A CRITICAL ANALYSIS OF BLUE COLLAR TAXTION IN KENYA

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DECLARATION

I, IVY WARUI declare that "A CRITICAL ANALYSIS OF BLUE COLLAR TAXATION IN KENYA" is my own work that it has not been submitted for any degree or examination in any other university or institution, and that all the sources I have used or quoted have been indicated and acknowledged by complete
references.

Signature ____________________ Date________________________

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This work has been submitted with my approval as the University supervisor

Signature ________________________ Date ______________________

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Abstract

Over the years, raising of revenue in Kenya has been heavily dependent on payment of taxes by the middle class. This has strained their pockets at the same time contributing to budget deficits year after year because they cannot raise enough money to fund a trillion-shilling budget. The motivation behind this study was the effects that taxation has on the small percentage of Kenyans who pay taxes. Majorly, a lot of Kenya's resources are not enough to cater for the population and to make up for the deficit; the state always results to taxation. Whether it is increasing Value Added Tax (VAT) on commodities, or imposing higher custom duty on imports or toughening policy on filing of tax returns, the solution usually revolves around a mark-up of taxes. This seemingly positive gesture to increase revenue to improve the lives of Kenyans is harmful in its practical aspect. This is because despite paying all these taxes, healthcare is still unaffordable for majority of the population; people are still living and learning in deplorable conditions. This study, done through resources such as books and desktop research, is designed to optimize the taxation system in Kenya. The overall purpose of this study is therefore to review the taxation legal framework and to propose changes that encompasses the inclusion of manual and blue-collar labourers in the taxpayers' bracket. Over the years leading up to now, there has been an increase in the digitization of commercial money transfers and mobile phone communication. These emerging trends in the country will be beneficial in this study because they will greatly influence the proposed solution and subsequently the success of the outcome.

Chapter 1

INTRODUCTION

1.1 Background of the Study

Taxes are charges that the government imposes on citizens as a way of raising revenue for the proper functionality of the state.[1] Taxes have different purposes. From payment of salaries and wages (recurrent expenditure) to funding projects by the government.[2] A system is defined as a set of things working together as parts of a mechanism.[3] This definition applies also to a taxation system. [4] A system can only be efficient, effective and productive if the main key players who are the taxpayer and the tax collector are working together for the betterment of society.[5] Now in order to understand Kenya's current taxation system and to comprehend the intensity of the issue with its efficiency, it is crucial to understand the constitutional and statutory framework of taxation in Kenyan law. The efficiency of a taxation system means a tax system that encompasses a majority of the principles of taxation as elaborated by Adam Smith[6]. The importance of this study, therefore, is to come up with a framework that provides for the inclusion of the larger majority of Kenyan citizens who constitute blue collar workers in the tax payers bracket which will increase the amount of taxes being collected while at the same time reducing the tax burden on the middle working class in the society and cooperates. Previous work by authors such as Francis Gitau[7] on taxation has sought to analyse the previous tax reforms and productivity in Kenya and concluded that there is an imbalance between revenue collection and government expenditure.

The main existing legislative frameworks on taxation in Kenya are the Kenya Revenue Authority (KRA) Act Cap 469[8] and the Constitution of Kenya 2010.[9] The Constitution of Kenya 2010 in Chapter 12 states that public finance subsequently providing the government with revenue raising power through imposing taxes and charges. Article 209 of the Constitution provides for the taxes

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[1] Oxford Learners Dictionary (9th edition,2015) 1550.
[2] Gabriel Kitenga, *Introduction to Tax Law* (2nd edn, Law Africa 2015).
[3] Oxford Learners Dictionary (9th edition,2015) 1550.
[4] Oxford Learners Dictionary (9th edition,2015) 1550.
[5] Oxford Learners Dictionary (9th edition,2015) 1550.
[6] David Ricardo, *On the Principle of Political Economy and Taxation* (3rd edition, John Murray 1821)
[7] Francis Gitau, 'Tax reform and productivity in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/15255/Gituku_Tax%20Reforms%20And%20Revenue%20Productivity%20In%20Kenya.pdf?sequence=2 > accessed 27th August 2019.
[8] Cap 469 Laws of Kenya.
[9] Constitution of Kenya 2010.

the government is allowed to impose on the people and also states that any other tax not stated in the constitution, should only be imposed if a statute provides for it. The functions of the Kenya Revenue Authority are set out in the KRA Act as follows, ‘ authority shall under the general supervision of the Minister of Finance be an agency of the government for the collection and receipt of all revenue’.[10]

These legal frameworks of taxation are helpful in the administration of taxation activities in Kenya though they curate some challenges. The constitution gives only a few taxes that the government can impose on Kenyans whether through direct taxation or indirect taxation. Direct taxes include income tax and customs duty while indirect taxes include Value Added Tax (VAT).[11] For a developing country like Kenya that heavily relies on borrowing and taxes to raise revenue, increasing tax rates or introducing new taxes whenever the government needs to raise funds usually is the route taken.[12] This is evident with the introduction of Turnover and Presumptive taxes[13] because of the need to increase revenue collected in Kenya.

The challenge with this approach to raising revenue is in its implementation.[14] According to the statistics realised by KRA in 2017, ‘the number of people who filed for income tax was 3.2 million with an estimated population of 46 million Kenyans bringing this to only 6.9% of the population.[15] With extreme figures such as these, such a small percentage of Kenyans cannot generate revenue through income tax enough to fund education, healthcare, salaries, infrastructure and pay off foreign debt without straining. This beats the sole purpose of taxation which is to improve the lives of Kenyans. The effect of such statistics is the little revenue collected will be stretched thin to allocate at least something to both national and county governments in all dockets that need

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[10] Kenya Revenue Authority Act (revised 2012) 1995, S 5(1).

[11] Francis Gitau, ‘Tax reform and productivity in Kenya’ (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/15255/Gituku_Tax%20Reforms%20And%20Revenue%20Productivity%20In%20Kenya.pdf?sequence=2 > accessed 27th August 2019.

[12] Daniel Muema, ‘Letters: Why Kenyans should embrace paying taxes’ (Business Daily, 15th January 2019) < www.businessdaily.com > accessed 3rd April 2020

[13] Kenya Revenue Authority, ‘What is presumptive tax’ < https://www.kra.go.ke/en/helping-tax-payers/faqs/presumptive-tax > accessed 3rd April 2020.

[14] Daniel Muema, ‘Letters: Why Kenyans should embrace paying taxes’ (Business Daily, 15th January 2019) < www.businessdaily.com > accessed 3rd April 2020.

[15] Daniel Muema, ‘Letters: Why Kenyans should embrace paying taxes’ (Business Daily, 15th January 2019) < www.businessdaily.com > accessed 3rd April 2020.

funding. This causes a deficit in the tax target annually because less than 10% of the population cannot feed a trillion-shilling budget, hence this study.

1.2 Significance of Study

This study is essential in understanding the gaps of Kenya's taxation system in failing to provide a framework for the taxation of the informal sector This study, shall dissect the Income Tax Act and how it fails to include blue collar workers in the taxation framework. A good tax system usually only considers the lowest tax rates which can be dangerous and lead to inaccurate results.[16]

Kenya shall be subject to comparison against foreign jurisdictions, specifically, India with a fairly good tax system that has managed to come up with a framework that includes taxation of incomes from the informal sector.

1.3 Literature Review

Primarily, a lot of literature has been written on taxation and its effects over the years. This review shall discuss some of the notable literature put forth by taxation scholars all over the world on the taxation of blue-collar workers. The aspects to be reviewed include the problems faced by taxation when it comes to taxation of blue-collar workers; the attempts to fix this problem through reforms and legislation; how some of these reforms have failed to successfully incorporate blue collar workers in the tax regime and the reasons why they have failed; and finally, a comparison between Kenya and India taxation of blue collar workers.

Aamir, Qayyum, Nassir, Hussain, Khan and Butt[17] seek to explain the types of taxes namely direct and indirect tax. This article is based on the determinants of tax revenue where the study seeks to compare direct and indirect taxes in Pakistan and India. It also compares the two with respect to their effects in their different countries of application. The cases of Pakistan and India will provide insight on the administration of direct and indirect taxes and the effects resultant of their different

[16] Adari M. 'Value added tax in Kenya'. Unpublished MA research paper, University of Nairobi. (1997) < http://erepository.uonbi.ac.ke> accessed 20th July 2019.

[17] Muhammad Aamir, Arslan Qayyum, Adeel Nasir, Shabbir Hussain, Kanwal Iqbal Khan and Sehrish Butt. 'Determinants of tax revenue: A comparative study of direct taxes and indirect taxes of Pakistan and India'. (2011) 10 <http://www.ijbssnet.com/journals/Vol_2_No_19_Special_Issue_October_2011/21.pdf> accessed 20th July 2019.

fiscal policies, and how these countries compare to Kenya given their similarities in population and development. Comparing the two regression equations and standardized betas the article explains how the more revenue is charged through direct taxation goes into economic growth. It also seeks to show how indirect taxes contribute to the widening gap between the rich and the poor and the exploitation of the working class. This will provide insight on direct and indirect taxes which is necessary for this study because, in order to understand Kenya's fiscal policy, the knowledge and differentiation of the different taxes are essential.

Another article by Adari[18] explains the meaning of Value Added Tax (VAT) in the Kenyan context. The author follows the history of VAT from when it was first introduced in Kenya in 1990 to replace the Sales tax which had been there since 1973. The author's objective is to evaluate the determinants of VAT that will help countries that have not yet adapted this taxation form on how to do so. Finally, the article explains how countries like Kenya will be quick to raise VAT when in need of increased revenue. This could be detrimental to the people and the economy and the importance of studying the Electronic Tax Register (ETR) and withholding tax in relation to VAT. Adari's work has proven to be important to this study especially when it comes to understanding the importance of VAT in economic growth. VAT is the only tax that affects a majority of the population including the blue-collar population since it is charged on commodities. This article is also important for statistical analysis of the effect of VAT on the total revenue collected.

When it comes to explaining the optimization of Tax in Kenya, Kitenga's[19] book is important because it provides the factors that constitute an optimal tax system. An optimal tax system means one which achieves the maximum possible number of principles of taxation.[20] The author states these principles/canons of taxation such as equality, certainty, convenience, economy and productivity. These principles stem from the four main canons that were originally argued by Adam Smith. He also goes ahead to explain the importance of an optimal tax system. He states that with an optimal tax system, collection and utilization of taxes would be maximized with little to no corrupt interference which would help the economy thrive.

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[18] Adari M. 'Value added tax in Kenya'. Unpublished MA research paper, University of Nairobi. (1997) 5 < http://erepository.uonbi.ac.ke> accessed 20th July 2019.
[19] Gabriel Kitenga, *Introduction to Tax Law* (2nd edn, Law Africa 2015).
[20] Gabriel Kitenga, *Introduction to Tax Law* (2nd edn, Law Africa 2015).

Simiyu[21] writes about the problems that have crippled justice in taxation. Some of the problems stated are lack of equality, poor distribution of the burden of taxation and corruption. The world over, these problems continue to cause a lot of problems when it comes to the collection and utilization of revenue collected through taxation. These problems hinder the optimization of the tax systems in the country. The author also goes ahead to explain the factors that are essential in a good tax system. He lists them as follows: conforms to the main canons of taxation, equitable, cheap collection of taxes (economical) and should promote the development of the trade and industry. In other words, a good tax system should embody the canon of taxation given by Adam Smith and expounded by other scholars. If a solution is to be reached through this study the problems of taxation need to first be addressed. This explains why Simiyu's work is important for this study because of its insight into the problems of taxation.

Like most developing and developed countries, tax amnesties have been introduced as part of the fiscal policies. Kwatemba[22] delves into the impact these tax amnesties have had on revenue collected in Kenya. The articles explicitly talk about the methodology of estimating the impact of tax amnesties in Kenya together with the control variables in tax revenues. This article highly recommends the adoption of amnesties by the Kenya Revenue Authority. The author also recommends transparency and honesty while handling international donations and zero tolerance policies for corruption to maximize the utilization of taxes.

Gituku[23] states that tax laws keep changing based on the needs of the country or the leaders in power. The type of president, governor or even Member of Parliament has a lot of impact on the laws that affect taxation in a country. It is therefore inevitable to have tax reform in a country whether developed or developing. These tax reforms usually lead to increased productivity or reduced productivity. This article focuses on the tax reform and productivity in Kenya depending

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[21] N.T.T Simiyu, *Taxation I: Professional Business Trainers*, (5th ed , Foundation Institute of Professionals 2003) 23.

[22] Ben Kwatemba, 'Impact of Tax amnesty on tax revenues in Kenya.' (2016)11 < http://erepository.uonbi.ac.ke/bitstream/handle/11295/100237/Kwatemba%20Ben_Impact%20of%20Tax%20Amnesty%20on%20Tax%20Revenues%20in%20Kenya.pdf?sequence=1&isAllowed=y > accessed 24th July 2019.

[23] Francis Gituku,' Tax reform and revenue productivity in Kenya.' (2011)6 < http://erepository.uonbi.ac.ke/bitstream/handle/11295/15255/Gituku_Tax%20Reforms%20And%20Revenue%20Productivity%20In%20Kenya.pdf?sequence=2&isAllowed=y> accessed 24th June 2019.

on the specific reform. Adjusting tax policy usually aims at raising revenue e.g. the increase of Value Added Tax to 16% was a move aimed at increasing government revenue in Kenya. This had a spiral effect on the price of commodities, wages and salaries and the overall saving and expenditure of the people. This article is important to the study because it expounds on the importance of tax reform which is key when it comes to finding a solution.

Kariba[24] explores the aftermath of the tax reform policies in Kenya. She seeks to understand whether the impact of these policies was beneficial to the Kenyan economy or not. Tax reform program began in 1986 to enhance: revenue collection, tax administration and reduce compliance and collection costs. She also advises on tax modernization like the itax portal. The author points out that despite these reforms, the Ministry of Finance and the Kenya Revenue Authority are still facing the same problems as before the reforms. These challenges are the impossible taxation of agriculture, livestock, the informal sector, high tariff rates, rigid customs, weak capacity to process large volume of returns and refunds. Despite the emphasis on tax reform as a way of solving the problems of taxation Kariba's work gives insight on what comes after the reform which is particularly important to this research because of its focus on reform as a solution.

Ndambuki's[25] work will also be useful because he seeks to understand the impact that taxation has on the economy and how, if any, the reforms have contributed to the improvement or decline of the economy. The author also seeks to understand the contribution that VAT has had on the economy it being a big contributor to indirect revenue in the country and also examines the effects of VAT on the economic growth rate. Through the three different approaches to the distribution of tax burdens which are progressive tax, proportionate tax and regressive tax the author seeks to explain taxation in a different light. The author also links these approaches to tax reform and the types of taxes there are to determine the economic welfare of the country. This article is important to this study because it gives the importance of taxation and particularly indirect taxation which

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[24] Lilian Kariba, 'An analysis of tax reform policies and tax revenues in Kenya.' (2011) 17,19.<https://pdfs.semanticscholar.org/5be3/4157377786da8fe21ff43ed607bfdd7f4a95.pdf> accessed 16th July 2019.

[25] Felix Ndambuki, 'Regressive Tax reforms and economic welfare in Kenya.' (2014) 1,4,5,9.<https://pdfs.semanticscholar.org/a533/85d6e8b95fc5a2423ce1ebdc60952050ab84.pdf> accessed 23rd July 2019.

full incorporates the populus including the blue-collar workers to an economy which is the main focus.

Gashneko, Zima and Davidyan[26] bring out the ideal situation of a taxation system. What it would be like for countries/states if and when these entities are to have an optimized taxation system. By an optimized system, the author means a system that is free of corruption and the monies collected in revenue are properly utilized with the minimum cost of doing so. With an optimized taxation system, the authors explain the benefits of this ideal situation to a country one of which includes reduced poverty levels. They however also list the challenges that a state would encounter when optimizing its taxation system. In conclusion, the article provides solid arguments in favor of optimization of tax systems and policies. The intended outcome of this study is an optimal tax system for blue collar workers in Kenya, this book sheds light on what that is like to optimize taxation of blue-collar workers.

The sampled authors for this literature review have done extensive research on the reforms of taxation law in Kenya and comparative studies of policies in various countries. Therefore, this study will analyse and determine the reason why there is a low percentage of taxpayers in Kenyan's economy and through additional reforms to the taxation policies in Kenya to include the larger percentage of Kenyans in the revenue pool.

1.4 Problem statement

The Kenya Revenue Authority (KRA) is the body mandated by statute to assess, collect and account for all the revenue collected in accordance with the KRA Act. In an ideal Kenya, the collection of these taxes would be optimized. This means that from the point of collection of the taxes, to the allocation of the said taxes and their utilization, the process would achieve the maximum possible number of principles of taxation like equity, convenience, certainty and economic efficiency. An optimal taxation system would include the equal and direct taxation of all citizens and residents. Also, ideally a proper taxation system would mean that the tax burden is equally distributed among all the citizens and foreign person or persons residing in Kenya. This is

[26] Irina Gashneko, Armenak Davidyan and Yulia Zima, *Optimization of the Taxation System: Preconditions, tendencies and perspectives* (Springer Nature Switzerland AG 2019)3,11.

where the responsibility of paying for taxes does not heavily rely on the working class, cooperate bodies and investors, who constitute the lower percentage of Kenyans, to feed the ever-growing budget. This would guarantee Kenyans world-class infrastructure, good and affordable healthcare, quality and standard education and a reduction in the poverty levels.

In actuality, however, Kenya's revenue is raised by a fraction of the entire population. There is a strain on the working class to deliver when it comes to paying of income tax. For instance, data released by the Kenya Revenue Authority (KRA) in 2018 indicated that the number of taxpayers who filed the annual income tax returns for the 2017 year of income stood at 3.2 million. Working with a population size of 46 million Kenyans, the number of those who filed income tax represents a partly 6.9 percent of the population.[27] This trend can only point to one thing; the country's economy is being driven by a very small portion of the country's total population.

In order for Kenya to move towards its desired goal of optimization and ultimately efficiency in the Kenyan taxation scenario it would take a miracle. However, more realistically, there needs to be a change in policy that addresses the issues of over taxation of the middle class. This can be achieved by finding a way to tax blue collar workers who are not registered as income taxpayers by KRA. This will increase the pool of revenue from around 7 percent of the population too much higher. Through this initiative, there will be less strain on the middle class while consequently increasing the amount of revenue collected. The proposed policy should also work towards curbing corruption and looting of taxes to ensure Kenyans get their money's worth.

1.5 Theoretical Framework

A theoretical framework is necessary in legal writing because it forms the basis on which the said topic is explained.

1.5.1 Natural law Theory

Natural law[28] is that theory that was heavily propagated by Thomas Aquinas. Aquinas said that natural laws are innate laws that people are born with. They have in them instincts that are given

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[27] Ibid.

[28] L.B Curzon, *Jurisprudence* (2nd Ed, CPL 1995) 37-58.

by the superior being, God. Natural law theorist believes that there is a God who created the world and all it pleasures. Aquinas argued that God created the world according to natural laws which are predictable, goal driven systems whereby life is sustained and everything functions smoothly. However, not everyone knew about God but they were driven to do good and have morals which is why Aquinas stated that God created us with instincts thus birthing the natural law theory. Unlike positivist, natural law campaigns for the involvement and inclusion of morality in laws. With natural law, Aquinas gave the seven basic goods which everyone should live by which are life, reproduction, educate one's offspring, seek God, Live in Society, avoid offence and shun ignorance. He also said that our instinct shows us the basic good and reason allows us to derive the natural law from them. Natural law related to taxation in many ways. The sacred writings tell us that man should give Caesar what belongs to Caesar and God what belongs to God.[29]Taxation, therefore, has a basis and a foundation in Natural law. It is therefore good, just, moral and noble to give taxes faithfully to the state.[30] Natural law condemns tax evaders. Out of the seven basic goods, the ones that relate to taxation are avoid offence and live in society.

Most of the taxation problems faced in Kenya today are as a result of not upholding the good 'morality'[31]. Tax collectors are assumed to be corrupt and therefore the taxes collected either do not go into their intended purpose because they end up in peoples personal accounts or, they are not collected at all. This according to Natural law goes against the innate instincts to do good and are evil and vile. "Thomas Aquinas' reply to one of the criticisms by David Hume on the viability of Natural law was that the reason people do bad things despite having the innate instinct to do good is ignorance and emotion"[32]. In this case, the emotion is greed. Therefore, to have an optimal taxation system, the law should borrow from Thomas Aquinas and create policies that are right and just for the benefit of society and the greater good. Laws of taxation should go towards developing the society which means excessive taxation of Kenyan citizens should stop, tax payers should also perform their due diligence by giving the state what is rightfully theirs and the Supreme Being commanded. Following Natural law would make our lives better.[33]

[29] Ibid.
[30] Ibid.
[31] Ibid.
[32] L.B Curzon, *Jurisprudence* (2nd Ed, CPL 1995) 37-58.
[33] Ibid.

1.5.2 Marxist Theory

This theory was propounded by Karl Max as a way of understanding the class struggle and class structures within the bourgeois/capitalist society.[34] This theory is pretty relevant in Kenya because after the white man, Kenyan's were damned to capitalism. Every man for himself, God for us all. Marx had three separate thoughts on his philosophy, the strand applicable in this taxation context is the laws of economic production. "Marx stated that with capitalism come exploitation of the working class, those with only their labor to sell, by the rich"[35]. Now, from a taxpayer's point of view, it is unequivocal that how our tax rates are determined and executed is exploitative. Any time the government needs more money to fund their ever-growing budget, they do so by imposing new taxes on tax payers or increasing the rates on the already existing ones. The basis of a society is its economic foundation. Kenya's economic foundation is not a very strong one given that according to the Kenya Bureau of Statistic, a majority of the citizens are poor or do not pay their taxes. This leaves the small percentage of companies and middle-class citizens to fund the budget. Taxation continues to broaden the class gaps in the country because the poor get poorer as the rich get richer. Political and legal structure like rules procedures, theories are usually controlled by the 'rich' who will work towards their own benefit when coming up with the said structures.

Therefore, if Kenyans would like to change their taxation system, the key issues that they need to reconcile is having elitists control the taxation laws. The majority of the population should be the ones to decide who gets into power and make sure their political agendas align. A good example is President Donald Trump and his taxation policies in the United States. Since assuming office, America has seen an increase in their GDP to 3.1 the highest it has been for 14years which is a record-breaking achievement. This is what happens when the political and legal structures align with the needs of the society.[36]

1.6 Research questions

1. What is an optimal taxation system of blue-collar workers?

[34] L.B Curzon, *Jurisprudence* (2nd Ed, CPL 1995) 139-148.
[35] L.B Curzon, *Jurisprudence* (2nd Ed, CPL 1995) 139-148.
[36] 'US 2020 Election: The Economy under Trump in Six Charts' BBC World News (London, 3 November 2020) 2.

2. What is the current tax system in Kenya with regard to taxation of incomes of blue-collar workers?
3. How is the tax system in Kenya failed to incorporate blue-collar workers in the income tax bracket?
4. Who should oversee the inclusion of blue-collar workers in the taxation bracket, ?
5. How can the government increase the number of income tax payers in the country?

1.7 Objectives of the Research

1. To assess the problem of blue-collar workers not paying income tax considering that they have incomes and the effects of that on the economy.
2. To assess the responsibility of the body that would be best suited to oversee the inclusion of the blue-collar workers in the Kenyan tax system whether the county government or the national government.
3. To suggest a suitable taxation framework that encompasses the blue-collar workers in the income tax bracket.

1.8 Justification of the Study

The taxation problem in Kenya needs to be investigated because paying taxes should be a guarantee to a good life. This is because they are charged heavily the results of which are not seen as promptly. It is therefore important to find out the reasons behind this discrepancy between the total number of Kenyans and the total number of people that actually pay for these taxes as it creates hostility between the government and the citizens. This study will contribute to the improvement of tax systems and policies that will allow the proper holistic collection, allocation, distribution and utilization of revenue. Kenyan citizens will be the main beneficiaries of the study because they will have the most to gain from a positive outcome of the study. They will receive the true value for their money that is world-class health care, globally competitive education, modern infrastructure, an overall improvement of the quality of life that includes reduction in poverty levels and most importantly a reduction in the tax burden on the taxpayer. This is because an optimum tax system means is good for the society.

Not much has been written on blue-collar taxation system in Kenya and the efficiency of these policies therefore a lot of the literature used in this study is foreign. This research is worth pursuing because it will positively affect the lives of so many Kenyans who have little to no knowledge of the adverse impact the current taxation system has on their lives. In the literature on this topic, the most prevalent issue is the strain caused to the low percentage of taxpayers. The expected outcomes are that every Kenyan that enjoys the same will equally share the burden of revenue raising and budget financing.

1.9 Hypothesis

The following premises form the basis of this research:

1. The entire working populus of the country including blue collar workers with an income regardless of the frequency of pay, daily, weekly or monthly, is a registered income tax payer with the Kenya Revenue Authority (KRA) and dutifully files returns and pays taxes as prescribed by the income tax Act.

1.10 Methodology

The principle method used in this thesis for research is the desktop research method. It mostly comprises of secondary sources of information such as the internet and online library resources. These sources provide a larger pool of information that is available across the world. Desktop research allows one to gain access to literature that is old or new from the different walks of life. Therefore, a lot has been written on the topic over the years which could be useful to this thesis. Desktop research also provides for comparative study of different taxation policies. Different countries have different tax policies. Some are good while others just do not work. In order to fulfil the purpose of this study, which ideally would be to come up with a framework to optimize the tax system in Kenya, then desktop would be necessary to provide a larger pool of information, analysis and statistics.

Secondary sources of information provide doctrinal research which is essential for this study. Books, journals, periodicals and statutes are important when it comes to analysis of the legal frameworks necessary for this study on taxation. They also help in proving or disproving the hypothesis.

1.11 Limitations

There have been challenges faced in conducting this study most of which have been with regards to information and its accuracy. KRA is responsible for matters of taxation in the country. They oversee the collection of data, its analysis and publication of the same for the public to be informed. This process however, is a very long one that consumes a lot of time which also affects the period of output of information. A lot of the readily available information is not current therefore it is difficult to have up-to-date accurate information which is essential for the research.

It is also difficult to determine the success or the failure of a tax charged on Kenyans because of this delay in releasing information. Lack of doing a formal survey is also a limitation to the study.

1.12 Chapter Breakdown

Chapter One sets outs the abstract, background to the study, problem statement, literature review, research questions and objectives, hypothesis, the theoretical framework, justification of the study as well as the research methodology of the topic.

Chapter two focuses on the analysis of the taxation regime in Kenya with the aid the existing legislation on Income Tax.

Chapter three breaks down blue-collar taxation, what it would mean for the Kenyan Economic while also introducing India as a model Nation for taxation of the informal sector.

Chapter four will comprise of the conclusion and summations of the findings of the study together with necessary recommendations.

CHAPTER 2

HISTORY, CURRENT STATE AND GAPS IN THE KENYAN INCOME TAX SYSTEM

2.1 Introduction

Blue collar taxation falls under the Income Tax bracket.[37]In order therefore to understand Blue Collar taxation in Kenya, it is important to understand the history of Income Tax in the nation. Taxation existed before colonization, during colonization and after colonization.[38] Granted the major source of income for most Kenyans was through manual labour, the British still managed to impose direct taxes on the colony. This is particularly important because the significance of this study is come up with a framework that encompasses Blue collar workers in the income tax bracket akin to the ways of the British colonialists.[39]

This chapter will therefore go in-depth in discussing the history of income tax, the current state of income taxation and its inadequacy in including the blue collar populous and the subsequent effects of that. The way the British collected taxes from the Africans will also deem very helpful in the formulation of a solution for the inclusion of Blue-Collar workers in the tax bracket.

2.2The Historical informal taxation in Kenya

In the years preceding in 1897 before Kenya became a British protectorate, before a formal taxation system was adopted in Kenya, different communities had different ways in which the collected taxes.[40] After a harvest, part of that which was harvested would be put as "tithe" for those who had little or none to also benefit from the banquet.[41] Despite not being formally referred to as taxation, it surmounted to it.[42]More specifically, income taxation. Initially in the African the setup, taxation happened even though informally.[43] It was not until the influx of colonialists when a formal taxation system was adopted.[44]

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[37] Augustus Mutemi, 'History of Income Tax Law in Kenya' (2015) < file:///Users/ivywarui/Downloads/History_of_Tax_Law_in_Kenya.pdf > accessed 13th April 2020.
[38] Augustus Mutemi, 'History of Income Tax Law in Kenya' (2015) < file:///Users/ivywarui/Downloads/History_of_Tax_Law_in_Kenya.pdf > accessed 13th April 2020.
[39] Ibid.
[40] Ibid.
[41] Ibid.
[42] Ibid.
[43] Ibid.
[44] Augustus Mutemi, 'History of Income Tax Law in Kenya' (2015) < file:///Users/ivywarui/Downloads/History_of_Tax_Law_in_Kenya.pdf > accessed 13th April 2020.

During this period Kenya was not only inhabited by the local native communities, but by Arabs and Portuguese who were majorly located in the coastal region.[45] The Arabs professed the Islamic religion and thus their modes of taxation were largely borrowed and guided by Islamic laws and principles. In Islamic law, taxation is not prohibited and the leaders had a right to tax the people in reasonable measure.[46] Calculation of such taxes was done by levying a fixed amount for every slave that was to be exported from Oman. Exports such as ivory cloves and beads were also subject to custom duties.[47] In respect of an agreement that the Portuguese had with the Sultan of Oman that required the Portuguese to remit a third of their customs revenue as his own property was considered a form of taxation of the proceeds collected from levying for custom duty.[48] On December 1895, the Sultan of Zanzibar gave away that entire region that was formerly under The Imperial British East African Company (IBEACO) to the British Government upon agreement with the British Government that he would receive an annual stipend of £11,000.[49]

The various ways in which Kenyan communities, Arabs and Portuguese imposed various taxes without them necessarily referring to the activity as taxation provides overwhelming evidence of income taxation in Kenya and its origins before colonization.[50]

2.3 Income taxation in Kenya after 1897

On August 12th 1897 the British annexed Kenya as their colony from the Imperial British East African Company (IBEACO).[51] It however took the British three years to come up with laws to govern the colony and during this time the British introduced direct taxation for the following reasons.[52] First, the custom duty that the British were collection was inadequate for the running of a colony and they needed to find another way of raising revenue.[53] Second was the fact that the

[45] Attiya Waris, 'Taxation without principles: A Historical Analysis of the Kenyan Taxation System' (2007) < file:///Users/ivywarui/Downloads/Taxation_Without_Principles_A_Historical.pdf > accessed 13th April 2020.
[46] Ibid
[47] Attiya Waris, 'Taxation without principles: A Historical Analysis of the Kenyan Taxation System' (2007) < file:///Users/ivywarui/Downloads/Taxation_Without_Principles_A_Historical.pdf > accessed 13th April 2020.
[48] Ibid
[49]Ibid
[50] Ibid
[51] William Ochieng, Robert Maxon, An economic History of Kenya (EAEP 1992) 63-75.
[52] Ibid
[53] ibid

settlers need protection and custom duty was not enough to cater for that and promote their welfare.[54] Income tax was administered by the British as a way to have Africans pay for their own civilization employed Chiefs and headmen to register African men and their households for taxation. In addition to hut tax, in 1910, the British also introduced poll tax with the introduction of the Kipande system.[55] Unlike hut tax that was charged to men for their households, poll tax was an individual tax that included even widows.[56]During the world war in 1915, the expense of the British increased and then led to the taxation system being progressive and failure to honour tax obligations resulted in sanctions such a distress of property or three months imprisonment.[57]

There were significant proposed changes in the administration of Income Tax in Kenya but none were significant enough to see the light of day until the Income Tax Ordinance of 1937 when the Devonshire White paper was introduced.[58]Its success in India and South Africa prompted the introduction of a scientific approach to Income Tax in Kenya that involved the Asians and the whites.[59] It was referred to as scientific because of its format of determining and defining Income.[60]The tax base was to be business profits, salaries and wages, rent and income from agricultural produce or livestock.[61]

The Income Tax Ordinance was in effect until 1948 when the East African Common Services Organization (EACSO) was formed by the 3 governors of East Africa who then formed the East African Income Tax Department.[62] They then reverted back to individualistic taxation systems that resulted in Kenya coming up with its own Income Tax Act of 1973[63] and an income tax department.

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[54] Bruce Berman, *Control and Crisis in Colonial Kenya: The Dialectic of Domination* (Ohio University Press 1990) 53.
[55] Ibid
[56] Ibid
[57] H.W.O. Okoth Ogendo, *Tenants of the Crown: Evolution of Agrarian Law and Institutions in Kenya* (Nairobi ACTS Press, 1991) 27.
[58] Ibid
[59] Ibid
[60] Ibid
[61] Ibid
[62] The East African Income Tax (Management) Act No 8 of 1952, East African High Commission Legislation, 1952.
[63] See also Eze O C, The Tanzanian Income Tax Act 1973: An Instrument of Social Change (1975) EALR 37 at 38.

2.4 Taxation in Kenya After 1973

The Income Tax Act of 1973[64] that was commenced on January 1st 1974 has been in effect from then to date. Despite certain reforms and amendments, Cap 470 remains the sole legislation in Kenya on Income Tax. Income Tax charged on individual incomes are usually as Personal Income Tax (PIT) and Pay As You Earn (PAYE). PIT is levied on incomes of small businesses and self-employed entrepreneurs at the end of each year and is charged on profits.[65] Blue collar taxation would fall under the category of individual incomes and would be subject to taxation through PIT or PAYE depending on the nature of the Blue-collar work and frequency of income. If the nature of the blue-collar job is employment, then the employer acts as an agent of the taxation authority. The employer recovers tax on income on behalf of the taxation authority (KRA).[66]

The following laws in relation to Blue collar taxation will express the place of taxation of blue-collar incomes in Kenya's taxation framework:

The Constitution of Kenya 2010 in Article 209 the power to impose taxes and charges is stipulated. Income Tax can only be imposed by the National Government. They do this through the Kenya Revenue Authority (KRA) that is formed by the KRA Act Cap 469 that gives the authority its job description and the scope of its power.

The preamble of the Income Tax Act Cap 470 defines the role of the Act as "An Act of Parliament 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 provisions relating thereto; and for matters incidental to and connected with the foregoing" [67]. The preamble is particularly very important because it provides the role of the Act. Charging of taxes on incomes being the sole purpose of the Act. Blue Collar workers also receive an income inform of daily or weekly wages depending on the contractual agreement between the employer and employee. This therefore means that based on that description alone, this Act has the mandate to charge the incomes of Blue-collar workers too.

[64] Cap 470 Laws of Kenya.
[65] Attiya Waris, 'Taxation and state Building in Kenya: Enhancing Revenue Capacity to Advance Human Welfare' (2007) Kenya Report.
[66] The East African Income Tax (Management) Act No 8 of 1952, East African High Commission Legislation, 1952.
[67] Income Tax Act 1974.

Section 3 (1) Subject to, and in accordance with, this Act Cap 470, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya. The section gives meaning to the term Income Tax. It states that every person residing in Kenya has the duty and mandate to remit Income Taxes to the government as long as they are receiving an income. Those who are not resident in Kenya but earn money in Kenya, are so liable to pay income tax. This section therefore includes Blue collar workers in Kenya. Given that they earn incomes and are resident in Kenya, then they are tasked under this Act to pay Income Taxes.

Section 3 (2) Subject to this Act, income upon which tax is chargeable under this Act is income in respect of—

(a) gains or profits from—

(i) any business, for whatever period of time carried on;

(ii) any employment or services rendered;

(iii) any right granted to any other person for use or occupation of property;

(b) dividends or interest;

(c) (i) a pension, charge or annuity; and (ii) any withdrawals from, or payments out of, a registered pension fund or a registered provident fund or a registered individual retirement fund; and (iii) any withdrawals from a registered home ownership savings plan;

(e) an amount deemed to be the income of any person under this Act or by rules made under this Act;

(f) gains accruing in the circumstances prescribed in, and computed in accordance with, the Eighth Schedule;

(g) subject to section 15(5A), the net gain derived on the disposal of an interest in a person, if the interest derives twenty per cent or more of its value, directly or indirectly, from immovable property in Kenya; and

(h) a natural resource income.

Section 3(2) gives the various sources of income that can be charged. Despite not being expressly stated, incomes from Blue collar workers fall under the category of gains from business, employment or any services rendered and subject to section 3(1) proceeds from blue collar jobs are incomes. This therefore means that Blue collar workers should also remit their taxes to the body mandated to do so that is the Kenya Revenue Authority (KRA). This section can be read together with part 5 of the Income Tax Act that talks about the ascertainment of total income. Section 15 (7)(e)(ii) specifically talks about the deductions allowed and the specific sources of income and states that employment (including former employment) of personal services for wages, salary, commissions, or similar rewards (not under an independent contract of service), and a self-employed professional vocation. The nature of Blue-collar work is that it is of a short contractual period and it usually a contract of service. Blue collar workers are often engaged as independent contractors given the manual nature of their job. The Income Tax Act in part 5 section 15 provides that incomes such as salaries, wages, commissions or similar rewards from contracts of service are also subject to deductions. Therefore, Blue collar workers should be taxed under the income tax Act.

Once an income has been established under the Act, the next step usually is the determination of the amount of tax that should be deducted from the said income. This is usually done through rates. Certain incomes are charged at certain rates. The taxation rates for Pay As You Earn (PAYE) which is a form of monthly income taxation in Kenya, a taxpayer earning Kshs 11,180 and below will remit 10 per cent of their earnings to KRA. Somebody earning Kshs 11,181 to Kshs 21,714 will remit 15 per cent. A Kenyan earning Kshs 21,715 to Kshs 32,248 is required to pay 20 per cent of their earnings to KRA while those earning Kshs 32,249 to 42,781 are supposed to pay 25 percent of their total earnings to the taxman.[68] This therefore means that Blue collar workers, depending on their monthly, weekly or commission earnings are required to pay taxes that will be calculated using the rates provided for by the Kenya Revenue Authority (KRA). When it comes to annual income taxation, according to Cap 470 the individual tax rates shall be as follows: Kenyans earning Kshs 42,782 and above will remit 30 per on the first Shs. 147,580 10% on the next Shs. 139,043 15% on the next Shs. 139,043 20% On the next Shs. 139,043 25% on all income over Shs. 564,709 30% cent of their gross salary to the KRA.[69]

[68] Anthony Owino, 'Taxes in Kenya: Different types of Taxes' (2019) < https://www.kenyans.co.ke/news/36993-taxes-kenya-different-types-taxes > accessed 18th April 2020.
[69] Anthony Owino, 'Taxes in Kenya: Different types of Taxes' (2019) < https://www.kenyans.co.ke/news/36993-taxes-kenya-different-types-taxes > accessed 18th April 2020.

The Kenya Revenue Authority began tax reforms in 1995 to improve efficiency of the Authority by leveraging technology in tax collection[70]. This meant that declaration of incomes, tax returns and applications for tax compliance and pin certificate was to be done electronically and not manually as before. The aim of this reforms was to improve the efficiency of the Authority in their mandate of assess and collect taxes. This included collection of Income taxes. This however came with challenges for the KRA and those who do not have access to technology and do not have the know-how on how to undertake the processes online.[71] Majority of the informal sector lack the necessary skills to navigate modern technology and its complexities. This poses a challenge to the taxation sector in their bid to modernise filing of taxes.

2.5 Weakness of Kenya's Income Tax Laws in Relation to Blue Collar Taxation

The laws in Kenya that govern Income taxation in Kenya as assessed have one major weakness, they are designed for formal employees. This therefore excludes the informal sector and those who work on commission or for a daily or weekly income. These sidelines a large population of the Kenyan work force when it comes to paying taxes no matter how benign the level of income may be. The Income Tax Act recognizes contracts of service as a deductible income but fails to give its taxation rates based on the level of income. It also fails to explicitly recognize manual work as a job group in the Fifth Schedule where the list of professions and their descriptions are listed. The Act also fails to put in place measures to provide for the declaration of these blue-collar incomes in order for them to be taxed. This is unlike with PAYE where the employer declares the incomes of their employee(s) on their behalf to the KRA to prevent tax evasion and ease the duty of the KRA to follow up with every single one of them.

The reforms by the KRA to digitize the tax collection process has, adverse to its intention, disadvantaged those who do not have access to technology. This includes a large percentage of the population that is undereducated or completely lacking in formal education and therefore cannot get formal employment and have to do manual jobs to make ends meet. This is who the blue-collar sector largely consists of. They therefore fail to register as taxpayers and end up not remitting any taxes on their incomes.

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[70] Institute of Certified Public Accountants, *Challenges and opportunities of modernization in tax administration: The Experience by Kenya Revenue Authority* (ICPAK Tax Conference, 2016).
[71] Ibid

2.6 Conclusion

Before formal income taxation was introduced in Kenya by colonialists, taxation still existed but was different and exclusive among the various local Kenyan tribes. Different tribes had different ways of imposing taxes on their people. Colonization and modernization gave rise to formal ways of taxation in Kenya. After the British took over in 1897, they introduced direct taxation to collect revenue meant to facilitate the running of the colony. Custom duty from settlers was not enough to keep the colony afloat therefore they had to find other ways to generate revenue, hence the introduction of direct taxation. The income tax Ordinance then came into effect to serve East Africa in 1937 up until 1948. Kenya then developed its on Income Tax Act in 1973 that then commenced in 1974 and has been in effect to date. Income taxation is also provided for in the Constitution of Kenya 2010.

In conclusion however, the Income Tax Act fails to include the Blue-Collar sector in the taxation bracket has resulted in the government missing out on collection of a lot of revenue that could greatly improve the Kenyan economy. This is the gap the this research is based on.

CHAPTER 3

UNDERSTANDING BLUE COLLAR TAXATION AND WHAT IT MEANS FOR KENYA'S ECONOMY

3.1 Introduction

Year after year, the Government announces its budget.[72] A budget that usually has a deficit that results in reliance on foreign nations for financial aid. In order to rectify that, the government needs to figure out a way to reduce the deficit in the budget by increasing the internal revenue the Kenya Revenue Authority collects.[73] There is a class of Kenyans who work and receive an income but that income however, is not directly taxed. These are the blue-collar workers. Given the informal nature of their work and mode of payment for that work, the Income tax act has does not have a clear set out formular to tax these incomes.[74] This in turn leaves a class of untaxed individuals that would potentially generate a lot of revenue required for the management of the country but continue to remain that way.

This study will therefore delve into identification of these blue-collar workers in the economy, formulation of a way to tax the said blue collar workers, the implication this would have on the Income Tax Act and the KRA.

3.2 What is blue collar taxation?

To understand blue collar taxation, we must first identify who blue collar workers are. Generally speaking, a blue-collar worker refers to an individual who performs manual jobs for a living. These could be masons, farmers, gardeners or cleaner.[75] Blue-collar taxation therefore is a form of income taxation that is levied on manual labourers. Blue collar taxation is applicable to the class of working individuals who receive a daily, weekly or by the hour wage.[76] Despite the mode in which their wage is administered it still qualifies as an income thus its relation to income tax and

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[72] Stella Osoro, 'Effects of Budget Deficit on Economic Growth in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/97484/Osoro-Effects%20Of%20Budget%20Deficit%20On%20Economic%20Growth%20In%20Kenya.pdf?sequence=1&isAllowed=y > accessed 25 April 2021.

[73] ibid

[74] Ibid

[75] Amy Christenson, 'Blue Collar worker definition' (2020) < https://resources.workable.com/hr-terms/blue-collar-worker-definition > accessed 25 April 2021.

[76] Ibid

should be treated as such. The premise of taxation is founded in the Constitution of Kenya 2010. Article 209[77] of the Constitution of Kenya 2010 gives powers only to the National government to impose Income taxes. This means that the national government is the only level of government that can tax the income of the blue-collar workers. Article 201[78] (b)(i) of the Constitution also states that the burden of taxation shall be shared equally. This implies that every Kenyan shall in their own capacity pay tax which includes blue collar workers. Statistics from the Kenya Revenue Authority show that Income tax accounts for 40% of all the taxes collected.[79]

In order to properly incorporate blue collar taxation, tax brackets could be broadened or the number of brackets increased or reduced depending on the objective.[80] The redistribution and equity purposes are more evident with personal income tax than with the other types of income tax. Evidently, the rationalization of tax brackets and rates is done so as to reduce tax burden on those with lower and fixed incomes and make the tax more equitable[81].

Income tax is charged on individual incomes from employment, self-employment and professional fees.[82] Blue collar workers may fall under any one of these categories depending on the nature of their contractual relationship with their employer. The reason why identification and tracking of these individuals is difficult is because the nature of their work does not require any formal documentation, it usually has a limited time frame and does not require any specialized skills. It is therefore safe to say that taxation in Kenya falls short of the principles stated by Adam Smith in his book, the wealth of nations[83] which provides that taxation is fundamentally built on four basic principles. These principles are fairness, certainty, convenience, and efficiency[84]. He stated that efficacy in taxation should mean that the administration of tax collection should not negatively

[77] Constitution of Kenya 2010.
[78] Constitution of Kenya 2010.
[79] John M. Mutua, 'A citizen's handbook on taxation in Kenya' (2012) 17 IEA < file:///Users/ivywarui/Downloads/Tax-Handbook%20(1).pdf > accessed on the 24 April 2021.
[80] Ibid
[81] John M. Mutua, 'A citizen's handbook on taxation in Kenya' (2012) 17 IEA < file:///Users/ivywarui/Downloads/Tax-Handbook%20(1).pdf > accessed on the 24 April 2021.
[82] Income Tax Act Cap 470
[83] Adam Smith, *Wealth of Nations* (first published 1776) .
[84] Adam Smith, Wealth of Nations (first published 1776).

affect or impact the tax payers[85]. The effectiveness of the Kenyan taxation laws is adverse to their intended purpose. Taking the income tax Act as our main point of focus, we can devise that the intention of the Act was to provide a law that allowed for the assessment and collection of Income taxes in Kenya based on its preamble[86]. However, the Income tax Act falls short of its intended purpose and efficacy as a principle of taxation according to Adam smith[87].

Blue collar taxation therefore entails the efficient taxation of incomes earned by manual labourers in Kenya according to the laws set out in the Kenyan constitution, the income tax Act and the principles of taxation by Adam Smith.

3.3 Who are blue collar workers?

For blue collar taxation to be effective, the law has to clearly identify who blue collar workers are. This will enable the tailoring of the laws on taxation of their income in a way that best suits their situations.

Blue collar workers are defined by the nature of their work[88]. They use their physical abilities to earn a living. These workers include, construction workers, farmers, quarry diggers, machine operators and cleaners. These jobs require minimal skills to perform them and more likely than not, no educational background is necessary for the performance of these jobs[89]. The informal nature of the blue-collar sector in Kenya has greatly contributed to them not being taxed. The fact that they are also short contractual relationships, usually with no paper or money trail, makes it even more difficult to identify those earning their incomes through blue collar work.

The Kenya Revenue Authority therefore requires a mechanism to identify blue collar workers in order to be able to tax them. The most basic way of identifying blue collar workers in Kenya is

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[85] https://www.futurelearn.com/courses/public-financial-management/0/steps/14705#:~:text=In%20The%20Wealth%20of%20Nations,with%20personal%20and%20family%20needs. Accessed 24 April 2021.
[86] Income Tax Act Cap 470.
[87] Adam Smith, *Wealth of Nations* (first published 1776).
[88] Amy Christenson, 'Blue Collar worker definition' (2020) < https://resources.workable.com/hr-terms/blue-collar-worker-definition > accessed 25 April 2021.
[89] Amy Christenson, 'Blue Collar worker definition' (2020) < https://resources.workable.com/hr-terms/blue-collar-worker-definition > accessed 25 April 2021.

through the definition of their work description, the nature of the work they do and the modes of payment for the work done. These are usually very distinct and tend to vary greatly from their antithesis, formal employment. This however does not guarantee their identification by the law. The Income Tax Act in Kenya generally captures the formal sector and business profits[90]. Section 5(2) of the Income Tax Act however states that gains and profits include any wages, salaries, leave pay, sick pay, payment in lieu of leave, fees, commission, bonus, gratuity, travelling, entertainment or other allowances received in respect of employment or services rendered in a year of income other than the year of income in which it is received shall be deemed to be income in respect of that other year of income[91]. Going by that definition, the reimbursement that blue collar workers receive for their services is deemed as an income by the Income Tax Act and is therefore subject to taxation under the same Act. However, that is one identifier of the incomes of blue-collar workers. The income tax Act fails to set out a clear and concise way in which the gains and profits of blue-collar workers should be taxed as it has with the incomes of white-collar workers through the Pay As You Earn (PAYE) rates set out in the Third schedule of the Income Tax Act.

3.4 Implications of blue-collar taxation: resultant measures of increased taxation

Undoubtedly, the most important resultant measure of increased taxation is economic growth. Economic growth means that multiple problems that encumber Kenyans are resolved. In his paper, 'The Relationship Between Tax Revenue and Economic Growth'[92], John Kinyua Daniel collected data that he later analysed, on the elasticity and buoyancy of taxation and its relevance to tax revenue and economic growth.

The performance of the economy can be directly attributed to taxation in the country.[93] It can be observed that Kenya experienced good performance in the 1960's and 1970's while the 70's and the 80's were characterized with persistently low economic growth due to the introduction of

[90] Attiya Waris, 'Taxation without principles: A historical analysis of the Kenyan Taxation system' (2007) KLR 272.
[91] Cap 470.
[92] John Kinyua Daniel, The Relationship between Tax Revenue and Economic Growth in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/61680/Kinyua_The%20Relationship%20Between%20Tax%20Revenue%20And%20Economic%20Growth%20In%20Kenya%20.pdf?sequence=3&isAllowed=y > accessed 24th April 2021.
[93] Ibid

competitive politics in the country[94]. These statistics were drawn up, analysed and conclude based on the taxation revenue that was collected at the time. These were the first initial indicators of the relationship between taxation and economic growth in a post independent Kenya.

The political arena also plays a role in the fluctuation of the economy.[95] Post 2002 there was a steady increase in the economic growth of the country and that could be attributed to the smooth political playground that was on going at the time[96]. This too was derived from the taxes collected at the time, most especially income taxes, the category in which blue collar taxation lies. A graduated rate system regulates personal income tax. The personal income tax system is divided into five tax brackets, with the lowest marginal tax rate of 10% and the highest marginal tax rate of 30%. Since 2002, the tax brackets and rates have remained essentially unchanged[97].

During this period the government developed an economic recovery strategy for the wealth and job creation action plan in 2003, whose policies helped the Kenyan economy recover. The economy developed at a growing pace from 2003 to 2007, with 2007 showing the highest rate of growth at 7%.[98] However, in the year 2008, the steady growth was disrupted by post-election crime that caused the development rate to fall by 1.5 percent.[99] During the period 2003-2011, the lowest growth rate was 1.5 percent in 2008, while the highest was 7 percent in 2007[100].

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[94] Francis Mwega, Njuguna Ndung'u, ' Explaining African Economic Growth performance: The case of Kenya' (2002) AERC < https://media.africaportal.org/documents/Kenya2.pdf > accessed 24th April 2021.

[95] ibid

[96] John Kinyua Daniel, The Relationship between Tax Revenue and Economic Growth in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/61680/Kinyua_The%20Relationship%20Between%20Tax%20Revenue%20And%20Economic%20Growth%20In%20Kenya%20.pdf?sequence=3&isAllowed=y > accessed 24th April 2021.

[97] John Kinyua Daniel, The Relationship between Tax Revenue and Economic Growth in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/61680/Kinyua_The%20Relationship%20Between%20Tax%20Revenue%20And%20Economic%20Growth%20In%20Kenya%20.pdf?sequence=3&isAllowed=y > accessed 24th April 2021.

[98] Ibid

[99] Ibid

[100] John Kinyua Daniel, The Relationship between Tax Revenue and Economic Growth in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/61680/Kinyua_The%20Relationship%20Between%20Tax%20Revenue%20And%20Economic%20Growth%20In%20Kenya%20.pdf?sequence=3&isAllowed=y > accessed 24th April 2021.

In his article “The Determinants of Taxation in Britain” Karran notes the positive relationship between tax revenue and economic growth[101]. He goes further to state that economic growth is characterized as an increase in gross domestic product over time, and it is largely related to income tax regardless of the tax base it impacts.[102] Tax revenues rise in tandem with economic growth, based on the premise that tax bases expand as GDP grows[103]. This herein portrays the direct relation that taxation has with economic growth in that increased revenue collection usually indicates a health growing economy. Both factors not being mutually exclusive could mean that one could precede the other. Either increased taxation of incomes could lead to a better economic playfield or a stable economic environment, or economic growth could lead to an increase in revenue collection. This assessment will however be crucial in determining the impact of blue-collar taxation on the economy. This is based on the work by Ulrich[104] that asserts that a tax system should provide revenue growth that keeps up with real income growth because demand for public goods and services as a supplement to private consumption is likely to rise as the standard of living rises. Mustafa also states in his article that as the economy rises, more individuals and enterprises will be able to gain more money and, as a result, will be liable to pay higher taxes[105].

According to Mansfield, individual taxes, which make up a tax structure, adjust to increases in economic development income in vastly different ways[106]. It is quite critical to determine the responsiveness of individual taxes most especially income tax to changes in the Kenyan economic environment. In an article by Mutua[107], the most crucial factor that contributed to the total taxes collected over the period of ten years from the year 2002 until 2012 is collection of income tax

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[101] Terence Karran, ‘ The Determinants of Taxation in Britain: An Empirical Test” (2008) CPU < https://www.cambridge.org/core/journals/journal-of-public-policy/article/abs/determinants-of-taxation-in-britain-an-empirical-test/BDE3F94E3F240D8172F1E608136F788C > accessed 24 April 2021.

[102] Ibid

[103] Terence Karran, ‘ The Determinants of Taxation in Britain: An Empirical Test” (2008) CPU < https://www.cambridge.org/core/journals/journal-of-public-policy/article/abs/determinants-of-taxation-in-britain-an-empirical-test/BDE3F94E3F240D8172F1E608136F788C > accessed 24 April 2021.

[104] Holley Ulrich, ‘Public Finance in Theory and Practice’ (2011) < https://competences-futures.com/wp-content/uploads/2019/11/Public-Finance-in-Theory-and-Practice-PDFDrive.com-1.pdf > accessed 24th April 2021.

[105] Jeyapalan Kasipillai, Muszafarshah Mustafa, ‘ Buoyancy Estimates of Malaysia’s Tax System 1961-1998’ < http://e-journal.uum.edu.my/index.php/mmj/article/view/8580 > accessed 24th April 2021.

[106] Charles Mansfield, ‘ Elasticity and Bouyancy of a Tax System: A method applied to Paraguay’ (1972) < https://www.elibrary.imf.org/view/journals/024/1972/002/article-A005-en.xml?language=en > accessed 24th April 2021.

[107] John M. Mutua, ‘A citizen’s handbook on taxation in Kenya’ (2012) 17 IEA < file:///Users/ivywarui/Downloads/Tax-Handbook%20(1).pdf > accessed on the 24 April 2021.

that was at a total percentile of forty. There has also been a steady increase in public expenditure in the country that has led to more money circulating in the economy.[108] This has resulted in the creation of more job opportunities that have directly impacted the income taxes collected positively. This consequently means that with the increase in money circulation and creation of job opportunities, blue collar jobs are also on the rise. This thus implies that there is an increase in blue collar incomes among the general Kenyan populous that are going by untaxed because the income tax Act does not provide for a framework to do so.

From a low budget of 310.8 billion in 2002/2003 financial year; government budget increased to 145.9 billion in 2012/2013 financial year which represent a 47% increase over the last 10 years.[109] Tax revenue remains the major source of government revenue in Kenya and it accounts for over 80% of total government revenue. Tax revenue increased from 180.7 billion in 2002/2003 financial year to 720 billion in 2011/2012 financial year[110]. In 1986 a tax modernization program was introduced that led to empirical studies on the relationship between tax revenue and economic growth[111].

3.5 How India Taxes the Informal Sector

Domestic taxation systems are crucial because they provide policymakers the tools they need to combat poverty and provide public services while also improving state capability, transparency, and responsiveness.[112] Governments in developing countries will benefit from strengthening their tax structures in order to mobilize the domestic capital needed to fund their own production. This is especially true for African nations, where the recent pattern of reduced official development

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[108] Ibid

[109] John Kinyua Daniel, The Relationship between Tax Revenue and Economic Growth in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/61680/Kinyua_The%20Relationship%20Between%20Tax%20Revenue%20And%20Economic%20Growth%20In%20Kenya%20.pdf?sequence=3&isAllowed=y > accessed 24th April 2021.

[110] John Kinyua Daniel, The Relationship between Tax Revenue and Economic Growth in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/61680/Kinyua_The%20Relationship%20Between%20Tax%20Revenue%20And%20Economic%20Growth%20In%20Kenya%20.pdf?sequence=3&isAllowed=y > accessed 24th April 2021.

[111] John Kinyua Daniel, The Relationship between Tax Revenue and Economic Growth in Kenya' (2011) < http://erepository.uonbi.ac.ke/bitstream/handle/11295/61680/Kinyua_The%20Relationship%20Between%20Tax%20Revenue%20And%20Economic%20Growth%20In%20Kenya%20.pdf?sequence=3&isAllowed=y > accessed 24th April 2021.

[112] Ibid

assistance (ODA) shows no signs of abating.[113] In general, revenue administration in developed countries is plagued by poor organizational systems, low tax officials' ability, and a lack of new, computerized risk-management techniques.[114] Many African countries have made strides in raising their domestic tax capacities and receipts since the 1990s. Despite these gains, there are still a number of sales leaks that need to be addressed.[115]

The structure of India's income taxation allows for the taxation of independent contractors, the self-employed and freelancers.[116] Blue-collar workers are more likely to fall under either of the stated categories depending on the nature of their work. The basics of income tax in India provide that income tax is a form of tax levied by the federal government on income received by individuals and corporations over the course of a fiscal year. Taxes are one of the government's main sources of income. This money is used by the government to build roads, provide hospitals, schooling, and subsidies to farmers and the agricultural industry, as well as other government welfare programs. There are two forms of taxes: direct taxes and indirect taxes. Income tax being a form of direct tax.[117]

In India, the income tax Act Section 4 provides that every person is required to pay taxes regardless of the mode of income. According to section 4 (1) that states that, "where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person : Provided that where by virtue of any provision of

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[113] Ngozi Okonjo- Iweala, ' In my view: Development depends on realising the potential of Taxation' < https://www.google.com/url?sa=t&source=web&rct=j&url=https://www.oecd-ilibrary.org/supporting-countries-in-growing-their-tax-base_5jxvncwbqh5h.pdf&ved=2ahUKEwjbp8H9yOzvAhWdUhUIHWOjC-4QFjAMegQIExAC&usg=AOvVaw3QC4UKQIj6LfBMGfQMH9Dw > accessed 24th April 2021.

[114] Ngozi Okonjo- Iweala, ' In my view: Development depends on realising the potential of Taxation' < https://www.google.com/url?sa=t&source=web&rct=j&url=https://www.oecd-ilibrary.org/supporting-countries-in-growing-their-tax-base_5jxvncwbqh5h.pdf&ved=2ahUKEwjbp8H9yOzvAhWdUhUIHWOjC-4QFjAMegQIExAC&usg=AOvVaw3QC4UKQIj6LfBMGfQMH9Dw > accessed 24th April 2021.

[115] Ngozi Okonjo- Iweala, ' In my view: Development depends on realising the potential of Taxation' < https://www.google.com/url?sa=t&source=web&rct=j&url=https://www.oecd-ilibrary.org/supporting-countries-in-growing-their-tax-base_5jxvncwbqh5h.pdf&ved=2ahUKEwjbp8H9yOzvAhWdUhUIHWOjC-4QFjAMegQIExAC&usg=AOvVaw3QC4UKQIj6LfBMGfQMH9Dw > accessed 24th April 2021.

[116] Income Tax in India: Basic Slabs and E-filing process' (2021) < https://cleartax.in/s/income-tax > 24th April 2021.

[117] 'Income Tax in India: Basic Slabs and E-filing process' (2021) < https://cleartax.in/s/income-tax > 24th April 2021.

this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly. (2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.[118] This section is particularly important because it imposes an absolute right on the Indian population to pay their income taxes to the government including blue-collar workers".

Indian law goes further to categorize the different types of income taxes. Specifically, section 28 of the Indian income tax Act talks about taxation of proceeds from businesses and professions. This is the section that acknowledges the proceeds from the informal sector. This section states that any sum, whether received or receivable, in cash or kind, under an agreement for (*a*) not carrying out any activity in relation to any business or professional agreement includes any arrangement or understanding or action in concert, whether or not such arrangement, understanding or action is formal or in writing.[119] Profits received by self-employed people, entrepreneurs, freelancers, or consultants, as well as wages earned by practitioners such as life insurance brokers, chartered accountants, physicians, and attorneys who have their own practice, and tuition instructors, are all taxable under this heading.[120]

In India, different incomes are categorized and taxed according to the different tax slabs that they fall under. Slabs are the tax brackets that are used to categorize incomes. This could be incorporated in the Kenyan legislation in the bid to address the fact that the income tax Act fails to provide a framework for taxation of informal incomes.

3.6 Conclusion

This chapter focuses on understanding blue collar taxation. Blue collar workers majorly comprise of the informal sector. This therefore means that blue collar taxation is therefore the taxation of incomes from the informal sector. Taxation of blue collar incomes would result in increased revenue, increased public expenditure and economic growth. This chapter chapter also discusses

[118] Indian Income tax Act, 1961.
[119] Indian Income tax Act, 1961.
[120] 'Income Tax in India: Basic Slabs and E-filing process' (2021) <https://cleartax.in/s/income-tax> 24th April 2021.

the ways in which India has incorporated taxation of blue collar workers in the income tax Act, they way they have done that and how Kenya can too.

In conclusion, the ways in which India has incorporated the informal sector in their taxation structure has enabled them to improve on revenue collection.

CHAPTER 4
CONCLUSION AND RECOMMENDATIONS

4.1 Introduction

This chapter will provide a summary of the discussions and arguments in the preceding chapters on blue collar taxation. This chapter will also cover the recommendations based on the findings of this research and if said recommendations are put into active consideration, will promote the existing legislative framework governing income taxation in Kenya to address the lack of a proper framework for taxation of Blue-collar workers.

4.2 Conclusion

This research has critically analyzed the Income Tax Act which is the legislative body that regulates the taxation of proceeds of incomes earned in Kenya by its citizens. Specifically, this research conducted an in depth analyses how the income tax Act fails to provide a framework in which the incomes of blue-collar workers can and should be taxed.

Chapter 1 of this research began by introducing blue collar taxation. This chapter gives he justifications towards blue collar taxation and why it would be important in the Kenyan context in revenue collection and distribution of the revenue raising burden among all working classes in Kenya. This chapter is particularly important because is form the basis of this research from a theoretic perspective and provides the justifications towards blue collar taxation.

Chapter 2 discusses the history of the laws of Kenya particularly on taxation of incomes. This chapters delves into the ways in which the colonizers taxed the incomes of Kenyans and how that changed after colonization. This chapter breaks down the Articles of the Kenyan constitution that give absolute mandate to the income tax Act to provide a clear and elaborate framework for taxation of incomes. This chapter also discusses the inadequacies of the Income Tax Act in failing to provide for taxation of the informal sector thus leading to over taxation of the working middle class and the corporate sector.

Chapter 3 discusses blue collar taxation, what it means to tax the blue-collar sector and its implications on Kenya's revenue. This chapter of the research also discusses the ways in which

India has incorporated blue collar workers in their taxation framework and the effects of the same. This chapter seeks to compare the ways in which Kenya's legal framework has inadequacies as compared to India's Income Tax framework.

Overall, this research focuses on the failure of the Income Tax Act in incorporating blue collar workers in the direct taation regime with insight on the history of income tax in Kenya and how it manifests itself in the modern day regime. This research has also put together the benefit of incorporating blue collar workers in the taxation framework and how they can be incorporated using India as an example.

4.3 Recommendations

Based on the findings of this research, this research seeks to make certain recommendations which, if implemented, which will lead to the improvement and harmonization of the collection of taxes form the informal sector. The recommendations will act as a means to an end, creating a ripple effect that will see to the improvement of taxation policies in Kenya, reducing the strain of constantly increasing taxes on the formal sector to finance budget deficits and most importantly, improving service delivery on majority of public services offered by the state.

The recommendations are as follows,

1. Express incorporation of the informal sector in the Income Tax Act.
2. Campaign on tax compliance by the informal sector.

The said recommendations will be discussed in depth and elaborated hereunder.

4.3.1 Express incorporation of the informal sector in the Income Tax Act

The Kenyan legislature through the Income Tax Act should work towards incorporating blue collar workers in their tax regime and also work towards coming up with a framework to tax the incomes of the informal sector. Relying majorly on India as a precedent example, granted that the Indian Income Tax Act in section 28[121] includes the informal sector. This is important because this enables the taxation of blue-collar workers thus increasing revenue collection. In Kenya, the income tax Act fails to take into account the incomes of the informal sector thus it fails to provide a clear set out way in which these incomes can and should be taxed. This could also mean that the Kenya

[121] Cap 470, Laws of Kenya.

Revenue Authority (KRA) the body that is mandated to collect taxes by the constitution, can come up with a taxation formular completely independent from the one used in the formal sector that is specific to the blue collar class in order to cater to their incomes.

4.3.2 Campaign on increasing tax compliance

It is one thing to have legislation on taxation, but it is another to have voluntary tax compliance by the informal sector. Inasmuch as taxation is a compulsory duty of every Kenyan. The Income Tax Act should incorporate ways in which tax compliance can be boosted in Kenya. Tax compliance can be done through simplification of the taxation process and constant filing reminders. The taxation system in Kenya is one very complex process that a majority of the informal sector would struggle to grapple including its lack of close proximity to the people. In an article by Pierre, Florence and John on Increasing tax compliance, the article states that "Tax avoidance by households and businesses is often the result of economic actors being unsure of whether or how to pay the taxes they owe. The amount of tax payments a medium-sized company must make each year varies from 3 to more than 60 depending on the country, and increased difficulty is linked to increased expectations of corruption, according to Doing Business 2020. Cohen (2020) found that SMS notification notifications improved tax payment by 6% in Uganda, while De Neve et al. (2020) reports that providing taxpayers with streamlined details reduced delinquent payments by 23% in Belgium, which is consistent with this trend.'[122]

That goes to show the importance of tax compliance and its effects to the economy. The same can be adopted in the Kenyan context to achieve the desired outcome which is to tax the incomes of the informal sector in order to increase revenue collected nationally.

[122] Pierre Bachas, Florence Kondylis and John Loeser, 'Increasing Tax Revenue in Developing Countries' < https://blogs.worldbank.org/impactevaluations/increasing-tax-revenue-developing-countries > accessed 24th April 2021.

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