tax justice network - Africa

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PRESS RELEASE

TJN-A and EATGN applaud Kenya Government on decision to phase out tax incentives

Tax Justice Network-Africa (TJN-A) and the East Africa Tax and Governance Network (EATGN) welcome the Government of Kenya's announcement to phase out tax incentives and exemptions largest economy in East Africa has been offering investors.

Kenya offers a number of tax incentives to foreign companies operating in the country, including a 10-year corporate income tax exemption and a 10-year withholding tax holiday on repatriated dividends and other remittances.

Foreign investors are also exempted from paying Value Added Tax (VAT), import duty on inputs and payment of stamp duty on legal instruments. Investors also qualify for 100 per cent tax deduction on new capital investments. Kenya, like many other African countries incurs significant loss of revenue through such unnecessary tax incentives. Cumulatively, these tax incentives cost the Kenyan economy an estimated US$1.1 billion (KES100 billion) each year.

According to the Kenya Investment Authority (KenInvest) chief executive, Moses Ikiara, government will invest more resources in "creating a conducive environment for doing business as opposed to offering tax incentive to foreign firms".

This announcement is indeed an endorsement of the longstanding position of TJN-A and EATGN that tax incentives are an unnecessary drain on African economies, feed a "race to the bottom" and fuel resource outflow from Africa.

A 2012 joint study by TJN-A and ActionAid International *"Tax Competition in East Africa: A race to the bottom"* shows that export processing zones (EPZ) constitute a huge leakage of revenue through tax incentives granted to these companies.

This study also shows that firms operating in EPZ shut down shop after the expiration of their 10-year holiday and re-register under new names or relocate to other jurisdictions to avoid paying tax.

Kenya's provision of tax incentives has been part of a fierce tax competition among members of the East African Community (EAC) since the regional economic bloc was formed in 1999.

In spite of Kenya's overly generous tax incentives in the East African region for example, the country has been the biggest loser in FDI inflows compared to Tanzania and Uganda.

Indeed, Kenya's FDI inflows stood at a mere US$133 million in 2010 compared to Tanzania's US$700 million and Uganda's US$848 million over the same period.

Empirical research evidence suggests that developing countries do not need to grant tax incentives and exemptions to attract Foreign Direct Investment (FDI) as the decision to invest is largely based on a country's overall investment climate.

A more critical factor in determining investment and FDI is a country's overall economic characteristics, including the quality of institutions, the size of the market and location-specific factors, particularly those linked to natural resources.

The cost of tax incentives are numerous and it includes not least budget revenue losses, administrative and compliance costs, rent-seeking behaviour and corruption and economic distortions that favour one industry at the expense of another, mostly local companies.

Tax incentives constitute a drain on government resources that could better be invested in infrastructural and social development. In 2010/11, the Kenyan government's entire health budget was KES 41.5 billion. Yet the government lost more than double this amount through tax incentives and exemptions to companies.

While we recommend the government for this bold pronouncement, we call upon the administration to move beyond political pronouncement and actually enact and implement policy measures to eliminate these harmful tax incentives that unnecessarily drain the country of significant domestic resources to finance Kenya's development, improve the quality of life of the citizenry and curtail the country's over dependence on external funding.

In applauding the Government of Kenya, we also urge other African countries to embark on similar measures to effectively address the problem of harmful tax incentives and to enhance domestic resource mobilisation in order to sustainably finance inclusive development in Africa.

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