Government implies functionaries and expenditures. How shall these be maintained? Evidently by the contributions of all, for all are interested in its existence. The aggregate of all sums collected by government is called its **Revenue**; the system by which it is collected is called **Taxation**. Although the single object of taxation is to obtain a given amount of wealth (generally in the form of money), yet the modes by which that object may be secured are various.

**THE OBJECTIVES OF TAXATION**

The fundamental purpose of taxation is to finance government expenditure. Beyond this primary purpose, modern tax systems are also guided by principles of efficiency, equity and simplicity. There are instances when these three principles conflict, and there are also instances when the principles conflict with the revenue raising purpose of taxation. Differences in public choice outcomes between countries reflect the different history and circumstances of each country, and there are many different approaches that can be taken to balancing the objectives of public policy.

The tax system can be used for purposes other than revenue raising. In certain situations, imposing a tax may potentially increase efficiency if markets fail to EXTERNAL factors such as pollution or congestion, or the health costs of particular types of behaviour such as cigarette smoking. Such costs external to the market mechanism are referred to as ‘externalities’. Some OECD countries have imposed specific taxes in an attempt to use market prices (inclusive of the price-correcting tax) to allocate resources efficiently, taking into account some of these externalities.

The current government's objectives for the tax system are broadly as follows:

* **The burden of tax**: To keep the tax burden as low as possible (the burden of tax for a country can be measured by the % of GDP taken in taxes.
* **To improve incentives**: The government believes that reducing tax rates on income and business profits helps to sharpen incentives to work and create wealth in the economy as a strategy to enhance long-run growth
* **Tax spending rather than income**: To shift the balance of taxation away from taxes on income towards taxes on spending – this is because it is thought that taxes on income have a greater effect on work incentives
* **Equitable taxes**: To ensure taxes are applied equally and fairly to everyone. Equality is not always the same as fairness – see the notes below on the canons of taxation
* **Correct for market failure**: As with many other governments in other countries, the UK government believes in the use of taxes to make markets work better (including taking account of externalities) – this is an important microeconomic objective. The government is committed to using the tax system as an instrument of correcting for market failures.

**PRINCIPLES OF TAXATION: THE CLASSICAL PERSPECTIVE**

The paramount question, in regard to taxation, is; on what principles shall it be founded? Adam Smith, in his "Wealth of Nations," written almost a century ago, laid down four maxims, or principles, which have been so generally concurred in from that day to this, that, as J. Stuart Mill says, "they have become classic."

I. "The subjects of every state ought to contribute to the support of the government, as nearly as possible, **in proportion to their respective abilities**; that is, in proportion to the revenue they enjoy under the protection of the state. In the observation or neglect of this maxim consists what is called the **equality or inequality of taxation**."

II. "The tax which each individual is bound to pay ought to **be certain, and not arbitrary**. The time of payment, the manner of payment, the quantity to be paid, ought to be clear and plain to the contributor, and every other person."

(a) "Certain, and not arbitrary." By this, Dr. Smith evidently meant that the taxes should be assessed by competent authority, and upon fixed and well-known principles'. In many countries, taxes have been, and in some are still, farmed out in gross to a publican, or tax-gatherer, who, under the authority of government, imposes such sums as he pleases to exact.

(b) The time of payment should be "clear and plain." The citizen should know when he/she pays; be conscious of the fact that he is paying the government a certain sum at the time he actually does it. Otherwise, he will be liable to great impositions, in one form or another.

(c) "The manner and the quantity plain." This for the same reasons as just stated. He certainly ought to know how he pays, and how much.

(d) Should be known "to the contributor, and everybody else." In the method of taxation, the people are joint partners: what one does not pay, another must. If A pays less than he should, B and C must pay more; hence the right of every man to know, not only what he pays, but what his neighbor does. Otherwise, how can he judge whether he is overtaxed or not?

III.  " Every tax should be levied at the time, or in the manner, which is most likely to **be convenient to the contributor to pay it."**

As, for example, when the harvest has been secured, and is ready for market;

IV. ”Every tax ought to be so contrived as to take out and keep out of the pockets of the people as little as possible, over and above what it brings into the treasury of the state."

**THE PRINCIPLES OF TAXATION**

**Effectiveness**

Effectiveness is essentially the capacity of the tax base to achieve its basic objectives. Taken together with the rate these would be to generate revenues and set the desired economic incentives. Within a single country, or within the EU.

Incentives may increase competitiveness but in the international context this depends on interaction with other systems, for example incentives which reduce the effective rate in a source country have no effect if a parent is taxed on the residence basis and the rate in the country of residence is above that of the source country. Such incentives simply shift tax revenue between the source country and the resident country.

**Simplicity, Transparency, and Certainty**

The simpler a tax base is the lower the administrative or compliance costs should be, for both administrations and business. These costs are difficult to measure so international comparisons, measuring the incentive provided by a tax base which has 'low' costs against a 'high' cost are difficult. The rules must also be certain and clear which links in to the requirement for transparency. Certainty is desirable to assist business planning, but also to provide a degree of revenue certainty for administrations, for example if the rules governing loss-offset are unclear then neither business nor government can predict tax payments and revenues. The rules must also provide an appropriate level of protection against tax evasion and the unacceptable use of purely artificial tax avoidance schemes. Transitional costs of introducing a new tax base also need careful consideration.

**Consistency & coherence**

When two transactions have the same commercial result they should have the same tax result – i.e. commercial decisions on the structuring of transactions should not be distorted by taxation considerations, for example the finance leasing of plant should arguably produce the same post tax profits as the purchase of plant.

**Flexibility**

Markets and business practices change over time so the tax base should be responsive and be capable of change as well. This is particularly relevant for a CCCTB which it might be more difficult to 'change' than the existing national tax bases. However, too much flexibility can endanger certainty from a business perspective.

**Enforceability**

The rules of a tax base must be easy to enforce as an unenforceable system is unlikely to be either equitable or neutral.

**Vertical equity**

The burden of taxation should be shared in accordance with taxpayers' respective ability to pay, sometimes referred to as 'the ability to pay' principle. It is difficult to see how this principle (normally applied to personal taxation) could or should be applied to company taxation. However, the 'ability to pay' could be relevant when considering whether or not unrealized profits should be taxable. The concept that higher profits should be taxed at higher rates is not often applied to companies other than certain reliefs for small companies in some countries.

**Horizontal equity**

Taxpayers in the same economic circumstances should receive equivalent treatment. In the context of international company taxation equity relates mainly to the fair allocation of the tax base between states where international companies operate. Traditionally inter-country equity can be satisfied by

(i) Source country entitlement

(The source country has the prior right to tax profits earned within its jurisdiction) and

(ii) Non-discrimination

(Countries agree not to discriminate against foreign companies). In this way different companies operating in a particular country are treated in a similar manner.

**Efficiency (also described as neutrality, particularly in relation to different types of investment)**

Generally taxes should be neutral to ensure that investment decisions take into account the 'best' location from an economic perspective. This avoids 'locational inefficiency' whereby investments are not placed where the productivity of capital is highest. However, taxation policy may be used to correct 'market failures' whereby distortions or inefficiencies in a particular market economy can be 'corrected' by the use of specific tax incentives. Determining whether a tax policy is correcting a market failure, or is inefficient can be difficult.

**TYPES OF TAXES**

**Direct versus Indirect Taxation**

* **Direct taxes** – are paid directly to the Exchequer by the individual taxpayer – usually through “pay as you earn”. The same is true of corporation tax. Tax liability cannot be passed onto someone else
* **Indirect taxes** – include VAT and a range of excise duties on oil, tobacco, alcohol. The burden of an indirect tax can be passed on by the supplier to the final consumer – depending on the price elasticity of demand and supply for the product.

In the last twenty years there has been a shift towards indirect taxation – economists differ in their views about what is the optimum mix of taxation between indirect and direct taxes

|  |  |
| --- | --- |
| Arguments For Using Indirect Taxation | Arguments Against Using Indirect Taxation |
| * Changes in indirect taxes are more effective in changing the overall pattern of demand for particular goods and services i.e. in changing relative prices and thereby affecting consumer demand (e.g. an increase in the real duty on petrol) | * Many indirect taxes make the distribution of income more unequal (less equitable) because indirect taxes are more regressive than direct taxes |
| * They are a useful instrument in controlling and correcting for externalities – all governments have moved towards a more frequent use of indirect taxes as a means of making the polluter pay and “internalizing the external costs” of production and consumption | * Higher indirect taxes can cause cost-push inflation which can lead to a rise in inflation expectations |
| * Indirect taxes are less likely to distort the choices that people have to between work and leisure and therefore have less of a negative effect on work incentives. Higher indirect taxes allow a reduction in direct tax rates (e.g. lower starting rates of income tax) | * There is no hard evidence that cutting direct tax rates has much of an incentive effect on people’s decisions about whether or not to work. If indirect taxes are too high – this creates an incentive to avoid taxes through “boot-legging” – a good example of this would be attempts to evade the high levels of duty on cigarettes |
| * Indirect taxes can be changed more easily than direct taxes – this gives economic policy-makers more flexibility when setting fiscal policy. Direct taxes can only be changed once a year at Budget time | * Revenue from indirect taxes can be uncertain particularly when inflation is low or there is a recession causing a fall in consumer spending |
| * Indirect taxes are less easy to avoid by the final tax-payer who might be unaware of how much indirect tax they are paying | * There is a potential loss of economic welfare (taxes can create a deadweight loss of consumer and producers surplus) |
| * Indirect taxes provide an incentive to save (and thereby avoid the tax)- a higher level of savings might be used by the economy to finance a higher level of capital investment | * Higher indirect taxes affect households on lower incomes who are least able to save in the first place |
| * Indirect taxes leave people free to make a choice whereas direct taxes leave people with less of their gross income in their pockets | * Many people are unaware of how much they are paying in indirect taxes – this goes against one of the basic principles of a good tax system – namely that taxes should be transparent |

**FLAT RATE TAX**

A ‘flat tax’ means that everyone is taxed at just one rate. I.e. everyone pays the same percentage (%) tax on any income earned above the tax threshold (the tax-free allowance. A similar system is often used for corporate taxes – taxes on company profits and also on indirect taxes such as VAT.

**Why have flat rate taxes?**

Supply-side economists are often fans of flat rate taxes because they think that they will

* Help reduce red tape and reduce the resources wasted on tax forms, [chasing up non-payers](http://news.bbc.co.uk/1/hi/business/4763984.stm) and enforcing complex tax laws. This would reduce the money spent on administering the tax system.
* Reduce inequity (because there is the same tax rate for all) – and having a generous tax free allowance is good news for low income families, improving their incentives to earn extra income.
* Boost incentives for people to work, to save (e.g. for retirement) and for companies to use profits to invest - both of which could increase the country’s potential growth rate.
* Generate increased tax revenue – based on the idea that cutting tax rates can actually boost the supply-side so much that the government ends up with more tax revenue (Laffer Curve) coming in allowing it to finance increased spending on priority areas.
* A flat tax may make the economy more attractive to foreign investment. In a global economy in which investors can move freely across country borders, a simple fiscal system attracts inward investment.
* A lower level flat rate tax on savings will positively impact the household savings ratio and thereby have a positive impact on future economic growth. It can also help to provide the funds for future investment strengthening growth and raising living standards. Currently, income tax is considered to hamper saving and the introduction of a flat rate tax is expected increase the saving rate. The key reason for this is the double taxation of personal savings, firstly on income and secondly on investment income or, once on company profits then on dividends.

Arguments against

* Flat rate taxes are no longer progressive (at least as far as the 'marginal' rates are concerned) and so the distribution of income will become more unequal – certainly in the short and medium term.
* Flat rate taxes tend to favor the wealthy at the expense of the poor because the wealthy are no longer taxed at high rates on their savings, their dividend incomes and their inheritance wealth.
* Flat taxes can form part of a “race to the bottom” with governments competing with each other to offer the lowest rates of tax to entice inward investment and skilled workers. The result is a widening gap between the wealthy and the poor and less revenue for the government to commit to social welfare spending.
* There is no guarantee that people will look to work more if tax rates are lower, indeed some people may choose to work less because they can earn the same income from working fewer hours.
* There is no guarantee that businesses will engage in more investment and R&D if company taxes are lower – they may simply offer more in the way of dividends to their shareholders!

**STRUCTURES OF A TAX SYSTEM**

* **A tax is proportional.** Meaning the government takes an amount of money from a person which is in direct proportion to his income. Ex. out of Ben salary the government is deducting 10% for tax.
* **A tax is regressive.** Meaning that the government takes a larger percentage of a person’s income per tax, while he is receiving a lower income. Ex. Ben’s salary 10,000 Ksh and government is asking him to pay 15% of his salary for tax while Paul who earns Ksh. 15,000 per month pays tax at a rate of 10%.
* **A tax is progressive.** Meaning that the government takes a larger percentage of his salary for tax due to his high salary. Ex. Ben has a monthly income of 30,000 Ksh. and the governments deducted 20% of his salary for tax, while Paul who earns Ksh. 20,000 pays tax at a rate of 15%. The tax amount is proportionately equal to someone’s status in the society. A rich man should pay more than a poor man.

**INCIDENCE OF A TAX**

Incidence of a tax is an economic term for the division of a tax burden between buyers and sellers. Tax incidence is the study of who bears the economic burden of a tax. It begins with the very basic insight that the person who has the legal obligation to make a tax payment may not be the person whose welfare is reduced by the presence of the tax.

Tax incidence is related to the price elasticity of supply and demand. When supply is more elastic than demand, the tax burden falls on the buyers. If demand is more elastic than supply, producers will bear the cost of the tax.

**Statutory Incidence**

The statutory incidence of a tax refers to the distribution of tax payments based on the legal obligation to remit taxes to the government.

**Economic incidence**

Economists focus on the economic incidence, which measures the changes in economic welfare in society arising from a tax. The standard view of the economic burden of the income tax in Kenya is that it is borne entirely by employees. Economic incidence differs from the statutory incidence because of changes in behavior and consequent changes in equilibrium prices. Consumers buy less of a taxed product, so firms produce less and buy fewer inputs – which change the net price of each input. Thus, the job of the incidence analyst is to determine how those other prices change, and how those changes affect different kinds of individuals.

**ECONOMIC EFFECTS OF A TAX**

The effects of a tax on demand and supply depend on the elasticity of demand. A tax shifts the supply curve to the left. However, the impact of a tax depends on the elasticity of demand. If demand is inelastic, a higher tax will cause only a small fall in demand. Most of the tax will be passed onto consumers. When demand is inelastic, governments will see a significant increase in their tax revenue. If demand is elastic, demand will fall more. The tax will be more effective in reducing demand, but less effective in raising revenue for the government

The diagrams below illustrate the effects of imposing a tax for a good/ service with inelastic, and another with elastic demand.

**TAX BUOYANCY**

As GDP rises, do tax revenues rise at the same pace? To answer this question it is useful to measure the buoyancy. Tax (or revenue) buoyancy is defined as

*TB = % Change in Revenue / % change in tax base*

Using numbers for the revenue and base actually observed. Typically the base is taken to be GDP, although other bases are possible (e.g. consumption as the base for sales taxes, imports as the base for tariffs, etc.). The revenue could refer to total tax revenue, or to revenue from any given tax.

**TAX BASE**

The assessed value of a set of assets, investments or income streams that is subject to taxation, or the assessed value of a single asset that is subject to taxation. Anything that can be taxed has a tax base. It is the [measure](http://www.businessdictionary.com/definition/measure.html) upon which the [assessment](http://www.businessdictionary.com/definition/assessment.html) or determination of [tax liability](http://www.businessdictionary.com/definition/tax-liability.html) is based. For example, [taxable income](http://www.businessdictionary.com/definition/taxable-income.html) is the [tax](http://www.investorwords.com/4879/tax.html) base for [income tax](http://www.businessdictionary.com/definition/income-tax.html) and [assessed value](http://www.businessdictionary.com/definition/assessed-value.html) is the tax base for [property](http://www.businessdictionary.com/definition/property.html) [taxes](http://www.investorwords.com/5972/taxes.html).

The tax base may refer to that of an individual asset, such as the tax base of a house, or a pool of assets, such as the tax base of all houses in a city. For example, the property tax base of a house is its value. The property tax base of a city is the collective value of all taxable real estate in the city.

**CLASSIFICATION OF TAXES**

1. **As to subject matter**
   * + Personal Income taxes (PAYE), Corporation tax.
     + Property Tax. (ex. Real estate tax)
     + Excise duty.
2. **As to who bears the burden**
   * + Direct Tax (example. Income Tax)
     + Indirect Tax (example. Buying of goods and services (VAT) )
3. **As to determination of account** 
   * + Specific Tax (example. Taxes on wines)
     + Ad Valorem Tax (example. Tax according to value such as Real Estate Tax.
4. **As to purpose** 
   * + General Tax (example Almost All Taxes)
     + Special Tax
5. **As to scope**
   * + National Tax
     + Local Tax

**SIGNIFICANCE/ PURPOSE OF TAXATION**

**Primary purpose:** generates funds or revenues use to defray expenses incurred by the government in promoting the general welfare of its citizenry.

**Other purposes:**

* + To equitably contribute to the wealth of the nation.
  + To protect new industries.
  + To protect local producers.

**DOUBLE TAXATION**

* **Direct Duplicate**

Elements:

* + Taxing twice
  + By the same taxing authority
  + Within the same taxing jurisdiction
  + For the same purpose
  + In the same taxable period
* **Indirect duplicate**
  + Indirect duplicate taxation, on the other hand, occurs when taxes on the property are not imposed by the same taxing authority. The local (County) and national governments impose taxes on the same property during one taxable period. This kind of imposition is legal.

**TAX EVASION VS TAX AVOIDANCE**

**FORMS OF ESCAPE FROM TAXATION**

1. **Shifting.** It is one way of passing the burden of tax from one person to another. Example Taxes paid by the manufacturer may be shifted to the consumer by adding the amount of the tax paid to price of the product.

*Kinds of Shifting*

* + - **Forward shifting**occurs when the burden of the tax is transferred from a factor of the production to the factor of distribution.
    - **Backward shifting** occurs when the burden of tax is transferred from the consumer to the producer or manufacturer.
    - **Onward shifting**occurs when tax is shifted to two or more times either forward or backward.

1. **Capitalization.** This refers to the reduction in the price of the tax object to the capitalized value of future taxes which the purchaser expects to be called upon to pay. Ex: A reduction made by the seller on the price of the real estate, in anticipation of the future tax to be shouldered by the future buyer.
2. **Transformation** occurs when the manufacturer or producer upon whom the tax has been imposed pays the tax and endeavor to “recoup” (*make up for*) himself by improving his process of production
3. **Tax Evasion** is the practice by the taxpayer through *illegal or fraudulent* means to defeat or lessen the amount for tax. This is also known as “tax dodging.”
4. **Tax Avoidance** is the exploitation by the taxpayer of legally permissible methods in order to avoid or reduce tax liability. This is also known as “tax minimization.”
5. **Tax Exemption** is the grant of immunity or freedom from a financial charge or obligation or burden to which others are subjected.

***Grounds for tax exemption:***

* Contract, wherein the government is the contracting party.
* Public policy
* Reciprocity

***Entities exempt from taxation***

* Religious Institutions.
* Charitable Institutions.
* Non-Profit, Non-Stock Educational Institutions.
* Government Institutions.
* NGOs and CBOs devoted wholly to community welfare.
* Foundations devoted wholly to community welfare.
* Foreign Diplomats.

**VALUE ADDED TAX (VAT)**

**Introduction to VAT**

A **value added tax** (**VAT**) is a form of [consumption tax](http://en.wikipedia.org/wiki/Consumption_tax). It is a tax on the "value added" to a product or material, from an accounting view, at each stage of its manufacture or distribution. The "value added" to a product by a business is the sale price charged to its customer, minus the cost of materials and other taxable inputs. A VAT is like a [sales tax](http://en.wikipedia.org/wiki/Sales_tax) in that ultimately only the end consumer is taxed. It differs from the sales tax in that, with the latter, the tax is collected and remitted to the government only once, at the point of purchase by the end consumer. With the VAT, collections, remittances to the government, and credits for taxes already paid occur each time a business in the supply chain purchases products from another business. The reason businesses end up paying no tax is that at the time they sell the product, they receive a credit for all the tax they have paid to suppliers.

[Maurice Lauré](http://en.wikipedia.org/wiki/Maurice_Laur%C3%A9), Joint Director of the French Tax Authority, the [Direction générale des impôts](http://fr.wikipedia.org/wiki/Direction_g%C3%A9n%C3%A9rale_des_imp%C3%B4ts), was first to introduce VAT on April 10, 1954, although German industrialist [Dr. Wilhelm von Siemens](http://en.wikipedia.org/wiki/Wilhelm_von_Siemens) proposed the concept in 1918. Initially directed at large businesses, it was extended over time to include all business sectors. In [France](http://en.wikipedia.org/wiki/France), it is the most important source of state finance, accounting for nearly 50% of state revenues.

Personal end-consumers of products and services cannot recover VAT on purchases, but businesses are able to recover VAT (input tax) on the products and services that they buy in order to produce further goods or services that will be sold to yet another business in the supply chain or directly to a final consumer. In this way, the total tax levied at each stage in the economic chain of supply is a constant fraction of the value added by a business to its products, and most of the cost of collecting the tax is borne by business, rather than by the state. Value Added Taxes were introduced in part because they create stronger incentives to collect than a sales tax does. Both types of consumption tax create an incentive by end consumers to avoid or evade the tax. But the sales tax offers the buyer a mechanism to avoid or evade the tax- persuade the seller that he is not really an end consumer, and therefore the seller is not legally required to collect it. The burden of determining whether the buyer's motivation is to consume or re-sell is on the seller, but the seller has no direct economic incentive to the seller to collect it. The VAT approach gives sellers a direct financial stake in collecting the tax, and eliminates the problematic decision by the seller about whether the buyer is or is not an end consumer.

**COMPARISON: VAT AND SALES TAX**

Value added tax (VAT) avoids the cascade effect of sales tax by taxing only the value added at each stage of production. For this reason, throughout the world, VAT has been gaining favor over traditional sales taxes. In principle, VAT applies to all provisions of goods and services. VAT is assessed and collected on the value of goods or services that have been provided every time there is a transaction (sale/purchase). The seller charges VAT to the buyer, and the seller pays this VAT to the government. If, however, the purchaser is not an end user, but the goods or services purchased are costs to its business, the tax it has paid for such purchases can be deducted from the tax it charges to its customers. The government only receives the difference; in other words, it is paid tax on the [gross margin](http://en.wikipedia.org/wiki/Gross_margin) of each transaction, by each participant in the sales chain.

In many developing countries such as Kenya, VAT is key revenue sources as high unemployment and low per capita income render other income sources inadequate. However, there is strong opposition to this by many sub-national governments as it leads to an overall reduction in the revenue they collect as well as a loss o f some autonomy.

Sales tax is normally charged on end users (consumers). The VAT mechanism means that the end-user tax is the same as it would be with a sales tax. The main difference is the extra accounting required by those in the middle of the supply chain; this disadvantage of VAT is balanced by application of the same tax to each member of the production chain regardless of its position in it and the position of its customers, reducing the effort required to check and certify their status. When the VAT system has few, if any, exemptions such as with [GST (General Sales Tax) in New Zealand](http://en.wikipedia.org/wiki/Goods_and_Services_Tax_(New_Zealand)), payment of VAT is even simpler.

A general economic idea is that if sales taxes exceed 10%, people start engaging in widespread tax evading activity (like buying over the Internet, pretending to be a business, buying at wholesale, buying products through an employer etc.) On the other hand, total VAT rates can rise above 10% without widespread evasion because of the novel collection mechanism.[[citation needed](http://en.wikipedia.org/wiki/Wikipedia:Citation_needed)] However, because of its particular mechanism of collection, VAT becomes quite easily the target of specific frauds like [**carousel fraud**](http://en.wikipedia.org/wiki/Missing_trader_fraud), which can be very expensive in terms of loss of tax incomes for states.

### Principle of VAT

### The standard way to implement a VAT involves assuming a business owes some percentage on the price of the product minus all taxes previously paid on the good. If VAT rates were 10%, an orange juice maker would pay 10% of the Ksh. 5 per litre price (Ksh. 0.50) minus taxes previously paid by the orange farmer (maybe Ksh. 0.20). In this example, the orange juice maker would have a Ksh. 0.30 tax liability. Each business has a strong incentive for its suppliers to pay their taxes, allowing VAT rates to be higher with less tax evasion than a retail sales tax.

*Example: sales tax vs. VAT*

Consider the manufacture and sale of any item, which in this case we will call a [widget](http://en.wikipedia.org/wiki/Placeholder_name). In what follows, the term "gross margin" is used rather than "profit". Profit is only what is left after paying other costs, such as rent and personnel.

#### Without any tax

* A widget [manufacturer](http://en.wikipedia.org/wiki/Manufacturing) spends Ksh.1.00 on [raw materials](http://en.wikipedia.org/wiki/Raw_material) and uses them to make a widget.
* The widget is sold [wholesale](http://en.wikipedia.org/wiki/Wholesale) to a widget [retailer](http://en.wikipedia.org/wiki/Retailing) for Ksh.1.20, making a gross margin of Ksh.0.20.
* The widget retailer then sells the widget to a widget [consumer](http://en.wikipedia.org/wiki/Consumer) for Ksh.1.50, making a gross margin of Ksh.0.30.

#### With a sales tax (e.g. Canadian provincial and U.S. state)

With a 10% sales tax:-

* The manufacturer pays Ksh.1.00 for the raw materials, certifying it is not a final consumer.
* The manufacturer charges the retailer Ksh.1.20, checking that the retailer is not a consumer, leaving the same gross margin of Ksh.0.20.
* The retailer charges the consumer Ksh.1.65 (Ksh.1.50 + (Ksh.1.50 x 10%)) and pays the government Ksh.0.15, leaving the gross margin of Ksh.0.30.

So the consumer has paid 10% (Ksh.0.15) extra, compared to the no taxation scheme, and the government has collected this amount in taxation. The retailers have not paid any tax directly (it is the consumer who has paid the tax), but the retailer has to do the paperwork in order to correctly pass on to the government the sales tax it has collected. Suppliers and manufacturers only have the administrative burden of supplying correct certifications, and checking that their customers (retailers) aren't consumers.

#### With a value added tax (e.g Kenya or the U.K. VAT)

With a 10% VAT:

* The manufacturer pays Ksh.1.10 (Ksh.1 + (Ksh.1 x 10%)) for the raw materials, and the seller of the raw materials pays the government Ksh.0.10.
* The manufacturer charges the retailer Ksh.1.32 (Ksh.1.20 + (Ksh.1.20 x 10%)) and pays the government Ksh.0.02 (Ksh.0.12 minus Ksh.0.10), leaving the same gross margin of Ksh.0.20. (Ksh.1.32 - Ksh.0.02 - Ksh.1.10 = Ksh.0.20)
* The retailer charges the consumer Ksh.1.65 (Ksh.1.50 + (Ksh.1.50 x 10%)) and pays the government Ksh.0.03 (Ksh.0.15 minus Ksh.0.12), leaving the same gross margin of Ksh.0.30 (Ksh.1.65 - Ksh.0.03 - Ksh.1.32 = Ksh.0.30).

With VAT, the consumer has paid, and the government received, the same as with sales tax. The businesses have not incurred any tax themselves. Their obligation is limited to assuming the necessary paperwork in order to pass on to the government the difference between what they collect in VAT (output tax) and what they spend in VAT (input tax). However they are freed from any obligation to request certifications from purchasers who are not end users, and of providing such certifications to their suppliers.

**CRITICISM OF VAT**

The "value-added tax" has been criticized as the burden of it relies on personal end-consumers of products. Some critics consider it to be a tax, meaning the poor pay more, as a percentage of their income, than the rich. Defenders argue that excising taxation through income is an arbitrary standard, and that the value-added tax is in fact a [proportional tax](http://en.wikipedia.org/wiki/Proportional_tax) in that people with higher income pay more at the same rate that they consume more. The effective progressiveness or regressiveness of a VAT system can also be affected when different classes of goods are taxed at different rates. To maintain the progressive nature of total taxes on individuals, countries implementing VAT have reduced income tax on lower income-earners, as well as instituted direct transfer payments to lower-income groups, resulting in lower tax burdens on the poor.

Revenues from a value added tax are frequently lower than expected because they are difficult and costly to administer and collect. In many countries, however, where collection of personal income taxes and corporate profit taxes has been historically weak, VAT collection has been more successful than other types of taxes. VAT has become more important in many jurisdictions as tariff levels have fallen worldwide due to trade liberalization, as VAT has essentially replaced lost tariff revenues. Whether the costs and distortions of value added taxes are lower than the economic inefficiencies and enforcement issues (e.g. smuggling) from high import tariffs is debated, but theory suggests value added taxes are far more efficient.

Certain industries (small-scale services, for example) tend to have more VAT avoidance, particularly where cash transactions predominate, and VAT may be criticized for encouraging this. From the perspective of government, however, VAT may be preferable because it captures at least some of the value-added. For example, a carpenter may offer to provide services *for cash* (i.e. without a receipt, and without VAT) to a homeowner, who usually cannot claim input VAT back. The homeowner will hence bear lower costs and the carpenter may be able to avoid other taxes (profit or payroll taxes). The government, however, may still receive VAT for various other inputs (lumber, paint, gasoline, tools, etc.) sold to the carpenter, who would be unable to reclaim the VAT on these inputs (unless of course the carpenter also has at least some jobs done with receipt, and claims all purchased inputs to go to those jobs). While the total tax receipts may be lower *compared to full compliance,* it may not be lower than under other feasible taxation systems.

**Introduction to VAT in Kenya**

Value added tax is charged on the supply of taxable goods or services made or provided in Kenya by a taxable person in the course of or in furtherance of any business carried on by that person and on the importation of goods and services into Kenya.

A taxable person is one who makes or intends to make taxable supplies while he is registered or required to be registered under the VAT Act.

The liability to VAT vests with the person making the taxable supply of goods or services. However, the liability to VAT in respect of imported taxable goods or services vests with the recipient of the service.

In the case of imported services, where the supplier of the services is normally resident outside Kenya, the Commissioner may appoint a resident person to collect the tax payable on the service and remit it to the Department.

VAT on the importation of goods into Kenya is payable at the point of customs entry by the importer.

Any goods which are not exempt or zero rated are deemed to be taxable at the standard rate of 16%.

Services shall deemed to have been supplied in Kenya where

(i) The supplier has established his business or has a fixed physical establishment in Kenya; or

(ii) The services are physically performed in Kenya; or

(iii) If in connection with immovable property, the place where the property is situated is in Kenya; or

(iv) If the service is in connection with receiving a signal or a telephone, television, radio or other communication service, the person receiving the signal/service is in Kenya.

Where transportation ends outside the country, the transport services shall be deemed to have been supplied outside Kenya.VAT is charged when a VAT-registered business sells to either another business or to a non-business customer. When a VAT-registered business buys goods or services they can generally reclaim the VAT they have paid.

There are three rates of VAT, depending on the goods or services the business provides. The rates are:

* standard - 16 per cent
* Exempted - 0 per cent (with no claim for input tax)
* Zero rated - 0 per cent

**The difference between exempt and zero-rated**

* If you sell zero-rated goods or services, they count as taxable supplies, but you don't add any VAT to your selling price because the VAT rate is 0 per cent.
* If you sell goods or services that are exempt, you don't charge any VAT and they're not taxable supplies. This means that you won't normally be able to reclaim any of the VAT on your expenses.
* Generally, you can't register for VAT or reclaim the VAT on your purchases if you sell **only** exempt goods or services. If you sell **some** exempt goods or services you may not be able to reclaim the VAT on all of your purchases.

**Registration and deregistration**

Compulsory registration applies to any person who in the course of his business has supplied taxable goods or taxable services or expects to supply taxable goods or taxable services, or both, the value of which is Ksh. 5,000,000 or more in a period of twelve months. Voluntary registration is permissible under the law but is granted at the discretion of the Commissioner.

If the value of taxable turnover does not exceed five million shillings in any period of twelve months, a registered person may apply for de-registration and will be subject to turnover tax under the Income Tax Act, upon notifying the Commissioner. A person applying for de-registration should notify the Commissioner of the value of his supplies in the relevant periods and the description and value of taxable materials and other goods in stock.

**Record Keeping**

4.0.1 Paragraph 7 of the VAT Regulations and the Seventh Schedule to the Act prescribe the records to be kept, which include:

• Copies of all invoices issued in serial number order;

• A VAT account showing totals of the output tax and input tax in each period and the tax payable or refundable;

• Copies of all credit and debit notes issued, in chronological order;

• purchase invoices, copies of customs entries, receipts for the payment of customs duty or tax, credit and debit notes received, all to be filed chronologically;

• Details of the amounts of tax charged on each supply made or received;

• Totals of the output and the input tax in each period and a net of the tax payable or the excess input tax at the end of each period;

• Details of goods manufactured and delivered from the factory;

• Details of each supply of goods and services from the business premises;

• Copies of stock records kept in a chronological order.

**APPORTIONMENT OF INPUT TAX**

Where a taxable person makes both taxable and exempt supplies, then only part of the tax attributable to taxable supplies qualifies as input tax. Taxable supplies include zero-rated supplies. However, the Commissioner is empowered to determine that tax relating to both taxable and exempt supplies shall be deductible if the tax attributable to the exempt supplies does not exceed a specified proportion of the whole tax. The specified proportion is currently set at **five per cent**.

Where VAT in respect of exempt supplies exceeds the above limit, then the registered person is required to apportion the VAT by securing a fair and reasonable attribution of tax to taxable supplies, upon receipt of the Commissioner’s approval of the attribution method.

The following method can be used to apportion tax without obtaining the approval of the Commissioner:

• Value of taxable supplies x Input tax = Deductible input tax

Value of total supplies

**Example 1: (NO APPORTIONMENT)**

Calculate the VAT payable/ refundable for the company with the transactions outlined below:

**Sales:**

Standard rate- Ksh. 7 million

Zero rate- Ksh. 10 million

Exempted rate- Ksh. 0.5 million

**Purchases:**

Standard rate Ksh. 3 million

Zero rate- Ksh. 12 million

Exempted rate - Ksh. 0.2 million

**EXAMPLE 2: (NO APPORTIONMENT)**

Calculate the VAT payable/ refundable for the company with the transactions outlined below:

**Purchases**

Standard rate, Ksh. 20 million

Zero rate, Ksh. 10 million

Exempted rate, Ksh. 0.1 Million

**Sales**

Standard rate, Ksh. 4 million

Zero rate, Ksh. 5 million.

Exempted rate, Ksh. 0.05 million.

**EXAMPLE 3: WITH APPORTIONMENT**

Consider the following purchases and sales made by X LTD.

**Sales:**

Standard rate- Ksh. 7 million

Zero rate- Ksh. 10 million

Exempted rate- Ksh. 10 million

**Purchases:**

Standard rate Ksh. 13 million

Zero rate- Ksh. 12 million

Exempted rate - Ksh. 0.2 million

Ksh. 25.2 million sales for the period, Ksh. 5 Million related to goods that had been purchased at the exempt rate. Calculate the input tax applicable in this case and the total VAT payable/ due to/ from the government.

**CUSTOMS DUTY**

**Customs duty** is a kind of [indirect tax](http://en.wikipedia.org/wiki/Indirect_tax) which is realized on goods of international trade. In economic sense, it is also a kind of [consumption tax](http://en.wikipedia.org/wiki/Consumption_tax). A duty levied by the government in relation to imported items is referred to as *import duty*. In the same vein, a duty realized on export consignments is called *export duty*. *Tariff* which is actually a list of commodities along with the rate (amount) of Customs duty is popularly understood as Customs duty.

Calculation of Customs duty depends on the determination of what is called **assessable value** in case of items for which the duty is levied ad valorem. This is often the [transaction value](http://en.wikipedia.org/w/index.php?title=Transaction_value&action=edit&redlink=1) unless the Customs officers determine assessable value in accordance with [**Brussels definition**](http://en.wikipedia.org/w/index.php?title=Brussels_definition&action=edit&redlink=1)**.** However, for certain items like petroleum and alcohol, Customs duty is realized at a specific rate applied to the volume of the import or export consignments.

For the purpose of assessment of Customs duty, products are given an identification code that has come to be known as the [Harmonized System](http://en.wikipedia.org/wiki/Harmonized_System) code. This code has been evolved and assigned by the [World Customs Organization](http://en.wikipedia.org/wiki/World_Customs_Organization) based in Brussels. H. S. Code may be from four to ten digits. For example 17.03 is the H. S. Code for *molasses from the extraction or refining of sugar*. However, within 17.03, the number 17.03.90 stands for "Molasses (Excluding Cane Molasses)".

Introduction of H. S. Code in 1990s has largely replaced what used to be known as SITC or Standard International Trade Classification, though SITC remains in use for statistical purposes. In drawing up the national tariff, the revenue department often specifies the rate of Customs duty with reference to the H. S. Code of the product. In some countries and customs unions, 6-digit HS codes are locally extended to 8 digits or 10 digits for further tariff discrimination.

## CUSTOMS DEPARTMENT

## The national authority that is entrusted the task of realizing taxes on international trade is often referred to as Customs department. Normally the Customs department operates under a national law and is authorized to examine the cargo in order to ascertain actual description, specification volume or quantity, so that the assessable value and the rate of duty may be correctly determined and applied.

## EVASION OF CUSTOMS DUTY

Evasion of Customs Duties takes place mainly in two ways. In one, the trader under-declares the value so that that the assessable value is lower than actual. In a similar vein, a trader can evade Customs duty by understatement of quantity or volume of the product of trade. Evasion of Customs duty may take place without or in collaboration of Customs officials. Evasion of customs duty does not necessarily constitute [smuggling](http://en.wikipedia.org/wiki/Smuggling).

## DUTY-FREE GOODS

Duty-free is the term that is often used to describe goods bought at [ports](http://en.wikipedia.org/wiki/Port) and [airports](http://en.wikipedia.org/wiki/Airport) that do not attract the usual government taxes and customs duties. Some countries impose [allowances](http://en.wikipedia.org/wiki/Allowance) in order to restrict the number of Duty-free items that one person can [import](http://en.wikipedia.org/wiki/Import) into the country. These restrictions often apply to [tobacco](http://en.wikipedia.org/wiki/Tobacco), [wine](http://en.wikipedia.org/wiki/Wine), [spirits](http://en.wikipedia.org/wiki/Distilled_beverage), [eau de toilette](http://en.wikipedia.org/wiki/Eau_de_toilette), [gifts](http://en.wikipedia.org/wiki/Gifts) and [souvenirs](http://en.wikipedia.org/wiki/Souvenir). Often foreign [diplomats](http://en.wikipedia.org/wiki/Diplomats) and [UN](http://en.wikipedia.org/wiki/UN) officials are entitled to Duty-free goods. Duty-free goods are imported and stocked in what is called [**Bonded warehouse**](http://en.wikipedia.org/wiki/Bonded_warehouse).

**CUSTOMS DUTY IN KENYA**

The Customs Services Department (previously known as Customs and Excise Department) of the Kenya Revenue Authority was established by an Act of Parliament in 1978. It is the largest of the four revenue departments in terms of manpower, revenue collection and countrywide operational network. The primary function of the Department is to collect and account for import duty and VAT on imports. Other taxes collected by the Department on an agency basis include:

* Petroleum Development Levy
* Sugar Levy
* Road Maintenance Levy
* Import Declaration Fee (IDF)
* Road Transit Toll
* Directorate of Civil Aviation Fees
* Air Passenger Service Charge
* KAA Concession Fees
* Fees on Motor Vehicle permits

Apart from its fiscal responsibilities, the Customs Services Department is responsible for facilitation of legitimate trade; and protection of society from illegal entry and exit of prohibited goods. Prohibited goods include:

1. All goods the importation of which is for the time being prohibited under this Act, or by any written law for the time being in force in the Partner State.
2. False money and counterfeit currency notes and coins and any money not being of the established standard in weight or fineness.
3. Pornographic materials in all kinds of media, indecent or obscene, printed paintings, books, cards, lithographs or other engravings, and any other indecent or obscene articles.
4. Matches in the manufacture of which white phosphorous has been employed.
5. Any article made without proper authority with the Armorial Ensigns or Court of Arms of a Partner State or having such Ensigns or Arms so closely resembling them as to be calculated to deceive.
6. E.t.c. refer to KRA website at <http://www.kra.go.ke/customs/customsrestrictedgoods.html>

Restricted goods include

1. All goods the importation of which is for the time being regulated under this Act by any written law for the time being in force in the Partner State.
2. Postal franking machines except and in accordance with the terms of a written permit granted by a competent authority of the Partner State.
3. Traps capable of killing or capturing any game animal except and in accordance with the terms of a written permit granted by the Partner State.
4. Unwrought precious metals and precious stones.
5. Arms and ammunition specified under Chapter 93 of the Customs Nomenclature.
6. Ossein and bones treated with acid.
7. Other bones and horn – cores, unworked defatted, simply prepared (but not cut to shape) degelatinized, powder and waste of these products.
8. Ivory, elephant unworked or simply prepared but not cut to shape.
9. Teeth, hippopotamus, unworked or simply prepared but not cut to shape.
10. Horn, rhinoceros, unworked or simply prepared but not cut to shape
11. Other ivory unworked or simply prepared but cut to shape.
12. Ivory powder and waste.
13. Tortoise shell, whalebone and whalebone hair, horns, antlers, hoovers, nail, claws and beaks, unworked or simply prepared but not cut to shape, powder and waste of these products.

The Department is headed by the Commissioner of Customs Services Department deputized by the Senior Deputy Commissioner.

Imports from certain countries are given preferential tariff treatment in accordance with requirements of the regional, unilateral and multilateral trade protocols where Kenya is a signatory.  It specifically covers certificates of origin for the: COMESA region, European Union, United States under the AGOA programme and the various GSP schemes.

**COMESA**         Common Market for Eastern and Southern Africa   
**GSP**                 Generalized System of Preferences  
**AGOA**               African Growth and Opportunity Act  
**EUR 1**             Export Certificate for the European Union  
**ACP**                 African Caribbean and Pacific countries  
**EU** European Union  
**ROO**                 Rules of Origin  
**CIF**                  Cost Insurance and Freight

**CUSTOMS IN KENYA: COMMON QUESTIONS ANSWERED**

Q1. **What are the procedures and the requirements for importation into Kenya and clearance through Customs?**

To import any commodity into Kenya, an importer will have to enlist the services of a clearing agent who will process the import documentation through Kenya Customs electronically on the Simba 2005 system and clear the goods on your behalf.  
              
An import declaration fee (IDF) of 2.25% of the CIF Value subject to a minimum of Ksh. 5,000.00 is payable.

Customs will assess duty payable depending on the value of the item(s) and the duty rate applicable. The East African Community Common External Tariff lays out the duty rates of imported items.

Q2. **What is the maximum age of second hand motor vehicles allowed into the country?**

Motor vehicles of over 8 years old are not allowed into Kenya as per the KS 1515:2000 quality standard by the Kenya Bureau of Standards. Kenya Customs enforces this requirement. This year (2010), KRA is allowing vehicles manufactured in the year 2001 and thereafter.

Q3.**How much duty can I expect to pay on importation of a second hand motor vehicle?**

The duty payable on the importation of a motor vehicle is as follows:

* + **Import Duty:** 25% of the CIF value of the vehicle
  + **Excise Duty**: 20% of the (CIF value + Import Duty)
  + **VAT:** 16% of the (CIF value + Import Duty + Excise Duty)
  + **IDF:** 2.25% of the CIF value or Ksh. 5,000, whichever is higher, is payable.

CIF – This is the customs value of the vehicle i.e. the Cost, Insurance & Freight paid for the vehicle. The CIF value of the vehicle is also deduced from the Current Retail Selling Price (CRSP) of the vehicle

Q4. **What are the requirements to enable me travel across Kenyan borders by road with a personal car?**

For Kenyan residents traveling with a vehicle registered in Kenya, you will have two options;

1. Deposit your logbook with Customs at the point of exit or border and collect it upon re-entry into the country.
2. Alternatively, you could deposit your logbook with Customs - Motor Vehicle Valuation. For foreigners, a carnet de passage has to be obtained. This document is issued by the Automobile Association (AA) office in any country.

Q5. **I am a Kenyan studying abroad and set to come back home soon, what am I entitled to bring into Kenya duty free?**

You are allowed, among other items, one motor vehicle (excluding buses and mini buses) into the country duty free subject to the following conditions:

1. You must have resided outside Kenya for at least two years during which period you should not have visited Kenya for an aggregate of more than 90 days.
2. You must have personally owned and used the motor vehicle for at least twelve months.
3. The motor vehicle must not be older than 8 years.
4. You must have attained the age of eighteen years.
5. You must not have been granted a similar exemption previously.

Other items that may be exempted when imported as baggage by a returning resident are:

* Wearing apparel
* Personal and household effects which were in his personal or household use in his former place of residence

Q6. **What items are exempt from duty upon importation?**

The [Fifth Schedule](http://www.revenue.go.ke/customs/pdf/Fifth_Schedule_Exemptions.pdf) to the East African Community Customs Management Act 2004 lays out the Exemptions Regime;

Part A – Specific Exemptions ‘Privileged Persons and Institutions’

Part B – General Exemptions ‘Exempt Goods’

Q7. **What duties are levied on computers and books?**

New computers, computer printers and parts only attract Import Declaration Fees of 2.25% of cost,(CIF).However, used computers attract excise duty at the rate of 25%,and Import Declaration Fees of 2025% of cost,(CIF). Books do not attract import duty and VAT. However there is an Import Declaration Fees of 2.25% of cost (CIF)

Q8. **Are donations or gifts liable to duty?**

Duty is payable on donations or gifts at the rate applicable under East Africa Community Common External Tariff, unless such goods do not attract duty in the first place. However, items which are exempted from duties are laid out in the Fifth Schedule of East Africa Community Customs Management Act.2004.

Q9. **Is filming and photography equipment temporarily brought into Kenya exempted from duty?**

Filming and photography equipment may be allowed into the country on a temporary basis upon clearance through the Customs Simba 2005 System. Such importation is not subject to Import Declaration Form (IDF). However, a security bond has to be furnished with the undertaking that the equipment will be exported within such period, not exceeding twelve months from the date of importation. A non refundable deposit of 1% of the value of the goods or Ksh.30, 000, whichever is higher, is payable.

**EXCISE DUTY**

An excise or excise tax (sometimes called a [duty](http://en.wikipedia.org/wiki/Duty_%28economics%29) of excise or a special tax) may be defined broadly as an inland [tax](http://en.wikipedia.org/wiki/Tax) on the production for sale, or sale, of **specific** [**goods**](http://en.wikipedia.org/wiki/Goods_%28economics%29), or narrowly as a tax on a good produced for sale, or sold, within the country. Excises are distinguished from [customs duties](http://en.wikipedia.org/wiki/Customs), which are taxes on importation. Excises, whether broadly defined or narrowly defined, are inland taxes, whereas customs duties are border taxes.

An excise is an [indirect tax](http://en.wikipedia.org/wiki/Indirect_tax), meaning that the producer or seller who pays the tax to the government is expected to try to recover the tax by raising the price paid by the buyer (that is, to shift or pass on the tax). Excises are typically imposed in addition to another indirect tax such as a [sales tax](http://en.wikipedia.org/wiki/Sales_tax) or [VAT](http://en.wikipedia.org/wiki/Value_added_tax). In common terminology (but not necessarily in law) an excise is distinguished from a sales tax or VAT in three ways:

* 1. an excise typically applies to a narrower range of products;
  2. an excise is typically heavier, accounting for higher fractions (sometimes half or more) of the retail prices of the targeted products; and
  3. an excise is typically specific (so much per unit of measure; e.g. so many cents per gallon), whereas a sales tax or VAT is [ad valorem](http://en.wikipedia.org/wiki/Ad_valorem_tax), i.e. proportional to value (a percentage of the price in the case of a sales tax, or of value added in the case of a VAT).

Typical examples of excise duties are taxes on [gasoline](http://en.wikipedia.org/wiki/Gasoline) and other fuels, and taxes on [tobacco](http://en.wikipedia.org/wiki/Tobacco) and [alcohol](http://en.wikipedia.org/wiki/Alcohol) (sometimes referred to as [sin tax](http://en.wikipedia.org/wiki/Sin_tax))

Excise tax is notable for the vagueness of its definition. According to the [New Oxford English Dictionary](http://en.wikipedia.org/wiki/Oxford_English_Dictionary), an excise is "a tax levied on certain goods and commodities produced or sold within a country and on licenses granted for certain activities". The formula "produced or sold" is applicable to both domestic and foreign products. But the word "certain" is not further explained in the definition.

**PURPOSE OF EXCISE DUTY**

In defense of excises on strong drink, [Adam Smith](http://en.wikipedia.org/wiki/Adam_Smith) wrote: "It has for some time past been the policy of Great Britain to discourage the consumption of spirituous liquors, on account of their supposed tendency to ruin the health and to corrupt the morals of the common people."[Samuel Johnson](http://en.wikipedia.org/wiki/Samuel_Johnson) was less flattering in his 1755 dictionary: "EXCI'SE. *n.s* ... A hateful tax levied upon commodities, and adjudged not by the common judges of property, but wretches hired by those to whom excise is paid."

Deducing from the types of goods, [services](http://en.wikipedia.org/wiki/Service_%28economics%29) and areas listed as excisable by many governments, and considering the thinkers' comments, a logical conclusion might be that excise duty was originally invented for some or all of the following reasons:

* **to protect people** –
  + from harming their health by abusing substances such as [tobacco](http://en.wikipedia.org/wiki/Tobacco) and [alcohol](http://en.wikipedia.org/wiki/Alcohol), thus making excise a kind of [sumptuary tax](http://en.wikipedia.org/wiki/Sumptuary_tax)
  + From harming themselves and others indirectly and [morally](http://en.wikipedia.org/wiki/Morality) by engaging in activities such as [gambling](http://en.wikipedia.org/wiki/Gambling) and [prostitution](http://en.wikipedia.org/wiki/Prostitution). (including [solicitation](http://en.wikipedia.org/wiki/Solicitation) and [pimping](http://en.wikipedia.org/wiki/Pimp)) – thus making it a type of [vice tax](http://en.wikipedia.org/wiki/Vice_tax) or [sin tax](http://en.wikipedia.org/wiki/Sin_tax)
  + From harming those around them and the general environment, both from overuse of the above-mentioned substances, and including curbing activities contributing to [pollution](http://en.wikipedia.org/wiki/Pollution) (hence the tax on hydrocarbon oil and of other environmental taxes, as in Kenya), or from harming the natural environment.
* **to provide monies needed** –
  + for the extra healthcare and other public expenditures which will be needed as a direct or indirect result of excisable activities, such as [lung cancer](http://en.wikipedia.org/wiki/Lung_cancer) from smoking or [road accidents](http://en.wikipedia.org/wiki/Traffic_collision) resulting from [drunk driving](http://en.wikipedia.org/wiki/Driving_under_the_influence).

**EXCISE DUTY IN KENYA**

Excise duty is a tax levied on certain goods and services made, imported, supplied and sold in the country. Like other taxes excise duties are levied with particular taxation and fiscal principles in mind including: raising government revenue and meeting socio-economic objectives.

The excise duty regime in Kenya is administered by the Kenya revenue authority under the auspices of the Customs and Excise Act. This Act prescribes the various licensing, administrative requirements regarding excise duties as well as the applicable tax rates. Excise taxes are levied on a wide range of goods and services and therefore affect the pockets of many Kenyans

Most countries that levy excise tax conventionally levy it (sin tax) on goods and services deemed to have injurious effects: the effects of alcohol abuse and tobacco use are well known as are those of excessive consumption of sugared soft drinks. Excise has also traditionally been levied on luxury items: cosmetics, perfumery and jewellery. In Kenya – for government revenue raising reasons – we have excise taxes charged on essential services such as mobile and wireless telephony and bottled mineral water.

**EXCISE DUTY VALUATION**

Excise duty is calculated on the basis of a product’s ex-factory price. This is the price excluding VAT and excise duty. VAT is calculated on cost plus excise duty – and also Customs duty if applicable.

**EXCISE DUTY RATES**

Excise duty rates applicable in Kenya are both ad valorem (tax based on the price or value of the tax base) and specific (tax based on the weight or size of the tax base). The ad valorem rates are: 10%; 20%; 25% and 120%. In Kenya excise duty is taxed on the following items:

* Alcohol – including beer, wines, spirits: Ksh.50-85 per liter
* Soft drinks, mineral water and juices: 10% or Ksh. 6 per liter
* Cigarettes and other tobacco products: Ksh.500-2,000 per mille
* Petroleum products: shs.3.7-19.8 per liter
* Cosmetics: 10%
* Vehicles: 20%
* Used motor vehicle spare parts: 20% or shs.10 per Kg.
* Jewellery and precious stones: 10%
* Casino and gambling services: 5%
* Mobile cellular and wireless services: 10%
* Plastic bags: 120%
* Used computers: 25%

**EXCISE DUTY LICENSING AND ADMINISTRATIVE OBLIGATIONS**

Manufacturers of excisable goods are required to be licensed with the commissioner of customs and excise. They are required to comply with various stringent excise control requirements such as stock records keeping and room marking. Excise duty refunds and rebates are available where excisable goods are exported.

**IMPACT ON BUSINESS AND PERSONAL EXPENDITURE**

The impact of excise duty cuts across business and personal expenditure increasing costs of purchases. This is exacerbated by the tax-on-tax nature of the subsequent levying of VAT on the same goods and services on which excise tax has been charged. For businesses this not only eats into the margins but also may dampen demand.

In sectors prone to non-compliant players, tax evasion causes a serious challenge for compliant businesses. There are arguments for and against the levying of this tax on one hand because of the distortions it causes and on the other the social impact of some of the products on which it is levied.

**TAXABLE INCOME**

**PAY AS YOU EARN (PAYE) IN KENYA**

The "Pay As You Earn" method of deducting income tax from salaries and wages applies to all income from any office or employment. Thus "Pay As You Earn" applies to weekly wages, monthly salaries, annual salaries, bonuses, commissions, directors' fees (whether the director is resident or non-resident) pensions paid to pensioners who reside in Kenya, where the amount from a registered pensions funds

Exceeds Ksh. 180,000 per annum, and any other income from an office or employment. The system applies to all cash emoluments and all credits in respect of emoluments to employees' accounts with their employers, no matter to what period they relate.

It includes the value of housing where this is supplied by the employer. It does not include earnings from "casual employment" which means any engagement with any one employer which is made for a period of less than one month, the emoluments of which are calculated by reference to the period of the engagement or shorter intervals. Regular part-time employees and regular casual employment where the employees are employed casually but regularly are not considered to be casual employees.

It is the employer's statutory duty to deduct income tax from the pay of his employees whether or not he has been specifically told to do so by KRA. If any employer fails to comply with this provisions which deal with the payment over of tax deducted and the accounting for it to the Commissioner, the Commissioner may by order impose a penalty equal to twenty five percent of the amount of tax involved or ten thousand shillings whichever is greater.

**DEFINITIONS OF TERMS USED**

**(a) Employer**

For "Pay As You Earn" purposes the term "employer" is to be taken, when necessary, to include:

(i) Any person having control of payment of remuneration;

(ii) Any agent, manager or other representative in Kenya of any employer who is outside Kenya;

(iii) Any paying officer of Government or other public authority;

(iv) Any trust or insurance company or other body or person paying pensions.

It may accordingly include the manager of a branch or farm as well as the main employer. The main employer must decide which offices, etc., are to be "pay point" (see below) and ensure that those in charge are adequately instructed in their duties under the scheme.

**(b) Employee**

This word is defined as inclusive of any holder of an appointment of office, whether public, private or calling, for which remuneration is payable. "Employee" should be read as including, for example, minister, chief, any public servant, company director (resident or non-resident), secretary, individuals working for any Religious Organization etc., in addition to those more commonly known as employees. It includes an employee who retires on pension and stays in Kenya where pensions received from a registered pension fund exceed Kshs. 15,000 per month (Kshs. 180,000 per annum).

**(c) Paying Point**

A "paying point" is the place at which remuneration is paid.

If a non-resident employer calculates remuneration abroad and remits the remuneration direct to the employee then such remuneration should be notified to the Department through the employer’s local **representative and P.A.Y.E. tax operated on the remuneration accordingly. Any cases of doubt should be** referred to the Domestic Taxes Office for advice.

**(d) Monthly Pay**

"Monthly pay" includes income in respect of any employment or service rendered, accrued in or derived from Kenya.

This will include:

* + 1. Wages, salary, leave pay, sick pay, payment in lieu of leave, directors' fees and other fees, overtime, commission, bonus, gratuity or pension whether payable monthly or at longer or shorter intervals.

(ii) Cash allowances, e.g. house or rent allowance, telephone allowance, round sum allowance etc.

* 1. The amount of any private expenditure of the employee paid by the employer otherwise than as a loan, e.g. house rent, grocery bills, electricity, water, telephone bills, school fees,
  2. Non-cash benefits when the aggregate value exceeds Kshs.3000 per month.
  3. The value of housing, where provided by the employer.

Any amount which is mere reimbursement of expenses of employment, e.g. subsistence allowance when on duty away from home, mileage allowance for use of employee's car or for traveling expenses incurred in the course of employment will be excluded. Such amounts must, however, be shown on any return of wages called for by the Domestic Taxes Office.