

Tax Non-Compliance Practices by Foreign Multinational Companies and the Efficacy of Tax Law Enforcement in Kenya

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Approval

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Abstract

This study explores the tax non-compliance practices employed by foreign multinationals that include transfer pricing (TP), use of tax havens and intercompany agreements. It analyses how these methods are used by foreign multinational companies specifically; Absa, Unilever, Coca-Cola, Safaricom and East Africa Breweries Limited, through legal means to achieve tax avoidance. Furthermore, the thesis examines the existing legislative framework on tax non-compliance by FMNCs operating in Kenya and evaluates the efficacy of the tax law enforcement framework in Kenya for addressing tax non-compliance practices. The statutes to be reviewed are the Constitution of Kenya, Income Tax Act, Income Tax (Transfer Pricing) Rules, Income Tax (Country-By-Country Reporting Standards for Multinational Enterprises) Regulations, Tax Procedures Act. It analyses other aspects of enforcement like capacity and gaps in the enforcement mechanisms. The study has demonstrated that there is a very basic understanding of non-compliance practices by respondents from the authority. However, in the data collection phase, the FMNC's declined the researcher's request for interviews after going through the interview questions. The researcher resorted to interview audit firms that carry out audits for the FMNC's. Information obtained enabled the completion of the thesis. The key finding is that FMNCs are not evading taxes but are involved in tax avoidance practices. This is done through exploitation of loopholes in the legislative framework to minimize taxes payable. This study concludes that the FMNCs under the study namely Absa, Unilever, Coca-Cola, Safaricom and East Africa Breweries Limited are not involved in tax non-compliance practices. The cases of transfer pricing by Unilever, export services by Coca-Cola were all cleared on appeal. Suggestions are made to strengthen legislation to include clear and upto date regulations to cope with emerging trends of TP and build capacity of the tax administration for better enforcement.

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List of Abbreviations

ADR – Alternative Dispute Resolution

BEPS – Base Erosion and Profit Shifting

CbC – Country-by-Country

CUP – Comparable Uncontrolled Price method

FMNCs – Foreign Multinational Companies

ITA – Income Tax Act Cap. 470 of the Laws of Kenya

KRA – Kenya Revenue Authority

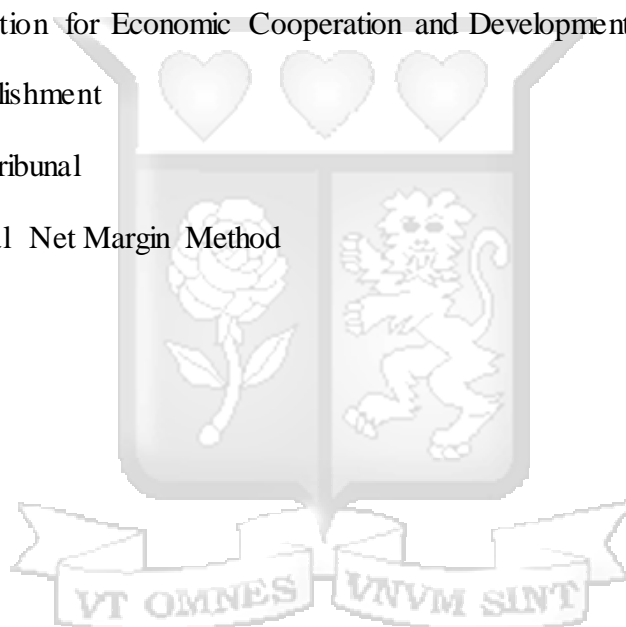
OECD – The Organisation for Economic Cooperation and Development

PE – Permanent Establishment

TAT – Tax Appeals Tribunal

TNMM – Transactional Net Margin Method

TP – Transfer Pricing

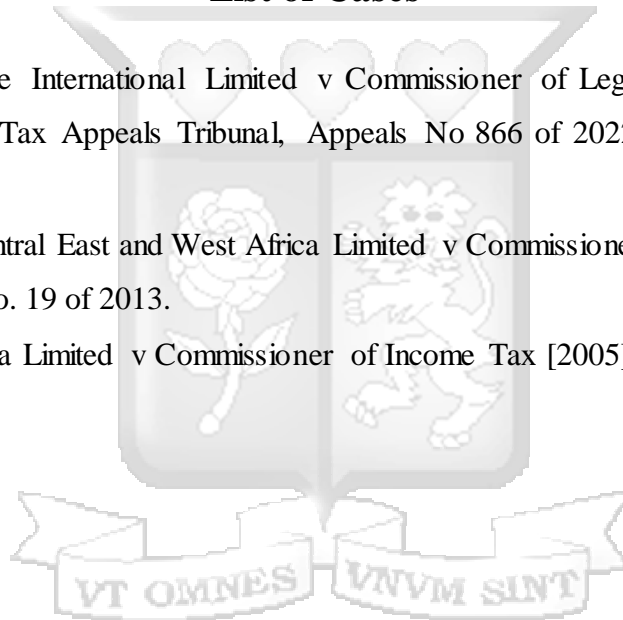


List of Legal Instruments

1. Constitution of Kenya, 2010
2. Income Tax Act Cap. 470 of the Laws of Kenya
3. Income Tax (Country-By-Country Reporting Standards for Multinational Enterprises) Regulations, 2021
4. Income Tax (Transfer Pricing) Rules, 2006.
5. Kenya Revenue Authority Act (Act No. 2 of 1995)
6. Tax Procedures Act Cap. 469B of the Laws of Kenya

List of Cases

1. Beta Healthcare International Limited v Commissioner of Legal Services and Board Coordination, Tax Appeals Tribunal, Appeals No 866 of 2022, [2024] KETAT 143 (KLR).
2. Coca-Cola Central East and West Africa Limited v Commissioner of Domestic Income Tax Appeal No. 19 of 2013.
3. Unilever Kenya Limited v Commissioner of Income Tax [2005] eKLR.



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CHAPTER ONE

1. Introduction

This chapter provides a discussion of the background of the problem. It puts forth the research problem, objectives, hypotheses and questions. Also brings out the justification of the study, theoretical framework, the methodology and approaches to be used in addressing the research objectives, the scope literature review and the chapter breakdown.

1.1. Background to the Problem

In a study of tax non-compliance among multinational companies, Tedds reports a prevalence of the practice in all regions with the most affected region being Africa and Asia with full revenue reporting of 33.85%.¹ This contrasts with the 57.92% reported among Organisation for Economic Co-operation and Development (OECD) member countries. The inference therefore, is that there is a global trend of non-compliance. Hofmann, Voracek, Bock and Kirchler, in a similar study posit that tax non-compliance among multinationals is predicated on regional influences with western countries recording higher compliance rates than developing nations.² In an estimation of overall revenue loss due to tax non-compliance, Cobham, Janský report that between USD 200 million to USD 500 billion is lost through this practice.³

In the regional context, in a study of perception of taxation in Kenya, Tanzania, Uganda and South Africa, Ali, Odd and Ingrid opine that compliance with taxation laws, in all four countries, was correlated with the perceived efficiency of service delivery.⁴ Of pertinence to the current study was the specific finding that frequent payment to non-state actors in the course of conducting business was found to be correlated with tax non-compliance. This finding, as applicable to the operations of multinational companies, indicates that the lack of straightforward business transaction and compliance channels result in the multiplicity of

¹ Tedds LM, 'Tax non-compliance and corporate governance: a comparative study' *Working paper, University of Manitoba* (2006).

² Hofmann E, Voracek M, Bock C, and Kirchler E, 'Tax Compliance across Sociodemographic Categories: Meta-Analyses of Survey Studies in 111 Countries' *Journal of Economic Psychology* 62 (2017), 63–71.

³ Cobham A, Janský P, *International Corporate Tax Avoidance*, Oxford University Press 2020, 81-128.

⁴ Ali M, Odd HF, and Ingrid H S, 'To pay or not to pay? citizens' attitudes toward taxation in Kenya, Tanzania, Uganda, and South Africa' 64 *World Development* (2014), 828–842.

government-affiliated agencies seeking to enforce ambiguous laws. The frequent and often undocumented interactions with such agencies result in a curtailing of the will to comply with taxation requirements as more funds are lost through undefined channels of undocumented taxation.⁵

In the Kenyan context, Kamau, Mutiso and Ngugi report that creative accounting, a practice involving tax evading manipulations, is predominant among companies both national and multinational operating in the local market.⁶ A 2013 assessment of 40 multinational firms operating in the country further revealed that tax evasion practices were rampant. An intervention initiated to address the issue as effected by Kenya Revenue Authority resulted in the recovery of up to KES 8 billion, pointing to the gravity of the matter. It is therefore apparent that the issue of tax non-compliance in Kenya requires attention.⁷ The current study seeks to address the phenomenon through an exploration of tax non-compliance practices employed by foreign multinational companies and the efficacy of tax law enforcement in Kenya.

Yusof, Ling and Wah advance that there is no standard definition for tax non-compliance. However, drawing from the views of multiple scholars, the authors highlight that the term depicts compliance as the filing of tax returns at the allocated time with accurate reports on liability in accordance with the tax codes, regulations and directives in place within the particular jurisdictions in question.⁸ Kirchler, Maciejovsky and Schneider highlight that from a macro-economic perspective, the impact of the various forms of tax non-compliance, such as tax evasion, avoidance and flight, impact similarly negatively on the national budget hence meriting joint assessment of the various practices as applicable to tax liable entities.⁹ This study tackles tax non-compliance as an umbrella grouping of violations on the filing of tax returns at the allocated time with accurate reports on liability in accordance with the tax legislation, regulations and directives in place within Kenya. The author seeks to find the tax

⁵ Ali M, Odd HF, and Ingrid HS, 'To pay or not to pay? citizens' attitudes toward taxation in Kenya, Tanzania, Uganda, and South Africa', 842.

⁶ Kamau CG, Mutiso AN, and Ngugi DM, 'Tax avoidance and evasion as a factor influencing creative accounting practice among companies in Kenya'⁴ *Journal of Business Studies Quarterly*, 2 (2012), 77.

⁷ Irungu G, 'KRA busts Sh8bn tax evasion scam involving multinationals, *Business Daily*', 24 December 2020, <https://www.businessdailyafrica.com/bd/economy/kra-busts-sh8bn-tax-evasion-scam-involving-multinationals-2041200> on 27 July 2022.

⁸ Yusof, Nor Azrina Mohd, Lai Ming Ling, and Yap Bee Wah, 'Tax non-compliance among SMCs in Malaysia: Tax audit evidence' *Journal of Applied Accounting Research* (2014).

⁹ Kirchler E, Maciejovsky B, and Schneider F, 'Everyday representations of tax avoidance, tax evasion, and tax flight: Do legal differences matter?' *24 Journal of Economic Psychology*, 4 (2003) 535-553.

non-compliance practices by foreign multinationals and the efficacy of the tax law enforcement within the Kenyan context.

1.1.1 Prevalence of non-compliance

The Allingham and Sandmo (AS -1972) theory indicates that the risk associated with non-compliance determines the predicates conformance to taxation requirements on the risk associated with non-compliance.¹⁰ The essence of the theory is that organizations that are well positioned to enjoy the benefits of non-compliance are less likely to conform to the set laws and regulations pertaining to taxation. Therkildsen observes that among the main reasons for non-compliance to tax regulations by multinational companies are the peculiarities of operating within the regions.¹¹ These include, among others, a lack of correlation between service provision and taxation, coercive approaches in taxation, and multiplicity of parties demanding compensation for service rendering. In the current study, the construct 'prevalence of non-compliance' is assessed by consideration of the proportion of multinational companies that do not adhere to taxation regulations; this approach is similar to that employed by Tedds.

1.1.2 Non-compliance practices

Non-compliance practices are practices employed by organisations seeking to cut corners and improve profits.¹² A variety of practices are employed to this end with the overall aim being the manipulation of revenue records in such a manner as to minimize exposure to taxation. In the current study, non-compliance practices are assessed through irregular transfer pricing, similar and related practices employed by multinational companies in the bid to avoid or minimize taxation.¹³ Irregular price transfer involves allocation of prices that are taxable to areas of the organization that attract the least amounts of or no taxation¹⁴. Sikka and Willmott

¹⁰ Allingham MG and Sandmo A, 'Income tax evasion: A theoretical analysis' 1 *Journal of public economics*, 3-4 (1972), 323-338.

¹¹ Therkildsen O, 'Understanding taxation in poor African countries: A critical review of selected perspectives' 28 *In Forum for Development Studies* 1 (2001), 109-123.

¹² Hemels S, 'Fairness and taxation in a globalized world' Available at SSRN 2570750 (2015).

¹³ Sikka P and Willmott H, 'The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness' 21 *Critical Perspectives on Accounting* 4, (2010), 342-356.

¹⁴ Sikka P and Willmott H, 'The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness', 356.

define transfer pricing as a technique used by corporations to allocate maximum revenues and costs among subsidiaries, divisions and joint ventures.¹⁵

1.1.3 Proactive efforts to mitigate non-compliance strategies and their efficacy

As opposed to compliance strategies, which generally centre on incentivising entities to remit taxes, efforts to mitigate non-compliance strategies, as conceptualized in this study, are aimed at stopping leaks in taxation by finding and addressing non-compliance practices. An overlap of perception is however anticipated as practices aimed at incentivising through punitive measures like tax penalties, will also be applicable in curbing non-compliance. In the current study, proactive efforts to mitigate non-compliance strategies are operationalized through considerations of congruence between enforcement strategies and expectations of the taxed¹⁶ for example ensuring service rendering commensurate with taxation, clarity of legislation,¹⁷ and international collaboration.¹⁸

In the Kenyan context, the challenges of transfer pricing as advanced by Waris, in a working paper on how Kenya has implemented and adjusted to the changes in the international transfer pricing regulations from 1920-2016, are legislative framework, capacity of the KRA officers, audit process, governance and technical obstacles which include comparable, choice of method and access to information.¹⁹ The issue of clarity of legislation is a problem. Identified problem areas are: definition of tax avoidance,²⁰ creation of a penalty for tax avoidance,²¹ offences and sanctions for tax avoidance schemes,²² and inadequate Transfer Pricing Rules²³.

¹⁵ Sikka P and Willmott H, 'The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness', 358.

¹⁶ Therkildsen O, 'Understanding taxation in poor African countries: a critical review of selected perspectives', 123.

¹⁷ Forstater M, 'Illicit financial flows, trade misinvoicing, and multinational tax avoidance: the same or different?' *CGD policy paper 123* (2018).

¹⁸ von Haldenwang C and Jakob S, 'Pathways to international tax governance: has the German G20 Presidency made a difference?' *3 Global Summitry*, 2 (2017) 141-155.

¹⁹ Waris A, 'How Kenya has implemented and adjusted to the changes in international transfer pricing regulations: 1920-2016', *working paper 69, International Centre for Tax and Development* (2017) 23-29.

²⁰ Section 2, *Tax Procedures Act*, Cap 469B.

²¹ Section 85, *Tax Procedures Act*, Cap 469B.

²² Section 92, *Tax Procedures Act*, Cap 469B.

²³ *Income Tax (Transfer Pricing Rules) Act 2006*.

1.2. Statement of the Problem

Tax non-compliance practices among taxpayers is a common problem globally, regionally and in Kenya. From the global perspective, USD 200 Million to 500 Billion was lost by developing countries due to non-compliance by multinational companies. The dynamics in an assessment of the situation show that it is going to remain the same or worsen if the peculiarities of taxation remain unaddressed. An assessment of 40 multinational firms operating in the country revealed that tax evasion practices were rampant. Further, intervention by Kenya Revenue Authority resulted in the recovery of up to KES 8 billion pointing to the gravity of the matter. Kenya Revenue Authority's tax officers note that among the reasons behind incidences of tax non-compliance are namely, a lacking legal framework, inadequate training of officers, and a lack of integrated approaches in addressing such issues as transfer pricing. However is noted that multinational companies employ a wide range of practices in their bid to avoid taxation.

The tactics employed in tax non-compliance practices proves as a major hindrance in identifying efforts to be put in place to address the matter. Considering the inadequacy of research addressing this problem, this thesis seeks to confirm the tax non-compliance practices currently practiced by FMNCs vis-à-vis the adequacy of legal framework in Kenya.

1.3. Hypotheses

1. A sizable portion of foreign multinational companies operating in Kenya engage in tax-non-compliance practices.²⁴
2. The current enforcement provisions against tax-non-compliance, in light of foreign multinational tax non-compliance practices in Kenya, are not sufficient to address the challenge of non-compliance.²⁵

²⁴ Kamau CG, Mutiso AN, and Nguui DM, 'Tax avoidance and evasion as a factor influencing creative accounting practice among companies in Kenya', 77.

²⁵ Irungu G, 'KRA Busts Sh8bn Tax Evasion Scam Involving Multinationals – Business Daily', (2013)

1.4. Research Objectives

1. To assess the rate of general adherence to tax requirements among multinational companies in Kenya.
2. To determine the current tax non-compliance schemes employed by multinational companies in Kenya.
3. To evaluate the efficacy of current enforcement provisions against tax non-compliance in light of multinational tax non-compliance practices in Kenya.

1.5. Research Questions

The research questions deriving from the specific objectives of the study are as follows:

1. What proportion of foreign multinational companies operating in Kenya engage in tax non-compliance?
2. What tax-noncompliance schemes are employed by multinational companies in Kenya?
3. How effective are the current anti-tax non-compliance enforcement provisions in light of foreign multinational tax non-compliance practices in Kenya?

1.6. Justification

This thesis will undertake an in-depth examination and intensive research into the FMNC's tax non-compliance practices in Kenya. This will include review of workings at KRA and the legal framework that deals with tax administration and compliance. This thesis will be impactful for the KRA to understand contemporary non-compliance practices, the tax enforcement gap and what it causing the loss of revenue to the Country. It will also be beneficial to both the executive and legislators in providing proposals for legislative and administrative reforms to curb the financial flows.

This thesis will contribute to the legal framework especially on the Transfer Pricing Regulations and recommendations of amending ambiguities in the existing tax legislation.

1.7 Theoretical Framework

1.7.1 Allingham and Sandmo Theory (AS)

A seminal publication on the impetus behind risk taking through tax non-compliance postulates that extant literature, focused on the effect of tax decision making pertaining to portfolios. There was a scarcity of studies on the motivation behind non-compliance. To address this gap, the authors proposed what is now the Allingham and Sandmo (AS - 1972) theory, which stipulates that it is generally short sighted to evade taxes.²⁶ The main premise of this assertion is that the short-term gains accrued through tax avoidance are often negated when enforcers discover non-compliance. This notwithstanding, the motivation to pay taxes rests on the perceived risk of non-compliance; if the entity in question deems taxes as overly burdensome and the risk of discovery low, then non-compliance is perceived beneficial. The inverse involving ease of discovery and taxes perceived to be fair results in a higher likelihood of compliance. Sandmo in a retrospective assessment of the implications of the AS theory asserts that among the main challenges associated with the theory is the convoluted extrapolation from individual's incentives to aggregated entities, as may be the case with the corporation.²⁷

Essentially, the author asserts that the factors that present as motivators for the individual may not necessarily present similarly for the corporation. As an example, the risk of discovery may be more apparent for the corporation, and more so international organizations, than it may be for individuals making decisions on declaration of income. It is interesting to note that despite these differences, multinational corporations still engage in tax evasion. Buehn, Lessmann and Markwardt in assessing the effect of decentralization of power on the shadow economy opine that the former has a curtailing effect on the latter.²⁸ As bureaucratic channels are broken down, organizations operating in the shadow economy and engaging in such processes as tax evasion and avoidance, among others, become more visible to regulators and enforcers; this results in more efficacious governing and promotes compliance. Given increased efforts to enforce a decentralization of the tax enforcement role from the national to county-level enforcement, it

²⁶ Allingham MG and Sandmo A, 'Income tax evasion: A theoretical analysis', 338.

²⁷ Sandmo A, 'The theory of tax evasion: A retrospective view' *National Tax Journal* (2005), 643-663.

²⁸ Buehn A, Christian L and Gunther M, 'Decentralization and the shadow economy: Oates meets Allingham-Sandmo' 45 *Applied Economics* 18 (2013), 2567-2578.

is inferable, as suggested by the authors, that multinational companies operating in the fringes of law will become more visible to enforcers of taxation laws.

The AS theory is of pertinence to the current study as it predicates compliance with tax regulation on the motivation of the entities involved. In the current study, the author seeks to address the non-compliance practices currently evidenced by multinational companies operating in the country. To effectively understand the practices, it will be necessary to view them in light of the legal framework and the enforcement mechanism; the AS theory is fitting in assessment of the mentioned constructs of interest in this study.

1.7.2. Natural Law Theory

Natural law theory, when applied to non-compliance in tax practices, provides a framework for understanding the moral and ethical dimensions of taxation beyond mere legal obligations. This theory posits that there are inherent rights and duties derived from human nature and reason, which can influence how individuals perceive and engage with tax laws. The classical natural law theory suggests a balance between individual rights and societal obligations, which can impact tax compliance behaviour.²⁹ This perspective is crucial in understanding the motivations behind non-compliance and the potential for aligning tax systems with natural law principles to enhance compliance.

1.7.3. Positivist Theory

Legal positivism, as a theory of law, provides a framework for understanding tax law and non-compliance practices by focusing on the formal structures of law rather than moral considerations. This approach is particularly relevant in the context of tax law, where the distinction between legal compliance and non-compliance can be blurred by the complexities of tax regulations and the potential for legal fictions. The theory's application to tax law highlights the challenges in distinguishing between lawful tax avoidance and unlawful tax

²⁹ Feser E, 'Classical natural law theory, property rights, and taxation' 27 *Social Philosophy & Policy*, 1 (2010), 21–52.

evasion, as well as the role of General Anti-Avoidance Rules (GAARs) in addressing these issues.³⁰

Legal positivism distinguishes law from morality, focusing on the formal structures of law. In tax law, this is exemplified by the distinction between capital and revenue, which is often treated as a matter of law rather than fact, leading to potential exploitation by tax avoiders.³¹

Kelsen's theory highlights the logical flaws in tax law, where legal fictions replace factual determinations, making it easier for tax avoidance strategies to exploit these weaknesses.³²

Hart's perspective on legal positivism suggests that GAARs, which aim to prevent tax avoidance, can be consistent with legal positivism despite their retroactive application, as they align with the formal description of law.³³

1.7.4. 'Bad Man' Theory

Oliver Wendell Holmes's "The Path of the Law" presents a transformative view of legal theory, emphasizing the practical and predictive nature of law over its normative and logical aspects. Holmes argues that the law should be understood as a tool for predicting the consequences of actions rather than as a system of moral or logical principles.³⁴

The "bad man" theory, posits that law should be understood from the perspective of a person who is only concerned with the consequences of their actions, rather than moral considerations. Holmes argued that lawful actions need not be motivated by moral reasons, highlighting a distinction between law and morality. This predictive theory emphasizes that understanding law involves recognizing its practical implications rather than conflating it with moral values, which can lead to misunderstandings of his views.³⁵ He further posits that the law should be understood from the perspective of a rational actor who is primarily concerned with the consequences of their actions rather than moral considerations. According to this theory compliance will be pegged on whether they can get away with the non-compliance.

³⁰ Upadhvav A, *Legal Positivism and Tax Law: Kelsen, Is/Ought and Capital/Revenue; Hart, Open Texture and GAARs*, 2022, 281–303.

³¹ Upadhayay A, *Legal Positivism and Tax Law: Kelsen, Is/Ought and Capital/Revenue; Hart, Open Texture and GAARs* 281–303.

³² Upadhayay A, *Legal Positivism and Tax Law: Kelsen, Is/Ought and Capital/Revenue; Hart, Open Texture and GAARs* 281–303.

³³ Upadhayay A, *Legal Positivism and Tax Law: Kelsen, Is/Ought and Capital/Revenue; Hart, Open Texture and GAARs* 281–303.

³⁴ Holmes Jr, OW, 'The Path of the Law' 10 *Harvard Law Review* (1897), 457-478.

³⁵ Strasser M, 'Holmes on Law and Morality' 44 *Alberta Law Review*,(2)(2015), 377.

1.8. Methodology

1.8.1 Research Design

This is a qualitative research, crafted in a confirmatory research design. As Khwaria (2024) emphasizes the importance of selecting appropriate research methodologies in legal research, including confirmatory methodologies. These methodologies are crucial for validating hypotheses and ensuring the reliability of findings. The author advocates for a systematic approach to address legal issues, highlighting the need for rigorous data collection and analysis methods.³⁶ , the researcher seeks to confirm or dispel pre-held notions of association between constructs. In the current study, the author seeks to identify and categorize contemporary tax non-compliance strategies employed by foreign multinational companies' vis-à-vis the efficacy of the current legal and enforcement framework.³⁷ A confirmatory-design is fitting in excavating the current aspects of non-compliance that are not, as yet, captured in extant literature. Qualitative interview data will be collected in accordance with the research questions of the study.

1.8.2. Population and Sampling

The population of the study is comprised of Kenya Revenue Authority tax compliance officers and respondents from foreign multinational companies specifically; Absa, Safaricom, EABL, Coca-Cola and Unilever operating in Nairobi County. As reported by a member of the tax compliance team and FMNC's there are upwards of 100 officers operating in this capacity. According to Hagaman and Wutich (2017), a sample size of 20 is sufficient in conducting an exploratory study based on the interview data. The researcher involved with the current study will target 20 individuals for recorded interviews.

A purposive sampling approach is applied in assessing tax avoidance practices, if any, as applicable to the top foreign multinational companies in the sectors.

Dworkin and Shari (2012)³⁸ however postulate that the concept of saturation is more important than the total number of interviews. Saturation entails the point whereby the most important

³⁶ Khwaria BM, Legal methodology "theory and practice", Lusail University, Qatar, 2024, 35.

³⁷ Jaeger, Robert G, and Tim RH, 'On confirmatory versus exploratory research' *Herpetologica* (1998), S64-S66.

³⁸ Dworkin, Shari L. "Sample size policy for qualitative studies using in-depth interviews." (2012): 1319-1320.

ideas of a study are captured with additional collection of data proving redundant. The researcher conducted 20 interviews and there was redundancy in responses.

1.8.3. Data Collection

The data for the study was collected through semi-structured interviews. The structuring of the interview prompt will be as follows: the first section shall contain questions on the current prevalence of non-compliance, the second section shall assess current non-compliance practices employed by foreign multinational companies, and the third and final section shall address the current efficacy of anti-non-compliance strategies employed by the enforcers. Respondents will be encouraged to elaborate on their answers and all interviews will be recorded and subsequently transcribed.

1.8.4 Data Analysis

As previously mentioned, interview data from audio will be transcribed to generate scripts. The generated scripts, prior to analysis, will be checked for accuracy and consistency. The scripts will then be analysed through an iterative theme excavating process to establish the main constructs discussed by the respondents; this will be done through the use of Nvivo – a qualitative data analysis tool. The theme setting process will be done through consultation with the supervisor to ensure accuracy and objectivity in the process. To further address the objectives of the study, word-density searches will further be run to investigate emergent subjects pertaining to non-compliance rates, practices and efficacy of anti-non-compliance strategies.

1.8.5 Research Quality

According to Bolarinwa (2015), reliability and validity, as pertains to academic research, entail the accuracy and consistency of research instruments. To ensure reliability of the study, the author draws the operationalization of constructs under assessment from existing theories and extant literature. Furthermore, design of the research tools will be conducted through consultation with the research supervisor, a subject matter expert. To ensure validity, the interview prompt will be provided to potential respondents, through a pilot study to ensure that the questions address that which they are meant to address. Feedback from the pilot study will

be used to further edit the interview prompt, where necessary, to ensure adherence to validity requirements.

1.8.6 Ethical Issues

According to Shamoo and Resnick (2003), adherence to ethical standards serves the purpose of promotive knowledge and truth hence lending credence to the authority of findings emanating from a study. The data collected from the tax regulation enforcement officers will be of sensitive nature as it may be deemed to divulge confidential information (particularly regarding efficacy of the enforcement mechanism) to the public; information that can be politicized. It is therefore necessary to ensure that all information is held confidentially and anonymized; the researcher in the current study will ensure that all interviews are conducted in a manner ensuring privacy and all collected data will be store security with access limited to the collector, analyser, and supervisor. All respondents will be informed of their right to decline to answer any of the questions put. Furthermore, approval will be sought from Strathmore University Ethics Committee.

1.9 Scope of the study

This study focuses on foreign multinational companies operating in Kenya. To gain insight into these companies, the researcher seeks to assess their tax compliance as perceived by the Kenya Revenue Authority Tax Compliance Team in comparison with data from the foreign multinationals in line with the current legislation. In checking the validity of the information and to get an insight of the foreign multinationals perspective, the researcher will also interview staff who deal with taxation matters in Kenya Revenue Authority and some foreign multinationals. The respondents were chosen on account of their interaction, as a part of their work mandate, with the foreign multinational companies operating in the country.

1.10 Literature Review

The purpose of this section is to assess present empirical findings on the constructs under study – prevalence of non-compliance, non-compliance practices, and anti-non-compliance strategies and their efficacy. Three subsections are put forward with each addressing a specific construct.

1.10.1 Prevalence of non-compliance

In a study of 10,000 multinational companies operating in different jurisdictions, Tedds (2006) employs a regression model to assess the various determining factors associated with non-compliance.³⁹ Findings from the study indicate that high taxes and government corruption were associated with increased incidences of non-compliance. Similarly, such industry-specific factors as size, owners, competition, and audit control were deemed to have a significant impact on the rate of compliance. Interestingly, however, factors such as access to finance, political instability, crime rates and the perceived fairness of the taxation system did not seem to have a significant impact on compliance. The authors further note that levels of compliance differed with region; whereas up to 57.92% of organizations operating in the Organisation for Economic Co-operation and Development (OECD) reported up to 100% of revenues, of the companies operating in Africa and Asia, as low as 33.85% did the same. In inferring from the aforementioned determinants of compliance, it is apparent that such factors as high taxation and corruption play a significant role in deterring tax compliance in Africa and Asia.⁴⁰

Davis, Hecht and Perkins (2003) conduct an analysis of tax-compliance as influenced by social norms and rigor of enforcement of regulations.⁴¹ The authors develop two models to assess the effect of increased or decreased compliance. The models are based on prior compliant and non-compliant populations. Findings indicate that for non-compliant entities, an increase in enforcement rigor results in marginal gains with regard to compliance whereas for prior compliant entities, decreased enforcement efforts, unto a critical point, do not result in non-compliance. However, increased enforcement efforts among non-compliant entities, past a critical point, result in increased compliance with reverting to prior enforcement levels not negating the gains of the previous increase in efforts. For compliant entities, decrease of compliance efforts below a critical point results in dramatic non-compliance and the reversal of the trend in non-compliance following the intervention proves inconsequential as non-compliance, among the entities, prevails. Viewing these findings in light of those put forward by Tedds' (2006)⁴², it is evident that enforcement efforts in areas such as Africa and Asia

³⁹ Tedds LM, 'Tax non-compliance and corporate governance: a comparative study' (2006).

⁴⁰ Tedds LM, 'Tax non-compliance and corporate governance: a comparative study' (2006).

⁴¹ Davis JS, Gary H and Jon DP, 'Social behaviors, enforcement, and tax compliance dynamics' 78 *The Accounting Review* 1 (2003), 39-69.

⁴² Tedds LM, 'Tax non-compliance and corporate governance: a comparative study' (2006).

should be increased to allow for higher levels of tax compliance by foreign multinational companies.

A study featuring 111 companies across various socio-demographic regions indicates that prior studies on the determinants of compliance to taxation regulations indicate varied findings on the influence of age, sex, education, and income⁴³. The ambiguity in inference, according to the author, can however be accounted for by segregating the data by region. Employing the use of a regression model to assess the impact of the various factors, the author postulates that among western countries, age, sex, education, and income can be considered valid albeit moderate predictors of compliance behavior; the same was however not true for countries operating in such regions as Africa, Latin America and the Caribbean. Of the identified factors, age, with a beta value of 0.12 was considered the most impactful determinant. The findings put forward in this study serve to indicate that the prevalence of non-compliance in Africa, Latin America, the Caribbean and other non-western countries presents as a contemporary practice and is not determined by the various socio-economic factors considered in the study by Hofmann, Voracek, Bock and Kirchler (2017).

Cobham and Jansky (2020) examines the ways through which tax avoidance, and tax evasion affect developments in finance among developing countries.⁴⁴ The cost of tax evasion in these countries is approximated to be approx. 500 billion US dollars each year. The author also states that increasing the amount of financial aid sent to these countries does not have any significant impact on the economy. However, increased aid negatively affects the political representation in these countries especially if the requirement for financial aid is full-trade liberalism. The author argues that there is need for developing nations to be steered towards becoming financially independent so as to sustain development in the long-term. When developing nations continue to receive aid, they are less likely to be motivated to grow their own economy thereby leading to a reduction in overall sustainable development. The authors also note that the main contributor towards tax evasion is corruption and it is only when this is addressed that developing nations will be able to live up to the standards set by developed nations in terms of tax rates and conformity to taxation policies.

⁴³ Hofmann E, 'Tax compliance across sociodemographic categories: Meta-analyses of survey studies in 111 countries', *Journal of Economic Psychology*. The Authors, 62(2017) 63–71.

⁴⁴ Cobham A, Janský P, *International Corporate Tax Avoidance*, Oxford University Press 2020, 81-128.).

1.10.2 Non-compliance practices

Janský, Prats and Aid (2013) discuss the problem of multinational corporations coming up with strategies to avoid paying taxes within their areas of operation.⁴⁵ The article addresses a report released by the Organization for Economic Co-operation and Development (OECD). Research conducted by the authors showed that approximately 1,500 multinational corporations that have operations in India employ the use of profit shifting strategies in order to avoid paying taxes thereby costing the Indian government a lot of money in revenue. For the study, the authors obtained and analysed financial ownership data on multinationals operating in India as stored by an information specialist company. In order to solve the problem of tax evasion, the authors suggest the implementation of a unitary approach of how multinationals all over the world are taxed. This approach is deemed effective since it would ensure that profit-shifting of revenue, to tax havens that are not economically active, is pointless.

Dyreng and Lindsey conducted a study to determine how foreign jurisdictions and tax havens have affected the rate of income tax for multinational companies that are based in the United States.⁴⁶ The researchers found that U.S based multinationals that disclosed their operations in one tax haven had reduced tax burdens of approximately 1.5% less compared to multinationals that did not operate in any tax havens. The researchers also pointed out that U.S firms paid 4.4% foreign income tax rates whether or not they operated in tax havens. The results of this study indicate that U.S firms working in tax havens may, in some instances, have to pay more taxes compared to those that do not. The data obtained also show that firms operating in nations that are associated with low tax rates pay higher federal taxes on foreign income. For instance, corporations in nations such as Costa Rica, the Cayman Islands and Ireland pay federal taxes on foreign income that is approximately four percent higher than the rates paid by firms operating in other nations.

Rego discusses the ways through which multinational corporations avoid paying taxes compared to other firms hence giving rise to lower tax rates.⁴⁷ The study found that

⁴⁵ Janský P, Alex P and Christian A, 'Multinational corporations and the profit-shifting lure of tax havens' *Occasional Paper* 9 (2013).

⁴⁶ Dyreng SD and Bradley PL, 'Using financial accounting data to examine the effect of foreign operations located in tax havens and other countries on US multinational firms' tax rates' *Journal of Accounting Research* 5 (2009) 1283-1316.

⁴⁷ Rego SO, 'Tax-avoidance activities of US multinational corporations' 833.

multinational corporations that have operations in foreign countries have reduced effective tax rates compared to other corporations. The author also observed the existence of a negative relationship between pre-income tax and effective tax rates. This relationship was noted to be consistent when firms had higher pre-tax income. These firms were also found to have more resources as well as incentives to take part in tax planning. The author also pointed out that the increased level of pre-tax income in the US was associated with lower tax rates in the US as well as reduced foreign effective tax rates and that increased foreign pre-tax income is associated with high foreign and US tax rates.

Otusanya, a professor at the department of accounting in the University of Lagos conducted a study to determine the role played by multinational corporations' tax behaviours within the dynamics of globalization and their pursuit to make profits. The main aim of the study was to show how multinationals' drive for profitability affects their decision to avoid taxes at extreme costs. The study found that offshore financial institutions as well as tax havens contribute to multinationals engaging in tax fraud. The author also notes that local professionals and business elites are the main players in tax evasion in Nigeria. The author states that when elites avoid taxes, the burden of the nation's taxes is transferred to citizens with low incomes. The author proposes serious reforms in taxation to help address the problems that have been created by multinationals in Nigeria.⁴⁸

Sikka and Willmott (2010) define transfer pricing as a technique used by corporations to allocate maximum revenues and costs among subsidiaries, divisions and joint ventures. The authors sought to understand how transfer pricing has facilitated tax evasion with the aim being the assessing of transfer pricing and its effect on economic growth. The authors note that transfer pricing involves allocation of resources in a way that helps them avoid paying taxes. The study observed that developing nations are not able to adequately keep track of transfer pricing policies since they have neither the resources nor man power. On the contrary, developed nations scrutinize the financial incomes of the firms operating within their borders by carrying out extensive audits. Given the fact that some corporations may raise complaints when they are asked to pay high taxes, some states may resort to imposing high taxes to consumption, wages and savings. The authors propose that in order to address the challenges

⁴⁸ Otusanya OJ, 'The role of multinational companies in tax evasion and tax avoidance: the case of Nigeria' 22 *Critical Perspectives on Accounting*, 3 (2011), 316-332.

brought about by transfer pricing, there is need for a unified front among financial decision makers in the globe.

Creative accounting refers to the process of organizations' management manipulating their books to make their companies appear financially weak or strong. In a study by Kamau, Mutiso and Ngugi (2012), the authors examine how tax evasion and avoidance have contributed to creative accounting in Kenyan companies with the aim of providing evidence that creative accounting is practiced in Kenya so as to avoid taxes.⁴⁹ For the study, the researchers obtained and analyzed data from accountants in different Kenyan companies. The study concluded that tax evasion played a significant role in encouraging organizations to engage in creative accounting. This shows that developing countries such as Kenya are not exempted from fraud. The researcher states that since tax is calculated based on how much income is generated by the organization, many companies reduce the income indicated on their books so as to reduce the amount of tax they are expected to pay.

1.10.3 Anti-non-compliance strategies and their efficacy

In a study funded by the Australian Research Council Discovery Grant, Sharman (2010) aims to identify how policymakers can come up with ways to curb high tax evasion rates. The author points out that blacklisting firms that do not pay taxes is not an effective way to fight the problem of tax evasion. This is because blacklisting firms after they have avoided taxes is a reactive approach. There is therefore a need for proactive legislation that will ensure firms do not avoid taxation to begin with. The author also observes that policy makers run the risk of facing public outrage when they do not take action against tax evasive firms. The author also notes that firms are blacklisted in different nations since they are usual suspects as opposed to on the basis of financial performance. The author recommends the need to adapt stringent approaches to tax policy transfers.

Therkildsen (2001) in an assessment of the taxation trends in developing nations postulates that the peculiarities of the socio-economic factors prevalent in such countries present as major

⁴⁹ Kamau CG, Mutiso AN, and Ngugi DM, 'Tax avoidance and evasion as a factor influencing creative accounting practice among companies in Kenya', 77.

determinants of the efficacy of the taxation system.⁵⁰ In particular, the author points to four main aspects as fundamental to understanding taxation trends; extent of informalisation of the economy, reciprocity between service delivery and taxation, composition and conditions of aid, extent of coercion and conflict in taxation. An effective taxation system would involve consideration of the implications of these four factors. As an example, high levels of coercion exercised in the collection exercise, and particularly so by the local government, would serve to create a negative perception of taxation. In the event that service rendering is deemed subpar, non-compliance would be likely to persist despite coercive efforts by the government. Viewing these findings in light of multinationals, it is apparent that a lack of service provision (e.g. through timely licencing) would provide impetus towards delays or non-compliance in taxation. An effective enforcement strategy would view the issue of taxation in a holistic quid-pro-quo manner in that the gains of taxation should be apparent to the taxed.

Forstater (2018) discusses how Illicit Financial Flows (IFF) has affected economic growth.⁵¹ The author proposes that the existence of conflicting illegal and legal behaviours under the same definition results in confusion as well as lack of clarity on the direction of cash flow. The author states that in order to overcome the challenge of illegal cash flows, there is need for international cooperation to ensure that countries are able to track, trace and retrieve assets across geographic borders as this will help curb impunity. The author states that developing countries have the most challenges in securing financial revenues from the companies operating within their borders. The challenge is especially significant when the country is exporting unprocessed minerals. The author proposes that in the bid to fight illicit financial flow, there is need to have clearer definitions of what IFF and offshore taxation entail. Tax treaties are also deemed an effective way to avoid double taxation as countries keep track of multinationals' revenue.

von Haldenwang and Schwab (2017) discuss ways in which the German presidency has implemented the G20 developments aimed at ensuring global tax cooperation.⁵² The authors argue that despite the fact that the German government has made progress with regards to

⁵⁰ Therkildsen O, 'Understanding taxation in poor African countries: A critical review of selected perspectives',123.

⁵¹ Forstater, M, 'Illicit financial flows, trade misinvoicing, and multinational tax avoidance: the same or different?' (2018).

⁵² von Haldenwang C and Jakob S, 'Pathways to international tax governance: has the German G20 presidency made a difference?' ' 3 Global Summitry, 2 (2017),150.

reducing tax evasion; the nation has not been proactive in presenting new ways to fight international tax evasion. It has instead limited itself to implementing initiatives that had been set previously. The authors note that the changes being implemented by the German government are not adequate in helping address the discrepancies between public service delivery and public finance. Developing nations find it difficult to manage spill overs with regards to multinationals paying taxes.⁵³ The authors propose that, in order to address these discrepancies, there is need for legislation that will ensure a common corporate tax system that goes beyond codes of conduct. Such a system would help increase tax certainty and would further improve international tax monitoring system in the bid to avoid tax evasion.

Akhtar, Akhta, John and Wong (2017) analyse tax evasion from the corporate world perspective postulating that the taxes affect the financial performance of multinational corporations.⁵⁴ The authors further assess the role of the corporation level of governance in determining the probability of engaging in tax evasion. The specific areas addressed in the paper are whether or not firms are affected financially when news of tax evasion is leaked as well as whether the level of governance in the country and organization in any way affects the likelihood of corporations evading taxes. The research results indicate that firms do face financial constraints when they are suspected of tax evasion. The research also shows that the reputations of multinationals are not affected by tax evasion reports in the long term. The research also shows that the size of the firm, its governance, and the type of national legislation has an effect on the organizations probability to engage in tax evasion. The research received partial funding from the Australian Research Council Grants and the University of Sydney. Findings from this study indicate that publicity on non-compliance plays a role in deterring participation in the practice.

Atwood, Drake, Myers and Myers (2012) discuss the efficiency of the taxation system as a function of country of operation.⁵⁵ The systems examined are based on a territorial approach to tax payment as compared to a worldwide approach, conformity to book-tax requirements and the perceived strength of tax legislature enforcement. The research shows that, on average,

⁵³ von Haldenwang C and Jakob S, 'Pathways to international tax governance: has the German G20 presidency made a difference?' 155.

⁵⁴ Akhtar S, Farida A, Kose J, and Su-Wen W, 'Multinationals' tax evasion: a financial and governance perspective' *Journal of Corporate Finance* (2017).

⁵⁵ Atwood TJ, Michael SD, James NM, and Linda AM, 'Home country tax system characteristics and corporate tax avoidance: International evidence' 87 *The Accounting Review*, 6 (2012), 1831-1860.

there was a reduced probability for firms to engage in tax evasion when there is strict book-tax conformity legislation, when the tax enforcement procedures in the nation are stronger as well as when there is a worldwide approach to taxation. The authors also state that the relationship between tax systems is contextual and highly dependent on management's view of compensation. The article is important in that it helps policymakers by suggesting approaches to curtailing tax evasion and avoidance for multinational corporations. The researchers propose that in order to avoid tax fraud, there is need for strict legislation regarding taxation and a unitary approach to how corporations are taxed.

1.11 Limitations

The main limitation of the study presents in the small sample size. Although saturation was achieved, the data collection process was hampered by non-response and direct refusals to participate in the study. Additional studies should therefore consider alternative data collection approaches including potential incentivisation of respondents to participate in the studies assessing taxation practices among multinational companies in Kenya.

1.12 Chapter Breakdown

Chapter one covers the introduction of the study, background of the problem and statement of the problem. The chapter contains an analysis of the theoretical framework of the study. Also included in the chapter are definitions of the key terms and concepts relating to taxation, its basis, tenets, tax policy and international taxation. The chapter concludes with a discussion of the approach and methodology employed in the study to address the research questions.

Chapter two discusses the current tax non-compliance schemes employed by multinationals vis-à-vis the current legal and enforcement framework. It will identify and highlight the gaps that exist in Kenya's legislation relating to transfer pricing.

Chapter three is an analysis of the data collected from the interviews. In particular the chapter will analyse the data collected and draw conclusions as pertains to the hypotheses.

Chapter four responds to the research questions, draws conclusions on the research and makes recommendations.

CHAPTER TWO

2 Tax Non-Compliance by Foreign Multinational Companies vis-à-vis the Tax Law Enforcement in Kenya.

2.1. Introduction

This chapter discusses the current tax non-compliance practices employed by multinationals vis-à-vis the current legal and enforcement framework. It will identify and highlight the gaps that exist in Kenya's legislation relating to tax law enforcement.

2.2. Tax Non-Compliance Practices by Foreign Multinational Companies in Kenya.

2.2.1 Tax non-compliance.

Tax non-compliance refers to the intentional or unintentional violation of tax laws,⁵⁶ encompassing actions like tax evasion and tax avoidance.⁵⁷ Tax evasion involves illegal practices to reduce tax liabilities, while tax avoidance utilizes legal means to minimize tax obligations.⁵⁸ Tax avoidance is typically described as a deliberate measure employed by a taxpayer to reduce the tax liability, thereby maximizing the income received after taxes. This is often achieved through strategic tax planning and the exploitation of loopholes present in tax laws and regulations.⁵⁹ The differentiation between the two is further exemplified by the utilization of various methods of tax avoidance frequently employed by taxpayers such as tax planning, profit shifting, establishment of branches in jurisdictions with lower tax rates, and utilization of tax incentives. Instances of tax evasion encompass activities like smuggling of

⁵⁶ Hanapi AM, 'Determinant of tax non-compliance among taxpayer' 4 *Asian Journal of Accounting and Finance*,1 (2022), 13.

⁵⁷ Awang, N and Amran, A. (2014), "Ethics and tax compliance", *Ethics, Governance and Corporate Crime: Challenges and Consequences (Developments in Corporate Governance and Responsibility, Vol. 6)*, Emerald Group Publishing Limited, Leeds, 105-113.

⁵⁸ Williams C, 'Evaluating public administration approaches towards tax non-compliance in Europe' 10 *Administrative Sciences* 3 (2020), 43.

⁵⁹ Alex Kasibwa: Tax avoidance and tax evasion: a tale of two errors <https://www.kra.go.ke/news-center/blog/1869-tax-avoidance-and-tax-evasion-a-tale-of-two-errors> on 20 March 2024.

goods, under declaration or non-declaration of income, tax fraud, dishonest tax reporting, and overstating deductions. Tax evasion and tax avoidance are often depicted as distinct antonyms, with the distinguishing factor being that tax avoidance is perceived as lawful while tax evasion is deemed illegal and an endeavour to undermine the legal system. However, this perception oversimplifies the concept, as the disparity is more intricate, particularly in the context of Kenya.⁶⁰

2.2.2. Legislative Framework on tax evasion and tax avoidance.

The Constitution of Kenya

Taxation within the jurisdiction of Kenya is fundamentally established in Article 209 and 210 of the Constitution of Kenya 2010 (Constitution 2010). It authorizes the National Government to levy Income Tax, Value-Added Tax, Excise Duty, Customs Duties, and additional levies on imports and exports, in conjunction with any other form of taxation that may be stipulated through legislative enactments by Parliament.⁶¹ A county may impose; property rates; entertainment taxes; and any other tax that it is authorised to impose by an Act of Parliament.⁶²

The national and county governments may impose charges for services. The taxation and other revenue-raising powers of a county shall not be exercised in a way that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour.⁶³ The Constitution further provides that a tax or licence fee can only be imposed, waived or varied through legislation.⁶⁴

The Tax Procedures Act

The Tax Procedures Act (TPA), was enacted to harmonise and consolidate the procedural rules for the administration of tax laws in Kenya.⁶⁵ The object and purpose of the Act is to provide uniform procedures for consistency and efficiency in the administration of tax laws; facilitation

⁶⁰ Alex Kasibwa: Tax Avoidance and Tax Evasion: A Tale of Two Errors <https://www.kra.go.ke/news-center/blog/1869-tax-avoidance-and-tax-evasion-a-tale-of-two-errors> on 20 March 2024.

⁶¹ Article 209, *Constitution of Kenya 2010*.

⁶² Article 209, *Constitution of Kenya 2010*.

⁶³ Article 209, *Constitution of Kenya 2010*.

⁶⁴ Article 210, *Constitution of Kenya 2010*.

⁶⁵ *Tax Procedures Act*, Cap 469B.

of tax compliance by taxpayers; and effective and efficient collection of tax.⁶⁶ The TPA defines “tax” as a tax or penalty imposed under a tax law; an instalment tax imposed under section [12](#) of the Income Tax Act ([Cap. 470](#)); or withholding tax.

The TPA provides for instances where fraud is committed in relation to tax. ⁶⁷ It creates offences when a taxpayer omits from his or her return any amount which should have been included; ⁶⁸ or claims any relief or refund to which he or she is not entitled;⁶⁹ or makes any incorrect statement which affects his or her liability to tax; ⁷⁰ or prepares false books of account or other records relating to that other person or falsifies any such books of account or other records;⁷¹ or deliberately defaults on any obligation imposed under a tax law.⁷²

This is distinct from tax avoidance since it is considered to be the practice of engaging in activities that are unfavourable to the government’s tax system but legal. However, the TPA defines tax avoidance to mean a transaction or a scheme designed to avoid liability to pay tax under any tax law. ⁷³

The Income Tax Act.

The Income Tax Act (ITA) was enacted to make provision for the charge, assessment and collection of income tax; for the ascertainment of the income to be charged; for the administrative and general related purposes. The ITA has provisions that prohibit tax avoidance.⁷⁴ The first section allows the Commissioner to charge tax or make adjustments, where, in the Commissioner’s opinion, the main aim of the transaction was designed to avoid tax liability. The Commissioner, if of the view that a transaction was carried out with the intention of avoiding or minimizing tax liability, whether before or after the enactment of this legislation, or if the primary benefit anticipated from the transaction in the three years following its completion was tax avoidance or reduction, has the authority to order adjustments to counteract the tax avoidance or reduction facilitated by the transaction, if deemed fair and appropriate. ⁷⁵

⁶⁶ Section 2, *Tax Procedures Act*, Cap 469B.

⁶⁷ Section 97, *Tax Procedures Act*, Cap 469B.

⁶⁸ Section 97(a), *Tax Procedures Act*, Cap 469B.

⁶⁹ Section 97(b), *Tax Procedures Act*, Cap 469B.

⁷⁰ Section 97(c), *Tax Procedures Act*, Cap 469B.

⁷¹ Section 97(d), *Tax Procedures Act*, Cap 469B.

⁷² Section 97(e), *Tax Procedures Act*, Cap 469B.

⁷³ Section 2 of *Tax Procedures Act* Cap 469B.

⁷⁴ Section 23 and 24, *Income tax Act* Cap 470.

⁷⁵ Section 23, *Income tax Act* Cap 470.

Second, the avoidance of tax liability by non- distribution of dividends. Where the Commissioner believes that a private company has not allocated a portion of its earnings to its shareholders in the form of dividends within a reasonable timeframe, not exceeding twelve months following the conclusion of its financial period, and this allocation would not negatively impact the company's operations, he has the authority to instruct that this portion of the company's earnings be considered, for the purposes of this legislation, as having been distributed to the shareholders based on their respective ownership stakes. Furthermore, it shall be deemed that this distribution occurred twelve months after the conclusion of the aforementioned financial period.⁷⁶

2.2.3 Transfer Pricing

In Kenya TP is provided for under the ITA and ITA, Transfer Pricing Rules of 2006. TP pertains to the valuation of transactions within a company involving affiliated entities.⁷⁷ It is a process through which branches of multinational corporations engage in the exchange of goods, services or use of property, playing a pivotal role in the allocation of income among the various entities.⁷⁸ This should be done at arm's length. Arm's length is transaction defined in Black's Law dictionary as; a transaction between two related and unaffiliated parties. A transaction between two parties, however closely related, may be conducted as if the parties were strangers, so that no conflict of interest arises.⁷⁹

Arm's length price is defined in the ITA as the price payable in a transaction between independent enterprises.⁸⁰ The OECD states the arms-length principle as: the international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. Further, as set forth in Article 9 of the OECD Model Tax Convention it states: where "conditions are made or imposed between the two enterprises in their commercial or intercompany relations which differ from those which would be made between independent enterprises then any profits which would, but for those conditions, have accrued

⁷⁶ Section 24, *Income tax Act* Cap 470.

⁷⁷ WittnedorfJ, 'Transfer pricing and the arm's length principle in international tax law' *Kluwer Law International* (2010), 3.

⁷⁸ <http://www.businessdictionary.com/definition/transfer-price.html> on 1 June 2024.

⁷⁹ Garner BA, *Black's Law Dictionary* 8ed, 2007, 1535.

⁸⁰ Rule 2, *Income Tax (Transfer Pricing) Rules* 2006.

to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in profits of that enterprise and taxed accordingly."⁸¹

The arm's length principle plays a crucial role in the assessment of transfer pricing. It acknowledges that transactions among affiliated entities are not impacted by market dynamics, unlike those involving unrelated parties. The terms of business interactions are often dictated by intra-group dynamics rather than market forces.⁸²

When transfer prices between related parties deviate from those observed between independent entities, the resulting misalignment may significantly reduce the amount of taxes that can be collected. In order to rectify this discrepancy, the profits derived from these transactions may need to be appropriately realigned.⁸³ This is accomplished by setting forth rational terms of commercial interactions that would typically exist in transactions between autonomous entities in analogous circumstances.

In making necessary adjustments, it is essential to differentiate between associated enterprises and uncontrolled transactions conducted among independent enterprises.⁸⁴ The notion of comparability is pivotal in this endeavour to establish a precise differentiation between transactions and to avoid unfairly discriminating against transacting entities. Transactions conducted among independent parties and those among affiliated entities are considered comparable when they exhibit substantial resemblance with inconsequential discrepancies that are unlikely to significantly impact the aspect being evaluated. Conversely, Attaining comparability is possible through implementing appropriate adjustments to mitigate the substantial impacts of such distinctions.⁸⁵

TP poses challenges and is susceptible to exploitation as a result of mispricing, primarily when it deviates significantly from the arm's length principle. Applying TP rules based on arm's

⁸¹ OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 2010, 357.

⁸² OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 2010, 1.6

⁸³ OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 2010, 1.7.

⁸⁴ OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 2010, 1.8.

⁸⁵ OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 2010, 1.8.

length is difficult, even when relying on the OECD guidelines. It's challenging to find comparable market transactions to set an acceptable transfer price.⁸⁶

FNMCs may in undertaking controlled transactions, use fictitious transfer pricing to manipulate profits. This aids tax avoidance by declaring losses or minimum profits in high tax jurisdictions and higher profits in low tax jurisdictions. This is also done through non-existent transaction with the aim to manipulate accounting entries.⁸⁷

The introduction of country-by-country reporting (CbC) on Multi National Enterprises (MNE) headquartered in Kenya, starting from the 1st of January 2022 was done through the Finance Act 2021.⁸⁸ Essentially, the CbC regulations, mandate that MNEs based in Kenya, with a consolidated revenue exceeding Kshs. 2.5 Billion, must submit an annual CbC report to the KRA. This report is expected to encompass details pertaining to capital, revenue, tax payments, assets, and workforce size across all jurisdictions of operation. Failure to adhere to these regulations will result in penalties under the TPA. Ultimately, the enforcement of this policy is anticipated to enhance compliance with transfer pricing standards.⁸⁹

In Kenya TP is often abused due to lack of proper legislation. The anti-avoidance sections of law and the TPR are not sufficient.⁹⁰ Furthermore, the FNMCs invest in talented employees who are properly trained on TP unlike the KRA counterparts.

2.2.4 Use of tax Havens

Tax havens are regions that provide various benefits to taxpayers such as advantageous tax policies and favourable business terms that collectively result in reduced tax obligations, confidentiality of financial data, and secure channels for illegal funds.⁹¹

⁸⁶ Chege P, The organisation of economic cooperation and development (OECD) transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, Unpublished LLM Thesis, University of Nairobi, 11 November 2012, 86.

⁸⁷ Abuya J, Aggressive tax avoidance by multinational corporations: a study on the sufficiency of the response mechanisms provided by the Kenya tax laws, Unpublished LLM Thesis, University of Nairobi, 9 November 2021, 23.

⁸⁸ *Finance Act 2021*.

⁸⁹ *Income Tax (Country-By-Country Reporting Standards for Multinational Enterprises) Regulations 2021*.

⁹⁰ Abuya J, Aggressive tax avoidance by multinational corporations: a study on the sufficiency of the response mechanisms provided by the Kenya tax laws, Unpublished LLM Thesis, University of Nairobi, 9 November 2021, 24.

⁹¹ Lenartova G, 'The economic and social consequences of tax havens in the World' 83 *SHS Web of Conferences*, 01041 (2020), 5.

Nominal taxes constitute a fundamental characteristic of tax havens, as all tax havens provide nominal taxes or favourable tax benefits, a feature that appeals to foreign individuals seeking to establish businesses, make investments, or deposit their funds within that particular jurisdiction.⁹²

Kenya's existing legislation on transfer pricing is insufficient to address transactions involving entities in tax havens. According to Section 18(3) of the ITA and associated rules, controlled transactions are those occurring between related enterprises.⁹³ Nevertheless, a significant challenge arises when one of the transaction parties is situated in a jurisdiction classified as a tax haven. In such cases, the party located in a tax haven may present itself as an independent entity and engage in transactions with a related party.

This situation is exacerbated by the strict confidentiality laws in tax havens, which hinder the proper identification of transaction participants. Kenya has observed a growing trend where entities purporting to be third-party service providers or financial institutions are based in tax havens. It is essential to revise the existing regulations to address potential revenue losses resulting from undisclosed third parties operating from tax havens.⁹⁴

Many service providers in Kenya are increasingly choosing to operate from countries such as Mauritius and Liechtenstein, which are known for their low tax jurisdictions.⁹⁵

2.2.5 Creative Accounting

Creative accounting is a term used to depict an accounting methodology that may or may not adhere to the established accounting standards and principles. Nonetheless, it strays from the fundamental essence of those standards and principles to portray a specific image of the business. Although not unlawful, creative accounting is deemed unethical as it fails to fulfil

⁹² Lenartova G, 'The economic and social consequences of tax havens in the World' 83 *SHS Web of Conferences*, 01041 (2020), 6.

⁹³ Section 18(3) *Income Tax Act Cap 470*.

⁹⁴ Chege P, The organisation of economic cooperation and development (OECD) transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, Unpublished LLM Thesis, University of Nairobi, 11 November 2012, 134.

⁹⁵ Chege P, The organisation of economic cooperation and development (OECD) transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, Unpublished LLM Thesis, University of Nairobi, 11 November 2012, 148.

the primary purpose of financial reporting, which is to provide an impartial and accurate depiction of the business.⁹⁶

The fundamental concept behind creative accounting revolves around identifying loopholes within regulations and accounting principles to improve financial statements and portray the business in a favourable manner. While creative accounting can yield positive outcomes for businesses, its effectiveness is contingent upon its application in a constructive manner and within defined limits. Nevertheless, instances arise where organizations exceed these boundaries and exploit this practice, leading to severe repercussions. It is evident that creative accounting predominantly exerts a detrimental influence on financial reporting.

Typically, the manipulation of financial reporting is attributed to company management, whose directives are adhered to by the personnel responsible for financial reporting. The primary incentives for engaging in creative accounting encompass personal gain, competitive advantage, investor attraction, capital augmentation or preservation, deferring debt settlement, and surpassing analysts' projections regarding future corporate performance.⁹⁷

This involves the use of right accounting techniques to take advantage of tax laws. Techniques employed include income smoothing and aggressive accounting that may be deemed as fraudulent.⁹⁸ Some of the prevalent strategies in legal accounting involve utilizing credits and deductions to minimise taxable income.⁹⁹

2.3 Tax Law Enforcement Framework in Kenya.

TPA provides for a tax avoidance penalty. It provides that if the Commissioner has invoked a tax avoidance provision during the evaluation of a taxpayer, the taxpayer bears responsibility

⁹⁶ Remenarić B, Kenfelja I and Mijoč I, 'Creative accounting – Motives, techniques and possibilities of prevention' *Econviews* (2018), 193.

⁹⁷ Remenarić B, Kenfelja I and Mijoč I, 'Creative accounting – Motives, techniques and possibilities of prevention' *Econviews* (2018), 196.

⁹⁸ Kamau GM, Mutiso AN and Ngui DM, 'Tax avoidance and evasion as a factor influencing 'creative accounting practice' among companies in Kenya' 4 *Journal of Business Studies* (2012) 2, 77.

⁹⁹ Kamau GM, Mutiso AN and Ngui DM, 'Tax avoidance and evasion as a factor influencing 'creative accounting practice' among companies in Kenya' 78.

for a tax avoidance penalty amounting to double the sum of the tax that could have been evaded if the tax avoidance provision had not been applied.¹⁰⁰

The TPA creates an offence against an agent who assists a taxpayer to create a tax avoidance scheme.¹⁰¹ It further prescribes the sanctions for the offences. The sanctions are provided for under the TPA as follows;

1. *A person convicted of an offence of fraud in relation to tax, shall be liable to a fine not exceeding ten million shillings or double the tax evaded, whichever is higher or to imprisonment for a term not exceeding ten years, or to both.*
2. *A person convicted of an offence as a tax agent shall liable to a fine equal to double the tax evaded or to a fine not exceeding five million shillings whichever is higher or to imprisonment for a term not exceeding five years, or to both.*¹⁰²

Payment of tax on conviction shall be as follows;

1. *Where a person is convicted of an offence under a tax law and for which taxes were not paid the court may order the convicted person to make payment to the Commissioner of the whole or such part as remains unpaid either in addition to, or in substitution of, any other penalty.*¹⁰³

To be able to use legislation to impose sanctions, the perpetrators should be convicted. The burden of proof lies with the tax authority. In summary, the law has provisions that can enable prosecution of a tax offender.

2.4 Conclusion

The chapter has discussed tax non-compliance practices, by FMNCs, the Kenyan legislative framework relating to non-compliance, tax evasion and tax avoidance and tax law enforcement. It has explained transfer pricing, use of tax havens and creative accounting as tax avoidance practices employed by FMNCs.

¹⁰⁰ Section 85, *Tax Procedures Act Cap 469B*

¹⁰¹ Section 92, *Tax Procedures Act Cap 469B*

¹⁰² Section 104 (3), (4), *Tax Procedures Act Cap 469B*

¹⁰³ Section 105, *Tax Procedures Act Cap 469B*

CHAPTER THREE

3 Analysis and Presentation of Findings

3.1. Introduction

The purpose of this chapter is to report on findings following an analysis of the data in accordance with the research objectives. The section is divided into three main sections each addressing an objective of the study. A preamble discussing the structuring and sourcing of the data is also included here.

3.2. Response rate

Data was gathered from two main cohorts, the KRA officials and FMNC accountants. The initial plan was to collect data directly from the companies of interest namely; Absa, Unilever, Safaricom, Coca-Cola and EABL. This was encumbered with stiff resistance from the target companies. Requests for formal contact with staff for purposes of responding to the interview prompts were met with unequivocal declines or frustrated by bureaucratic requirements of chain of command authorizations. To navigate the hurdle, the researcher focused on auditing firm respondents that had insights of the inner workings of the industry as pertains to FMNCs and their tax practices. Noteworthy also was the strict requirement of absolute anonymity as a prerequisite to participation in the study. A total of 20 respondents provided feedback with 12 from audit firm 8 being KRA officials. Despite the low numbers, there was a convergence in views with common themes emergent from sector responses. Saturation was deemed attained on account of the convergence of views.

3.3. Descriptive observations

It emerged, from the auto-assessment of themes through word-density searches, that multinationals and taxes were the main points of focus of the discussion; no emergent themes were observed from the dataset.

depicted as a consequence of the tax planning efforts of the companies. In a summative observation, one respondent notes:

Compared to other countries, our rates are actually high. Our corporate tax because corporate tax rates, that tax on the profits made by corporates and multinationals in a country. So I was looking at the list of the rates, the percentage rates of corporate tax world rate and Kenya ranks at position 27 worldwide in corporate tax which is higher than almost ... number 27 out of 200 that is on the higher percentage. So our corporate tax rate on average from 2016 was 27.99%, 2015 was 28.11%, 28.21%, 28.26%, 28.09%, so right now it's at 30%. So I think that is high for the corporates or the multinationals.

AUDIT FIRM

I'm really avoiding to say tax evasion because it is very emotive. You can't say tax evasion really. For our work, once we audit a multinational and raise taxes, it's really ... you see we don't prosecute because tax evasion is illegal. It's a crime. So unless someone is actually convicted, you can't say that they were tax evading. Now that's a moral issue.

KRA

Similar sentiments are raised by a respondent from the FMNC cohort:

We have to understand what tax evasion and tax avoidance are. Tax evasion is actually an illegal way of actually avoiding to pay taxes but tax avoidance is actually a legal way of reducing the amount of tax that you are liable to pay to the government.

AUDIT FIRM

This distinction was deemed seminal to understanding the practices employed by FMNCs as they went about reducing their tax liability within the provisions of the law. The nature of the exposure to multiple jurisdictions allowed for FMNCs to consider tax practices that would enable minimal exposure to taxation. To achieve this, the FMNCs sought the best talent so as to ensure that adherence to the laws was guaranteed even as practices resulted in minimizing tax due. The following quotes substantiate the observation:

One advantage the multinationals have is their ability to hire very smart tax consultants.

KRA

They operate in a very smart way. They use very experienced tax experts.

They invest in planning. When they invest in planning they reap a lot in terms of not paying taxes legally. They do it legally.

AUDIT FIRM

Not really because you find that they have the same tax ... the audit firms are normally the same, PKF ... Ernst and Young ... and all those are reputable. So, I would peg compliance at almost the same level meaning the FMNCs are generally compliant and engage in extensive or aggressive tax avoidance practices.

KRA

Notably, the observation of high evasion practices among FMNCs was not popular for both cohorts; FMNCs were deemed to be under close scrutiny preventing them from engaging in non-compliance practices. Regarding the observation of high evasion practices among FMNCs, as made by the former commissioner, one respondent notes:

On the statement on tax non-compliance among MNCs as made by the then KRA commissioner, I think first of all it is baseless. It was made to appeal to the emotions of the citizenry. As a member of the team, I confirm that there has been no prosecution of any MNCs or FNMCs for tax evasion. The statement exhibits incompetence because if evasion is detected as the Authority we should have taken action against the perpetrators.

KRA

According to the audit firm respondents, the government's lack of accountability with respect to tax collection and utilization was considered a major driver of tax avoidance practices exercised among FMNCs. This resonates with the natural law theory that posits that there is a moral basis for tax compliance.

Essentially, FMNCs enforcing rigorous tax avoidance practices did so with the justification of high costs of taxes and accompanying mismanagement of funds. The lack of satisfactory contribution towards national infrastructure and underdevelopment in the nation was viewed to contrast with the high taxation context within which companies operated. The issue of morality in tax practices arose with the matter considered one of typical cost savings whereby if one could get away with the practice then it would be considered justifiable. This observation is evidenced by the following quotes:

“...The mismanagement of taxes by the government has led to a high cost of conducting business, prompting taxpayers to seek alternative methods to reduce this expense. Justification can always be sought, but the absence of tax accountability provides grounds for tax evasion. The inability to justify such actions stems from the moral implications involved. One may question the moral competence of the government - whether it is wasteful, corrupt, or possesses the ethical authority to enforce taxes on industrious individuals facing challenging operational circumstances. This situation can be likened to a double-edged sword.”

KRA

It's unjust where taxes are high and no significant contribution to development of the country. It's a strain to the multinationals or even the individual tax payers.

AUDIT FIRM

3.5 Objective two: Current tax non-compliance schemes employed by foreign multinational companies in Kenya

The theme of high taxation rates was also evident with the situation deemed central to the motivation to avoid taxation. The FMNCs are using tax planning methods to maximize the use of low tax jurisdictions. The most commonly used tax planning methods are transfer pricing, tax treaties to use tax havens to avoid tax and shifting profits through transfer pricing.

3.5.1. Transfer Pricing

Transfer pricing was the most commonly quoted tax planning practice. The practice was the arm's length requirement that affiliated parties engage in exchange of products and services at market rate costs. The difficulty of keeping track of multinational companies' operations was considered to be the most significant contributor to the frequency of the practice, among most FMNCs.

Transfer pricing is an area which is prone to exploitation by FNMCs. The requirement to trade in goods and services between a subsidiary based in Kenya and a subsidiary domiciled in another jurisdiction is carried out at “arm's length” basis. An example of this is the landmark case of *Unilever Kenya Limited*,¹⁰⁴ finding, where KRA held that the transactions were not at

¹⁰⁴ *Unilever Kenya Limited vs Commissioner of Income Tax (2005) eKLR.*

arm's length because the price of products sold to the subsidiary was less than that being sold to local customers. Unilever Kenya was selling goods to Unilever Uganda with only a 5% mark-up causing a loss to Unilever Kenya. The ruling in the Unilever case, resulted in the enactment of the Transfer Pricing Rules of 2006.

Some of the respondents were not very knowledgeable in the area of research hence giving answers that were not up to standard.

So first of all there is something called transfer pricing. So transfer pricing, basically, it's an accounting practice where the prices of one division in a company or one section of a company or one subsidiary of a multinational prices commodities or items differently to another subsidiary of the same FMNC in different tax jurisdictions, for the FMNC with the aim to reduce taxes.

AUDIT FIRM

Cross-border transactions, known as cross-border tax transactions or commercial transactions, are required to be conducted at arm's length. The concept of arm's length involves ensuring that the transaction is executed at the prevailing market rate.

Consequently, the question arises: what factors influence this market rate when engaging in transactions at market value? Moreover, how can one effectively allocate charges among related entities operating in disparate tax jurisdictions?

AUDIT FIRM

VT OMNES VNVM SINT

The cross-border transactions have tax implications. Domestic tax laws for each of the countries involved in a transaction apply independently. This may lead to double taxation where the same income is taxed more than once in different countries.

KRA

Despite tremendous contribution of the Unilever decision to the Kenyan Tax arena, particularly on the development of transfer pricing concept, questions are being asked as to whether there existed any sound legal foundations for the court, not only to recognise, but also proceed and apply the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing (TP) Guidelines in Kenya, in resolving the dispute notwithstanding the fact that Kenya is not a member of the OECD and was not involved in drafting the guidelines.

3.5.2. Tax Treaties

FMNCs are taking advantage of the tax treaties. Kenya has signed double tax agreements with the UAE, The Netherlands and Mauritius. Double taxation is a tax principle referring to income tax paid twice on the same source of income, which is an unintended consequence of tax legislation. It is considered as a negative element of tax systems that tax authorities want to avoid. The taxes were however pursued under a well-structured legal framework with respondents noting that the nature of the laws in place was advanced in comparison to other comparable jurisdictions.

The motivation to avoid tax was however different for different companies due to the contextual taxation requirements that were industry specific. A respondent notes:

The opinions of the respondents was sometimes marred with their understanding or practices being as KRA officers.

Most FNMCs that operate in Kenya are registered in tax havens such as Mauritius, the reason being that Mauritius signed a treaty with Kenya on 30th June 2020. They use double taxation agreements to avoid taxation rates in Kenya where they operate. The tax havens are used by FMNCs to ensure they pay minimal tax contributions in jurisdictions where they generate profits such as Kenya. This denies the Kenyan government the much needed revenue to finance accessible, quality and gender responsive public services.

3.5.3. Intercompany Agreements

Other stated practices relate to intercompany agreements such as export of services agreements. The structuring of business operations by FNMCs through these intra-group agreements is aimed at achieving advantageous tax arrangements. This aspect is further elucidated by multiple survey participants, as evidenced in their responses. The concept of tax planning was widely perceived to encompass a diverse range of strategies that were deemed justifiable based on the specific requirements and circumstances of the relevant industry. Despite the KRA's perspective, the general attitude towards such practices was not inherently negative. The

interaction between the involved parties was characterized by a level of professionalism, with each party striving to achieve favorable financial outcomes for their stakeholders; while the tax authority aimed at enhancing revenue generation, FMNCs endeavored to leverage legal tax provisions to minimize their tax liabilities.

Both counterparts regarded each other's actions as part of their respective professional duties. The complexity of the strategies employed by FMNCs to reduce tax obligations was seen as accomplishments rather than transgressions against governmental regulations. This perception aligns with the assessment made by the former tax commissioner regarding the widespread tax avoidance by many multinational entities. Moreover, the identified deficiencies outlined in the initial objective were attributed primarily to shortcomings in the current implementation mechanisms, rather than inherent flaws in the applicable legislation.

In the Coca cola case,¹⁰⁵ Coca-Cola Central East and West Africa is a limited liability company incorporated in Kenya. Its principal business is to provide marketing and promotion services for the world famous Coca-Cola brands. It is a subsidiary of the Coca-Cola Company which is incorporated in the United States of America and the owner of the Coca-Cola trade mark. Coca-Cola Africa asserts that the benefit of the marketing and promotion services accrues outside Kenya and should be treated as exported services. This, from the perspective of Coca-Cola Africa, is in consonance with the definition of the phrase “a service exported out of Kenya” found in section of the repealed VAT Act 2.¹⁰⁶ This defined an export service as “*A service provided for use or consumption outside Kenya, whether the service is performed in or outside Kenya, or both inside and outside Kenya*”.

The Commissioner of Domestic Taxes was of the view that the marketing and promotion services provided by Coca-Cola Africa are consumed locally as the target audience is Kenya and that such services should be treated as services consumed in Kenya.

These differences and views took a practical significance when the Commissioner conducted an in-depth tax audit into the operations of Coca-Cola Central East and West Africa Limited (Coca-Cola Africa) for the period 2007-2010 and issued an of assessment for Kshs.516,075,557/= being VAT on undeclared locally consumed services plus accrued interest

¹⁰⁵ Coca-Cola Central East and West Africa Limited vs. Commissioner of Domestic Taxes TAT Appeal No. 5 of 2018.

¹⁰⁶ Repealed *Value Added Tax Act* CAP 476.

compounded at the rate of 2% per month. The divergence of views turned into a tax dispute which escalated to the local committee and finally as an appeal before the VAT Tribunal. The Tribunal ruled in favour of the Commissioner.

Coca-Cola Africa appealed the decision; ¹⁰⁷ the issue for determination in the said appeal was whether marketing services provided by the Appellant to Coca-Cola Export, a company located outside Kenya amounted to exported services and chargeable to Value Added Tax (VAT) the rate of zero percent. The Court overturned the ruling of the Tribunal and agreed it was an export service hence the rate of tax was zero percent.

There are differences in adherence among FMNC's operating in Kenya. Given the existing loopholes in law that provide for ideal conditions to have the existence of Export Service Agreements for subsidiaries and in some cases affiliates of FMNCs operating in different tax jurisdictions and also the intercompany agreements that provide the leeway for companies.

KRA

The answers being given by some of the respondents were not well thought out and superficial. There was suspicion on the purpose of the study. The answers were like the one below;

I think the area where most companies ... not only multinationals is maybe income tax. Like in Kenya, you find most of them are in a loss position so I think that's where the problem usually lies. That's where I think KRA has not really done well.

KRA

You can refer to Coca-Cola vs KRA whereby Coca-Cola were claiming ... they were saying they only offer marketing and promotional service for their Coca-Cola Company registered in the USA. Coca-Cola Africa, in objecting to a decision to pay taxes assessed by the Commissioner stated the service they were offering is exported service of marketing and promotion, is for use and consumption in the USA hence should be taxed, KRA argues on the contrary, I think it should be apportioned so that KRA gets its rightful revenue and the other country should also get its rightful revenue.

¹⁰⁷ Coca-Cola Central East and West Africa Limited vs. Commissioner of Domestic Income tax Appeal No. 19 of 2013.

Coca-Cola and Unilever were the companies specifically called out on actual taxation violations that had been observed in practice, whereas Safaricom payment of royalties to Vodafone was considered an effort toward minimization of taxable income. Section 18 (3) of the ITA, ¹⁰⁸ provides;

Where a non-resident person carries on business with a related resident person and the course of such business is such that it produces to the resident person or through its permanent establishment either no profits or less than the ordinary profits which might be expected to accrue from that business if there had been no such relationship, then the gains or profits of such resident person or through its permanent establishment from such business shall be deemed to be of such an amount as might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length.

This section outlines how taxable gains or profits of business in relation to certain non-resident persons is determined. A non-resident person engaged in commercial activities within Kenya is obligated to fulfil tax obligations in Kenya on the profits derived from said activities. The operations of a non-resident person have the potential to establish a permanent establishment (PE) that is subject to taxation in Kenya. A PE constitutes a fixed business location encompassing a management office, a branch, a factory, a workshop, a mine, an oil or gas well, a quarry, or any site for natural resource extraction, a construction project that has existed for at least six months, or a representative acting on behalf of the non-resident. Interactions between a non-resident person and their PE or affiliated resident entity must be regarded as transactions between independent parties operating at arm's length for taxation purposes. Any interest, royalties, management fees, or professional fees disbursed by the PE to the non-resident person, as well as foreign exchange gains or losses linked to net assets or liabilities between the PE in Kenya and the non-resident individual, cannot be deducted when calculating the taxable income of the PE.¹⁰⁹

¹⁰⁸ Section 18(3) *Income Tax Act* Cap 470.

¹⁰⁹ Anne Maina: Tax implications on cross border transactions 12 March 2021 <https://www.kra.go.ke/news-center/blog/1137-tax-implications-on-cross-border-transactions> on 27 May 2024

I will speak about Safaricom because their engagements are clearer. Taxes like corporation tax are charged in Kenya but you know, still Safaricom is a subsidiary with the mother company being Vodafone. So they also have royalty arrangements. They pay for that name and they pay a good figure. So ideally there is pilferage in that way. For the rest I cannot say, I am not sure. Someone who would tell you would be one dealing with such companies directly which would be very difficult for someone to give you that information if they are complacent.

AUDIT FIRM

Though the above allegation was made by an FNMC respondent against Safaricom, there was contrary allegation showing Safaricom was compliant. Absa and EABL were not specifically mentioned as participants in non-compliance practices; rather, the prevailing belief was that the issue stemmed from the complexity of strategies employed for tax avoidance rather than adherence to sound taxation principles. The respondents stated as follows;

Absa has since its rebranding in 2020 successfully integrated the Country by Country report method to its annual financial reports through its annual group consolidated and separate financial statements that align to the regulator's requirements.

KRA

In 2019, EABL paid a total of Kenya Shillings 64 billion to the collections of countries it operates in. It has additionally over the years been noted as one of Kenya's consistent top tax-payers.

KRA

In 2020, Safaricom was feted as the top taxpayer in the country under the large taxpayers' category by the KRA. KRA honoured them for outstanding contribution to the development of our economy through diligent payment of taxes....In FY 2020 they paid Kshs. 98Billion in taxes. In 5 years form 2015-2020 the company's cumulative tax has amounted to Kshs. 409 billion.

KRA

3.6 Objective Three : Efficacy of current tax non-compliance enforcement provisions

The efficacy of the tax regime was considered to emanate from the provisions of the law; the laws were generally construed to be satisfactory when compared to those of peer nations. Licensing requirements placed on companies were complemented by the general tax regime approach of trust and facilitation as opposed to forceful enforcement.

However, despite the suitability of current laws, loopholes were considered inevitable on account of the multi-jurisdictional nature of FMNCs operations.

You know I think first of all KRA is at the front. It's actually trailblazing. Even in Africa, itself, I think it's probably the most aggressive of the taxing administrations in Africa. Okay, amongst the most aggressive, because you know you could think about South Africa and Egypt and Uganda is coming up.

KRA

...the account management system where these days every company has an account manager so if you ever have any issue or you want to seek clarity on a particular law, the door is always open towards the company. So you can always call directly and ask for clarity or any guidance in whatever laws that you don't understand something.

KRA

EABL, the largest tax payer in its sector. ... So if you get it right with the multinationals then you're a long way ... because again, there's no point of using a lot of money on administration for the small entities and yet you can focus on the big person and get the bulk of your tax. I think that's where we come from.

KRA

Laws were however considered to tell a fraction of the story with the other resting on enforcement efforts, external treaties, taxpayer's motivation to evade taxation, or carry out aggressive tax avoidance and the risk of discovery. Such external treaties developed by the

OECD were considered not to serve the interest of developing countries but were however un navigable on account of the counter force of external governments seeking to advance their will and in so doing the will of FMNCs seeking to operate within the country. The issue of FMNC taxation was also considered a political one in that current established authorities considered to have a stake in proceedings. Persons in positions of authority within the tax collecting body and the government were therefore viewed as reluctant to change legislation and champion enforcement efforts as they were directly benefiting from the status quo. Respondent asserts;

First, funding is key, political will is key, capacity is key and all these things are what is really lacking because you know there is all this push that we need to collect taxes, collect taxes. That's all they are saying but are you providing the right environment for that? Are you providing the environment for the multinationals to actually want to pay taxes? Are you providing the environment for your tax administration to be able to pick out the gaps?

KRA

The issue of taxation was also viewed through a broad angle in that FMNCs were operating in a hostile business environment on account, in part, of the complacency of the government in meeting its obligations developing the nation. The theme of corruption was also evidenced.

Moreover, the Kenyan government has established tax anti-avoidance regulations outlined in section 23 of the Income Tax Act Chapter 470. This provision grants the commissioner of taxes the authority to levy taxes in cases where a transaction is perceived to have been conducted with the purpose of reducing tax obligations. While such actions may not be deemed illegal, the KRA possesses the legal prerogative to demand payment of taxes that were lawfully avoided, provided they can prove that there was evasion.

AUDIT FIRM

The Finance Act 2021, introduced country-by-country reporting (CbC) reporting on Kenya headquartered Multi National Enterprises (MNE) groups, with effect from 1st January 2022. This led to the introduction of the Income Tax (Country-By-Country Reporting Standards for Multinational Enterprises) Regulations 2021. In summary, it provides that an MNE whose headquarters are in Kenya, generating a consolidated revenue of at least Kshs. 2.5 Billion, are required to file an annual CbC report at KRA. The report should contain information on capital,

revenue, tax paid and accrued, assets and the number of employees for each jurisdiction in which it operates. MNEs that do not comply with the regulations shall be penalized under the TPA. The implication of the regulation will be increased transfer pricing compliance.

The Authority will derive several benefits from the new CbC requirements. It will use the CbC reports to make high-level assessments for an MNE transfer pricing and Base Erosion and Profit Shifting (BEPS) risk, including assessing potential non-conformity to transfer pricing rules by the MNE. It will also use the information for economic and statistical analysis. Any inconsistencies between the CbC reports and the group transfer pricing policies will likely be flagged as indicators of tax risk.

KRA

The enforcement law is efficacious, as none of the FMNCs has been found in violation with the evidence to charge or prosecute in any court of law. However, capital flight by multinational companies being experienced in Kenya is due to reduced competitiveness in the EAC region and high cost of doing business. This is attributed to unplanned taxation and unpredictable business environment.¹¹⁰

3.6. Conclusion

In summation, the FMNCs that were subject to this study operating in Kenya engaged in tax planning activities but none engaged in tax non-compliance or tax evasion practices. The most commonly used tax avoidance practices were transfer pricing, use of tax treaties to take advantage of the tax havens, and intercompany agreements. With regard to effectiveness of tax non-compliance enforcement provisions, enforcement efforts we considered efficacious despite the prior reported loss in revenue because, the laws are in place and none of the FMNC's was found to be in breach of any law. The interviews could not give enough evidence to prosecute the FMNCs for tax non-compliance practices.

¹¹⁰ Phylis Wakiaga: The cost of doing business is becoming unbearable, Why Big firms plan to ditch Kenya for her neighbours, 28 January 2024 Nation: <https://nation.africa> > Home> Business: accessed on 27 May 2024.



CHAPTER FOUR

4. Discussion, Conclusion and Recommendations

4.1. Introduction

The purpose of this chapter is to assess findings from the forgoing chapter in light of extant literature and current legislation in accordance with the research questions. Three main

questions guided the study. First, what proportion of foreign multinational companies operating in Kenya engage in tax non-compliance. Second, what tax-noncompliance schemes are employed by multinational companies in Kenya and lastly how effective are the current anti-tax non-compliance enforcement provisions in light of foreign multinational tax non-compliance practices in Kenya. This chapter is divided into four main sections namely discussion, conclusion, limitations and recommendations.

4.2. Discussion

This section addresses research findings in light of legislation and postulations in extant literature. The section is divided into three main sub-sections each focusing on a study objective.

4.2.1. Proportion of foreign multinational companies engaging in tax non-compliance

There was marked hesitance, among potential study respondents, to participate in the study. This suggested potential hesitation to divulge information that would paint the organizations under study in bad light. The actual rate of prevalence of non-compliance to tax regulations may therefore be understated in subsequently discussed findings.

Two of the organizations under study were considered to have engaged in tax non-compliance practices. This places the estimate, based on the sample of the current study, at 40%. Tedds (2006) notes that levels of compliance differ with region, whereas up to 57.92% of organizations operating in the OECD reported up to 100% of revenues, of the companies operating in Africa and Asia, as low as 33.85% did the same. Findings from the current study, despite the low sample size, are therefore in keeping with those posited by OECD therefore suggesting validity by corroboration of statistics from an independent study.

An assessment of the amounts lost through unpaid taxes was subsequently conducted. Estimates ranged from 40 billion to 100 billion, annually. Cobham and Jansky (2020) place the cost of tax evasion in African countries at approximately 500 billion US dollars each year. The author also states that increasing the amount of financial aid sent to these countries does not have any significant impact on the economy. The continued leakage of taxation points to established channels of tax evasion.

Noteworthy, however, was the lack of distinction between funds lost through actual tax evasion and those lost through tax avoidance practices. There was reluctance, on the part of tax administration, to mark the various companies as engaging in explicit tax evasion on account of the legal implication of the statement. It was however apparent that the companies, on account of hiring experienced and talented individuals, found legal loopholes that could be exploited in minimizing their tax expenditure. This practice, though legal, was viewed by tax-law enforcers as a factor that was to be addressed through the consideration of better-fitting legislation.

An appreciation of the intricacy of the mechanisms employed in minimizing taxation was further noted as a significant factor in the quest to seek recompense for lost or foregone tax amounts as the enforcers deemed tax structuring talent in the companies as peculiarly talented and therefore capable of elaborate, albeit legal, schemes that progressively lower the amounts payable in tax.

4.2.2. Tax non-compliance schemes employed by foreign multinational companies in Kenya

Foreign multinationals in Kenya commonly engage in tax non-compliance through various schemes. One prevalent method is the manipulation of transfer pricing, where companies set prices for transactions between related entities to shift profits to low-tax jurisdictions.¹¹¹ Additionally, the use of subsidiaries in tax havens is a concern, allowing companies to minimize their tax obligations by routing profits through low-tax jurisdictions.¹¹² Use of intercompany agreements to reduce tax obligations. Explicit elaboration of tax non-compliance practices was limited to Unilever and Coca-Cola. These examples are however viewed in light of the assertion that tax practices among FMNCs were increasingly intricate and therefore difficult to identify. Additionally, most of the respondents reached for the interview were hesitant as they feared painting the companies in bad light by divulging damaging information.

A conflation of tax avoidance and tax evasion practices was also apparent. Most of the respondents on the tax enforcement side deemed the two practices, at least in motivation and outcome, of equal impact to the tax system as both resulted in a high amount of revenue loss. To this end, tax avoidance practices were discussed and among these, transfer pricing was the

¹¹¹ Chege PN, OECD transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, 123.

¹¹² Hubert D, The use of tax havens in the ownership of Kenyan petroleum rights, 2016, 10.

most commonly quoted practice. That involves the shifting around of costs within jurisdictions in order to achieve the lowest possible tax obligations across all jurisdictions. Related to the practice was the arm's length requirement that affiliated parties engage in exchange of products and services at market rate costs. The difficulty of keeping track of multinational companies' operations was considered to be the most significant contributor to the frequency of the practice among most FMNCs.

Janský, Prats and Aid (2013) observe that approximately 1500 multinational corporations that have operations in India employ the use of profit shifting strategies in order to avoid paying taxes thereby costing the Indian government a lot of money in revenue. The practice of tax planning to the end of tax avoidance was therefore considered, from a legal perspective, to be within the rights of the companies; hence although a frustrating outcome for tax officials, one that was addressable except by legislation and human resource empowerment via additional training and education. A sense of professional respect was evident from tax respondents as they viewed the tax planning personnel employed by the companies to be exceptionally good at their job hence were likely to perpetuate tax avoidance practices without immediate risk of disbanding of such practices by the tax officers. The administration of transfer pricing legislation is faced with challenges.¹¹³ The OECD TP guidelines, were drafted for developed economies hence the tax administration has experienced challenges, that sometimes cause loss of revenue.¹¹⁴

Sharman (2010) in identifying ways to curb high tax evasion rates, notes that the practice of blacklisting organizations that fail to remit taxes is an ineffective strategy for addressing the issue at hand. This inefficacy arises from the fact that blacklisting entities after their tax evasion constitutes a reactive methodology. Consequently, an imperative exists for enacting proactive legislative measures designed to preclude firms from evading taxation from the outset. In view of this observation in light of the provisions of current law, it is apparent that more needs to be done to address currently existing provisions that serve as loopholes in the interpretation of tax liability for companies. Such loopholes exist in the current Transfer Pricing Rules of 2006. The regulations that were developed as a result of the Unilever case. These regulations need to be

¹¹³ Chege P, The organisation of economic cooperation and development (OECD) transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, Unpublished LLM Thesis, University of Nairobi, 11 November 2013, 47.

¹¹⁴ Chege P, The organisation of economic cooperation and development (OECD) transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, Unpublished LLM Thesis, University of Nairobi, 11 November 2013, 49.

amended to provide for clearer provisions on the application of arm's length principles. The tax legislation also needs to include domestic anti-abuse rule for treaty application.

TPR of 2006, as a legal tool for transfer pricing is not effective. The same position was emphasised by Chege who enumerated challenges in aspects of transfer pricing that were absent in the Rules that rendered operation of arm's length principle difficult.¹¹⁵ These include; a gap scope of rules, consanguinity and affinity, definition of a permanent establishment, lack of legislation to deal with parties operating in tax havens, lack of safe harbour rules, lack of penalties for non-compliance with transfer pricing reporting requirements, lack of capacity of the tax administration, local committees and specialized courts, comparables - lack of a prescribed tool for database to support comparability analysis, application methods- lack of legislation to specify the acceptable range and lack of provision for allowing ADR in TP disputes.¹¹⁶

In recent proposals by the Ministry of Finance, a draft TPR¹¹⁷ has been developed, first, to try and adopt the changes proposed in the OECD guidelines and last to aim to address challenges in applying the arm's length principle.¹¹⁸ These rules are crucial due to inadequacies in existing transfer pricing laws and the need for reforms in the legal and institutional framework.¹¹⁹ Kenya has been facing transfer pricing issues, prompting the government to consider alternative approaches to the OECD Transfer Pricing guidelines, such as establishing a local database for pricing comparisons and implementing a penalty regime for non-compliance.¹²⁰

The draft regulations have proposed to include definition of commodities and expands the definition of related enterprises. This is to mean any two enterprises that meet any of the conditions outlined in section 18, 18A, 18B, 18C, 18D, 18E and 18F in the ITA.¹²¹ In the draft

¹¹⁵Chege P, The organisation of economic cooperation and development (OECD) transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, Unpublished LLM Thesis, University of Nairobi, 11 November 2012, 132.

¹¹⁶ Chege P, The organisation of economic cooperation and development (OECD) transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, Unpublished LLM Thesis, University of Nairobi, 11 November 2012, 133- 144.

¹¹⁷ Draft Transfer Pricing Rules (2023).

¹¹⁸ Kenya – Budget 2022-23 Highlights. *Africa Research Bulletin: Economic, Financial and Technical Series*, (2022), 59(3), 23805A.

¹¹⁹ Chege P, The organisation of economic cooperation and development (OECD) transfer pricing guidelines: an evaluation of their effectiveness in the Kenya's tax regime, Unpublished LLM Thesis, University of Nairobi, 11 November 2012, 145.

¹²⁰ Mbiuki JM, The legal and institutional framework of transfer pricing in Kenya: a case study of the Unilever case and its aftermath, Unpublished LLM Thesis, University of Nairobi, 1 March 2011.

¹²¹ Clause 2, Draft transfer pricing rules, (2023).

there is a proposal to include a proviso that, defines a publicly quoted price,¹²² tries to cure the current scenario in the case of *Beta Healthcare vs Commissioner of Legal Services and Board Coordination*¹²³. In this case, following an audit, KRA, issued a tax assessment of Kshs. 480 million relating to controlled transactions, which the company had applied the transactional net margin (TNM) method and the Authority applied comparable uncontrolled price (CUP) method. KRA applied a method other than the one the company had used to determine the price at arm's length. It used their formula, CUP, to carry out an assessment and demand additional taxes.

Application of methods in the draft regulations, is expanded to include transactions as provided for in the Act.¹²⁴ On the powers of the Commissioner, there's inclusion of a requirement of producing additional information for each category of controlled transaction.¹²⁵ This is more descriptive and an inclusion in the new rules. Clause 12 of the draft rules seeks to amend the current clause, by introducing the wording... '*any unpaid tax in a transfer pricing arrangement*'..., is deemed additional tax as provided in section 38 of the TPA.¹²⁶

Focusing on the legal provisions currently in place, it is evident that more is to be done to address inconsistencies that provide loopholes for tax avoidance. Definition of tax avoidance, scope of the tax avoidance schemes, Adherence to OECD-prescribed tax practices was considered detrimental to local tax collection exercises. Such treaties were seen to broadly represent the interest of developed countries at the expense of the developing. An example of this is the provision that taxes are supposed to be charged where the company was incorporated. The binding nature of such provisions and possible ramifications upon exit however meant that they remain a permanent feature that can be exploited by FMNCs.

There is need to develop updated TPR that are updated and capture realities in the country. In view of the proposals by the Treasury, as highlighted, there are still gaps on the safe harbour rules, lack of penalties for non-compliance with transfer pricing reporting requirements and

¹²² Clause 7(1)(i) and (ii), Draft transfer pricing rules.

¹²³ *Beta Healthcare International Limited v Commissioner of Legal Services and Board Coordination*, Tax Appeals Tribunal, Appeals No 866 of 2022, [2024] KETAT 143 (KLR).

¹²⁴ Clause 8, draft transfer pricing rules.

¹²⁵ Clause 9, draft transfer pricing rules.

¹²⁶ Clause 12, draft transfer pricing rules.

inclusion of ADR in the TP legislation to aid in resolution of disputes due to their technical nature.

4.2.3. Efficacy of current anti-tax non-compliance enforcement provisions

Both industry accountants and KRA officials considered Kenya's law on taxation as progressive. The efficacy of KRA officials was seen as deriving from both their application to the pursuit of tax offenders and the relative provisions of the law in comparison to the laws of comparable jurisdictions. However, despite the suitability of current laws, loopholes were considered inevitable on account of the multi-jurisdictional nature of FMNC operations. The enforcing bodies within which FMNCs operate were therefore considered to be engaged in a catch up exercise in identifying and addressing current loopholes even as they seek to provide personalized attention to companies.

Enforcement provisions for non-compliance are provided for in section 104 of the TPA.¹²⁷ The penalties for evasion or being involved in a tax avoidance scheme range from payment of a fine of ten million or double tax for the amount evaded or ten years imprisonment or both¹²⁸. Agents, however, get fined five million or double the tax evaded or five years imprisonment or both.¹²⁹ The thin line on the definition of tax avoidance,¹³⁰ the creation of offences when one engages in tax avoidance schemes, the sanctions imposed for being involved in a tax avoidance scheme or aiding and abetting the same,¹³¹ makes it difficult for tax administrators to enforce legislation.

4.4 Conclusion

This thesis sought to answer the three questions, namely; what proportion of foreign multinational companies operating in Kenya engage in tax non-compliance? What tax non-compliance schemes are employed by multinational companies in Kenya? How effective are the current tax non-compliance enforcement provisions in light of foreign multinational tax non-compliance practices in Kenya? In answering the first, it emerged that 40% of the companies can be surmised to engage in tax non-compliance practices. Tax evasion was not

¹²⁷ Section 104, *Tax Procedures Act Cap 496B*.

¹²⁸ Section 104(3), *Tax Procedures Act Cap 496B*.

¹²⁹ Section 104(4), *Tax Procedures Act Cap 496B*.

¹³⁰ Section 2, *Tax Procedures Act Cap 496B*.

¹³¹ Sections 97 and 104 *Tax Procedures Act Cap 496B*.

reported; tax avoidance practices, with transfer pricing the most common, others were profit shifting and intercompany agreements. The efficacy of current enforcement approaches was compromised by an unclear legal framework to govern tax avoidance, binding foreign agreements like the OECD Transfer Pricing Guidelines for Multinational Enterprises and Administrations that are not adaptable to the local context and lack of capacity among tax officers.

4.5 Recommendations

Three main recommendations are forthcoming from the study: First, the need to apprise and update current taxation legislation. Clearer definition of tax avoidance, the amendment or repeal of the sections that create offences and penalties for the same. The TPR 2006, needs to be amended to include provisions that will address the challenges faced as posited in this thesis, and assist in the enforcement of regulation hence ease the operation of the arm's length principle. Draft and adopt treaty anti-abuse legislation. Second, the need to provide professional development opportunities amongst tax officers; and the need to employ transparency measures in the enforcement of current legislations limiting KRA and FMNC concerted malpractice in identification and prosecution of those that engage in tax evasion. The first recommendation derives from the fact that there are shortcomings in the current legal framework.

Tax management professionals in FMNC are exceptionally talented and well trained. Recruitment exercises among tax bodies should therefore adjust in appreciation of this fact. Additionally, current staff should be trained on the emerging tax evasion practices so as to meet the needs of the industry. Finally, tax transparency measures on the enforcement side should be considered to prevent loss of revenue through corrupt practices in the collection process.



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Appendix A: Similarity Report

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Appendix B: Ethical Clearance Release Letter



28th May 2024

Ms Kamar Belinda,
belinda.kamar@strathmore.edu

Dear Ms Kamar,

RE: Tax Non-Compliance Practices by Foreign Multinational Companies and the Efficacy of Tax-Law Enforcement in Kenya

This is to inform you that SU-ISERC has reviewed and approved your above SU-masters proposal. Your application reference number is SU-ISERC2278/24. The approval period is from 28th May 2024 to 27th May 2025.

This approval is subject to compliance with the following requirements:

- i. Only approved documents including (informed consents, study instruments, MTA) will be used.
- ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-ISERC.
- iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-ISERC within 72 hours of notification.
- iv. Any changes anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-ISERC within 72 hours.
- v. Clearance for the export of biological specimens must be obtained from relevant institutions.
- vi. Submission of a request for renewal of approval at least 60 days prior to the expiry of the approval period. Attach a comprehensive progress report to support the renewal.
- vii. Submission of an executive summary report within 90 days of completion of the study to SU-ISERC.

Before commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology, and Innovation (NACOSTI) <https://research-portal.nacosti.go.ke/> and obtain other clearances needed.

Yours sincerely,

Mr Ambrose Rachier,
Chairperson; SU-ISERC

Appendix C: Interview Guide

Objective 1 – General adherence to tax requirements among multinational companies in Kenya

It is generally believed that foreign multinational companies evade tax in Kenya? How do they do it?

What is the extent of tax non-compliance in terms of revenue lost? (year and amount)

How compliant are the following foreign multinational companies to tax requirement regulations in Kenya? Barclays, Unilever, Coca-Cola and EABL.

Are there possible differences in adherence among the companies? If so, why do you think that is the case?

Questions for KRA staff who deal with the taxation affairs of multinational companies in Kenya:

It has been claimed by many persons, including John Njiriani the former KRA Commissioner, that foreign multinational companies (MNCs) operating in Kenya evade tax in Kenya?

How do they do it?

Have you “caught” any MNC doing it? If so, how did you “catch” them and what exactly were they doing?

If they have not been “caught” evading tax, why do so many people state that they are evading tax? Please state very precisely the basis of the statements that many people have made and what is generally believed by many in KRA and in Kenya.

Are MNCs able to evade tax because Kenya tax law is deficient in some way? If Kenya tax law is deficient, how can it be improved to eliminate or reduce tax evasion by foreign MNCs in Kenya? Or is it impossible to formulate law so that this evasion is eliminated? If it is impossible, why is it so?

Do Kenyan MNCs (e.g. Equity Bank, KCB, TPS, etc.) evade tax in the foreign countries in which they operate? If so, how do they do it? If they do not evade taxes in these foreign countries, on what basis do you say they do not? Do you really know with concrete facts to prove your opinion?

Is the tax law in Kenya clear, unambiguous, easy to understand and easy to interpret? If Kenya tax law displays all of these qualities, is tax still evaded? If so, how? If not, why and how not?

Questions for multinational company staff who deal with the taxation affairs of those multinational companies in Kenya, both foreign MNCs and Kenyan MNCs:

It has been claimed by many different people that MNCs evade tax by setting up sister companies in tax free jurisdictions through which they channel their transactions so that profit is made in the tax free jurisdictions and very little profit is made in the tax-charging countries in which they operate. How would you prove to an official from the revenue authority in a tax-charging jurisdiction that the MNC for which you work does not do this? Or does it do this?

Is the rate of tax in Kenya high?

Is the tax law in Kenya just?

Is the tax law in Kenya clear, unambiguous, easy to understand and easy to interpret? If Kenya tax law displays all of these qualities, is tax still evaded? If so, how? If not, why and how not?

Do you find that the KRA interpretation of tax laws is different from yours? Please give me specific concrete examples.

Have you ever dealt with the tax tribunal or a local committee in Kenya? Have you had decisions made by the tax tribunal, local committee, court or intermediary? In your opinion, was the decision the correct one? Why or why not?

Objective 2 - Current tax non-compliance schemes employed by multinational companies in Kenya.

What general tax non-compliance approaches are employed by foreign multinational companies?

Which of the foreign multinational companies practice the tax non-compliance practices?

What is the reason for selection of one practice over another?

Objective 3 - Efficacy of current tax non-compliance enforcement provisions in light of multinational tax non-compliance practices in Kenya.

What provisions does the Kenya Revenue Authority employ to ensure that foreign multinational companies adhere to taxation requirements?

How effective are the current approaches considering the various tax non-compliance practices employed by foreign multinational companies?

Regarding efficacy of preventative and remediation measures, how does the KRA compare to other regulation agencies within which the various foreign multinational companies operate?

What are the legislative gaps that can allow a foreign multinational engage in tax non-compliance practices?

If you engaged in tax evasion how would you do it?

