TAX EXPENDITURES IN KENYA: A CIVIL SOCIETY PERSPECTIVE

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OUTLINE

- Transparency of the Tax Expenditure Framework
- Accountability of Tax Expenditures
- Equity in the Tax Expenditures Framework
- Adequacy of Tax Expenditures
- Efficiency of Tax Expenditures
- Conclusion and Recommendations
- Forthcoming Publication
- Further Reading

TRANSPARENCY OF TAX EXPENDITURE FRAMEWORK

Legal and policy framework on TEs → TE data including revenue foregone → Elgibility criteria,beneficiaries

Legal and policy framework

- TEs can only be authorized through legislation as per Art.210 of the Constitution and s.77 of the PFM Act; These laws including the tax laws and non-tax laws also provide for TEs e.g. EPZ Act etc, are publicly accessible.
- However, laws providing for TEs provide discretionary powers to CS' to grant TEs which is formalized through gazettement of the incentives.
- This and the provision of TEs in disjointed laws- inefficient administration and corruption e.g. the case of **Commissioner of Domestic Taxes v Dominion Petroleum Dkenya Limited**

TE reports

- The above- mentioned laws provide for annual publicly accessible TE reporting - However, the only reports that are publicly accessible are for the FYs 2017/18- 2019/20. This has been due mostly to international development partner pressure.

Eligibility criteria/beneficiaries

- Eligibility criteria is readily available information however information on beneficiaries and whether these beneficiaries are meeting/ failing to meet the criteria is not accessible. This makes evaluation of TEs difficult.
- The law does not clearly provide for instances when beneficiaries have breached the eligibility criteria.

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ACCOUNTABILITY OF TAX EXPENDITURE FRAMEWORK

Explicit socio-economic policy goals → Periodic evaluation of TEs → Sunset clauses

Explicit socio-economic policy goals	• The policy goals of TEs are provided. These include: spurring economic growth, increasing investment and creation of employment; These are too broad and could lead to exploitation of TEs and increase the risk of non-performing TEs
Periodic evaluation of TEs	• There are no publicly accessible ex-ante and post- ante evaluations of TEs in Kenya. Hence, it is not clear if TEs are meeting their stated policy goals. The law does not provide for periodic review of TEs
Sunset clauses	• Sunset clauses are provided for TEs such as tax holidays provided in preferential tax regimes such as EPZs etc. However, the same is not provided for TEs such as excise duty exemptions.

EQUITY OF TAX EXPENDITURES

Equity of TEs during the COVID-19 pandemic → Equity of TEs in the real estate sector in Kenya → Correlated direct expenditure that is being used to address inequality

COVID-19

- It is difficult to get data on the distributional impact of TEs especially for VAT. However, most TEs designed for low -income earners are provided through VAT zero rating or exempting
- COVID-19 led to the introduction of TEs aimed at cushioning the poor e.g. Reduction of VAT rate from 16% to 14%, reduction of CIT from 30% to 25% etc.

Real Estate Sector

- Benefits mostly wealthy and middle- income individuals. (Oxfam Kenya, 2020)
- 150% investment allowance (100%) on construction that takes place outside Nairobi, Kisumu and Mombasa at an investment value of KES 200 million ; reduced CIT for developers who have at least 400 units(in planned development areas)
- Further incentives were provided under the Affordable Housing Scheme – these TEs are estimated to cost around KES 50 billion (Oxfam Kenya, 2020)
- Tax incentives for the poorer are capped – maximum interest deduction of KES 300,000 p.a./Tax relief of 15% on gross emoluments to a limit of KES 108,000 per annum for purchases made under the affordable housing scheme

ADEQUACY OF TAX EXPENDITURES

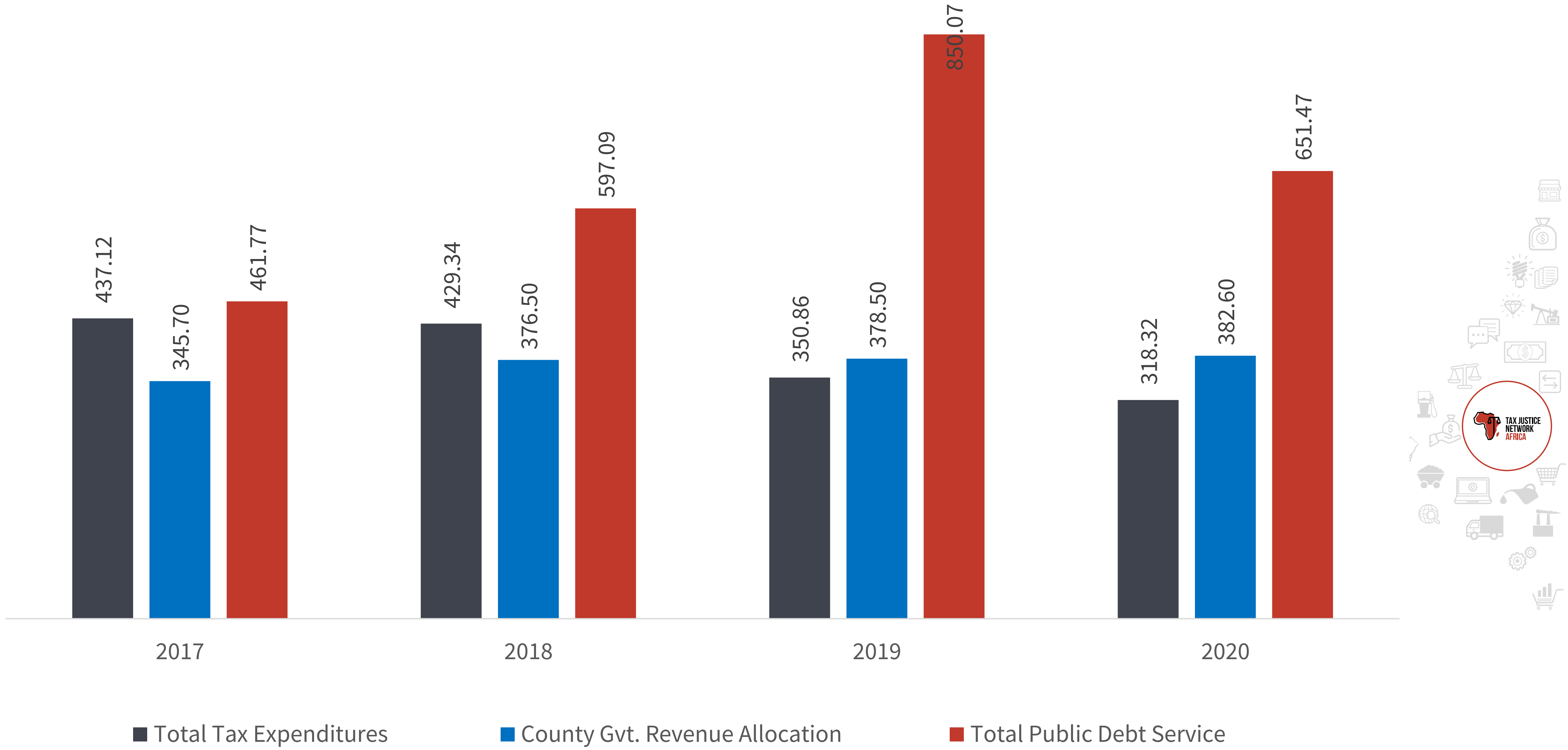
TEs within Kenya's overall fiscal condition → TEs in relation to other public expenditures

Kenya's overall fiscal condition

- Fiscal deficit has been on the increase due to growing budget.
- This has led to an increase in public debt which in turn has led to an increase in public debt service.
- It is estimated that debt servicing will make up 65% of total revenues collected by the financial year 2023/2024

TEs v other public expenditures

- In 2017 (as shown in the graph in the next slide) TEs were roughly at par with other important expenditures such as country revenue allocation (fiscal decentralisation) and public debt service.
- However, by 2020 county government allocations and public debt service surpassed TEs with debt service more than doubling TEs.



437.12
345.70
461.77
429.34
376.50
597.09
350.86
378.50
850.07
318.32
382.60
651.47
2017
2018
2019
2020
Total Tax Expenditures
County Gvt. Revenue Allocation
Total Public Debt Service
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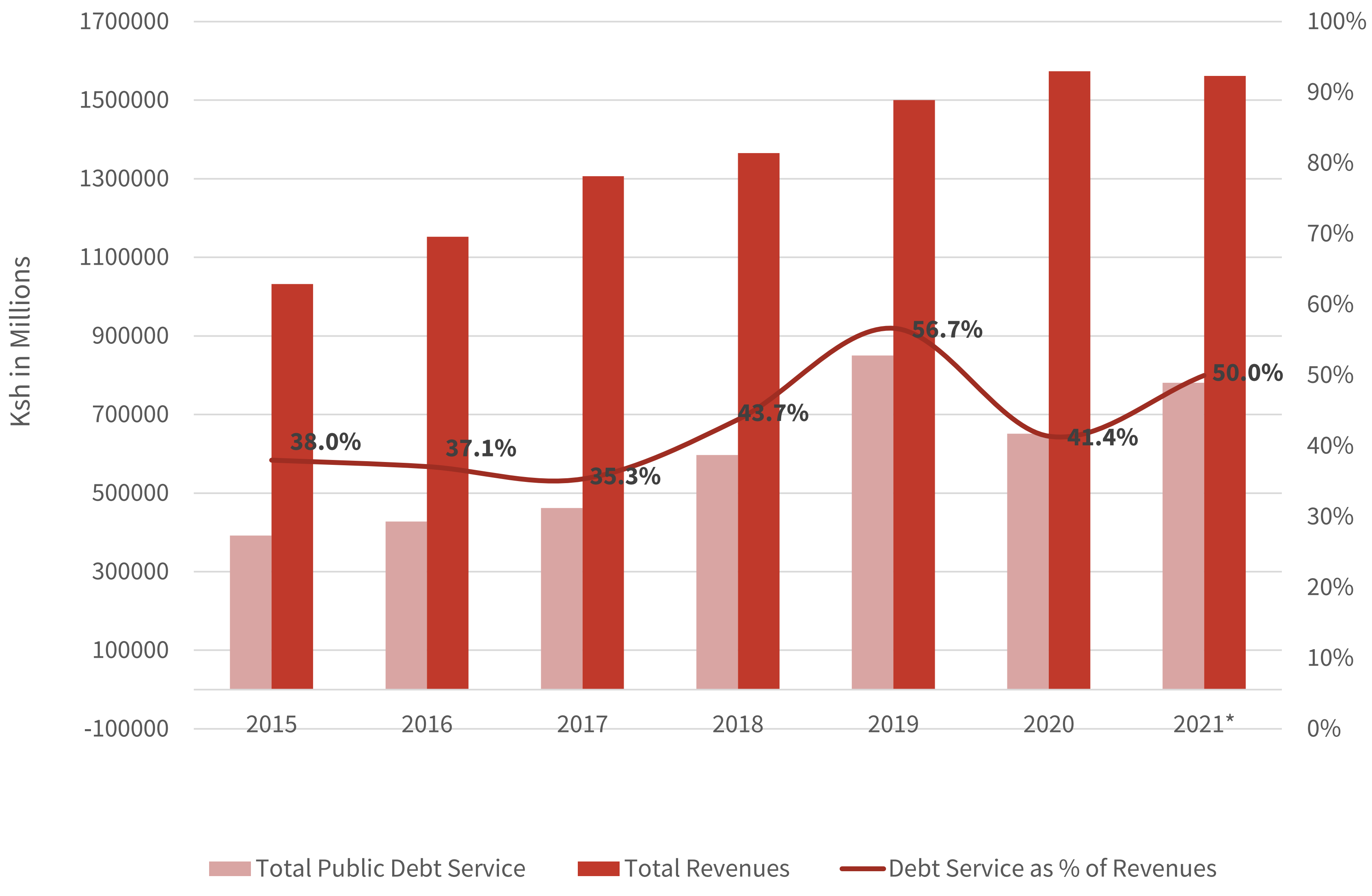

Ksh in Millions
1700000
1500000
1300000
1100000
900000
700000
500000
300000
100000
-100000
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
2015
2016
2017
2018
2019
2020
2021*
38.0%
37.1%
35.3%
43.7%
56.7%
41.4%
50.0%
Total Public Debt Service
Total Revenues
Debt Service as % of Revenues

EFFICIENCY OF TAX EXPENDITURES

Is the objective of the TE being addressed?

What market failure is being addressed?

Is a TE the best way to address the market failure?

How much will the specific TE cost?

It was not possible to properly assess the efficiencies of TEs due to data limitations. However, a preliminary comparison was done between the revenue forgone due to tax expenditures, the employment that was created and the growth in specific sectors of the economy. This is shown in the next slide.

EFFICIENCY OF TAX EXPENDITURES

Sectors	Revenue foregone in 2020 (in Ksh billions)			Contribution to GDP in 2020	Growth Rate in 2020	New Wage Employment in the Sector	
	CIT Expenditure	VAT Exempt	VAT Zero Rated			2019	2020
Agriculture	1.17	6.03	28.0	23.0%	4.8%	2000	-16300
Manufacturing	29.41	9.25	48.5	7.6%	- 0.1%	5400	-36400
Construction	15.93	4.36	-	7.0%	11.8%	3100	0
Financial and Insurance	-	23.8	-	6.5%	5.6%	2000	-300

Acepis computations based 2021 Tax Expenditures Report (National Treasury) and Economic Survey (KNBS)

FORTHCOMING PUBLICATION

This presentation was based off the forthcoming publication that was the result of collaboration between Tax Justice Network Africa(TJNA), the East African Tax and Governance Network(EATGN)and the Africa Centre for People, Institutions and Society (ACEPIS) titled, **'Revenue Waivers and National Economic Pressures :The Hidden Cost of Tax Expenditures in Kenya'**

CONCLUSION

- Kenya's TE framework is prone to abuse and manipulation by special interests due to inherent opacity, limited accountability, and inadequate citizen participation.
- Generalization of the purpose of tax expenditures limits effective scrutiny and monitoring of performance of tax expenditures.
- There is lack of clarity concerning certain components of tax expenditures, for example, special economic zones (SEZs) receive preferential tax treatments and ought to be considered as tax expenditures, yet Treasury excludes them
- Competing developmental priorities and resource demands raise questions about the adequacy of tax expenditures incurred by treasury considering the prevailing fiscal situation in the country
- Poor monitoring framework for tax expenditures means that government could be proceeding with inefficient and inequitable tax incentives
- Information asymmetries - limited data regarding tax expenditures in Kenya
- There is weak correlation between tax expenditures to sectors and the performance of the sector
- Tax expenditures could be furthering income inequalities that exists between international companies and local companies plus income inequalities between entities in the formal and the informal sector

RECOMMENDATIONS

Increased parliamentary oversight is required in TE governance in areas such as rigorous audit and evaluation of tax expenditures to minimise their abuse and mismanagement.

Owing to the substantive amount of revenue forgone from issuing tax expenditures, there is an urgent need for stakeholders (National Treasury and KRA) to publish comprehensive tax expenditure reports on an annual basis as required by the PFM Act 2012.

Periodic review of TEs is necessary to ensure that they meet their objectives and to increase their overall efficiency. In order to successfully carry this out, the National Treasury must collaborate not only with KRA and other sector ministries but also other key agencies such as the national statistics bureas, registrar of companies, amongst others. Increased coordination shall also lead to efficient administration that minimises non- performing TEs.

There is need for interagency cooperation to improve availability of credible data for evaluating costs and benefits of tax expenditures. Stakeholders can encourage KRA, Treasury and KNBS to pursue interagency collaboration to allow access to such information.

Owing to the costs associated with tax expenditures, there is an urgent need for robust explorative analysis of the country’s tax expenditure framework. This must involve rigorous monitoring and analysis of the implications of tax expenditures for the tax base and overall fiscal space.

Civil Society can play a stronger role in monitoring Tax Expenditures – especially in evidence generation (through studies) and advocacy for a more transparent and equitable framework. This includes advocating for more public participation in the planning phase of tax incentives.

More specific objectives should be provided for TEs to ensure effective scrutiny of their performance.

FURTHER READING

International Budget Partnership. (2018)Evaluating Tax Expenditures: A Framework for Civil Society Researchers.https://internationalbudget.org/wp-content/uploads/evaluating-tax-expenditures-framework-for-civil-society-english-2018.pdf

Oxfam. (2019). Analysis of Tax Incentives and Exemptions in The Finance Acts from 2009 – 2019. https://oi-files-cng-prod.s3.amazonaws.com/kenya.oxfam.org/s3fs-public/file_attachments/Tax%20Incentives%20study%20Report.pdf

National Treasury. (2021) Kenya Tax Expenditure Report 2021. https://www.treasury.go.ke/wp-content/uploads/2021/09/2021-Tax-Expenditure-Report.pdf

Tax Justice Network Africa. (2020) https://taxjusticeafrica.net/wp-content/uploads/2020/01/FTC-Use-and-Abuse-of-Tax-Breaks.pdf

THANK YOU!