

Tax compliance: An African Perspective

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1. Introduction

When the data on illicit financial flows and tax compliance began emerging in the media 15 years ago in the early 2000s, the line between states that were perceived to be weakly governed,¹ and those with strong governance seemed to be clearly divided. In addition, the difference between a corrupt and a less corrupt nation similarly seemed clear.² Since then with the release of the Financial Secrecy Index,³ and numerous leaks and scandals such as Luxleaks, Wikileaks, SwissLeaks, Panama papers, and most recently the Paradise papers, it has become growingly clear that concerns around weak governance are not only global but today, no country has remained untouched by the problems facing tax compliance and its spillover into governance and corruption.

If one breaks tax compliance into the two elements of governance and then further corruption, one sees that more and more countries are seeing the linkage between the two areas as having a direct connection to tax compliance. Compliance is both traditionally and historically affected by governance and/or corruption at different levels of government, on different taxpayers and varying levels of complexity.

Before unpacking the problem, we must first set out where the resting position of tax compliance ought to be and what needs to guide it. To put it differently: The guiding principles by which a fiscal state must be understood. Compliance to laws within a state is a direct reflection of the legitimacy of a state and tax compliance similarly is a reflection of the fiscal legitimacy of a state. In order to ensure there is fiscal legitimacy, there are several key principles: accountability, responsibility, transparency (good governance principles) effectiveness and efficiency and fairness and justice. States can enhance fiscal legitimacy, by firstly, involving independent third parties in the auditing and evaluation of public policies to strengthen transparency and accountability⁴ Secondly, promoting better, fairer and more public spending; thirdly, broaden the tax base and making tax systems fairer and more balanced. Finally, reinforce the capacity, authority and accountability of sub-national government bodies.

Fiscal legitimacy is however not only an issue of capacity, in addition to strengthening administrative capabilities, societal participation and open and informed debate can result in more transparency. Independent actors with the capacity and the financial independence to carry out a critical evaluation of policies and proposed reforms can also add to the good governance and fiscal legitimacy (Waris 2013). Achieving a fiscally legitimate system that achieves these parameters is, as always, going to be a compromise and sub optimal. However, we need to move forward on these principles continually and consistently. In addition, the last 2 principles cannot be compromised: fairness and justice if the legitimacy is to be built.

This article as a result will engage with the 7 principles set out above and how they are engaging in the developed and developing world with a focus on Kenya. It will firstly discuss from a historical

¹ Ibrahim Index of African Governance, Mo Ibrahim Foundation 2017.

² Corruption Perceptions Index, Transparency International 2017.

³ Financial Secrecy Index, Tax Justice Network 2018.

⁴ For the previous see: Waris 2013.

perspective how developing countries like Kenya have reached the position they are in and secondly, where they stand on the issue of compliance and corruption and governance and finally, what needs to be done to improve the current status to improve the fiscal legitimacy of these states.

2. Developing Countries and their Fiscal Legitimacy: A Kenyan Focus

Although different countries continue to grow and develop differently there are certain key issues one must analyse before one can understand it. The first is to place the state based on certain key indicators. This includes but is not limited to the following characteristics: durable characteristics that vary with the level of fiscality of the state: the financial theory, the form of government, the central administration, the local administration, the office holders, state responsibility, the method of financing, public finance, expenditure, revenues, credit structure, the role of the economy, economic policy, public enterprises, political participation, social consequences, statistics and finally the causes of instability. The principles of variation include the uniqueness of individual states and that they are a combination of a diverse set of characteristics that may not lend themselves to being categorised clearly and precisely. However, the presentation of these variations are not as clear cut when applied to individual states.

Firstly, effectively one can divide countries into states that include groups of nations and ethnicities. Most African countries have more than one ethnicity. Kenya for example has 44 recognised ethnic communities. All these communities within a developing country have completely different understandings and experiences with taxation before, during and after colonisation. Their level of exposure varies within and between communities and the state and as a result the compliance may also be different between urban and rural areas and between ethnic communities and between opposition areas and areas whose political leaders are in power. Numerous allegations and grand corruption scandals over the years since independence reflect a form of state capture by certain ethnic communities and families which was also the result in South Africa when Zuma resigned. In addition, this tribalism also prevents African states like Kenya and South Africa from uniting into one nation with one government for one people (Khamisi 2017).

Secondly, from a historical perspective, before, during and after the colonial era in what are today most developing countries, the different populations and peoples in countries around the world had very diverse understandings of taxation. Some communities in Kenya had a well-developed monetary and tax system financing the state: these include the city states on Mombasa, Lamu and Malindi (Waris 2007, 279). On the other hand, we have basic communities with simple forms of exchange of services by people for security where the young warrior clan provided security and in return they were housed and fed and their families cared for or on the other hand a chief who administered and settled disputes in return for food for the chief and his/her family. Thus to date there are peoples whose fiscal knowledge varies from those that had no comprehension of it simple people living close to the ground to more complex societies and kingdoms with a payment of taxes in goods or services or even in money where a monetary currency existed. However during colonisation the decision to introduce a capitalist economy in the African communal or socialist society led to the introduction of taxes with varying rates depending on the community (ibid. 286). Those that opposed colonisation most, paid more hut/poll tax than those that were quick to collaborate.

Thirdly, the failure to develop and update the fiscal treaties, constitution, laws, policies and regulation. Many developing countries still have very old legal documents. Whereas Constitutions may be newer for example in Kenya the Constitution was passed in 2010, the laws surrounding the area of finance tend to be outdated. At the same time, the Income Tax in force currently in Kenya is the 1920 Colonial model ordinance adopted at independence. It has been amended several times but the majority of the document in place remains the substantial text of the 1920 colonial law. In areas of policy and administrative regulation developing countries rarely have these in place and when they do exist are not often implemented or enforced. Finally, international treaties are inherited from before independence and again these need to be revisited and there must be reflection on their necessity and reform.

Fourthly, the challenge of separation of the state from business continues to overwhelm the ability of the government and the economy to run. In average in developing countries like Kenya 80% of the economy tends to be through government business. The biggest challenge currently is that between 1970 and the 2000 in Kenya, civil servants were allowed to own businesses. As a result most civil servants began to secure procurement tenders for their companies and this problem continues to undermine the stability of the economy as the opacity in tenders due to the absence of beneficial ownership registers leaves a wide margin for the potential of corruption (Nsehe 2015).

Fifthly, the issue of corruption continues to undermine the ability of the state to collect taxes. A recent scandal showing procurement contracts where towels were being purchased by the National Youth Service for 1000 Euros each further undermines the willingness of taxpayers to contribute to the state. Although the government has arrested people involved in the theft of approximately 500 thousand Euros, 8.5 million Euros remain unaccounted for and the people responsible have not been arrested (Ilado 2018). Evidence of good spending develops tax payer compliance more effectively than efficient systems and well trained staff.

Sixthly, while there has been impetus to train revenue authority in issues of taxation there has been no similar training of ministry of finance, treasury, attorney general staff and the judiciary as well as the general public. The result is that the better encapacitated revenue officials are seen as aggressive and when cases need to go for dispute resolution the decisions can be swayed where the judge is less clear on the tax claim.

Seventhly, Kenya, ranked prominently in the latest Financial Secrecy Index and has passed legislation to set up the Nairobi International Financial Centre. While the actual terms of secrecy and tax incentives are not publicly known what it does show is that although Kenya engages at the UN Tax Committee and has signed onto the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, it remains unclear what standpoint the country will take on the taxation of MNE. There seems to be no question on the signing onto international platforms and yet at the same time no clarity at the domestic level on what position the state is making: this lack of clarity makes for poor tax and fiscal policy.

Eighthly, participation and access of people to the state is limited predominantly to those that lobby. In the current efforts to review the Income Tax Bill of 2018, only 8 days were given for comments to the Bill and the only people who are receiving publicity on their opinions nationally in Kenya seems to be the private big accounting firms and the big companies. This lack of public

access to participate in the process is resulting in a skewed understanding by politicians of the issues and as a result the passing of laws that are not well thought out.

Finally, the network of wealth chains globally and the secrecy jurisdictions in which the nodes sit allow for the continual holding of assets in foreign states to which developing country tax collectors have no access to the information in these countries (Seabrooke, Wigan 2017, 22). The result is that both nationals and non-nationals residing in a state are continuing to place their assets and accounts outside their countries of residency in order to evade, aggressively plan and avoid taxes. Removing secrecy provisions and sharing all information regarding domestic taxpayers is very important.

3. What Developed Countries Can do to Help Developing Countries

There are certain key actions I believe that countries must undertake domestically, regionally and globally and for which assistance can be given by neighbouring countries as well as those countries that are further away and in different parts of the world to ensure increased tax compliance and reduce corruption.

Firstly, developing countries can themselves improve some of the areas to control and reduce corruption and improve tax compliance. One of the key ways of increasing tax compliance is by not only spending tax properly but also on ensuring there is clear transparency in the spending in order that tax payers are aware of the proper spending (IMF, OECD et al. 2011). A good example is Rwanda where tax spending as well as development aid was on projects based on the national development plan of the state,⁵ as a result, it was very clear that the one laptop and child project and the one cow a family project were provided for by the state.⁶ This clear social spending and redistribution process showed clearly that the state is assisting the people and when it comes to time for tax compliance this may be made easier as the trust between the citizens and the state has been built and is evident. Developed countries can assist in this by ensuring that development aid ascribes to the development policies of the state and helps build the development agenda.

Secondly, there needs to be capacity building of communities, professionals and states coupled with the development of a tax ethic at national, regional and global level. However this requires debate and capacity building of national educational curriculums as well as ethical codes being developed at anti-corruption authorities which are circulated and to which citizens ought to be required to sign on to if possible. Developed and developing countries are facing this challenge as a result there is need for a collaboration on a global code of conduct for professionals, states and citizens. There has been some training of tax officials by among others GIZ and TIWB however in addition to equipping the officials to assess and collect taxes better, it has also led to an increase in a bullying approach by many tax officials which needs to be tempered and can only be done effectively by capacitating all sectors of society.

Thirdly, the entire framework of regulation needs to be reconsidered. Developing countries like Kenya have not as yet set out their domestic and cross border tax policies, regulations laws. As a result there is a

⁵ See Republic of Rwanda Ministry of Finance and Economic Planning (2000): Rwanda Vision 2020. <https://www.sida.se/globalassets/global/countries-and-regions/africa/rwanda/d402331a.pdf>

⁶ One Laptop Per Child (2011) Transforming Society Through Access to a Modern Education. http://wiki.laptop.org/images/5/53/Rwanda_Report-v7.pdf

need to have a clearly articulated and written out tax policy of a state at the domestic cross-border regional continental and global levels. There is a need to link academia in developing countries with Ministry of Finance/Treasury in order to develop these policies in order that there is a guide before treaties are signed as well as before any laws regarding tax are put in place or amended. Developed countries can support this process by sharing their policies and approaches with developing countries like Kenya.

Fourthly, the OECD unfortunately today dominates the global tax game. Whereas developing and emerging countries, cooperating in the so-called G77, would prefer the UN Framework for defining and regulating international tax cooperation, and Kenya supported this position at the Financing for Development Process in Addis Ababa in 2015, developed countries cooperating in the OECD prevented this from happening against the declared will of the majority of nations. OECD member states should respect and support the process for a democratically decided global tax framework where not the strong setting rules and forcing them upon the rest, but each nation has a say in defining a common cooperative framework. Supporting such the system for all nations is very important, again because the legitimacy going along with it. However, as long as such a legal-political space has not yet come to pass, states should support the setting up of locally sourced, national, regional and continental tax committees to advise governments better on tax issues and all states ought to support each other within such sub-level contexts in achieving this for the common good of all.

Finally, the biggest and probably the most important place where developed countries can provide support and help change the global direction. The international calls for more specific laws such as removal of secrecy in jurisdictions housing illicit bank accounts and corporations should have data publicly available in beneficial registries, through country by country reporting of corporate accounts, exchange of information (Davies and Gower 2015).

4. Conclusion

In order to build a just and fair society that is fiscally sustainable, it is therefore crucial that jointly and separately all countries make changes not only domestically but in their cross-border activities. However, these are global problems requiring global solutions and unfortunately if only one sector, group or state undertakes it will inherently fail as it requires a global collaboration and therefore a global change in the rules of international tax.

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