

**40TH CATA TECHNICAL CONFERENCE
MALAYSIA**

**SHADOW ECONOMY
ISSUES AND CHALLENGES - KENYAN COUNTRY
EXPERIENCE**

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SCOPE

- Where is Kenya?
- Government Structure
- Economy
- Types of Shadow Economy
- Tax base Vs Shadow Economy
- Manifestation of Shadow Economy in Kenya
- Causes of Shadow Economy
- Impact on Taxation
- Interventions

WAPI KENYA?



CAPITAL CITY: *NAIROBI*

AREA: *582,650 Km²*

POPULATION: *47 MILLION*

NEIGHBOURS: *UGANDA, TANZANIA, ETHIOPIA, SOMALI & SOUTH SUDAN*

KEY SEA PORT: *MOMBASA*

NATIONAL AIR CARRIER: *KQ*

CURRENCY: *KENYA SHILLINGS*



GOVERNANCE STRUCTURE

BI-CAMERAL PARLIAMENT

GOVERNANCE STRUCTURE

CONSTITUTING:

- ❖ NATIONAL GOVERNMENT
- ❖ SENATE
- ❖ NATIONAL ASSEMBLY
- ❖ COUNTY GOVERNMENTS(47)



NATIONAL ASSEMBLY



SENATE

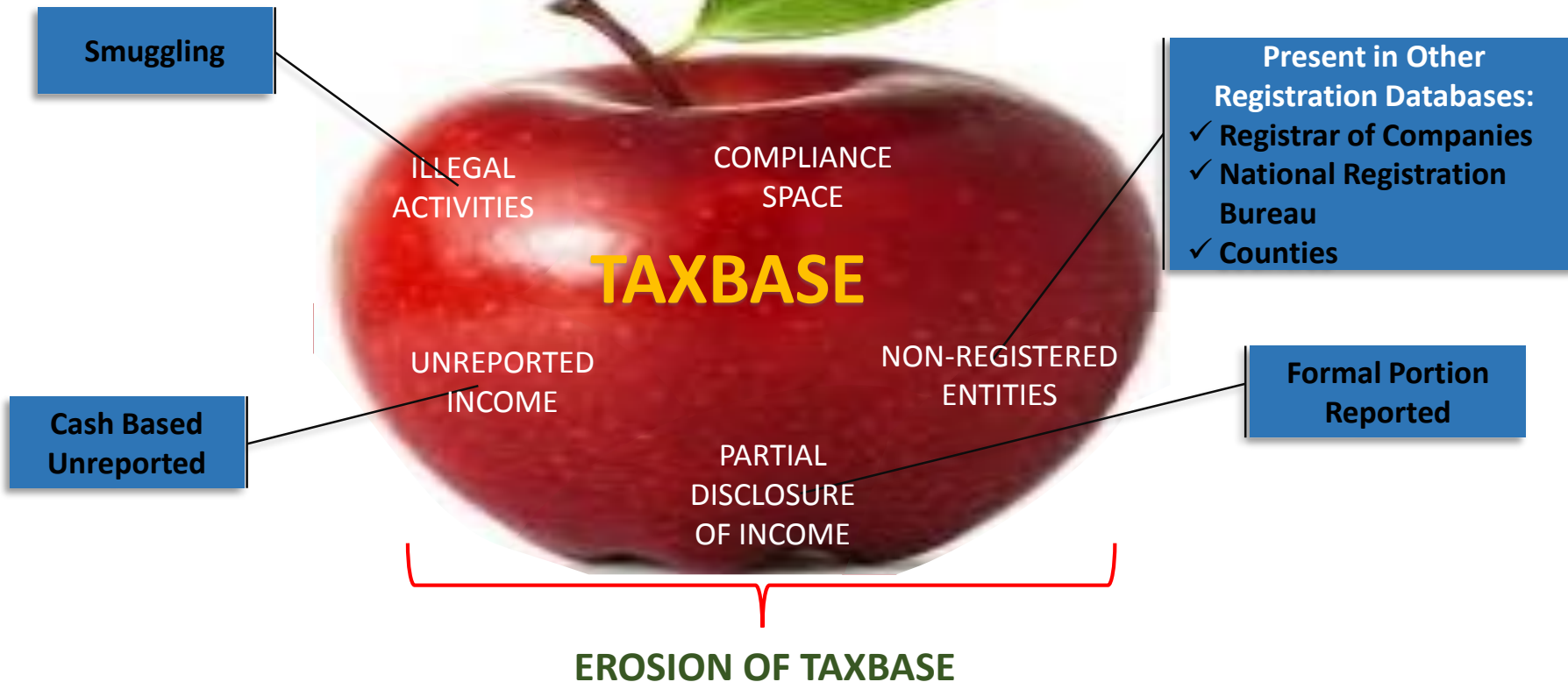
ECONOMY



TYPES OF SHADOW ECONOMY

- ❖ Illegal Economy e.g. Money laundering, Smuggling etc.
- ❖ Unreported Economy - unreported revenue from either legal or illegal sources
- ❖ Unrecorded Economy - Economy with no records

TAXBASE VS SHADOW ECONOMY



MANIFESTATION OF SHADOW ECONOMY IN KENYA

- ❖ Huge Cash Transactions
- ❖ Large Informal Sector (Jua-Kali)
 - ✓ Estimated to constitute **34.3%** of GDP
- ❖ Low Detection Rates

CAUSES OF SHADOW ECONOMY IN KENYA

In Kenya, the growth of shadow economy is influenced by:

1. Unemployment levels - Formal economy not creating enough jobs to sustain the labour market.
2. Taxation regimes - Perception of high tax rates act as a disincentive.
3. Culture. Low compliance levels
4. Cost Benefit Calculus:
 - ❑ Low probability of detection and high penalty upon detection vs amount evaded
 - ❑ High probability of detection and low penalty upon detection vs amount evaded

CAUSES OF SHADOW ECONOMY IN KENYA

5. Resource distribution- Lack of equity and fairness.
6. Competitive edge (price flexibility) over formal sector.
7. Digitalization - low levels of digitization.

IMPACT ON TAXATION

- ✓ Low revenues reducing governments' ability to provide goods and services
- ✓ Heavy Tax burden on formal sector.
- ✓ Incentive for SMEs in the formal sector to join the shadow economy.
- ✓ High level of non compliance

INTERVENTIONS

❖ Government Wide:

- ✓ De-Monetization
- ✓ Tax Amnesty on Foreign Income and Assets
- ✓ Common Identifier for Government Services (Huduma No.)
- ✓ Registration and payment of Government suppliers from one common system (IFMIS)
- ✓ Multi Agency Approach to compliance
- ✓ System integration and information sharing - common gateway to accessing & paying for government services - (e-citizen)

INTERVENTIONS

Tax Administration

- ✓ Data driven compliance and use of intelligence & focused risk profiling
- ✓ Information Sharing both locally and internationally
- ✓ Leverage on 3rd party data to identify active businesses not in the tax base - use of DWBI & enhanced data analytics
- ✓ Integration with various government agency systems to track taxable transactions

INTERVENTIONS

Tax Administration

- ✓ Simplified tax regimes and procedures
- ✓ Enhanced service delivery and education to the informal sector.
- ✓ Tax Compliance Requirements for Government Tenders & appointments/ recruitments, opening bank accounts.
- ✓ Incentive Regime to Formalize Informal Sector-incubation/ CSR

INTERVENTIONS

Tax Administration

- ✓ Creation of a robust intelligence framework
- ✓ Sharing of information both locally and internationally
- ✓ Leverage on 3rd party data to identify active businesses not in the tax base - **SBP , Electricity, property, shares, banks**
- ✓ Integration with various government agency systems to track taxable transactions -IFMIS, LIMS, CR, NSSF, NHIF, NTSA
- ✓ Simplified tax regimes and procedures- Presumptive Tax, use of Mobile App, cashless payments etc
- ✓ Implementation of Tax Invoice Management System (TIMS).

INTERVENTION - EXCISE SECTOR

- Monitoring and sharing online transactions from manufacturing lines - Electronic Goods Management System (EGMS)
- Introduced in 2012 when tax evasion in the sector was quite high- compliance in the sector was barely 20% and was below industry potential.
- Use of digital stamps - Tobacco and Alcohol - expanding same to juices , soda and bottled water.
- Ability to identify and reduce illicit goods arising from production lines.

EXCISE SECTOR

- Ability to estimate revenue expectations before due date from production reports sent online to our system.
- Ability to identify illegal production from the comfort of our offices through the EGMS system.
- Fully fledged Enforcement Team of 130 officers carrying out Market Surveillance - Well Equipped with tools to track and trace genuine stamps affixed on products.
- Revenue grew to >Ksh 5B in 2019 from Ksh 700M in 2013.
- Reduced Tax Frauds
- Improved level playing ground

PE CONCEPT

- With digitalization, the concept of Permanent Establishment is relevant yes but with limitations. eg Developing countries with limited exchange of information network are at a disadvantage since some have signed the Multilateral Agreement on Administrative Assistance (MAC) but have not ratified the same.
- This requires a global perspective because individual jurisdictions cannot define their own PEs. (OECD on universal approach).

PE CONCEPT

- In addition KRA has developed a legislative framework that allows for appointment of tax representatives - allows collection of taxes where the transaction are carried over a digital platform by a non resident person. (eg Google, Netflix, Amazon , Facebook etc).
- Currently - working on a framework that will allow collection of taxes on real time based on the payments that are made for transactions carried out over the digital platform.
- We are leveraging on the robust Kenyan Money Transfer infrastructure to facilitate implementation of digital payments.

PE CONCEPT

- It is therefore important that International Tax rules be changed - they need to be realigned to changing business environment including taxation of digital economy.
- International rules needs to be domesticated to take care of circumstances of each country.
- Kenyan perspective - Passed legislation this year to introduce taxation of digital economy with respect to services where we introduced reverse VAT for non registered taxpayers ie. VAT is going to be charged on all imported services to facilitate collection of VAT on B to B transactions.

THINKING DIFFERENTLY

- Change in compliance approach.
- Introduced project approach to compliance
- Identify critical areas with high risk of non compliance and create a project.
- Creates disruption on any set cartels.
- Enhances focus on use of data specific to the problem.
- Enhances accountability
- Gives better results.

Thank You