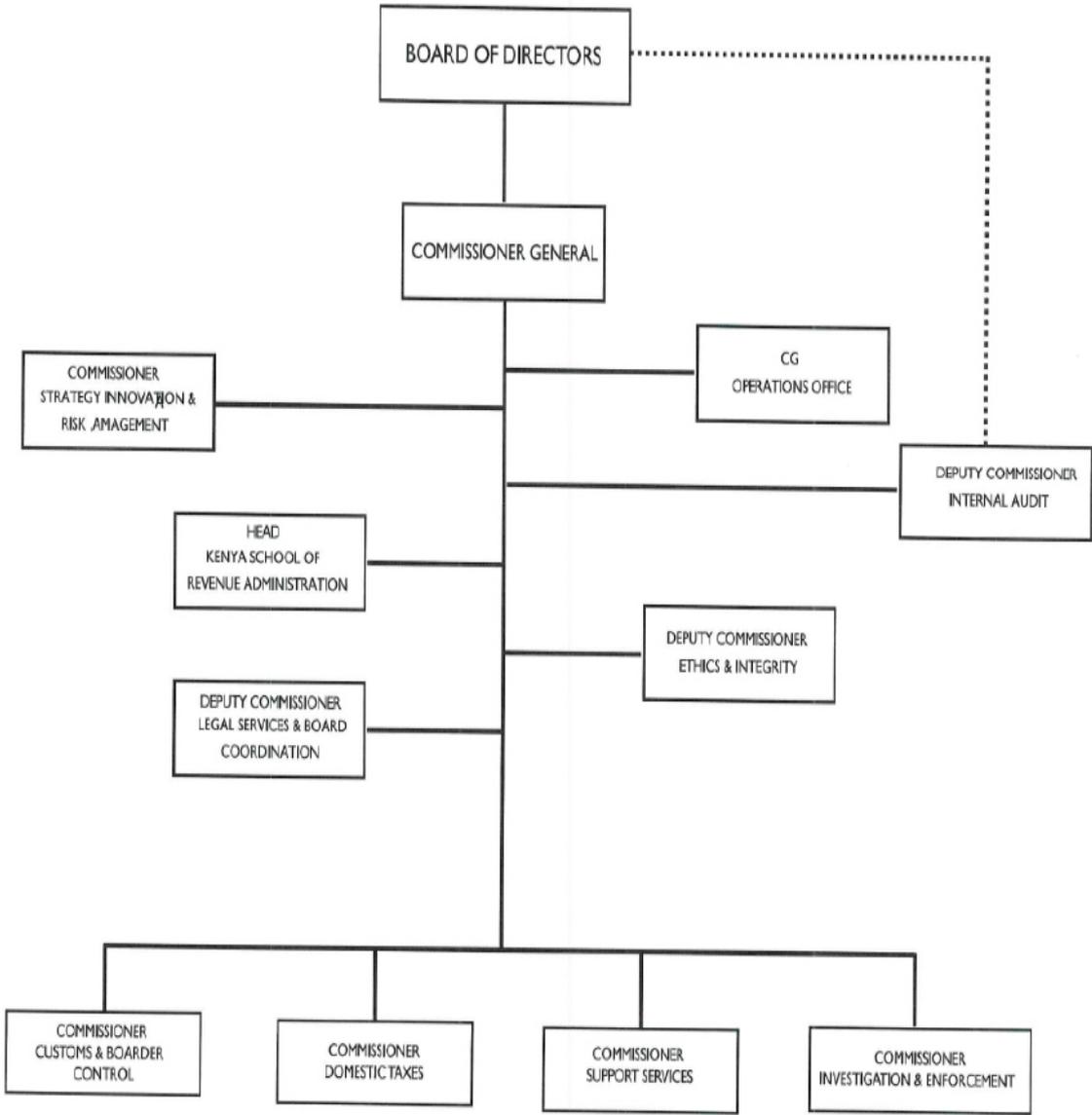
The overriding objective shall be to enable government to achieve revenue independence by 2018 (p.18+44).

### 1.3 Structure of KRA

The KRA is a Semi-Autonomous Revenue Authority (SARA) and it is organized as per recommended international best practice for SARAs. There are plans, however, to split the existing KRA into two autonomous, but interdependent entities, namely the Inland Revenue Agency and the Customs and Border Control Agency, with a view to increase efficiency of both agencies within their respective areas (Kenya Revenue Authority, 2015a, p. +34).

From February 2015 onwards, KRA revised its organizational structure for a trial period of three years, which looks as follows

Graphic 1 Approved Corporate Organizational Structure of KRA beginning February 2015



Source 1 (Kenya Revenue Authority, 2015a, p. 76)

Given the research interest into the wealth gap, two offices are of particular interest:

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- The Large Taxpayer Office, established in 1998 and undergoing numerous reforms ever since, is of major interest. Its goal is to provide one-stop shop services in the administration of Income Tax and VAT matters affecting large taxpayers. By 2010, it was in charge of almost 75% of all domestic revenue by servicing 1100 large taxpaying institutions, a list of them being publicly accessible.<sup>1</sup>
- The Medium Taxpayers Office, which is in charge of wealthy private individuals. This office, too, published in July 2017 a list of its largest taxpayers, i.e. a list of 100 individuals. Their earnings within the “annual range of Sh350 million to Sh1 billion represents all gross income earned by an individual,’ a source familiar with the workings of the medium tax office (MTO), which handles these individuals” revealed to the newspaper Business Daily (Juma, 2017).

With the most recent reform, this office has been merged with the medium and small taxpayers’ office under the head of the Domestic Tax Department. Newly established has been the Department for Strategy, Innovation and Risk Management, containing the Marketing & Communication, Research Knowledge Management & Corporate Planning, Corporate Tax Dispute Resolution and Compliance & Enterprise Risk Management Divisions (Office of the Auditor General, 2015, p. 16).

Based upon the Fifth Corporate Plan there was the intention to establish an office specifically for large private taxpayers (HNWIs), but so far it has not yet been implemented.

## **2 KRA Workforce and performance**

### **2.1 Staff shortage**

The Sixth Corporate Plan publishes the following as staff status (approved and current) within KRA:

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<sup>1</sup> <http://www.revenue.go.ke/ito/TAXPAYERS%20BY%20SECTORS.pdf> (retrieved 28 June 2017)

Graphic 2 KRA staff level as of 24 June 2015

DEPARTMENT	APPROVED ESTABLISHMENT	CURRENT STAFF IN POST
Commissioner General's Office	20	21
Customs & Border Control Department	1,905	1,457
Domestic Taxes Department	2,203	1,509
Investigations and Enforcement	207	179
Corporate Support Services Department	1,532	1,046
Strategy, Innovation & Risk Management	536	293
Ethics and Integrity	26	7
Legal Services & Board Coordination	77	36
Kenya School of Revenue Administration	76	47
Internal Audit Department	36	34
<b>TOTAL</b>	<b>6,618</b>	<b>4,629</b>

Source 2 (Kenya Revenue Authority, 2015a, p. 74)

The table illustrates that the largest operative departments are Customs & Border Control and Domestic Taxes while Strategy, Innovation & Risk Management and Investigation & Compliance are among the smallest.

KRA intends to amend the obvious staff deficit gradually during the current Strategic plan by filling vacant positions as follows: 40% 2015/16, 30% 2016/17 and the rest 2017/18.

- ➔ Given some insights into areas where it is likely to collect far more revenue if tax compliance is observed, namely among Large Taxpayers, it would be interesting to know how many people in the LTO work in audits, and it is surprising how little people are employed in the investigative and enforcement department, namely less than 5% of the total workforce. As illustrated below (4.2.1#) those positions are worth its money.

## 2.2 Staff remuneration

- ➔ It is about payment, promotion, welfare packages and pension plan.
- ➔ Salaries and remuneration commission

According to the KRA most employees join KRA at Management Trainee/Graduate Trainee level but there are a few who join the institution as temporary employees and later secure employment within the institution. When you join KRA as a graduate Trainee, the first salary is Sh 25,000-Sh 68,000. But once you join the system after more than one year of training, your salary is appraised to Sh 80,000. The salary status remains at this level until you get a promotion to the level of acting supervisor or supervisor. The supervisors earn Sh 160,000-Sh 200,000 while senior most employees earn more than Sh 300,000.<sup>2</sup>

<sup>2</sup> <http://venasnews.com/kenya-revenue-authority-kra-salaries/>

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Regarding remuneration, this topic was more prominent in previous Corporate Plans, e.g. the Fourth. There it stated explicitly that recruitment and retaining qualified staff is as big a problem as staff turnover, because staff tends to move on to “greener pastures” if they find better paid positions, which is why improved payment, promotion and remuneration incentives need to be developed (Kenya Revenue Authority, 2009, pp. 37-22).

Other than the above thoughts on salaries KRA, posits by its 6<sup>th</sup> Corporate plan to come up with interventions that will ensure that the staff ‘live’ the KRA core values; KRA anticipates in its ongoing programme to be revamped to meet the requirements of a high performance organisation; raise employee satisfaction rate to 80%; improving the framework for management of high performance individuals; put in place an innovation promotion framework; enhance knowledge management; enhance integrity; and establish Kenya School of Revenue Authority( KESRA)as the pre-eminent National and regional institution for fiscal management training. (Kenya Revenue Authority, 2015 c, p. 15) The authority has however, been able to successfully implement its Change programme,<sup>3</sup> with a strategy completed, structures put in place, change champions identified and trained, and staff sensitised, among other initiatives. In the KRA 6th Corporate plan it does emphasis that the Authority will demonstrate appreciation of employees’ contribution to its overall goals, put in place a mentorship programme, provide employees with the necessary working tools and equipment and enhance employee feedback channels for effective communication (Kenya Revenue Authority, 2015a, p. 60f.)

### **2.3 Staff training**

The lack of administrative experience and capacity; A simple example is that under the VAT legislation, no tax liability is due when loans are made from one business to another. Administration that is seen as unfair and capricious may bring the tax system as a whole into disrepute.

With 224 training courses and an additional coaching and monitoring program, KRA tried to advance competence and professionalism (Office of the Auditor General, 2015, p. 22).

- ➔ On what? More information on the kind and areas of training?
- ➔ More training by outside agencies see below from Denmark and Sweden at ICT and GIZ at Outside Assistance and Cooperation

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<sup>3</sup> This actuated the Revenue Administration Reform and Modernisation Program (RARMP) which commenced in 2004/05 with the objective of transforming KRA into a modern, fully integrated and client-focused organization. The RARMP process has adopted project management and business analysis techniques in accordance with international best practice with the creation of the Programme Management and Business Analysis Office (PMBO) under the Office of the Commissioner General. This has led to the development of an institutionalized administrative framework for the RARMP making it easier to track progress in the reform initiatives and enhance project ownership and acceptance to change from both internal and external stakeholders. Further to this see the revamped organogram of KRA;

## **2.4 Staff satisfaction**

Under the heading “People perspective”, the Sixth Corporate Plan deals with one of its four strategic priorities, namely creating a staff establishment that is professional etc. and willing to proactively solve customers’ problems (Kenya Revenue Authority, 2015a, p. 58ff.).

Proposals range from training staff on KRA values and ethics, bonuses for high performers, better promotion and career development. This also has to do with work load (i.e. whether the work at hand can be handled by the staff in place) and training (i.e. the more professionalism there is the more can be collected and, perhaps, be received as bonus).

Only if all three areas are in balance, staff satisfaction can be hoped for.

However, not much seems to have happened ever since: The Sixth Plan reports findings of an employee survey, where dissatisfaction with an “overall satisfaction of 65% with the poorest”, sub-average results being “in recruitment and promotion (53% satisfaction), training and development (58%) and remuneration (60%).” This, KRA notices correctly, ”makes it unlikely that KRA’s current employees can be expected to rise to the challenge of meeting stretch targets” (Kenya Revenue Authority, 2015a, p. 59).

- ➔ How many do they actually leave, and you need to distinguish how many leave after training and how many leave after some years of practice.

## **2.5 Corruption and bribery?**

Not surprising, KRA is not above suspicion for being corrupt and open for bribes, when it admits that there are cartel-like schemes in an auditing context (➔ audits?) or that the Corruption perception survey in 2013 found an overall corruption perception of 52.73% with the highest level at Customs Service at 66% (Kenya Revenue Authority, 2015a, p. 13). The question is whether a tougher line against corruption is the only or best way to fight against that (➔Staff satisfaction).

KRA in partnership with Ethics and Anti-Corruption Commission (EACC) has put in place a categorisation of the corruption status among state bodies, not the least for itself. The highest level is level being 5, ‘zero tolerance to corruption’. In view of this, KRA’s objective is to achieve level 5 by 2017/18.?? Level 5 requires existence of internal controls to mitigate corruption and their effectiveness constantly reviewed; promotion and maintenance of high standards of ethical culture; enhanced transparency and accountability; unqualified reports from the Auditor General and anti-corruption assessment; and reduced corruption perception - where the perception index is determined by the involvement of stakeholders. The strategy aims at improving the citizen’s perception towards KRA by undertaking initiatives geared towards enhancing integrity among staff and taxpayers. The expected outcome is reduced perception index from 3.92 in 2013. The acceptable index for integrity certification is 1.0 out of 10. (Kenya Revenue Authority, 2015a, p. 66)

## **2.6 “Agency collection”**

A number of taxes and mandatory contributions is collected by other agencies and agents, for example...

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- ➔ See, e.g. Revenue List by KRA, section “Agency”
- ➔ The problem of hiring personnel for collecting Withholding Tax on rental income (below 4.3.2#)
- ➔ What about personnel sent out to do registration of property titles? (also below 4.3.2#)

There may be good reasons: “Outsourced” personnel is cheaper than KRA staff, they are easier to “hire and fire”, fewer labour rights... but: Is this the best way to handle also confidential stuff like the registration of property and the collection of withholding tax? Are they not even more prone to corruption and bribery? In general, there are too many people around doing things which nobody checks and supervises....

## **2.7 Discussion**

An interviewee from KRA laments that lack of efficiency is mostly due to understaffing, high staff turnover and likes. After completing training, most staff move to organizations paying them better than KRA.

Attractive payment and welfare provisions are not only important to attract competent recruits and keep them engaged in the jobs. As experience from the German study learns, the fear of losing those perks of office in the case of misconduct is also a strong insurance against corruption and bribery.

Tax officials must be adequately compensated, so that they do not need to steal to live. They should be professionally trained, promoted on the basis of merit, and judged by their adherence to the strictest standards of legality and morality. Tax officials should have relatively little direct contact with taxpayers and even less discretion in deciding how to treat them. Bribery is sometimes so common that it is considered a regular part of the compensation of tax officials. Such corruption undermines confidence in the tax system, negatively affects willingness to pay taxes, and reduces a country’s capacity to finance government expenditures.

It is striking, however, how much the Sixth Corporate plan talks about education and training of staff, and how little about recruitment and competitive payment as regards similar jobs in the private sector, even though this problem had some prominence in the Fourth Corporate Plan and even this is a big problem in Bavaria and Zambia. ➔ we reiterate that staff satisfaction is a composite of remuneration, training and adequate staff for workload at hand.

The hope to fill the staff gap of almost 2000 missing employees in just 3 years seems to be over-optimistic, given deficits with staff satisfaction and competition by private market contenders.

## **3 Integration, modernization, ICT**

### **3.1 Tax integration**

Tax integration is the constitution of one process, system or resource to be applied in different tax applications, instead of every application having its own. This definition also includes the constitution of cross-reference links, which connect processes with different objectives, but with identical source data. Integration challenges with other stakeholders arising from

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procurement process, system maturity. For example ( a)one appeal process and procedure for all tax assessments; (b)one invoicing system for different taxes; and (c)One information desk for all sorts of tax clients.

Tax integration is never a goal in itself; however, it can be an instrument to help achieving one or more of the following objectives: – effectiveness: implementation of the political goals to an optimal extent; – efficiency: execute the tasks with maximum result at minimum cost; and – serviceability: obtaining a high level of client’s satisfaction will increase the compliance of the client.

The responsibility for the development and implementation of integration possibilities depends on the level of these possibilities. They may be at strategic, tactical or operational level. However, the impact of integration may very well exceed the borders of its implementation area. Managerial attention to any integration effort is therefore essential.

There are several aspects or areas to take into consideration when dealing with tax integration: –**Legislation and regulation:** Bringing together or linking to each other tax regulations and/or other regulations such as social laws. The incentive to this is mostly the government policy to cover public issues by looking at them from the outside, namely from the citizen’s point of view rather than from the administration’s point of view.

**Processes:** Integration of (sub-) processes of different taxes and duties within the Tax Administration, but also process integration of processes with external organizations such as the Ministry of Social Affairs.

**Management:** The (integrated) way how to organize the execution of the main and primary tasks of the Tax Administration.

**Systems:** Developing and operating (mainly information and communication) systems, both of hardware and software, so that they function for multiple purposes.

**Resources:** Integrating facilitating business components like offices, canteens and maintenance can be easily foreseen. More challenging is integrating support functions such as training and development services, planning, control and finance activities and, probably the most important, human resources management (Matthijs Alink, Victor van Kommer, 2016).

### **3.2 KRAs ICT strategy**

Part of the Vision 2030 approach is an enhanced use of ICT instruments, to be coordinated on all government levels and agencies by the national ICT Authority, created in 2013. KRA is just one element in this development which should lead to “integration and interoperability” of government institutions and extended forms of “digital government”. Not the least, of course, is the goal to enhance revenue collection. KRA supports its enthusiasm about enhancing and enlarging ICT and e-services by pointing to the positive experiences in other African countries such as South Africa, Rwanda and Uganda (Kenya Revenue Authority, 2015b, p. 21).

Within this context, ICT improvement seems to be the major way to go for KRA. It will not only make tax administration cheaper and easier, it will also increase the number of tax payer, the tax base, transparency and accountability, it will decrease the tax gap, redundancy, red

tape and corruption and, all in all, be a contribution for a more efficient and fair taxation system. A typical quote from the report is the following one, under the headline “Innovatively applying technology to enhance voluntary compliance and to combat tax evasion and fraud”:

It is essential for the public to perceive that there is equity and fairness in taxation, and that the tax system is administered in keeping with the highest value of honesty, uprightness, integrity and impartial application of the law. On the one hand, it must be shown that the public machinery with regard to taxation and application of privileges is exempt from corruption. On the other hand, the same machinery must endeavour to punish the taxpayer’s evasive behaviour in an upright and fair manner. Above all, measures should be put in place to reduce discretion, tax evasion and fraud. Further, tax awareness raises the level of compliance. (Kenya Revenue Authority, 2015a, p. 53)

### **3.3 Selected instruments**

#### **3.3.1 Customs and Excise**

Especially customs procedures and the management of trade with imported and exported goods can be made easier with ICT, the surveillance of movements of goods across borders can be improved, e.g. by using geographic information systems or satellite technologies (Kenya Revenue Authority, 2015b, p. 22). This means, for example: → If you find anything more update...

Originally, up to 19 forms have to be filled out for capturing in- or outgoing transactions the correct way. This has been chanted by the introduction of the Customs Single Entry Document (SED) in 1999/2000 (Institute of Economic Affairs, 2012a, p. 41)

The Simba Transformational Project of 2005 needed updating and upgrading due to an ever increasing volume of trade and will eventually be integrated in the DTD i-Tax system with the aim to contribute to a unified view of taxpayers operations. By talking about “performance challenges” and the need to migrate “to a modern and stable platform” it is indicated that the system is having its ups and downs (Office of the Auditor General, 2015, p. 18)

#### **3.3.2 Electronic registration**

In the 1990s, KRA introduced already the individual PIN number in the attempt to identify taxable persons, trace their income and thus to improve on direct income tax collection. Nowadays individual taxpayers are being registered via the iTax system<sup>4</sup> which has been implemented in two phases: The first aimed at improving taxpayer services such as e-registration, e-filing and other support modules leading up to e-payments, the second phase implemented core modules such as audit, compliance, debt, refunds etc. The system

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<sup>4</sup> The iTax System is a web based application that gives taxpayers the luxury of filing returns from the comfort of their homes or offices at any hour of day or night. The current system allows taxpayers to file returns for Pay As You Earn (PAYE), Value Added Tax (VAT), Individual annual Income Tax Return (IT1), and agency revenue that includes Sugar Development Levy and Kenya Bureau of Standards. The iTax System has several in-built security features, among them one which requires taxpayers to provide an e-mail address that is unique for every PIN registered. The threshold for the creation of a password has also been strengthened and the taxpayers are at liberty to determine the strength of their passwords.

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cooperates with 35 commercial banks and at its introduction, made public via the media, achieved that 2 million taxpayers updated their i-Page in the system for further use. The system is accompanied by the opening of seven regional iTax support service centres outside Nairobi (Office of the Auditor General, 2015, p. 18).

All corporate entities must register for a personal identification number (PIN) with the KRA. They are also required to register for applicable tax obligations, which include income tax, PAYE for employees, VAT and excise duty. They also have to register with the National Hospital Insurance Fund and the National Social Security Fund.

It is also in the interest of the employer to check, whether the employee has a PIN, even though it is the employee's responsibility to obtain a PIN. But it is an offence to pay an employee who does not have a PIN. The penalty for such an offence is KSh2000 (\$22) for every payment made.

### **3.3.3 Risk Management Systems**

As in the other countries of this research, also KRA is introducing and implementing Risk Management technology in order to identify areas of non-compliance or serious risk of non-compliance. To date, individual risks have been clustered into 17 risks for assessment, in the Vision 2018 plan the following 5 were identified as being prioritized risks during the plan period:

- Under/mis-declaration of income/goods,
- Falsification of customs documents,
- Noncompliance with Electronic Tax Register (ETR) requirements,
- Non-filers, and
- Diversion of transit and export cargo into the domestic markets. (Kenya Revenue Authority, 2015a, p. 47f.)

### **3.3.4 Enterprise Risk Management Framework**

Kenya has a challenge in collecting tax revenue from businesses. In support of this perception, the research and interviewees added that “the tax regime focuses only on salaried people and consumption. Most of the income that should be taxed however is in big businesses, and stock exchanges. KRA is either too lazy or unwilling to rope in more businesses.”

Interviewees further added that, “Taxation discourages citizens from earning more, because the more a person earns, the more s/he is taxed.” In general, there is a feeling that Kenya's tax system, like those of other East African democracies, is still unfair in the sense that it does not tax businesses but burdens the poor.

This, however, is also happening on the lower level: “Filing tax returns<sup>5</sup> is a problem. Most small enterprises usually report nil returns (tax declaration) to KRA yet the business is running and making profits. This leaves the burden of tax to the few who do accurate returns filling.”

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<sup>5</sup> Filling returns means reporting the tax status of the business/tax declaration.

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It is cross cutting opinion among the respondents that due to heavy taxation, many people evade paying taxes and “Since supporting documents do not need to be sent to the KRA,” they can manipulate the figure in the tax returns. There is need to redefine the Taxpayer Education and Recruitment Programmes and strategies on the best way of targeting the taxpayers e.g. sector wise taxpayer education. Officers require are not facilitated with IT based resources thus the process of recruitment and registration is not completed while in the field.

Possibly in order to cope with the previous, KRA wants to fully implement an “Enterprise Risk Management Framework”, whose initiation started in 2010.

- ➔ Much more information needed: Whats the outcome since 2010? Which steps are planned and which are de facto implemented. For example: KRAs intention is to introduce “automated audit systems” (2015a, p. 49): Is there at all an “E-balance-sheet” in place which would be the precondition for data mining? For what businesses is this required? Large ones, SMEs?

### **3.3.5 From IFMIS to Single Account**

So far, the Integrated Financial Management System was open to misuse and manipulation. In November 2016, for example, documents showed that Kilifi County “lost Sh43 million to a cartel suspected to operate in cahoots with unscrupulous county government officials or fraudsters manipulating the much discredited integrated financial management system (Ifmis).”<sup>6</sup> Investigation of KRA and EACU was complex but, in the end, resolved by the Ethics and Anti Corruption Unit via the use of ICT. Fraud like that shall, however, come to an end. Beginning July 2017, government starts the Treasury Single Account, meaning that all government spending will be channelled through one account via sub-accounts.<sup>7</sup>

This complements the Public Procurement and Asset Disposal Act, which obliges private sector suppliers “have obligations to give effect to the key principles of integrity, transparency and accountability required of government officials.” This, too, if working, will reduce corruption.

### **3.3.6 More areas for ICT improvement**

- ➔ Land registration below#
- ➔ Fighting crime below#
- ➔ ....

## **3.4 Expanding the tax net via ICT**

So far, Kenya has 1.6 million active taxpayers, which is few when compared to the 8.1 million persons contained in the Personal Identification Number (PIN) data base. Accordingly

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<sup>6</sup> Leftie, P.(2016, November 19) Kenya: Sh1.1 Billion Remitted to National Treasury as Withholding Tax, Says County. In: AllAfrica. Retrieved from <http://allafrica.com/stories/201611210569.html>

<sup>7</sup> “the National Treasury is now in a position to operationalize the Treasury Single Account starting July this year” (2017). (Rotich, 2017, p. 13)

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the goal of KRA is to increase the number of active taxpayers up to 4 million by 2018 by a number of groups and areas by accessing information contained in data bases, making use of ICT technology and other investigative means (Kenya Revenue Authority, 2015a, p. 46):

- Matching taxpayers with the number of registered motor cycles
- Looking into commercial small scale farmers whose income would put them into the tax bracket,
- Identifying SMEs doing business via mobile platforms and using agency banking or mobile money transfer platforms, who register for water, electricity or use other services with automated payments etc.
- Going after landlords earning enough to move into tax brackets, also by the use of data mining technology at mobile payment platforms

All this requires giving KRA the right to access those data bases and search them for their purposes which KRA is seeking from government.

### **3.5 Data bases and data exchange**

Due to the expansion of cashless money transfer and payment operations, automated payment systems and a growing number of electronic data bases, KRA sees opportunity to match registered Personal Identification Number holders or registered businesses financial situation with their taxpayers' compliance. In its Sixth Corporate Plan, KRA therefore details that it will propose legislation which will provide KRA with this access. Depending on the extent of data access, a number of Withholding Taxes could be implemented even though there is no fixed residence to both private citizen and registered business. A problem will not only be data protection and privacy concerns, but also rolling back consequences of devolution, for example, cooperating with counties when it comes to match (nationally issued) PINs with (local) SME business registration (Kenya Revenue Authority, 2015a, p. 46f).

### **3.6 Data security**

Looking at KRA Strategic plans one detects adequate concern about data security as far as ownership and security of data at KRA is concerned.

KRA recognises that risks are caused by people, systems and external events. These causes of risks trigger risk events which may include fraud (internal or external), work place health and safety, environment, business disruption and system failure, or damage to assets. The effects of such events have the potential to affect positively or negatively the achievement of objectives. (Kenya Revenue Authority, 2015a, p. 72)

Given the enthusiasm of KRA to outsource important areas of its ITC complex, including service and security appliances (Kenya Revenue Authority, 2015b, p. 20) one wonders whether potential dependency and intrusion risks are appreciated and how granting outsiders access to tax relevant data agrees with tax secrecy and data privacy provisions.

Other risks: dependence from purchased software, instability in the electrical grid, hacker attacks...

### **3.7 Data privacy**

The approach taken by KRA is aiming towards the transparent taxpayers

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- a) Identification of Taxpayers, to adequately know and identify the taxpayers. Differentiation of Taxpayers and applying risk profiling to apply strategies on the basis of aspects related to the concepts of reliability and tax risk, to treat taxpayers according to their tax risk profile. Segmentation of Taxpayers, to stratify taxpayers based on some specific characteristics such as economic activity, amount of revenues, taxes under which they are registered, withholding agent status, etc. which allows for the establishment of equitable and specific rule treatments.
- b) Collaboration with other government agencies and county governments on practical aspects of exchange of information with key partner organisations to leverage on 3rd party information for compliance purposes. Provision of a single source of compliance information, for decision making both at operational and strategic levels.
- c) Tax intelligence and analytics, to facilitate business intelligence and data mining capabilities to support KRA's focus on using risk-based approaches to tackling non-compliance to detect fraudulent behaviour and potential tax evasion, and to provide analytic capability to users for better decisionmaking and revenue growth. Enhance IS Security with electronic signatures for the required level of trust and confidence in tax information. (Kenya Revenue Authority, 2015b, p. 22)

### **3.8 From integration towards full automation?**

While this report is being written, the process is under way to integrate and modernize the disparate systems into one system with the help of funding by the governments of Sweden, Denmark and Kenya. The improved data management, data warehousing, business intelligence and other big data options will assist in detecting low compliance and tax evasion by providing a single view of the taxpayer, thus aiding monitoring and reporting and leading to informed decisions. This process is hoped to be concluded by the end of 2017 (Office of the Auditor General, 2015, p. 19).

But KRA is already envisioning one step beyond such an integrated approach and strives towards being a “fully automated single collector”. The Strategic Plan spells out:

Greater transparency and fairness in Government-to-Business interactions can dramatically improve investor confidence, spur economic growth, provide better public services to the population, and increase public confidence in democratic institutions. This is best achieved through automation.<sup>8</sup>

This means that IT systems will be scaled up „to ensure most taxpayers carry out their transactions with KRA on IT platforms.“ This goal exists towards individual taxpayers, but also towards agencies and businesses.

### **3.9 Transparency**

The degree of transparency practiced by KRA is surprising for the partners in the Tax Justice & Poverty research. The fact, for example, that KRA publishes the names of the largest private and corporate taxpayers without them objecting to it (see above LTO,MTO#). Those publications of KRA are founded on tax relevant data and tax secrecy and requirements of

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<sup>8</sup> (Kenya Revenue Authority, 2015a, p. 69) This optimism is throughgoing, as it also says elsewhere “Substantial automation was done during the 5th Plan period and has positioned KRA where a fully automated future is within reach.” (p.14) and others.

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data privacy concerns, e.g., in Germany, would prohibit German tax administrations to publish that information, most particular about wealthy individuals.<sup>9</sup>

On the other side, not much is revealed except that wealthy individuals and large corporations pay the largest amount of tax, which common sense would assume anyhow and, not surprising, the ranking of Kenya's top private wealth holder is based on KRA's knowledge of income only: "KRA says the data used to calculate the gross income of these individuals for purposes of taxation represents consolidated incomes earned from employment, private partnerships, marketable securities and the array of businesses they control" (Juma, 2017). It can further be assumed that KRA's knowledge is due to the fact that those listed in that top list are those taxpayers who at least make some effort to be compliant since they have more to lose than a good reputation and the social-economic-political position going along with it:

"The KRA list is mainly made up of individuals who have adopted relatively greater transparency in management of their wealth and tax obligations" and even though this list offers some fresh "insight into the population of Kenya's billionaires (its) ranks are expected to be much larger but remains undocumented for tax purposes. Kenya is known to have a large group of super-rich individuals (especially the politically connected), who have hidden their wealth in trusts and a labyrinth of companies to evade taxes." (Juma, 2017)

In other words: KRA's knowledge about income of those top wealth-holder may well be restricted to those sources of income which are known to KRA. Other sources of income, asset ownership or shares in asset ownership of those individuals and even of many more unknown to KRA may not be known or hidden via shell companies and fake directors, hiding plenty of taxable assets from KRA. Hence, there are indications that even this commendable publications regarding those earning Super-Salaries would justify a more investigative approach (see below#).

### **3.10 Discussion**

- ➔ We do need more specific and practical examples here to judge KRA's optimism on ICT so that we can justifiably judge KRA's ICT strategy. Normally, politicians are much more optimistic about what such systems can do as practitioners who have to work with them. Therefore more examples about the strengths and weaknesses of those technologies would be important. This would be an important issue to address with KRA people, starting from the weaknesses we have above on Risk Management Systems, perhaps also referring to the German studies insights.
- ➔ The collection of Personal Income Tax e.g. by professional or business people or other people earning outside the PAYE system still follows the steps of self-declaration by the taxpayer, followed by the fixation of payable tax by KRA. When discussing sub-chapter 3.3.2 we could not remember what this means. Probably that PIT submissions have more options to underreport and cheat as PAYE who are electronically registered and taxed. And that they are in a privileged positions since KRA has to prove them wrong in the first place before they can do anything against it, which is unlikely since it would require audits and investigation and KRA does not have the resources. But: If

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<sup>9</sup> This does not imply that the names of large private and corporate wealth holder are not known to the German public. The source of information is different.

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you do not remember why this piece of information was put into the tax administration chapter, just delete it.

### **3.10.1 General**

It is astonishing, how much hope KRA places in the increasing automation of tax administration. And this is not merely reflected by the latest Corporate Plan, but also the previous ones. This is also reflected in the numbers of additional personnel which shall be hired for this department of KRA: The Sixth Strategic Plan talks of 1000 more personnel (Kenya Revenue Authority, 2015a, p. 73).

It is true, of course, that the use of internet, especially with mobile devices, is on the increase. In 2014, 31.8 million Kenyans were on record for having subscriptions to mobile phones, out of a population of 44 million (Kenya Revenue Authority, 2015b, p. 19). On that background it makes sense to offer mobile payment services to taxpayers e.g. via Mpesa or Airtel money. The question is that of the difference for the “average citizen” between online payments, which is relatively easy, and the management of tax related affairs, which is of a higher complexity. It is also seen that mobile phones do not contain computing power which is needed for Government to Citizen purposes (Kenya Revenue Authority, 2015b, p. 19). On that background the question may be justified whether the optimism to achieve both high internet use for tax related affairs and high compliance can be achieved. The only fact so far established is that taxing financial transactions via mobile devices boosted revenue considerably – but burdens low income and poor households over proportionately since it has a regressive effect.

### **3.10.2 Preparing the ground**

First, there is widespread reluctance and inability to use ICT by the wider public (ignorance, no access, no skills ...). It could also be because submitted hardcopies are more difficult to check for KRA and people and business know that. This need to be countered by a lot of education and motivation of all taxpayers.

Secondly: When it comes to interagency data exchange, the lack of integration and connectivity creates delays in data processing, data validation, and creation of unnecessary debts. This makes it possible for people as well as institutions to give varying figures when filling tax returns. With efficient and effective data sharing system in place, the collection will be higher. The lack of electronic integration and connectivity between KRA and institutions dealing with tax-related data creates delays in data processing, data validation, and creation of unnecessary debts. This also makes it possible for people as well as institutions to give varying figures. If there exists efficient and effective data sharing system in place, tax collection revenue would be higher.

Thirdly: ICT processing only works if data is accurately entered into the ICT operated system. But: Even large businesses often submit manual accounts and need to be audited manually. “Auditing of taxpayers is currently focused on corporations where the process is *manual* and takes long to complete.” (Kenya Revenue Authority, 2015a, p. 49). Similar, taxing rental income is deficitary since ownership is not yet registered in valuation and ownership roles.

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Regarding businesses and large wealth owner one needs to take into account legal conditions regulating transparency of ownership so that KRA can gain insight into beneficial ownership.

Hence: Before ICT really can fly, a lot of “preparing the ground” work needs to be done besides buying computer and IT programs. However, it can be assumed that considerable progress can be made in those areas mentioned here. The following observations and objections are more grave in principle.

### **3.10.3 Risks of Risk Management**

Nowhere the potential of inadequacy or mistakes is addressed, e.g. regarding the inadequacy of risk filter programming or possibilities for manipulation. But this would be an important issue since those systems have an important influence on resource allocation within KRA and those systems are known, not only from the German research, to have mistakes.

Some problems are mentioned, e.g. multiple user accounts, the use of “diverse devices, inability to cope with technological change, unreliable third party managed network segments... and integration with partners that do not conform to standards” (Kenya Revenue Authority, 2015b, p. 19), all of which is seen to be “solvable”.

Linked to this is the observation of an informant with KRA, arguing that authorities lack the resources and technical equipment to closely follow up on the figures reported by large companies. This, however, is probably a deficit which can be easily resolved since new and larger computers will be able to search and process large quantities of data. Large computers on their own will, at the other side, hardly be able to determine whether the submitted or accessed information is complete and qualitatively comprehensive or whether it contains manipulated material.

And indeed: Good Risk Management Systems still need the good tax official operating (with) it: You need the best programmers, you need complete information (and the question is whether self-assessing and self-reporting HNWI and TNCs do this), information needs to be entered into the program correctly and protected from manipulation....

The question should be:

- Are those RSM as good as people
- Are they better/more efficient than people
- Are they only support/serve the work of people

All this implicates to the discussion regarding what status ICT should have in KRA, especially since KRA seems to aim for full automation.

- ➔ Deficits and problems of Risk Based Approaches from German Report? Any computer is only as clever as his/her programmer and German experience with risk management should caution of being over-optimistic. Here, too, it will be important to hire the best possible experts. Those are, however, expensive and will probably be tempted by better payments elsewhere.

### **3.10.4 The relationship between Computerization and Staff**

Here the question is whether the trust in automated tax administration fulfills hopes also to combat tax related crimes such as aggressive tax avoidance, tax evasion, tax fraud etc. Or whether the existence of auditing and investigation also has its importance. If yes, it is surprising, how little talk was of that department in the Corporate Plan and its achievements and importance for tax administration and tax justice, especially towards equity and equality of tax administrative interests towards private, corporate and criminal wealth holder.

A conversation partner from KRA states: Even though a substantial part of the information submitted by taxpayers comes in electronic form, the tax authorities still lack the means to electronically screen and process this data in order to develop a risk-based audit strategy. In other words: Only if KRA knows enough about TNCs practices it could develop risk codes – provided submitted material is honest and not made “fit to KRAs risk codes”, as one accusation in Germany runs against tax advisors deducting or knowing tax administrations risk code programming.

Immediate follow-up of non-filers and those whose payments do not match their liabilities is a too often neglected aspect of good tax administration. The best computer is not able to replace an experienced inspector and does not replace the link between “declaration and verification”

### **3.10.5 Machines, the wealthy and legal frameworks**

Kenya research also observes the tendency of tax crime and tax fraud making increasing use of IT systems, adding to the tax evasion and avoidance already present: The tax on turnover (ToT) compliance is low thereby failing to achieve the revenue targets. Fraud has shifted from manual to the automated environment making it harder to detect and resulting in high amount of revenue leakage. The automated environment has also exposed the KRA automated systems to hacking and other system abuse from both within and without. Regarding Kenya, there are problems to do with data exchange between institutions, difficulties in filing and persistence of options to evade taxes despite computerization of tax administration.

This goal of transparency will certainly be achieved with the ordinary taxpayer, the question is whether this can be achieved with the private, corporate and criminal wealth holder and their many options to transfer and hide wealth. That this is the case in Kenya as well has been suggested above (transparency#) where journalists conclude that the list of HNWI's published by KRA are only those who “have adopted relatively greater transparency in management of their wealth and tax obligation.” What about those, who do not intend to cooperate?

For them options inherent in internet usage for businesses, banks and wealthy individuals is growing. As the German study exemplifies, electronic means also provide many opportunities for manipulating tax declarations, and legal constructs are in place to hide assets and transfer them legally, illicitly and illegally out of the country without computers being able to detect it, one more argument for investigators and auditors to look behind the veil. In other words: Without legal reforms putting away constructs assisting the hiding of assets, computers alone will not be able to do the jobs. Without skilled inspectors in place who are assisted by computers, a lot of fraud will never be detected.

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(see also below, Crime/ICT approach#).

### **3.10.6 Security and privacy concerns**

Reference is to the over ambitiousness of KRA on ICT, it is prudent to point out the following as an example to watch. In March this year a case of a one Mr Mutuku was accused of causing the loss of Sh3, 985,663,858 from KRA by interfering with the institution's computer systems between March 2015 and March 2017.<sup>10</sup> This flies in the face of over reliance on ICT as a panacea for minimizing fraud.

There is very little discussion about individual and corporate data privacy concerns which is surprising when comparing the extent of electronic data collection and processing in Kenya and data privacy concerns and discussion elsewhere, e.g. with the German partner study.

Privacy concerns are also afflicted if anywhere in the big unified government network a security breach occurs since every databank will be linked to others and manipulations or hacker in one segment can affect the integrity of a person or business elsewhere.

Is this aimed-for absolute transparency (if it at all can be obtained by just linking computer networks) and the disregard for data privacy not also an obstacle for investors? Meaning, that there should be at least some sort of compromise between total data protection via non-penetrable Corporate Veil and some protection of personal and legitimate business data via a well designed tax secrecy provision so that individuals and businesses have no reason to fear that sensitive data area leaked and find their way into the net.

Again: Important is a compromise between the Right to tax and the Right to privacy. It should also be prevented that the right to too much privacy facilitates crime, as it is the case with Shell companies and Trusts facilitating tax evasion and money laundering

### **3.10.7 Other concerns**

ICT also enables in the middle and long term saving personnel due to automation – this can be a temptation.

ICT is also a way to monitor performance and to detect misconduct of employees, that way being an insurance against underperformance and corruption.

A wrong setting of priorities/over-emphasizing in this area affects resource allocations to other areas, e.g. of personnel: It is right and just to look for more 1000 ICT specialists (see above#). But is this in proportion, if the investigation and enforcement departments staff level is as low as it is right now current 179 (by 207 approved, see above #)?

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<sup>10</sup> Read more at: <https://www.standardmedia.co.ke/business/article/2001233552/man-charged-with-hacking-kra-and-causing-sh4b-loss> Updated Wed, March 22nd 2017

See also “Police bust ring of hackers in multi-million shilling KRA, bank thefts”

<http://www.nation.co.ke/news/Police-bust-ring-of-hackers/1056-3842558-11h7q5xz/index.html>

## 4 Other efforts to improve compliance

A second and third important element to advance the expansion and integration of the tax net is enforcement and the combined effort to improve service and education.

### 4.1 *Anti Avoidance measures*

First, there are measures to limit the extent of (legal) tax avoidance and prevent it from developing into (illicit) aggressive tax avoidance. It arises from KRAs option to initiate legal reforms if deficits are detected in the course of its own practical effort to enforce tax laws.

- The following three paragraphs contain information from an informant. But that way not really intelligible to the reader: And: What was the outcome of this? Is it working or not?

The KRA amended section 18(3) to ensure that the section is not interpreted in an anti-avoidance context. Prior to this amendment (and in a strict legal sense), there could have been an argument (untested) given the wording of this section that the KRA can only make adjustments to transactions if it can prove that there was an intention to avoid tax. The definition of related parties under the law has also been expanded to include relationships between natural persons.

In 2010, the KRA introduced a schedule to the annual tax return requiring related parties to declare whether they have related-party dealings and, if so, the quantum of such related-party dealings. The schedule also requires the taxpayer to disclose whether they have prepared tax procedures and Transfer Pricing (TP) documentation. Although the KRA has verbally stated that this return is in effect for financial years ending December 2010, the schedule appears only to be available where a taxpayer completes their annual income tax returns online. [The reason for having the Tax Procedure Act in place is the Act allows the Kenya Revenue Authority \(KRA\) to investigate suspicion of pricing agreements and gives the authority rights to reverse any that appear to be structured for the purpose of avoiding taxation](#)

At present in Kenya, taxpayers have the option of either filing their returns online or manually. The majority of taxpayers still prefer to file manually using hard copy return forms which do not contain this new schedule. Consequently, it is unlikely that this new schedule is currently serving the purpose for which it was intended. The KRA has also stated in the past that it is in the process of issuing TP practice notes. These notes have not been circulated for comment, however.

A final point: On a similar note, there is an enforcement deficiency when it comes to assessing profit margins for MNCs in order to determine the appropriate tax rate. The officer with KRA said, “There is a belief that MNCs under-report their profits in order to pay less tax. Some go a step further in the name of Corporate Social responsibility and advertise their brands. For example building a school and branding it. All this is to reduce profit that is reported and in turn tax paid to the government”.

## 4.2 Audits

### 4.2.1 National Audits

The best ICT based risk management eventually needs feet on the ground, i.e. tax auditors visiting suspects or checking books on a routine basis. Here, KRA admits a number of deficits in the Sixth Corporate Plan.

Auditing of taxpayers is currently focused on corporations where the process is *manual* and takes long to complete. This has led to a long list of pending cases for audit hence technically excluding small and medium taxpayers from possible audit. The process also lacks transparency leading to integrity concerns on the part of audit staff. The Authority therefore plans to invest in automated audit systems to hasten the audit process and ensure that no taxpayers with audit issues escape the scrutiny. The Authority plans to review the governance of the audit and investigation programmes with the objectives of achieving an objective and transparent model for case selection of audits and investigation, documented frameworks outlining governance and control processes, a performance management system and integrity assessment programme its auditors and investigators, and a staff deployment programme that prevents the emergence of cartel-like schemes in audit and investigation programmes.

In order to have a wider scope and reach,

the Authority will: i) Develop regional audit centres and shift audit from a station-function to a regional office-function, ii) Use automated audit selection and risk profiling through iTax, and iii) Develop and implement an audit performance management and governance framework (Kenya Revenue Authority, 2015a, p. 49).

Integrating integrity components in all ongoing automation initiatives: the focus of KRA is to carry out integrity related audits to ensure that as automation proceeds, transparency and accountability are integrated in all systems to minimise discretion, human contact and delays and enable customers to track KRA progress in providing services, especially provision of refunds and rulings.

According to a conversation partner with KRA: Under certain conditions (e.g. in the case of false information), the tax authorities have the right to assess the appropriate measure to take corresponding action to the figures declared by the taxpayer. The problem is how KRA finds out whether submitted information is false in the first place, providing for a justification to take whatever “appropriate measures there are.”

According to the same informant, an issue or aspect increasingly attracts the attention of tax authorities are historically loss-making companies – an indication of BEPS practices, easily to be done within the network of low-tax secrecy tax havens.

KRA implemented an Audit Governance Framework with the goal to improve transparency and efficiency in the way audits are being carried out, to eliminate multiple audits, to have an objective case selection system which is independent from audit execution and to ensure that audits are concluded on time. Audits are also having the goal to improve voluntary tax compliance (Office of the Auditor General, 2015, p. 18).

The taxman forced more than 10 multinational companies to rewrite their financial statements, turning Sh8 billion losses into profits that have yielded Sh4 billion in tax revenues. The companies had used the transfer pricing mechanism to declare losses that effectively disqualified them from paying income tax. But a Kenya Revenue Authority (KRA)

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audit of 40 multinationals discovered widespread abuse of transfer pricing – the accounting world’s lingo that is used to describe the costing of transactions between multinationals and their subsidiaries – to declare losses and evade taxation. “The audit has seen a claw back of loss positions accumulated by these companies to the tune of Sh8 billion, moving them to tax payment positions with respect of future operations,” said KRA commissioner general John Njiraini (Irungu, 2013).

According to the Commissioner General most of the suspect transactions involved local companies and their subsidiaries located in tax havens that do not charge income tax or whose tax rates are much lower than Kenya’s 30 per cent. KRA said subsidiaries of the transnational companies in the tax havens had, for instance, disbursed expensive loans to the Kenyan associates or purported to charge them for ridiculously over-priced management services that ate into the local company’s profits, leading them to declare losses. KRA said it had busted the tax evasion syndicate by comparing what the tax haven-based associates of local firms had charged with the prevailing market prices of the goods and services. Mr Njiraini said that more than 40 companies were audited cutting their losses by Sh8 billion and leading to a tax liability assessment that found that Sh4 billion had been lost in the transfer-pricing racket. The culprits are expected to agree with KRA on a payment schedule that will enable them to clear the tax.

There are promising development and improvement: The OECD/ITC report on successful Domestic Resource Mobilization mentions that case:

In Kenya revenue collection from transfer pricing audits has doubled from USD 52 million for year from June 2012 to USD 107 million for year ended June 2014. Moreover, with development partners, Kenya now provides transfer pricing technical assistance in the East African region, including transfer pricing capacity building workshops. (OECD, 2015, S. 33)

#### **4.2.2 County Audits**

Also Counties have their problems with collecting taxes: According to an interviewee formerly working with an international organization, doing budget monitoring in Kenya “Some of the taxes aren’t even enforceable, the counties just do not have the resources to send someone around collecting ‘chicken’ fees.” As such they propose that county governments should not only focus on taxing everything they can get their hands on but what will help benefit the local people more. One interviewer summed it up, “They need to balance raising revenue to develop their counties.

ATTENTION: Audit done by the Auditor-General, Edward Ouko and it certainly provides arguments that also KRA should have a closer look!

The report shows irregularly paid leave allowances, duplicated revenue receipts leading to loss of millions, and payments for billions worth of projects that were either not viable or incomplete. Nyeri County paid Sh30 million to all its staff as leave allowance between December 2014 and February 2015 with no leave forms signed and in what the report said was untenable... Similarly, he said the purchase of Sh472 million supplies for Othaya Sub-county

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hospital from the Ministry of Health was ill-advised as the hospital was still under construction.<sup>11</sup>

- ➔ Regarding the National Youth Service Scandal from Chapter IV: Was it not also discovered by an Audit? If yes, by whom?

### **4.2.3 Joint Audits**

When asking a Nairobi based tax expert about the potential and chances of Joint Audits especially when checking upon TNCs he replied in a mail:

I believe the administrative necessity is there and therefore, its just that Countries have tended to hide under issue of legal jurisdiction for both national and cross boarder audits which in my view are either here nor there. Its unnecessary legalese. Now in the area of twinning in joint audits, it's an idea I have heard but the good will to realize is none existent. As what it means is trying to address issues of uniformity in standards, level of comprehensiveness, and most importantly capacity differential that are tied to institutional culture that's in my view is very diverse and know of local legislation (knowledge) hence posing risks for addressing timeliness while undertaking joint audits and the risks of not achieving the timeliness criteria. However, in the area of twinning for knowledge sharing and exchange for supreme audits I know, the most critical challenge is to get European or German auditors willing to work in Africa. They tend to be in high demand in their countries and expensive such that normal TA is unable to access them.

This confirms statements from other experts in other countries saying that Joint Audits are not pursued more vigorously because TNCs try to block them since they are very well aware that this could uncover more than they like to be known.

Joint Audits, of course, can only be done if other countries are prepared to co-operate in it (see below InternationalCoop# and VII/#)

## **4.3 Collection of certain taxes**

### **4.3.1 Collecting VAT**

KRA aims to collect more VAT so that revenue here will make up 35% of total revenue, while, so far, this share is at 25%. To achieve this, a whole range of measures shall be implemented: Harmonization of local rates, taxpayers education and assistance (when filing for returns), identification of non-compliant taxpayer, but also the introduction of the Trader Information Management System (TIMS) with the goal to achieve more transparency between input, output and credit information on the one hand, and filed returns and payments on the other (Kenya Revenue Authority, 2015a, p. 51).

### **4.3.2 Collecting tax from real estate and property**

As has been explained in chapter V and above (##), there are a number of deficits between Kenyan laws regulating the taxation of real estate and property and the de facto collection of tax, duties and fees.

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<sup>11</sup> Lang'at, P./Nyamai, F. (2016, November 23) Audit report shows massive losses of taxpayers' money in central counties. In: Daily Nation. Retrieved from <http://www.nation.co.ke/news/audit-report-massive-losses-of-taxpayers-money-central-counties/1056-3462742-hthd8u/index.html>

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Since wealth is context dependent, rented houses are a common form of wealth in Kenya. According to Attiya Warris, in interviewing her she had this to say: “Investors in real estate hardly ever pay taxes, even when their tenants in formal employment are taxed heavily. Ideally, non-residents earning rental income from real properties are subject to a withholding tax at a rate of 30% on gross rental income received. Yet this is supposed to apply even to residents but the KRA finds it difficult to tax rental income since the values or incomes are not documented”. In view of this, the government is considering asking tenants to volunteer information on the rent they pay. But this is challenging since tenants may fear victimization by proprietors of rented property.

In the context of its Real Estate Revenue Enhancement Initiative (see V/4.4.7#), KRA relies both on the initiation of legal changes, administrative-technological innovation and (once more) boots on the ground:

Government supports issuance of land Title Deeds and the digitalization of Land Registries with 1.6 billion and 0.9 billion KShs respectively (Rotich, 2017, p. 24).

The amnesty for landlords to come forward being expired (see V/6.5#), KRA now intends to “increase withholding tax agents to 1,000 from present 800 in a move targeting corporate tenants and public institutions.” Those agents are supposed to collect 200 million KSh per months from tax evading land lords. “In the four months to April tax collection from landlords was Sh4.8 billion, the taxman said. This is a 220 per cent increase from Sh1.5 billion during the same period in 2012 when the agency enhanced measures to increase tax revenue from the sector, considered to be lucrative in return on investment.” It is hoped to identify 20,000 new landlords every year.<sup>12</sup>

The “use of appointed agents to collect and remit tax on rental income on withholding basis” as well as the “Implementation of a Geographic (Geospatial) Information System (GIS) due to its capability to automatically link data on land parcels, property ownership and development with KRA tax information to establish tax compliance. This will be achieved through partnership with relevant government institutions.” Doing that it is hoped that revenue from this sector can be increased to up to 4 billion KSh (Kenya Revenue Authority, 2015a, p. 51)

➔ Also Deloitte states that withholding tax on rental income withheld by agents appointed by the government (Deloitte, 2017). ➔ Who are those guys? Civil servants? Paid toll collectors? Who is supervising them? Are they corrupt? Why NOT employing civil servants for this task etc.

Besides taxing real estate, KRA hopes to collect more taxes from property owner. “The average for developing countries is 0.6%. Kenya’s National Government property taxes revenue as a proportion of GDP is 0.22% (or Kshs 11.1 billion). The target is to increase the collection to 0.9% of GDP or Kshs 76.0 billion by 2017/18.” (Kenya Revenue Authority, 2015a, p. 51). Doing that requires again cooperation with County governments in order to

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<sup>12</sup> Ilako, C. (2017, June 3) KRA to appoint more agents in war on tax evading landlords. In: The Star. Retrieved from [http://www.the-star.co.ke/news/2017/06/03/kra-to-appoint-more-agents-in-war-on-tax-evading-landlords\\_c1572994](http://www.the-star.co.ke/news/2017/06/03/kra-to-appoint-more-agents-in-war-on-tax-evading-landlords_c1572994)

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arrive at a harmonized and efficient tax structure, but at the same time concentration on Nairobi County is advisable since it accounts for 60% of the country's property value, and Mombasa, Nakuru, Kisumu and Uasin Gishu counties accounting for the bulk of the rest. "A preliminary analysis shows that Nairobi County has residential property valued at Kshs 2,650 billion, indicating considerable potential for enhanced revenue from property taxation. There is also 3.88 million square metres of non-residential property in Nairobi as well as a substantial amount of undeveloped land." (p. 52).

- ➔ Two comments on that move: First: Given the extent of private wealth-holder it can be assumed that those agents will also discover undeclared assets within that category. Second: This move supports our view that, all in all, the best ICT does not replace agents on the ground in order to increase tax compliance.

### **4.3.3 Collecting Capital Gains Tax**

There is uncertainty about the nature of the CGT and the proper time of collection. Is the CGT a Withholding Tax? And is the tax justifiably collected before the transfer takes place or when the transfer is registered (KRA, 2014).<sup>13</sup>

More problems:

Despite various controversies over the matter, the KRA has been of the view that CGT is a transaction-based tax and should therefore be paid upon transfer of property, and not later than the 20th day of the month following that in which the transfer was made. Since the introduction of the tax, there have been a number of challenges in its implementation and administration. For securities traded on the NSE, for instance, a proposal was made in the Finance Bill, 2015 to tax such gains at 0.3% of the gross amount payable per transaction. This basically moves this from the ambit of CGT to withholding tax. The legislation around CGT is constantly being refined and investors are advised to ensure their information is up to date or to seek guidance (Oxford Business Group, 2016a).

## **4.4 Special unit for private wealth holder?**

Given the fact that large corporations are being handled by a special unit, the LTO, the question is why private wealth holder in Kenya are handled on the level of the MTO and not, by a special unit in charge of private wealth holder, even more though, since the Uganda Revenue Authority seems to have good experiences with it.

All that which is known about de-facto HNWIs and UHNWIs living in Kenya and the tiny number of registered, self-declaring and known taxpayers from that segment, indicates that there is a lot of income and wealth hidden from KRA. The list made public by KRA about private wealth holder is interesting for many reasons: It does not only contain business people, entrepreneurs, financiers and investors, but also manager working at the Big Four auditing companies, top lawyers and doctors. It also brings substance to the widely held belief that there is a link between Supersalaries and wealth on the one hand, and being "politically

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<sup>13</sup> Regarding this point a lawsuit has been decided by Justice Mr. J. Mativo on 15 March 2017: He ruled "that Paragraph 11 A is inconsistent with other provisions of the Income Tax Act, that the same paragraph is inconsistent with the Constitution of Kenya in that it imposes an unfair tax burden on the public by being levied on or before the transfer instead of upon registration of the transfer." Writeup, Advisory Opinion 5/2017

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connected” on the other – if both (high income and (former) public office does not go parallel anyway as is illustrated not only with the presidential family, but also the fact that Philip Kinisu, the former chairman of the ethics and anti-corruption commission is one of the silent billionaires (Juma, 2017).

This link between wealth and politics may be an explanation why plans of KRA to set up a specific unit for private wealth holder does not really get started.

According to an analyst of PwC (Watoro, 2016), KRA, in its Fifth Corporate Plan, set up a special operational unit targeted to bring HWIs and UNHWIs into the tax net. “KRA is hopeful that the establishment of this special team and its ability to have wider powers and means for accessing taxpayer data will boost its gathering plan as it seeks to identify and prosecute companies and individuals who either understate income or fail to remit the right amount of taxes.” Besides using new ICT based instruments to detect multiple account user via iTax and PIN and other transparency and investigative advancing instruments, the unit is also said to increase the advance Tax Information Exchange Agreements with other states, to engage with tax advisors and to “encourage co-operative compliance”.

“Current practical steps implemented by KRA can be seen through initiatives such as the introduction of the iTax system, which is designed to capture multiple revenue streams and transactions and link various parties together through the use of an individual’s PIN number; the reinstatement of capital gains tax; and the introduction of a special regime for the taxation of rental income and the associated tax amnesty that expired on 30th June, 2016.” (Watoro, 2016)

Sadly, this Fifth Corporate Plan is, other than its predecessors, no longer retrievable in the internet. The research team could also not obtain any reliable evidence upon the status of this unit.

#### **4.5 Customer education and compliance**

Talking about traditions and ignorance due to the lack of taxation in earlier history, a lot of education needs to be undertaken to (a.) inform the population about the meaning of paying taxes, (b.) the value they get in return and (c.) the ways and means of how to do it.

In 2015 large activities to inform about 100,000 taxpayers about iTax and win them over for the system<sup>14</sup>

#### **4.6 “Customer Satisfaction”**

Once education takes hold in the minds of the people, it is also important to offer simple and efficient services to citizens.

One of KRAs priorities for the Vision 2018 is customer satisfaction and it offers a wide range of measures with which it hopes to improve information, services, assistance and outreach. It contains proposals to improve KRA Website and service systems as well as specific assistance for those having problems with the current VAT refund system and measures to

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<sup>14</sup> June 2015 <http://www.cio.co.ke/news/top-stories/kra-targets-to-train-100,000-taxpayers-on-itax>

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improve the “KRA brand” to improve internal and external perception (Kenya Revenue Authority, 2015a, p. 53ff.).

For businesses, the government has embarked on a countrywide project to establish a network of one-stop investment centres, known as Huduma, or “service”, centres. These investment centres facilitate investments by bringing together all the relevant government agencies in one location. This will help to ensure the efficient and transparent provision of services to investors. Through these investment centres, the government aims to reduce the time it takes to register a business to one day by enabling investors to more quickly and easily obtain all the necessary documents and statutory approvals that are needed to set up a business in Kenya (Oxford Business Group, 2016a).

Additionally, a Corporate Tax Dispute Resolution Division has been opened with an Alternative Dispute Resolution (ADR) framework, aiming to resolve tax disputes without having the need to go to court (Office of the Auditor General, 2015, p. 20). Here, the Tax Appeals Tribunals replaced the Local Committee, Customs Appeals and VAT Tribunals (see also below, 10.2#)

(→ Clearly, nothing would improve customer satisfaction as much as transparency and accountability....)

#### **4.7 Rewards**

Public recommendation and rewards for top taxpayers.

→ Some more information here because for Germany something like the “Taxpayer of the Month” would be inconceivable.

#### **4.8 Fines**

Adequate interest charges must be imposed on late payments to ensure that non-payment of taxes does not become a cheap source of finance. Similarly, an adequate penalty structure is needed to ensure that those who should register do so, that those who should file do so, and that those who under-report their tax bases are sufficiently penalized to increase the costs of evading tax.

The same by defaulting and debt (see below#)

#### **4.9 Discussion**

##### **4.9.1 Business taxation**

Regarding tax avoidance measures: Here the quote of the international expert in 4.1. suggests that Corporate Social Responsibility measures are (mis)used to lower the tax obligation. Since lowering poverty and inequality is the prime goal of this research and not taxation at all costs we need to look into the issue, whether CSR is an adequate or even better instrument to achieve that goal than taxation. This will be done in VI/#

Regarding business audits (4.2): Right now, there are two situations which spark off an audit:

→ If Risk Management tells KRA that something fishy needs to be checked

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- ➔ If KRA have other grounds to suspect that an audit might be called for, but the burden of proof is on their side to justify an “initial suspicion”, e.g. by making suspiciously high and permanent losses

The problem is: They only get information about losses if submitted documentation is comprehensive and honest. If this is not the case and the handed-over material does not suggest foul play, there is no justification or reason for an initial suspicion, necessitating an audit. The same problem applies for the accuracy of Risk Management: it only indicates something suspicious – if data is complete and correct(ly entered). A balance of power is only given if there is also the option for chance audits.

The question is: Is there also a provision for a “chance audit”, i.e. that the automation efforts are complemented by chance audits, where the computer selects businesses by chance for audits in order to assure the public that everybody, the good ones included, need to be ready for audits at any time (as it is in GER).

#### **4.9.2 Other issues**

KRA is in a comparatively weak position regarding self assessing and self-submitting HNWI, and here they do not even have a specific HNWI unit

Regarding property taxation, there is a clear case to focus resources upon urban areas

A lot needs to be done to educate taxpayers about not just how to use ICT, but also why they should do it – which, of course, is also linked to the spending of taxpayers money.

Finally we reiterate that it needs a balanced approach between ICT and the use of personnel.

## **5 Combating IFFs**

### **5.1 Tax related crimes**

#### **5.1.1 Crimes of prime interest, Whistleblower**

The Kenya Revenue Authority (KRA) has started a new search for the supplier of a web-based platform that will enable anyone to secretly report tax cheats and get rewarded for it. Anonymous reporting of tax cheats has long been part of KRA’s fight against unreported income and diversion of taxable goods offences, which are estimated to cost Kenya Sh137 billion in uncollected tax revenues annually. As it stands now, KRA currently relies on walk-ins, e-mails and telephone calls made through its Complaints and Information Centre (CIC) for tax evasion tips. This system has had limited success partly as it requires informants to submit their personal details such as name, postal address telephone contacts as well as their PIN numbers (Mutegi, 2015).

KRA offers an “Informer reward scheme” in the Directory “Investigations and Enforcement”.<sup>15</sup> It starts with long list of actions that might precede or result in tax evasion,

- a) Manifest Fraud

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<sup>15</sup> <http://www.revenue.go.ke/index.php/investigations-and-enforcement/informer-reward-scheme>

This occurs when shipping agents illegally alter manifests prior to uploading them to the Customs Manifest Management System (MMS), thereby setting the stage for false declarations.

b) Use of fake security bonds to clear transit goods

Some importers and clearing agents use fake Customs transit bonds to clear transit goods. This happens by collusion between clearing agents, insurance companies and Customs officers.

c) Diversion/Dumping of transit goods

Transit goods are goods imported through the East African Community (EAC) region to a country outside the region. Transit goods within the EAC region are not subject to import duty. However if the consignment fails to exit the region within the prescribed period and no official extension is granted, duty becomes due (this is diversion of transit goods). Customs department secure the duty due on transit cargo through the execution of a security bond. Goods prone to diversion include sugar, petroleum, rice and motor vehicles

d) Customs Mis-declarations

A Customs declaration is a statement showing goods being imported on which duty will have to be paid. This is done by filling in a Customs declaration form. However, some importers/clearing agents make wrong declarations with the objective of evading payment of duties or reducing the duties payable. Making a wrong declaration (i.e. mis-declaration) is a prosecutable offence.

e)Smuggling

This involves importation or export of goods secretly in violation of the law, especially without payment of duties. Recent cases include: importation of high end vehicles cleared as mattresses, baby car seats, bed sofas, toys, clothes, beach beds, shoes, belts and handbags.

f) Fraudulent cancellation of export entries

This is use of fake Customs entries as proof of export, which thereafter leading to fraudulent VAT refund claims.

g) Import/Export of prohibited or restricted goods

Prohibited goods are the goods that cannot be imported/exported into/out of the country. Restricted goods are those which must meet certain conditions before clearance through Customs. Examples: ivory, macadamia nuts, flora and fauna etc

h) Fake payments of import taxes

This happens when Customs entries are fraudulently posted in the Customs system and validated with fake bank payment receipts.

i) Dealing with excisable goods without a valid licence

By Law, dealers in excisable products (especially tobacco, wines and spirits) should be licensed.

j) Nil/non filing income tax returns

All individuals with income are required by law to submit Income tax returns together with accounts where applicable. The returns are due on or before the end of the 6th month after the end of accounting period. Non-submission of tax return may result into prosecution.

k) Invoice fraud

The scheme involves shell companies through which money is channeled as payments for purchase of goods while in actual sense no goods are supplied.

l) Under declaration of income

By Law, all income earned in Kenya is taxable. However, some individuals under declare their income for purposes of reducing their tax liability.

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This list is followed by the statement: “Section 5A(b) of the KRA Act Cap 469 provides for payment of rewards to informers in the case of information leading to the recovery of unassessed duties or taxes, **5% of the taxes or duties so recovered** or **KES 2 million**, whichever is the less.”

For that reason it seems deductible that those crimes are either of major interest for KRA or of particular importance or of particular quantity or particularly difficult to resolve because KRA appeals to whistleblower, offering a reward scheme.

- ➔ Most regarding Customs and Excise, little upon Domestic Taxes/Wealth Tax?? Many areas are missing e.g. cheating on Capital Gains Tax, capital flight, misuse of transfer pricing, money laundering, capita flight, illicit BEPS trickery or hiding of assets??? Why?? Because it is the areas above mentioned where they think that most damage occurs (which is in accordance with Bakers 15/30/60 approach). But how do they know that tax evasion, money laundering etc is not large and therefore would merit equal effort and rewards?

### 5.1.2 ICT approach

KRA must meet a myriad of challenges posed by the informal sector and large corporations. The former is the fastest growing sector while the latter operates in an increasingly complex global environment, characterised by growing electronic commerce. Both sectors have unique ways of tax evasion and avoidance. (Kenya Revenue Authority, 2009, p. 58)

When looking at the Sixth Corporate Plan, also the fight against tax related crimes is discussed almost exclusively within ICT related innovative strategies, involving smart intelligence (Big Data, Business Intelligence, Data Warehousing), risk based intelligence and other programs designed to detect “deviation from the rule”, thus indicating where something might merit a closer look.<sup>16</sup>

According to the 2<sup>nd</sup> ICT strategy of KRA, the entire process of ICT upgrading, especially in the field of business taxation, is geared towards increasing tax compliance and enforcement:

The need for enterprise information infrastructure is driven by the need to shift emphasis from ‘operational’ business activities to ‘compliance’ activities based on risk analysis and intelligence-led decision-making. We need to become more proactive in our response to data received, relating data from one source to another, with our systems automatically reacting to any anomalies detected. Our information management strategy also needs to address challenges in the management of a growing volume of unstructured data. (Kenya Revenue Authority, 2015b, p. 26)

- ➔ The wording “need to become” indicates also that there is still a long way towards achievement, if that can be achieved at all due to the shortcomes and options to manipulation with ICT (see above ICT/Discussion#)

### 5.1.3 Investigative approach

Introduction and integration of corruption related audits into KRA’s audit framework. The auditing profession, as it has evolved, has its roots in the private sector where audit against

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<sup>16</sup> See Sixth Corporate Plan p. 10, 13f., 44-48, 53, 64, 72,

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corruption is not a serious concern of the stakeholders since their customers will not bribe for service – they will vote with their cheque books and private companies are usually able to put in place internal controls to counter procurement related corruption. Corruption auditing is a specialized field since it is primarily concerned with the public sector and it often has no documentary trail. Corruption based audits have to focus on documenting opportunities for corruption in the KRA system with a focus on ensuring all key KRA systems and processes have undergone at least one corruption related audit during the Plan period.

As part of its contribution to the National efforts to tackle corruption, KRA agrees to enhance the role of its tax auditors in detecting corruption in private entities, disallowing and reporting the same. This is in line with the framework of the Sixth Corporate Plan for reporting suspicions of corruption and corruption related payments (Kenya Revenue Authority, 2015a, p. 66)

KRA policy requires the prosecution of all cases involving tax evasion which is classified as an economic crime under the Anti-Corruption & Economic Crimes Act. Prosecution is undertaken in conjunction with other law enforcement agencies and is in addition to other recovery measures as e.g. the Financial Reporting Centre or the Asset Recovery Agency.

Areas of investigation for KRA are as follows: Materially false statements made, or materially false documents provided, Deliberate concealment, deception, conspiracy or corruption is suspected; cases involving false or forged documents; Previous Tax fraud offences; or a repeated course of unlawful conduct; or a previous Civil Investigation [particularly where they involve incorrect Statements of Assets or Certificates of Full Disclosure]; People in positions of trust or responsibility (e.g. a company FD who is a qualified accountant, or JP); In a Tax Avoidance scheme - where reliance is placed on false or altered documents; or material facts are misrepresented.

To mitigate on cross-border related tax avoidance and evasion, KRA has set up monitoring units at cross border, an international Tax office to gather information on cross border transactions from hitherto inaccessible jurisdictions to ensure correct taxes have been declared in Kenya by companies involved in such transactions.<sup>17</sup>

In March, KRA established a unit specialized upon investigations about „tax evading cartels“, combining both tax auditors and investigators competent in investigating crime in the area of tax evasion, financial flows and fraud. In the latter area, the Commissioner General said, KRA is hiring more professional personnel.<sup>18</sup>

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<sup>17</sup> KRA sets up cross-border monitoring unit, <http://www.businessdailyafrica.com/KRA-sets-up-cross-border-monitoring-unit/-/539546/2722688/-/14g9wytz/-/index.html> Accessed 12th December 2015.

<sup>18</sup> Kamau, M (2017, June 28) Kenya Revenue Authority to hire spies in clamp-down on tax cartels. In: Standard Digital, Retrieved from <https://www.standardmedia.co.ke/business/article/2001245120/kra-to-hire-spies-in-clamp-down-on-tax-cartels>

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#### **5.1.4 Tax administrations privileged place**

Regarding the discovery of other IFFs, tax administration is in a privileged place: Due to access to financial balance sheets during tax audits also plenty of insights into other suspicious transactions KRA is able to detect, trace and investigate also other IFFs, e.g. monies originating from corruption, money-laundering or other sources. That's at least the experience of Germany.

The problem is: Are tax auditors reporting those cases since tax payments are ceasing as long as penal investigations are going on? Or: Are they suspect to bribery, inducing them to not report it? Or: Are they afraid to report because in case it is not justified they are dragged to court for compensation due to bad talking?

#### **5.1.5 Discussion**

Plenty of tax crimes of prime interest should in theory be detectable and resolvable with data mining, business intelligence and other ICT technology, as is expressed in the optimistic quotes above at ICT approach. That KRA puts all those crime on its website introducing the "informer-reward-scheme" indicates that KRA at least right now depends on insider information more than on ICT wizardry.

Hence, efforts to combat tax evasion are resting on the three pillars whistleblower, ICT, and investigative personnel! The list above in combination with incentives for informants therefore seem to indicate that the crimes listed are so far best detected with the help of whistleblower and not with related technological and investigative efforts. Each of those areas need equal attention and adequate investment.

The real ethical question is: Is a state, obliged to the rule of law, entitled to encourage unethical behavior (whistleblowing) to fight unethical behavior (tax evasion)? As long as there is no alternative, it is justified on the background of the greater damage to the common good.

### **5.2 Other IFFs**

#### **5.2.1 Multilevel approach**

Currently, GIZ assistance is given in the area of fighting corruption and IFFs. The following excerpt indicates how complex/confusing the institutional setup for investigating and prosecuting IFFs is:

The planned activities follow a multi-dimensional, multi-level approach. On the individual (micro) level, human capacity development will be implemented in the areas of parallel investigations, analysis of suspicious transaction reports (STRs), customer due diligence (CDD) compliance and undertaking risk assessments. On the institutional (meso) level, the interventions will particularly aim at the organisational development of the institutional key players combating IFF. Specific support will be given to ARA and FRC in their full operationalisation. Furthermore, intensified networking and the tooling of an inter-agency information sharing system will connect AML/CFT and anti-corruption authorities. On the cross-border, inter-agency (macro) level, networking and knowledge sharing efforts are supported, specifically between members of the *Asset Recovery Inter-Agency Network for Eastern Africa* (ARIN-EA) and the *East African Association of Anti-Corruption Authorities*

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(EAAACA). Overall, the activities will contribute to both, the upstream-section of the fight against IFF (investigation and tracing) as well as the downstream-section (freezing, confiscation, repatriation).<sup>19</sup>

## **5.2.2 Cooperation with other national and regional authorities**

### **5.2.2.1 Overview**

Besides KRA, a number of other government agencies are in charge to combat tax related crimes, e.g. the Asset Recovery Agency (ARA), a semi-autonomous body under the Office of the Attorney-General. The Financial Reporting Centre (FRC) an independent governmental body, furthermore the Ethics and Anti-Corruption Commission (EACC), the Office of the Director of Public Prosecutions (ODPP), the National Police Criminal Investigations Department.

On the level of the East African Community (EAC) exists the Asset Recovery Interagency Network for Eastern Africa (ARINEA), and the East African Association of Anti-Corruption Authorities (EAAACA).

More specifically regarding IFFs, Kenya is member of the Anti-Money Laundering Regime and the Financial Action Task Force through the East African group ESAAMLG.

It is no member in the Leading Group on Innovative Financing for Development (advocating for example, for a Transaction Tax on everything that, e.g. has been exempted from taxation at the Nairobi Securities Exchange (see V/(#) and the Task Force on Financial Integrity and Economic Development, a major global network to combat IFFs.

### **5.2.2.2 National Police Service**

The Service has further embarked on the process of the establishing specialized units to address transnational and emerging crimes such as trafficking in drugs and trafficking in persons, money laundering, economic crimes, terrorism, wildlife and forest crime, sexual and gender based violence, international crimes, international cooperation (Nairobi- Interpol), cybercrime among many others. Some of the challenges which face NPS in effective implementation include:

- Inadequate human resources, the current ratio of security personnel to population is below the UN recommended ratio of 1:450. The Government is in the process of recruiting ten thousand (10,000) police officers this year.
- Inadequate provision of modern tools, equipment and technology.
- Lack of awareness of community role in crime prevention
- Inadequate infrastructure and operational environment. (Attorney-General- Department of Justice, 2015)

We disagree with the formulation “lack of awareness of community role”. Rather: there is need for increased awareness on the role of the community on crime prevention.

### **5.2.2.3 Ethics and Anti-Corruption Service**

“The Ethics and Anti-Corruption Commission is now constitutionally entrenched under Article 79, and is mandated to combat and prevent corruption and mainstream integrity and

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<sup>19</sup> Activity Profile 2015, Polifund Project „Combating Illicit Financial Flows”

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ethics in the country.” The challenges facing this institution are the same as with the police (see above#), but one interesting addition is mentioned: “Lack of an Integrated National Policy that harmonizes the activities of various agencies.” (Attorney-General-Department of Justice, 2015)

#### **5.2.2.4 Prosecution Services**

The Constitution of Kenya, 2010 established an Independent Prosecutorial Authority....The Office of the Director of Public Prosecutions Act, 2013 and policy documents namely the National Prosecution Policy and the Code of Conduct have been developed....The ODPP has set up specialized divisions to address all crimes including transnational and emerging crimes... (Attorney-General-Department of Justice, 2015)

The challenges facing this institution are the same as with the police (see above#)

#### **5.2.2.5 Financial Reporting Centre**

The Financial Reporting Centre (FRC) ... is established by section 21 of... POCAMLA with a mandate to receive, analyze and disseminate Laundering suspicious transaction reports and other information. FRC started operations in 2012. The FRC is an independent institution under the National Treasury and fully funded by the National Treasury. ... Over 239 Reporting Institutions have been registered to date. (Attorney-General-Department of Justice, 2015)

➔ Check on Central Bank of Kenyas Circular Nr. 8 of 2012 regarding FRC?

The challenges of the FRC are similar to the police (see above#), in addition they complain about the lack of “AML knowledge outside the financial sector” and “Crafting a strategic plan for the FRC as well as a national AML/CFT strategic plan.” (Attorney-General-Department of Justice, 2015)

#### **5.2.2.6 Asset Recovery Agency**

Kenya has also established the Asset Recovery Agency for tracing, freezing and recovery of proceeds of crime and money-laundering. The Agency is in the process of being fully operationalized as it is currently using staff from the office of the Attorney General. The Agency is integral institution in the fight against all kinds of crime domestic and transnational. It is working closely with other law enforcement agencies in particular the EACC in mutual legal assistance and recovery of corruptly acquired assets in Switzerland with the assistance of the Swiss authorities. (Attorney-General-Department of Justice, 2015)

➔ Only Switzerland? Or now also UK?

The setup of the Assets Recovery Agency is to complement the Anti-money laundering and the Proceeds of Crime (Amendment) Act, 2017. The director of the agency had this to say “Corruption, economic crimes, tax evasion and money laundering have in the last few years globally been the topical issues with new approaches being explored to combat these heinous crimes against society. International institutions have urged states to review their law enforcement to ensure a single approach or speaking as one Government, to addressing these issues in investigations and prosecution,” the Director of ARA ( Department of Public Communications, 2016). The aim is to aid in combating organized crime such as asset tracing freezing/restraint and recovery, prosecution, net worth analysis was enlightening.

### **5.2.2.7 Joint training/working groups/Task Forces**

GIZ is engaged in training and supporting civil servants of some of the above. Regarding the most recent training of 143 offices especially of EACC and ODPP, the GIZ summarizes:

the GIZ Global Programme on Combating Illicit Financial Flows supports a Multi-Agency Taskforce of different financial investigation authorities, such as the anti-corruption agency, revenue authority and FIU, which pursues the facilitation of inter-agency cooperation. As a result of this, Kenya has experienced significant freezing and seizing of assets arising from crime for which the country was able to freeze 1.8bn shillings in assets (about 173.6m USD). German development cooperation supports capacity development of investigators, prosecutors and enhances courts appreciation of the relevant laws for combating corruption and anti-money laundering. As a result, a sharp and unprecedented rise in conviction rate of economic crimes from two convictions 2015 to 23 convictions by the end of 2016 has been observed, including first time imprisonments of senior government officials.<sup>20</sup>

- ➔ Are there „institutionalized“ working groups? Are there institutionalized “joint operational groups” or are there only ad hoc taskforces. Institutionalized groups are much smoother for operations, while ad hoc task forces have a lot of work to spend on getting started in the first place.

### **5.2.2.8 Data exchange**

As illustrated above (3.10#) regarding data collection, integration and exchange, problems are multiplying in this area, where so many different institutions are concerned. A lot of tax related fraud requires an effective and efficient exchange of information, e.g. Missing Trader Fraud. Equally, aggressive tax avoidance and tax evasion as well as crimes such as money laundering can only be uncovered if states are willing and able to exchange information across borders because instruments of hiding beneficial ownership are the same in all cases: Shell companies, trusts and foundations, preferably located in secrecy jurisdictions.

Regarding Kenya, there are problems to do with data exchange between institutions, difficulties in filing and persistence of options to evade taxes despite computerization of tax administration.

The lack of electronic integration and connectivity between KRA and institutions dealing with tax-related data creates delays in data processing, data validation, and creation of unnecessary debts. This also makes it possible for people as well as institutions to give varying figures. If there exists efficient and effective data sharing system in place, tax collection revenue would be higher.

- ➔ However: Is this not meant to improve with the efforts to connect data bases (see above 3.10#)

### **5.2.2.9 Discussion**

- ➔ So many actors – should be difficult to coordinate and network – and many options for leaks

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<sup>20</sup> Internal note „Trainingsaktivitäten in Kenia“

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As indicated by the EACS and FRC above#, the absence of a national strategic plan makes work extremely difficult.

If you look at the EAC Cooperation Website on money laundering you see that many states have a national plan in place and for download. Of the EAC, Tanzania and Uganda have a National Plan, but not Kenya<sup>21</sup>

## **5.2.3 Cooperation with financial institutions**

### **5.2.3.1 Context**

The AML Act requires financial institutions in Kenya to maintain accurate records for a minimum of seven years including details such as name and physical and postal address for each person conducting a transaction with them.

### **5.2.3.2 National**

- ➔ In case that Circular 8 of CBK spells out the ways how financial institutions have to cooperate it needs to go in here rather than above with the FRC.

Given the importance of the financial sector and industry IN Kenya for the country, and OF Kenya for the region, and given the multiple level and options on where money transfers can be placed (see IV/4.1&4.2#), the cooperation of KRA and other administrative, investigative and prosecuting institutions and the financial sector institutions is of crucial importance.

According to the US-State Departments International Narcotic Control Strategy Report (INCSR), the enforcement requirements regarding Anti-Money Laundering regimes are in place:

Financial institutions and entities reporting to the Financial Reporting Center (FRC) are subject to KYC and STR rules and have enhanced due diligence procedures in place for foreign and domestic PEPs.

Also the reporting requirements are apparently working: Between January and October 2015, 534s (Suspicious Transfer Reports) were file as well as 2,504 CSTRs (Cash Suspicious Transfer Report).

Concerning financial regulation, the INSCRs 2016 report lists for Kenya the following:

The Central Bank of Kenya (CBK) licenses money remittance providers. Kenya's National Payment System Act provides regulation over mobile money and is another important component of Kenya's move toward financial integrity and security. ... All cell phone devices and all mobile-money accounts must be registered, with proper identification. While mobile payment and banking systems are increasingly important, the tracking and investigation of suspicious transactions remains difficult. There is a risk that illicit actors could use mobile payment systems to engage in structuring, particularly by using illicit funds to purchase mobile credits below reporting thresholds. Nevertheless, data on these transactions have the potential to facilitate investigations and tracking, especially compared to transactions executed

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<sup>21</sup> <http://www.esaamlg.org/reports/index.php> Tanzania AML-CFT National Strategy & Uganda AML-CFT National Strategy

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in cash. The lack of rigorous enforcement in this sector, coupled with inadequate reporting from certain reporting entities, increases the risk of abuse (Bureau of International Narcotics and Law Enforcement Affairs, 2016, p. 157).

And Wycliffe Muga writes

Without much fanfare, the noose has steadily been tightening on all such beneficiaries of official corruption. First, thanks to much-improved monitoring by the Central Bank of Kenya, the option of just depositing such funds in a personal account was no longer an option. One local bank had already landed in hot soup for not reporting faithfully on the large cash withdrawals from certain accounts linked to the fraudulent procurements at the National Youth Service. (Muga, 2017)

### *5.2.3.3 International*

- ➔ Details on how international data exchange is organized should be regulated in Memorandum of Understanding as the one with Switzerland (Muga, 2017), in TIEA Agreements and DTAAAs. Is there not also some sort of Agreement with Jersey in connection with the Okemo and Gichuru case? This needs to be looked up in cases of relevance.

### *5.2.3.4 Discussion*

There is a conflict of interest: According to some authority bank operations are governed by confidentiality rules and thus they are exposed to the risk of lawsuits and of loss of trust if they breach confidentiality by reporting customers, whose identity is then revealed. Bankers argue that banking is first and foremost a business and that anti-money laundering measures sometimes scare off potential or existing customers. This is a short-term problem for the banks, though reputable banks are willing to take this risk as they believe there will be long-term benefits for their efforts (Kiplagat, 2010).

And is there any checks and controls as to the extent those obliged institutions do indeed oblige? According to recent surveys, financial institutions with a presence in Africa indicated that the largest expenditure in anti-money laundering compliance is on “Know Your Client” Processes, identification of Politically Exposed Persons and enhanced transaction monitoring. (Muga, 2017). This trend is mirrored in Southern, Western and Eastern Africa. If this is the case it would indicate that the eagerness to comply is pretty low because of the costs involved.

KRA is reviewing the exchange of information with the financial services sector, which includes banking, the stock exchange and the Registrar of Companies, to increase transparency and track down tax defaulters. This is known as the information exchange network (IEN) (Okoth & Were, 2013).

Furthermore: As the German experience tells: The financial sector cooperates because it is easy to control (provided there ARE controls)

- ➔ Reporting and KYC regulations covers formal sector institutions – and from that all STRs and CTRs seem to come – nothing from DNFBPs and nothing from informal economy.

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#### **5.2.4 Cooperation with DNFBPs**

See above, FRC#: The non-financial sector is a dark hole. According to the Reporting Requirements, at least some of them are under obligation to participate according to the POCAMLA legislation. But do they oblige? German experience says that they do not because it is difficult to check – e.g. real estate agents.

Deficits in the mobile sector are being admitted in the (Bureau of International Narcotics and Law Enforcement Affairs, 2016).

#### **5.2.5 Smuggling**

The government has also established a ceiling amount of USD 10,000 for movements of cash through borders (→ Rotich in Addis Ababa FFD3)

### **5.3 Staff related issues**

#### **5.3.1 Number**

As the presentation of legal issues (V/#) indicated already, AML have major weaknesses: The first weakness is that many provisions leave legal doors for hiding assets and facilitating IFFs wide open, other provisions could work only if adequate “investigative personnel” is at hand.

An even larger problem is the number of trained and professional personnel and, given the small number, their being overburdened with too many complex and very diverse investigative cases:

The Office of the Director of Public Prosecutions (ODPP) has significantly expanded since 2013 and now has approximately 700 prosecutors, with plans to expand to 900. The Department of Economic International and Emerging Crimes (DEIEC), one of four departments within the ODPP, is responsible for the prosecution of corruption and economic crime, cybercrime, narcotics, organized crime, money laundering, terrorist financing, piracy, and other terrorism-related cases. The AML/CFT division, a thematic subdivision formed in July 2014, specifically deals with money laundering and terrorism financing offenses. The AML/CFT division is made up of 18 Prosecution Counsels from the Nairobi office, complemented by eight Prosecution Counsels from county offices. The ODPP has used ancillary provisions in the POCAMLA to apply for orders to restrain, preserve and seize proceeds of crime in Nairobi. In 2015, the ODPP filed a money laundering case and arrest warrants against the top management of Dubai bank. For the first time, in 2015 the ODPP used the POCAMLA to freeze the assets of nine ivory trafficking suspects. (Bureau of International Narcotics and Law Enforcement Affairs, 2016, p. 159f.)

As indicated in the overview above covering the individual agencies, they all complain about the lack of staff. Not surprisingly, the Mutual Evaluation Report of the ESAAMLG states in Nr. 52 in plain language “Some government agencies have expressed concern regarding the lack of qualified and skilled human resources, funding and other technical resources to meet their obligations under the POCAMLA.” Which made the report put the following three items under the headline “Priorities for recommended plan of action”, calling not only for legal, but also resource related strengthening:

- give priority to the investigation and prosecution of the money laundering offences;
- build the technical AML/CFT capacity of law enforcement agencies, the regulators, the public prosecutors and the judiciary; and

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- engage aggressively with the financial services and the DNFBP sectors to encourage and assist compliance with AML/CFT requirements. (ESAAMLG, 2011)

### 5.3.2 Training

There is some training done by outside experts (5.2.2.7) and supervision and coaching provided by experts “on loan” from other countries – but this is not seen to be enough.

The government, and especially the police, should allocate appropriate resources and build sufficient institutional capacity and investigative skill to conduct complex financial investigations independently. (Bureau of International Narcotics and Law Enforcement Affairs, 2016, p. 160)

## 5.4 Problems

- ➔ This chapter is about problems common to KRA/tax administration and IFF combating agencies

### 5.4.1 Problems of investigation

- ➔ Conflicts of interest within financial institutions
- ➔ Conflicts of interest between tax collecting and prosecuting institutions (tax law/revenue vs. penal law/crime)
- ➔ Fear of false reporting with the risk of being sued for bad talking...

A number of weaknesses are known, arising from the weak legal framework, including the burden of proof. For example:

In order to demand bank account records or to seize an account, the police must present evidence linking the deposits to a criminal violation and obtain a court order. The confidentiality of this process is not well maintained, which allows account holders to sometimes be tipped off, providing an opportunity to move their assets or contest the order. (Bureau of International Narcotics and Law Enforcement Affairs, 2016, p. 159)

A problem for investigators is that most of the constructions used for hiding, transferring and/or investing by, at the same time, hiding beneficial ownership, are difficult to distinguish from legitimate businesses. At a conference of security experts of the East Africa Community, the following summary was drawn:

Rwanda’s financial system like those other countries in the region has been infiltrated by money laundering. *Authorities admit that it has been hard to eradicate the vice as criminals use legal instruments to cover their tracks.* In the East African Community, Kenya is ranked number one in money laundering followed by Uganda, Tanzania and Rwanda respectively.<sup>22</sup>

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<sup>22</sup> Emphasis added. Money laundering on the rise in East Africa, security experts warn. In: The East African. Retrieved 7 July 2015 from <http://www.theeastafrican.co.ke/Rwanda/News/Money-laundering-on-the-rise-in-East-Africa/-/1433218/1520096/-/view/printVersion/-/392xnd/-/index.html>

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The option of mobile money transfer makes it even more difficult for authorities to track the trail of money.<sup>23</sup> All that is understandable on the background of the importance, Kenya has due to the size of its financial system and as a financial hub for East Africa.

An automated system would improve the FRC's efficiency and ability to analyze suspicious transactions. Although the FRC receives STRs from some MVTs Money or Value Transfer Service providers (MVTs), this sector is more challenging to supervise for AML compliance. And: The tracking and investigation of suspicious transactions within the mobile payment and banking systems remain difficult. For example, criminals could potentially use illicit funds to purchase mobile credits at amounts below reporting thresholds. The lack of rigorous enforcement in this sector, coupled with inadequate reporting from certain reporting entities, increases the risk of abuse.<sup>24</sup>

Tanzania recently reported that it had 14 cases instituted in its subordinate courts since the promulgation of the Anti-Money Laundering legislation in 2006. This is an improvement on its neighbouring states yet a continued failure to prosecute is worrying and an issue which must be addressed by the rest of African states

#### **5.4.2 Problems of prosecution**

Clearly, weaknesses with investigation continues in the department of prosecution and judiciary.

Despite the positive impression created by the numerous international initiatives and the general trend of African States to criminalise money laundering, a common problem in African States occurs when the enforcement of the legislation is lacklustre or non-existent. Although numerous investigations have ensued there have been very few, prosecutions or convictions (Petersen, Reccado and Marelise van der Westhuizen, 2014). Countries including Niger, Nigeria, Sierra Leone, Kenya, Uganda and Ethiopia have very poor levels of enforcement and implementation of the anti-money laundering measures. The INCSR lists for Kenya 2 prosecutions only in 2015, with 0 convictions (Bureau of International Narcotics and Law Enforcement Affairs, 2016, p. 158).

#### **5.4.3 Cooperation with international authorities**

There is, of course, also need to cooperate with and to be supported by international agencies and authorities (see below#).

### **5.5 Discussion**

Kenya has a lot of good intentions:

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<sup>23</sup> Mungai, Chr. (2012 August 25). Mobile Money Laundering on the rise in EA. In: The EastAfrican. Retrieved 7 July 2015 from <http://www.theeastafrican.co.ke/news/Mobile+money+laundrying+on+the+rise+in+EA/-/2558/1487114/-/685w5bz/-/index.html>

<sup>24</sup> Is said to be in the INCSR, but it is not <http://www.knowyourcountry.com/kenya1111.html>

In July 2015, the Government of the Republic of Kenya made commitments to promote good governance and anti-corruption efforts, including strengthening its AML/CFT regime. The Government of Kenya committed to work toward membership in the Egmont Group of Financial Intelligence Units. Additionally, Kenya agreed to work with international donors to conduct a full risk assessment for money laundering and terrorism finance and to work with development partners to facilitate the full implementation of its AML rules and regulations. Kenya also agreed to accelerate its work to strengthen the capacity of the FRC and CBK to track illicit financial flows and to increase bilateral information sharing and enforcement efforts. The government, and especially the police, should allocate appropriate resources and build sufficient institutional capacity and investigative skill to conduct complex financial investigations independently. Kenya should also address the bureaucratic and other impediments preventing it from pursuing investigation and prosecution of these crimes. The Government of Kenya should fulfill its commitments on good governance, anti-corruption efforts, and improvements to its AML/CFT regime. (Bureau of International Narcotics and Law Enforcement Affairs, 2016, p. 160)

The problem is whether Kenya can live up to it, as long as the deficits which this report raises remain as they are:

The legal framework is an important prerequisite for any enforcement activity. A well-functioning body of tax administration system is essential for the detection and prosecution of cases of tax fraud and other tax related crimes. The lack of sufficient capacities in tax administrations reduces the probability of having higher tax collection; detection, that again influences the decision of a taxpayer as to whether evade or not.

Regarding combating of IFFs applies the same (perhaps even more since many crimes are only underground) what applies to KRA and which the Commissioner General admits regarding KRA: Successful fighting here relies heavily on “volunteers and whistleblower” to learn about crimes. “He said KRA was also deploying more technology to assist the department to get more information from volunteers and whistle blowers as well as help in the processing of information gathered by its intelligence teams.”<sup>25</sup>

As soon as adequate transparency measures are in place (which is a legal problem), administration and investigation with and without ICT support will be much easier and can do without whistleblower.

## **6 Taxing the informal sector**

### **6.1 Issues**

A revamped recruitment strategy will be required to ensure more taxpayers are put into tax net; KRA will also be required to look for other strategies for improving tax compliance as methods to improve compliance mainly based on examination and sanctions have been found to be counterproductive and hence not effective. The proposed strategies should have a preventive effect on taxpayers’ behaviour and limit the ability and willingness of taxpayers not to comply. (Kenya Revenue Authority, 2015a, p. 37)

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<sup>25</sup> Kamau, M (2017, June 28) Kenya Revenue Authority to hire spies in clamp-down on tax cartels. In: Standard Digital, Retrieved from <https://www.standardmedia.co.ke/business/article/2001245120/kra-to-hire-spies-in-clamp-down-on-tax-cartels>

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Enforcement, administration and compliance of VAT depends on proper recording of transactions which again requires knowledge about those transactions and checks

It also depends on the ability of small businesses to purchase electronic cash registers and the knowledge how to handle the administration of receipts.

Turnover Tax: This is usually a final tax and the eligible persons are free to apply for exemption from this tax. There are attendant penalties for failure to pay or file the returns as required by the act. Collection of this tax faces challenges due to lack of goodwill among the affected taxpayers as well as limited capacity by the KRA to enforce compliance.

## 6.2 Discussion

Achieving an acceptable degree of tax compliance from a fast growing and profitable, but, increasingly complex informal sector: The informal sector is a fast growing segment of Kenya's economy, but tax evasion by the sector remains particularly high. The structural challenges of accessing the sector are exacerbated by populist politics, which seeks to shield some constituencies of potential taxpayers from their tax obligations.

→ Why is there no Block Management approach, even though it had been mentioned in the 4<sup>th</sup> Corporate Plan?

## 7 Collection of debt

A problem common in the country of study is that that, which is due, is not always being paid –both that which is due to regular tax, nor that which is established as surplus-earning when checked, nor that which is imposed as fine in case of non-compliance.

KRA faces a backlog of debts that are more than seven years old and it has been difficult to trace some taxpayers and companies as some have since closed down. In addition, taxpayer's illiteracy level and ignorance on online return filing has led to unnecessary debts due to wrong data entries.

Table 1 Penalties in the case of non-payment of taxes

Penalties	
Failure to furnish a return by due date	5% of tax due (min. Shs. 10,000 for companies and Shs. 1,000 for individuals)
Penalty on unpaid tax	20% of unpaid tax
Interest on unpaid tax	2% per month
Underestimation of installment tax	20% on the difference between the installment tax payable and 110% of installment tax paid
Fraud or willful omission in a return	Double the amount of tax underpaid, Fine not

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	exceeding Shs. 200,000 Imprisonment not exceeding 2 years
Failure to deduct or remit PAYE	25% of the amount of tax involved (min. Shs. 10,000)

By March 2015, a total debt of 161,170 million KSh was outstanding which is 15.9% of the annual revenue collection. A large share of that was tied up in courts and other complaint resolution bodies, ca. 5 billion KSh were simply not collectible and 92.4 billion KSh were collectible in theory and principle, while KRAs record in de facto collecting debt was “below best practice” (Kenya Revenue Authority, 2015a, p. 48). Strategies thought of here are

- Developing and implementing Alternative Dispute Resolution via Tax Appeals Tribunals, which ends conflicts much faster than court cases (see below#).
- Doing some internal reorganization so that debt management is more concentrated than before.
- Improving ITC options for facilitating debt enforcement
- Hiring bailiffs in order to circumvent the own lack of personnel.

Late payments of self-assessed tax are subject to a 20% penalty, plus a 1% penalty per month. Also a late filing penalty of 25% of tax due applies under certain conditions (Deloitte, 2017)

## 8 Cost of collection

→ Statistics by KRA!!!!

Tax Administration should operate as efficiently and cost effectively as possible. In addition to receiving value for their money, the public would expect that the Tax Administration and its employees will be free from any type of corruption or undue influence. The most cost-effective means of collecting taxes is through the voluntary compliance of the public with the tax laws. The more enforcement activities would be necessary, the more expensive the administration of the tax system will be. In order to encourage taxpayers to comply with their tax-paying responsibilities voluntarily, it is important that the Tax Administration assists them in understanding their responsibilities.

Besides efficiency and transparency, also cost effectiveness is reason for increased usage of ICT. But here, too, goods and values need to be evaluated on balance, e.g. rate and ratio of mistakes and potential for manipulation, tax justice via audits,

With the introduction of the new I- tax system the cost of tax compliance has reduced. The impacts of this can be felt in terms of the total revenue generated which has greatly improved since the implementation of the I- tax system.

## 9 Funding problems

Corporate Plans are ambitious, but, as the Sixth Corporate Plan admits:

For several corporate plans now KRA’s corporate strategy has failed to be implemented due to underfunding. Indeed, with respect to the 5th Plan, underfunding was the single most

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important reason for non-performance accounting for 28% of non-implemented activities and critically undermining the work environment. (Kenya Revenue Authority, 2015a, p. 79)

There is also an astounding note on page 3 of the Report of the Auditor General, namely that in the case of “Kshs 2,123,899,000 as due from the Treasury as at 20 June 2015...” no “documentary evidence showing commitment by the National Treasury” is available and “therefore its recoverability is doubtful.”

➔ Auditor General's remark that KRA cannot do his work?

This is surprising that government in its MTEF budgeting process does not take care that the agency in charge of tax revenue is adequately funded. As it is in Germany and Zambia, KRA is probably also worth any investment since returns of its officers are a manifold of that which is going into funding in the first place. It is difficult to comprehend that KRA is not merely occupied with collecting revenue for government and enforce tax laws efficiently and fairly, but also has to take care of filling up funding deficits by “internally generated funds”. The latter, however, also includes saving on expenditures which is, especially if an agency is dependent on purchasing and implementing highly expensive ICT technology and to offer and pay market competitive salaries in order to attract good people which, otherwise, go to private sector employer, counterproductive.

As has been demonstrated above, similar funding problems underlie all efforts to combat IFFs because relevant institutions lack adequate manpower.

## **10 Taxpayers Rights**

### **10.1 Privacy and confidentiality**

Given the new constitution, Kenyans enjoy a number of rights which they increasingly try to obtain. Here, the right to privacy and the confidential treatment of tax data is among those rights. Here, KRA officials are supposed to be trained.

### **10.2 Bodies of complaint and redress**

“Kenya has increasingly become a litigious society” (Kenya Revenue Authority, 2015b, p. 19), including protesting against tax bills.

This made redress procedures expensive, which is why an Alternative Dispute Resolution Procedure was implemented.

The main objective of ADR is to reduce litigation and “free up” revenues held up in the various tax dispute resolution mechanisms including tax tribunals and courts to enhance revenue collection. Studies have shown that use of alternative dispute resolution (ADR) mechanism is a speedy, non-adversarial and more effective way of resolving taxpayer disputes than prosecution. KRA plans to implement the ADR policy framework that will ensure timely resolution of disputes and thereby free up revenue held up in the judicial process to enhance revenue collection. In best practice countries, 80% of the tax disputes are resolved through ADR. .... It is estimated that Kshs. 13.5 billion currently held up in courts will be released to the ADR process with a much higher resolution rate by 2018. (Kenya Revenue Authority, 2015a, p. 48f.)

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Here, KRA points to South Africa whose record here leads to the fact that conflicts are resolved in ca. 2 months, while Kenya, with its prominence of court cases, takes about 4 years before conflicts are resolved. Also litigation costs in South Africa are much lower than the present system (Kenya Revenue Authority, 2015a, p. 49).

### **10.3 Discussion**

With greater autonomy comes greater responsibility, and accordingly any change in the status of the tax authority is usually accompanied by a suite of additional checks and balances. This trend towards tax agency independence is often accompanied by taxpayer appeal rights, external scrutiny of the tax agency, for example, the government audit office and a tax ombudsman, as well as parliamentary reviews.

It is advisable that tax administrations enshrine, in writing, the specific rights of taxpayers when they are dealing with the Tax Administration (these rights may be enumerated in the tax laws). This will provide clear guidance to taxpayers regarding their rights in dealing with the Tax Administration. Ethical standards and rules of conduct for employees should also be set down in writing, and every employee of the Tax Administration should be trained both in the rights of taxpayers and in the rules of conduct to which they are expected to adhere. There should be provisions for (and a process for) dealing with employees whose actions violate taxpayers' rights or who fail to comply with the rules of conduct. There should also be a means of redress for taxpayers whose rights have been violated (this is also often a part of the tax law). Any disclosure of tax information should be within strict guidelines established in the law and only for the purpose of the proper administration of the tax laws. Taxpayers should be able to expect that their tax information will remain private and there should be legal and employment-related consequences for improper disclosures by any employee of the Tax Administration. Every employee of the Tax Administration should be trained regarding the confidentiality of tax information and the consequences for improper disclosures. Taxpayers have the right to expect that employees of the Tax Administration will be well trained in their area of technical responsibility. Employees should also have an overall understanding of the Tax Administration's operations so taxpayer problems can be resolved without forcing taxpayers to make numerous contacts. It is a valid expectation on the part of the public that the Tax Administration will have procedures and processes in place on how the law should be applied and how employees should conduct themselves in performing their duties. Proper attention must be paid to the training of employees in order to ensure that the Tax Administration has a technically proficient and professional workforce as well as one that respects the rights of taxpayers.

## **11 Assistance by and cooperation with other states**

- ➔ This is NOT about national and regional issues (which is already covered above), but beyond, e.g. outside the EAC, with Europe, the US, tax havens.

### **11.1 Training**

The GIZ supports Kenyan Government and Government Agencies in a number of areas:

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- ➔ 2011-2014 GIZ experts were involved in assisting the improvement of financial governance/reforms in the area of public finances in the area budgeting, procurement, auditing and inner-state financial relationships (state-counties-municipalities).
- ➔ Training of combating IFFs

## **11.2 Administrative**

Over the last decade the OECD's Forum on Tax Administration (FTA) has shone the spotlight on tax administration issues. Within the context of a global economy, rapid technological change and fiscal challenges for government, the forum aims to improve taxpayer services and tax compliance –by helping revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance. It seeks to do this by sharing experiences of revenue bodies, promoting co-operation between member countries, and developing joint programmes of action on key tax administration issues. For example, at the Ninth Meeting of the FTA (Dublin 23-24 October 2014) (D'Ascenzo, 2015, p. 86).

But there are moments when all these good proposal fail, e.g. in the case of the porous borders with a failed state –Somalia: The combined effect of smuggling and insecurity in the region, arising from the failure of the Somali state, will remain obstacles to tax administration for quite some time;

- ➔ Do you know of any staff seconded from other tax administrations to KRA or other IFF agencies for training, supervising and coaching. GIZ does in Kenya and Tanzania.

## **11.3 Financial/material**

Financially by Sweden and Denmark regarding integration of ICT<sup>26</sup>

# **12 Social Protection, Mandatory Social Security Contributions**

## **12.1 Administrative issues**

The administration of social protection before the National Social Protection Policy is fragmented; because programmes are run by different implementing agencies. What this meant is that line ministries have their own structures through which they implement the programmes. The National Social Protection Policy proposed a strategy that would coordinate the different interventions to reduce duplication and fragmentation of benefits which would in effect not compromise benefits of the vulnerable. The Social Assistance Act of 2012 that was

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<sup>26</sup> “The project is directly linked to the institutional collaboration between the Swedish Tax Agency (STA) and Kenya Revenue Authority (KRA). DWBI is one of three components in the collaboration and STA will give advice, support and capacity development on DWBI and the development of the DWBI. The total budget for the project is 59 million SEK of which Sweden contributes 35 million SEK, Denmark 8 million SEK and the GoK 16 million SEK (210 million KES). The contributions are based on the same project document, budget and results framework. The financial contributions from Sweden and Denmark will be managed by the Public Financial Management Reform (PFMR) Secretariat under the National Treasury.” <https://openaid.se/activity/SE-0-SE-6-5111008101-KEN-15111/>

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put in place for instance provides an alternative structure for the administration of Social Assistance as do the Social Security and Social Insurance Acts (HakiJamii, 2014).

But, accountability and transparency in Social Protection programmes is weak. Firstly, accountability tends to be upwards towards government and ministry officials rather than downwards towards citizens. This has meant that the quality and effectiveness of programmes has not been a prudent consideration with respect to service delivery. It is for this reason that issues of delayed disbursement, double dipping and corruption plague the programmes. The NSNP proposes to institute a monitoring and evaluation framework, which is a commendable initiative which should really encompass both an upwards and downwards accountability framework.

## 13 Discussion

➔ It would be interesting to know more about KRAs view regarding the importance of personnel for enforcement and compliance. Who could spell this out for us???

The European Commission sets out what it considers to be essential requirements for a modern Tax Administration. These include: – it is guaranteed an adequate level of autonomy; – its obligations are clearly translated into its mission, vision and objectives; – it has its own structure and powers allowing for efficient and effective operations; – it is provided with adequate resources to implement and manage the tax system; – it is provided with a stable legal framework ensuring proper administration and enforcement of tax dues – it is accountable for its operations, which are subject to control and assessment; and – its operations are managed and assessed on the basis of the performance management system.

Measured on the previous, KRA has to cope with less than ideal policy, legal and other institutional environments: One illustration of this challenge is that there have been significant gaps between revenue targets set by Ministry of Finance and the KRA's targets. The other is that KRA does not have a free hand to properly remunerate and motivate its staff.

Regarding the general public, KRA revenue authority as it shifts towards a customer service orientation which reflects the growing awareness of the need to offer a quality service to the taxpaying public and be responsive to public concerns; It must also put measures to simplify the taxpaying process and promoting service oriented tax administration that include a reduction of the number of tax forms and officers assisting clients in filling out documents. The introduction of online services such as I-tax is the way to go. Similarly to low tax morale, the ability to enforce taxes is influenced by a broad variety of factors. Not all of these can be tackled directly by reforms of the tax system or the tax administration.

Regarding tax related crime and IFFs: From the study the view is that tax evasion and avoidance may derive from low tax morale, high compliance costs or may result in the course of firms' endeavours to maximize profits by reducing their tax liabilities. Hence, in the same way as there is not only one type of tax evasion and avoidance, there is "no one size fits all. Any imbalance between a country's absorptive capacity and the complexity reforms can either induce a failure of reform or a wasted opportunity. If, for example, the absorptive capacity is low, reform strategies should either not be too ambitious or be accompanied by

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extensive capacity development initiatives. If, on the other hand, the absorptive capacity is very high, simple reform strategies will likely be successful.

An element that needs further assessment in this study is increased international co-operation. Collaboration is important because, on the one hand, the international exchange of knowledge can strengthen all parties involved. This includes the promotion of exchanges on tax procedures and reforms to identify ‘best practices’, on the other hand, co-operation is essential as a great deal of tax evasion and avoidance arises from cross-border activities. Reforms in the tax regime are necessary for tax policies and strengthening tax administrations as is crucial for transparency.

On that background KRA Motto: “Kulipa ushuru ni kulinda uhuru” (Pay taxes and set your country free) and “Kulipa Ushuru ni Kujitegemea” (Paying taxes is being independent)? Long way to go, and without international assistance, cooperation and concession impossible.

## 14 Literaturverzeichnis

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