MEASURES OF TAX BASE BROADENING IN KENYA: A CASE STUDY OF TAXATION WITHIN THE INFORMAL AND ILLEGAL SECTOR IN KENYA

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DECLARATION

I, Mwaura Edwin Njuguna, declare that this research paper which I submit for the degree of Law at the Riara Law School is my original work and has not previously been submitted for a degree at another university.

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ABSTRACT

Taxation is an important source of revenue for any country; it is basically the process where the government collects funds from its citizens in exchange for services such as education, roads and security among other amenities. On 15 April 2016, the Court of Appeal of Kenya rendered a landmark ruling. In the seminal case of Republic v Kenya Revenue Authority ex parte Yaya Towers Limited, the Kenya Revenue Authority sought to have an employee of the applicant remit his income tax. Despite finding the employee's employment contract to be illegal, the court proceeded to hold that income accrued from the said contract was liable to taxation. For the first time in Kenya, income derived from illegal activity was held to be taxable pursuant to the provisions of the Income Tax Act of Kenya. As in many other countries, the debate as to taxability of illegal income has found its way into Kenya's judiciary, this decision opened a plethora of issues, which the court may not have anticipated. This paper delves into the definition of income provided in the Act, the court's interpretation of the same and whether income generated from illegal activity falls within the law's purview. The question as to whether or not a criminal should be allowed to deduct expenses incurred in the process of procuring the said illegal business is also dealt with. The link between the criminal justice system especially, the right not to self-incriminate and the taxability of income generated from crime will be examined and finally, this paper analyses the use of tax law to reinforce criminal law. Since the issues raised above are not unique to Kenya, it is important to tackle them with reference to other jurisdictions that have experienced similar problems.

The paper will be based on factual data taken from various sources as well as scholarly works and articles. Throughout the study the main objective is to look into other ways the government can raise revenue besides taxation and give suggestion or recommendations into the nature of laws of policies that are required.

List of Abbreviations

EAC	East Africa Cooperation
CGT	Capital Gains Tax
GOK	Government of Kenya
GDP	Gross Domestic Product
IEA	Institute of Economic Affairs
KRA	Kenya Revenue Authority
PAYE	Pay As You Earn
PIN	Personal Identification Number
SME	Small Medium Enterprises
TMP	Tax Modernization Program

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CHAPTER ONE
INTRODUCTION

1.1 INTRODUCTION

The debate on taxation is not unique to Kenya; we have always seen a steady increase in taxation over the years and the different tax regimes. Taxation is the sole hub of revenue that the government of Kenya uses to provide public services to its citizenry. Due to its usefulness, tax policy debates and decision making becomes a critical issue to the citizens, to businesses and the economy at large owing to the impact that it will have on each of these enterprises. Therefore the format and success of the tax system has implications for inequality and as such it is the role of the government to ensure that it pursues and attains a fair tax system for equitable distribution of income and welfare of nationals.[1]

The Government in Kenya has in most cases resorted to increase in taxation to meet the budget deficits that arise; this is a problem since as a nation Kenya cannot tax itself to prosperity. We need to find other ways or rather improve on the other sources of revenue so as to spare the people the burden of taxation every time a deficit arises. Governments in developed and developing countries collect taxes to fund public services. Marinaet argues that, "taxation is the only known practical manner for collecting resources in order to finance public expenditure for goods and services consumed by any citizenry". However, this is not entirely true, as developing countries; mostly, get revenue from other varied sources besides taxation, including non-tax revenue such as user-fees charged for services rendered by ministries, state department and agencies, as well as income from sale of government assets and privatization. Moreover, many of the developing countries are dependent on foreign aid as an external source of revenue. This paper thus poses the question on how and why Kenya cannot tax itself to prosperity and the need for a sound fiscal policy. This research will equally propose and a make a case for taxing illegal activities in Kenya as a way of raising revenue. A keen reference and focus will be laid on the income tax Act 2018 and the VAT act 2018 which came into effect this year and have brought about some significant changes in the field of tax in Kenya.

1.2 BACKGROUND INFORMATION

The tax regime in Kenya has undergone various reforms over the years. Between 1963 and the 1980s, public spending in Kenya was financed through a rather uncoordinated set of tax

[1]Mutua P.m., *A Citizens Handbook on Taxation in Kenya* (Institute of Economic Affairs 2011).

policies and measures borrowed from British colonial system and supplemented by foreign aid streams. The oil shock in the early 1970s led to the country's initial significant fiscal crisis, in reaction to which some relatively minor tax reforms and adjustments were undertaken[2].

The political and global financial downturn ushered in new complexities to and changes in economic choices and level of income in Kenya. The introduction of Structural Adjustment Programmes (SAPs) which essentially meant that citizens had to cost share with government for most essential services did not help matters. Taxes on revenues from business sales were introduced, as well as trade taxes in order to control the increasing deficit in balance of payment. In 1986, the then government introduced the Tax policy and Modernization Program (TMP). This program aimed at raising revenue levels by expanding the tax base, attaining 24% tax/ GDP ratio and maintaining that level of performance, making the tax structure more equitable and sealing tax leakage loop holes among other objectives[3].

This situation left a significant populous destitute, especially those whose income levels were low as well as those without formal employment. These people were left with no choices but to start engaging in small businesses that could offer them an opportunity to supplement their incomes and this is how the 'informal sector' was born. The First International Labour Organization (ILO) Employment Mission in 1972 to Africa, Kenya, recognized that the informal Sector had not just persisted but expanded in Kenya[4]. The government therefore took up the initiative, albeit very slowly, the process of involving the then heavily populated market into its national economic policies. Through government's policy effort towards this end, Session Paper No. 1 of 1986 was published followed by the National Development Plan (1989-1993) and later the Sessional Paper No. 2 of 1992[5]. While these efforts prepared the ground for the growth and expansion of the informal sector, the pace with which this sector grew was unprecedented and government policy for inclusion of this sector in planning and policy was lethargic and has never fully matched the pace of the sectors' growth.

[2] Eissa, N. and Jack, W. (2009) 'Tax Reform in Kenya: Policy and administrative issues', IPD working paper series, Initiative for policy dialogue, Columbia University
[3] Moyi E. & Ronge E., (2006) Taxation and Tax Modernization in Kenya: A Diagnosis of Performance and Options for Further Reform, Institute of Economic Affairs: An ATAF Publications.
[4] International Labour Organization Employment Mission, *Employment, Incomes and Equality: A Strategy for Increasing Productive Employment in Kenya*, (Geneva: 1970). and ILO, *Report on Ist ILO Employment Mission for Africa, Kenya, 1972*, http://rru.worldbank.org/Documents/PapersLink/Sida.pdf accessed on 28.10.18
[5] Sessional Paper No. 2 of 1992, *Small Enterprises and Jua Kali Development*, (Nairobi: Government Printer, 1992)

The informal sector activities started with an upsurge of craftsmanship in towns especially in major cities where services like electricity were available for use in welding and other activities. Later, the sector grew to manufacturing, building and construction, distributive trades, transport and communication, community and personal services industries[6]. Currently, the major activities include tailoring, carpentry, blacksmith crafts and retail shops that offer durable and perishable goods of low amounts. Among other sectorial distribution of these business activities shows a wide variation, with 64.5% of the total business being in wholesale and retail trade, while only 0.3% accounted for in private households. Overall, 71% of industries are in the rural areas with the dominant industries being trade and manufacturing[7].

As the informal sector growth became widespread, pressure on important government services like water, electricity, sanitation among others increased coupled with an increase in rural urban migration as the industry became a big pull factor of populations from rural to urban centres. In an effort to respond to the increasing need for better services to serve the increasing population and need for essential services in urban centres, government's started focusing on how to widen its tax base. In as much as this market controls a significant yet growing percentage of the population whilst providing employment through enterprise to a large population especially that of young people as well as having a recognisable financial outlay, the government found it extremely difficult to fully include the sector in its tax bracket[8]. The tax base was relatively narrow and the burden heavier on the taxpayers but there was a need to expand it. In addition to this, there was no comprehensive legislative framework on the taxation of the informal sector. In 2007, the Government of Kenya reacted to this shortfall and promulgated the Income Tax (Turnover Tax) Rules, 2007 (herein Turnover Tax Rules) under the Income Tax Act[9].

The above policies were introduced after the realization that the then tax regime did not raise adequate revenues to support the government recurrent and development needs. Further, there was increasing pressure on the government to engage in domestic borrowing thereby emasculating private sector and to an extent the small businesses from their accessing of loans

[6] Atieno, R (2006). 'Female participation in the labour market: The case of the Informal Sector in Kenya', AERC Research paper series, No. 157, Nairobi, Africa Economic Research Consortium.
[7] Ibid
[8] Flodman B., 'Fact Finding Study: The informal Economy' (SIDA, 2004) http://rru.worldbank.org/Documents/PapersLink/Sida accessed on 29.10.18
[9] See Hart K., 'Informal Income Opportunities and Urban Employment in Ghana' (1973) *The journal of Modern African Studies,* Vol. 11, No. 1 as quoted in Women in Informal Employment: Globalizing and Organizing at p. 1 http://wvvw.wiego.org/about ie/definitionsAndTheories.php accessed on 29.10.18

from lending institutions such as banks. The government increased its appetite for external borrowing to meet is financial deficit. Among the source of loans in the international market were the Bretton woods agencies like the Word bank and the International Monitory Fund (IMF). However, even these could not be relied upon as the global political climate shifted to the cold war financing[10]. The government was therefore left with no choice but to look for internal revenue collection measures which was mainly through taxation. The first efforts focused on raising taxation within the formal sector but this did not provide the solution as the sector is not only small but is already overtaxed.

1.3 LITERATURE REVIEW

The reviews illustrated are those that relate to the subject of taxation and as such aim at finding other relevant measures for the government to raise revenue besides taxing the citizens. The first will be the Kenya law review article titled ***Taxation without Principles: A Historical Analysis of the Kenyan Taxation System*** by Attiya Warris published in 2007. The piece puts down an overview of the sub optimum tax system. It gives a layout of the inception and development of tax law in Kenya. It contextualizes the absence of tax principle and policy considerations that previously were applied and analyze how they keep affecting Kenya's present taxation system, which is essentially the cogent factor in my proposal, the article also expounds on the other avenues available to the government of Kenya for raising revenue other than taxation.

The second literature under review will be ***the citizen's handbook on taxation in Kenya*** published by institute of economic affairs. This masterpiece promulgates Kenya's complex tax system into a user friendly form for easy comprehension by anyone. It among other issues discusses design of various tax heads, their purposes and differences and also how they are implemented. The book also gives us a background into the various tax regimes over the years in Kenya as well as giving us statistical data on relevant issues in regards to the tax system in Kenya. The handbook also highlights on the nature of taxation for it to be just and fair. The tax legislations particularly the tax act 2018 which is the most recent legislation accented by the president into law, the effect of course being an increase in tax to the citizenry.

[10] Gelb, A. (1993). "Socialist Transformations: Some Lessons and Implications for Assistance". In SIDA Redefining the Role of the State and the Market in the Developing Process, Skara, Vastergot Lands, Tryckeri.

Eva Maina and Edward Paranta have a deep conversation on taxing of illegal income sector in Kenya.[11] They make an analysis on taxation of illegal income in Kenya. The essay makes an analysis on the legal framework governing taxation of illegal income and examines the judicial precedent that held that illegal income was chargeable to tax. They have made parallel comparison with other jurisdictions such as South Africa and United States of America. They conclude that illegal income is taxable. They also conclude that it will contravene public policy if the government does not tax illegal income. Concerning deductions, they argue that the allowable deductions should be those that are legitimate. This research informs this study especially on the Kenyan jurisdiction.

One author that informs this study is Avraham Tabbach.[12] The writer has looked into the effect of taxing illegal income. He argues that jurisdictions that allow deductions on illegal income are susceptible to increase in crime as compared to those that do not allow deductions on illegal income and those that do not charge tax on illegal income. He argues that most illegal income will arise from legal businesses. Fraud, corruption and insider trading can result to illegal income but from legal businesses. He argues that tax of illegal income leads to lower levels of illegal activities.

Lynette Oliver has also written on this area with regards to the South African Jurisdiction. The article is mostly an analysis on the decision by the court of appeal of South Africa that held that illegal income was taxable. It also analyses similar decision in other states such as Zimbabwe. The article discusses on what can be termed as received in illegal income. It takes the position that before taxing illegal income, it must first be established that it is an income. Money obtained from theft cannot be defined as income as it is not received. This article forms a good basis for comparative analysis and provides a platform for better understanding on what can be termed as illegal income.

Siska Lund[13] makes an analysis on taxation of illegal income. She states that income in tax captures all from all sources income regardless of the source. This is another American author who makes a deep analysis on the issue. Her main argument is that the tax regime in United States of America was never intended to look into how one got the income nor was it intended to act as deterrence. Her analysis is that not allowing deductions on illegal income goes against the tax principles of neutrality and equality. Her argument is that the USA jurisdiction should

[11]Eva Maina& Edward Paranta ,' Taxing Income from Illegal Activity : The Kenyan Perspective,' (2017) 2 Strathmore Law Review.

[12] Avraham n25.

[13] Siska Lund,' Deductions Arising from Illegal Activities,' (2003) 13 Revenue Law Journal.

allow give illegal income a similar treatment with legal income. This thesis is essential in this research as it one of the few articles providing support for deductions on illegal income. This provides a room for different points of critique in the Kenyan jurisdiction.

Celeste Black also has a deep analysis on taxation of illegal income.[14] The author looks into taxation of illegal income in Australia. The author states that without disclosure it is hard to determine illegal income. Like Kenya, taxation of illegal income in Australia has been determined by court and not expressly provided in a statute. This was in the case of *Federal Commissioner of Taxation vs. La Rosa.* The author states that the intention of government is not explicit on taxation of illegal income. From his analysis, taxation ought to be on the whole amount arguing that illegal income does not enjoy deductions like the legal income. He also looks at the role income tax can play against illegal income. This article is essential in this study since it analyses a jurisdiction whereby taxation of illegal income arises out of a judicial interpretation and not expressed in a statute. It forms a good basis for comparative analysis. However, it does not discuss much on deductions and right against self-incrimination.

Donald Eckhart[15] makes an analysis on criminal prosecution in illegal income. He argues that one cannot plead illegal tax information was obtained illegally as a defense to criminal prosecution. He makes a deep analysis on the historical development of the issue. He portends an analysis on both the state law and federal law in USA jurisdictions. He argues that in criminal prosecutions, even though illegal income is taxable, it does not stop prosecution. He argues that tax law can be a tool to impose sanctions on such income. This article offers great insight for comparative analysis.

1.4 THEORETICAL FRAMEWORK

One theory that supports the taxation of illegal income is the theory of public policy.[16] The theory posits that certain acts are injurious to public hence they should be subjected to more burdens.[17] The proponents of this school of thought advocate for denial of deductions on those transactions that are against public policy. They posit that allowing illegal income the benefit

[14] Celeste Black,' Taxing Crime: The Application of Income Tax to Illegal Activities,' (2005) 20 Australian Law Forum.
[15]Donald Eckhart, 'Illegal Income as a Defense in Criminal Prosecution,' (1955) 38 Marquette Law Review.
[16]Crown Dwight, 'Deductibility of Expenditure Offending Statutes and Regulations,' (1959) 17 New York University Journal of Taxation, 157.
[17]Ibid.

of deductions will encourage many people to engage in illegal activities.[18] Taxation of illegal income and allowing deduction of expenses reduces the risk of carrying out a crime.[19]

When taxing illegal income such as smuggling, if such activities enjoy the benefit of deductions such as transport or even fines and penalties, it will encourage more people to engage in such activities.

Another theory is the rational choice theory. This theory posits that people engage in illegal activities weighing potential risks.[20] Deductions of expenses from illegal income reduce the potential risk of an illegal act.[21] If one can is protected from self-incrimination when declaring illegal tax and he or she can deduct the fines or penalties imposed on the income, the risk on engaging on illegal activities is heavily reduced. Taxation of illegal activities should not enjoy the benefit of deductions. On the other hand, if there is no protection against self- incrimination when disclosing illegal income, then many of those who earn from illegal activities will not disclose illegal income and less will engage in illegal activities.

1.4.1 THE EXPEDIENCY THEORY

This theory asserts that every tax proposal must pass the test of practicability. It must be the only consideration weighing with the authorities in choosing a tax proposal. Economic and social objectives of the state as also the effects of a tax system should be treated as irrelevant. This proposition has a truth in it, since it is useless to have a tax which cannot be levied and collected efficiently. There are pressures from economic, social and political groups. Every group tries to protect and promote its own interests and the authorities are often forced to reshape tax structure to accommodate these pressures. In addition, the administrative set up may not be efficient enough to collect the tax at a reasonable cost of collection. However, as we can easily see, to build up an entire tax system solely on the considerations of expediency is also full of pitfalls. Taxation provides a powerful set of policy tools to the authorities and should be effectively used for remedying economic and social ills of the society such as income inequalities, regional disparities, unemployment, and cyclical fluctuations and so on. Practicability is an essential consideration in every tax proposal. If a tax cannot be collected, it is ridiculous to impose it. But given the set of different practicable taxes, and different

[18] GG Tyler,' Disallowance OF Deductions on Public Policy Grounds,' (1965) 20 Tax Law Review 665.
[19] Avraham Tabbach,' Criminal Behavior, Sanctions and Income Taxation: An Economic Analysis,' (2002) 169 Economic Working Paper University of Chicago page 1.
[20]David Cornish, Theories in Criminology: learning theory and rational choice approaches, routine activity and rational choice by r v g Clarke and Marcus Felson 351.
[21]Ibid n25.

practicability rates, a choice has to be made with reference to their possible effects on the working of the economy. By itself, this approach is not at all able to help the authorities in deciding as between different practicable taxes. And of course those who are going to suffer by the imposition of a new tax or by a change in any existing tax are bound to advocate that the tax under consideration is not practicable.[22]

1.4.2 BENEFIT THEORY

According to this theory, the state should levy taxes on individuals according tobenefit conferred on them. This mean that, the more benefits a person derives from the activities of the state, the more he should pay to the government. This theory seeks to ensure that each individual's tax obligations are as far as possible based on the benefits that he or she receives from the enjoyment of public services[23]. This approach has been advocated by many scholars including, Pantaieoni Mazzola, de Vitide Marco, Sax and Lindahl, in one form or another[24]

1.5 PROBLEM STATEMENT

Taxation is an important aspect in every economy, in Kenya it is the largest source of revenue for the government accounting for nearly 70% of total government revenue, however the problem is that despite the heavy taxes levied by the Government there is always budgetary deficits that need to be filled and as such the government in most cases increases the tax levies so as to generate more income. This is a serious problem considering the fact that Kenyans already pay a lot more in taxes than most countries around the world, the increase in taxation makes it even harder for Kenyans to make ends meet. The second issue is the fact that the government has other sources of generating revenue and as such it is their duty to improve on the other income sources and save the citizenry from the burden of taxation. This includes ensuring public funds are safe and not embezzled which in turn leads to loss of funds and thereby leading to deficits in budgets which contributes to increase in taxes.

Taxation of income from illegal activities raises two issues. One is on the aspect of self-incrimination in criminal investigations of tax related offences and the aspect of allowable

[22]way254, "THEORIES OF TAXATION - THEORIES OF TAXATION Taxation..." (The logistic model has good and bad features PROS CONS Mathematically tractable) <https://www.coursehero.com/file/14702094/THEORIES-OF-TAXATION/> accessed December 21, 2018.

[23] "Theories of Taxation:" (Big Push Theory By Rosenstein Rodan and Economic Development - Definition and Explanation - Three Types of Indivisibilities - Diagram/Figure - Criticism/Demerits - Economicsconcepts.com) <http://economicsconcepts.com/theories_of_taxation.htm> accessed December 21, 2018.

[24] Musgrave, R.A. and Musgrave, P.B., Public finance in Theory and Practice, McGraw Hill Kogakusha Ltd., London 1980, P.803.

deduction in illegal income. These issues need to be expressly clarified in order to ensure that uncertainties are cleared and one's right is guaranteed. There needs to be cautious on how illegal income is treated for taxation purposes. A look into the legal framework is very essential in order to address the loopholes.

In the *Yaya Case* the court pronounced itself and stated that illegal business is subject to taxation. The thesis is not arguing against or for the determination but the consequences of it. If illegal income is deemed taxable, then all those having illegal income are required to file tax returns. In filing their returns, the Income Tax Act allows the taxation authorities to investigate one's books of accounts. Under its investigative powers, tax officers can ask any questions or seek any books of accounts. The information solicited has the potential of self- incriminating to the tax payer. Furthermore, there is no provision that prevents such information from being used by the prosecuting authorities. The *Yaya case* has opened this loophole in law and thus allowed the infringement on the right against self-incrimination.

The basis of Article 49 and Article 50 is that one cannot be compelled to give self-incriminating evidence and one has right from self-incrimination. The nature of Income Tax Act and Tax Procedure Act in requiring total disclosure of disclosure through tax returns is not an aspect of self-incrimination if used for determination of tax obligations and compliance. However, it becomes an aspect of self-incrimination whereby it is aimed at someone who is suspected of a crime, there are criminal offences under the statute and one is required to provide the information that that he/she knows will be available to prosecuting authorities. This are the three tenets established in the case of *Macheti vs. United States.*

Section 58(2) of the Tax Procedure Act states that an officer may require any owner, employee or representative to give him all assistance and to answer all questions relating to an inquiry. Section 59 states that the Commissioner or any authorized person can by notice require one to produce information, furnish information or give evidence. The provision allows a tax officer to compel for evidence and information even in criminal investigations. If an officer is investigating criminal tax offences, he can compel one to produce self- incriminating evidence. While the right against self-incrimination cannot be pleaded in filing of tax returns for illegal incomes, it can be pleaded where there are criminal investigations on a tax payer in relation to tax matters. Once one is a suspect in a criminal act, the right against self-incrimination arises.

Ascertainment of allowable deduction in illegal income is one area of uncertainty. To qualify for deduction, the expenditure in question must, in addition to satisfying the 'trade' requirement, be incurred wholly in the generation of income. This is well provided in Section 15 of the Income Tax Act. This means that the only deduction that is allowed in one which is

so directly associated with the purpose of raising the income. The policy on deductions of expenses should be based on establishing equality between those who earn legal income and those who receive illegal income. There should be no moral interpretation or consideration of public policy in interpreting the provisions of the Income Tax Act. United States of America has a long history of taxation of illegal income. It has been established that those who report illegal income become more susceptible to investigations for non- tax offences.[25]

1.6 JUSTIFICATION OF STUDY

The issues that the research seeks to evaluate are vital in tax computation. The research seeks to analyze whether to allow deductions on illegal income and if allowed, the extent that is allowable. The research will aid in analyzing the grey areas in the legal framework and pointing out the inadequacies.

Secondly, taxation of illegal income will require disclosure. Every person has the freedom not to be compelled to produce self-incriminating evidence. The state has an obligation to protect and enforce the fundamental rights and freedoms. Filing of tax returns is a civil duty and one cannot plead self-incrimination. However, where there are criminal investigations in tax related matters, a tax payer should not be compelled to produce any information that can be used as evidence against him. This research seeks to contribute to this issue in order to ensure the protection of fundamental rights of each person to its greatest extent.

1.7 HYPOTHESIS

The thesis is based on several hypotheses. The hypotheses are as follows.

1. Allowing deductions on illegal income can encourage people to engage in illegal activities
2. The obligation to file tax returns does not violate ones right from self-incrimination but opens up criminal investigations by the tax authorities for tax offences and also respective authorities for non-tax offences which in turn can abuse the right to self-incriminations.

The right to self-incrimination begins when one is deemed a suspect and not when one is arrested

[25] Borris Bittker,' Taxing Income from Unlawful Activities,'(1974) 25 Case Western Reserve Law Review , page 140.

1.8 RESEARCH OBJECTIVES

The objectives of this research are

1) To analyze the deductibility of expenses from income gained from illegal activities.
2) To analyze how mandatory disclosure of income and taxation of illegal income can lead to the taxpayer giving self-incriminating evidence.
3) To analyze if the right not to give self-incriminating evidence is protected when illegal incomes are disclosed.
4) To make a comparative analysis with other jurisdiction such as United States on taxation of illegal income.

1.9 RESEARCH QUESTIONS

The research seeks to analyze the following:

1. Should Kenya allow deductions incurred in income gained from illegal income?
2. Does the mandatory full disclosure of income affect ones right from self- incrimination?
3. What measures have other jurisdictions taken on allowable deductions of illegal income and the right from self-incrimination?

1.10 RESEARCH METHODOLOGY

The method to be used to gather information for this paper will be through the use of the library. The library research will seek to analyze and interpret the different tax laws in Kenya and compare them to other jurisdictions as well as look at the various laws or policies that relate to sources of revenue in Kenya in order to understand the various sources and how best to improve on them. The research will also look at scholarly writings on the subject of taxation as well as articles that elaborate on the impact of the new tax laws in Kenya. This research paper will be based on the case study of other countries as well as the comparative methods in order to prove or disprove the hypothesis.

It derives information mainly from books, journals and case law. It analyses a number of writings with regard to taxation of illegal income. It focuses specifically of deductions and right against self-incrimination. The research will be library based. The methodology is through analyzing the countries that have for a long time taxed illegal income and the issues of self-incrimination that have arises.

1.11 CHAPTER BREAKDOWN

This research paper shall be divided into five chapters.

CHAPTER 1

This chapter shall entail the research proposal. In it a brief introduction of the legal question shall be canvassed, an abstract, literature and theoretical framework and well as hypotheses.

CHAPTER 2

Privilege against Self-Incrimination, the constitution and Tax Law. This chapter looks at the protection of one against self-incrimination after disclosure of illegal income. It looks into the legal framework and analyzes it provides enough protection.

CHAPTER 3

This chapter is an analysis on the expenditure that results from illegal income. The analysis under this chapter looks at examining the law on deductions provided under the various statutes on taxation.

CHAPTER 4

This chapter looks at how United States of America a developed nation and South Africa a developing nation has dealt with deductibility of expenses incurred in the production of illegal income and the constitution protection against self-incrimination during disclosure of illegal incomes.

CHAPTER 5

This chapter will be concluding the research. Will submit recommendations that will enrich the jurisprudence, literature and legislation around Kenya fiscal policy and ways of taxing illegal activities in Kenya. It shall be making a case against Kenya taxing itself to prosperity.

CHAPTER TWO
HISTORICAL ANALYSIS OF KENYA TAXATION SYSTEM

2.1 INTRODUCTION

This Chapter will try to evaluate and examine the history of taxation in Kenya. The Chapter assumes the position that Taxation as it is now in Kenya is unsustainable and thus a keen analysis on how it was before Kenya got itself in the present situation. Tax law is not based only on doctrines but also on pragmatism. There is no element of permanence about tax law, only the persistent rattle of the immediate and semi-permanent. A State cannot run a democracy well without taxation and a taxation system cannot be run well without democracy. As Oliver Wendell Holmes has said on one occasion, "Taxes are what we pay for civilized society."[26]

Like many former colonies and developing countries, Kenya has inherited a tax system. According to the World Bank and proof given by revenue authorities in 1994, the main variables underwriting poor tax results include, poor adherence to the informal sector economy. Furthermore, limited coverage of current tax tools and, finally, unscrupulous efforts to manage and collect taxes. Due to a change from one scheme to another, for instance from monarchical rule to parliamentary democracy or from a centralized economy to free market' or from colonialism to independence,' the failure of a prior scheme can be brought about by basic modifications in governance relations. It becomes essential that the reform procedures involve the re-negotiation of citizens ' values and aspirations. However, current reform procedures suppose that the taxation legal framework is not of main concern.

Firstly, in its practical context, this paper must be read with regard to latest statistics showing that 56% of Kenya's population lives below the poverty line, revenue distribution is unequal, 20% of the nation is liable for consumption and, lastly, a high dependency ratio. Secondly, Kenya's tax history stems from its inextricably intertwined beginnings. This research will therefore refer to components of their shared tax history in East Africa.

As a result of these and other constrictions, there is a need primarily, to look into the catastrophe historically of the colonial establishments to, ab initio, establish a system of taxation based on the universally recognized principles of taxation. Furthermore, and as a result, investigate the context of existing tax legislation enforced during colonization in order to usher present legislation in Kenya.

[26] http://www.quotegarden.com/taxes.html

First of all, the aim of this research is to present a gestalt of the sub-optimal tax scheme. Secondly, to propose an overview of Kenya's tax law enactment and growth. Thirdly, to put into perspective the absence of tax principle and policy considerations that historically were applied and analyze how they may keep affecting Kenya's present taxation system.

2.2 THE OPTIMUM TAX SYSTEM

Schumpeter stated, “The spirit of the people, its cultural standard, its social extent, and the performances its policy may prepare…is written in its fiscal history. He who knows how to heed to its dispatch here distinguishes the thunder of world history more clearly than anywhere else.”

Any tax arrangement is a mixture of antiquity, people's awareness, politics, economics, and law. However, through retrospective assessment of the implementation of taxation, academics have tried to comprehend the complexity of taxation by establishing laws and values. There are as an upshot five vital considerations in examining any tax system. Firstly, to cogitate tax system in seclusion from other items of community revenue or spending is an improbable and inadequate effort. Taxation is just one component of the government's complete budget. Other forms of revenue include charges, fees, licenses and administration commercial holdings. Furthermore, there are many aspects of a tax scheme. This includes volume, composition, rates, coverage, and timings of collection, mode of collection among other things in order to clasp its effects in their entirety. Thirdly, choosing the best tax scheme theoretically is almost impossible. Government has to hypothesize the different issues while harnessing the best possible scheme and will usually settle for a concession between competing factors and thus eventually resolve for a sub-optimal tax scheme. Fourthly, insolence possessed by taxpayers. Every taxpayer normally wants to be released from the tax encumbrance, which does not matter if it is endured by the others. A healthy tax scheme must be equitable for all taxpayers. Other variables such as the current political scenario, natural calamities and the financial condition also influence attitude.

Lastly, vagaries in the tax system itself can implemented progressively. A drastic disorder is unbearable and the effects of an impulsive overhaul in a tax system can yield to the downfall of an economy.

2.3 THE PRINCIPLES OF TAXATION

Taxation precepts are regarded criteria in the classification of procedure factors, but in themselves they are not deemed complete. Taxation resolutions require trade-offs and

judgments of political or worth. There is no distinctive strictly right elucidation for the optimal tax scheme, each with its own particular benefits and disadvantages, only different and varied sub-optimal tax systems. The tax scheme chooses and adheres to certain values, which are called its features, in order to attain certain goals. Therefore, a healthy tax system is one intended on the grounds of a suitable set of values agreed upon. Tax goals, however, conflict with each other, and generally at the political stage there is a need for compromise.

Adam Smith articulated the first four of these ideologies.[27] He assumed that the private sector was more proficient than the public one, and that the prime obligation of the economic progression should bestow with the private sector, however, in view of progresses in economic philosophy and snags of the modern state, five additional ideologies were also proposed by latter writers and have also been largely acknowledged. The mortars of Adam Smith include, first, the parity or equity cannon. This cannon is seeking economic justice. It says that the poorer should pay more taxes because of state protection and permitting additional revenue to be earned and enjoyed. Second, the certitude cannon. Taxpayers should not be subject to tax officials ' arbitrariness, and the tax officials ' discretion is that they breed a corrupt tax administration. Thirdly, there is the comfort cannon. The tax payment method and timing should be as convenient as possible for the' taxpayer.' Fourthly, he argued the economic weapon. These cannon advise that the price of collection tax be as low as appropriate for both the state and the public taxpayer.

Additional intellectuals have added on, fifthly the cannon of efficiency. Also called the cannon of fiscal adequacy, the tax system should be able to advance sufficient income for the Treasury and government is such that there should be no reason to resort to scarcity financing. Sixthly, the cannon of resilience. The tax revenue should have an intrinsic tendency increased along with the increasing national income even if the rates and coverage taxes are not reviewed. Seventhly, the cannon of litheness. It should be possible for establishments without undue interruption, to review the tax structure, both with respect to its coverage and rates, to suit the changing conditions of the economy and of the Treasury. Eighthly, the cannon of simplicity. The tax system should not be too convoluted. It should be easy to comprehend, oversee and not breed problems of elucidation and legal disputes. Finally, the cannon of variety. Tax revenue should not be contingent upon insufficient sources of public income.

[27] He called these canons of taxation. See Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nation (Ed Edwin Cannan), New York, the modern library, pp. 777-779.

Although there are no particulars on which of these ideals are most essential, Joseph Stieglitz,[28] abridged the features of a vigorous tax scheme as essentially consisting of a mix of the following values. First, economic efficacy, the tax should make it possible to allocate funds efficiently. Secondly, the tax should be simple and cheap to administer, administrative plainness. Third, suppleness, the tax system should be able to react to changes in financial circumstances readily. Fourthly, clearness, the tax burden should be readily ascertainable and politically handmade to the desirability of society. Finally, impartiality, the tax scheme should be just in its management to diverse entities.

2.4 BASIC POLICIES ON TAXATION

Taxation cannons feature a nice tax scheme and taxation goals overlay and communicate. However, the emphasis of the goals is on what is intended to be accomplished through it, ideologies are the guidelines to be observed in the articulated tax framework, while characteristics amount to a wide depiction of the tax scheme conceived in accordance with the principles above. Tax system objectives in any economy are linked to public policies as a whole. The goals vary from developed to unfledged countries. These goals may be contradictory and the tax system must best solve them. It cannot be anticipated that a tax scheme will fully accomplish all the objectives. Value Added Tax, for instance, is regarded an optimal form of indirect taxation, but its implementation in developing nations is not as extensive as it is in European nations.

The primary and usually accepted goals of taxation include: firstly, the increase of government revenue; secondly, the restructuring of income parity; thirdly, the elimination of market imperfections; fourthly, the stabilization of the economy; fifthly, the fight against antisocial behavior; sixthly, the implementation of public policies; seventhly, the moderation of cultural differences within society in order to allow the deprived to lead a life of in material self-worth. Eighthly, it is possible to highlight certain indirect taxes in a tax portfolio because they are less noticeable to the public and therefore less credence to political conscription. Finally, on modern decisions, the impact of domestic traditions and' path reliance'

Lastly, the impact that national conducts and ‘path dependence’ wield on the existing choices of tax policy. They tax a particular way because they have always taxed that way but the inspiration of ancient patterns is not reflected steadily.

[28] Former chief economist of the World Bank http://iss2.etax.com.my/vld/ctaxvld.nsf/0/e63dba2969b172ed48256a6300116cd3?OpenDocum ENT See Globalization and its discontents.

2.4.1 ADVANCEMENT OF SMEs POLICIES AND LAWS IN KENYA

As earlier indicated, the revolution of government strategies on SMEs or the informal sector can be traced back after the ILO report of 1972 on Employment, income and equity in Kenya which recognized SMEs as important sector for creating income and employment for the Kenyan population. The sector's importance in economic development was spelt out in Sessional Paper No.1 of 1986, Economic Management for Renewed Growth[29] which set out mechanisms for enhancing an enabling environment for the informal sector. The government's assurance in Sessional Paper 1 of 1986 was strengthened in the 1989 government report, 'the strategy for small Enterprises, which outlined the mechanisms for eradicating the constrictions to growth and the development of the SME sector[30].

Another determination by the government to articulate a policy framework on informal sector was in Sessional Paper No.2 of 1992, "Small and Medium Enterprises (MSMEs) and Jua kali Development in Kenya". The Sessional paper indorsed that the relevant ministries in discussion with the Attorney general's office address the legal and regulatory framework to support the creation of an enabling business environment for SMEs. The Sessional paper specifically recommended the need to carry out a comprehensive review and analysis of the Acts and licenses that pertain to SMEs, especially those that undesirably impacted on the growth and progress of the SMEs. The paper also promoted for the formation of association to avail information to various enterprises in the country.

The Development Plan for 1989-1993 disguised that the government would expedite the already commenced evaluation of the local authorities by laws and regulations that have proved constricting to the development of SMEs[31]. The small Enterprise Policy Implementation Programme mission report of 1994 also recognized the failure to address some key issues such as legislative reform, land allocation and poor infrastructure as the main weakness impeding

[29] Government of Kenya (1986). *"Economic management for renewed growth".* Sessional Paper No. 1 of 1986. Nairobi: Government Printer.

[30] Government of Kenya (1989). *"A strategy for small enterprise development in Kenya: towards the Years 2000".* Nairobi: Government Printer

[31] Ibid

the improvement of the SMEs. The government also pledged to complement the licensing regime and abridge requirements so as to embolden commercial and industrial investment[32].

Sessional paper No.2 on the development of SMEs for wealth and employment creation for poverty reduction charted key measures to address business registration, business licensing and the tax regime.

Another policy geared to addressing the informal sector issues incorporated the informal sector issues in the Private sector Development Strategy[33]. It is palpable that several attempts have been made to verbalize policies to support the SMEs sectors in Kenya. However, the existing policies have been nationwide oriented, with restricted concentration on addressing region explicit SMEs issues in Kenya. Such regulatory framework also requires a well-established foundation to superintend the enactment of the respective legislations.

2.5 KENYAN SOCIETY BEFORE COLONIZATION AND THE TAXES

Kenya afore colonization was divided up into an innumerable number of tribal based societies all with their own static ethnic geographical territory. African society in pre-colonial times can be dubbed as a communist/socialist society where almost all the possessions were mutually owned with all members sharing in community wealth. In most, if not all, clans in general, however, whatever manufacturing took place needed quota of it to be moved to the house of the tribe leader and community. This included constituents of any harvest whether they were agricultural products, revenues from trading or donations. Both foreign and local traders were needed to pay tithes, particularly in ivory and slaves, with the intention of be permitted to pass through a specific tribe's land. Thus, in the manner we know it today, there was usually no taxation but there were transmittals to the ruler in return for which peace was conserved and fortification was contracted.

The tithe levied was never more than inexpensive and often the tribe's chief as well as the more successful farmers would offer food to the hungry-affected members of the tribe in instances of famine. None died of hunger as long as there was food in the tribe and a part of manufacturing paid tithes, thus applying the concept of' efficiency.' Economy,' the levy of a set proportion of the product was retained. Hence an' easy' system based primarily on voluntary payment, resulting in a relatively effective scheme of administration. After a harvest, the tithe

[32] Government of Kenya. National Development Plans: 1994-1996. Nairobi: Government Printer
[33] Government of Kenya (2006-2010), Private Sector Development Strategy: Government Printer

was generally transferred to the leader in the form of a product that made it both' comfortable' and' flexible.'

Since the fee was in the form or unpreserved products, a potentate would not request profligately as he would take only enough for himself. Thus, there has always been an aspect of almost scrupulous fairness and equity in the implementation of tithes. In addition, there was an unwritten scheme of manufacturing quotas despite a particular notion of voluntary payment of tithe. Insofar as traders were concerned, this was implemented on the grounds of the quantity of products being ferried into or out of the tribal land and was a set proportion levied by the tribal warriors who brought the traders to the king directly to pay homage. There are no documented cases of traders waiting for days or refusing payment and therefore the values of effectiveness, simplicity by accepting any type of payment including in the merchandise being traded. In the levy of this type of' passage correct' tax, the principle of equity was used, it was generally a set amount for passage through property depending on the number of persons or quantity of products.

Nevertheless, ineptitude may have been demonstrated by the reality that the intact trading group had to present itself to the leader or king and personally pay his homage to him. Some intellectuals contended that every member of the chief family was expecting presents and therefore the price of movement was comparatively higher for some tribes vis-à-vis others, but there is no information of cripplingly high homages that in turn made trade unbearable or even abridged it. The trade despite the tributes levied during this period remained exceptionally feasible and allowed to trade to bourgeon.

In summary, at best these various tribal tax systems were highly elementary, easy and wrought on a very tiny scale. It was appropriate for the economy of the time and at that point in time it was quite efficacious in its time frame and the state of the economy.

2.6 CONCLUSION.

Tukur settles that:

“... the taxes enforced by the British, remote from being scarcer, more lucid and daintier than the pre-colonial taxes as was claimed by the British, were in fact additional in number and heftier in prevalence than the pre-colonial taxes, that many of them were unsubstantiated and capricious, some of them having as their primary tenacity not the provision of revenue to the Colonial Administration and the Native Authorities, but the creation of a colonial economy

bereft of an native industrial base and geared towards the manufacture and export of crude raw materials. We have also seen."

Tukur augments:

"... That through our period British Residents and Assistant Residents were very much involved in the assessment and assemblage of these taxes than people are led to trust by the theoreticians of "Indirect Rule".[34]

Economist Joseph Schumpeter has detailed those fiscal systems are central to the political and cultural life of a nation: "The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare --all this and more is written in its fiscal history, stripped of all phrases. He who knows how to listen to its message here distinguishes the thunder of world history more clearly than anywhere else."[35]

Fiscal history, not only in Kenya, but globally, continues at the periphery of mainstream historiography. This assessment tries to examine one portion of Kenya's tax history that has influenced the domestic latitude, imitating Schumpeter's belief that taxes inform countries and their growth.

At this stage in time, Kenya had created a comprehensive taxation system through British colonization that retains a consideration of colonial policy. In Kenya, it is a capitalist economy that has almost no fundamental procedures, laws or tax values that have been recognized globally. This led in a tax scheme, extremely dependent on import duties, which today in a globalizing globe seeking to open borders and decrease tariffs creates more issues.

[34] See M. M. Tukur, 'The Imposition of British Colonial Domination on the Sokoto Caliphate, Borno and Neighboring States: 1897-1914:
A Reinterpretation of Colonial Sources.' Unpublished Ph.D. Thesis Submitted to the Department of History, A. B. U. Zaria. July 1979. At 579.

[35] Joseph J. Thorndike, 'Historical Perspective: What Goes Around, Comes Around' October 11, 2005 <http://www.taxhistory. org/thp/readings.nsf/0/462eeea8a69253c8852570ac005eba4d? Open Document>, accessed 12/6/19).

CHAPTER THREE:

POLICY AND INSTITUTIONAL FRAMEWORKS ON TAXATION AND GOVERNMENT FINANCING

INTRODUCTION.

In this chapter the policy outline for anti- corruption will be examined. Sound policy framework promotes sustainable and synchronized tactic in the eradication of corruption. The policy helps to lay strong legal and institutional frameworks in tackling corruption. Questions to be addressed in this chapter are; is there an anti-Corruption Policy and strategy for its achievement? Are the laws being legislated by parliament in pursuance of enforcing that policy? If yes, where is the policy to be found and how is it being implemented? It is important to understand policy at this juncture before addressing the questions posed. This chapter equally scrutinises the formal framework for anti-corruption in Kenya. Both formal and informal institutions are scrutinised. The official institutions are those established by law or through the government Departments. The non-formal institutions are those that are not essentially recognised by the government such as civil society organizations. There are innumerable institutions centring on the war against corruption.

The country's economy has seen sturdy progression over the years, characterized by the upsurge in substructure projects, growth in agricultural production, and proliferation in foreign direct investments and enlargement in the tourism sector. One would unsurprisingly expect that these improvements would have a knock-on influence on the total tax revenue collected by the Kenya Revenue Authority (KRA). This conversely has not been the case with KRA falling short of its revenue collection aims every passing year.

In determination to nurture collection of revenue while inspiring investments in the country, Kenya has embarked on a tax reform journey which has seen the adoption of its new Value Added Tax Act, 2013 (VATA), Excise Duty Act, 2015 and the Tax Appeals Tribunal Act, 2013. A key breakthrough in this tax reform process is the current enactment of the Tax Procedures Act, 2015 (TPA) which came into force on 19th January, 2016. The TPA occasioned from the need to streamline and amalgamate tax administration both from the Government and taxpayer perspectives, while extenuating the highly belligerent issue of aggressive tax planning by corporate entities.

VAGARIES USHERED BY THE TPA

The TPA has not only proven to streamline tax administration for the government, it has also nurtured tranquil tax acquiescence by the taxpayer. It has attained this through making a number of variations in the following key areas: -

Record keeping

The TPA has restricted a taxpayer's onus to retain records to a period of 5 years. Formerly, the Income Tax Act, (Cap. 470) had a maintenance period of seven (7) years while the VAT and the Customs and Excise Acts provided for five (5) years.

Tax assessments

KRA can only issue valuations for a maximum period of five (5) years. However, in a case where there is desertion, shirking or tax fraud by the taxpayer, a valuation may exceed the five (5) year limit.

Payment of taxes and filing of returns

A taxpayer can now appeal for a leeway of the period to submit tax returns and payment of the tax associated with the returns, provided that the Commissioner is contented with the reasons for delay.

Transfer of tax liability

Dependent on the TPA, a taxpayer (transferor) can also handover tax liability in the event that it handovers all or part of its business possessions to a related party, in which case the person to whom the business assets are transferred will be responsible for the taxes.

Information Technology (IT)

In an effort to augment submission, the TPA provides for the use of technology for purposes of compliance of returns and payment or repayment of taxes on any day including weekends and public holidays which was not previously possible.

Public and Private Rulings

The Commissioner in accordance with provisions of the TPA can make a public ruling which will be binding on him, unless he extracts it by dissemination of a notification in at least two (2) newspapers with national circulation. This provision of guidance by the Commissioner is a most welcome improvement given the fact that tax rows have often been as a result of conflict in the elucidation and/or applicability of tax statutes. In addition, taxpayers may also apply for private rulings which shall be published (with the taxpayer's privacy) in at least two (2) newspapers with national circulation.

This will enable taxpayers to acquire lucidity on the tax repercussions of certain transactions they intend to undertake. Not only will this achieve inevitability of taxation, as already stated, it reduces the chances of future rows on the tax treatment since the Commissioner will be bound by the ruling from a tax administration standpoint, taxpayers can now be registered by the Commissioner for purposes of different tax onuses without their express application to be registered. It is notable that before the enactment of the TPA, this was only catered for in the VATA.

Severe penalties

The TPA also has castigatory provisions. Especially, it has not only raised the stakes in terms of tax liability but has also presented severe penalties and offences in instances of defiance with certain tax law provisions as itemised below: -

i) Late compliance of PAYE returns formerly attracted a penalty of KES 10,000 per return filed late. Conditional on the TPA, the taxpayer will be exposed to a penalty equal to 25% of the PAYE due or KES 10, 000, either that is higher.

ii) On late filing of any other tax return; the fine is now equal to 5% of the tax payable under the return to a minimum of KES 20, 000. The minimum amount has been revised from KES 10, 000 and KES 1, 000 in respect of corporate entities and individual taxpayers.

iii) Furthermore, the penalty for a tax underperformance attributable to a considered deceitful or distorted statement was KES 1, 000,000 or imprisonment for a term of three years or both in the case of VAT and 200% of the tax amount involved in the case of Income tax. The TPA has now revised this to a penalty of 75% on the tax shortfall in case of duplicitous tax filing, and 20% where the deficit is not as a result of deceitful tax filing.

Confidently speaking, the interest charged in the event of a late payment of tax has been reduced from 2 percent per month to 1 percent and is charged as simple interest.

The TPA has and will indubitably continue to play a momentous role in tax administration and collection. Nonetheless, the TPA has powered a weighty hullabaloo over the fine line between illegal tax evasion and tax planning that is a legal implementation of the law to reduce tax liability. Especially, it offers that if the Commissioner considers a transaction to be entered into for tax scheduling reasons, then the taxpayer will be accountable to pay double the tax that would otherwise have been paid as a penalty. This means a taxpayer will be fined for benefitting from tax law ambiguities.

In the not-so-distant future, this effort by the TPA to penalize effective tax planning will certainly be the topic of litigation. This provides credence to what former Exchequer

Chancellor Denis Healey of the United Kingdom said, “The peculiarity between tax dodging and tax circumvention is the jail wall thickness...”

DEFINITION OF POLICY

The term “policy” is subject to variation in meaning and usage in different context. As encapsulated in the metaphor, “policy is rather like an elephant you can recognize it when you see it, but cannot easily define it”[36]. Concise Oxford dictionary[37] defines policy as path or belief of action adopted or proposed by a government, party, business, individual or prudent conduct, or sagacity. The definition suggests that ‘policy’ is a wise course of action. Birkland[38] defines a policy as a announcement by a government of what it aims to do or not to do, such as law, guideline, decision or order or a combination of these. The lack of such statement may also be an inherent statement of policy. Jenkins[39] provides a useful definition that focuses on the instrumentality of policy and emphasizes that it should not merely be aspirational, but also within the control of those responsible for making policy. He defines policy as a set of interconnected pronouncements taken by apolitical actor or a group of actors concerning the selection of goals and the means of attaining them within a quantified situation where these decisions should, in principle, is within influence of these actors to realize. From the definitions it can be said that policy is a set of principles and purposes used to guide resolution making. Having looked at the definitions on policy, it is necessary to interrogate whether there is existing anti-corruption policy in Kenya.

OVERVIEW OF THE POLICY FRAMEWORK

Corruption has many faces and can occur in different forms across all sectors and institutions in Kenya. Hence, there is need for effective, coordinated anti-corruption policies to address the problem strategically. In Kenya there is no National Anti-Corruption Policy which sets out a comprehensive plan on how to tackle corruption.

[36] Thomas Birkland: An introduction to policy process: theories, concepts, and models of public Policy making.Sarp.Inc.2"d Ed, 2005 p 138.
[37] Concise Oxford dictionary 9th edition, Oxford University Press, 1995 pg. 1057.
[38] Supra footnote 48 pg. 138.
[39] Jenkins, W: Policy Analysis; Apolitical and Organizational Perspectives: London, Martin Robertson! 978, pg. 15.

This lacuna has been admitted by the Minister for Justice, National Cohesion and Constitutional Affairs[40] who acknowledges that "one of the major lessons we have learnt from various good governance initiatives the government has put in place is that anti-corruption efforts and initiatives cannot exist in a policy vaccum.That is why my Ministry is working towards the formulation of a National Anti-Corruption policy, to mainstream the fight against corruption in the management of public affairs and resources and provide an enabling environment for operation of law enforcement agencies." It is therefore apparent from the statement that in Kenya there is no anticorruption policy. Countries such as Tanzania and Zambia[41] have developed anticorruption policies.

However, despite the absence of national anti-Corruption policy, the government's intention/expression to fight corruption can be inferred from various statements made by the Plead of State for instance in his opening speech of the 9th parliament the president reaffirmed the government's commitment to fight corruption when he stated that, "I reiterated some of our campaign promises during my inauguration speech.

Today marks yet another step towards fulfilling these pledges. We reiterate our commitment towards creating a culture of zero tolerance to corruption in Kenya[42] other government commitments on anti-Corruption are found in the Economic Recovery Strategy for wealth and Employment Creation (ERS) 2003-2007.Under ERS anti-corruption objectives was "strengthening ethics, integrity and anti-corruption". The specific targets set against this objective includes: Implementing provisions of the Economic Crimes Act; preparing a 5-year Anti-corruption strategy; organizing anti-corruption campaigns including stakeholders and community leaders, to provide autonomy from political interference to departments and institutions fighting corruption; identifying and prosecuting corruption cases and removing from office civil servants involved in corrupt activities.[43] Vision 2030 documents under the pillar of 'transparency and accountability' the objective under this pillar is to have a transparent, accountable, ethical and result oriented government institutions. The goal for the 2012(midterm plan) is to enact and operationalize necessary policy, legal and institutional framework needed to strengthen public transparency and accountability.

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[40] Keynote address by Hon.Mutula Kilonzo Minister for Justice, National Cohesion and Constitutional Affairs during the induction workshop for the members of the Kenya Anticorruption Advisory Board at the Great Rift Valley Lodge and Golf Resort Naivasha on 9th July, 2009 pg. 7 accessed on 30.9.2009 at www.kacc.go.ke.

[41] Zambia National Anti-Corruption Policy launched on the 28th August 2009 www.scibd.com/Zambia national Anti-Corruption Policy, 2009.

[42] President Mwai Kibaki's speech during the State opening of the 9lh Parliament! 8th February,2003.

[43] End Term Review Economic Recovery Strategy for wealth and employment creation (ERS) 2003-2007. Government of the Republic of Kenya, 2009 pg. 158.

The specific approaches encompass: solidification of the legal framework for integrity and reliability; endorsing result oriented administration within the public service; encouraging access to information and data; introducing civilian oversight around the key legal, justice and security institutions; and empowering parliament's legislative oversight aptitude.[44] Both ERS and Vision 2030 have strategies for fighting corruption however, they are not comprehensive; there is no mention of harmonizing the legal and institutional frameworks. The Vision 2030 in its objectives among others indicates that there are plans to 'enact and operationalize necessary policy' this is an acknowledgment that there is no policy on anti-corruption.

THE OPERATION OF KRA

The Kenya Revenue Authority was established in 1995 under the Kenya Revenue Act[45] as the principal body for the valuation and collection of revenue and for the management and implementation of the laws concerning to revenue.[46] KRA was set up to assemble and represent all government revenue[47] under a semiautonomous plan.[48] This brought together the formerly independent revenue collection departments. [49] It was projected to advance revenue administration and augment armament of domestic resources. The general objective was to develop efficacy, proficiency and impartiality in revenue management. Undeniably it was established as a step to keep up to international best practice. It has been noted earlier that this happened as a result of guidance from western donor organizations.[50]

In terms of section 5 of the Act, KRA is an organisation of the government for the assortment and reception of all revenue. Conversely, it is under the general regulation of the Cabinet Secretary in charge of the Treasury. [51] This brings into attention the claim of its freedom. The jury is still out as to whether there is any material variance between the objectivity it enjoys and that enjoyed by the previously revenue collection departments within the ministry. KRA is only endowed to oversee and implement specific statutes. These are set out in Part I and Part II of the First Schedule to the Act. For the Part I statutes, it administers and enforces all provisions while for Part II statutes, its power only prolongs to the stated provisions.[52]

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[44] Supra footnote 26 pg. 18.
[45] Chapter 469 of the Laws of Kenya, whose commencement date was 1st July 1995.
[46] The Preamble to the Act.
[47]Government revenue includes taxes and other sources of government revenue. KRA is therefore not just a tax collection body.
[48] Kenya Revenue Authority (2010) supra, p. 13.
[49] These were departments in the Ministry of Finance. They included the Customs & Excise department, the Income Tax department and the VAT department.
[50] Kenya Revenue Authority (2010) supra, p. 13.
[51] Previously Minister for Finance.
[52] Ibid Section 5(2).

Part I statutes are the Income Tax Act,[53] the Customs and Excise Act,[54] the Value Added Tax Act,[55] Road Maintenance Levy Fund Act,[56] Air Passenger Service Charge Act, [57]Entertainments Tax Act,[58] the East African Community Customs Management Act, 2004, and the Annexes to the Protocol on the Establishment of the East African Community Customs Union. The Part II statutes are the Traffic Act,[59] Transport Licensing Act,[60] Second Hand Motor Vehicles Purchase Tax Act, the Civil Aviation Act, the Widows and Children's Pensions Act, the Parliamentary Pensions Act, the Betting Lotteries and Gaming Act, the Stamp Duty Act, the Horticultural Crops Development Authority (Imposition of Fees and Charges) Order 1995, the Standards Levy Order 1990, the Sugar Act and the Government Lands Act.

The above infers that the KRA was accountable for fully executing the Entertainment Tax Act and partially enforcing the Betting, Lotteries and Gaming Act. These include tax on entertainment. Entertainment taxes are now under county governments ' authority. In addition, it was also engaged in the administration of property taxes owing to its authority to gather stamp duty under the Stamp Duty Act and land rent under the Government Lands Act (now abolished). Property rates are now under the county government's prerogative. As you can see in the Constitution is unequivocal on estate prices but inaudible on other estate taxes. KRA is controlled by a board of directors consisting of the chairperson appointed by the Chairperson, the Commissioner-General, the Principal Secretary, Treasury or his representative, the Attorney-General or his representative, and six other individuals appointed by the Cabinet Secretary. Only the president and the other six appointees have the power to vote. The board has three primary tasks. These include approving and swotting the Authority's policy; pursuing the Authority's efficiency in carrying out its tasks; and disciplining and tracking all personnel members of the Authority.

This denotes that it achieves executive purposes even though the board is not intended as an executive board. This is dependable with the model of the BoD. The Commissioner-General is the authority's chief executive. The Treasury Cabinet Secretary appoints him on the Board's commendation. He works under the Board's overall oversight and control. He is answerable for the Authority's day-to-day activities; handling the Authority's resources, assets, and dealings;

[53] Chapter 470, Laws of Kenya.
[54] Chapter 472, Laws of Kenya.
[55] Chapter 476, Laws of Kenya.
[56] Act No. 9 of 1993.
[57]Chapter 475, Laws of Kenya.
[58] Chapter 479, Laws of Kenya
[59] Chapter 403, Laws of Kenya.
[60] Chapter 404, Laws of Kenya.

and managing, organizing, and controlling the Authority's employees. The Board has the ability to assign Commissioners to the Authority's service. He has appointed in the exercise of this authority to appoint functional heads of departments.

The revenues collected by the Authority are paid into the Consolidated Fund except where the revenue is in respect of a special fund established under an Act of parliament to which it is paid.[61]

The Authority's funds comprise of one and a half percent of the income projected by the Authority in the financial appraisals for each financial year to be collected; and three percent of the income essentially raised in each subsequent three-month period in the financial year exceeding the quantity estimated for the period to be collected. However, in regard of that epoch, the total should not surpass two percent of the real quantity gathered.

KRA's capacity to continue to fulfil its mandate was doubted unless the issue of underfunding was resolved. The Auditor General described the 2010/11 KRA reports as follows:"... it is worrying that the Authority has posted negative results over the previous four years. The Authority also revealed adverse working capital amounting to Ksh 405,052,000.00 as reflected in the financial statement as at 30 June 2011. Therefore, the capacity of the Authority to carry out its mandate in the lengthy term is threatened. Observers believe that the creation of KRA has not led to a drastic rise in profits. When one considers the quantity, this becomes even more prominent. On the constructive side, KRA is seen just as a lustre of legality to Kenya's tax management.[62]

CONCLUSION

Undoubtedly the TPA is a multi-coloured coat. It is not only retributive, it is concrete and, above all, a welcome way forward for certain administrative tax processes. With its introduction, there is no doubt that a war against tax avoidance systems has been waged "formally." This is obvious not only with the adoption of the TPA, but also with the recent signing of the Convention on Mutual Administrative Assistance in Tax Matters by Kenya (on 8 February 2016). The purpose of this convention is to strengthen administrative collaboration between nations to counter international tax evasion, tax avoidance and other types of non-

[61] Section 13A. This is clearly a remnant of the direct political interference that the creation of an ARA may have wanted to eliminate. The Commissioner-General, as a supervisee of the Board, should have recourse only to the Board.

[62]Cheeseman, N. & R. Griffiths (2005) supra, pp. 12-13.

compliance. It also seeks to facilitate data exchange, tax retrieval aid, document service and joint tax audits by the Convention's parties.

Conjuring the picture of a person struggling to raise himself by the handle of a bucket in which he stands, as explained by Churchill, one might wonder if the TPA is just a camel's nose of more stringent legislation to arrive in Kenya directed at tackling the higher' evil' of tax planning, culminating in a rise in tax revenue collection. Before embarking on the same, it is therefore essential to guarantee that one is properly informed on the tax consequences of a structure or company transaction.

In this chapter the anti-corruption policy framework in Kenya has been examined. Based on such observations, it is has emerged that there is no policy on anti-corruption. Although, there have been a number of anti-corruption initiatives undertaken by the government, lack of sound policy framework has led to disharmony not only among the institutions involved in the fight against corruption but is also on laws relating to corruption in Kenya.

CHAPTER FOUR:

RITHINKING TAXATION AND FINANCING IN KENYA THROUGH TAXING ILLEGAL ACTIVITIES IN KENYA

4.1 INTRODUCTION

On 15 April 2016, the Court of Appeal of Kenya rendered a landmark ruling. In the seminal case of ***Republic v Kenya Revenue Authority ex parte Yaya Towers Limited***,[63] the Kenya Revenue Authority (KRA) sought to have an employee of the applicant remit his income tax. Despite finding the employee's employment contract to be illegal, the court proceeded to hold that income accrued from the said contract was liable to taxation. For the first time in Kenya, income derived from illegal activity was held to be taxable pursuant to the provisions of the Income Tax Act of Kenya.[64] As in many other countries, the debate as to taxability of illegal income has found its way into Kenya's judiciary. This decision opened a plethora of issues, which the court may not have anticipated. This paper delves into the definition of income provided in the Act, the court's interpretation of the same and whether income generated from illegal activity falls within the law's purview. The question as to whether or not a criminal should be allowed to deduct expenses incurred in the process of procuring the said illegal business is also dealt with. The link between the criminal justice system especially, the right not to self-incriminate[65] and the taxability of income generated from crime will be examined and finally, this paper analyses the use of tax law to reinforce criminal law. Since the issues raised above are not unique to Kenya, it is important to tackle them with reference to other jurisdictions that have experienced similar problems.

4.2 IS INCOME FROM ILLEGAL ACTIVITY TAXABLE IN KENYA?

Lord McNaghten defined income tax as a tax on income irrespective of other considerations, notably, legality. Whether one has fixed property or lives by his wits he contributes to the tax if his income is above the prescribed limit.[66]

Section 3(1) of the Income Tax Act of Kenya stipulates as follows: 'Subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of

[63] (2008) eKLR.
[64] Kenya Revenue Authority v Yaya Towers Limited (2016) eKLR.
[65] Article 50(2) (l), Constitution of Kenya (2010).
[66] London County Council & Others v The Attorney General (1901), The United Kingdom Court of Appeal as adopted by the court in Pili Management Consultants Ltd v Commissioner of Income Tax, Kenya Revenue Authority (2010) eKLR

income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.'

Pursuant to section 3(1) above, there are two requirements requisite for the income tax to be levied: one, there has to be income; and two, the said income must have been accrued in or derived from Kenya. The reason for the cancellation is, the requirements are already easily derived from the statute. The question as to what constitutes income can further be viewed from two perspectives: (1) the legality and illegality of the amount in question or (2) the source of taxable income. The former, as we shall see, is not an easy question to answer. With regards to the latter, the Act provides for taxation of: all income from businesses, [67]income from employment,[68] income from the use of property,[69] income from management or professional fees, royalties, interest and rents.[70] The scope of this article is confined to income that meets the definition of income under the Income Tax Act but tainted by an illegality. As held in Pickford v Quirke,[71] the repeated nature of transactions is key in ascertaining whether the amount in question is liable to income tax or not. For example, income derived from sporadic loot would not qualify as income under the Act, but, income derived from embezzlement by a career embezzler, save for the question of illegality would qualify as income from a business.[72] The Act uses the phrase 'all income', [73] and at no place does it qualify the nature of income to be either legal or illegal. This leaves a wide margin for interpretation, illegally obtained income as well as legally obtained income may very well fit the description 'all income'. In Republic v Kenya Revenue Authority ex parte Yaya Towers Limited, [74] the Kenya Revenue Authority sought to have an employee of the applicant remit his income tax, the court found the employee's employment contract to be illegal. The High Court further held that the Kenya Revenue Authority cannot use an illegal relationship to assess tax as that would be contrary to public policy. [75] In arriving at this conclusion, the court was guided by several judicial decisions, among them Lord Mansfield's proposition in Holman v Johnson[76] where he stated

[67] Section 4, Income Tax Act (Chapter 470).
[68] Section 5, Income Tax Act (Chapter 470).
[69] Section 6, Income Tax Act (Chapter 470).
[70] Section 10, Income Tax Act (Chapter 470).
[71] Pickford v Quirke (1927), The United Kingdom Court of Appeal.
[72] Section 2 & 4, Income Tax Act (Chapter 470); Rutkin v United States (1952), The Supreme Court of the United States; James v United States (1961), The Supreme Court of the United States
[73] Section 3(1), Income Tax Act (Chapter 470).
[74] (2008) eKLR
[75] Republic v Kenya Revenue Authority ex parte Yaya Towers limited (2008) eKLR.
[76] Holman v Johnson (1775), The United Kingdom Court of King's Bench

that no court will lend its aid to a man who founds his cause of action upon an immoral or illegal act.[77]

The Kenya Revenue Authority proceeded to file an appeal at the Court of Appeal, the highest court in Kenya at the time. A three-judge bench of the Court of Appeal held that whether a business is illegal or services obtained were rendered by an illegal entity, it is still subject to tax for two reasons; firstly, holding otherwise would entitle a wrong doer to benefit from illegal profits earned from unlawful business and, on top of that, be exempted from taxation. It would be an absurdity to tax the gains of an honest man while the dishonest escape taxation. Secondly, if profits of an illegal business were not taxable, honest taxpayers would be incentivised to taint their businesses with an illegality for purposes of securing exemption from taxation.[78]

There are two main arguments that critics often level against taxation of illegal income: that the state would be a silent partner in crime[79] and that it is a contravention of public policy.[80] Proponents of the first argument often hold that receipt of proceeds of any profitable activity in the form of taxes makes the state a partner to the given business.[81] In the same vein, taxing proceeds of crime makes the state a partner to the criminal activity which it sought to prevent in the first place by criminalising it.[82] The second argument is best expounded by Nyamu J in Republic v Kenya Revenue Authority ex parte Yaya Towers Limited[83] where he stated that 'Illegality as to the formation of a contract implies that it is intended to be performed in an illegally prohibited manner and the courts cannot enforce it or provide any other remedies arising out of the contract as it is against Public Policy'.[84] Consequently, receipt of proceeds of an illegality by the state amounts to the state aiding and abetting contravention of the law, as such contravening public policy.

In Mann v Nash,[85] in which an argument on the immorality of the taxation of tax profits was raised, Rowlatt J rejected it while asserting that: 'The Revenue representing the State is merely looking at an accomplished fact. It is not condoning it; it has not taken part in it; it merely finds

[77] Holman v Johnson (1775), The United Kingdom Court of King's Bench
[78] Kenya Revenue Authority v Yaya Towers Limited (2016) eKLR
[79] Mann v Nash (1932), The United Kingdom Court of King's Bench; Scott v Brown (1892), The United Kingdom Court of King's Bench; Judge Manton's holding in Steinberg v United States (1926), The United States Court of Appeals for the Second Circuit.
[80] Republic v Kenya Revenue Authority ex parte Yaya Towers limited (2008) eKLR
[81] Bittker I, 'Taxing income from unlawful activities', Yale Law School, Faculty Scholarship Series, Paper 2289, 1974, 144 – on 4 June 2016.
[82] Judge Manton's holding in Steinberg v United States (1926), The United States Court of Appeals for the Second Circuit
[83] (2008) eKLR.
[84] Republic v Kenya Revenue Authority ex parte Yaya Towers Limited (2008) eKLR
[85] Mann v Nash (1932), The United Kingdom Court of King's Bench.

profits made from what appears to be a trade, and the Revenue laws happen to say that the profits made from trades have to be taxed, and they say: 'give us the tax'. It is not to the purpose in my judgment to say, 'but the same State that you represent has said they are unlawful.' That is immaterial altogether… It is said again: 'Is the State coming forward to take a share of unlawful gains?' It is mere rhetoric. The State is doing nothing of the kind; they are taxing the individual with reference to certain facts. They are not partners; they are not principals in the illegality, or sharers in the illegality; they are merely taxing a man in respect of those resources. I think it is only rhetoric to say that they are sharing in his profits and a piece of rhetoric which is perfectly useless for the solution of the question which I have to decide'.[86]

In Commissioner of Inland Revenue v Aken[87] where the issue was whether income from prostitution was taxable, the court, despite questions on morality of the trade, proceeded to hold that the profits from prostitution were taxable and that the word 'trade' in itself has no connotation of lawfulness.[88] Similarly, the Court in Southern (H.M. Inspector of Taxes) v AB[89] was of the view that irrespective of the illegality of the businesses in question, they nevertheless fit the meaning of trade as posited by the Act and that the profits therefrom were properly assessable to income tax.[90]

As Gupta argues, taxation, in theory, knows no morality[91] neither is it, in theory, an issue of fairness, but of statutory application and that is the same for the taxpayer earning income from criminal activities, which constitute business, as it is of the ordinary legitimate taxpayer.[92] The state does not tolerate crime, neither is it a silent partner to crime by taxing proceeds of illicit trade.[93] As expounded by Rowlatt J, the state is merely looking for an accomplished fact, which arises from application of express provisions of the law.[94] A dollar of profit from an unlawful activity will buy as much as a dollar from a lawful activity.[95] Taxing legal income while exempting illegal income is tantamount to incentivising an illegality, which would in turn be

[86] Mann v Nash (1932), The United Kingdom Court of King's Bench.
[87] Mann v Nash (1932), The United Kingdom Court of King's Bench.
[88] Commissioner of Inland Revenue v Aken (1988), The United Kingdom Queen's Bench Division of the High Court.
[89] Southern (H.M Inspector of Taxes) v AB (1933), The United Kingdom Court of King's Bench
[90] Southern (H.M Inspector of Taxes) v AB (1933), The United Kingdom Court of King's Bench.
[91] In Commissioner V Wilcox (1946), The Supreme Court of the United States, the court posited as follows; 'Moral turpitude is not a touchstone of taxability. The question, rather, is whether the taxpayer in fact received a statutory gain, profit or benefit. That the taxpayer's motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of 22 (a)'
[92] Gupta R, 'Taxation of illegal activities in New Zealand and Australia' 3 (2) Journal of the Australasian Tax Teachers Association 2, 2008 106.
[93] Mann v Nash (1932), The United Kingdom Court of King's Bench.
[94] Mann v Nash (1932), The United Kingdom Court of King's Bench.
[95] Bittker I, 'Taxing income from unlawful activities', 137.

contrary to public policy and not vice versa? In any case, refraining from taxing ill-gotten gains would amount to exempting persons from one law simply because they have violated another.[96] In Sullivan v United States where a matter of this nature was addressed, the court ruled that there is no justice in taxing persons in legitimate enterprises while allowing those who thrive by violation of the law to escape.[97] If indeed the government wants to disincentives illegal trade, it makes perfect sense both legally and economically to then tax proceeds of crime rather than grant them a tax exemption. In any case exempting from tax, income derived from illegal activity in order to discourage the public from engaging in such is a needlessly blunt instrument to say the least.[98] Moreover, it beats logic to think that a legislature in its right mind would ever want to incentivise crime at the expense of law-abiding citizens.[99] In Kenya's scenario, the Act makes no distinction between legally or illegally derived incomes.[100] Consequently, provided an amount falls within the definition of assessable income, regardless of its legal or illegal roots, it makes perfect sense to subject it to tax. This has been the case in several other tax jurisdictions faced with questions pertaining to taxability of illegal income. In the United States, Congress, pursuant to the Sixteenth Amendment[101] is empowered to levy and collect taxes from all income from whatever source derived.[102] The Internal Revenue Code further defines gross income to include all income from whatever source derived except where provided otherwise.[103] The courts on numerous occasions have interpreted these provisions to include income derived from illegal activities.[104] To state but a few: In Sullivan v United States[105] where the court held that gains derived from illicit traffic were taxable income under the 1921 Internal Revenue Act, Justice Holmes ruled that they see no reason why the fact that a business is unlawful should exempt it from paying taxes that if lawful it would have to pay.[106] In Rutikin v United States[107] where the defendant was involved in extortion of funds, the Supreme Court held that both lawful and unlawful gain constituted taxable income provided its recipient (the criminal) has control over the gain and derives realizable economic value from

[96] Lusty D, 'Taxing the untouchables who profit from organized crime' 10 Journal of Financial Crime3, 2003, 2
[97] Sullivan v United States (1927), The Supreme Court of the United States
[98] Bittker I, 'Taxing income from unlawful activities', 140
[99] Sullivan v United States (1927), The Supreme Court of the United States
[100] Section 3(1), Income Tax Act (Chapter 470).
[101] 16th Amendment, United States Constitution.
[102] 16th Amendment, United States Constitution
[103] Sec 61(a), Internal Revenue Code (United States)
[104] Sullivan v United States (1927), The Supreme Court of the United States; Rutkin v United States (1952), The Supreme Court of the United States; James v United States (1961), The Supreme Court of the United States.
[105] Sullivan v United States (1927), The Supreme Court of the United States.
[106] Sullivan v United States (1927), The Supreme Court of the United States.
[107] Rutkin v United States (1952), The Supreme Court of the United States.

it.[108] In James v United States,[109] where the petitioner embezzled large sums of money during the years 1951 through 1954 and, failed to report those amounts as gross income in his income tax returns for those years, the Supreme Court held that the embezzler was required to include his ill-gotten gains in his 'gross income' for federal income tax purposes.[110]

The courts in South Africa have adopted a similar position. In CIR v Delagoa Bay Cigarette Co,[111] where an issue of taxability of proceeds of an illegality was raised, the court held that the legality or illegality of the source of income was immaterial.[112] In reaching this decision, it was guided by the holding in Partridge v Mallandaine[113] where profits of a betting business were held to be taxable as income tax.[114] In MP Finance Group CC (in liquidation) v C: SARS[115] where perpetrators were operating an illegal investment enterprise,[116] the Supreme Court held that an illegal contract is not without all legal consequences, and it can have fiscal consequences before proceeding to hold that the amount received by the perpetrators constituted receipts within the meaning of the Income Tax Act of South Africa.[117]

In conclusion, revenue from illicit activities complies with the Kenya Income Tax Act definition of revenue. The collection of such proceeds does not contravene public policy; in reality, it is in the public interest to tax such revenue. This stance, as described above, has been adopted by several other tax jurisdictions, so Kenya should follow suit.

4.3 TAXATION OF ILLEGAL INCOME AND THE RIGHT AGAINST SELF INCRIMINATION

One of the criticisms that can be levied against illegitimate income taxation is the breach of the right to self-incrimination. If an individual is forced to file a tax return and pay taxes on unlawful revenue, they may be involved in criminal activity. This requirement may run against self-incrimination from the constitutional right, as an individual may reveal data that may be used against him later. This is particularly the case when the data is used in criminal instances involving non-tax law. The right to self-incrimination is intended to safeguard the accused so

[108] Rutkin v United States (1952), The Supreme Court of the United States
[109] James v United States (1961), The Supreme Court of the United States.
[110] The court was guided by the definition of gross income in Commissioner of Internal Revenue v Glenshaw Glass Co. (1955) where the Supreme Court of the United States held that taxpayers had gross income when they had 'an accession to wealth, clearly realized, and over which the taxpayers have complete dominion.
[111] CIR v Delagoa Bay Cigarette Co (1918), The Supreme Court of South Africa
[112] CIR v Delagoa Bay Cigarette Co (1918), The Supreme Court of South Africa
[113] Partridge v Mallandaine (1886), The United Kingdom Queen's Bench Division of the High court.
[114] More specifically in the words of Denman J in Partridge v Mallandaine (1886), 'even the fact of a vocation being unlawful could not be set up against the demand for income tax'
[115] MP Finance Group CC (in liquidation) v C: SARS (2007), The Supreme Court of Appeal of South Africa
[116] In other words, a pyramid scheme
[117] MP Finance Group CC (in liquidation) v C: SARS (2007).

that they are not compelled or needed to provide proof that would negatively influence them. It stands to reason that any disclosure through tax returns of income from an illegal activity is an assertion that the person has committed an illegal act. The person therefore incriminates himself. The Constitution of Kenya[118] guarantees the right of an arrested person against self-incrimination.[119] This right is encompassed in the right to a fair hearing which is one of the rights which cannot be limited.[120] This right is also protected by international instruments as an aspect of the right to a fair trial.[121] The Evidence Act also provides for the protection of accused persons against self-incrimination in Section 128.[122]

On various occasions, the courts in Kenya have had to grapple with the right against self-incrimination though never in the circumstances of a tax related case. Under the repealed Constitution, the right against self-incrimination was discussed in the case of ***Christopher Ndarathi Murungaru v Kenya Anti-Corruption Commission & Another***. [123] The court stated that the requirement by the Kenya Anti-Corruption and Economic Crimes Act, that a person who is under investigation for corruption must give information about all their property and how they acquired it, was not in violation of the person's right against self-incrimination. Under this law, one was required to omit to the investigator information that would effectively incriminate him in illegal activity. The court held that this law was constitutional. This reasoning can be applied to the tax laws to find that the requirement that a person who files tax returns listing their illegal income does not violate their right against self-incrimination. Moreover, the court held that this right is only available to persons once they have been arrested and not before then. Hence if one has not been arrested or is not involved in a court proceeding they will not be able to claim the right against self-incrimination.

Under the new constitutional dispensation, the question of self-incrimination has once again been dealt with by the High Court in the case ***of Richard Dickson Ogendo & 2 others v Attorney General & 5 others***.[124] In this case, Justice Majanja found that an accused person's right against self-incrimination concerns the giving of oral or documentary testimony against himself or herself. Moreover, the purpose of this protection is to protect the accused person from giving information that has been obtained through coercion or unfair means.[125] Justice

[118] Article 50(2) (l), Constitution of Kenya (2010).
[119] Article 25, Constitution of Kenya (2010)
[120] Article 10, Constitution of Kenya (2010).
[121] Article 14, International Convention on Civil and Political Rights, 19 December 1966.
[122] Section 128, Evidence Act (Chapter 80).
[123] Christopher Ndarathi Murungaru v Kenya Anti-Corruption Commission & Another (2006) eKLR
[124] Richard Dickson Ogendo & 2 others v Attorney General & 5 others (2014) eKLR.
[125] Richard Dickson Ogendo & 2 others v Attorney General & 5 others (2014) eKLR.

Majanja further explained the purpose of the protection against self-incrimination by quoting the US case of ***Miranda v Arizona*** where the justices stated:

'All these policies point to one overriding thought: the constitutional foundation underlying the privilege is the respect of a government, state or federal, must accord to the dignity and integrity of its citizens. To maintain a 'fair state-individual balance, to require the government to shoulder the entire load' to respect the inviolability of the human personality, our accusatory system of criminal justice demands that the government seeking to punish an individual produce the evidence against him by its own independent labours, rather than by the cruel, simple expedient of compelling it from his own mouth.'[126]

Kenyan law has not specifically dealt with the issue of self-incrimination in the case of taxation of illegal income. It is therefore instructive to look at other jurisdictions. One of the jurisdictions that have dealt with this issue is the United States. In the case of ***United States v. Sullivan***, [127] the court dealt with the taxation of income from the illegal liquor trade, as this was during the prohibition. The defendant, Sullivan had refused to file tax returns claiming that by doing so, his right against self-incrimination would be violated. When the case reached the Supreme Court, this court held that the defendant could not refuse to file the tax return. Everyone is required to file their return but they can claim the privilege of the protection of the right against self-incrimination at the moment of fling the returns. The court held that one can refuse to answer certain questions in return or find other ways to claim the privilege provided by the Fifth Amendment. In the case of ***Garner v United States***, [128] the court had to grapple with the issue whether the prosecutor in a non-tax related criminal case could use tax returns. In this case, the prosecution presented the accused person's tax return where he had indicated that his income was from gambling in a case against him for the offense of gambling. In the court of first instance, Garner was convicted based on the evidence adduced. On appeal, the Court of Appeal found that the accused person was not given protection against self-incrimination. The Court of Appeal held that 'submitting to the statutory compulsion to disclose information in an income tax return did not constitute a voluntary waiver of Fifth Amendment protections.' The court held that the government should prove its case without using the defendant's tax returns as evidence but the government can use these returns in further tax related prosecutions. At the Supreme Court the court held that the accused person had waived his right against self-incrimination as he could have claimed the privilege of the Fifth

[126] Miranda v Arizona (1996), The Supreme Court of the United States
[127] United States v Sullivan (1927), The Supreme Court of the United States.
[128] Garner v United States (1976), The Supreme Court of the United States.

Amendment at the time of fling the returns. Generally, the Supreme Court stated that at the point of fling the returns, the defendant could have claimed the privilege against self-incrimination. This means that this avenue is available to those who are fling returns on illegal income.

If Kenya is to begin taxing illegal income, it needs to ensure that adequate protection is given to all persons. There are two possible ways of ensuring this balance of the government's need to collect tax even from illegal income and the right against self-incrimination. These approaches were dealt with to some degree in the case of *Garner v US* in the different courts. The first method is the restriction approach which was used by the Court of Appeal in this case.108 According to this method, in order to protect the accused person, the government is limited in the instances where it can use compelled information that can incriminate a person. Generally, the government will not be able to use the tax returns that the taxpayer has fled during consequent non-tax criminal cases.[129] Therefore, if a person has admitted to having income from an illegal source, the government cannot use the person's tax returns to prove the person's involvement in that illegal activity.

The second approach, which was alluded to in the Supreme Court judgment,[130] is simply having provisions where a person can raise the privilege of self-incrimination when fling the tax returns. This can be done by allowing a person to refuse to answer question regarding their source of their income. Alternatively, there could be a section of Miscellaneous Income where income from illegal activities is simply termed as miscellaneous income.[131] All this should be done in order to protect persons whose source of income is an illegal activity. In the authors' view, Kenya should adopt a hybrid method which incorporates both approaches. Simply put, taxpayers should be allowed to raise the privilege of the right against self- incrimination when revealing their source of income if it is from an illegal act. At the same time, ambitious prosecutors should still be stopped by law from adducing evidence against taxpayers in subsequent non-tax criminal cases by presenting the taxpayers' returns as evidence against them.

This research is of the view that the hybrid system is necessary as the current state of affairs as set out in Section 128 of the Evidence Act is not sufficient. Currently, what happens in Kenya is that a witness must answer all questions that they are asked during a hearing, even if

[129] Bucci A, 'Taxation of illegal narcotics: a violation of the Fifth Amendment rights or an innovative tool in the war against drugs?' 11(3) Journals of Civil Rights and Economic Development, 1996, 774.
[130] Garner v United States (1976), The Supreme Court of the United States
[131] Alemu Y, 'taxing crime: the application of Ethiopian income tax laws to incomes from illegal activities' 4(1) Jimma University Journal of Law, 2012, 173.

there are incriminatory. Their evidence, however, will not be used against them in a later trial. However, from the wording of Section 128 the Evidence Act, it is not clear whether the protection against self-incrimination extends to documentary evidence. The hybrid system will therefore better protect the constitutional rights of the accused person because a prosecutor in a later case will not be able to produce the accused person's tax returns as evidence of criminal activity. Moreover, if such tax returns are admissible, the source of the income will not be clearly stated, as it will be under a generic source of income.

4.4 USE OF TAX LAW TO REINFORCE CRIMINAL LAW

The final issue for consideration is whether the government can use tax as a tool to try and reduce crime. Tax is a tool generally used by governments to 'raise revenue, to provide incentives or disincentives for certain activities and to correct market failures'.[132] The imposition of taxes or tax subsidies is also used by governments to enforce its policies such as redistribution of wealth between the rich and the poor.[133] In order to encourage a struggling sector, the government can decide to lower tax on the goods or services produced by that sector. In 2014, an interesting amendment was made to the Income Tax Act,[134] through the Finance Act 2014.[135] The amendment was meant to exempt from the definition of taxable income any expenditure on vacation trips to destinations in Kenya that are paid by the employer on behalf of his employees and immediate family. This exception was to apply until 1st July 2015.[136] This was meant to encourage local tourism and to boost the tourism sector. The government also uses tax as a tool whenever it wants to discourage the consumption of certain goods or services. The issue therefore is whether the taxation of income from illegal activities can be used as a tool to discourage criminal activities and lower the crime rate.

Illegal activities are a source of profit to those who engage in such activities. It is therefore assumed that if one removes the profit from such activities, there would be fewer reasons for committing crimes.[137] Thus taxing illegal activities will lead to a decrease in crime. In the United States, taxation has been used to a certain degree to control criminal activities. Tax has been used in the fight against organised crime, where tax is used to gain access to the large

[132] Prasad N, 'Policies for redistribution: the use of taxes and social transfers 'International Institute for Labour Studies, Discussion Paper Number 194, 2008, 6 – on 15 December 2016.
[133] Prasad N, 'Policies for redistribution: The use of taxes and social transfers,'1.
[134] Income Tax Act (Chapter 470).
[135] Finance Act (Act No 16 of 2014).
[136] Section 5, Finance Act (Act No 16 of 2014).
[137] DeMattei K, 'The use of taxation to control organized crime' 39 California Law Review, 1951, 226-227 – on 15 August 2016.

amount of money raised through organised crime.[138] It has been seen that for this to be used effectively as a tool to discourage crime, these taxes must be enforced. Moreover, it is better to first ensure that the leading criminals or heads of criminal organisations are forced to pay taxes. In the United States after Al Capone was convicted, many other gangsters began to pay taxes including their back taxes.[139] Thus it can be assumed that it resulted in their crimes being less lucrative.

Tax has also been used as a tool to help the law enforcement authorities catch certain criminals when all else fails. It was used in the United States of America with the famous criminal Al Capone in the 1930s.[140] In this case, Al Capone was prosecuted and convicted for federal tax evasion instead of the crimes he was suspected of, such as bootlegging, prostitution, gambling and assault. In this instance, tax proved to be an important tool in fighting crime. Therefore, in Kenyan jurisdiction, taxing criminal operations can be a helpful instrument in the fight against crime. This is because it will render crime less lucrative by forcing those involved in these illegal operations to pay taxes. In addition, law enforcement agencies may be able to levy tax evasion against individuals engaged in illegal operations if they do not pay taxes. Their operations will be interrupted and the crime rate reduced.

4.5 IMPORTANCE OF TAXATION OF INFORMAL SECTOR

The informal sector consists of all the economic activities that are carried out by economic agents operating outside formal arrangements and official legislation requirements. In Kenya, these exclude pastoralist activities and subsistence farming[141].

The literature on the driving forces underlying the size of informal economy has mainly focused on the effects of government actions, notably taxation and regulation[142], and has reached the widespread conclusion that the existence of an informal sector is the result of the failure of political institutions to promote a working market economy. Consistently with this view, Johnson et al. (1998) and Friedman et al. (2000) find that institutional traits (for instance,

[138] DeMattei K, 'The use of taxation to control organized crime,' 233
[139] DeMattei K, 'The use of taxation to control organized crime,'234
[140] Bittker I, 'Taxing income from unlawful activities,' 130.
[141] Muchiri, B. and Audi, P. (2007) 'Statistical measures of growth and their changes over time' KNBS online Publication www.knbs.go.ke accessed on 5.12.18
[142] De Soto, H. (1989), The other path: The invisible revolution in the Third World, London: IB Tauris.

the extent of corruption or the strength of the rule of law) explain most of the cross-country variation of the available informality measures[143].

On the flipside, Levenson and Maloney (1998)[144] provide a fresh, alternative interpretation to the emergence of an informal sector, in particular to the size choice of informal sector, without relying on the burden imposed by the government to the private sector. They state that small firms do not scale down to avoid paying taxes, but their limited investment needs and the narrow nature of their operations make stable property rights unimportant and the gains from civic participation flimsy. Naturally, since the benefits from participating in societal institutions grow larger as firms do, voluntary compliance and the will to being charged (i.e., taxed) for participation arise[145].

According to Chen (2005), informal sector activities provide the only opportunity for many people to secure their basic needs for survival. In countries without unemployment insurance or other kinds of social benefits, the only alternative to being unemployed is engaging in informal sector employment. Other informal sector employment (as employers in informal manufacturing establishments or as skilled self-employed workers in small businesses) may sometimes provide better pay. These workers may even earn more than regular employees working in formal jobs[146].

Taxation of Informal Sector has increasingly gained enormous proportion of attention as a tax broadening measure than just as a mere tax collection exercise. After collection of data for some time[147], the Government has become aware that the Informal Sector in Kenya is a major employer of a vast majority of people, controls a substantial business population and has within its ranks an enormous amount of capital. The Government had established that the majority of future non-farm job opportunities were in the Informal Sector. According to the Government, unquestionably, the sector offers 'unmatched potential as a source' of employment[148]. The

[143] A striking finding of Friedman et al. (2000) is that higher tax rates are associated with a small informal sector. They argue that high tax rates increase tax revenues that would enable the government to finance a stronger legal environment and, consequentially, to reduce informality

[144] Levenson, A. R. And Maloney, W. (1998), 'The informal sector, firm dynamics and institutional participation', World Bank Policy Research Working Paper Series, No. 1988. Washington, DC, World Bank.

[145] Ibid

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Sessional papers beginning with No. 2 of 1992[149]and beyond categorically state that the informal sector 'provide most prolific sources of employment creation, income generation and poverty reduction'[150].

The sector has made other fundamental contributions to the economy of the country. It has led to increased output of goods and services. Majority of Informal Sector activities employ easy and unsophisticated methods of production. Their numerous number and wide presence in almost every part of the country has incredibly increased goods and services to the people at a much cheaper price. That is why the Government considers development of Informal Sector an appropriate way of promoting economic growth and poverty reduction[151].

Proponents of taxation of the informal sector assert that beyond the mechanical increase in the fiscal receipts that a taxation of the informal sector would generate, it is also premised on the promotion of a greater social justice and the respect of the sovereignty of political power[152]. Despite the fear that taxation may hinder growth, a growing body of research suggests that formalization – of which entry into the tax net is a central component – may in fact have significant benefits for growth, or, at the very least, may not hinder growth. At the core of those findings is the fact that informality carries a variety of costs to firms, and it also precludes access to certain opportunities available to formal firms. The benefits of formality may include greater access to credit, increased opportunities to engage with large firms and the government, and reduced harassment by police and municipal officials, and access to broader training and support programmes[153].

Joshi Ayee[154] gives the reasons for interest in the taxation of the informal sector as revenue need following the introduction of neo-liberal reforms under structural adjustment programmes (SAP) with emphasis on liberalization, downsizing and changing tax policy as well as tax administration that has brought to the fore the urgent practical necessity of increasing revenues

[149] Sessional Paper No. 2 of 1992, *Small Enterprises and Jua Kali Development,* (Nairobi: Government Printer, 1992)
[150] Ibid
[151] Session Paper No. 1 of 1986, *Economic Management for Renewed Growth* ('Nairobi: Government Printer, 1986)
[152] Joshi, A., Prichard, W., Heady, C. (2012), 'Taxing the informal economy: Challenges, possibilities and remaining questions', *ICTD Working Paper Series,* No. 4, International Centre for Tax and Development, Brighton, UK, Institute of Development Studies.
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for the state to deliver basic services with primary objective to revenue maximization. The informal sector therefore becomes the obvious avenue to be drawn into the tax net having been mostly out of it. 142 Besides, the phenomenal size and growth of the informal sector due to the liberalization of world economies as a result of SAP has pushed many formal businesses into the informal sector in most developing countries.

Further, recent calculations estimate that the size of the informal sector in developing countries varies between about 20 percent in Indonesia to around 67 percent of GDP in Bolivia. Thus, the informal sector is complex and heterogeneous comprising of large enterprises and small; urban firms and rural ones; visible activities as well as invisible ones; owners as well as workers; local activities as well as those that cross jurisdictional boundaries which makes it the ideal area for revenue collection[155].

An equitable tax system ensures that individuals with higher incomes bear greater tax burden compared to individuals on low incomes. Most players in the formal sector are already paying taxes heavily at the expense of others who should have been in the tax bracket. 168 As clearly espoused by John Mutua, tax fairness should be considered as an important goal by policy makers for the following reasons: fair taxes are essential to adequate funding of public services because they tax those who have the most to give. Again, fair taxes help the government in its relations with its citizens, who are likely to support and tolerate tax reforms that will lead to fair tax systems. A fair tax system is also important on grounds of moral imperative[156].

Finally, it is argued that countries with complex and costly taxation and regulatory schemes end up in an economically unproductive equilibrium with a large informal sector [157]. Also, high taxes on the formal sector induce non-compliance, that is, informal businesses. This reduces government revenue and thus the amount of funds available to provide and maintain market supporting, public sector goods and services such as the court system, government administration agencies and roads and so on[158]. The fewer funds and the impossibility of preventing informal sector operators from using many of these services without paying for them diminishes their quality, increases prices, and leads to congestion. This, in turn,

[155] Ibid
[156] 8Mutua M. John: "A Citizen's Handbook on Taxation in Kenya", Institute of Economic Affairs, Kenya, 2012.
[157] 7 Johnson S., Kaufmann D. and Shleifer A. (1997), The Unofficial Economy in Transition, Brookings Papers on Economic Activity, Vol. 2, p. l59.
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encourages even more entrepreneurs to leave the formal sector to avoid bearing an increasing share of the tax burden for poor goods and services.

4.6 CONCLUSION

Illegal income, pursuant to section 3 of the Income Tax Act of Kenya is taxable, a position reiterated by the Court in Kenya Revenue Authority v Yaya Towers Limited. The contrary would not only entitle a wrong doer to benefit from his/ her illegal transactions but further exempt him/her from paying taxes. Moreover, honest taxpayers would be incentivised to taint their businesses with an illegality with a view of benefiting from such an exemption. Failure to tax illegal income does not further public policy but rather contravenes it.

Income tax pursuant to section 3(2) and 15 of the Income Tax Act is levied on the profits and gains of a business not the gross income. As such if income from illegal activity is taxable then such taxes shall apply not on the gross income but rather on the profits and gains of such activity. Nonetheless, Article ten of the Constitution obliges state organs and state officers while interpreting or applying any law to consider various principles among them the rule of law and the national interest. Deducting illegitimate expenses contravenes the nation's interest as well as public policy which are not the case with legitimate expenses. As such legitimate expenses of an illegal business should be deductible while illegitimate expenses are non-deductible.

Imposition of tax on illegal activities can prove to be a useful tool for the government to help it collect more revenue and even indirectly decrease crime by making illegal activities less profitable. This can also lead to a more equitable distribution of the burden of taxation amongst all citizens as envisioned by the Constitution. When the government is taxing illegal income, however, it must ensure that there are sufficient safeguards to protect the rights of persons engaging in such activities, especially their right against self-incrimination. The government should therefore publish rules and guidelines to clarify how these taxes will be collected. These rules should provide adequate protection to all persons and deal with topics such as deductions of expenses.

CHAPTER FIVE
CONCLUSION AND RECOMMENDATION.

5.1 CONCLUSION

The first chapter outlined the research framework. It addressed goals, theoretical framework, conceptual framework, justification, review of literature, and the fields of the research discussion. This section created an area that needed debate, particularly through the hypothesis, literature review and theoretical framework. It set out the flow of ideas to be followed by the studies.

In Chapter Two this study discovered that, at the periphery of mainstream historiography, fiscal history remains, not only in Kenya, but worldwide. This evaluation attempts to examine a part of the tax history of Kenya that has affected the national scope, reflecting Schumpeter's conviction that taxes inform nations and their development.

At this point in time, through British colonization, Kenya had developed an extensive taxation system that maintains a colonial policy reflection. In Kenya, it is a capitalist economy that has been acknowledged worldwide with almost no basic rules, legislation or tax values. This resulted to a tax system that is highly dependent on import duties, creating more problems today in a globalizing world that seeks to open borders and lower tariffs.

The anti-corruption policy framework in Kenya was discussed in Chapter Three. It has emerged from the debates that there has been no anti-corruption policy. Although a number of government-led anti-corruption projects have been conducted, the absence of a sound policy framework has resulted in disharmony not only among the organizations engaged in the battle against corruption, but also in Kenya's corruption legislation.

In Chapter Four, this study realized that taxing illegal activity could prove to be a helpful instrument for the state to assist it gain more income and even indirectly reduce crime by making illegal activity less lucrative. As envisaged by the Constitution, this could also lead to a more equitable distribution of the tax burden among all people. However, when the government taxes illegal income, it must guarantee that adequate safeguards are in place to safeguard the freedoms of individuals engaged in such operations, in particular their right to self-incrimination. Therefore, the government should publish rules and regulations to explain how these taxes will be collected. These rules should provide adequate protection to all persons and deal with topics such as deductions of expenses.

From the above analysis these research makes the following conclusions and recommendations.

The Constitution of Kenya puts public policy above all. The Constitution focuses on the power belonging to the people and values. The first conclusion that can be made is that there is no explicit legislative mandate that allows Kenya Revenue Authority to collect taxes from illegal income. The court in its interpretation took quite a literal approach in stating that income under the Act included illegal income. Without a legislative approach, there are a lot of ambiguities that arise in the question of deductions and use of information and evidence from disclosure of illegal income in criminal prosecutions.

Since the Income Tax Act does not explicitly provide on taxation of illegal income. If income is income as per the *Yaya Tower* case, it means that it enjoys the same deductions as legal incomes.

This therefore signifies that there is need for reforms to specifically state that where illegal income is taxed, there are no allowable deductions. USA through the Internal Revenue Code does not allow deductions on illegal income. It is only a legislative approach that can correct this in Kenya.

The denial of allowing deductions is on a public policy basis in order to deter one from engaging in illegal activities. The denial of deductions for illegal businesses is meant to constitute a punishment. USA has in some laws allowed deductions of legal expenses and disallowed deductions in illegal expenses.

Illegal income can have both illegal expenses and legal expenses.in assessing such tax, if the government is considering public policy; it can either disallow any expense, either legal or illegal or allow illegal and legal income. However, this can go against the principle that all expenses that are wholly incurred in generating income be deducted to determine taxable income.

The legal framework in Kenya governing tax does not provide on how illegal income is to be treated. Though taxing illegal income is allowed, the taxing authority does not have a recognized and a legally provided guideline on how it should assess tax on such income. USA jurisdiction has provided on how such tax should be treated. Since its legal framework is highly developed, it has addressed matters of deductions and self-incrimination. This has been seen in a number of court cases and statutes. South Africa is also slightly ahead compared to Kenya in addressing the two issues. Kenya has a lot to borrow from the two jurisdictions.

Consideration of public policy is highly essential in the determination of the two issues especially on the question of deductions. Kenya has laid out in Article 10 of its Constitution,

its national values and principles. These principles guide any decision that is to be made on matters of taxation. If the issue of illegal taxation comes before the Parliament, the Parliament can decide on the grounds of public policy to exclude illegal income from taxation in order to discourage such activities.

On self-incrimination, the right is provided under the Constitution and it is protected. Under tax law, the right cannot be pleaded if one is statutory required to produce certain documents. This research is of the conclusion that every person must file tax returns. One cannot refuse to file tax returns by pleading the right against self-incrimination.

The determination that illegal income is taxable means that one has to disclose illegal income. Lack of disclosure attracts penalties and even criminal sanctions. The requirement for disclosure in the Kenyan legal framework does not provide adequate protection against self-incrimination. The aspect of self-incrimination comes out of the power of tax officers to compel for information from a tax payer and lack of confidentiality of that information. The Income Tax Act gives tax officers the power of a police officer. This means that police officers can search, interrogate and produce evidence in court. This can go beyond the purpose of tax collection. Self- incrimination arises from the aspect that the information compelled from a tax payer can be used in both ta and non-tax criminal prosecution. If one refuses to answer questions of a taxation officer, the Act has made it an offence. The information collected can be used against him in tax related criminal prosecution. The Act allows the tax payer to pass the information to the police or Office of the Prosecutor. This leads to criminal prosecution in non-tax offences.

Using tax law to prohibit and punish illegal activities goes against the purpose of tax. The court in the case of *Yaya* held that tax law was not concerned on whether income was legal or illegal. Its focus was on what amounted to income. If the tax authorities use the requirement of disclosure to nub those earning illegal income and present them before relevant authorities for prosecution, it will go against the purpose of taxation.

5.2 RECOMMENDATIONS

Having analysed the taxation of illegal income in Kenya, the suggestions for reforms from the analysis and conclusion made in this research are as follows:

a) The Income Tax Act should be amended in order to capture the effects of the decision in *Yaya Tower* case. There is need to provide clarity on the aspect of deductions. Kenya should not adopt a practise of allowing deductions on illegal income. The common law doctrine of public policy should be applied in it. In consideration of public policy,

those who benefit from illegal tax should not enjoy similar benefits to those who derive legal income. Illegal income should incur a heavier tax burden. This can be done by either disallowing deductions or only allowing legal expenses. USA in its Tax Law amended the tax laws to disallow deductions of expenses from illegal businesses.

b) The Income Tax Act will need to define what can be termed as an illegal income. Illegal income can arise from both legal and illegal business. In *Yaya Tower* case, it arose from a legal business. Therefore, there is need to state if illegal income arising from a legal business and income arising from illegal business should be treated the same,

   Only come from definition. Both should not enjoy deductions. Illegal income should be defined as an income arising from an illegal business, contract or the income itself.

a) Tax laws should provide stringent rules to prevent taxing authorities from disclosing information they get from tax payers as a result of disclosure of illegal income. Such information should only be used in matters of tax offences such as evasions and tax fraud. The prosecution should not use such information in court to prosecute against cases such as working without permit or license or activities such as smuggling. The Tax officers are limited to tax matters and should not compel tax payers to give them information while they are investigating them for criminal offences. The State should also not use this loophole to source for evidence for non-tax offences.

b) The Tax authorities should assure every tax payer's information will be strictly confidential. When a tax payer discloses illegal income, the tax payer should not compel further information to establish the illegal income other than the tax obligations. Section 6 should be amended to only allow for disclosure of information for taxation on tax related matters to the Office of the Prosecutor. Kenya Revenue Authority has no mandate to investigate non-tax offences or seek and pass information on matter unrelated to tax.

c) On Section 58 and 59 of Tax Procedure Act, Tax officers should only seize documents for purposes of tax collection matters and not for prosecution of non-tax related matters. If one is arrested for tax offences, he should not be compelled to give information or evidence as provided under these provisions. If one is under criminal investigations, he should have a right to plead the right and refuse to give information without the threat of being persecuted for not coordinating with tax office

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