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KENYA HUMAN RIGHTS
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FROM CHINA:
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on
ALL
KENYA
Taxation, economy and human rights nexus: KHRC analysis

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01

Introduction

In an era marked by dynamic economic challenges and shifting fiscal policies, Kenya Human Rights Commission (KHRC) remains steadfast in its commitment to safeguarding the fundamental rights and well-being of every Kenyan citizen.

Today, as part of our ongoing e° orts to uphold human rights in the face of economic developments, we are releasing a comprehensive assessment of the Kenyan economy, with a particular emphasis on introducing new taxation measures. As the economic landscape of Kenya evolves, it is imperative that we critically examine the implications of recent tax changes on the livelihoods and rights of our fellow citizens.

The purpose of this analysis is to shed light on key aspects of taxation, its impact on human rights, and the government's adherence to established principles of taxation. We aim to provide a balanced analysis that acknowledges the govern-ment's responsibility to raise revenue and ensures that such measures do not dispro-portionately burden individuals or infringe upon their rights.

Through this evaluation, we seek to foster a constructive dialogue between policy-makers, civil society, and the public, ultimately aiming for a taxation system that is not only equitable but also condu-cive to the protection and enhancement of human rights in Kenya. We invite all stake-holders to join us in this vital examination of the Kenyan economy and taxation's role within it.

Principles of Taxation

The principles of equity, neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility have traditionally guided the development of taxation systems.

Neutrality

The principle of neutrality in taxation is centred on the idea that taxation should not influence economic decision-making or distort market forces. It ensures that taxes do not favor or discriminate against specific industries, products, or individuals. The Kenyan government has introduced or increased VAT on essential goods and services, such as petroleum products. These taxes can have regressive effects, disproportionately impacting low-income individuals and households. This does not align with the neutrality principle, as it distorts consumption patterns and affects vulnerable populations. Similarly, the Housing Fund Levy, aimed at financing affordable housing, is intended to be paid by employers and employees. While it serves a specific policy goal, it may influence labor market dynamics and employment costs, departing from neutrality in the labor market.

Effectiveness and fairness

The effectiveness and fairness principle in taxation underscores the importance of collecting the right amount of tax at the right time, avoiding both double taxation and unintentional non-taxation, while minimizing the potential for evasion and avoidance. For instance, the Finance Act, of 2023 introduced a new provision that prevents refunds of excess withholding tax paid on expenses disallowed on audit. The provision will effectively result in double taxation as the restricted payment will be subject to corporate income tax. The withholding tax on the payment will neither be utilized as a credit nor refunded to the taxpayer.

Efficiency

The efficiency principle in taxation emphasizes the need to minimize compliance costs for businesses and administration costs for governments. It aims to ensure that the tax system operates smoothly and cost-effectively. The application of VAT to essential goods and services has increased administrative complexity both for businesses and the government. Compliance costs for businesses have risen due to additional record-keeping and tax collection requirements. Additionally, the government must manage the collection and refunding of VAT on these essential items, increasing administration costs. This suggests a departure from the efficiency principle.

Certainty and simplicity

The certainty principle in taxation states that taxpayers should be able to understand the tax laws and regulations with ease. This principle emphasizes clarity and predictability in tax rules, making it clear to taxpayers how taxes are calculated and their obligations. Simplicity in taxation emphasizes the need for tax systems to be straightforward and uncomplicated. It aims to minimize the complexity of tax codes, making it easier for taxpayers to comply with tax laws and for tax authorities to administer and enforce them efficiently. The Digital Service Tax (DST), while targeting services provided through a digital marketplace, has raised questions about its implementation and potential complexity. Determining which digital services are subject to the tax and how it applies to international transactions can be challenging for taxpayers and tax authorities alike.

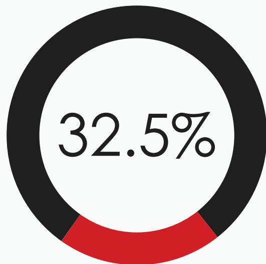
03

Implications of the Finance Act, 2023

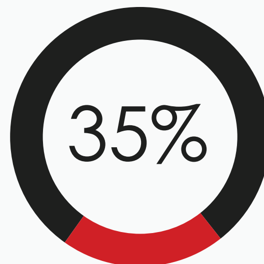
On 26th June 2023, President Ruto signed the Finance Act 2023 (the Act) that provides critical changes to tax collection and administration. The changes, most of which took effect from 1st July 2023, have affected the imposition of income tax, value-added tax, excise tax, and various fees and penalties, as well as general tax com-pliance requirements. Some of the notable highlights include the following

1. Income tax

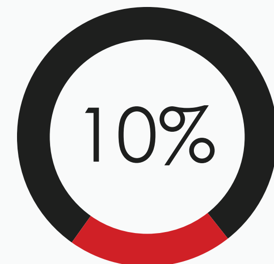
Removal of the limitation on deductions for interest expense on local debt, a five-year carry-forward period for foreign-exchange losses for specific companies, a 15% tax on income repatriated from branches or permanent establishments, withholding taxes on rental income and sales promotion, marketing, and advertising services, a preferential tax regime for qualifying intellectual property income and new income tax exemptions.



PAYE for incomes between KES. 500,000 to KES. 800,000



PAYE for incomes above KES. 800,000



PAYE rate for those earning up to KES 24000 monthly gross

The Act introduced a Housing Levy at a rate of 1.5% of the employee's gross monthly income, to be matched equally by the employer, among other changes related to employ-ment income.

The National Social Security Fund (NSSF) and National Health Insur-ance Fund (NHIF) rates have also been reviewed. For NSSF, e° ective February 2023, the monthly matching contributions by both employ-ees and employers rose from KES 400 to 12% of a worker's monthly pensionable income (6% from the employee and 6% from the employ-er-both contributing an equal amount), with a maximum contribution of KES 2160 for workers earning more than KES 18000 per month. The employee pays KES 1080, which their employer matches Similarly, e° ective 1st July 2023, a salaried person contributes a standard rate of 2.75% of the gross monthly salary towards the NHIF cover. A self-em-ployed person is expected to make a unique contribution of 2.75% of the declared or assessed gross monthly income, subject to a minimum of KES 300. Low-income earners and self-employed contributors will pay KES 300 down from KES 500.

Ikolomani MP Benard Shinali has also sponsored the Unemployment Insurance Bill, 2023. The Bill proposes that employees contribute 1% of their pay, matched by 1% from the employer to the Unemployment Insurance Fund.

	Tier 1	Tier 2	Tier 3	Tier 4	Tier 5
Gross Pay (KES)	24000	30000	50000	600000	900000
Housing Levy	360	450	750	9000	13500
NSSF	1080	1080	1080	1080	1080
Taxable Income	22560	28470	48170	589920	885420
Personal Relief	2400	2400	2400	2400	2400
P.A.Y. E	0	1117.5	6834.35	171607.3	269780.3
NHIF	750	900	1200	1700	1700
Unemployment Insurance Func	240	300	500	6000	9000
Net Pay (KES)	**21570**	**26152.5**	**39635.65**	**410612.7**	**604939.7**

Furthermore, beginning January 1, 2024, transporters will have to incur additional tax expenses. The Act increases the advance tax on vans, pick-ups, trucks, prime movers, trailers, and lorries from KES 1500 per ton of loading capacity to KES 2500 per ton of loading capacity or KES 5000 per year, whichever is higher. Also, the advance tax for saloons, station wagons, minibusses, buses, and coaches has increased from KES 60 per passenger capacity per month or KES 2,400 per year to KES 100 per passenger capacity per month or KES 5,000 per year, whichever is higher. For a matatu that carries 14 passengers, the owner will pay an advance tax of KES 1400 per month or KES 16800 per year. The proposed changes touching the transport sector are expected to pile additional pressure on the cost of living as operators comply with the proposal.

2. Value Added Tax (VAT)

Increased rates on certain goods, exemptions for others, a zero rating for some supplies, and a new deadline for remitting the tax. Notably, the government doubled the VAT on petroleum products from 8% to 16%. Also, the government is mulling over increasing VAT to 18% to align with other rates of countries within the East African Community (EAC) in the Draft Medium Term Debt Management Strategy for 2024/25 and 2026/27. Currently, super petrol retails at KES 211.64 per liter within Nairobi. A further increase in VAT to 18% will raise the commodity's price to KES 215.87, considering the current EPRA-approved prices.

3. Excise tax

New deadlines for remitting specific excise duties, increased rates on certain goods, and increased and decreased rates on certain services. For instance, imported sugar, excluding imported sugar purchased by a registered pharmaceutical manufacturer, will attract an excise duty of KES 5 per kilogram. Similarly, imported cellular phones will attract an excise duty of 10%. Kenya Copyrights Board (KECOBO) has begun implementing the Blank Tape Levy, which will see Kenyans pay more for mobile phones and other electronic gadgets with audio and video recording functions. The levy is set at 1.5% of the purchase price (net taxes) for personal laptops, computers, mobile phones, and smartwatches. For instance, a mobile phone that used to cost KES 2000 after tax will now cost KES 2030.

4. Others

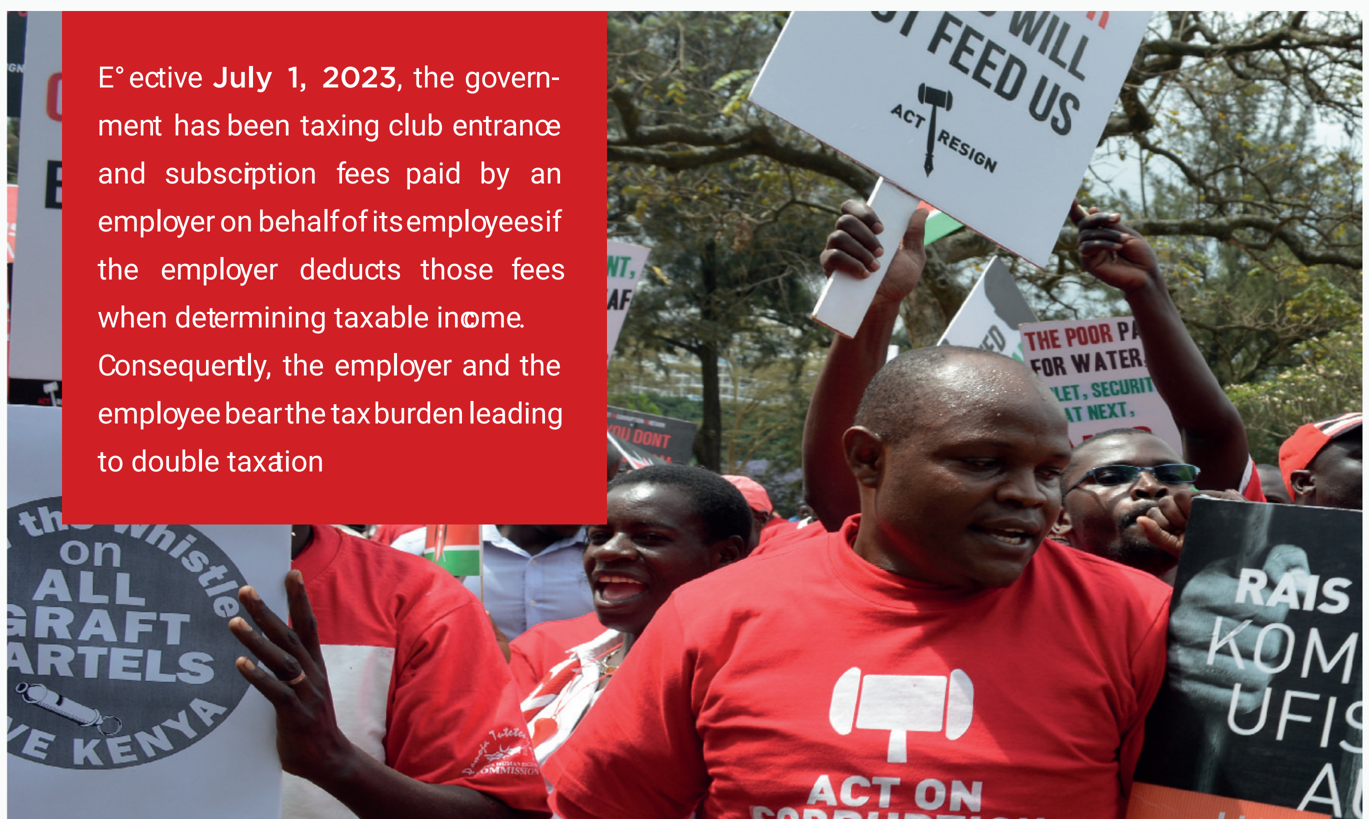
A new electronic system for tax invoices and penalties for those who do not use it, a tax amnesty program for penalties and interest on outstanding principal tax due before 31st December 2022, and limits on government authority to waive penalties and interest on outstanding tax debts

In addition, the government is mulling over introducing more taxes and levies. It proposed changes to the National Health Insurance Fund (NHIF) under the Social Health Insurance Bill 2023. The Bill proposed a mandatory contribution of 2.75% of the employee's monthly basic salary towards the scheme. However, changes to the Social Health Insurance Bill 2023 proposed a maximum cap of KES 5000 and a minimum cap of KES300 for formal workers. This is subject to public participation. The capping of the monthly pay at KES 5000 is regressive since high-salaried individuals will not pay a fair share of their earnings to the scheme

More proposals include increasing excise duty on spirits and other products with higher alcohol content, harmonizing excise duty rates for tobacco products, and reviewing taxes on sugar-based non-alcoholic beverages; Motor Vehicle Circulation Tax payable annually by all motor vehicle owners in addition to a graduated amount based on the engine capacity of the vehicle, Carbon Tax based on the carbon content of fossil fuels, VAT on Insurance Services, VAT on services in educational institutions that are not directly linked to education such as swimming, Digital Service Tax to be amended to apply to non-residents and residents. A 5% Withholding Tax on Agricultural Produce delivered to cooperatives or other organized groups has also been proposed. A farmer who o° ers produce worth KES10000 will now have to pay KES500 withholding tax. Also presented is the re-introduction of a minimum tax charged at 1% of the Gross turnover of speciÿed individuals. This proposal, if implemented, will a° ect loss-making businesses and those with lower proÿt margins. The members of the public have until October 6, 2023, to submit their recommendations on the proposals regressive since high-salaried individuals will not pay a fair share of their earnings to the scheme

The Government is Promoting Double Taxation

Double taxation refers to the situation where a taxpayer is liable to pay taxes on the same income or transaction in more than one country or jurisdiction. It can occur in international taxation when an individual or business has income or assets subject to taxation in their home country and another country or domestically where the national government and county governments tax the same income.



Effective **July 1, 2023**, the government has been taxing club entrance and subscription fees paid by an employer on behalf of its employees if the employer deducts those fees when determining taxable income. Consequently, the employer and the employee bear the tax burden leading to double taxation

The government has also expanded the scope of taxable supplies to include compensation for loss The Act provides a standard VAT rate for insurance compensation related to taxable supplies whose bona fide owner deducted input tax on purchasing the lost supplies Insurance compensation is a replacement of value after a damaging event, and thus taxing it amounts to double taxation

The Finance Act further restricts taxpayers from getting a deduction for Withholding Tax (WHT) paid on payments to nonresident persons where an audit adjustment has been made regarding such charges. The provision could lead to double taxation where the tax credit is not allowed in Kenya, and the income is taxed in Kenya and the recipient's jurisdiction

Kenyans also risk being taxed by both the county government and the national government for the same income. For example, Nairobi City County proposes a tax of KES 10000 per month for vehicles up to 7 tons carrying construction materials in and out of Nairobi. Similarly, effective 1st January 2024, vans, pick-ups, trucks, prime movers, trailers, and lorries will have to pay an advance tax of KES 2500 per ton of loading capacity or KES 5000 per year, whichever is higher as provided in the Finance Act.

Lastly the Finance Act introduces a branch/permanent establishment repatriation tax of 15%. This is in addition to tax chargeable on the income of the branch. The Act provides a formula for computing this tax based on the branch's net assets and profitability. A similar provision is also in the Nairobi City County Finance Bill 2023, where an insurance company will be required to pay a charge of KES 10000 and KES 25000 for branch and head office, respectively, if the bill is passed in its entirety.

Taxation and the Human Rights Agenda

Double taxation refers to the situation where a taxpayer is liable to pay taxes on the same income or transaction in more than one country or jurisdiction. It can occur in international taxation when an individual or business has income or assets subject to taxation in their home country and another country or domestically where the national government and county governments tax the same income.

1. Resource Allocation and Realizing Rights

Realizing human rights requires adequate resources. Taxes represent the primary mechanism by which governments raise the necessary funds to provide essential public goods and services, such as education, healthcare, and social welfare, which are critical for the protection and promotion of human rights. This has not been achieved in the current Kenyan context, as these critical sectors suffer funding crises For example, in the education sector, government capitation fees have often delayed, paralyzing learning in most public primary and day secondary schools Higher learning institutions have also not been spared. The government changed the University funding model substantially, raising fees and affecting thousands of learners from poor backgrounds who cannot join the universities

2. Taxation and Equality

Taxation policies have a direct impact on the principles of equality and non-discrimination, which are fundamental to the human rights framework. The design of tax systems, whether they are regressive or progressive, can shape the distribution of resources both within and between countries. Regressive tax policies can exacerbate social, economic, and political disparities, while progressive taxation can help alleviate such disparities. The increase in VAT, particularly on fuel which has led to the rise in the prices of essential commodities, has disproportionately affected low-income earners who rely on these commodities Similarly, poor Kenyans who rely on public healthcare and education have also been affected due to resource constraints in these institutions These situations continue to worsen the already existing socio-economic inequalities

3. Regulatory Impact of Tax Policies

Taxation is a regulatory tool that can either encourage or discourage specific behaviours. Through repricing, tax rules can influence individual and corporate conduct, such as encouraging sustainable practices, discouraging harmful activities (e.g., tobacco or carbon emissions), or incentivizing investment in areas that benefit society. Kenya currently does not have a national tax policy that provides a framework within which tax-related laws, regulations, and rules are formulated and implemented. This negates the regulatory impact that taxes are supposed to achieve.

4. The Relationship between Individuals and the State

Both tax policy and human rights law fundamentally revolve around the relationship between individuals and the state. Taxation manifests state power and the social contract between citizens and their governments. It is a means by which governments fulfill their obligations to protect and promote human rights, as well as uphold the principles of accountability, transparency, and participation. In a democratic society like Kenya, citizen participation is crucial in shaping tax policies Heavy taxation has led to social unrest as citizens are excluded from the decision-making process Moreover, tax measures have not been accompanied by transparent budgeting and spending practices to ensure that funds are allocated effectively and efficiently.

Public Participation in Kenya is a Cosmetic Exercise

Public participation in the taxation process is a critical aspect of democratic governance in Kenya. It gives citizens a say in how tax policies are formulated and implemented and how the government utilizes tax revenue. The Constitution of Kenya, 2010, explicitly recognizes public participation as a fundamental principle of governance. Article 1 of the Constitution states that all sovereign power belongs to the people, and Article 10 emphasizes the values and principles of governance, including public participation, accountability, and transparency. In addition, the Public Finance Management Act (PFMA), 2012 provides a legal framework for public participation in financial matters, including taxation. It requires public participation in the development of budget policies, preparation of the County Fiscal Strategy Papers (CFSPs), and approval of county budgets.

Although there are existing policy and legal frameworks around public participation, the government has not fully adhered to this principle, or if it has, then it has been more of a cosmetic exercise The majority of Kenyans (92.9%) were opposed to the Finance Bill 2023, as revealed by studies done by the Centre for Fiscal Affairs and Twaweza. Most Kenyans objected to introducing new or additional taxes and supported reduction or removal. Specifically 137 submissions from stakeholders opposed the Finance Bill 2023 in its entirety, with most objections being around the introduction of the Housing Levy and the doubling of VAT on fuel. The Parliament ignored the views of the citizens and passed these controversial clauses

Moreover, out of 1080 submissions received from stakeholders during the public hearing, only 1001 can be traced in the report tabled in Parliament. This therefore begs the question whether it was a case of over-reporting or a case of some proposals missing or removed from the report. The low participation of ordinary citizens (9.2%) during the bill's hearing also raises severe questions on public education and awareness when signiÿcant national interests are being discussed

The Government has Passed Taxation Limits

The limit to taxation in a healthy economy primarily revolves around balancing the government's need for revenue to fund essential services and the economic well-being of individuals and businesses. For instance, taxation should not sti˝e economic growth and productivity; tax policies should provide incentives for savings and investment; taxation should not make a country less competitive in the global market; and tax rates should be set at a level where they do not encourage widespread tax evasion or aggressive tax avoidance schemes

The World Bank, in its 27th Kenya Economic Update, a¸rms that the tax reforms, signiÿcantly raising VAT on fuel, will discourage growth in the near term. Although tax revenues have recorded modest growth, this has been at the expense of economic activity, resulting in sluggish growth in employment and household consumption. The already high fuel and electricity tari°s, coupled with the tight monetary policy, will dampen private consumption –the main driver of domestic demand in Kenya. This means that the government will collect less revenue from value-added taxes (VAT) and income tax, which currently account for about 76% of all ordinary revenues in the country.

Global rating Agency Moody's also expressed concerns about the proposed tax measures. The ÿrm says that Kenya will face di¸culties associated with the government's limited capacity to enforce tax compliance because of the quality of tax administration, the large size of the informal economy, and the complexity of the tax code. The measures have already been met with intense political and social resistance, considering the wave of deadly street protests in some parts of the country.

The tax measures have exacerbated the unemployment situation in the country as companies downsize to cut increased operational costs This year alone, agri-tech ÿrm Twiga Foods, British printing ÿrm De La Rue, e-commerce startup Copia, Brookside Uganda, and Buzeki have laid o° their workers, citing depreciating shilling and high taxation. Motorists are also crossing for fuel in neighboring countries, particularly Uganda, where fuel is cheaper , transferring revenue.

Moreover, investors are shunning Kenya as a preferred investment destination. In the latest report by the UN Conference on Trade and Development (UNCTAD), Kenya lags Tanzania, Uganda, and Ethiopia in the race to attract foreign direct investment (FDI) . This has been attributed to slow licensing processes, complex taxation procedures, and the high cost of registering property

Essentially, too much taxation is counterproductive, as it reduces consumer demand, discourages entrepreneurship and innovation, and leads to inflation, increasing tax evasion and avoidance. Over-taxation also reduces foreign investments and can lead to political instability if the people's cost of living becomes unsustainable.

The Interplay between Politics, Governance and Resource Allocation

In Kenya, like in many other countries, the relationship between political decisions and taxation policies is significant. Political factors play a crucial role in shaping tax decisions, and tax policies often reflect the priorities and interests of the government in power.

President Ruto ran his campaign on a populist "Hustler" narrative promising to improve the lives of ordinary citizens, create jobs, and lower the cost of living while emphasizing his poor background. He persistently chided the then government's efforts to increase fuel prices, promising to remove taxes on fuel and lower the cost of essential commodities once elected. However, during his inaugural speech, he announced the end of the subsidy program, subsequently raising the prices of fuel and maize flour.

Political cronyism has fostered a culture of impunity, leading to the diversion of public funds to benefit a select few, often at the expense of critical public services and infrastructure projects. The president illegally appointed 50 Cabinet Administrative Secretaries (CAS), which were set to cost taxpayers more than KES 500 million annually in salaries and benefits. The High Court has since quashed their appointment, terming it unconstitutional. Also, the Office of the Prime Cabinet Secretary was created, although it is not envisaged in the constitution. It is set to spend KES 648,080,000 in the current financial year, more than the allocation to the Women and Youth Enterprise Development Funds (KES 182.8 million and KES 175 million, respectively). The Offices of the President, Deputy President, and Prime Cabinet Secretary were allocated an extra KES 9.4 billion in a fresh mini-budget, more than the allocation towards the Fertilizer Subsidy Program and Free Maternity Healthcare (KES 4.5 billion and KES 4.1 billion respectively). Thus, recurrent expenditure has grown, with limited resources for development expenditure.

The interference of the executive branch with the functioning of parliament is also an issue of great concern. The role of Parliament has been reduced to that of a conveyor belt where members vote based on their party affiliations rather than the national interest. The President even publicly warned MPs from Kenya Kwanza against opposing the Finance Bill. Such interferences undermine the separation of powers and checks and balances essential for a healthy democracy.

Tax revenues have been allocated to multi-billion projects that have often become scandalous, benefiting political powers through kickbacks at the expense of suffering Kenyans. Kenya loses a third of its budget to corruption annually, according to the Ethics and Anti-Corruption Commission (EACC). If this trend continues, the country will lose about KES 1.2 trillion considering the current FY budget (KES 3.68 trillion), which is about 7.8% of GDP. This amount can finance the Education sector for nearly two FYs (The education sector was allocated KES 628.6 billion in the current FY). The country's taxation decisions have been shaped by its commitments to international organizations such as the IMF and other creditors. Kenya is currently implementing IMF-backed reforms

aimed at enhancing fiscal consolidation. The proposals by the IMF have resulted in far-reaching changes in consumption tax laws.

A massive chunk of revenue generated by the government goes to debt repayment. In the current financial year, debt servicing is expected to gobble up 48.6% of the total revenue (about KES 1.25 trillion).

According to the Controller of Budget, Dr. Margaret Nyakang'o, KES 1.15 trillion, representing over one-third of the total FY 2022/23 national budget, was used to repay debt totaling KES 10.25 trillion.

This leaves the government with limited resources to invest in critical areas such as health, education, and social protection. For instance, the government has often delayed in disbursing money for free secondary education, putting many schools in financial crisis even as enrollment surges due to the 100% transition policy. Public hospitals have also not been spared as they struggle with inadequate resources to meet their operation needs, including paying salaries to healthcare personnel

A Call to Action

In the wake of persistent revenue shortfalls that have necessitated more taxation measures, the government should strive to find a balance between collecting revenues and upholding the welfare of its citizens, particularly the vulnerable.

Firstly, the government should put in place a National Tax Policy. The current tax regime is unpredictable, challenging individuals and businesses since it is mainly based on financial legislation introduced every fiscal year. An operational National Tax Policy would provide a framework within which tax-related laws, regulations, and rules are formulated and implemented. Essentially, taxing the hard-to-tax sectors such as agriculture, the informal sector, and online businesses requires a framework to guide the process

Secondly, the government should broaden the tax base by focusing on unexploited revenue sources less detrimental to economic growth. An example of a tax base mainly unexploited in Kenya is property taxes which can be feasible to enforce in a crisis since high-income earners own properties. For example, in Nairobi city county, by updating the valuation roll, it is anticipated that the rate collection for properties will more than double from the current 36%.

Thirdly, the government should curtail tax evasion by high-net-worth individuals that results in a narrowing of the tax base through initiating proper legislation on cross-border transactions, financial secrecy, and beneficial ownership. It is estimated that the government has been losing an average of KES 40 billion every year through illicit financial flows since 2011. Also, the government needs to do away with inefficient and wasteful tax incentives that give away the tax base.

Fourthly, addressing unique challenges in tax administration and improving efficiency and effectiveness requires digitization. Kenya can borrow a leaf from Rwanda, whose electronic billing system has almost doubled its VAT collections. Rwanda's version of electronic billing provides real-time data and increasingly captures the informal sector, making it efficient in tax collection. Additionally, in South Africa, e-taxation has lowered the time (by 21.8%) and cost (by 22%) of complying with the value-added tax (VAT).

Lastly the government needs to urgently tackle corruption and the runaway wastage of public funds. Resources should be invested in sectors that guarantee high returns, promote sustainable development, and improve the welfare of the citizens. The citizens should also remain vigilant, hold their leaders to account, and advocate for their interests

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