

TAXING THE 'HARD-TO-TAX' IN LOW AND
MIDDLE-INCOME COUNTRIES: AN
EXAMINATION AND KENYAN CASE STUDY

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A THESIS SUBMITTED IN FULFILMENT OF THE REQUIREMENTS
FOR THE DEGREE OF DOCTOR OF PHILOSOPHY (LAW)

SUPERVISOR: PROFESSOR JUDITH FREEDMAN

MICHAELMAS TERM 2018

WORD COUNT: 81,500

ABSTRACT

The term 'hard-to-tax', in tax evasion literature, refers to farmers, small and medium-sized enterprises (SMEs), and professionals. However, scholarly discourse on the hard-to-tax in low and middle-income countries (LMICs) has focussed primarily on farmers and SMEs. Professionals are rarely critically considered despite the acknowledgement in the literature that, considering their potential earnings, the absolute amount involved in evasion by professionals in LMICs is probably higher than farmers and SMEs. The primary goal of this thesis is to interrogate the phenomenon of tax evasion by hard-to-tax professionals in LMICs by answering the research question: what are the barriers to tax compliance by these hard-to-tax professionals and how can tax authorities in LMICs effectively improve compliance among these taxpayers? The researcher utilises several methods and data sources to answer this question. Secondary data sources provided useful knowledge regarding theoretical accounts of tax evasion and the administrative options available to tax authorities dealing with hard-to-tax groups. The researcher enriched this secondary data using primary data collected for a case study explicitly interrogating tax compliance among self-employed dentists and lawyers in Kenya, a lower-middle income country. Through the case study, the researcher obtained rich qualitative data via open-ended semi-structured interviews with taxpayers and tax experts in Kenya. The interview data was analysed, using key tax evasion theories, applying a thematic analysis method. A detailed narration of the major and minor themes that emerged from the data is presented in Chapter 4. The findings of this research make a significant and substantial contribution to: existing knowledge on tax evasion and compliance in Africa, taxation of hard-to-tax professionals in LMICs, effects of corruption and poor service delivery by government on tax compliance attitudes, presumptive taxation of professionals, and the potential role of professional bodies and associations in promoting tax compliance among their members.

DEDICATION

For daddy. I did it; you may not be here to witness this, but I did it.

Love and miss you, always.

ACKNOWLEDGMENTS

I am grateful to God for blessing me beyond measure; I owe everything that I have, and everything that I have achieved, to Him.

I owe an immense debt of gratitude to my supervisor, Professor Judith Freedman. She first believed in me, strongly encouraged me to pursue my doctoral studies at Oxford and made an immense effort to ensure that I was always well-funded and supported throughout my programme. She has been an exceptional mentor and outstanding supervisor, providing critical and highly constructive feedback on my work, and continuously encouraging me to stay the course. I am particularly grateful for her patience, understanding, and gentle encouragement as I navigated the challenges that came with being a first-time mother, right in the middle of a rigorous doctoral program, away from home and a social support system. I am honoured to have been supervised by Judith.

I am also eternally grateful to my friend, and husband, Andrew, for being the perfect life-partner. I am thankful for his prayers, unparalleled selflessness, positive attitude, endless patience, financial sacrifice, and unconditional love. I thank him for leaving his family, friends, and work to allow me to pursue my dreams. I also thank him for picking up more than his share of the housework, cooking, and childcare, so that I could flourish and succeed. I am always in awe of his belief in me, and my potential, and I am incredibly grateful to have had him in this season of my life.

I am grateful for my late father Benn, and my mother Rose, who spared nothing in ensuring that their daughters received the best education and pursued their dreams. I thank them for giving us a chance to live a better life than they did, for sacrificing everything and holding nothing back from us. The only sorrow that mars my joy at this

moment is that my father did not live long enough to celebrate my achievements. I thank my mother for her enduring love, friendship, and constant prayers. She has inspired me to pursue greatness and perfection in every aspect of my life.

I thank my sisters, Brenda and Kimberley, for their support throughout my doctoral studies; they have been a steady source of prayers, humour, empathy, wisdom, encouragement, and love. I thank them for taking time out of their busy schedules to care for my son Ivan, when I had urgent deadlines. I also thank my aunt, Joyce Choto, who has played the role of ‘mom’ while I have lived in the United Kingdom; she has been generous to a fault, giving of her time, resources, and love to ensure that we thrived. I would not have completed this journey without her unwavering love and support.

I also owe a debt of gratitude to the many people, and institutions, that have ensured I was well funded during my studies. I am particularly grateful for the Oxford University Centre for Business Taxation, without whom I would have been unable to attend Oxford and pay my tuition fees. I also thank everyone at the Centre, particularly Professor Michael Deveraux, Professor Glen Loutzenhiser, Professor John Vella, Dr Anzhela Cedelle, Dr Alice Pirlot, Dr Irem Gucer, and Dr Martin Simmler, for providing valuable and constructive feedback on my work at different stages. I am also very grateful to the Chartered Institute of Taxation and the Oxford Law Faculty for funding my fieldwork, without which this work would not have been possible. I am equally grateful to Strathmore University, St. Edmund Hall, and the Oxford Law Faculty, who have ensured that I always had a comfortable place to call home, finances to pay childcare, and resources for my living expenses. I express sincere gratitude to Principal Keith Gull and my college advisor, Professor Adrian Briggs, for their concern for my welfare and success at St. Edmund Hall, and for stimulating discussions on my work. I also express sincere gratitude to the Mustard Seed Foundation for awarding me the Harvey

Fellowship, which, not only provided much-needed funding, but encouraged and affirmed my vocation and aspirations and connected me to wonderful life-long friends.

I am incredibly grateful for the many professional colleagues and friends who have walked with me through this journey. I begin by thanking Dr Naomi Creutzfeldt, who has been a source of inspiration, support, and encouragement in every way. I thank her for reading many drafts of my case study and methodology chapter, and for moral support as I began to think about the next steps in my career. I also thank the wonderful and supportive friends that I have made along the way; they read through my work, provided a steady supply of humour, and provided wise advice when I needed it. I particularly thank Maayan Ravid who has become like a sister to me and an aunt to my son; she has been what a true friend should be in every circumstance, and I thank her, as well, for always being ready to babysit when I need it. I appreciate the ‘lunch club’ at the Centre for Criminology at the Law Faculty— Maayan, Arushi, Liz, Annika, Leila, and Kalpana; they brought companionship, good food, and joy into the very intense and stressful final stages of my work. I also thank Dr Martin Hearson, Dr Stephen Daly, and Dr Diego Quinones, who have been wonderfully supportive fellow PhD Students.

Finally, I thank all those who have inspired me as a young adult, at different stages of my life, planting the seed and nudging me towards greatness. I particularly thank the ‘Chama girls’, my former colleagues and lifelong friends at Oraro & Company Advocates, as well as my undergraduate professors- the late Professor Okoth Ogendo, Professor Patricia Mbote, Professor Migai Akech, and Professor Attiya Waris.

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| | |
|-------|------------------------------------|
| HMRC | HM Revenue & Customs |
| HNWIs | High Net-worth Individuals |
| HTT | Hard-to-Tax |
| KRA | Kenya Revenue Authority |
| LMICs | Low and Middle-income Countries |
| PAYE | Pay As You Earn |
| PIN | Personal Identification Number |
| SME | Small and Medium-sized Enterprises |
| URA | Uganda Revenue Authority |
| VAT | Value Added Tax |

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1. THE HARD-TO-TAX: WHO ARE THEY & SHOULD WE TAX THEM?

1.1. INTRODUCTION

1.1.1. Context

This doctoral thesis examines the phenomenon of tax evasion among the *hard-to-tax* in low and middle-income countries (hereinafter referred to as LMICs).¹ Tax evasion literature uses the term '*hard-to-tax*' (hereinafter referred to as HTT) to refer to farmers, professionals, and small and medium-sized firms (hereinafter referred to as SMEs).² We will return to the description of the HTT in Section 2 of this chapter. At this point, it is important to note that, although multinational enterprises and businesses carried on the internet present real and widely acknowledged challenges for revenue authorities, they do not fall within the description of the HTT.³

While the term HTT includes farmers and SMEs, the particular focus of this thesis is on professionals, for reasons elaborated in Section 1.1.2 below. The chief aim of this research is to identify the main barriers to compliance by professionals in LMICs and propose some measures that tax authorities in those countries can take to improve the compliance levels by these taxpayers. Non-compliance in this thesis refers to *tax evasion* involving any one or more of the following: failure to register with the revenue authority, failure to keep accurate financial records, failure to file tax returns on time, underpayment of taxes, non-payment of taxes, and the failure to abide by any applicable tax legislation as amended from time to time.

¹ 'For the current 2019 fiscal year, low-income economies are defined as those with a GNI per capita, calculated using the World Bank Atlas method, of \$995 or less in 2017; lower middle-income economies are those with a GNI per capita between \$996 and \$3,895; upper middle-income economies are those with a GNI per capita between \$3,896 and \$12,055; high-income economies are those with a GNI per capita of \$12,056 or more.' World Bank, 'World Bank Country and Lending Groups' (*World Bank Data Help Desk*) <<https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups>> accessed 5 October 2018.

² James Alm, Jorge Martinez-Vazquez and Friedrich Schneider, "'Sizing" the Problem of the Hard-to-Tax' in James Alm, Jorge Martinez-Vazquez and Sally Wallace (eds), *Taxing the Hard-to-Tax: Lessons from Theory and Practice*, vol 268 (Elsevier 2004) 4.

³ *ibid.*

1.1.2. Gaps in Knowledge

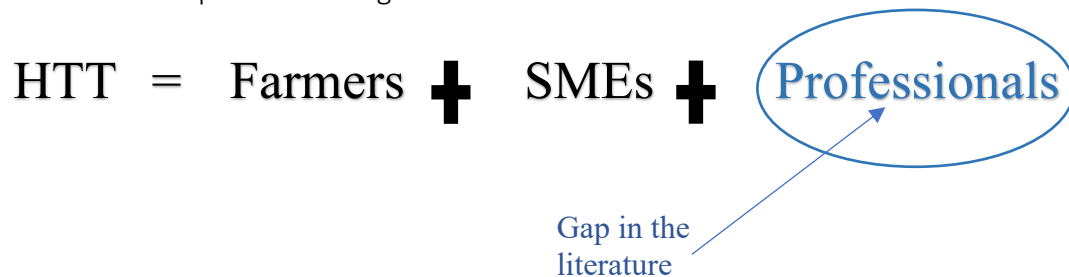


Figure 1: Gap in the Literature

The choice to focus on professionals, to the exclusion of farmers and SMEs, is motivated by the dearth of research on this group of taxpayers, particularly in the case of LMICs. Prior research on the HTT in LMICs has focussed almost exclusively on farmers and SMEs, and largely ignored tax evasion by professionals.⁴

Farmers have been of interest because most LMICs have relied on agriculture and cash crop farming for revenue through international trade. Cash crops such as coffee, tea, cotton, sugarcane and cocoa generated significant revenues for these countries in the past. In recent decades, however, this has changed because of various factors including: climate change, political instability, corruption, a significant drop in global prices for these crops, and the failure of LMICs to mechanise and utilise technological advancements in agriculture. Other factors include the progressive elimination of duties and tariffs in international trade and the global movement towards services, e-commerce, technology, and innovation as significant sources of profit.

⁴ For example, see Indira Rajaraman, 'Presumptive Direct Taxation: Lessons from Experience in Developing Countries' (1995) 30 *Economic and Political Weekly* 1103; Seth Terkper, 'Managing Small and Medium-Size Taxpayers in Developing Economies' (2003) 29 *Tax Notes International* 211; Indira Rajaraman, 'Taxing Agriculture in a Developing Country: A Possible Approach' in James Robert Alm, Jorge Martinez-Vazquez and Sally Wallace (eds), *Taxing the Hard-to-tax: Lessons from Theory and Practice*, vol 268 (Emerald Group Publishing Limited 2005) <[https://doi.org/10.1016/S0573-8555\(04\)68812-2](https://doi.org/10.1016/S0573-8555(04)68812-2)> accessed 27 November 2018; European Commission, 'Simplified Tax Compliance Procedures for SMEs' (European Commission Enterprise and Industry Directorate-General 2007); Jacqueline Coolidge and Fatih Yilmaz, 'Small Business Tax Regimes' (*World Bank Group Viewpoint no 349*, 2016) <<http://documents.worldbank.org/curated/en/331931468179662817/Small-business-tax-regimes>> accessed 23 May 2018.

SMEs have also occupied much of the research on the HTT in LMICs because these countries typically have large informal sectors characterised by small-scale traders and cottage industries. The interest in SMEs in LMICs has not been confined to academic research. Page and Söderbom explain that SMEs ‘are big business in the aid industry... Financial and technical assistance to micro, small and medium enterprises is a major “product line” of the aid business’.⁵ Development funding in support of the creation of jobs in LMICs often comes in the form of aid for the growth and formalisation of SMEs.⁶ There is also significant funding for policy research into government efforts (or lack thereof) to tax SMEs in LMICs.

As a result, professionals have not been extensively studied, and this project seeks to fill that gap. Professionals are an important group to study also because the scope of underreporting for high-income earners like doctors, lawyers, contractors, and consultants is often significant, particularly when professionals deal with cash transactions, a phenomenon which is not uncommon in LMICs.⁷ According to Keen, these sectors can be responsible for some of the most severe instances of revenue loss and damage to the fairness of the tax system, particularly in developing countries.⁸ However, since they are so highly qualified and tightly regulated, it often appears unnatural to refer to professionals as ‘informal’.⁹ Keen argues that considering their earnings, the absolute amount involved in evasion among professionals is probably higher than any other group.¹⁰

⁵ John Page and Måns Söderbom, ‘Is Small Beautiful? Small Enterprise, Aid and Employment in Africa’ (2015) 27 *African Development Review* 44, 44–45.

⁶ *ibid.*

⁷ Helaway Tadesse and Günther Taube, *Presumptive Taxation in Sub-Saharan Africa; Experiences and Prospects* (International Monetary Fund 1996) 4; Michael Keen, *Taxation and Development; Again* (International Monetary Fund 2012) 16.

⁸ Keen (n 7) 16.

⁹ *ibid.*

¹⁰ *ibid.*

The goal of this research is to fill in the gap in the literature by interrogating deeply why professionals in LMICs fail to comply with their tax obligations, and what changes tax authorities in these countries can make to improve compliance levels. Further, this research will focus specifically on *self-employed* professionals, rather than those in employment, since the latter is a low-risk group. The self-employed have significantly more opportunity for tax evasion than employees whose salaries and wages are subject to employer withholding schemes— this idea is well-documented in tax evasion literature.¹¹

1.1.3. Contribution to Knowledge

This thesis makes a significant and substantial contribution to existing knowledge on: (i) tax evasion and compliance in Africa, (ii) taxation of the HTT, particularly self-employed professionals, in LMICs (iii) effects of corruption and poor service delivery by government on the compliance attitudes of professionals, (iv) suitability of simplified tax regimes or presumptive taxation for professionals, and (v) the role of professional bodies in tax compliance. These contributions are discussed in greater depth in Chapter 5.

1.1.4. The Significance of the Project

This research is important now, as all countries, not just LMICs, seek to expand their revenue base and close the tax gap to meet ever-expanding budgets and social needs.

¹¹ Milka Casanegra de Jantscher and Vito Tanzi, *Presumptive Income Taxation; Administrative, Efficiency, and Equity Aspects* (International Monetary Fund 1987); Benno Torgler, ‘The Importance of Faith: Tax Morale and Religiosity’ (2006) 61 *Journal of Economic Behavior & Organization* 81; Joel Slemrod, ‘Cheating Ourselves: The Economics of Tax Evasion’ (2007) 21 *Journal of Economic Perspectives* 25; Benno Torgler and Neven T Valev, ‘Gender and Public Attitudes Toward Corruption and Tax Evasion’ (2010) 28 *Contemporary Economic Policy* 554; Henrik Jacobsen Kleven and others, ‘Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark’ (2011) 79 *Econometrica* 651; Christoph Kogler, Stephan Muehlbacher and Erich Kirchler, ‘Testing the “Slippery Slope Framework” among Self-Employed Taxpayers’ (2015) 16 *Economics of Governance* 125; Ana Cinta G Cabral, Christos Kotsogiannis and Gareth Myles, ‘Self-Employment Income Gap in Great Britain: How Much and Who?’ *CESifo Economic Studies* <<https://academic.oup.com/cesifo/advance-article/doi/10.1093/cesifo/ify015/5032456>> accessed 12 October 2018; Arun Advani, William Elming and Jonathan Shaw, ‘The Dynamic Effects of Tax Audits’ [2017] IFS Working Paper W17/24 39.

African countries, in particular, are striving towards improving tax collection in recognition of rapid changes in development funding and the urgent need to harness domestic resources to meet their growing socio-economic needs sustainably. While research on taxation in LMICs has, in recent times, almost exclusively focussed on the impact of tax avoidance by multinational enterprises and challenges in the international tax system, there is increasing awareness that domestic resource mobilisation is equally important and requires more attention.¹² This thesis turns the spotlight onto domestic resource mobilisation by searching for the barriers to compliance by professionals, an under-researched group of taxpayers, and how these can be overcome.

This project is particularly crucial for LMICs because of the prevalence of the HTT in these countries. In contrast to high-income countries, the industrial sector in most LMICs is underdeveloped. Thus, tax authorities are faced with a high number of HTT taxpayers like farmers and small business owners who are much harder to tax than the industrial sector with its visible and accessible firms.¹³ Recent estimates suggest that the informal economy is approximately 42% of GDP in a sample of 31 LMICs compared to 22% in 32 higher-income countries.¹⁴ These figures mean that, in LMICs, revenue authorities face a large number of individual taxpayers, and the associated high cost of collection, with the risk of minimal returns. In dealing with the HTT or ‘informal sector’, the default policy reaction seems to be to focus on the agricultural sector and SMEs with relatively low incomes, while ignoring potentially high income-earning self-employed professionals who operate in the informal sector and evade taxes. This professional class

¹² Michael Carnahan, ‘Taxation Challenges in Developing Countries’ (2015) 2 Asia & the Pacific Policy Studies 169, 170.

¹³ Giulia Mascagni, Mick Moore and Rhiannon McCluskey, ‘Tax Revenue Mobilisation in Developing Countries: Issues and Challenges’ (Directorate-General for the External Policies of the European Union: Policy Department 2014) EXPO/B/DEVE/2013/35 18.

¹⁴ Christopher Woodruff, ‘Registering for Growth: Tax and the Informal Sector in Developing Countries’ (2013) The CAGE-Chatham House Series No. 7 2
<<https://www.chathamhouse.org/publications/papers/view/193007>> accessed 10 October 2018.

is growing in countries such as Kenya, and the failure to effectively administer taxes on self-employed professionals appears unjustifiable. This thesis advocates for a tax policy and administration shift, i.e., in policy and administrative efforts aimed at increasing tax collection from the informal sector, the taxation of professionals is a sensible place to start.

Finally, this research is significant for LMIC revenue authorities that face greater administrative challenges in tax enforcement than their counterparts in high-income countries. These challenges are, to a great extent, a result of inadequate resourcing, political exigencies, and limited technical expertise. These limitations impede the enforcement of the law among taxpayers who are already difficult to tax, further exacerbating the problem of tax evasion among HTT taxpayers. Thus, this project aims to provide credible research upon which tax authorities in LMICs can base their tangible solutions to the problem of tax evasion by professionals.

1.1.5. The Research Questions

The key research question in this thesis is: what are the barriers to tax compliance by *hard-to-tax* professionals in LMICs and how can revenue authorities in those countries effectively improve compliance among these taxpayers?

The implicit question is, why does this problem arise, and what should we do about it?

In the subsequent chapters, the primary research question will be answered through several sub-questions:

- i. should the already under-resourced tax authorities in LMICs spend their time, effort, and resources in improving compliance among the HTT?
- ii. what administrative options do tax authorities have when taxing the HTT?

- iii. what theories have been advanced, in the literature, to explain tax evasion?
- iv. what factors discourage or prevent self-employed professionals in Kenya, the case country, from complying with their tax obligations?
- v. what do tax experts in Kenya deem to be the most significant barriers to compliance by self-employed professionals?
- vi. what are the implications of the findings of this research for tax authorities designing a compliance strategy for self-employed professionals?

1.1.6. The Research Methodology

The decision to carry out qualitative research was made carefully, and with the research questions in mind. It would have been possible to premise this study on any of the ontological¹⁵ or epistemological¹⁶ assumptions that are discussed in social science literature; however, each assumption would lead to an approach that would produce distinct outcomes. In addition, the objective of a researcher greatly determines the research approach that would be ideal; not all approaches are ‘fit for purpose’ in every instance.

For example, a positivist approach to studying tax evasion among the HTT, by way of measurement, would assume that there is a single reality out there that exists independently of the research process; in addition, the researcher would assume that to access that single reality, it is critical to control behavioural events and control for or

¹⁵ Ontology refers to the study of reality; is reality singular or multiple? Does reality exist separate from the human mind or is it socially constructed? Braun and Clarke explain that ontology will determine ‘whether or not we think reality exists entirely separate from human practices and understandings-including the research we conduct to find such things out- or whether we think it cannot be separated from human practices’ Virginia Braun and Victoria Clarke, *Successful Qualitative Research* (2013) 27.

¹⁶ Epistemology is concerned with knowledge. It asks the questions, what is legitimate or meaningful knowledge? ‘What counts as knowledge determines how meaningful knowledge can be generated (and what it is seen to represent)’ *ibid* 29.

remove their subjective influences on the research process.¹⁷ A researcher operating on the basis of such assumptions would rely on experiments, tests, or surveys to generate knowledge since these methods allow for the control of behavioural events and the measurement of variables.

Experiments and survey cannot, however, be used to provide rich descriptions or explanations based on causal mechanisms beyond the regularity of observable events. In addition, quantitative data leaves no room for the various interpretations that context provides since the data is completely stripped of context. The results of the experiments may answer ‘why’ and ‘how’ questions when there is behavioural control of events in the ‘lab’ but does not tell us about spontaneous reactions or responses in nature where these influences cannot be controlled for or eliminated. Thus, qualitative research serves a different and important function in social science research.¹⁸ Qualitative approaches have been successfully used to produce credible and useful tax knowledge in a variety of disciplines.¹⁹

¹⁷ Realists, view reality or truth as independent of human knowledge and we can access that reality by carrying out research; they believe that there is a single truth, in the words of Braun and Clarke, ‘out there’ for us to access through research. Positivists hold the view that reality (single Truth) exists independently of research and that knowledge is discovered through research. Positivists believe that ‘valid knowledge is obtained through the application of established scientific methods which control variables and removes various forms of contamination and bias’ *ibid* 27, 29.

¹⁸ For further reading, see Robert Bishop, *The Philosophy of the Social Sciences: An Introduction* (Continuum 2007).

¹⁹ For example, see Judith Freedman, Geoffrey Loomer and John Vella, ‘Analysing the Enhanced Relationship between Corporate Taxpayers and Revenue Authorities’ in Lynne Oats (ed), *Taxation: A Fieldwork Research Handbook* (Routledge 2012); Karen Boll, ‘Mapping Tax Compliance’ (2014) 25 *Critical Perspectives on Accounting* 293; Karen Boll, ‘Shady Car Dealings and Taxing Work Practices: An Ethnography of a Tax Audit Process’ (2014) 39 *Accounting, Organizations and Society* 1; Carlene Beth Wynter, ‘Property Tax Administration in Practice: A Case Study of the Portmore Municipality, Jamaica’ (Thesis for the degree of Doctor of Philosophy in Accountancy, University of Exeter Business School 2014)

<<https://ore.exeter.ac.uk/repository/bitstream/handle/10871/17580/WynterC.pdf?sequence=1&isAllowed=y>> accessed 25 March 2019; Lotta Björklund Larsen, ‘Common Sense at the Swedish Tax Agency: Transactional Boundaries That Separate Taxable and Tax-Free Income’ (2015) 31 *Critical Perspectives on Accounting* 75; Lynne Oats and Diana Onu, ‘“Cozy Deals,” Social Media, and Tax Morale’ (2016) 84 *Tax Notes International* 69; Diana Onu and Lynne Oats, ‘“Paying Tax Is Part of Life”: Social Norms and Social Influence in Tax Communications’ (2016) 124 *Journal of Economic Behavior & Organization* 29; Lotta Björklund Larsen, *A Fair Share of Tax: A Fiscal Anthropology of Contemporary Sweden* (Springer Berlin Heidelberg 2017); Diana Onu and Lynne Oats, ‘Tax Talk: An Exploration of Online Discussions Among

The objective of the present research is not to make predictions by describing causal mechanisms; rather, the objective is to explain social phenomena using the tendencies or patterns emerging from data. Context is extremely important in the study of complex, dynamic, and multi-faceted phenomena like tax evasion and therefore the qualitative approach is fit for purpose because it acknowledges that knowledge emerges from context. The reasons why people evade tax and the reasons behind the policy and legislative failure in curbing tax evasion will be multiple, multifaceted, and complex. The perceptions of legislators, policy makers, revenue administrators and tax payers will inevitably be varied because they are drawn from their interpretations, culture, biases, and experiences. In addition, the researcher's own analysis of the views of these actors cannot possibly be value free; the researcher's perceptions of reality or knowledge is also influenced by their experiences, background, bias and previous knowledge.

Thus, in summary, the research questions in this thesis were best answered by reviewing the existing literature on the HTT and tax compliance, as well as undertaking a rich and detailed qualitative study of the tax compliance attitudes of self-employed professionals in LMICs. With respect to research methods, the case study method was selected for its suitability for in-depth study of phenomena.²⁰ The usefulness of case studies has been questioned and these questions are based on several misunderstandings.²¹ Case studies generate concrete, practical knowledge and it is often assumed that such context-dependent knowledge is less valuable than theoretical context-independent knowledge.²² However, the counter-argument to this criticism is that

Taxpayers' (2018) 149 *Journal of Business Ethics* 931; Carlene Beth Wynter and Lynne Oats, 'Don't Worry, We Are Not after You! Anancy Culture and Tax Enforcement in Jamaica' (2018) 57 *Critical Perspectives on Accounting* 56.

²⁰ John W Creswell and J David Creswell, *Research Design: Qualitative, Quantitative, and Mixed Methods Approaches* (SAGE Publications 2017) 14.

²¹ Bent Flyvbjerg, 'Five Misunderstandings About Case-Study Research' (2006) 12 *Qualitative Inquiry* 219.

²² *ibid* 221.

‘[C]ontext dependent knowledge and experience are at the heart of expert activity’.²³ Case study research gives us a ‘nuanced view of reality’ and helps us understand that ‘human behaviour cannot be meaningfully understood as simply...rule-governed acts...’.²⁴

In addition, case studies, and qualitative research in general, are often criticised on the basis that one cannot make statistical generalisations from qualitative data. However, ‘[T]hat knowledge cannot be formally generalized does not mean that it cannot enter into the collective process of knowledge accumulation in a given field or in a society.’²⁵ Case study data serves an important purpose and it is possible to use the rich qualitative data to contribute, and generalise, to existing theory.

Data collected for this case study came from documentary sources and semi-structured interviews, both recognised as useful sources for case studies.²⁶ In order to obtain the depth and breadth of data required for extensive research objectives, the case study focussed on tax compliance attitudes of self-employed professionals in a single country, Kenya, (the case country) and in two professions selected for further analysis — law and dentistry. This in-depth analysis enabled the researcher to interrogate a multi-faceted and complex social phenomenon in a comprehensive and contextualised manner. Justifications for the selection of the case country and the two professions are discussed, in detail in section 1.2 below.

The researcher relied on a significant number of documentary sources for this project, including books, journal articles, working papers, and other research publications. Texts were primarily drawn from economics, politics, psychology, and

²³ *ibid* 222.

²⁴ *ibid*.

²⁵ *ibid* 227.

²⁶ Robert Yin, *Case Study Research: Design and Methods* (SAGE Publications 2013) 106.

sociology. A much smaller number were drawn from law; as acknowledged by Freedman, there is an abundance of literature on taxation in these other disciplines, but tax has ‘not thrived in the same way as other legal research topics’.²⁷ Parliamentary and other government reports supplied important policy information. Certain internet resources provided information that could not be obtained any other way, such as off-the-cuff statements and remarks made by high-level government officials. These resources were used with caution as it was not always possible to verify their contents.

1.2. WHY KENYA?

1.2.1. The Economy

Underpayment by the self-employed affects both high-income countries and LMICs; these taxpayers have greater opportunity for tax evasion and often utilise those opportunities.²⁸ However, as will be demonstrated further below, LMICs are, disproportionately, more affected by tax evasion by the HTT. For this reason, this thesis focuses primarily on LMICs. The author has selected Kenya as the case-country for this case study, for the reasons outlined below.

Located in East Africa, Kenya borders Uganda to the West, Tanzania to the South, South Sudan to the North West, Ethiopia to the North, and Somalia to the North East. Kenya’s capital city, Nairobi, is a cosmopolitan and economically vibrant city; it is home to over 3 million people, large, medium, and small businesses, Africa’s fourth largest securities’ exchange, over 100 multinational enterprises, a large United Nations Office, and the United Nations Environment Program (UNEP) Headquarters.

²⁷ Judith Freedman, ‘Taxation Research as Legal Research’ in Margaret Lamb and others (eds), *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press 2005) 16.

²⁸ Jantscher and Tanzi (n 11); Torgler, ‘The Importance of Faith’ (n 11); Slemrod (n 11); Torgler and Valev (n 11); Kleven and others (n 11); Kogler, Muehlbacher and Kirchler (n 11); Cabral, Kotsogiannis and Myles (n 11); Advani, Elming and Shaw (n 11).

The case country has been selected both for its status as an LMIC, and its economic progress and promise. Kenya is classified as a lower middle-income country with a GDP per capita, PPP of \$3,285.91.²⁹ Kenya's tax-to-GDP ratio is 18.1% (in 2016), which is similar to the average tax-to-GDP ratio (18.2%) for 21 African countries surveyed by the OECD.³⁰ According to the US Central Intelligence Agency website, Kenya is 'the economic and transport hub of East Africa' and has an approximate population of 47 million.³¹ The World Bank also describes Kenya as 'one of the fastest growing economies in sub Saharan Africa'.³² The World Bank's 2015 Kenya Economic Update report projected a growth rate of 5.7% in 2016 up from 5.4% in 2014.³³

Kenya possesses a significant number HTT taxpayers; there is evidence that the underground economy in Kenya is about 20% of its GDP and has a tax potential of 4%.³⁴ According Budlender, 61% of Kenyans working in the urban areas are engaged in the non-agricultural informal sector and the informal sector employs over 80% of the Kenyan working population.³⁵ As explained in Chapter 1, the HTT incorporates a broad spectrum of workers, i.e., the HTT is made up of workers from both the formal and informal sectors, with some workers falling somewhere between the two sectors. The Kenya Labour Market Profile 2014 also suggests that the labour market in Kenya constitutes a

²⁹ World Bank, 'GDP per Capita, PPP (Current International \$) | Data' (*World Bank DataBank*) <<https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD>> accessed 29 October 2018.

³⁰ OECD/ATAF/AUC, *Revenue Statistics in Africa 2018* (OECD Publishing 2018) 1.

³¹ Central Intelligence Agency, 'The World Factbook' <<https://www.cia.gov/library/publications/the-world-factbook/geos/ke.html>> accessed 13 June 2016

³² World Bank, 'Kenya Among the Fastest Growing Economies in Africa' (*World Bank*) <www.worldbank.org/en/news/press-release/2015/03/05/kenya-among-the-fastest-growing-economies-in-africa> accessed 13 June 2016.

³³ World Bank, 'Kenya Economic Update: Laying the Foundation for Strong Growth in a Challenging Environment' (*World Bank*) <www.worldbank.org/en/country/kenya/publication/kenya-economic-update-storm-clouds-gathering-special-focus-public-participation> accessed 13 June 2016.

³⁴ Shem Ouma and Kenya Institute for Public Policy Research and Analysis (eds), *Estimating the Size of the Underground Economy in Kenya* (Kenya Institute for Public Policy Research and Analysis 2007) 18.

³⁵ Debbie Budlender, 'Statistics on Informal Employment in Kenya' (*WIEGO Statistical Brief no 5, May 2011*, May 2011); Institute of Economic Affairs, 'Economic Burden of the Informal Sector' (*Number of the Week, 7 December 2016*) <www.ieakenya.or.ke/number_of_the_week/economic-burden-of-the-informal-sector> accessed 11 July 2018.

spectrum with the very formal sitting at one end, and the very informal at the other; with several groups falling in between.³⁶ The self-employed HTT taxpayers in Kenya fall within index 1-5 as demonstrated in Figure 7; they exhibit wide and varying degrees of informality. Kenya, therefore, is an excellent example of a LMIC with a significant number of HTT taxpayers drawn from both the informal and formal sector.

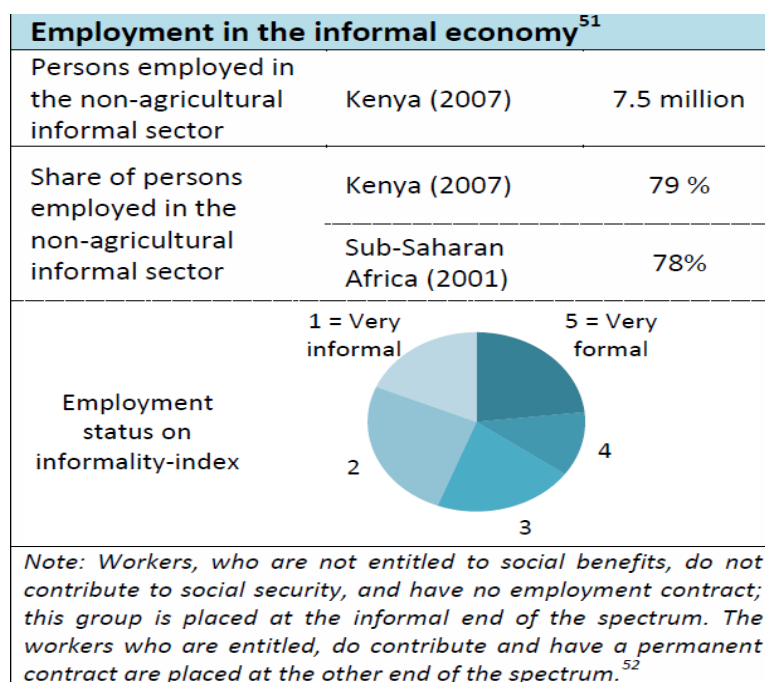


Figure 2: Employment in the Informal Economy in Kenya³⁷

1.2.2. Tax Reform and the HTT

Despite its robust efforts at tax reform, Kenya is yet to tax the HTT effectively. Since 1986, Kenya has engaged in a continuous exercise of revenue reform. In the mid-1980s, Kenya entered into an economic restructuring agreement with the International Financial Institutions under which it adopted the Structural Adjustment Programs (SAPs).³⁸ Tax

³⁶ Philip Nordentoft, 'Kenya – Labour Market Profile 2014' (Danish Trade Union Council for International Development Cooperation) 15.

³⁷ *ibid.*

³⁸ Eliud Moyi and Eric Ronge, *Taxation and Tax Modernization in Kenya: A Diagnosis of Performance and Options for Further Reform* (Institute of Economic Affairs, 2006) 3.

reforms adopted in 1986 were part of these SAPs, and began with the adoption of the Tax Modernisation Program in 1986, and the Budget Rationalisation Program in 1987.³⁹ The former focused on increasing revenue collection, while the latter focused on rationalisation of government spending.

In 1995 the Kenya Revenue Authority (KRA) was set up as a semi-autonomous central body, carrying out the revenue administrative functions that had hitherto been carried out by various departments in the Ministry of Finance. Despite these 'real improvements in the Kenyan tax system', the tax authority has not successfully increased revenue collection from the HTT.⁴⁰

Legislative amendments have not fared any better. The Kenyan government attempted to tax the agricultural sector through a presumptive turnover tax, but the regime was unsuccessful and was repealed in 1993; the government reintroduced the tax in 1995.⁴¹ Despite efforts to reform the presumptive tax regime before the 1995 reintroduction, the regime continued to perform poorly, and was suspended in 2001.⁴²

With effect from January 2007, the government introduced a turnover tax with the intention of bringing the non-agricultural informal sector into the tax net. According to Section 12 and 34 of the Income Tax Act (Chapter 470 of the Laws of Kenya), the maximum threshold for eligibility was an annual income of Kshs. 5 million, approximately equivalent to £38,000. The applicable tax rate was 3% of annual gross sales, and taxpayers were required to keep cash books, receipts and invoices, purchase invoices, and bank statements. The statute explicitly excluded professional income from

³⁹ Nicholas Cheeseman and Robert Griffiths, 'Increasing Tax Revenue in Sub-Saharan Africa' The Oxford Council on Good Governance Economic Analysis (2005) 29, 5.

⁴⁰ *ibid* 12.

⁴¹ Moyi and Ronge (n 38) 13.

⁴² Moyi and Ronge, (Institute of Economic Affairs, 2006).

the applicability of this provision, even when professionals meet the other eligibility criteria. Despite enquiries at KRA and the Ministry of Finance, the researcher did not find any policy documents explaining the exclusion of professionals.

In both Budget Options 2013 and Budget Options 2014, the Parliamentary Budget Office acknowledged that, despite legislative reform, the turnover tax had failed to yield significant revenue, and its implementation ought to be rethought.⁴³ The main reasons for the poor performance of this tax are (i) the tax authority has very poor data regarding these taxpayers, and was incapable of enforcing the tax, (ii) the prohibitive cost, to the tax authority, of enforcing the provision on a large number of HTT taxpayers, (iii) the poor uptake of the regime, by taxpayers, because of complexity, lack of knowledge about the tax, and cost of compliance, and (iv) the inability or unwillingness, by these taxpayers, to keep proper accounting records.

In the 2016 Budget Reading, on 8th June 2016, the Cabinet Secretary announced that the government's intention to reform and reintroduce the presumptive tax regime, to draw the non-agricultural informal sector into the tax net and thus expand the tax base. In the 2018 Finance Act, the government implemented this new regime by applying a tax base that the government had not attempted to apply before. Rather than a tax on gross sales, the presumptive tax is now 15% of the single business permit fee issued by the county governments; the maximum eligibility threshold remains unchanged. The tax, which commences in January 2019, will be collected at the point of purchasing an annual business permit. This new tax base alleviates taxpayers of the burden of keeping records, assessing their gross sales, and computing the tax due, and partially resolves the tax

⁴³ Parliamentary Budget Office Kenya, 'Setting the Pace for Sustainable Growth' (Kenya Parliament 2013) Budget Options for 2013/2014 and the Medium Term; Parliamentary Budget Office Kenya, 'Keeping the Promise' (Kenya Parliament 2014) Budget Options for 2014/2015 and the Medium Term.

authority's problem of limited data regarding these taxpayers. The success of the tax now depends on the county governments' success in ensuring that all informal business operators are applying for the single business permit and the county governments' officers are collecting the tax effectively, without corruption.

These efforts at taxing the HTT have, unfortunately, focused solely on SMEs and farmers, to the exclusion of self-employed professionals. The tax authority does not seem to treat self-employed professionals as 'informal' despite the fact informality is not pegged to one's level of education or occupation. It is certainly conceivable that a significant number of professionals in Kenya operate small firms, with a turnover that is, realistically, not be far off from the maximum threshold of eligibility for the presumptive tax. Waris et al rightly argue that the revenue capacity of the shadow economy in Kenya may be underestimated in the available economic data, and that the potential revenue from the self-employed may be much higher.⁴⁴

1.2.3. Corruption

Kenya's experience with corruption, and the potential influence of this corruption on the tax morale of taxpayers, also makes it an important country to study. The Transparency International Corruption Perceptions Index 2017 ranks Kenya at position 143 out of the 180 countries surveyed, with a corruption index of 28-where 0 is attributed to the highly corrupt countries and 100 is attributed to the very clean countries.⁴⁵

⁴⁴ Attiya Waris and others, 'Taxation and State Building in Kenya: Enhancing Revenue Capacity to Advance Human Welfare' (Tax Justice Network)

<www.taxjustice.net/cms/upload/pdf/Kenya_1004_TJN_Spreads.pdf> accessed 10 February 2015.

⁴⁵ Transparency International, 'Corruption Perceptions Index 2017' (www.transparency.org) <www.transparency.org/news/feature/corruption_perceptions_index_2017> accessed 16 July 2018.

Schlenther reviews the effect of corruption on taxation in various African countries and with respect to Kenya, he states:

*Corruption in Kenya is described as ‘endemic’ and ‘pervasive, dominating the provision of public services, the formation of contracts and, of course, political life’. According to Hope, corruption persists in Kenya primarily because those in power benefit from corruption and the existing governance institutions lack both the will and capacity to stop them from doing so... According to Hope, the main reason for high levels of corruption is the deliberate undermining of the basic institutions that underpin and support the rule of law and good governance.*⁴⁶

Allegations of corruption have plagued both government agencies like the revenue authority, as well as high-level and powerful individuals close to the president. An example of the latter is the alleged misappropriation, by members of the president’s immediate and extended family, of USD 50 million intended for use in free maternal health care programs at the Ministry of Health.⁴⁷

Corruption negatively affects tax morale, destroys trust in government and revenue authorities, and adversely affects the amount of revenue collected.⁴⁸ Studying

⁴⁶ Bernd Schlenther, ‘The Impact of Corruption on Tax Revenues, Tax Compliance and Economic Development: Prevailing Trends and Mitigation Actions in Africa’ (2017) 15 eJournal of Tax Research; Sydney 217, 224 citing Kempe Ronald Hope, *Corruption and Governance in Africa - Swaziland, Kenya, Nigeria* (Springer International Publishing) 63.

⁴⁷ Washington Osiro, ‘Corruption in Kenya: We All Know Uhuru Kenyatta’s Government Is Corrupt But “Raila Will ‘Nefa’ Be President!”’ (*Huffington Post*, 5 November 2016) <www.huffingtonpost.com/washington-osiro/corruption-in-kenya-yes-w_b_12791380.html> accessed 16 July 2018.

⁴⁸ See the discussion on corruption and tax morale in Chapter 5, at section 5.2.

the HTT in Kenya provides an opportunity to investigate how corruption in the country has influenced professionals' tax morale.

1.2.4. Political Legitimacy

The electoral processes of 2007, 2012, and 2017, and the subsequent political and legal upheaval, are also relevant. Kenya has faced tremendous challenges in its efforts to mount credible and fully transparent elections; the 2007 elections were marred by a violent post-election reaction, resulting in a coalition government after weeks of high-level mediation efforts led by former U.N. Secretary General Kofi Annan.

The 2012 election were similarly tense. Uhuru Kenyatta, and his running mate, William Ruto, were, at the time, facing charges at the International Criminal Court for crimes against humanity tied to the 2007 post-election violence. Kenyatta and Ruto successfully used the ICC case to their, during the presidential campaign, by galvanising domestic support from their tribes against perceived 'foreign persecution'.⁴⁹ Their success at the polls was met with claims of rigging and electoral malpractice by the opposition and although the Supreme Court upheld their win in a controversial judgment, the opposition leaders, led by Raila Odinga, and opposition supporters maintained that the election was not fairly won.

The recent 2017 election was also hotly contested. Uhuru Kenyatta and William Ruto won the August election but their victory was subsequently nullified by the Supreme Court, in a surprising but widely celebrated judgment; the Supreme Court held that the electoral body had conducted the election so poorly that it was impossible to tell who had

⁴⁹ 'Kenyatta and the ICC' *BBC News* (11 March 2013) <www.bbc.com/news/world-africa-21739347> accessed 2 January 2018; For an analysis of these political events from a political theory perspective, see Chapter 3 of Gabrielle Lynch, *Performances of Injustice: The Politics of Truth, Justice and Reconciliation in Kenya* (Cambridge University Press 2018).

won.⁵⁰ Raila Odinga declined to participate in the subsequent re-election, 60 days later, citing the failure by the electoral body to assure the opposition that the re-election would be free and fair; as a result, Uhuru Kenyatta won the re-election virtually unchallenged.⁵¹

Kenya's electoral experience in the last 10 years and the perception by a significant section of the population that the elections have not been credible, has certainly had an effect on the perception of legitimacy of the government. According to Tyler, 'the classic argument of political and social theorists has been that for authorities to perform effectively, those in power must convince everyone else that they "deserve" to rule and make decisions that influence the quality of everyone's lives'.⁵² Arguably, effective taxation also relies on such legitimacy. Although this study did not specifically focus on the effects of the elections on tax morale in Kenya, it was expected that the political experience of the Kenyan taxpayer would inform and enrich the qualitative data. Finally, the researcher is Kenyan and therefore possesses a good understanding of the tax regime, the challenges that the revenue authority faces, and has useful contacts at the revenue authority, treasury, tax advisory firms, and the sectors that have been selected for the case study. All these factors were instrumental in gaining access to key respondents during the fieldwork stage.

1.2.5. Taxation of Professionals in Kenya

Income Tax

Under Kenyan law, income tax is chargeable, for each year of income, on the employment income of professionals whether resident or non-resident, which accrued in or was

⁵⁰ *Raila Amolo Odinga & Another v IEBC & Others* (2017) eKLR.

⁵¹ 'Kenya Voters Shun Election Re-Run' *BBC News* (27 October 2017) <www.bbc.com/news/world-africa-41773919> accessed 2 January 2018.

⁵² Tom R Tyler, 'Psychological Perspectives on Legitimacy and Legitimation' (2006) 57 *Annual Review of Psychology* 375, 377.

derived from Kenya; the professionals, like other employees, are also entitled to personal relief— currently set at Kenya Shillings 16,896 per month (the equivalent of £130).⁵³ Employment income includes “any wages, salary, leave pay, sick pay, payment in lieu of leave, fees, commission, bonus, gratuity, or subsistence, travelling, entertainment or other allowance received in respect of employment or services rendered” and other benefits and contributions as stated in the Income Tax Act.⁵⁴

Income earned from a self-employed professional vocation ought to be computed separately from any other sources of income of the professional and such self-employment income is subject to income tax “charged for a year of income at the individual rates for that year of income.”⁵⁵ The individual rates for self-employment income are similar to the rates in applied on employment income.⁵⁶ Further, unlike their peers in employment, self-employed professionals are entitled to deduct “expenditure wholly and exclusively incurred” by them in the production of their income, when ascertaining their total income.⁵⁷

Under the Income Tax Act, any resident person whose income from business does not exceed five million shillings during a year of income, may elect to pay income tax under the simplified tax regime known as the presumptive tax regime, rather than the ordinary tax regime.⁵⁸ The governing statutory provision expressly bars professional income from eligibility for this presumptive tax regime, even when the professional meets the income criteria.⁵⁹

⁵³ Section 5 and Third Schedule Head B of the Income Tax Act (Chapter 470 of the Laws of Kenya).

⁵⁴ Section 5 of the Income Tax Act (n 43).

⁵⁵ Section 15 (7) (e) (ii) and Section 34 (1) (a) of the Income Tax Act (n 43).

⁵⁶ Third Schedule Head B of the Income Tax Act (n 43).

⁵⁷ Section 15 (1) of the Income Tax Act (n 43).

⁵⁸ Section 12C (1) of the Income Tax Act (n 43). This presumptive tax applies to persons who are issued or liable to be issued with a business permit or trading license and is collected annually, through the county government, when the taxpayer applies to renew his or her trading license or business permit.

⁵⁹ Section 12C (5) of the Income Tax Act (n 43).

Professional fees earned by self-employed professionals is also subject to withholding tax, and “[T]he Commissioner shall not assess any person for any year of income on that portion of income which has been subject to withholding tax which is also a final tax.”⁶⁰ Where the professional fee is not a contractual fee, the withholding tax rate is 5% of the gross fee and is payable on fees amounting to Kenya Shillings 24,000 a month and above — equivalent to approximately £180.⁶¹ Where the professional fee is a contractual fee, the withholding tax rate is 3% of the gross fee and is payable on fees amounting to Kenya Shillings 24,000 a month and above.⁶²

Value Added Tax

The provision of professional services is a taxable supply.⁶³ In 2013, Kenya enacted a new VAT law that met stiff resistance from various quarters. Within the dental profession, there was disquiet regarding the introduction of VAT on various materials and equipment on the basis that this move posed a threat to achieving affordable and safe healthcare for all and increased private sector investment in healthcare; additionally, the dentists argued that the additional tax would result in serious economic hardship for self-employed professionals.⁶⁴ As we will see in the case study chapter, the imposition of VAT on dental equipment and materials has had an adverse effect on the tax attitudes of dental practitioners in Kenya.⁶⁵

In the legal profession, the resistance to VAT revolved around the introduction of electronic tax registers, and the mandatory requirement that lawyers who were making taxable supplies begin using these devices. The rationale behind the introduction of the

⁶⁰ Section 76A of the Income Tax Act (n 43).

⁶¹ Third Schedule Head B of the Income Tax Act (n 43).

⁶² *ibid.*

⁶³ Section 5 (1), as read together with Section 2, of the Value Added Tax Act, Act No 35 of 2013.

⁶⁴ Kenya Dental Association, ‘The New Tax on Dental Health’ (12 September 2013) <<http://www.kda.or.ke/news/23-dental-health-tax.html>> accessed 25 March 2019.

⁶⁵ See Section 4.4.2 in Chapter 4.

electronic tax registers was to bring into the tax net, traders who had hitherto been evading VAT, by electronically tracking their receipts and payments. The legal profession strongly resisted this move and filed a judicial review application in the High Court challenging decision; the Law Society of Kenya lost the case and filed an appeal.⁶⁶ These events are discussed in greater detail in Chapter 4; at this juncture it suffices to say that the Society obtained an order of stay pending appeal, and that order remained in place for more than ten years before the appeal was prosecuted. As we shall see in Chapter 4, the order of stay had unintended consequences for tax compliance behaviour in the legal profession.

1.3. THESIS LAYOUT

1.3.1. Chapter 1: The Hard-to-Tax: Who are They and Should we Tax Them?

This first chapter contains an introduction to, and an overview of, the thesis aims. The body of the chapter contains a description of the taxpayers referred to as hard-to-tax and distinguishes them from other taxpayers. The chapter then moves on to a discussion of existing arguments for and against taxing the HTT, particularly in LMICs. The chapter concludes by making a case for more genuine efforts to tax the HTT, particularly self-employed professionals, and argues that these taxpayers should not be overlooked when tax authorities are designing compliance strategies.

1.3.2. Chapter 2: Taxing the Hard-to-Tax: What are the Options?

The second chapter contains a discussion of the different administrative and enforcement options for tax authorities dealing with the HTT. Options include exempting them from taxation altogether, strengthening enforcement to improve compliance, increased

⁶⁶ See Section 4.4.3 of Chapter 4, below, for a detailed discussion of these events and the High Court and Court of Appeal cases that followed.

reliance on voluntary compliance, increased reliance on indirect taxation where direct taxation is a challenge, or introducing simplified tax regimes (presumptive taxation).

1.3.3. Chapter 3: Why do People Evade Taxes?

The third chapter is dedicated to a discussion of the various theories explaining why people evade (or comply) with their tax obligations. It also presents various studies in which these theories have been empirically tested.

1.3.4. Chapter 4: Case Study of Tax Compliance among Self-Employed Professionals in Kenya

Chapter 4 begins with a concise explanation of the case study design and data collection methods. The author then applies the lens of key compliance theories in tax literature, to analyse the way in which the self-employed professionals selected for the case study construct compliance behaviours within their profession. This lens is also applied in analysing a select number of tax experts' perspectives on tax evasion by self-employed professions in Kenya, in order to obtain a holistic account of the phenomenon.

1.3.5. Chapter 5: Implications of Case Study Findings and Contributions to Previous Research

This chapter aims to identify the most critical implications of the case study findings. It elucidates the significant contributions that this thesis makes to existing knowledge in this field.

1.3.6. Chapter 6: Looking Forward: Recommendations for Future Action

This penultimate chapter focusses on presenting practical options for tax authorities in LMICs. It teases out sensible measures that tax authorities can include in an overarching compliance strategy for professionals, informed by the case study analysis and outcomes.

1.3.7. Chapter 7: Conclusion

The concluding chapter summarises the research by re-stating and addressing the main objectives and research questions. It recaps methods used for data collection and analysis and highlights the most important claims made, to show how the thesis fills gaps in existing research. It also aims to summarise the important contributions made by this thesis, and implications of the research insights for tax authorities in LMICs. It concludes by evaluating the research, pointing out its strengths, limitations, as well as the unanswered questions that remain for future research.

1.4. WHO ARE THE HARD-TO-TAX?

Developing an equitable, neutral, and sound tax policy that meets the approval of all stakeholders and taxpayers is arguably one of the most challenging tasks that the government of any country has to undertake; yet, taxation is the lifeline of governments, without which they would cease to exist. While Adam Smith's famous canons of taxation—equality, certainty, convenience of payment, and economy of collection—come together rather neatly on paper, in reality, most countries struggle to come up with a tax regime that satisfies all four principles.⁶⁷ A tax that fosters equality may result in less than economic collection, and one that has achieved convenience of payment may not tick the equality box. Even one that miraculously manages to balance all canons may still not meet with the approval of critical taxpayers.

The Mirrlees Report acknowledges the difficulties associated with balancing all four canons when designing a tax system.⁶⁸ The Report argues that, in any event, these canons are not as comprehensive as they are often held out to be particularly since they 'do not help with the tough questions which arise when one objective is traded off against

⁶⁷ Adam Smith, *Wealth of Nations* (Electric Book Company 2000).

⁶⁸ James A Mirrlees and others (eds), *Tax by Design: The Mirrlees Review* (Oxford University Press 2018).

another.’⁶⁹ Advocating for the ‘optimal tax theory’, the Mirrlees Report suggests three rules of thumb that tax policymakers ought to rely on in designing a tax system: *simplicity, neutrality and stability*.⁷⁰

Neutrality refers to similar treatment for similar activities in order to eliminate or minimise the risk that taxpayers will distort their behaviour in a bid to reduce their tax liability.⁷¹ While the Mirrlees Report does acknowledge that neutrality is not always desirable or appropriate, it points out that in most instances, the lack of neutrality is unjustifiable; lack of neutrality introduces unnecessary complexity and inefficiency.⁷²

Simplicity, in tax law, is a difficult concept to define. Indeed, the Mirrlees report does not purport to provide an exact definition; instead, it explains that the characteristics of a simple tax system include transparency and low administrative costs, and that neutrality and simplicity are inextricably linked.⁷³

Stability means that the system should not be in a state of continuous change. According to the Mirrlees Report, it is vital to avoid two extremes - inaction in the face of a ‘poorly designed system’ on the one hand, and constant poorly thought-out changes on the other.⁷⁴ Instead, the Report advocates for the middle ground, i.e., ‘...a clear and transparent method of making changes to the tax system, and a clear long-term strategy for change.’⁷⁵

⁶⁹ *ibid* 22.

⁷⁰ ‘Optimal tax theory is all about the choice of a system of taxation that balances efficiency losses against the government’s desire for redistribution and the need to raise revenue...The theory of optimal taxation begins by clarifying the objectives of policy and identifying the constraints under which it operates. The tax system that best achieves the objectives whilst satisfying the constraints is identified as the optimum.’ *ibid* 39.

⁷¹ *ibid* 40.

⁷² *ibid* 41. The examples given of the latter include the difference in tax treatment between debt and equity and tax treatment between different business forms.

⁷³ *ibid* 42–43.

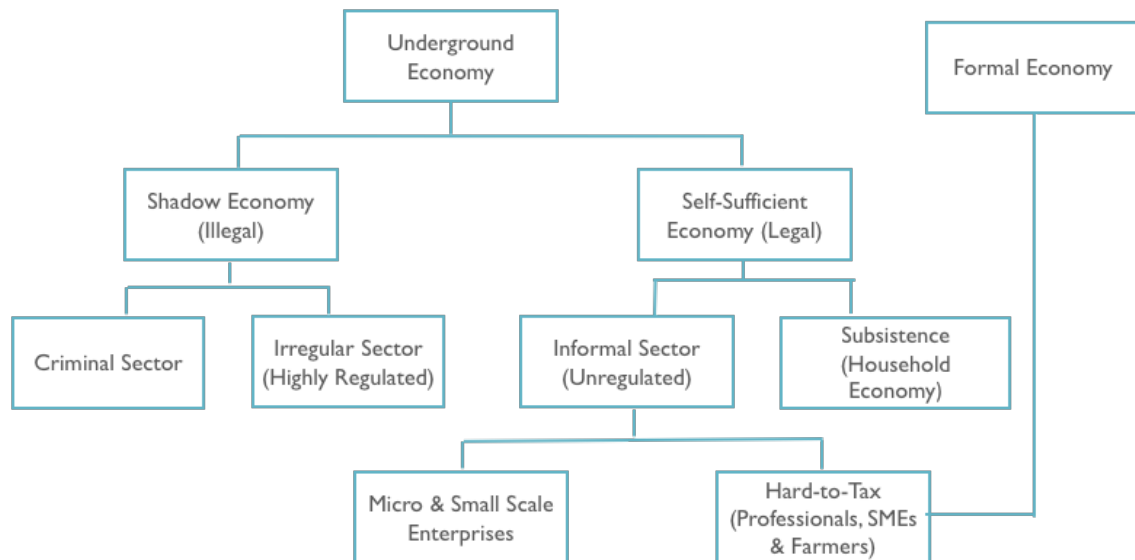
⁷⁴ *ibid* 44.

⁷⁵ *ibid*.

The purpose of the preceding discussion is to illustrate that the making of tax policy and tax law is a complicated affair. It requires a delicate balance of different, and often competing, considerations. It is even more complicated for LMICs faced with the reality of under-resourced tax authorities, and tax policy departments, attempting to pursue taxpayers who are deemed hard to tax. So, who are the ‘hard-to-tax’?

In order to identify the HTT, viz-a-viz other taxpayers, it is necessary to examine the taxonomy of participants in the economy. Tax evasion literature is inundated with a plurality of terms used to refer to concepts with varying meanings; this makes comparison between existing studies on tax evasion a very challenging task.⁷⁶ Schneider and Enste list 13 different terms that have been ‘used synonymously or for different areas’ by researchers in this field.⁷⁷ The following section explains some of the terms found in the literature and concludes with the definitions adopted for this study.

Figure 3: Taxonomy of Taxpayers



⁷⁶ Ana Cinta G Cabral, Gareth Myles and Christos Kotsogiannis, ‘Self-Employment Underreporting in Great Britain: Who and How Much?’ (2014) TARC Discussion Paper 010-14 4. This discussion paper is an earlier draft of a subsequent publication; Cabral, Kotsogiannis and Myles (n 11).

⁷⁷ Friedrich Schneider and Dominik Enste, *The Shadow Economy: An International Survey* (2nd Edition, Cambridge University Press 2013) 6.

1.4.1. The Underground Economy

According to Carillo and Pugno, the underground economy consist of ‘activities which are not registered, taxed or regulated but which produce for legal market’.⁷⁸ Schneider and Enste seem to adopt a more extensive definition and suggest that the underground economy comprises both legal and illegal activities.⁷⁹ In other research, Schneider and Enste have used the terms underground, informal, parallel, and shadow economy interchangeably.⁸⁰ Schneider and Williams take the view that both the wide and narrow definitions are valid; although they adopt the narrow definition in their work, they acknowledge that this narrow definition exists within a ‘sub-set of a wider definition’.⁸¹ For the purposes of this thesis, the term underground economy refers to the broad definition encompassing both legal and illegal activities, i.e., ‘those economic activities and the income derived from them that circumvent or otherwise avoid government regulation, taxation or observation.’⁸²

1.4.2. The Shadow/Hidden Economy

Schneider and Enste provide a helpful discussion on the dichotomy between the ‘legal arm’ and the ‘illegal arm’ of the underground economy.⁸³ They describe the legal arm as the ‘self-sufficient economy’ and the illegal arm is classified as the ‘shadow or hidden economy.’⁸⁴

⁷⁸ Maria Rosaria Carillo and Maurizio Pugno, ‘The Underground Economy and Underdevelopment’ (2004) 28 *Economic Systems* 257, 258.

⁷⁹ Schneider and Enste (n 77) 11.

⁸⁰ Friedrich Schneider and Dominik Enste, *Hiding in the Shadows: The Growth of the Underground Economy* (International Monetary Fund 2002).

⁸¹ Friedrich Schneider and Colin C Williams, *The Shadow Economy* (The Institute of Economic Affairs 2013) 25. They exclude both illegal underground economic activities and activities in the informal household activities from their definition of underground economy.

⁸² *ibid* 23.

⁸³ Schneider and Enste (n 77) 12.

⁸⁴ *ibid*.

Within the shadow economy, Schneider and Enste distinguish between the irregular sector, which covers illegal production and distribution but legal output (e.g., operating a business without a licence or in breach of industry codes), and the ‘criminal sector’, which covers illegal production and distribution and illegal output (e.g., drug trafficking or slave trade).⁸⁵

1.4.3. The Self-Sufficient Economy

Within the self-sufficient economy, Schneider and Enste also differentiate between the ‘informal sector’ or ‘alternative economy’ operating on the one hand, and the ‘household sector’ on the other; the former refers to the sector where market activities take place, while the latter includes subsistence activities such as Do-it-Yourself work, home office work, babysitting and barter trade.⁸⁶

1.4.4. The Informal Sector

Schneider and Enste distinguish the irregular sector (described in 1.4.2 above) and the informal sector by law enforcement. Both sectors are subject to rules and regulations; however, legal and administrative regulations are hardly enforced in the informal sector, while the irregular sector is highly regulated through enforcement and supervision by the relevant administrative bodies.⁸⁷

While Schneider and Enste⁸⁸ use the term ‘informal sector’ to refer to activities such as self-help organisations and counselling centres, Joshi et al. adopt a wider definition, proposed by Hart, that has also been adopted in this thesis.⁸⁹ Hart originally

⁸⁵ *ibid* 12–13. The authors further argue that irregular or illicit work also include legal production accompanied by tax evasion such as occasional freelancing work where the worker fails to disclose this income to the tax authority. .

⁸⁶ *ibid* 11.

⁸⁷ *ibid* 12.

⁸⁸ *ibid* 11.

⁸⁹ Schneider and Enste (n 77); Anuradha Joshi, Wilson Prichard and Christopher Heady, ‘Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research’ (2014) 50 *The Journal of Development Studies* 1325, 1326.

proposed the term ‘informal sector’ in 1973, to refer to the self-employed or those not earning wages in formal employment.⁹⁰ In the 1970s, the International Labour Office, in a widely read report on the informal sector in Kenya, conceptualised this term and mainly used it to refer to small and micro enterprises that were not regulated or taxed by the government.⁹¹ The report identifies seven characteristics of the informal sector⁹²:

- i. ease of entry;
- ii. reliance on indigenous resources;
- iii. family ownership of enterprises;
- iv. small scale of operation;
- v. labour-intensive and adapted technology;
- vi. skills acquired outside the formal school system; and
- vii. unregulated and competitive markets.

In the 1980s, H. De Soto defined the informal sector as a ‘source of dynamism and growth held back only by inappropriate government regulation’.⁹³ This new school of thought viewed the informal sector and formal sector as distinguishable on the basis of regulation or legal status.⁹⁴

Kenyon’s broad and helpful description of the informal sector ties these various definitions and descriptions together:

It is essential to recognise the heterogeneity of the ‘informal sector’, encompassing as it does almost all sorts of activities, from the self-

⁹⁰ Keith Hart, ‘Informal Income Opportunities and Urban Employment in Ghana’ (1973) 11 J. Mod. Afr. Stud. 61, 68.

⁹¹ International Labour Office, *Employment, Incomes and Equality: A Strategy for Increasing Productive Employment in Kenya* (International Labour Office 1972). See chapter 13.

⁹² *ibid* 6.

⁹³ Hernando de Soto, *The Other Path: The Invisible Revolution in the Third World* (Harper & Row 1989) cited in Joshi, Prichard and Heady (n 37) 1326.

⁹⁴ Soto (n 93) 237–252.

*employed to small businesses employing a handful of workers to, in some developing countries, quite large enterprises with several hundred employees. Some firms may be registered with one set of authorities but not another, for instance, or registered but under-declaring sales or workers for tax purposes.*⁹⁵

While Schneider and Enste divide the self-sufficient sector (i.e., the legal arm of the underground economy) into the informal sector and the household economy, Joshi et al. view the household economy as a subset within the informal sector. The latter therefore present a trichotomy within the informal sector comprising: subsistence enterprises (or household economy), micro-enterprises and small businesses, and small and medium-sized enterprises. In the flow chart above, the author has elected to categorise the subsistence economy independently for greater clarity, as these activities are never taxed and therefore are out of the scope of this thesis.

1.4.5. The Hard-to-Tax

The above definitions and distinctions are complex, and the fact that scholars in the field use these terms interchangeably makes it challenging to identify universally accepted terminology. The term ‘hard-to-tax’ is not defined in the literature; instead, it is used to describe a group of taxpayers who share specific common characteristics.

The consensus in the literature is that the term hard-to-tax encompasses farmers, small and medium-sized firms, and professionals.⁹⁶ It is important to unpack this description in order to understand *why* these groups are deemed as hard to tax and why other groups are left out of this description. Alm, Vasquez and Schneider acknowledge

⁹⁵ Thomas Kenyon, ‘A Framework for Thinking About Enterprise Formalization Policies in Developing Countries’ (World Bank 2007) World Bank Policy Research Working Paper 4235 2 <<http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-4235>> accessed 12 October 2018 cited in; Joshi, Prichard and Heady (n 89).

⁹⁶ Jantscher and Tanzi (n 11) 12; Richard Musgrave, ‘Income Taxation of the Hard-to-Tax Groups’ in RM Bird and Oliver Oldman (eds), *Taxation in Developing Countries* (4th edn, The John Hopkins University Press 1990) 297, 299; Tadesse and Taube (n 7) 3; Alm, Martinez-Vazquez and Schneider (n 2) 4.

that all taxpayers are hard to tax for various reasons; however, they take the view that some taxpayers are *harder* to tax than others. They classify those taxpayers as HTT because they do not typically:

- i. voluntarily register themselves with the revenue authority;
- ii. keep proper books of accounts showing their income and expenditure;
- iii. file their tax returns promptly; and
- iv. there is a significantly higher rate of tax evasion among these taxpayers.⁹⁷

There is a consensus among scholars in this field that while multinational enterprises and businesses engaged in electronic commerce pose significant challenges for tax authorities, they fall outside the category of HTT taxpayers.⁹⁸ Looking at the four characteristics above, one could argue that multinational enterprises do not fall within the description of the HTT because:

- i. they are more likely to engage in complex tax avoidance schemes than basic tax evasion;
- ii. they generally employ highly qualified accountants to keep proper and detailed books of accounts and will comply with international accounting standards;
- iii. they generally engage the services of highly skilled tax advisors who will file their tax returns on time;
- iv. because these tax payers are highly likely to incorporate and comply with with registration requirements, they will, in almost all cases, voluntarily register with the revenue authority.

⁹⁷ Alm, Martinez-Vazquez and Schneider (n 2) 3–4.

⁹⁸ *ibid* 14.

As suggested in Figure 2 above, the informality of the HTT ought to be viewed on a continuum, with HTT taxpayers coming from both the formal and informal economies.⁹⁹ In the case of professionals for example, the HTT includes professionals operating in cash in the informal sector and who are genuinely unable to keep proper financial records; it also includes professionals who operate in the formal sector, are capable of keeping and do keep financial records, but will hide their financial affairs from the revenue authority through a mix of tax evasion and avoidance.¹⁰⁰ Professionals engaged in moonlighting, such as doctors taking up locum work and who fail to disclose that income to the tax authority, would additionally come under the irregular sector.

Terkper addresses the difficulties associated with taxing HTT taxpayers from the informal economy; he explains that professionals and small and medium-sized businesses in the informal economy are typically controlled by owner-managers and a network of close family members, professional associates, friends, and employees. These taxpayers, therefore, tend to have poor management systems and financial structures.¹⁰¹ Additionally, the ‘compliance costs or what it takes to meet tax obligations are also higher for small entities especially in relation to the amount of taxes they pay’ leading most of them to avoid compliance altogether.¹⁰²

Musgrave provides some additional insight into the challenges associated with taxing the HTT in developing countries.¹⁰³ These taxpayers operate mostly in a cash-based economy and either do not keep proper records, or the revenue authority has a

⁹⁹ Richard M Bird and Sally Wallace, ‘Is It Really So Hard to Tax the Hard-to-Tax? The Context and Role of Presumptive Taxes’ in James Alm, Jorge Martinez-Vazquez and Sally Wallace (eds), *Taxing the Hard-to-tax: Lessons from Theory and Practice*, vol 268 (Emerald Group Publishing Limited 2005) 124; Alm, Martinez-Vazquez and Schneider (n 2) 14.

¹⁰⁰ Alm, Martinez-Vazquez and Schneider (n 2) 14.

¹⁰¹ Terkper (n 4) 212.

¹⁰² *ibid* 213.

¹⁰³ Musgrave (n 96).

difficult time extracting the records from them; when the revenue authority does succeed in doing so, it is difficult to ascertain the accuracy and validity of those records.¹⁰⁴

Further, because the HTT make up a significant portion of the economy of developing countries, revenue authorities are challenged. They face a large number of individual taxpayers, associated high costs of collection, with the risk of minimal returns. Revenue officials will, more often than not, choose to pursue a small number of large taxpayers and overlook a large number of small taxpayers.¹⁰⁵

Based on the preceding discussion on terminology confusion, it suffices to say, in the words of Kanbur, that the existing literature in this field ‘is in a mess... a plethora of definitions, which leads to incoherence in analysis and, at its worst, major policy failures.’¹⁰⁶ This conclusion’s importance is discussed in Section 1.4.

What Keen suggests, and is the primary goal of this thesis, is:

*...to go beyond the comfort of broad labels and probe deeper into the anatomy of non-compliance, and how tax design and implementation should reflect and address it. These are complex issues but facing them head-on at least points to potentially fruitful areas of inquiry and action.*¹⁰⁷

In any discussion about taxation of the informal sector or of the HTT, particularly in the context of LMICs, self-employed professionals are an under-explored group. HTT professionals do not seem to fit the stereotypical label of informality on the one hand and are overlooked in compliance strategies for the formal sector on the other. The goal of

¹⁰⁴ *ibid* 297–299.

¹⁰⁵ *ibid* 299; Bird and Wallace (n 99) 125, 130.

¹⁰⁶ Ravi Kanbur, ‘Conceptualizing Informality: Regulation and Enforcement’ (Cornell University, Department of Applied Economics and Management 2009) 48926 2, 4

<<https://ideas.repec.org/p/ags/cudawp/48926.html>> accessed 15 October 2018.

¹⁰⁷ Keen (n 23) 16

this thesis is to go beyond this stereotypical labelling and deeply interrogate non-compliance by professionals in LMICs. Self-employed professionals falling under the HTT category may be either in the informal or the formal sector; compliance strategies for professionals must, therefore, take that into consideration and examine both sectors. Musgrave argues that the HTT in the informal economy (he refers to them as small taxpayers) should be treated differently from the HTT in the formal sector.¹⁰⁸ This thesis will support and advance this argument, in Chapter 5 and 6.

1.5. SHOULD RESOURCE-CONSTRAINED LMICS MAKE A SERIOUS ATTEMPT TO TAX THE HTT?

We now turn our attention to a fundamental policy question: should resource-constrained LMICs make a concerted effort to tax HTT taxpayers? The answer to this policy question will have significant implications for the design of an overall tax policy and tax compliance strategies of many LMICs. While this question is vital for both high-income countries and LMICs, it is of particular importance for LMICs. One reason for this is that LMICs record higher numbers of HTT taxpayers than high-income countries. According to Table 1 below, the informal sector- characterised by high numbers of HTT taxpayers- supplies a significant share of employment opportunities in urban areas, new jobs, and non-agricultural employment opportunities in developing countries. For example, the statistics in Table 1 show that in Africa, the informal sector provides 93% of new job opportunities and 61% of job opportunities in urban areas.

¹⁰⁸ Musgrave (n 96) 299–309.

| Informal Sector as a Percentage Share of: | Latin America- Caribbean | Africa | Asia |
|---|--------------------------|--------|-------|
| Non-agricultural Employment | 57 | 78 | 45-85 |
| Urban Employment | 40 | 61 | 40-60 |
| New Jobs | 83 | 93 | NA |

Table 1: Make-up of the Informal Sector in Latin America- Caribbean, Africa & Asia¹⁰⁹

Woodruff explains that in comparing the informal economy as a percentage of GDP, and taxes as a percentage of GDP, the former is higher in developing countries while the latter is higher in many OECD countries.¹¹⁰ For example, in Kenya, taxes are approximately 20% of the GDP while the informal economy is approximately 40% of the GDP; the variances are higher in countries such as Liberia, Honduras, and Georgia (Figure 5).

Figure 4: Taxes and Shadow Economy as a % of GDP in OECD Countries¹¹¹

¹⁰⁹ Martha Alter Chen, ‘Women and Informality: A Global Picture, the Global Movement’ (2001) 21 SAIS Review 72.

¹¹⁰ Woodruff (n 14) 2–3.

¹¹¹ *ibid* 2.

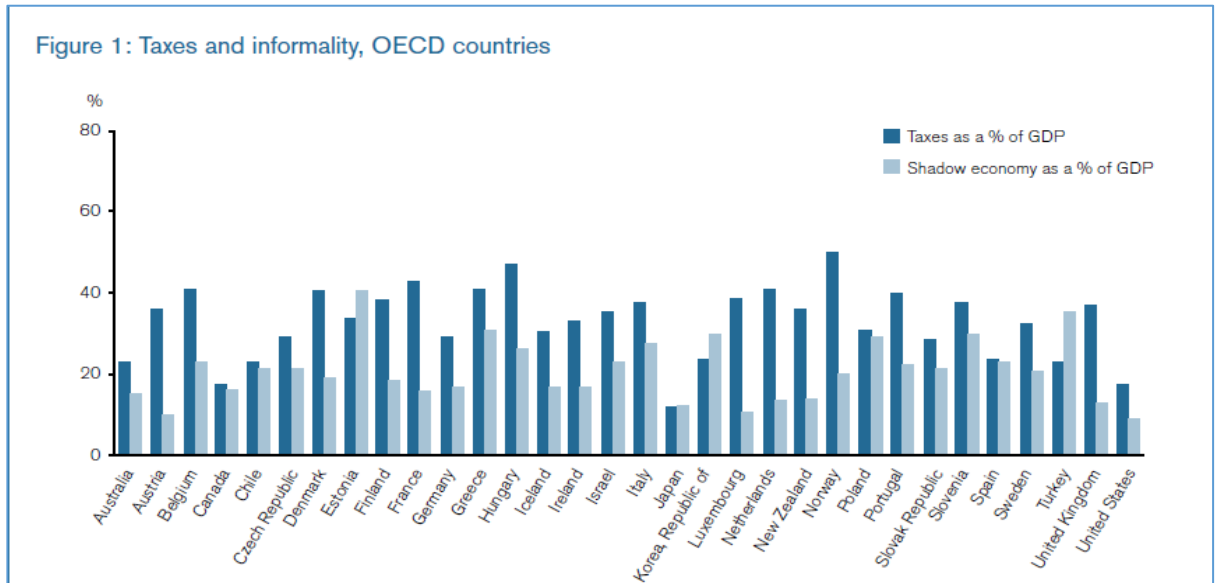
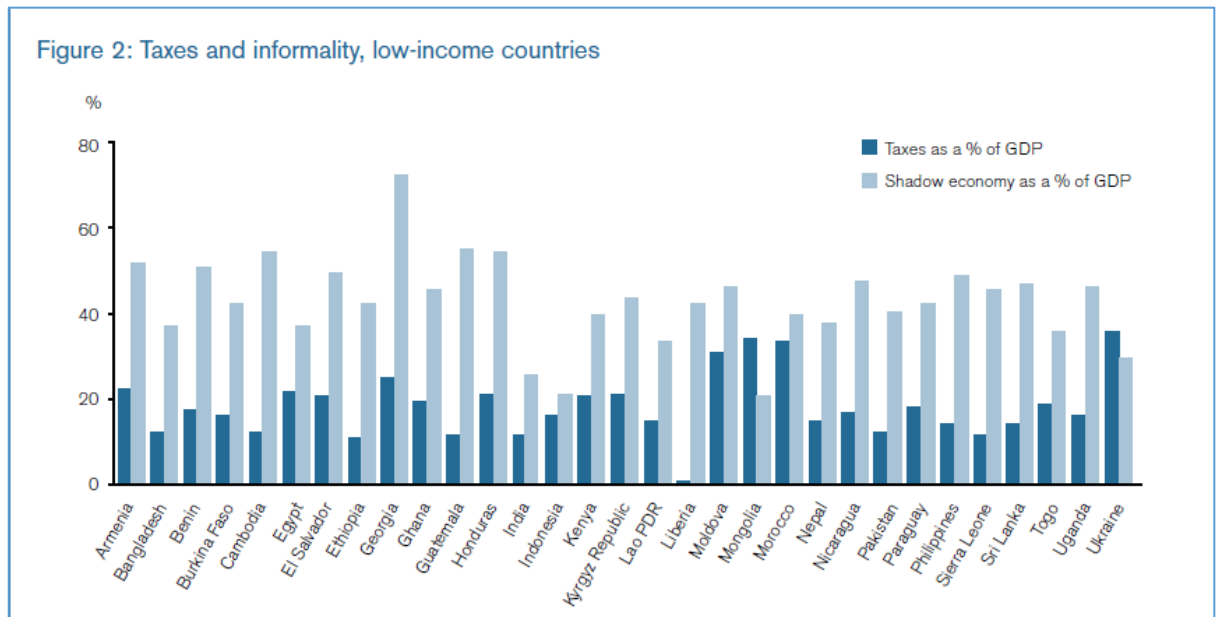


Figure 5: Taxes and Shadow Economy as a % of GDP in Low-income Countries¹¹²



Another reason why this policy question is more critical for LMICs is that they tend to have much smaller budgets and fewer resources for tax collection compared with high-income countries.¹¹³ These limited resources are often utilised to pursue larger and more visible corporate taxpayers, tax-avoiding multinational enterprises, and taxes such as PAYE for which compliance levels are relatively higher (because the burden of

¹¹² *ibid* 3.

¹¹³ Musgrave (n 96) 299.

compliance lies with a third party).¹¹⁴ Tax effort tends to follow the money. Is this the correct approach? In failing to adopt a comprehensive tax compliance strategy for the HTT, do revenue authorities risk missing out on potentially significant sources of revenue? Is there more to taxation than revenue? Are there other benefits of taxation? The various answers to these questions are explored below.

1.5.1. Arguments against Pursuing the Hard-to-Tax

The High Cost of Ensuring Compliance

Taxing the HTT is often not a high priority for revenue authorities in LMIC. This is due to the significant costs associated with ensuring compliance by these taxpayers, and high risk of low returns. In other words, LMICs choose to use their scarce resources to collect taxes where they are somewhat guaranteed relatively uncomplicated, yet significant revenue collection.¹¹⁵

Many tax authorities in LMICs are under-resourced and enforcing compliance among numerous individual taxpayers and SMEs, can be an expensive venture. This is especially the case for many taxpayers known as ‘ghosts’ (unknown to the tax authority because they have failed to register), or ‘icebergs’ (known to the tax authority but are under-declaring their income).¹¹⁶ These taxpayers can evade the tax authority with relative ease because of their size, nature of their businesses, informal nature of their management and accounting structures, and sometimes geographic location. As a result, tax authorities in LMICs focus much of their administrative effort on corporate taxpayers and PAYE, while investing less effort in ensuring compliance by the rest of the formal

¹¹⁴ Bird and Wallace (n 99) 125.

¹¹⁵ Terkper (n 4) 213; Bird and Wallace (n 99) 130.

¹¹⁶ Bird and Wallace (n 99) 122; Keen (n 7) 16.

sector. The informal sector is more severely neglected, meaning very little attention, if any, is paid to the HTT in this realm.

This enforcement approach has been described as sensible, or at the very least, understandable, by several scholars.¹¹⁷ Alm et al. explain that the policy decision to focus on large taxpayers does make sense ‘because scarce resources for tax enforcement can be much more productive in the development of large taxpayer units’.¹¹⁸ Cheeseman and Griffiths go a step further and argue that financial resources that are being utilised to ensure that tax authorities tax the informal economy more effectively, would be better utilised to increase taxpayers’ ability to pay tax or fund welfare needs such as education, health, and food security.¹¹⁹

Technical Expertise and ICT Constraints

The argument for investing state funds in areas of competing priority and taxpayer empowerment, and the argument against pursuing the HTT are linked. Taxing the HTT is complex and challenging, even for countries with well-resourced and technically competent tax authorities. It requires a sound compliance strategy and technical tax audit skills to identify taxpayers, bring them into the tax net effectively, and ensure that they are paying the correct amount of tax; these strategies and skills are not always well developed in many LMICs.¹²⁰

In a case study on taxation in sub-Saharan Africa, Cheeseman and Griffiths explain that Kenya, like many LMICs, needs to invest heavily in its tax administration in order to tax the HTT effectively.¹²¹ In light of competing priorities such as health care

¹¹⁷ Musgrave (n 96) 299; Bird and Wallace (n 99) 130.

¹¹⁸ Alm, Martinez-Vazquez and Schneider (n 2) 12.

¹¹⁹ Cheeseman and Griffiths (n 39) 15.

¹²⁰ Mascagni, Moore and McCluskey (n 13) 4, 17.

¹²¹ Cheeseman and Griffiths (n 39) 23.

and education, they argue that it is not prudent to spend the limited resources in LMICs on purchasing expensive and sophisticated information technology systems and improving revenue administration in order to tax the informal sector successfully.¹²² They take the position that to increase tax collection, LMICs should utilise their limited resources to improve service delivery in the health and education sectors, and pay civil servants better wages; in these ways, LMICs indirectly improve the ability of citizens to pay taxes.¹²³ Keen poses a pertinent question, along this line of thought,:

Simply from the perspective of efficiently allocating administrative resources, for instance, does it make sense to devote more effort to taxing smaller businesses rather than, for instance, improving refunding for exporters under the VAT or tackling aggressive tax planning by large multinationals?¹²⁴

In summary, therefore, LMICs making a serious effort to tax the HTT would require significant financial resources to build a tax authority staffed with highly skilled revenue officers, robust information and communication systems, and excellent technical skills. Various scholars cited above argue that for countries already struggling with limited budgets, this would be a significant investment, with uncertain returns, involving resources that should be utilised for social and welfare needs within the state. They assert that it may be more prudent to spend these resources in areas with significant impact on higher numbers of citizens.

Poverty

It has also been argued that intensifying efforts to ensure tax compliance within the informal sector would push citizens who live just above the poverty line into poverty, and those who are already living below the poverty line would be reduced to complete

¹²² *ibid.*

¹²³ *ibid* 23–25.

¹²⁴ Keen (n 7) 16.

and abject destitution.¹²⁵ Also, in the poorest LMICs, taxes targeting the smallest taxpayers within the informal sector are not likely to yield significant revenue. This is primarily due to the fact that this segment of the economy is predominantly made up of poor and untaxable individuals.¹²⁶

Supporters of this view argue that emphasising taxation of the informal sector amounts to placing the cart before the horse. Instead, LMICs ought to encourage formalisation of informal businesses and improvements in wages earned by their citizens which would, in turn, provide revenue for the state to tax.¹²⁷ This argument is assessed and challenged in section 1.4.2 below.

The Vulnerability of Small Firms

Taxation of the informal sector may ‘just create new avenues of predation’.¹²⁸ The effective taxation of the HTT necessitates the identification and tax registration of previously unregistered small firms and sole proprietors. Registration would significantly increase the level of interaction between these taxpayers and revenue officials. Revenue officials may request [or indeed demand] access to their books of accounts, bank statements, business premises, employee records, and even evidence of compliance with other regulatory requirements.

It has been argued that, in situations like these, the small business or sole proprietor is in a vulnerable position. If the law does not provide proper checks and balances that guard against unfair or undue use of power by tax officers, the exercise can quickly descend into a vicious cycle of extortion, bribery, intimidation, and other forms

¹²⁵ Cheeseman and Griffiths (n 39) 16.

¹²⁶ *ibid* 16–17.

¹²⁷ *ibid*.

¹²⁸ Kate Meagher and Ilda Lindell, ‘ASR Forum: Engaging with African Informal Economies: Social Inclusion or Adverse Incorporation?’ (2013) 56 *African Studies Review* 57, 67.

of corruption. Corruption is a severe problem in many LMICs, and this is therefore a real concern. Such a situation would defeat the purpose of pursuing these taxpayers, since the government would not receive the anticipated revenue, as it would be lost to bribery. Further, the growth of the informal economy and its move towards formality would be stifled, and the ensuing damage to the legitimacy of the revenue authority may well dampen the tax morale of other taxpayers.

In summary, proponents of this view argue that increased enforcement among the HTT may ‘make firms vulnerable to unequal treatment and harassment by making them more visible to state authorities.’¹²⁹ It is therefore essential for LMICs to identify the conditions under which formalisation of small businesses for purposes of taxation would be beneficial. These conditions will vary from context to context. For example, several studies of informal sectors in border areas of countries experiencing conflict show that in certain instances, the registration and attempted taxation of these businesses may disrupt a valuable source of sustenance and expose them to new forms of vulnerability.¹³⁰

Stifling Growth and Entrepreneurship

There is some evidence from previous studies that formalisation and taxation of informal businesses may stifle growth and entrepreneurship. McKenzie and Sakho conducted a study on the effects of formalisation and taxation on informal business; they concluded that while taxation may increase the profit margins of particular firms, it lowers the profit margins of very small firms and larger firms.¹³¹ Chen also argues for an economic paradigm shift, or what she terms as ‘economic diversity’ — an economy where the

¹²⁹ Joshi, Prichard and Heady (n 89) 1329.

¹³⁰ *ibid.*

¹³¹ David McKenzie and Yaye Seynabou Sakho, ‘Does It Pay Firms to Register for Taxes? The Impact of Formality on Firm Profitability’ (2010) 91 *Journal of Development Economics* 15, 15. The authors explain that the increase in profits resulted from ‘an increase in the customer base through the ability to issue tax receipts’.

informal and the formal operate together side by side.¹³² She views some level of informality as inevitable and good; while she does not go as far as stating that the informal businesses should not be taxed, she does advocate for a model that creates an equal and fair playing field for both the formal and informal to thrive side by side.¹³³ De Soto also argues that a thriving informal sector can only be achieved through deregulation and complete abolition of state intervention.¹³⁴

1.5.2. Arguments for Pursuing the Hard-to-Tax

Raising Revenue is a Legitimate Policy Goal

To begin with, the fundamental reason why a country should consider increasing enforcement among the HTT is to increase the revenue that it generates from this group; this is a legitimate and worthy policy goal. In the face of increasing budget deficits, rapid changes in development funding, and the pressure to achieve long-term financial sustainability without depending on foreign assistance, it is logical that LMICs should aim to increase the revenue collected from all sectors of the economy.¹³⁵ The HTT should not be an exception merely because they are difficult to reach.

While it is true that initial efforts to tax the HTT may not yield significant revenue, with consistency and flexibility, revenue collection from the HTT can improve over time. If existing legislation is sufficiently flexible to evolve in response to the tax authority's administrative challenges, the administrative effort can become more efficient and productive over time. In the case of the HTT, this process may take longer but, with

¹³² Martha Alter Chen, 'The Informal Economy: Definitions, Theories and Policies' [2012] WIEGO Working Paper No. 1 20.

¹³³ *ibid.*

¹³⁴ Soto (n 93) 237–252.

¹³⁵ Mascagni, Moore and McCluskey (n 13) 4.

consistency and constant evaluation of the effectiveness of legislation and administrative strategies, the HTT can bring in increasingly significant revenue.

Increasing the revenue collected from the HTT ought to be viewed as a long-term policy goal. When LMICs treat it as a short-term policy goal, they are more likely to abandon their efforts because of initial disappointing low collections. When overnight success is expected but not realised, LMICs are more likely to begin engaging in haphazard and poorly thought-out statutory amendments and, ultimately, premature repeal of legislation or abandonment of enforcement initiatives.

When viewed as a long-term policy goal, and when the indirect benefits of taxing the HTT are considered, revenue collection is more likely to increase over time.¹³⁶ Keen summarises it this way: in order to tax the HTT effectively, policymakers ought ‘to be aware that fundamental strengthening of revenue collection will be largely a matter of persistent and unspectacular effort’.¹³⁷

The Danger of Lumping Different Taxpayers Together

As discussed above, some researchers in this field have argued that taxing the informal sector has the effect of making the poor even poorer.¹³⁸ It is true that taxation of those in the informal sector, who are engaged in subsistence activities or whose income falls very close to the subsistence level, would lead to extreme levels of poverty among poor people already struggling to make ends meet. The HTT does not, however, comprise only of subsistence producers. In the introductory section of this Chapter, we saw that the HTT includes players in both the formal and informal economy, and the HTT may or may not be operating in cash-based industries. This diverse group of taxpayers includes farmers,

¹³⁶ Terkper (n 4) 213.

¹³⁷ Keen (n 7) 23.

¹³⁸ Cheeseman and Griffiths (n 39) 16.

professionals, and small and medium-sized businesses whose incomes may fall well above the subsistence threshold. Many of these taxpayers' incomes may fall well within the tax threshold, were they in formal employment. If their peers in formal employment are paying taxes on their income, there are insufficient economic or legal justifications for arguing that these taxpayers should not be taxed.

Keen argues that most under-payment of taxes among the HTT is carried out by professionals such as doctors, lawyers, architects, etc., yet classifying them as 'informal' may appear 'wrong'.¹³⁹ In fact, the literature acknowledges that, in many LMICs, 'informality' also occurs within firms in the formal sector.¹⁴⁰ For example, Terkper includes large and medium entities that do not comply with tax legislation, and in respect of which the revenue faces enforcement challenges, among the HTT.¹⁴¹

The self-employed are responsible for declaring their income and paying tax on income declared; they can, therefore, opt not to declare any income and evade taxes completely, or under declare their income and pay as little tax as possible. In jurisdictions where the revenue authority does not have sufficient capacity or resources to monitor the self-employed closely, it becomes tough to tax this group effectively. Being self-employed quickly becomes very attractive.¹⁴²

Therefore, while it is true that the HTT category of taxpayers does in part comprise of poor subsistence producers and traders, informality is not always an indication of poverty. In some instances, informality is a deliberate choice taken by traders or professionals. In some cases, it enables avoidance of over-regulation by the

¹³⁹ Keen (n 7) 16.

¹⁴⁰ Mascagni, Moore and McCluskey (n 13) 18.

¹⁴¹ Terkper (n 4) 212.

¹⁴² Musgrave (n 96) 297.

government; other times it is due to the government raising barriers (regulatory and financial) to formalisation.¹⁴³

According to the Voluntarist approach to informal economy, propagated by William Maloney, the self-employed (particularly male entrepreneurs) voluntarily enter the informal sector; they do so in order to earn a living while avoiding costs associated with formalisation, such as taxes and social protection contributions.¹⁴⁴ While acknowledging that those in the informal sector may indeed be poor, Maloney views the informal sector as ‘the unregulated, developing country analogue of the voluntary entrepreneurial small firm sector found in advanced countries, rather than a residual comprised of disadvantaged, workers rationed out of good jobs.’¹⁴⁵ While Maloney’s view might not be accurate of all HTT taxpayers, it is undoubtedly true of some of them, such as most professionals.

Lumping different taxpayers together and applying a single tax policy to them impedes the efforts to tax them effectively. Martha Chen discusses the conceptual framework of informality postulated by Kanbur and demonstrates how this ‘lumping’ can defeat legitimate policy goals.¹⁴⁶ Kanbur demonstrates his point using a hypothetical scenario where the world economy operates without regulation, and regulation is then introduced: the players in the economy then have to choose between four different responses to the new regulations:¹⁴⁷

- i. Player A: This player will choose to remain within the scope of the new rules and play according to the rules;

¹⁴³ Woodruff (n 14) 2.

¹⁴⁴ William F Maloney, ‘Informality Revisited’ (2004) 32 *World Development* 1159, 1160.

¹⁴⁵ *ibid* 1159.

¹⁴⁶ Chen (n 132) 10–11.

¹⁴⁷ Kanbur (n 106) 5.

- ii. Player B: This player will choose to remain within the scope of the new rules but not play according to the rules (this has an element of illegality);
- iii. Player C: This player will modify their activity in order to fall outside the scope of the new rules and in that way avoid complying with them;
- iv. Player D: This player already falls outside the scope of the new rules and so does not need to comply with them.

Kanbur argues that if we had to apply the labels ‘formal’ and ‘informal’ to these four players, we would most likely describe player A as playing in the formal sector and describe the other three players as playing within the informal sector.¹⁴⁸ That is where the problem begins; players B, C and D are very different. B is informal but also illegal; C is informal and legal but has deliberately structured themselves in a certain way in order to be informal; D was out of the scope of the new rules, to begin with, so the regulations do not affect them at all.

It begins to become clear that using a single term like ‘informal sector’ obscures these subtle differences and does not allow room for policymakers to deal with each case on its merits. Chen puts it this way:

...using a single label, “informal,” for B, C, and D obscures more than it reveals—as these are distinct categories with specific economic features in relation to the regulation under consideration. While...it is useful to have aggregate broad numbers on the size and general characteristics of the informal economy...disaggregation provides for better policy analysis.¹⁴⁹

In summary, it is necessary to underscore two points. One is that the term ‘informality’ is confusing and loaded; once it is unpacked, a strong argument for using a clearer term

¹⁴⁸ *ibid* 6.

¹⁴⁹ Chen (n 132) 11.

is inevitable. This is why Keen argues that the term HTT, used in this thesis, 'is much closer to the mark'.¹⁵⁰

The second point is that while scholars like Cheeseman and Griffiths make an essential point regarding poverty and taxation of the informal economy, the term informal economy has acquired baggage over time and become quite loaded; the term may well include taxpayers who cannot be accurately classified as 'poor'. Once disaggregation takes place, it becomes difficult to justify the failure to tax the HTT on the grounds of poverty. It is difficult to justify a sector's privileged position in tax legislation merely because the revenue authority finds it challenging to tax that sector. The failure to make a genuine effort to tax the HTT then raises equality issues which are discussed below.

Ensuring Equality

One of the canons of taxation postulated by Adam Smith is equality. Equality connotes notions of 'fairness', i.e., that the tax burden must be distributed as equally as possible among citizens. In the context of this thesis, this principle is used to argue that it is inequitable to collect taxes from those who are 'easier' to tax such formal employees or larger corporations, while categorising other taxpayers- potentially earning comparable incomes- as hard to tax and pursuing the latter group less aggressively or leaving them out of the tax net altogether.¹⁵¹

Although it may be impossible to achieve comparable levels of compliance in all sectors of the economy, asking whether or not the HTT should be taxed is not the correct question. Ignoring the HTT, or leaving them out of the tax net altogether, introduces

¹⁵⁰ Keen (n 7) 16.

¹⁵¹ Roy Bahl, 'Reaching the Hard to Tax: Consequences and Possibilities' in James Robert Alm, Jorge Martinez-Vazquez and Sally Wallace (eds), *Taxing the Hard-to-Tax: Lessons from Theory and Practice*, vol 268 (Emerald Group Publishing Limited 2005) 343.

unfairness into the tax regime by benefiting some occupations or business forms over others because of the ease with which one can evade tax.

Rather than ask *if* the HTT should be taxed, the better question to ask is *how* they can be taxed efficiently and effectively. The failure to address the inequity in treatment between the HTT and other taxpayers can have severe implications for the overall tax system.¹⁵² Bird and Wallace describe the undue reliance on the ‘easier to tax’ taxpayers as a dangerous long-term strategy and use an analogy of milking cows already in the barn; as the pressure on them increases, the cows are likely to kick down the doors of the barn and escape.¹⁵³ The difference in treatment between the HTT and other taxpayers may encourage existing taxpayers to migrate to those occupations or business forms benefiting from the unfairness, thereby exacerbating the challenge posed by the HTT. Alternatively, corporations under pressure from tax authorities may resort to aggressive tax avoidance schemes or other strategies that allow them to evade taxes. Thus, it is necessary to have a compliance strategy for small and medium-sized HTT taxpayers as well, to maintain equity and overall integrity of the tax system.¹⁵⁴

The limited revenue potential of the HTT is often presented as a justification for the little focus paid to these taxpayers. However, while it is true that increasing revenue collection from the HTT is not a realistic short-term goal, the indirect benefits of making an effort to ensure their compliance are well worth the effort and investment.¹⁵⁵ Moreover, as the efforts become more efficient, the amount of revenue collected may improve in the long-term. Some of the potential indirect benefits are discussed below, i.e., boosting the tax

¹⁵² Terkper (n 4) 214; Bahl (n 151) 343.

¹⁵³ Bird and Wallace (n 99) 130.

¹⁵⁴ Musgrave (n 96) 299.

¹⁵⁵ Terkper (n 4) 213.

morale of other taxpayers, creating a culture of tax compliance in the nation, encouraging citizens to advocate for better governance, and encouraging formalisation of informal firms.

Improving Tax Morale

When citizens perceive the tax regime as treating all taxpayers fairly and equally, they are more likely to pay their taxes willingly. However, when a group of taxpayers perceive the system as dealing leniently with particular groups, they may begin to feel disgruntled and devise ways to either fall within that favoured group or find another way to evade or avoid the taxes that they are supposed to be paying. For example, a taxpayer in employment may know others in self-employment who are operating as ghosts or as icebergs. If those others appear unlikely to be detected, pursued, and penalised by the revenue authority, the taxpayer may be tempted to quit employment and pursue self-employment or retain their job but seek additional income from self-employment. Reciprocity plays a vital role in the decision to evade, i.e., ‘tax evasion seems to be more morally justified (objectionable) the more others evade taxes as well (comply)’.¹⁵⁶

In a paper on why people pay their taxes even when the risk of being detected for evasion is low, the authors use data drawn from less developed countries in Eastern Europe and more developed countries in Western Europe and find the same result: the behaviour of other taxpayers influences taxpayers tax morale.¹⁵⁷ The authors conclude that ‘if taxpayers believe tax evasion to be common, tax morale decreases. Alternatively,

¹⁵⁶ Gebhard Kirchgässner, ‘Tax Morale, Tax Evasion, and the Shadow Economy’ [2010] University of St. Gallen Department of Economics Working Paper Series No. 2010-17 11 <<https://ideas.repec.org/p/usg/dp2010/2010-17.html>> accessed 17 October 2018.

¹⁵⁷ Bruno S Frey and Benno Torgler, ‘Tax Morale and Conditional Cooperation’ (2007) 35 *Journal of Comparative Economics* 136.

if they believe others to be honest, tax morale increases. ... The size of the effect is substantial, and the results remain robust.¹⁵⁸

Thus, making a genuine attempt to tax the HTT is essential for the credibility of the tax system. An increase in the number of taxpayers complying with their tax obligations boosts tax morale among other taxpayers in the economy; if the other taxpayers feel that they are carrying a disproportionate amount of the tax burden, it crushes existing tax morale and encourages them to look for ways to escape their tax obligations.

Inculcating a Tax Compliance Culture

Another indirect benefit of taxing the informal sector is the importance of bringing in small businesses into the tax net, thus inculcating a compliance culture and ensuring improved tax compliance if they grow over time.¹⁵⁹ Inculcating a culture of tax compliance ought to be a top priority for all revenue authorities, but particularly those in LMICs.¹⁶⁰

In some LMICs such as the relatively young post-colonial nations in Africa, the formalised culture of paying income tax to a central government is not as entrenched as it is in higher-income jurisdictions where income tax came into existence much earlier.¹⁶¹ In the United Kingdom, for example, income tax was introduced in 1799 by William Pitt the Younger, to cover the cost of the Napoleonic Wars.¹⁶² The culture of paying income tax has, therefore, had time to evolve and become entrenched in the minds and lives of

¹⁵⁸ *ibid* 153–156.

¹⁵⁹ Joshi, Prichard and Heady (n 89) 1329.

¹⁶⁰ Carnahan (n 12) 176.

¹⁶¹ Timothy Besley and Torsten Persson, ‘Why Do Developing Countries Tax So Little?’ (2014) 28 *Journal of Economic Perspectives* 99, 116.

¹⁶² <http://www.parliament.uk/about/living-heritage/transformingsociety/private-lives/taxation/overview/incometax/>

the people over several centuries. Factors such as corruption, weak national identity, ethnic fragmentation, and a weak social norm of securing social reputation by complying with tax laws have perhaps contributed to the weak tax compliance culture in many LMICs.¹⁶³

When small firms become accustomed to keeping poor financial records and operating as ghosts or icebergs, it becomes difficult to reverse this way of working when the firms grow. Poor tax compliance habits will spill over into their new status and merely become more sophisticated. It is therefore crucial that tax authorities begin working closely with informal firms, right from the start, and prod them towards increasing compliance as they formalise and grow.

Encouraging Firm Growth

As discussed under section 1.4.1 above, some researchers in this field have taken the view that taxation may stifle growth and entrepreneurship among some firms. For example, in a study on formalisation in Sri Lanka, de Mel et al. concluded that, based on the results of their research, firms ‘...don't appear to get the more touted benefits of formalising, such as increased access to credit, obtaining government contracts, or participating in government programs’.¹⁶⁴

However, there is also a significant and growing amount of research suggesting that taxation may actually encourage firm growth by enabling those firms to access credit facilities, enjoy state protection, and benefit from government contracts.¹⁶⁵ The growth

¹⁶³ Besley and Persson (n 161) 116–117.

¹⁶⁴ Suresh De Mel, David McKenzie and Christopher Woodruff, ‘The Demand for, and Consequences of, Formalization among Informal Firms in Sri Lanka’ (2013) 5 *American Economic Journal: Applied Economics* 122, 148. It is important to point out that they noted the fact that the firms that formalised did realise some modest increases in their profits, potentially as a result of the fact that they began to advertise and issue their customers with receipt books thus growing their customer base.

¹⁶⁵ Joshi, Prichard and Heady (n 89) 1329.

levels among these firms is admittedly not heterogeneous, as some firms enjoy higher levels of growth, others enjoy only modest levels of growth, and the rest register no growth. Joshi et al¹⁶⁶ discuss various studies including: a study in Mexico which showed that formalisation through various means, including taxation, positively affected the profits of the firms in the study and allowed them to reach their optimal size¹⁶⁷; a study on SMEs in Vietnam showed that formalisation positively impacts profits and investment¹⁶⁸; and a study on micro firms in Bolivia indicated that registration for tax purposes increases the profits of medium-sized businesses¹⁶⁹. The Mexican study by Fajnzylber et al. investigated whether there was a difference in benefits to firms that began to pay taxes to access the benefits of formalisation and benefits to firms that began to pay because they were caught out by the revenue authority; they found that ‘paying taxes resulted in a benefit for all firms, leading to at least a 20 per cent increase in profits, regardless of whether they were caught or willingly compliant.’¹⁷⁰

The general position in the literature now seems to be that formalisation has the potential to produce broader economic gains, but it is unclear ‘whether the smallest micro firms are likely to be beneficiaries’.¹⁷¹ Also, Joshi et al. correctly note the power relations between the state and the citizen also play a significant role in determining whether entering the tax net benefits businesses or not.¹⁷²

The position taken in this thesis is that the failure to make a serious effort to tax HTT taxpayers can deprive them of the opportunity to formalise and grow, thereby

¹⁶⁶ . *ibid* 1330.

¹⁶⁷ Pablo Fajnzylber, William F Maloney and Gabriel V Montes-Rojas, ‘Releasing Constraints to Growth or Pushing on a String? Policies and Performance of Mexican Micro-Firms’ (2009) 45 *The Journal of Development Studies* 1027.

¹⁶⁸ John Rand and Nina Torm, ‘The Benefits of Formalization: Evidence from Vietnamese Manufacturing SMEs’ (2012) 40 *World Development* 983.

¹⁶⁹ McKenzie and Seynabou Sakho (n 131).

¹⁷⁰ Joshi, Prichard and Heady (n 89) 1330.

¹⁷¹ *ibid*.

¹⁷² *ibid*.

holding them back from the potential benefits of such growth. However, corruption poses a significant challenge in many LMICs and if the law does not protect small and vulnerable informal firms that are beginning to formalise, their growth would indeed be stifled by such practices.

Implications for Governance and Democracy

Politics, civic engagement, and taxation are closely linked. As a result, the link between the collection of taxes and agitation for better governance manifests in the history of various countries. For example, the development of Parliament in the United Kingdom is significantly linked to the monarchy's need to raise taxes in order to fund various wars.¹⁷³ The right to levy taxes also significantly contributed to the fight for independence and self-governance in the United States of America where the colonies were completely against 'taxation without representation'.¹⁷⁴

The relationship between the paying of taxes on one hand, and governance and democracy on the other, has been extensively discussed in previous scholarly research including: research into the efforts by Ghana's government to tax informal sector firms, efforts that increased the bargaining space between their associations and the government¹⁷⁵; research into presumptive taxation of small firms in Ethiopia that triggered greater public engagement and prompted the government to engage the business community in the implementation of the tax¹⁷⁶; and research into formalisation in Sri

¹⁷³ For a detailed discussion of the history of politics and taxes in the United Kingdom, see MJ Daunton, *Trusting Leviathan: The Politics of Taxation in Britain, 1799-1914* (Cambridge University Press 2001) and MJ Daunton, *Just Taxes: The Politics of Taxation in Britain, 1914-1979* (Cambridge University Press 2002).

¹⁷⁴ See 'A Timeline of the American Revolution from 1763 - 1787' (*The British Library*) <<http://www.bl.uk/the-american-revolution/articles/american-revolution-timeline>> accessed 17 October 2018.

¹⁷⁵ Anuradha Joshi and Joseph Ayee, 'Associational Taxation: A Pathway into the Informal Sector?' in Deborah Brautigam, Odd-helge Fjeldstad and Mick Moore (eds), *Taxation and State-Building in Developing Countries* (Cambridge University Press 2008).

¹⁷⁶ Wilson Prichard, *Taxation, Responsiveness and Accountability in Sub-Saharan Africa: The Dynamics of Tax Bargaining* (Cambridge University Press 2015) 160.

Lanka where de Mel et al. found that firms that began to pay taxes began to trust the state more even if the formalisation and subsequent taxation did not lead to increased profit levels¹⁷⁷. Fjeldstad et al. also discuss the link between governance and taxation in a publication on the views of Africans on taxation.¹⁷⁸ A study conducted into local government responsiveness in sub-Saharan Africa found that citizens who paid their taxes were not more likely to demand better governance and leadership.¹⁷⁹ That aspect of the findings of the study has however been criticised for focusing on local government responsiveness and overlooking the possibility that the link between taxation and responsiveness at the national government may be much stronger.¹⁸⁰

The broad themes emerging from those studies can thus be summarised: the state's responsiveness and accountability to taxpayers may encourage quasi-voluntary compliance; taxpayers are more likely to demand state accountability and responsiveness; the state's effort to tax the informal sector 'could catalyse collective action and political engagement' by their associations thus enhancing the dialogue and bargaining space between the two sides.¹⁸¹

The potential benefits of taxation for improved governance and democracy in LMICs is, therefore, another important reason why the HTT should not be ignored. The HTT make up a sizeable section of the economy of these countries, and they can be a powerful vehicle for change by agitating for greater government responsiveness and

¹⁷⁷ De Mel, Mckenzie and Woodruff (n 164).

¹⁷⁸ Odd-Helge Fjeldstad, Collette Schulz-Herzenberg and Ingrid Hoem Sjursen, 'Peoples' Views of Taxation in Africa: A Review of Research of Determinants of Tax Compliance' (2012) CMI Working Paper 2012:7 <<https://opendocs.ids.ac.uk/opendocs/handle/123456789/2306>> accessed 6 August 2018.

¹⁷⁹ Michael Bratton, 'Citizen Perceptions of Local Government Responsiveness in Sub-Saharan Africa' (2012) 40 World Development 516, 525.

¹⁸⁰ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 31.

¹⁸¹ Joshi, Prichard and Heady (n 89) 1331.

accountability, efficiency in public spending and service delivery, competency in state institutions, and more effective Parliamentary oversight.¹⁸²

1.5.3. Conclusion

From the discussion above, it is clear that there are some sensible or pragmatic reasons on both sides of the argument. The hesitation by many LMICs to make a serious attempt to pursue the HTT is understandable; it can be a complex, expensive, and risky exercise with no guarantee of significant revenue. The argument in this thesis is, however, that a blanket decision regarding the full spectrum of taxpayers falling under the HTT is unwise and unjustifiable. Taxpayers are heterogeneous and even within the HTT label, there is significant heterogeneity. Well-thought-out tax policy requires consideration of such heterogeneity rather than painting all HTT taxpayers with a broad stroke. For example, while it may be prudent for a cash-strapped tax authority to ignore the smallest HTT taxpayers in its tax compliance strategy, and in some instances, it may be politically and economically expedient to grant farmers a tax holiday, there is no reason why professionals should not be subject to a comprehensive compliance strategy.

Weighing the arguments against and in favour of a genuine effort to tax the HTT, the position taken in this research is that LMICs should make a real attempt to tax these taxpayers effectively. In fact, heavily focusing on ‘easier’ to tax taxpayers like corporations and employees, while ignoring the HTT, amounts to ‘implicitly allowing greater departures from the law’ by the HTT, thereby altering the way tax statutes work.¹⁸³ Lederman and Sichelman rightly argue that ‘changes in agency-level

¹⁸² OECD (ed), *Tax and Development: Aid Modalities for Strengthening Tax Systems* (OECD Publishing 2013) 26–27.

¹⁸³ Leandra Lederman and Ted Sichelman, ‘Enforcement as Substance in Tax Compliance’ (2013) 70 *Washington and Lee Law Review* 1679, 1687.

enforcement (not rulemaking) can lead to de facto changes in the law that have the same effect as customization at the substantive lawmaking level.’¹⁸⁴

With effort, it is possible to design a compliance strategy for the HTT that both exempts the poorest and most vulnerable HTT taxpayers and takes into consideration the financial and technical limitations of tax authorities in LMICs. This thesis intends to propose some compliance strategies that fit these criteria, aimed explicitly at hard-to-tax professionals.

1.6. CONCLUSION

The primary objective of this chapter has been to introduce the reader to the research topic and lay the foundation for the rest of the thesis. The introductory section set out the (i) context of the research, (ii) current gaps in knowledge, (iii) contribution that this thesis will make to existing knowledge, (iv) significance or importance of this project, (v) the research questions and methodology, and (vi) the layout of the thesis.

The primary concern of this thesis is the tax compliance challenges that the HTT, and in particular self-employed professionals, pose for tax authorities in LMICs. The central question that this thesis will address is: what are the barriers to tax compliance by *hard-to-tax* professionals in LMICs and how can revenue authorities in those countries effectively improve compliance among these taxpayers? Thus, the remainder of this chapter has been dedicated to setting out the boundaries of this research by identifying and describing the HTT, in relation to other sectors of the economy, as well as addressing the thorny question regarding whether or not LMICs should make a real effort to tax the HTT. The three main questions that have been tackled in this chapter are: (i) who are the HTT? (ii) how do they differ from other taxpayers in the economy? (ii) should LMICs

¹⁸⁴ *ibid.*

make a real effort, considering their resource constraints, to tax the HTT? These questions have been tackled through an extensive literature review.

While there is a significant amount of research on informal sector taxation, analysing and comparing these studies is challenging because of the terminology confusion in this field. Since there are no universally accepted definitions for terms such as *informal sector*, *underground economy*, *shadow economy*, *black economy*, and *hard-to-tax*, authors in the field have tended to use the terms interchangeably and in different and sometimes vague ways. The terminological confusion has resulted in scientific and political controversies.¹⁸⁵

This terminological confusion has made it quite difficult to compare existing literature and understand where a particular piece fits in within the larger picture. For example, certain taxpayers within the HTT category also fall within what is sometimes termed as the informal sector. The consequence is that in certain sections of the paper, it has been impossible to avoid using the term *informal sector* because that is the term that is used in the relevant literature; however, there are taxpayers in the formal economy who also fall under the category of the HTT. Professionals, for example, fall under the HTT category but may or may not be in the informal sector. Further, professionals like doctors and dentists may take up a second job such as locum work and fail to declare that income for tax purposes; thus, although they would not ordinarily be considered as engaging in illicit work, this would bring them under the ‘irregular sector’ of the shadow economy (see Figure 2).

Using these labels can lead to confusion and prevent deep and flexible thinking about policy and administrative interventions that respond appropriately to the challenges

¹⁸⁵ Schneider and Enste (n 77) 6.

that HTT taxpayers pose. The goal of this thesis is to go beyond the broad labels of 'formal' and 'informal' and interrogate why professionals are hard to tax and what we can do about it.

This chapter concludes with an analysis of the arguments in favour of and against a genuine effort by LMICs to tax the HTT. As discussed above, there are various sound arguments on both sides of the debate. The author concludes by supporting the arguments in favour of a genuine effort to tax the HTT.

The author acknowledges that making a genuine effort to tax the HTT can be expensive, complicated, and unpopular with under-resourced tax authorities that are unsure of how much they can collect from these taxpayers. It may even be risky in countries struggling with corruption since it may expose small and vulnerable informal businesses to harassment by unscrupulous tax officials. Pursuing the HTT may also present political challenges for politicians who take the view that attempting to tax this segment of the economy could threaten their electoral base. The author also accepts that taxing subsistence producers is not only economically unsound but also inequitable.

Despite these arguments, more and more LMICs are turning their attention to the HTT and special tax regimes targeting the informal sector. It is therefore no longer a question of 'if' but a question of 'how'; how can they tax these businesses more effectively than they currently are?

It is also important to remember that although there is some terminological confusion in this field, with some authors viewing all informal sector players as 'poor', 'street hawkers' or lowly paid informal workers, the boundaries of this study have been carefully chosen and defined. The term HTT has been shown to be more helpful as it includes both formal and informal sector participants, such as professionals, who

although not traditionally viewed as ‘informal’, present significant challenges for revenue authorities. Therefore, while it is acknowledged that some groups must be left out of the tax net for equity, economic, and efficiency reasons, it has also been shown that lumping different taxpayers together and labelling them as ‘informal’ does not help to take the discussion forward. The term HTT encompasses a broader range of difficult to tax groups, and even that term needs unpacking; the taxpayers comprising the HTT group have different characteristics, are difficult to tax for different reasons, and may require different interventions.

Once the term informal sector is unpacked, and it becomes clear that informality is not always a result of poverty and may be a choice or the norm in a particular sector, equity in taxation arguments begin to emerge. It is inequitable for certain groups in the economy, such as those subject to PAYE or corporate tax, to carry the most significant portion of the tax burden while others, occupying the most substantial portion of the economy of LMICs, evade tax because the revenue authority has taken the position that they are too hard to tax. In addition to introducing unfairness into the tax system, it also causes significant damage to the tax morale of other taxpayers and may encourage them to either move out into more informal work or take on additional work for which they earn undeclared income.

There is more to taxation than revenue; the indirect benefits of taxing the informal sector (and it is argued that these indirect benefits extend to the taxation of the HTT in general), also provide compelling reasons for taxing the sector. Perhaps one of the essential indirect benefits is that it has the potential to increase the citizenry's level of engagement in governance matters. It would seem to be a wise choice to promote any effort that would serve to enhance the dialogue and bargaining space between citizens and the state.

The next two chapters are dedicated to discussions on the different approaches that tax authorities can take when dealing with the HTT, and theories that have been advanced to explain why people pay or evade their taxes. These two chapters will lay the foundation for the case study in Chapter 4, an empirical study showing the trends in attitudes towards tax compliance among professionals in Kenya. This empirical approach is intended to enrich the theoretical discussions on tax evasion by professionals in LMICs and provide a map that can guide the development of compliance strategies for tax authorities in LMICs dealing with tax evasion by professionals.

2. TAXING THE HARD-TO-TAX: WHAT ARE THE OPTIONS?

2.1. INTRODUCTION

The goal of the previous chapter was to contextualise the research by identifying the gaps in knowledge, the contribution that this thesis makes to existing literature, the significance of the research, the research questions and methodology, and the layout of the thesis. The chapter then delved into a detailed discussion on the description and characteristics of the HTT and an evaluation of the arguments for and against making a serious attempt to tax the HTT.

Having concluded, at the end of Chapter 1, that LMICs should make a genuine effort to tax the HTT, we now turn our attention to the various administrative options that tax authorities have at their disposal when dealing with these taxpayers. The options that will be discussed in this chapter are: (i) exempting the HTT from taxation altogether, (ii) strengthening enforcement to improve compliance (iii) increased reliance on voluntary compliance where enforcement is a challenge (iv) increased reliance on indirect taxation where direct taxation is a challenge, and (v) the use of simplified regimes (presumptive taxation).

2.2. EXEMPTING THE HTT FROM TAXATION

One option for tax authorities in LMICs is to limit the administrative effort spent on the HTT by exempting them from taxation; this may be done as a matter of law through statutory provision, or as a matter of fact by choosing not to make a genuine effort to ensure that these taxpayers are complying with their tax obligations.

There are various reasons why a tax authority may want to exempt the HTT, some of which have already been discussed in the previous chapter.¹⁸⁶ First, as a result of the large number of HTT taxpayers in LMICs, tax authorities in those countries face high

¹⁸⁶ See Section 1.4.2 in Chapter 1.

administrative costs in ensuring their compliance; yet the amount of revenue that they can collect from the HTT is far from certain. Since these tax authorities also have to contend with limited financial and technical resources, a cost-benefit analysis will usually lead to a decision to ignore or exempt most of the HTT from the administrative effort.¹⁸⁷

A second related reason is the failure by the HTT to keep proper financial records, either by choice or inability to do so; even when these taxpayers do keep financial records, it is difficult to ascertain their veracity. These obstacles make it difficult for an already under-resourced tax authority to audit the HTT and determine the accuracy of their financial records (where they exist).¹⁸⁸

A third reason why LMICs may ignore or exempt the HTT is the inclusion of the poor within the HTT sector.¹⁸⁹ It is politically difficult, as well as morally unjustifiable, to subject the poor to taxation. Besides, the amount of revenue collected from the poor would not economically justify the administrative effort required to ensure their compliance. However, as argued in Chapter 1, the terms informal sector, shadow economy, and HTT have been conflated, and the lines between them blurred; it is often assumed that all HTT taxpayers are poor and ought to be exempt from taxation or largely overlooked in the tax authority's compliance strategy. However, the HTT includes taxpayers whose 'income falls well within the middle or even upper ranges of the taxable income scale' like professionals and many SMEs.¹⁹⁰

Finally, Bird and Wallace also explain that the HTT status can be 'legitimised' through tax holidays and exemptions enshrined in the law for 'at least moderately good

¹⁸⁷ Musgrave (n 96) 299; Bahl (n 151) 342–343; Bird and Wallace (n 99) 125.

¹⁸⁸ Musgrave (n 96) 299; Alm, Martinez-Vazquez and Schneider (n 2) 13.

¹⁸⁹ See Section 1.4.2 in Chapter 1.

¹⁹⁰ Musgrave (n 96) 308.

reasons'.¹⁹¹ The agricultural sector, for example, is protected from taxation in various countries for political and food security reasons.¹⁹²

Should Tax Authorities Exempt Self-employed Professionals from Taxation?

Most tax policy and administration experts would categorically state that tax authorities in LMICs should not exempt self-employed professionals from taxation. Indeed, it is difficult to come up with a justification for doing so. However, the reality is that the failure by most LMICs to make a genuine effort to pursue the HTT results in significant tax evasion by self-employed professionals. Thus, while these professionals are not exempt from taxation in law, they are *de facto* exempt, or at least not paying their statutory share of tax, as a consequence of being ignored by tax authorities. There is no justification for the fact that these self-employed professionals carry a lower tax burden than those in employment, despite earning comparable or even higher incomes. To ensure fairness and equity in the tax system, and for the potential revenue gains, tax authorities in LMICs should make a concerted effort to tax the HTT and exempt or ignore only the genuinely poor.

2.3. STRENGTHENING ENFORCEMENT

The second option available for tax authorities interested in pursuing the HTT is the strengthening of enforcement in order to sharpen the tax compliance culture.¹⁹³ Enforcement is one of the administrative responsibilities of a tax authority, and it refers to the actions that ensure tax law and rules are appropriately adhered to. It has been argued that 'an unenforced law is tantamount to no law at all'.¹⁹⁴ The failure to enforce tax law among a group of taxpayers like the HTT renders the law meaningless and hurts the tax

¹⁹¹ Bird and Wallace (n 99) 129.

¹⁹² *ibid.* For example, the agricultural sector in India is constitutionally protected from taxation.

¹⁹³ Carnahan (n 12) 176–177.

¹⁹⁴ Lederman and Sichelman (n 183) 1681.

morale of other taxpayers. The evidence from previous empirical research generally suggests that enforcement encourages compliance, perhaps ‘because enforcement signals not that many taxpayers are evading taxes but that few taxpayers successfully evade’.¹⁹⁵ However, most tax authorities do not have sufficient resources for enforcement; tax authorities in LMICs are even more resource constrained, meaning that enforcement is often partial or completely absent.

Tax authorities have various enforcement tools at their disposal. One way to ensure that the law is being adhered to is to work towards eliminating ‘ghosts’ by identifying and registering all potential taxpayers. The HTT sector is made up of many ghosts who avoid their legal obligations under tax law by hiding in the shadows; finding and registering these taxpayers is an essential first step in creating a paper trail that will facilitate enforcement of tax law.¹⁹⁶

Finding and registering the HTT is an expensive exercise for many LMICs where data is not readily available and curated; tax authority officers may need to go physically from street to street to identify small business owners.¹⁹⁷ In the case of self-employed professionals, tax authorities can significantly benefit from taking advantage of various sources of data including professional associations and regulators as well as public entities to which these professionals provide their services.¹⁹⁸ This measure is discussed in greater detail in Chapter 6 of this thesis.

¹⁹⁵ Leandra Lederman, ‘Does Enforcement Reduce Voluntary Tax Compliance?’ [2018] Brigham Young University Law Review, Forthcoming; Indiana Legal Studies Research Paper No. 395 53 <<https://papers.ssrn.com/abstract=3222803>> accessed 24 October 2018.

¹⁹⁶ Bird and Wallace (n 99) 130.

¹⁹⁷ Bahl (n 151) 349.

¹⁹⁸ Bird and Wallace (n 99) 130.

Another way to ensure that tax law is adhered to is by increasing the risk of detection through increased audit rates.¹⁹⁹ Audits may be random or targeted.

*Targeted audits are based on the perceived risks of non-compliance. Random audits are unconditionally random from the population and are used to ensure that all self-assessment taxpayers face a positive probability of being audited, as well as to collect statistical information about the scale of non-compliance and predictors of non-compliance that can be used to implement targeting.*²⁰⁰

When taxpayers know that there is a relatively high probability of getting audited and caught, they are less likely to choose to evade.²⁰¹ However, ensuring a relatively high probability of audit and detection is a challenge for tax authorities in LMICs; they would require considerable financial resources and a large pool of skilled auditors, both of which are likely to be in short supply. While a country like Israel audits about 50% of the tax returns filed by the self-employed, most tax authorities in LMICs will use the few auditors they do have to audit large corporations from whom they can collect much more revenue than the HTT.²⁰² While there are no statistics on the exact outlay required for audits in LMICs, audits are costly; the average estimated cost of audits in the U.K. is £2,500 per audit.²⁰³ This is a significant amount for most LMICs; even in the U.K., one-third of the taxpayers selected for audit ‘end up not being audited, largely due to resource constraints’.²⁰⁴ Terkper explains that while the cost of auditing a small or medium-sized taxpayer may not be high, the total amount required for auditing a satisfactory number of these taxpayers could be significant.²⁰⁵

¹⁹⁹ Bahl (n 151); *ibid* 349; Lederman (n 195) 25.

²⁰⁰ Advani, Elming and Shaw (n 11) 9.

²⁰¹ Lederman (n 195) 30. See also the discussion on economic deterrence in Chapter 3.

²⁰² Bahl (n 151) 349.

²⁰³ Arun Advani, ‘Who Does and Doesn’t Pay Taxes?’ (*Institute for Fiscal Studies Briefing Note*, 26 October 2017) <<https://www.ifs.org.uk/publications/10003>> accessed 25 October 2018.

²⁰⁴ Advani, Elming and Shaw (n 11) 9.

²⁰⁵ Terkper (n 4) 221.

Audits also take up a significant amount of time; in the U.K., ‘the average time between when a return is filed and when the audit is concluded is 14.3 months but... for 10 per cent it is almost two years or more’.²⁰⁶ The actual audits take an average of 5.3 months with about 10% of audits running for 13 months or more.²⁰⁷ Audits also require significant human resource; one study estimates that audits take up 30% of a tax authority’s professional and administrative staff.²⁰⁸

While the threat of audit may successfully deter evasion in the short term, LMICs would have to follow through and actually carry out audits in order to have an impact on compliance attitudes. Many LMICs will not have a sufficient number of skilled auditors required to carry out an effective number of audits, given the cost, time, and manpower that audits take. Further, in countries with a corruption problem, unscrupulous auditors may take the opportunity to extort or collaborate with tax evaders by turning a blind eye to evasion in exchange for a bribe.

A third way in which tax authorities can enforce the law is by levying fines, penalties, and even prison terms, when an audit reveals noncompliance. However, ‘the existence of a penalty for noncompliance deters tax evasion but only in light of the probability that a penalty will actually be imposed’.²⁰⁹ The probability that a penalty will actually be imposed is tied to the probability of an audit. If fines and penalties are high but the probability of audit and detection is low, then the penalty is not likely to sufficiently deter a would-be evader. In fact, existing literature shows that the threat of an audit is much more effective in deterring evasion than the threat of a penalty.²¹⁰

²⁰⁶ Advani, Elming and Shaw (n 11) 11.

²⁰⁷ *ibid.*

²⁰⁸ Margaret McKerchar and Chris Evans, ‘Sustaining Growth in Developing Economies through Improved Taxpayer Compliance: Challenges for Policy Makers and Revenue Authorities’ (2009) 7 *eJournal of Tax Research* 171, 195.

²⁰⁹ Lederman (n 195) 15.

²¹⁰ *ibid.* 34.

Penalties are therefore not likely to be very effective in LMICs unless LMICs can improve their audit rates.

There are several matters to bear in mind when considering stricter enforcement among the HTT. Poor tax literacy among the HTT makes it difficult to enforce the law on these taxpayers. As we saw in Chapter 1, the HTT are challenging to tax partially because they do not keep proper books of accounts, making it difficult to audit them. An essential step, following the registration of taxpayers, would therefore seem to be to educate them on their tax and financial record keeping responsibilities and provide the support that they need to keep proper records.²¹¹ Taxpayer education and support must precede enforcement.

Also, many small taxpayers will fail to keep proper records and evade because they are unable to absorb the high costs of compliance in the same way that larger taxpayers can. It is, therefore, necessary to take steps to simplify the tax compliance requirements for these taxpayers.²¹² Although at first glance it may appear that professionals do not fall within this category, we will see in Chapter 4 that certain self-employed professionals, particularly those who are at a very early stage of their career and are mainly receiving cash payments, do need support in record keeping and compliance simplification. In Chapter 5 and 6, we will explore whether simplified tax regimes would be appropriate for a limited number of self-employed professionals.²¹³

Increasing Enforcement among Self-employed Professionals

Enforcement is an essential function of tax authorities, and improving enforcement is an essential tool for improving compliance among self-employed professionals. Bird and

²¹¹ Carnahan (n 12) 177.

²¹² *ibid.*

²¹³ See Section 2.6 below for an introduction to simplified tax regimes.

Wallace argue that the failure to administer taxes on self-employed professionals is purely a result of failure to enforce the law.²¹⁴

However, as explained above, improving enforcement is a challenge for many tax authorities in LMICs, who have to contend with insufficient financial resources, a large number of small HTT taxpayers, taxpayers with poor or non-existent financial records, and an insufficient number of skilled auditors. In some cases, these professionals may also be connected to and enjoy protection from highly influential politicians.

Taube and Tades explain that:

*Small-scale businesses dealing with cash transactions are notoriously difficult to tax, and not just in Africa. Among professionals, including doctors, lawyers, building contractors, and consultants, the scope for underreporting of incomes is often considerable, even though they may be some of the highest income recipients in a country.*²¹⁵

We cannot run away from the reality of the prohibitive cost of ensuring a sufficiently high audit and detection rate in respect of self-employed professionals; resources for enforcement are limited in all countries, including high-income countries.²¹⁶ Further, we should not merely prescribe increased enforcement as an antidote for tax evasion by self-employed professionals in LMICs while ignoring these genuine barriers to enforcement. More research is therefore required into simple and cost-effective ways of enforcing tax law in LMICs, particularly among self-employed professionals in the cash economy; some proposals to that end are presented in Chapter 6.

²¹⁴ Bird and Wallace (n 99) 130.

²¹⁵ Tadesse and Taube (n 7) 4.

²¹⁶ Lederman (n 195) 3.

2.4. INCREASED RELIANCE ON VOLUNTARY COMPLIANCE

Tax authorities that are unable to overcome the barriers to effective enforcement may choose, instead, to rely on voluntary compliance. The voluntary aspect of a tax compliance strategy manifests ‘when a revenue authority pursues a citizen-inclusive approach to compliance through policies that encourage dialogue and persuasion’.²¹⁷ Voluntary compliance is borne out of a paradigm shift in tax administration whereby, tax authorities take the position that ‘a cooperative and positive engagement with taxpayers and their advisers in a customer-service focused and user- friendly environment will be more productive and efficient than more traditional adversarial and antagonistic approaches.’²¹⁸ In most high income countries, voluntary compliance is central to tax collection; this paradigm shift has now caught on in LMICs as well.²¹⁹

This new approach to taxpayers and tax compliance is borne out of the realisation that there are a myriad of factors that shape tax compliance decisions; tax compliance is not merely a question of rational choice, as advanced in economic deterrence theories.²²⁰ Tax authorities are therefore responding to tax compliance research on ideas such as ‘the slippery slope framework’²²¹, ‘enhanced relationship and cooperative compliance’²²², as well as ‘responsive regulation’²²³. These ideas all share the common goal of putting the taxpayer at the centre of tax compliance strategies by building on the pillars of

²¹⁷ Forum on Tax Administration Compliance Sub-group, ‘Compliance Risk Management: Managing and Improving Tax Compliance’ (OECD 2004) Guidance Note 48.

²¹⁸ McKerchar and Evans (n 208) 190.

²¹⁹ Odd-Helge Fjeldstad and Mick Moore, ‘Tax Reform and State-Building in a Globalised World’ in Deborah Brautigam, Odd-Helge Fjeldstad and Mick Moore (eds), *Taxation and State-Building in Developing Countries: Capacity and Consent* (Cambridge University Press) 248.

²²⁰ Jeff Pope and Margaret McKerchar, ‘Understanding Tax Morale and Its Effect on Individual Taxpayer Compliance’ [2011] *British Tax Review* 587, 589. The theories on tax compliance, forming the theoretical framework of this thesis, will be discussed in Chapter 3.

²²¹ The slippery slope framework is discussed in detail in Chapter 3.

²²² OECD (ed), *Co-Operative Compliance: A Framework* (OECD Publishing 2013) <<http://dx.doi.org/10.1787/9789264200852-en>>.

²²³ Valerie Braithwaite, ‘Responsive Regulation and Taxation: Introduction’ (2007) 29 *Law & Policy* 3.

‘commercial awareness, impartiality, proportionality, and openness through disclosure and transparency and responsiveness’ by both the tax authority and the taxpayer.²²⁴

This paradigm shift is also borne out the reality of the prohibitive cost of enforcement discussed in Section 2.3 above. Tax authorities in LMICs, faced with this reality, have chosen to re-brand and re-strategise in order to encourage taxpayers to comply voluntarily without the threat of sanctions. These tax authorities have employed various strategies including adopting new language by referring to taxpayers as customers, emphasising their focus on customer service, and focusing on presenting a friendly face to the public. The mission and vision statements of these tax authorities all reflect this new approach to tax administration. For example:

- The Vision of Tanzania Revenue Authority: "To increase domestic revenue through enhancement of voluntary tax compliance."²²⁵
- The Vision of Kenya Revenue Authority: “To facilitate Kenya's transformation through Innovative, Professional and Customer-Focused Tax Administration.”²²⁶
- The Uganda Revenue Authority Strategic Direction: “Cultivate a taxpaying culture through provision of reliable services, leadership development and building strategic partnerships.”²²⁷

Other strategies include creative and ‘fun’ advertisements using popular comedians and celebrities aimed at encouraging all taxpayers to file tax returns in Kenya²²⁸, customer

²²⁴ OECD, *Co-Operative Compliance* (n 222) 19.

²²⁵ ‘Tanzania Revenue Authority - Vision & Mission Statement’ <<http://www.tra.go.tz/index.php/about-tra/vision-mission-statement>> accessed 25 October 2018.

²²⁶ ‘About Us - KRA’ <<https://www.kra.go.ke/about-kra>> accessed 25 October 2018.

²²⁷ ‘Uganda Revenue Authority: Mandate Strategic Direction, Mission, Vision & Core Values’ <<https://www.ura.go.ug/readMore.do?contentId=99900000000199&type=TIMELINE>> accessed 25 October 2018.

²²⁸ Kenya Revenue Authority, *KRA ITax* <<https://www.youtube.com/watch?v=JOi0slh11P4>> accessed 26 October 2018.

appreciation advertisements showing that “your taxes paid for this road/school/hospital” in South Africa²²⁹, customer appreciation week celebrations in Uganda²³⁰, and open engagement with taxpayers on social media platforms like Twitter and Facebook.

Voluntary Compliance by the HTT

When dealing with the HTT, tax authorities in LMICs need to ask whether these strategies are appropriate. One argument suggesting that these strategies may not be particularly effective with the HTT is that, in most cases, these strategies amount to nothing more than ‘window dressing’.²³¹ Despite the many promises made in the mission and vision statements of these tax authorities, taxpayers in LMICs still contend with corruption, inefficiency and ‘obstructiveness, rather than willing, responsive service’.²³²

In Indonesia, the Directorate General of Taxes (DGT) has reiterated its commitment to eradicating corruption within the organisation per its core values of integrity, professionalism, synergy, service, and excellence; it has even held celebrations commemorating World Anti-Corruption Day.²³³ Despite these promises, recent research shows that the perception of corruption within the DGT is strongly related to underreporting among personal income taxpayers in Indonesia.²³⁴ This thesis demonstrates a similar situation in Kenya; as explained in Chapter 4, negative perceptions about the Kenya Revenue Authority persist, despite its efforts at modernisation and reform towards customer-centric administration. It is, therefore, a risky, and perhaps

²²⁹ Fjeldstad and Moore (n 219) 14.

²³⁰ George Okello, ‘Hundreds Throng Kololo for Free Services at Tax Appreciation Week’ *PML Daily* (27 September 2018) <<http://www.pmldaily.com/news/2018/09/hundreds-throng-kololo-for-free-services-at-tax-appreciation-week.html>> accessed 25 October 2018.

²³¹ Fjeldstad and Moore (n 219) 14.

²³² *ibid.*

²³³ Directorate General of Taxes, ‘Harmonisation in Building the Nation: 2012 Annual Report’ (DGT 2013) 159.

²³⁴ Arifin Rosid, Chris Evans and Binh Tran-Nam, ‘Tax Non-Compliance and Perceptions of Corruption: Policy Implications for Developing Countries’ (2018) 54 *Bulletin of Indonesian Economic Studies* 25, 49.

reckless, approach for tax authorities in LMICs to depend heavily on voluntary compliance without the guarantee that their customer-centric approach to tax administration is more than just cosmetic.

Second, this customer-centric approach ‘is most widely practised, and most appropriate, to the relations between tax administrations and their larger corporate clients’.²³⁵ There is little persuasive research, to the author's knowledge, establishing the appropriateness of this approach for the HTT. It is more probable that consistent enforcement, rather than dialogue and persuasion, is likely to have a stronger effect on taxpayers engaged in the level of noncompliance such as that found among the HTT.²³⁶

Third, while co-operative and positive engagement with taxpayers and elimination of corruption in tax authorities in LMICs may lead to increased trust in these authorities, and a corresponding increase in voluntary compliance, tax authorities in LMICs are constrained by general government corruption. It will be argued, in Chapter 5 of this thesis, that tax authorities have no control over general government corruption, yet that corruption severely impedes the effectiveness of the positive relationships that tax authorities may build with taxpayers. This reality casts additional doubt on the achievability of the goal of widespread voluntary compliance among the HTT, on the strength of the customer-centric approach to tax administration.

2.5. HEAVIER RELIANCE ON INDIRECT TAXATION

The fourth option for improved tax collection from the HTT is the increased reliance on indirect taxation, through Value Added Tax (VAT), where direct taxation is a challenge. Taxes on consumption, such as VAT, are ordinarily considered regressive, particularly

²³⁵ Fjeldstad and Moore (n 219) 14.

²³⁶ Rosid, Evans and Tran-Nam (n 234) 46.

when they are levied on basic goods consumed by the poorest in society. However, there is a growing body of evidence that VAT exemptions on basic goods do not help the poor.²³⁷ There is also evidence that VAT may be progressive in countries where a large number of informal sector taxpayers are successfully evading their tax obligations, and the burden of the personal income tax regime is borne by a small number of taxpayers in employment.²³⁸ Thus, the argument for the heavier reliance on indirect taxation is that although it ‘will not bring those entities into the formal sector, but it may increase the equity in tax treatment between the formal and informal sector’.²³⁹

A second argument is that indirect taxes would be a good substitute for presumptive tax regimes, to the extent that these indirect taxes shift into the wages, returns to capital or consumer prices of the HTT; however, while this argument may be relevant for SMEs, it would not be applicable to HTT professionals like lawyers and doctors²⁴⁰.

Bird and Wallace additionally argue that in countries where the tax authority has achieved a decent level of success in the administration of VAT, it may be more effective (and, presumably cheaper) to concentrate on indirect taxation than attempt to increase enforcement on the HTT.²⁴¹ This argument may be reasonable, but the reality is that most countries in Africa, for example, are struggling with the administration of VAT. While in high-income countries, refunds are ordinarily settled within four weeks or less of making a claim, in transitional and developing countries, businesses often wait several

²³⁷ See analysis in Jeremy Cape, ‘Progressive Regressive — Why Politicians Are Wrong to Argue That VAT Exemptions Help the Poorest in Society’ (*Tax Analysts*) <<https://www.taxnotes.com/tax-notes-international/value-added-tax/progressive-regressive-why-politicians-are-wrong-argue-vat-exemptions-help-poorest-society/2018/10/29/28jrd?highlight=regressive>> accessed 30 October 2018.

²³⁸ Bird and Wallace (n 99) 132.

²³⁹ *ibid.*

²⁴⁰ *ibid* 131.

²⁴¹ *ibid.*

months or years to receive their refunds.²⁴² These delays effectively alter the nature of VAT, ‘in part, from a tax on final consumption to a tax on production’.²⁴³ This inefficiency in the administration of VAT has adverse cash flow implications for businesses, particularly VAT registered SMEs.

There are several reasons for the inefficient administration of VAT and the resulting backlog of tax refunds. Tax authorities in LMICs struggle to set up an efficient and effective VAT risk assessment strategy which would streamline and expedite the VAT audit process by quickly identifying fraudulent refund claims and promptly paying out the legitimate ones.

Further, the tax authorities remit all the VAT they collect to the Ministry of Finance and wait to receive the funds they require to settle refunds through the Ministry’s budget allocation; due to competing budget demands, VAT refunds rank very low on the Ministry’s priorities and are consequently ignored leading, to the backlog. This failure to settle refunds promptly puts significant strain on the cash flow of firms, particularly mid-sized domestic firms. It also paints an inaccurate picture of the revenue collected by the tax authority since the amount collected does not factor in the refunds due to taxpayers.

As a result, Zambia recently announced its decision to repeal VAT legislation and move to a retail sales tax (RST) regime, which is considered, by some tax scholars, inferior to the VAT.²⁴⁴ In Kenya, the revenue authority has been sued by disgruntled taxpayers with long overdue refunds, and court orders issued ordering the authority to

²⁴² Graham Harrison and Russell Krellove, ‘VAT Refunds: A Review of Country Experience’ [2005] IMF Working Papers 5 <<https://www.imf.org/en/Publications/WP/Issues/2016/12/31/VAT-Refunds-A-Review-of-Country-Experience-18646>> accessed 12 December 2018.

²⁴³ *ibid.*

²⁴⁴ Alex Parker, ‘VAT Refund Delays in Africa Cause Rancor Among Companies’ *Law 360 Tax Authority* (19 October 2018) <<https://www.law360.com/tax-authority/articles/1092406/vat-refund-delays-in-africa-cause-rancor-among-companies>>; For a discussion on VAT and RST in developing countries, see Carnahan (n 12) 173–17.

pay the refunds expeditiously; despite making significant progress in clearing the backlog, it was recently announced that the number of outstanding refunds had risen dramatically once more.²⁴⁵ Even South Africa, whose tax system is considered to be of OECD standard, is facing a severe problem with outstanding VAT refunds.²⁴⁶

In light of these challenges in the administration of VAT, it is questionable whether African countries can afford to concentrate on indirect taxation rather than increase enforcement among the HTT.

2.6. PRESUMPTIVE TAXATION

The final option for improving the taxation of the HTT, considered in this chapter, is the use of presumptive taxation. This section is divided into four parts: (i) the 'What' section explaining what presumptive taxation is; (ii) the 'When' taxation explaining why presumptive tax regimes may be beneficial; (iii) the 'How' section discussing the different ways in which presumptive taxes can be designed; and finally (iv) a brief discussion on the use of presumptive taxes for professionals.

2.6.1. What are Presumptive Taxes?

Presumptive taxes are not new; in fact, present-day tax systems have evolved from presumptive regimes over time. In past centuries, taxes were levied based on the value of

²⁴⁵ Daisy Ogembo, 'Conference Paper on VAT Refunds and Tax Justice', *Tax Justice and Human Rights Symposium, McGill University* (2014); Patrick Alushula, 'Experts Hit Out at KRA Over VAT Rules' *Daily Nation* (5 October 2018) <<https://www.nation.co.ke/business/Experts-hit-out-at-KRA-over-VAT-rules/996-4792524-12b571oz/index.html>> accessed 26 October 2018; Dominic Omondi, 'Relief as KRA Pays Traders Sh20.5b Tax Refunds' *Standard Digital* (14 August 2018) <<https://www.standardmedia.co.ke/business/article/2001291786/relief-as-kra-pays-traders-sh20-5b-tax-refunds>> accessed 26 October 2018.

²⁴⁶ Michael Cohen, 'South Africa Misses Tax Target After "Coming Clean" on Refunds' (24 October 2018) <<https://www.bloomberg.com/news/articles/2018-10-24/south-africa-misses-tax-target-after-coming-clean-on-refunds>> accessed 26 October 2018.

land one held, one's lifestyle or standard of living, the number of windows or doors in one's home, among other indicators of wealth.²⁴⁷

In modern tax systems, the goal is to apply the tax rate to 'a well-defined measure of the income earned by taxpayers...in a given period....'²⁴⁸ Presumptive taxation 'involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts'.²⁴⁹ In presumptive tax regimes, the "'desired' base for taxation...is not itself measured but is inferred from some simple indicators which are more easily measured than the base itself.'²⁵⁰ The presumption, therefore, replaces 'an entire tax base or at least a large portion of the base'.²⁵¹ In other words, where the revenue authority cannot ascertain a taxpayer's income, or cannot verify the accuracy thereof, presumptive regimes allow them to *presume* the amount of income based on alternative observable indicators, i.e., an alternative base determined by the revenue authority.²⁵²

Thuronyi provides a helpful discussion of the various legal characteristics of presumptive taxation methods; the legal presumption that the taxpayer's income is no less than what is assessed using the alternative indicators *may or may not be rebuttable*.²⁵³ Where they are not rebuttable- legally binding and not appealable- this should be explicitly specified in the relevant legal instrument and defined precisely.²⁵⁴ Where they are rebuttable, the revenue authority uses administrative approaches to reconstruct the taxpayer's income, and the taxpayer is free to appeal and supply the revenue authority

²⁴⁷ Jantscher and Tanzi (n 11) 2.

²⁴⁸ *ibid* 1.

²⁴⁹ Victor Thuronyi, 'Presumptive Taxation' in Victor Thuronyi (ed), *Tax Law Design and Drafting* (Kluwer Law International 2000) 401.

²⁵⁰ Ehtisham Ahmad and Nicholas Stern, *The Theory and Practice of Tax Reform in Developing Countries* (Cambridge University Press 1991) cited in Thuronyi (n 186) 401.

²⁵¹ Reuven Shlomo Avi-Yonah and Congress of the International Fiscal Association (eds), *Presumptive Income Taxation: Proceedings of a Seminar Held in New Delhi, in 1997 during the 51st Congress of the International Fiscal Association* (Kluwer Law International 1998) 1.

²⁵² Bird and Wallace (n 99) 124.

²⁵³ *ibid*.

²⁵⁴ *ibid* 404.

with evidence that their actual income, under standard accounting rules, is less than the income assessed using the presumptive method.²⁵⁵

Presumptive methods that are irrebuttable may be described as either *minimum tax* or *exclusive*. Where the minimum tax presumption is applied, the taxpayer's liability is no less than what is determined under the applicable presumptive rules.²⁵⁶ If the tax liability would be higher under the standard rules, the taxpayer will pay tax according to the ordinary method of assessment. On the other hand, where an exclusive presumption is applied, the taxpayer's liability is determined solely using presumptive methods, even if the usual rules would result in higher tax liability.²⁵⁷ This type of presumption is very simple to administer and does not create a disincentive to earn income, particularly where the item upon which the presumption is based is in inelastic supply; however, it can lead to horizontal inequity.²⁵⁸

Presumptive methods may also be *mechanical or discretionary*.²⁵⁹ Where the revenue officials have greater discretion, it is appropriate to use a rebuttable system; otherwise, the presumption could result in hardship, injustice, or corruption. Mechanical methods are clearly described in the legal instrument, such as where tax is based on turnover or assets; they may or may not be rebuttable.

2.6.2. When are Presumptive Taxes Used?

Presumptive taxes have been used for a wide range of reasons in several countries; although they are found, in some form, in high-income countries like France, Germany,

²⁵⁵ *ibid.*

²⁵⁶ *ibid.*

²⁵⁷ *ibid.* Thuronyi gives the example of an agricultural tax based on the value of the land rather than crop yield. He explains further that this type of presumption results in a tax on the item used to determine the presumption rather than a tax on income.

²⁵⁸ *ibid.* 404, 405.

²⁵⁹ *ibid.* 405.

Belgium, and Israel, they mostly feature in the tax systems of LMICs. In this section, we examine some of the reasons why revenue authorities turn to presumptive taxes for some categories of taxpayers.

2.6.2.1. Tax Simplification

In many LMICs, there is a significant number of taxpayers who are unable to meet complex tax and accounting compliance requirements; simplified bookkeeping and tax compliance rules would best serve their needs. These taxpayers run micro, small, or medium-sized businesses with modest turnover; subjecting them to the usual compliance burden places an onerous financial burden on them, driving many business owners towards evading their compliance obligations altogether. For example, small business owners are often unable to comply with their accounting and tax obligations without paying for professional help.²⁶⁰ These costs, both regarding time and money, are very burdensome for a business of this size.²⁶¹ As a result, these business owners will often not keep financial records, and when they do, they are incomplete, inaccurate, or deliberately misleading.²⁶² The literature confirms that even self-employed professionals, who are highly educated, keep very rudimentary, unreliable, and inaccurate books of accounts that are incapable of being effectively utilised for tax audit assessment.²⁶³

In LMICs, the number of businesses of this size is significantly higher than in higher income countries; revenue authorities in LMICs, with their already limited budgets, face serious administrative challenges in trying to audit a large number of taxpayers with these scanty or non-existent records.

²⁶⁰ Terkper (n 4) 219.

²⁶¹ European Commission (n 4) 8–13.

²⁶² Jantscher and Tanzi (n 11) 5.

²⁶³ Tadesse and Taube (n 7) 4.

One of the primary goals of presumptive regimes is, therefore, to cater to such taxpayers. It can be argued that all the other intended benefits of presumptive tax regimes stem from, or are related to, the goal of simplification. Policymakers and revenue authorities anticipate that if the compliance burden is low, and the rules are kept simple, taxpayers will be motivated to comply voluntarily. The target, in this case, is taxpayers who (i) evade taxes because of lack of knowledge or understanding of their obligations or (ii) evade taxes because of the cost (financial or otherwise) of compliance is too high. Further, since the revenue authorities cannot ascertain the actual tax base because of poor record keeping, presumptive regimes allow them to come as close as possible to ascertaining the income of the business using presumptive methods.²⁶⁴ Presumptive tax regimes are intended to simplify tax administration in LMICs and ‘overcome administrative weaknesses that are endemic to many countries in Africa’.²⁶⁵

However, as we will see in Chapter 3, taxpayers engage in evasion for a diverse range of reasons including, but not limited to, the complexity and cost of compliance. Therefore, presumptive regimes will not necessarily lead to increased voluntary compliance among all taxpayers. For example, taxpayers who evade taxes because of dissatisfaction with or lack of trust in the government, would not begin to comply simply because the process is more straightforward. Besides, striking the correct balance when it comes to simplification is easier said than done. In many countries, the simplified tax regimes are still far too complex and burdensome for micro-enterprises; on the other hand, where the regime is too simple with little accountability, the risk of abuse of the system by medium-sized enterprises increases significantly.²⁶⁶

²⁶⁴ Jantscher and Tanzi (n 11) 4.

²⁶⁵ Tadesse and Taube (n 7) 11.

²⁶⁶ Coolidge and Yilmaz (n 4).

2.6.2.2. *Enhancing Horizontal Equity*

One of the principles of a good tax system is equity- both horizontal and vertical. Proponents of presumptive tax regimes are primarily concerned with horizontal equity, i.e., treating similar taxpayers similarly. The fact that the self-employed have significantly more opportunity for evasion than employees whose salaries and wages are subject to employer withholding schemes is well documented.²⁶⁷

Presumptive regimes aim to encourage greater voluntary compliance among these difficult-to-tax groups to reduce the ‘unfair advantage’ that they have, i.e., the opportunity to evade their tax obligations while those who are salaried bear the full burden of their obligations. Horizontal equity demands fairness in the distribution of the tax burden, and this is what presumptive regimes aspire to achieve.

Table 2 below shows the significant disparity between income tax paid by employees through PAYE, and income tax paid by the self-employed in 6 African countries. Taking into account the fact that only a fraction of workers in Africa are employed in the formal sector, the stark disparity in these figures suggests a high level of tax evasion by the self-employed.

²⁶⁷ See note 11 in Chapter 1.

Table 2: Comparison of Revenue from PAYE and Personal Income Tax from the Self-Employed in 6 African Countries (2016)²⁶⁸

| COUNTRY | PAYE | PIT FROM SELF-EMPLOYED | PIT FROM PROFESSIONALS |
|----------------|---------------------|-------------------------------|-------------------------------|
| Egypt | EGP 28,098,000,000 | - | EGP 731, 000,000 |
| Eswatini | SZL 2,662,000,000 | SZL 52,000,000 | - |
| Ghana | GHS 3,466,000,000 | GHS 237,000,000 | - |
| Kenya | KES 312,032,000,000 | KES 8,821,000,000 | - |
| Rwanda | RWF 245,138,000,000 | RWF 8,752,000,000 | - |
| South Africa | ZAR 402,200,000,000 | ZAR 27,313,000,000 | - |

Further, an increase in horizontal equity is intended to result in greater neutrality in the economy. The fact that the self-employed have significantly more opportunity to evade tax than salaried taxpayers can lead to distortions in the economy; taxpayers could choose to pursue self-employment instead of employment because of the opportunity to evade tax rather than efficiency considerations. Since neutrality in choice is one of the cornerstones of a good tax system, presumptive regimes are designed to level the playground between the self-employed and the employed, to promote neutrality.

In summary, presumptive regimes are used to encourage voluntary compliance among the HTT, who find it difficult to comply with the ordinary tax rules, with the objective of enhancing horizontal equity, fairness, and neutrality within the tax system.

Presumptive regimes have, however, been criticised for resulting in exactly the opposite- abuse of the law, unfairness, inefficiency, and distortion in decision making.

²⁶⁸ OECD/ATAF/AUC (n 30).

Where the threshold for eligibility is too high, for example, larger taxpayers who are fully capable of keeping proper books of accounts and complying with ordinary tax rules can take advantage of presumptive regimes to pay lower taxes.²⁶⁹ Presumptive regimes have also been accused of eroding vertical equity. For example, where taxpayers in a specific sector are subject to a lump-sum tax, all the taxpayers in that sector end up paying the same amount of tax regardless of their varying income, business expenses, or unexpected losses.

2.6.2.3. Expanding the Revenue Base

The expansion of the tax base is an urgent need of many LMICs. These countries depend heavily on corporate income tax, pay as you earn from those employed in the formal sector, and value-added tax. The informal sector contributes very little to the tax revenue collected in LMICs, despite making up a very significant percentage of the economy, due to widespread tax evasion among these taxpayers. The rationale behind the introduction of presumptive taxes is that, once the tax rules are simplified, and the cost of compliance comes down, actors in the informal sector, who have previously been non-compliant, will begin to comply voluntarily, thereby reducing evasion and expanding the revenue base.²⁷⁰

Presumptive regimes are, however, not without their risks. For example, there is a risk, that taxpayers who fall within the criteria of eligibility for the presumptive regime, but who were previously complying under the ordinary rules, will elect to shift to the presumptive regime, if the latter guarantees a lower tax burden. Thus, rather than expanding the revenue base, the presumptive regime would result in abuse and erosion of the existing tax base. Such risks call for careful research and design of the presumptive regime to avoid distortions and economic instability.

²⁶⁹ Bird and Wallace (n 99) 6.

²⁷⁰ Alm, Martinez-Vazquez and Schneider (n 2) 49.

2.6.2.4. *Encouraging Formalisation and Firm Growth*

As explained above, the primary objective of presumptive regimes is tax simplification for the HTT to prod them into the tax base. Also, rebuttable presumptive methods give these taxpayers the opportunity to provide the revenue authority with evidence that their actual revenue is lower than the revenue assessed using the presumptive method. What this sort of arrangement hopes to achieve is to encourage the SMEs to increasingly keep proper records, formalise, and grow so that they can benefit from a potentially lower tax burden.

Apart from the specific opportunity that rebuttable presumptive methods provide, it is also anticipated that the opportunity to register with the revenue authority, keep simplified accounts, and pay taxes will enable businesses that previously operated entirely in the shadows to move towards formalisation of their operations. Thus, these businesses may begin to enjoy the direct and indirect benefits of formalisation such as better access to credit facilities, better access to markets, better opportunities to negotiate and do business with other formal firms and government, and better access to highly skilled and qualified workers.

Once again, the achievement of this goal is heavily dependent on the design of the presumptive regime. If the tax burden under the presumptive regime is significantly lower than the tax burden a firm would face if it grew and transitioned into the ordinary regime, there is little financial incentive to do so. As a result, firms will deliberately remain small to continue benefiting from the lower tax burden. This sort of distortion defeats the goal of the presumptive regime and hampers efforts to ensure neutrality and fairness in the tax system. It is important to bear these considerations in mind when designing these tax regimes.

2.6.3. How are Presumptive Taxes Designed?

Tax policymakers and revenue authorities have various methods at their disposal when designing presumptive taxes regimes. The methods vary in terms of effects, benefits, and risks; a one-size fits all approach is unsuitable, since each country has peculiar circumstances or conditions that must be borne in mind when designing a presumptive regime. Besides, some methods work best in some sectors but would be ineffective in others. There are some excellent and detailed discussions in the literature on these various methods, which will not be repeated here.²⁷¹ The purpose of this section is to highlight the essential characteristics of each method, and briefly discuss the opportunities and risks they present.

2.6.3.1. *Methods that Involve Reconstruction of Income*

These are methods that the revenue authority uses when it does not have any or substantial information regarding a taxpayer's income for the financial year in question. They are used when a taxpayer has either failed to file a return or has significantly underreported their income; the authority will, in this instance, derive the legal authority to use other means to estimate the taxpayer's income from the general wording of the relevant legislation.²⁷² The authority's presumption is rebuttable- the taxpayer can provide evidence proving that their income for that year was less than what the authority has presumed.

The Net Worth Method

This method requires the revenue authority to ascertain two main things, (i) the change in the taxpayer's net worth over the financial year in question and (ii) an estimate of the

²⁷¹ Jantscher and Tanzi (n 11); Tadesse and Taube (n 7); Thuronyi (n 249); Terkper (n 4); Bird and Wallace (n 99).

²⁷² Thuronyi (n 249) 407.

taxpayer's personal consumption expenses over the year. The latter estimate is arrived at through a lifestyle audit. The sum of these two figures is presumed to be the taxpayer's income for the year based on the conceptual understanding of income as the sum of consumption and net worth.²⁷³ The power of the revenue authority to use this method is derived from 'the broad power of the tax administration to make best judgment-assessments'.²⁷⁴

Opportunities

Since it is applied in instances where the taxpayer has utterly failed or refused to comply, it is a useful tool in inducing compliance among difficult taxpayers who are likely to elect to produce documentation and records that give a more accurate reflection of their income, if it will result in paying a lower amount in tax. This opportunity to rebut the authority's presumption also alleviates the risk of injustice, where the amount of income presumed is too high.

Risks

Implementation of the net worth method is time-consuming, labour intensive and, requires sophisticated audit methods.²⁷⁵ As a result, although it is provided for in the legislation of various developing countries, it is rarely applied in practice because of administrative constraints within the revenue authorities.²⁷⁶

Besides, since it is being applied to taxpayers who have already concealed information about their financial status, it is difficult for the revenue authority to 'determine with any precision the initial and end-of-year net worth of a taxpayer and the

²⁷³ Henry Calvert Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago, Ill: University of Chicago Press 1938) <<https://trove.nla.gov.au/version/26834171>> accessed 16 July 2018 cited in Thuronyi (n 198).

²⁷⁴ Thuronyi (n 249) 408.

²⁷⁵ *ibid* 409.

²⁷⁶ Jantscher and Tanzi (n 11) 9.

expenditures incurred during the tax year'.²⁷⁷ Thuronyi explains that, as a result, the net worth method and other methods of reconstructing income use very crude estimates with the goal of inducing the taxpayer to produce more accurate records or return.²⁷⁸ Unscrupulous revenue officers can easily abuse this setup, in the absence of proper checks and balances.

Bank Deposit and Expenditures Methods

The presumption in these cases is that, in the absence of rebutting evidence, deposits made into the taxpayer's accounts, or total cash expenditures, constitute the taxpayer's income.

Opportunities

As is the case with the net worth method, these crude methods of reconstructing income can be very effective in inducing non-compliant taxpayers to produce proof of their actual income to rebut an exaggerated presumed income.

Risks

The bank deposit method is not particularly useful with the HTT in LMICs where cash transactions are much more prevalent, either out of necessity or deliberate design, to avoid taxation.

2.6.3.2. *Methods that Use a Percentage of Gross Receipts*

These methods are an example of minimum taxes. The taxpayer's taxable income, in this case, is 'no less than a specified percentage of the gross receipts of the business'.²⁷⁹ It is, therefore, a tax on turnover.

²⁷⁷ *ibid.*

²⁷⁸ Thuronyi (n 249) 408.

²⁷⁹ *ibid* 410.

Opportunities

With the hard-to-tax, it is simpler to administer and will enable the revenue authority to collect revenue from those unable to comply with ordinary tax and accounting rules.

Risks

Turnover is not a good indication of income; unless the revenue authority conducts research to determine profit margins in each industry, the presumption can be very inaccurate. Such research would be expensive and, and there is no guarantee that it would be possible to accurately determine profit margins in every country.²⁸⁰

Also, this method would be ineffective among taxpayers whose gross receipts are easily hidden or manipulated, such as the professionals with whom we are concerned in this research. Since the basis for the presumption is gross receipts, it is not an ideal solution in instances where the audit challenge is determining gross receipts. The gross receipts presumption may be rebuttable or irrebuttable, but the former ‘also takes the teeth out of this type of minimum tax’.²⁸¹

2.6.3.3. *Methods that Use a Percentage of Assets*

Another example of minimum taxes, the tax, under these methods, is based on a fixed percentage of the (gross or net) assets of a business. ‘The economic rationale for the assets tax is that investors can expect ex-ante to earn a specified average rate of return on their assets.’²⁸²

²⁸⁰ *ibid* 411.

²⁸¹ *ibid* 412.

²⁸² *ibid*.

Opportunities

It is a useful way of addressing transfer pricing problems, underreporting and other types of evasion as well as problems of timing in the income tax.²⁸³

Risks

The assumption in this method is that the taxpayer will realise a guaranteed return on their profit. There is a risk of unfairness if the return realised is less than what was anticipated.

2.6.3.4. *Industry-Specific Methods for SMEs*

Fixed Amounts Based on Profession or Trade

Taxpayers pay a minimum tax, a lump sum, set at a very low threshold, based on their profession or trade. The regime may be designed with two or three turnover bands corresponding to increasing rates of tax.

Opportunities

This method is simple to administer, particularly among hard-to-tax taxpayers such as self-employed professionals whose income can be difficult to ascertain. ‘A fixed lump-sum tax on self-employed professionals such as doctors or lawyers relieves the tax authority of ascertaining or verifying a particular individual's actual income through auditing and investigation’.²⁸⁴

Moreover, since it is predicated on an average income for that industry, it can have positive incentive effects because any income earned by the taxpayer above the ‘average’ is effectively taxed at 0%.²⁸⁵ Also, as with other presumptive methods, it

²⁸³ For a more detailed discussion on this, and presumptive taxes on a percentage of assets generally, see *ibid* 412–421.

²⁸⁴ Tadesse and Taube (n 7) 14.

²⁸⁵ *ibid*.

promotes horizontal equity by bringing the hard-to-tax into the tax base, and once the revenue authority is aware of their existence, it is easier to keep them in the tax base and gradually transition them into the ordinary income tax system. Finally, unlike the *forfait* method discussed below, there is no negotiation or agreement with the revenue authority, and therefore it is not as susceptible to corruption.

Risks

Taube and Tades provide an excellent discussion on the drawbacks of this method. One such drawback is the little revenue it yields. For example, a lump sum tax on professions such as law and medicine, where incomes widely diverge, will, for fairness, be based on the income of the lowest earners, rather than the actual average, resulting in limited revenue yield.²⁸⁶ Apart from the risk of low revenue yield, this tax is also very regressive; it erodes the ability to pay principle since the taxpayers face the same tax burden despite their varying incomes, merely because they belong to the same profession. Further, this presumption leaves no room to factor in unusual losses that may be made by the business owner in a financial year.

Variations to the method, that allow for increased vertical equity, result in compromises to the above-stated benefit of administrative simplicity. Taube and Tades explain:

Devising the criteria for differentiating lump-sum levies implies that more or less detailed studies on the profitability and income patterns of various occupational and business groupings will have to be undertaken on a regular basis... Given the substantial information and financial and manpower resources required for such exercises, it is not surprising that some tax administrations in African countries resort to the fixed, noncalibrated levy.²⁸⁷

²⁸⁶ *ibid.*

²⁸⁷ *ibid* 15.

Forfait Method

This method is a sort of 'contract' between the revenue authority and the taxpayer that involves an advance agreement between the revenue authority and the taxpayer on the estimated income that will form the basis for taxation for a fixed period, usually between 1-3 years. The term *forfait* refers to the estimated income that the business can typically produce.²⁸⁸ This method, which was widely used in France in the past, requires the taxpayer to furnish the revenue authority with specific financial information from the previous financial year, including 'purchases, sales, the value of closing inventory, number of employees, amount of wages paid, and number of cars owned by the taxpayer'.²⁸⁹ The revenue authority then supplies an estimate of general business expenses derived from extensive research of the various industries, and after that, the *forfait* is determined.

Risks

The taxpayer is required to keep detailed books of accounts to supply the revenue authority with the information they require to establish the *forfait*. It is therefore not suitable for taxpayers who are completely unable to keep such records. This method also requires the revenue authority to carry out detailed and highly technical studies, in a wide range of industries, to come up with an estimate of general business expenses before calculating the *forfait*. Revenue authorities in many LMICs do not have adequate human, financial, and technical resources to effectively carry out such studies.

Further, the revenue authority depends on the taxpayer to supply financial information relating to the previous financial year, to facilitate the process of estimating income. There is scope for the taxpayer to manipulate such information to pay less tax,

²⁸⁸ Thuronyi (n 249) 423.

²⁸⁹ *ibid.*

and the revenue authority therefore requires an adequate number of officers to verify the information before using it to determine the *forfait*.²⁹⁰ One of the most significant administrative challenges that revenue authorities in LMICs face is inadequate staffing; this method would, therefore, put an added strain on the limited number of revenue officers.

Finally, the *forfait* method is a risky one to use in countries already facing corruption and bribery challenges. It involves negotiation and agreement between revenue officers and taxpayers and is therefore susceptible to abuse if revenue officers are dishonest.²⁹¹

Presumptive Taxation of the Agricultural Sector

In many countries where farmers (excluding large agricultural enterprises) are taxed, presumptive regimes are the favoured method both for political and practical reasons. An estimate of the income that the farmer can earn is arrived at by looking at acreage, productivity and quality of the land, the average cost of production, and the pricing of the farm products.²⁹²

Standard Assessment Guides

An excellent example of this method is the *tachshivim* used in Israel, which was subsequently replaced by *tadrihim*. Like the *forfait*, it involves an advance ‘agreement between taxpayers and the tax authorities’, but unlike the *forfait*, ‘the agreement is on the *tachshiv* in general (being negotiated with industry representatives), not on its application to particular taxpayers’.²⁹³ The objective of the *tachshiv* is to use other ascertainable factors to determine net profit, where the taxpayer does not have proper books of

²⁹⁰ Jantscher and Tanzi (n 11) 12.

²⁹¹ *ibid* 13.

²⁹² Thuronyi (n 249) 425.

²⁹³ *ibid* 424.

accounts. In Israel, it was not limited in use by turnover thresholds; further, although it did not relieve taxpayers of the responsibility to keep proper financial records, they were not penalised if they did not do so.

Opportunities

Apart from the general benefits of presumptive methods already discussed above, there is some evidence that if it is well designed, this method, unlike the lump sum method, can be a substantial revenue earner.²⁹⁴ It also provides a useful method of ascertaining turnover in industries where turnover can be determined using external evidence.²⁹⁵

Risks

Where taxpayers are free to select whether to use the tachshiv system or keep proper records, they can abuse the system by selecting the route that results in less tax, thereby deriving the state of revenue.

Although, from the perspective of the taxpayer, compliance is more straightforward, it is not as simple to administer as some of the cruder presumptive methods. ‘Considerable background work is required by the tax authorities in specifying the factors to be used for particular industries and the relevant multipliers for each factor.’²⁹⁶ In the case of LMICs, this method would only work if the government has the political will and resources to invest in the administrative infrastructure, and the time required to design the tax.

²⁹⁴ Tadesse and Taube (n 7) 19. They explain that the fact that the tachshiv was widely used, and well-designed, significantly contributed high levels of income tax collection in Israel.

²⁹⁵ Thuronyi (n 249) 425.

²⁹⁶ *ibid.*

2.6.4. Presumptive Tax Regimes for Self-Employed Professionals

As explained above, presumptive tax regimes target the HTT, a term which covers farmers, SMEs, and professionals. However, to the best of the author's knowledge, in practice, almost all countries that have some form of presumptive tax regime apply the regime to SMEs, but explicitly make professional income ineligible, through the language of the statute. Thus, self-employed professionals are usually unable to take advantage of presumptive tax regimes, even where they meet the other eligibility criteria.

One apparent reason for this is that professionals are highly educated, and it is assumed that they are financially and tax literate, and sophisticated enough, to keep proper financial records and comply with tax legislation. Also, tax policymakers and revenue authorities are perhaps hesitant to apply presumptive methods to this group because of the potential high earnings of professionals and the challenges associated with factoring in widely divergent incomes among professionals in the same sector when designing the presumptive tax. There is the risk that high income-earning professionals can abuse a poorly designed presumptive tax to pay lower taxes.

These assumption and fears are blind to several realities. First, in LMICs, a significant number of professionals run owner-managed small firms with a modest income; these professionals run their businesses as informally as other HTT taxpayers.²⁹⁷ The data collected during the case study for this research, and presented in the next Chapter, suggests that financial and tax capability among this group is not as high as the literature often assumes.

Second, the blanket distinction between self-employed professionals and SMEs is problematic. Many self-employed professionals in LMICs face the same compliance

²⁹⁷ Terkper (n 4) 213.

challenges that SMEs face, i.e., the ‘compliance costs or what it takes to meet tax obligations are also higher for small entities especially in relation to the amount of taxes they pay’.²⁹⁸ While there are self-employed professionals who run large successful firms with significant turnover and can afford professional accounting services, there are many self-employed professionals who struggle to cover their compliance costs on their modest income. For professionals running small firms, or recent graduates at the beginning of their practice, the typical costs of compliance are incredibly high and prohibitive, forcing many of them to evade taxes and operate in the informal economy. This category of professionals is ignored in the literature.

There are a few instances where countries have chosen to apply presumptive income taxation to professionals; these instances are discussed below.

India

As explained above, virtually all LMICs exempt professional income from presumptive tax regimes in the language of the statute. This was the case in India, before 2016. However, since the financial year 2016/2017, self-employed professionals in India, whose total gross receipts did not exceed Rs. 50 Lakhs in the previous financial year, can benefit from the presumptive regime under the new Section 44ADA of the Income Tax Act.²⁹⁹ The taxpayer's income is presumed to be 50% of their total gross receipts for the year, and since a deemed deduction for all expenses is applied, no further deductions are allowed.

The provision further relieves the taxpayer of the obligation to maintain proper audited books of accounts, but the presumption is a rebuttable one and the taxpayer can

²⁹⁸ *ibid.*

²⁹⁹ This provision covers professionals in the following sectors: legal, medical, architecture, accounting, interior design, engineering, information technology professionals, company secretaries, artists and technical consultancy.

produce audited books and receipts showing that their income was less than 50% of gross receipts.³⁰⁰ This presumptive regime is not mandatory, and taxpayers are free to opt in and out from year to year, without restriction. This amendment was introduced in accordance with the recommendations of a committee set up to look into simplification of income tax in India- Expert Committee on Tax Simplification chaired by Rtd. Justice Easwar. The committee recommended, based on the popularity of the presumptive regime among small traders, the expansion of the presumptive regime to include professionals.³⁰¹ The report suggested that the presumed income should be 33^{1/3} % of total gross receipts.³⁰² This presumed income is significantly lower than the figure of 50% that eventually found its way into the statutory amendment to the Income Tax Act. The committee also recommended that professionals running small businesses should be alleviated of the burden of keeping audited books of account, a recommendation incorporated in the amendments.³⁰³

It is too early to determine the success or failure of this regime, and there is as yet no scholarly literature on it. However, the rate set for the presumptive tax, i.e., 50% of total gross receipts, is significantly high and is likely to affect the uptake of the regime. It is not clear why the government chose to depart from the lower rate recommended by the Committee, but it is likely that the policy motive is to deter taxpayers from paying tax on a presumed base and, instead, file accurate returns on a certain basis.

³⁰⁰ Income Tax Department, Government of India, 'Tax on Presumptive Basis in Case of Certain Eligible Businesses or Professions' <www.incometaxindia.gov.in/tutorials/13.%20tax%20on%20presumptive%20basis%20in%20case%20of%20certain%20eligible%20businesses.pdf> accessed 29 May 2018.

³⁰¹ Expert Committee on Income Tax Simplification, 'First Report on Income Tax Simplification' (2016) 9, 20 <<http://taxsimplification.in>>.

³⁰² *ibid* 20.

³⁰³ *ibid* 19.

Greece

Greece has faced a significant problem with widespread tax evasion, especially among professionals; according to one study, 43%-45% of self-employment income goes unreported and untaxed in Greece, and the primary tax evaders are professionals like lawyers, doctors and engineers.³⁰⁴ Attempts to increase enforcement on professionals in 2010 were unsuccessful with Parliament voting down a proposed bill to that effect.³⁰⁵ Greece introduced presumptive taxation of professionals as part of the economic and financial policies in response to the 2010 financial crisis; the regime was expected to raise 'at least EUR 400 million in 2011 and increasing returns in 2012 and 2013'.³⁰⁶ All the primary sources of information on the legislative change are in Greek, but the changes can be summarised as follows:

The law in (sic) the taxation of professionals changed in 2010 and Number 3842/2010 amend (sic) the law of 2238/199. With the new law...taxation was imposed on the incomes of some categories of professionals such as: 38% for those who supervise building or architectural studies, 26% for economic, statistical, transport, social, energy, territorial, structural and engineering studies, 22% for agricultural, fisheries, urban, transport, hydraulic and electric studies and installations and 17% for surveying and supervision of topographical work...In 2013, the new law 4172/2013 was voted and it is still in force today, incorporated new changes in taxation of professionals and in particular those in the financial and investment sector by defining procedures for determining profits from stock or investment activities and the taxation of those profits at a rate of 15%.³⁰⁷

It is worth noting that the new legislation did not apply to liberal professionals like doctors and lawyers, despite the research showing that such professionals are the primary

³⁰⁴ Nikolaos Artavanis, Adair Morse and Margarita Tsoutsoura, 'Measuring Income Tax Evasion Using Bank Credit: Evidence from Greece' (2016) 131 *The Quarterly Journal of Economics* 739, 743, 763.

³⁰⁵ *ibid* 782.

³⁰⁶ International Monetary Fund, 'Greece: Request for Stand-By Arrangement' (2010) 10 IMF Staff Country Reports 1, 50.

³⁰⁷ Styliani Ntoulaki, 'Email Correspondence on Reforms in Greece' (7 June 2018).

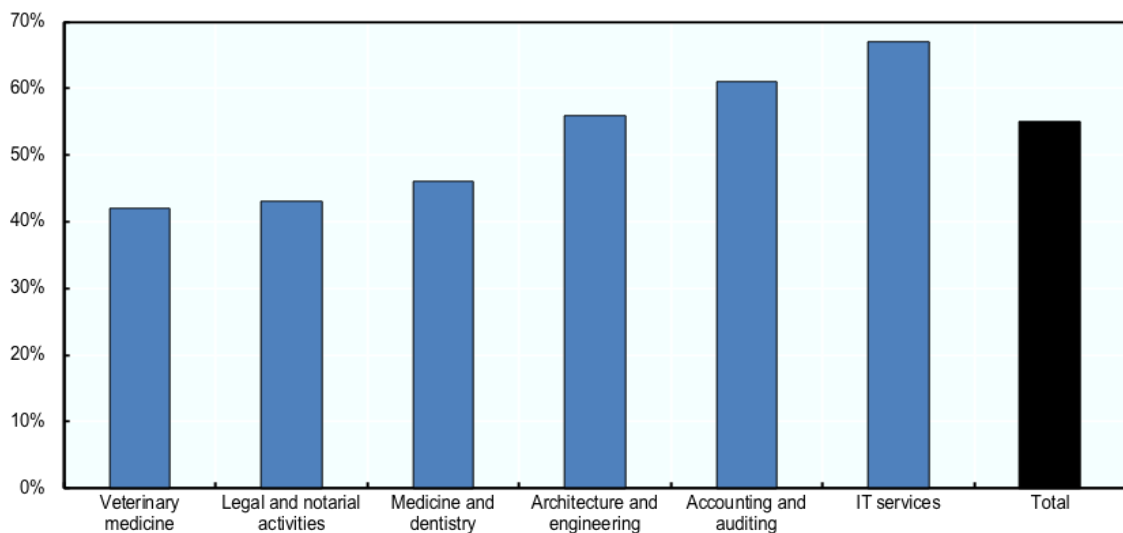
tax evaders. To the best of the author’s knowledge, there is no academic research on the implementation and success or failure of this presumptive regime.

Costa Rica

In the 1990s, the presumptive regime for professionals operated at a fixed per cent and applied to doctors, architects, engineers, lawyers, accountants, brokers, notaries and economists, and other technicians and professionals who failed to file their tax returns.³⁰⁸

Costa Rica still faces widespread tax evasion among liberal professionals including lawyers, architects, doctors, dentists, and accountants.³⁰⁹ The receipt of professional fees in cash, for which these professionals do not issue receipts, allows them to underreport their income; they also ‘easily over-report deductible expenses or claim expenses that should not be claimed’.³¹⁰ According to Figure 5 below, in 2015, tax evasion was highest among professionals in I.T., accounting, and auditing.

Figure 6: Share of Taxpayers Declaring Zero Income Tax in Different Liberal Professions in Costa Rica in 2015³¹¹



³⁰⁸ Rajaraman, ‘Presumptive Direct Taxation’ (n 4) 1110.

³⁰⁹ OECD, *OECD Tax Policy Reviews: Costa Rica* (OECD Publishing 2017) 71.

³¹⁰ *ibid* 72.

³¹¹ *ibid*. Data based on a 2015 report- Contraloria General de la Republica.

Further, 55% of professionals declared zero income tax and, ‘on average, this share remained relatively constant over the 2011-15 period at an average of 56%’.³¹² The assets and gross earnings of most of the taxpayers in this group suggest that they are grossly underpaying taxes. 86% of the taxpayers in this group ‘accounted for about 48% of assets and 30% of gross earnings of the total group while accounting for only 9% of total taxes paid’.³¹³

Under the current Costa Rican presumptive regime for professionals, professionals who fail to file their tax returns when due, pay their taxes, as well as issue appropriate receipts are presumed to earn an income that ‘is either 250 or 335 times the basis salary depending on the profession’.³¹⁴ The higher presumption, i.e., 335 base salaries, is equivalent to approximately \$242,000³¹⁵; this amount is significant in comparison to the GDP per capita based on purchasing power parity of Costa Rica which is approximately 17,000.³¹⁶ This disparity suggests that the policy motivation for the presumptive regime is to discourage tax evasion by compelling professionals to file returns and keep accurate records, or face a heavy tax burden

³¹² *ibid* 71.

³¹³ *ibid* 72.

³¹⁴ *ibid* 71. See the statutory provision in Box 1.

³¹⁵ Diego Quinones, ‘Email Correspondence with Diego Quinones on the English Translation of the Statutory Provision’ (28 October 2018).

³¹⁶ World Bank, ‘GDP per Capita, PPP (Current International \$) | Data’ (n 29).

Law No. 7092 Income Tax Law (Legislative Assembly of the Republic of Costa Rica)

Article 13. Other presumptive incomes. For those taxpayers who are individuals, independent of their nationality and of the venue where contracts are celebrated, as well as for individual limited responsibility companies and individual companies who act in the country, it shall be presumed that, except where there is direct or indirect evidence to the contrary, they obtain a minimal annual income for the following concepts:

a.) Provision of services in a liberal form: Any professional or technician who provides services without the existence of a dependency relationship with his clients, who does not file his tax statement when it is due and, thus, does not pay the corresponding tax or issue the bills or receipts authorized by the tax administration, as established under this Law, or who incurs in any of the causals established in incises 1) and 2) of the present article, shall be presumed to obtain a minimal annual net income in accordance to the following classification:

i.) Physicians, dentists, architects, engineers, lawyers and notaries, agricultural surveyors, public accountants, economic sciences professionals, and real estate brokers, the sum equivalent to three-hundred-and-thirty-five (335) base salaries.

ii.) Surveyors, private accountants, technicians, and in general, all professionals and technicians, chartered or not, who are not contained in the previous numeral, the sum equal to two-hundred-and-fifty base salaries.

In no case shall those minimal presumptive incomes be prorated between the time that the professional or technician devotes to providing other services, be they under a dependency relationship, or in the course of performing other activities subject to this tax.

³¹⁷ Quinones (n 315).

Guatemala

In 1987, Guatemala introduced a presumptive tax for professionals who failed to file a tax return, as part of broader reforms on all aspects of individual income tax.³¹⁸ The statute indicated an unindexed and absolute presumed rate for each profession; however the revenue authority failed to revise the specified amounts in line with inflation, rendering them obsolete.³¹⁹ ‘By 1990, most professionals would find it advantageous to pay taxes according to the fixed presumptive income assigned to their profession in the tax law.’³²⁰ Guatemala still faces a significant problem with tax evasion among the HTT; its low tax to GDP rate (2011-2014) is partially as a result of high levels of tax evasion.³²¹ ‘For the income tax, the estimated average rate of tax evasion for individuals and firms in Guatemala is about 64 per cent...’³²²

Under the current Guatemala presumptive regime, professionals who fail to register as taxpayers, or who register but do not file their tax returns, are presumed to have earned an income of 30,000Q per month; if the professional graduated less than three years prior, or is over the age of 60, that presumed income is reduced by 50%.³²³ The tax due is then calculated by applying the relevant tax rate to the presumed income. The presumptive regime is a rebuttable one; the taxpayer is permitted to present evidence proving a lower income. However, the taxpayer would still face penalties for failure to file their returns and pay the tax promptly. The presumed income of 30,000Q per month

³¹⁸ Roy Bahl and Jorge Martinez-Vazquez, ‘The Nexus of Tax Administration and Tax Policy in Jamaica and Guatemala’ in Richard M Bird and Milka Casanegra de Jantscher (eds), *Improving Tax Administration in Developing Countries* (International Monetary Fund 1992) 80.

³¹⁹ *ibid.*

³²⁰ *ibid.*

³²¹ Stewart Kettle and others, *Behavioral Interventions in Tax Compliance: Evidence from Guatemala* (The World Bank 2016) 2 <<http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-7690>> accessed 29 October 2018.

³²² *ibid.*

³²³ See the statutory provision in Box 2.

is the equivalent of \$3,800.³²⁴ This amounts to approximately 75% of Guatemala's annual GDP per capita which is approximately \$4,470.³²⁵ Once again, this disparity suggests that the policy motive for the regime is to deter would-be evaders and prod them to file their tax returns on the basis of their actual income.

³²⁴ Quinones (n 315).

³²⁵ World Bank, 'GDP per Capita (Current US\$) | Data' (*World Bank DataBank*) <<https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=NI-GT-HN-SV-BZ-CR-PA>> accessed 30 October 2018.

Decree 10-2012 -Tax Update Law- (Congress of the Republic)

Art.17. Presumptive income of professionals. When a university professional has received income and they are not registered as taxpayers, or they are registered but they have not filed their income tax returns, it is presumed de jure that they obtain from the liberal exercise of their profession a taxable income of thirty-thousand Quetzales per month (Q 30,000).

The taxable income in question is reduced by fifty per cent (50%) whenever the professional has graduated less than three (3) years ago or when they are older than sixty (60) years.

In assessing the tax under a presumptive basis in accordance to this article, the tax rate for which the professional is registered in shall be applied. For the assessment of the tax obligation, the taxpayer must declare the full amount of their taxable income. If the amount declared differs from the income presumed by the tax administration, the taxpayer must present for its review all the documentary evidence that supports what was declared. In any case, the taxpayer is subject to the penalties contemplated in the tax code, notwithstanding the authority of the tax administration to determine the taxable income under a certain basis.

If the taxpayer was not registered in any regime, the tax administration shall register them ex officio in the Regime on the Profits of Lucrative Activities and shall determine the tax in accordance to the previous paragraph.

³²⁶ Quinones (n 315).

Ghana

In the past, Ghana operated a presumptive tax regime for professionals as part of a more extensive presumptive regime aimed at small businesses and the self-employed³²⁷. The presumptive income for professionals was based on standard assessment guides; there was no threshold for eligibility, and the base was determined by years of practice.³²⁸ The professionals made lumpsum tax payments, and the amount was dependent on the type of profession; the ‘amounts were adjusted periodically to reflect inflationary trends and presumed increases in income’.³²⁹

The broader presumptive regime was poorly implemented, besieged by corruption, and the tax authority was insufficiently prepared to deal with the increased number of taxpayers; as a result of these challenges, the scheme did not generate much revenue.³³⁰

The presumptive regime has undergone several amendments over the years, and according to the 2015 Income Tax Act, the presumptive regime no longer applies to professionals, even where they meet the other eligibility criteria for the regime.³³¹

Summary

These country-specific experiences tell us several things. First, presumptive taxation is not a very popular option with tax authorities dealing with the HTT; the uptake of these tax regimes, for professionals, is limited to very few countries and it is therefore difficult to carry out a comprehensive comparative analysis across countries.

³²⁷ George K Adeyiga, ‘Baseline Study of Ghana’s Tax System’ (Commissioned by Ghana Integrity Initiative in Collaboration with Oxfam America with Funding from German International Development 2013) 38.

³²⁸ Rajaraman, ‘Presumptive Direct Taxation’ (n 4) 1110.

³²⁹ Adeyiga (n 327) 38.

³³⁰ *ibid* 38–39.

³³¹ Schedule 2, Ghana Income Tax Act (2015).

Second, there is scant literature on the policy considerations that inform the decision to adopt presumptive taxes for professionals. In the Greek case, it is obvious that the decision was motivated by extraneous economic circumstances and external political pressure during the economic crisis. In India, the government introduced a presumptive tax regime for professionals in response to the recommendations of a government-mandated Committee which proposed its introduction based on the popularity of the presumptive regime among small traders. Apart from these insights, there is little scholarly discourse on the policy considerations that may underpin the decision to introduce presumptive taxes for professionals; the scepticism over their suitability for professionals seems to be generally accepted without critical consideration of any counterarguments.

Third, one could argue that in Guatemala, Costa Rica, and India, the high tax rates associated with the presumptive tax regime suggest that the policy motivation for the presumptive regimes is to discourage tax evasion by compelling professionals to file returns, and keep accurate records, or risk an unusually heavy tax burden. In India, for example, the government openly acted contrary to the Committee's recommendation that the presumed income should be $33^{1/3}$ % of total gross receipts and, instead, introduced a much higher rate of 50%. Thus, while presumptive regimes for SMEs and farmers are framed as devices intended to *simplify and facilitate compliance*, governments seem to adopt a much more *punitive* stance with professionals.

This thesis seeks to challenge these assumptions and stances by considering whether, and under what conditions, presumptive taxes may be a *useful* rather than a *punitive* device for taxing professionals.

2.7. CONCLUSION

The objective of this chapter was to explore the various administrative options that tax authorities in LMICs have at their disposal, when dealing with the HTT. The author has presented and discussed five options, which are summarised below.

LMICs have the option of simply ignoring the HTT or exempting them from taxation altogether in the language of the relevant statute. Governments in LMICs may wish to do so for economic, political, or administrative efficiency reasons, as well as to protect the poorest in society from taxation and further destitution. However, this argument is weak when applied to self-employed professionals, with whom this research is concerned. There appears to be little political, economic, or administrative justification for exempting self-employed professionals from taxation. Further, professionals are highly unlikely to fall within the category of the poorest in society.

LMICs also have the option of strengthening enforcement to improve compliance by the HTT, and the benefits and cost of enforcement have been discussed in detail. The argument for increasing enforcement of the law on self-employed professionals is strong, but the reality remains that tax authorities in LMICs face considerable challenges in achieving this goal. Enforcement is costly and skill-intensive; the financial and human resources required to achieve a satisfactory level of tax enforcement in LMICs are in short supply.

LMICs may also choose to rely heavily on voluntary compliance, where enforcement is a challenge. High-income countries have, in recent decades, shifted towards trust-based and customer-centric tax administration, a trend that has picked up rapidly in LMICs. The extent to which this paradigm shift has transformed tax administration in LMICs remains open to debate; research suggests that while these tax

authorities have made significant strides, administrative changes remain cosmetic, and have not had a significant impact on tax compliance by the HTT.

LMICs also have the option of heavily relying on indirect taxation, where direct taxation is a challenge. While indirect taxes like VAT can be progressive in countries with very high rates of evasion of personal income taxes, many LMICs face serious challenges in administering VAT effectively and efficiently. It is therefore questionable whether LMICs can afford to concentrate on indirect taxation rather than increase enforcement among the HTT.

The final option discussed is subjecting the HTT to presumptive tax. These regimes are popular among LMICs trying to reach the HTT. The author has discussed what presumptive taxes are, their legal characteristics, how they can be useful, how they are designed, and their benefits and risks. Scholarly discourse on the use of presumptive taxes has mostly considered their suitability for SMEs and farmers.³³² Scholarly literature rarely explores the suitability of presumptive tax regimes for professionals, and when it is mentioned, the conclusion is to reject the use of presumptive taxation for professionals.³³³ The author has also explained that although these regimes are intended for the HTT, most countries will opt to exempt professional income from presumptive taxation. A tiny number of countries have applied presumptive tax regimes to professional income, but the policy goal in those countries seems to be deterrence, i.e., to ensure that the rate is punitive, in order to deter evasion and encourage taxpayers to

³³² Musgrave (n 96); S Nuri Erbas, *Presumptive Taxation: Revenue and Automatic Stabilizer Aspects* (International Monetary Fund 1993); Christian R Jaramillo, 'On the Use of Presumptive Income Taxes to Alleviate the Burden of Tax Compliance' (National Tax Association 2003) <<https://search.proquest.com/docview/195454232/abstract/6C99CB14309C4C61PQ/1>> accessed 1 August 2018; Terkper (n 4); Richard M Bird and Eric M Zolt, 'Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries Symposium - Rethinking Redistribution: Tax Policy in an Era Rising Inequality' (2004) 52 *UCLA Law Review* 1627; Bird and Wallace (n 99); Rajaraman, 'Taxing Agriculture in a Developing Country: A Possible Approach' (n 4); Konstantin V Pashev, 'Presumptive Taxation: Lessons from Bulgaria' (2006) 18 *Post-Communist Economies* 399.

³³³ Musgrave (n 96); Thuronyi (n 249); Bird and Wallace (n 99).

file their income tax returns in a timely manner and on a certain basis. Presumptive taxes for professionals do not appear to be aimed at lowering the cost of or simplifying compliance. This thesis will propose that LMICs should consider the limited and targeted use of presumptive taxation for some professionals, for purposes other than deterrence.

The options presented in this chapter are very diverse; further, the most suitable option(s) for a country will depend mainly on local reality and the main drivers of tax evasion by the HTT in that country. Therefore, in the next chapter, the author will discuss the main theories on tax evasion and compliance, thus setting out the theoretical framework for the case study. After that, using the case study data, the author will discuss the strategies that best respond to the reasons for evasion in by self-employed professionals.

3. WHY DO PEOPLE EVADE TAXES?

3.1. INTRODUCTION

The author's goal, in the two previous chapters, was to introduce the reader to the HTT, distinguish them from other taxpayers in the economy, and explore the administrative options, at the disposal of tax authorities in LMICs, for dealing with the HTT. These diverse options ranged from doing nothing on the one hand, to strict enforcement or introduction of special tax regimes on the other. The author concluded by suggesting that the most suitable option(s) for a given country will partially depend on the main drivers of tax evasion by the HTT in general, and self-employed professionals in particular, in the country concerned.

Thus, in this chapter, we turn to the key theories on, or determinants of, tax compliance in tax literature. These theories provided the theoretical framework which served as the lens through which the data collected for the case study in Chapter 4 was analysed.

3.2. WHAT IS TAX COMPLIANCE?

What are the attributes of a compliant taxpayer? What exactly does the term 'tax compliance' mean? Tax compliant behaviour has been described as including:

- i. registering with the revenue authority as required;
- ii. filing the required returns on time;
- iii. reporting tax liability accurately (in the required returns) per prevailing legislation, rulings, return instructions, and court decisions;
- iv. paying any outstanding taxes as they fall due; and
- v. maintaining all records as required.³³⁴

³³⁴ McKerchar and Evans (n 208) 172.

Non-compliance would, therefore, refer to the failure to meet one or more of these requirements. Non-compliance may take many forms; Figure 6 below demonstrates a spectrum of non-compliant behaviour.



Figure 7: Spectrum of non-compliance

It is important, and helpful, for tax authorities to view non-compliance along a spectrum; this perspective enables authorities segment taxpayer behaviour into different categories and take targeted and appropriate action against the non-compliance, taking into account its nature, motivation, and effects. In recent years, the border between tax planning and

tax avoidance has become hazy. The debate on the boundary between the two terms is further complicated by the introduction of vague terms such as ‘aggressive tax planning’ and ‘illicit financial flows’, whose definitions are far from universally agreed.

This thesis does not delve into this debate; for our purposes, it is enough to note that the law takes cognisance of this spectrum of non-compliant behaviour and, as a result, will treat ‘offenders’ differently based on where they fall in the spectrum. The law recognises that tax avoidance is not a criminal or fraudulent activity, but rather a non-fraudulent misapplication of the law. As such, if the court finds that a tax planning structure is ineffective, it will disregard the activities that led to the lower tax obligation and direct the taxpayer to pay the correct higher tax amount; however, criminal sanctions will not attach unless the court specifically finds additional evidence of fraudulent or dishonest behaviour by the taxpayer. Characterising the non-compliance as tax avoidance does not prevent the revenue authority from levying interest and penalties on the tax due.

Evasion, unlike avoidance, involves the aspect of dishonesty.³³⁵ Tax evasion is very clearly a criminal offence, and is penalised as such by use of custodial sentences and financial penalties.³³⁶ However, even under this class of non-compliance, there is a spectrum. Tax evasion or compliance theorists do not often segment evaders in this way, choosing, instead, to focus on the macro determinants of compliance- economic, socio-political and cultural motivations. On the other hand, the law focuses on micro-determinants of compliance by segmenting taxpayers according to the seriousness of their motivation or reason for non-compliance, rather than on socio-political concerns. This approach may explain the dearth of compliance theory literature within tax law literature.

³³⁵ Mark McLaughlin (ed), *HMRC Investigations Handbook 2016/2017* (Bloomsbury 2017) 64.

³³⁶ R. Seer and A.L. Wilms (eds), *Surcharges and Penalties in Tax Law: 2015 EATPL Congress Milan, 28-30 May 2015* (IBFD Publications 2016) 6.

3.3. WHY DO PEOPLE EVADE TAXES? PERSPECTIVES FROM LAW

Although tax law does not theorise tax evasion behaviour, tax statutes in all countries will segment taxpayer behaviour by motive, and this segmentation is reflected in the proportionality of the applicable penalties. Tax statutes will often use the following words to distinguish the ‘motives’ for evasion:

- i. People evade taxes as a result of ‘mistake’, ‘misapprehension’, ‘misinterpretation’, ‘clerical error’, ‘taking a reasonably arguable position’, and ‘the taxpayer not knowing the correct position and cannot be reasonably expected to have known’³³⁷;
- ii. People evade taxes as a result of ‘failure to notify the tax authority that an assessment is to low’,³³⁸
- iii. People evade taxes as a result of ‘failure to take reasonable care’³³⁹;
- iv. People evade taxes as a result of ‘recklessness’;³⁴⁰
- v. People evade taxes as a result of ‘taking a position that is not arguable’;³⁴¹
- vi. People evade taxes as a result of ‘deliberate understatement’, ‘deliberate intent to mislead’, and ‘intentional disregard’;³⁴²

³³⁷ McLaughlin (n 335) 653, 655 on U.K. provisions on tax evasion; Section 84 (5) of the Kenyan Tax Procedures Act No. 29 of 2015; Australian Taxation Office, ‘Australian Taxation Office | Penalties’ (*Australian Government | Australian Taxation Office*) <<https://www.ato.gov.au/General/Interest-and-penalties/Penalties/Statements-and-positions-that-are-not-reasonably-arguable/?default>> accessed 31 October 2018.

³³⁸ McLaughlin (n 335) 648.

³³⁹ *ibid* 661; Australian Taxation Office (n 337); Section 84 of the Kenyan Tax Procedures Act No. 29 of 2015.

³⁴⁰ Australian Taxation Office (n 337).

³⁴¹ *ibid*.

³⁴² *ibid*; Section 84 of the Kenyan Tax Procedures Act No. 29 of 2015; McLaughlin (n 335) 661.

- vii. People evade taxes as a result of ‘deliberate understatement and concealment’, ‘failing to lodge a tax return’ and ‘failing to keep proper records’³⁴³.

These varied motives for non-compliance require different interventions by the revenue authority. Principles of fairness demand that taxpayers who are non-compliant as a result of a mistake or a clerical error, ought to be treated differently from taxpayers who are deliberately intent on misleading the tax authority. Tax authorities ought to apply administrative effort to separate the genuinely ‘unable to comply’ group, who require greater administrative support and education, from the ‘will not comply’ group, for whom stronger enforcement is a better approach.

The researcher will demonstrate, through the case study in Chapter 4, that causes of non-compliance by self-employed professionals in Kenya range from:

- i. the failure or inability to keep proper records;
- ii. Situations where taxpayers genuinely did not know that they were making false statements to the revenue authority. For example, where a professional genuinely but erroneously believed that the 5% withholding tax levied on their income was the only tax they needed to pay on that income. Would the revenue authority treat this taxpayer's erroneous belief as ‘reasonable’ within the meaning of Section 84 (5) of the Tax Procedures Act?
- iii. Deliberately misleading the Authority by failing to disclose or under-disclosing income.

³⁴³ McLaughlin (n 335) 661; Australian Taxation Office (n 337); Section 82 of the Kenyan Tax Procedures Act No. 29 of 2015.

3.4. WHY DO PEOPLE EVADE TAXES? PERSPECTIVES FROM ECONOMICS, PSYCHOLOGY & POLITICS

Tax compliance theories are quite well developed in economics, psychology, and political literature. Most literature on tax compliance and evasion loosely group the theories on taxpayers' compliance behaviour into three categories: economic deterrence or coercion theories, fiscal psychology or fiscal exchange theories, and social psychology or influences theories.³⁴⁴ Fjeldstad et.al. refer to the theories as the 'five schools of thought' on determinants of tax evasion and expands on those groups to include (i) comparative treatment or equity which, arguably, can be adequately covered under social psychology or social influences theory and (ii) political legitimacy which, again, can be adequately covered under, fiscal exchange theory.³⁴⁵

In the last section of this chapter, we will delve into the 'slippery slope' framework. The proponents of the framework suggest that it can be used as a conceptual tool to study the other determinants of compliance stated above, as well as used as an operational tool within the context of responsive regulation approaches to increase tax compliance.³⁴⁶ In Chapter 5, the author will interrogate whether, in light of the findings of the case study in Chapter 4, the slippery slope framework ought to be modified for countries with large informal cash-based economies, very high levels of corruption, low tax morale, and a weak tax compliance culture.

3.4.1. Economic Deterrence Theories

Proposition: Taxpayers who perceive tax evasion as costly are more likely to comply.

³⁴⁴ Odd-Helge Fjeldstad and Joseph Semboja, 'Why People Pay Taxes: The Case of the Development Levy in Tanzania' (2001) 29 World Development 2059, 2060; McKerchar and Evans (n 208) 175.

³⁴⁵ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 3.

³⁴⁶ Erich Kirchler, Erik Hoelzl and Ingrid Wahl, 'Enforced Versus Voluntary Tax Compliance: The "Slippery Slope" Framework' (2008) 29 Journal of Economic Psychology 210, 214.

The economic deterrence model enables researchers to study tax compliance behaviour from a theoretical perspective. The economic deterrence or coercion theories are the focus of the influential work by Becker and the well-known classical tax evasion model by Allingham and Sandmo.³⁴⁷ Allingham and Sandmo studied some aspects of the decision to evade income tax and concluded that taxpayer behaviour is influenced primarily by punishment or sanctions. The theories assume that taxpayers carry out a cost-benefit analysis, i.e., assess the benefits of evasion (the undeclared income) and the costs of evasion (the risk of detection and the penalties and interest subsequently imposed as punishment) and thereafter arrive at a rational decision. Under this 'utility theory,' if the costs outweigh the benefits, would-be evaders are likely to be deterred. The assumption here is that the taxpayers are 'perfectly moral, risk-neutral or risk-averse individuals who seek to maximise their utility and chose to evade tax whenever the expected gain exceeded the cost.'³⁴⁸

The various variables that have been examined under this theory include, the probability of detection through audit, the enormity of penalties for non-compliance, the potential for withholding and information reporting, and the level of tax rates.

Audits, fines, and penalties for noncompliance are viewed as central to the taxpayer's decision not to evade, i.e., taxpayers respond to the threat of punishment. Allingham and Sandmo suggest that the deterrents can be used interchangeably; if the risk of detection is high, penalties can be low, or moderate, as the risk of detection is probably sufficient to deter would-be evaders.³⁴⁹ If the risk of detection is low, the

³⁴⁷ Gary S Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 *Journal of Political Economy* 169; Michael G Allingham and Agnar Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 1 *Journal of Public Economics* 323.

³⁴⁸ VC Milliron and DR Toy, 'Tax Compliance: An Investigation of Key Features' (1988) 9 *Journal of the American Taxation Association* 84, 85.

³⁴⁹ Allingham and Sandmo (n 347) 330.

penalties should be high enough to be a deterrent.³⁵⁰ However, the evidence on the efficacy of penalties and audits is mixed. For example, there is evidence that a high risk of detection is much more effective than the penalties imposed for the infraction.³⁵¹

The classical evasion model has been criticised for being too simplistic in its view by overstating the rationality of taxpayers, erroneously assuming the homogeneity of taxpayer response, and ignoring other social and psychological influences on compliance decisions. Over time, the theory has been modified and extended to address its perceived deficiencies.³⁵² One extension has been the proposal that a tax system that penalises evasion and rewards compliance is more effective than one that only has penalties.³⁵³ Another extension of the theory is that if the penalty for evasion is levied on the unpaid tax (rather than the undeclared income, per Allingham and Sandmo), an increase in the tax rate does not alter the taxpayer's decision.³⁵⁴ 'As the tax rate rises, the cost of a detected understatement of taxes rises in exact proportion to the reward from a successful understatement of taxes, so the reward-to-risk ratio is unchanged.'³⁵⁵

Despite these modifications and extensions, the model is generally criticised for having a very narrow and theoretical view of human behaviour, reducing human behaviour to numerical or mathematical expression, and relying on unrealistic

³⁵⁰ Betty R Jackson, 'Salience of Tax Evasion Penalties Versus Detection Risk' (1985) 6 *The Journal of the American Taxation Association* 7.

³⁵¹ Charles R Tittle and Charles H Logan, 'Sanctions and Deviance: Evidence and Remaining Questions' (1973) 7 *Law & Society Review* 371; Lederman (n 195) 15.

³⁵² See, for example, Frank A Cowell, 'The Economic Analysis of Tax Evasion' (1985) 37 *Bulletin of Economic Research* 163; Michael J Graetz, Jennifer F Reinganum and Louis L Wilde, 'The Tax Compliance Game: Toward an Interactive Theory of Law Enforcement' (1986) 2 *Journal of Law, Economic, & Organisation* 1; Suzanne Scotchmer and Joel Slemrod, 'Randomness in Tax Enforcement' (1989) 38 *Journal of Public Economics* 17; *ibid.*

³⁵³ Josef Falkinger and Herbert Walther, 'Separating Small and Big Fish: The Case of Income Tax Evasion' (1991) 54 *Journal of Economics* 55, 56.

³⁵⁴ Shlomo Yitzhaki, 'A Note on Income Tax Evasion: A Theoretical Analysis' (1974) 3 *Journal of Public Economics* 201, 201.

³⁵⁵ Slemrod (n 11) 36.

fundamental assumptions.³⁵⁶ Besides, it has also been argued that these theories cannot account for high levels of compliance within populations with low levels of surveillance and audit, such as the United States of America and Scandinavian nations, and therefore largely ignores aspects of consensual compliance. Allingham and Sandmo do acknowledge, in their conclusion, that the model does no more than yield some insight into the nature of evasion and that more research, from different theoretical and empirical perspectives, is required.³⁵⁷

While some scholars have argued that this utilitarian approach delivers an incomplete picture as there is little empirical evidence of their accuracy³⁵⁸, there are scholars, who disagree with the wholesale dismissal of the theory; they opine that while there has been no compelling empirical evidence addressing how noncompliance is affected by penalties, this is distinct from how noncompliance is affected by the probability that noncompliance will be detected and punished.³⁵⁹ One piece of evidence offered in support of this view is that, in the United States, there are stark differences in compliance rates across taxable items that line up closely with detection rates, which suggests that deterrence plays a significant role in evasion decisions.³⁶⁰

Compared to high-income countries where there is a long history of research into tax evasion and the testing of various compliance theories, there is comparatively little knowledge on the validity of economic deterrence theories in LMICs in Africa. This dearth of research is partly because of the unavailability of adequate and reliable data upon which to base such studies.

³⁵⁶ McKerchar and Evans (n 208) 175.

³⁵⁷ Allingham and Sandmo (n 347) 323.

³⁵⁸ McKerchar and Evans (n 208) 175.

³⁵⁹ Slemrod (n 11) 38.

³⁶⁰ *ibid* 45.

However, a study on taxpayer attitudes and perceptions among citizens of Kenya, Uganda, Tanzania, and South Africa found that ‘respondents in South Africa and Kenya are more likely to express a tax compliant attitude if they perceive that enforcement makes evasion more difficult’; this was not the case in Tanzania and Uganda.³⁶¹ This finding partially confirms the proposition of the economic deterrence theories.

The proposed explanation for the divergence witnessed in Tanzania and Uganda is the size of their informal sectors- 60% compared to approximately 30% in Kenya and South Africa.³⁶² As explained in Chapter 1 and 2, it is notoriously difficult to enforce taxes on the informal sector since they are cash-based and highly mobile; therefore, the actors in that sector know that the risk of detection is low, rendering the penalties stated in the law meaningless. As Ali et al. rightly argue, it is possible that we witness the fear of enforcement having a more significant impact on compliance attitudes in Kenya and South Africa because of the presence of a smaller informal sectors.³⁶³ In countries with larger informal sectors, tax evasion is more likely to be driven by illiteracy and a breakdown in trust between the taxpayer and the government, rather than by fear of enforcement.³⁶⁴

A similar confirmation of the economic deterrence theories comes from a South African survey on perceptions of taxation amongst different groups; 45% of the respondents to the survey indicated that they believed people evade tax because the risk of getting caught by SARS is low, suggesting that deterrence efforts play a significant role in influencing compliance decisions.³⁶⁵

³⁶¹ Merima Ali, Odd-Helge Fjeldstad and Ingrid Hoem Sjurset, ‘To Pay or Not to Pay? Citizens’ Attitudes Toward Taxation in Kenya, Tanzania, Uganda, and South Africa’ (2014) 64 *World Development* 828, 837.

³⁶² *ibid.*

³⁶³ *ibid.*

³⁶⁴ *ibid.*

³⁶⁵ R Oberholzer and EM Stack, ‘Perceptions of Taxation: A Comparative Study of Different Population Groups in South Africa’ (2014) 40 *Public Relations Review* 226, 236.

3.4.2. Social Psychology or Social Influences Theories

Proposition 1: Taxpayers who believe that other taxpayers are complying, are more likely to comply

Tax compliance literature now firmly accepts that social interactions influence taxpayer behaviour. This view is partially premised on *social influence theory*, i.e., behaviour and attitudes of individuals are affected by the behaviour and social norms of that individual's reference group.³⁶⁶ Snavelly argues that this theory applies in the field of taxation in the same way, i.e., the willingness to engage in tax evasion is influenced by one's social interactions.³⁶⁷ If a taxpayer knows many people who are engaged in tax evasion, in groups that are important to him, i.e., professional colleagues, family members, and friends, he is likely to be more willing to evade as well.³⁶⁸

In addition to the influence exerted by social groups, the fact that one's peers are evading removes the fear of informal sanctions from those peers, if one is caught evading, a fear that may encourage compliance.³⁶⁹ Existing research also suggests that social influences can influence taxpayers' perceptions about the probability of being detected when one engages in evasion.³⁷⁰

Taxpayers who report that they have evaded, are also likely to report that they believe their peers are also cheating. Therefore, the failure to deal with tax evasion has severe consequences beyond the loss of revenue. Ignoring or inadequately dealing with tax evasion threatens the tax morale of other taxpayers, undermines the overall credibility of the tax system, and is likely to result in more evasion.

³⁶⁶ Ali, Fjeldstad and Sjursen (n 361) 829.

³⁶⁷ Keith Snavelly, 'Governmental Policies to Reduce Tax Evasion: Coerced Behavior versus Services and Values Development' (1990) 23 Policy Sciences 57, 62.

³⁶⁸ *ibid* 57; Fjeldstad and Semboja (n 344) 2061; Onu and Oats, "'Paying Tax Is Part of Life'" (n 19) 29.

³⁶⁹ McKerchar and Evans (n 208) 178.

³⁷⁰ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 6.

Empirical evidence, from a diverse range of countries, confirms the validity of this proposition.³⁷¹ For example, evidence in the literature shows that there is a positive relationship between occupational culture and tax compliance.³⁷² In an Australian study on the role of occupational taxpaying culture on tax evasion or compliance decisions, the authors argued that new members of an occupation are ‘tax novices’ but soon adapt to the taxpaying culture within their occupation-be it one of compliance or one of evasion.³⁷³ The central question in that study was ‘whether individuals’ perceptions of their occupational group’s taxpaying norms and values influence their taxpaying behaviour and attitudes’.³⁷⁴ The researchers concluded, based on their findings, that occupational taxpaying culture shapes how taxpayers position themselves vis-à-vis the revenue authority, i.e., whether they are honest, co-operative, or resistant.³⁷⁵

A British qualitative study on tax communication and social influence found that under declaring or not declaring payments received in cash was a common practice among construction workers in Britain.³⁷⁶ There is also interesting qualitative research in the United Kingdom, showing that taxpayers in similar professions communicate about tax and influence each other through online platforms.³⁷⁷

A Latin American study identified higher tax morale among taxpayers who reported that they believed that others were complying with their tax obligation, while those who believed that others were noncompliant had significantly lower tax morale.³⁷⁸

³⁷¹ See Onu and Oats, “‘Paying Tax Is Part of Life’” (n 19) for a discussion on evidence from various empirical studies.

³⁷² *ibid* 31–32.

³⁷³ Julie S Ashby, Paul Webley and Alexander S Haslam, ‘The Role of Occupational Taxpaying Cultures in Taxpaying Behaviour and Attitudes’ (2009) 30 *Journal of Economic Psychology* 216, 217.

³⁷⁴ *ibid*.

³⁷⁵ *ibid* 224.

³⁷⁶ Maria Sigala, Carole B Burgoyne and Paul Webley, ‘Tax Communication and Social Influence: Evidence from a British Sample’ (1999) 9 *Journal of Community & Applied Social Psychology* 237, 238.

³⁷⁷ Onu and Oats, “‘Paying Tax Is Part of Life’” (n 19); Onu and Oats, ‘Tax Talk’ (n 19).

³⁷⁸ Benno Torgler, ‘Tax Morale in Latin America’ (2005) 122 *Public Choice* 133, 153.

A study on tax attitudes in Kenya, Uganda, Tanzania, and South Africa identified, in Tanzania, an increase in tax compliance among those who perceived that others were complying; a similar attitude was not observed in the other three countries.³⁷⁹ The authors posit that this is a reflection of the high level of homogeneity within Tanzania, unlike the other three countries where citizens demonstrate powerful ethnic or racial identity, and those identities often take precedence over their national identity.³⁸⁰ They explain that ‘while the whole country is the likely reference group for the majority of Tanzanian respondents, this might not be the case in the other countries where the reference group might be the tribe or race, and not the whole country’.³⁸¹

In an investigation into the reasons for the variation in compliance behaviour within and between local authorities with similar socio-economic characteristics, in South Africa, the researchers analysed the results of two comprehensive national surveys and concluded, *inter alia*, that trust in other citizens to pay their share of the service charges played a significant role.³⁸²

Specifically, the research found that:

*...knowledge of the compliance behaviour of others seemed to influence the perceived probability of being detected for non-payment. The larger the fraction of the local population that was observed not paying the lower was the perceived risk of being prosecuted. ... Furthermore, the interaction between social networks and overlapping collective activities had in some instances... provided a framework in which it was difficult for individuals to pay their charges without provoking reactions from their non-paying neighbours and other members of the community.*³⁸³

³⁷⁹ Ali, Fjeldstad and Sjursen (n 361) 837.

³⁸⁰ *ibid.*

³⁸¹ *ibid.*

³⁸² Odd-Helge Fjeldstad, ‘What’s Trust Got to Do with It? Non-Payment of Service Charges in Local Authorities in South Africa’ (2004) 42 *The Journal of Modern African Studies* 539, 556.

³⁸³ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 27–28.

Proposition 2: Taxpayers who believe that they are treated comparatively fairly to other taxpayers are more likely to comply.

According to the equity theory, ‘individuals are more likely to comply with rules if they perceive the system that determines those rules to be equitable. Where there are perceived inequities, individuals will adjust their inputs to the exchange until equity is restored.’³⁸⁴ Thus, taxpayers who believe that they, and those within their reference group, are being treated fairly by the government are more likely to exhibit compliant behaviour.³⁸⁵ By extension, taxpayers who perceive the tax system to be unfair or unjust may reduce or stop their contribution in a bid to restore fairness in their relationship with the government. There is empirical evidence that trust in the revenue authority is a precondition to viewing the actions of the revenue authority as fair.³⁸⁶

A study on 17 African countries, using data from Afrobarometer surveys, suggests that fair treatment by the state, both of individuals and groups, results in a more positive attitude towards tax compliance.³⁸⁷ For example, taxpayers who believed that (i) they were treated comparatively equitably to taxpayers from different ethnic communities, (ii) government officials who were caught evading would face the same extent of law enforcement that ordinary citizens would and (iii) they, and people like them, would face enforcement; were more likely to demonstrate a positive attitude towards tax compliance.³⁸⁸ However, Fjeldstad et al., advise approaching these findings with caution on the basis of several critiques, i.e., the choice of variables used to test the

³⁸⁴ McKerchar and Evans (n 208) 176.

³⁸⁵ Ali, Fjeldstad and Sjursen (n 361) 830.

³⁸⁶ Peggy Jimenez and Govind S Iyer, ‘Tax Compliance in a Social Setting: The Influence of Social Norms, Trust in Government, and Perceived Fairness on Taxpayer Compliance’ (2016) 34 *Advances in Accounting* 17, 18.

³⁸⁷ Michelle D’Arcy, ‘Why Do Citizens Assent to Pay Tax? Legitimacy, Taxation, and the African State’ (2011) Working Paper No. 126 Afrobarometer Working Papers 14.

³⁸⁸ *ibid* 17.

hypothesis, the operationalisation of the dependent variable, and the omission of other primary theoretical considerations- economic deterrence and social influences -which, in their view, renders the results inconclusive.³⁸⁹

A study testing the effects of the comparative treatment of one's ethnic group on compliance attitudes provided no evidence of its effects on tax compliance attitudes in Kenya and Uganda; the evidence from Tanzania and South Africa was, at best, inconclusive.³⁹⁰

Conclusion

Social influence theories go a step further than economic deterrence theories, which focus on the rational aspects of compliance decisions, by considering the social and psychological factors that influence human behaviour, and which cannot be reduced to a mathematical expression. Some of these factors may produce an irrational decision since what is perceived is not always the reality, i.e., the perceived unfairness or perceived level of evasion within one's reference group does not always reflect the reality.

3.4.3. Fiscal Psychology/Exchange Theory

Proposition: Tax compliance behaviour is positively correlated with the taxpayers' level of satisfaction with government provision of goods and services

According to the fiscal exchange theory, government expenditure may motivate tax compliance.³⁹¹ In other words, tax compliance increases to the extent that taxpayers perceive that they are obtaining the benefits they expect from the government.³⁹² Alm et al. theorise that even in the absence of the risk of detection and punishment, some

³⁸⁹ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 29.

³⁹⁰ Ali, Fjeldstad and Sjursen (n 361) 828.

³⁹¹ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 4.

³⁹² Ali, Fjeldstad and Sjursen (n 361) 829.

taxpayers will increase their compliance if there is an increase in the value of the goods that they receive from the government, and will voluntarily comply so that they can receive government services.³⁹³ Therefore, increased government expenditure may increase low levels of compliance. The evidence suggests that ‘government can increase compliance by providing goods that their citizens prefer more by providing these goods in a more efficient manner, or by more effectively emphasizing that taxes are necessary for receipt of government services.’³⁹⁴

The basis for the fiscal exchange theory is the belief that citizens look at their relationship with government as a social contract; a quid pro quo arrangement in which they meet their end of the bargain by paying taxes and the government, in return, delivers services as expected.³⁹⁵ In other words, in paying taxes, citizens surrender their purchasing power in the market, in exchange for government services.³⁹⁶ Fjeldstad et al., argue that the existence of positive benefits for the citizen would encourage voluntary compliance, although that compliance is always varied and conditional on the government’s ‘performance, honesty, attention to due process and other determinants of government reliability’.³⁹⁷ Against this backdrop, tax evasion is, therefore, an attempt by an aggrieved taxpayer, who is dissatisfied with his terms of trade with the government, to alter those terms of trade.³⁹⁸ When the system breaks down, the taxpayers will attempt to restore ‘fairness’ in their relationship with government by reducing or stopping their tax payments. When the taxpayer is satisfied with the government’s performance, they are more likely to continue to fund it.

³⁹³ James Alm, Gary H McClelland and William D Schulze, ‘Why Do People Pay Taxes?’ (1992) 48 *Journal of Public Economics* 21, 36.

³⁹⁴ *ibid* 34.

³⁹⁵ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 4.

³⁹⁶ Fjeldstad and Semboja (n 344) 2061.

³⁹⁷ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 4.

³⁹⁸ Fjeldstad and Semboja (n 344) 2061.

There is mixed evidence on the validity of the fiscal exchange theory. A South African study did not find clear correlations between service delivery and compliance.³⁹⁹ D’Arcy finds evidence, using Afrobarometer survey data, that government provision of health and education services influences compliance attitudes in the 17 African states pooled in the research.⁴⁰⁰

Another study, utilising Afrobarometer survey data to study compliance attitudes in Kenya, Uganda, Tanzania, and South Africa, concluded that ‘those who are more satisfied with public service provision are more likely to have a tax compliant attitude in all the four countries’.⁴⁰¹ However, the study also found that the countries differed regarding the services that taxpayers valued and thereby linked to their compliance. While South Africans valued policing services, the Kenyan respondents valued infrastructure (roads and electricity); in Uganda and Tanzanian, education and health services encouraged a compliant attitude.⁴⁰² The research did not explore the rationale behind these variations, although the authors suggest some explanations.⁴⁰³

There is also evidence, in support of these theories, from research carried out in West Africa, examining ‘how public goods delivery and local community context affect tax morale where state capacity is weak and tax evasion is prevalent’.⁴⁰⁴ Using data from an independent academic survey on taxation and political attitudes conducted in 11 Nigerian states, the researchers found that the receipt of concrete benefits from the state, and a favourable view on state use of taxes had a positive effect on compliance

³⁹⁹ Fjeldstad (n 382) 550.

⁴⁰⁰ D’Arcy (n 46) 17. However, as explained above, the results of this study have been criticised for being incomplete. See Fjeldstad, Schulz-Herzenberg and Sjursen (n 12) 29.

⁴⁰¹ Ali, Fjeldstad and Sjursen (n 361) 837.

⁴⁰² *ibid* 835.

⁴⁰³ *ibid* 837.

⁴⁰⁴ Cristina Bodea and Adrienne LeBas, ‘The Origins of Voluntary Compliance: Attitudes toward Taxation in Urban Nigeria’ (2016) 46 *Brit. J. Polit. Sci. British Journal of Political Science* 215, 218.

attitudes.⁴⁰⁵ The study further develops the fiscal exchange theory by finding that, citizens who benefited from club goods, without the intervention of the state, were less likely to view tax compliance as an obligation; however, citizens in conflict-prone areas were an exception to this finding.⁴⁰⁶

Finally, another study on the relationship between electricity provision and revenue mobilisation, also utilising Afrobarometer data alongside other data sources, provided evidence that access to electricity has a robust positive impact on tax compliance in sub-Saharan countries.⁴⁰⁷ Interestingly, the researchers also found that ‘extending grid connection to a community induces positive attitudes among residents toward honouring their tax obligations, even if the individual’s household is yet to be connected to electricity’.⁴⁰⁸ The authors explain that ‘access to electricity improves citizens’ sense of “belonging” to the state as opposed to ethnic groups’ thereby increasing their willingness to pay taxes.⁴⁰⁹

3.4.4. Political Legitimacy

Proposition: Taxpayers who trust their government and view it as legitimate are more likely to comply with their tax obligations.

Corruption and failure in service delivery damage the political legitimacy of authorities and institutions thereby, discouraging voluntary tax compliance.⁴¹⁰ Legitimacy has been

⁴⁰⁵ *ibid* 235.

⁴⁰⁶ *ibid*.

⁴⁰⁷ Moussa Blimpo and others, ‘Electricity Provision and Tax Mobilization in Africa’ (2018) Working Paper 8408 World Bank Policy Research Working Papers <<http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-8408>> accessed 1 November 2018.

⁴⁰⁸ *ibid* 27.

⁴⁰⁹ *ibid* 24.

⁴¹⁰ Benno Torgler, ‘Tax Morale, Rule-Governed Behaviour and Trust’ (2003) 14 Constitutional Political Economy 119; Torgler, ‘The Importance of Faith’ (n 11); Lars P Feld and Bruno S Frey, ‘Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation’ (2007) 29 Law & Policy 102; Bernard Fortin, Guy Lacroix and Marie-Claire Villeval, ‘Tax Evasion and Social Interactions’ (2007) 91 Journal of Public Economics 2089; James Alm, Jorge Martinez-Vazquez and Chandler McClellan, ‘Corruption and Firm Tax Evasion’ (2016) 124 Journal of Economic Behavior & Organization 146; Baum A and others, ‘Corruption, Taxes and Compliance’ (2017) 15 eJournal of Tax

described as ‘belief or trust in the authorities, institutions and social arrangements to be appropriate, proper, just and work for the common good’.⁴¹¹ The political legitimacy theory espoused by Kirchler et al., among others, states that there is a positive relationship between citizen's perceptions about the government's legitimacy and obedience to rules, policies, and decisions.⁴¹² Tyler argues that using power or coercion as the basis of getting citizens to obey the rules and policies of an institution or authority is inefficient and rarely effective; since it involves enormous expenditure of resources to set up an extensive and accurate surveillance and detection systems, the influence exerted by such authorities is difficult to create and maintain.⁴¹³ In comparison, ‘when people view their authority as being appropriate and proper, ... they feel obligated to defer to the decisions made by leaders with legitimacy and the policies and rules they create’.⁴¹⁴

This argument applies both at the national government level and at the level of government agencies such as the revenue authority; per Kirchler et al., when citizens believe that the revenue authority is legitimate, i.e., trustworthy, just, fair, benevolent, and aims to work for the good of all, they are more inclined to comply.⁴¹⁵ Simply put, when citizens view their government and their revenue authority as just and working for the common good, they may respond more readily to tax legislation without the need for costly and time-consuming surveillance, audits, and enforcement procedures.

Empirical evidence on this theory is mixed. A study on compliance attitudes in Kenya, Uganda, Tanzania, and South Africa did not find strong evidence in support of

Research; Sydney 190; Björn Jahnke, ‘How Does Petty Corruption Affect Tax Morale in Sub-Saharan Africa: An Empirical Analysis’ WIDER Working Paper 2017/8 32; Schlenker (n 46); Rosid, Evans and Tran-Nam (n 234).

⁴¹¹ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 7.

⁴¹² Kirchler, Hoelzl and Wahl (n 346) 211.

⁴¹³ Tyler (n 52) 377.

⁴¹⁴ *ibid* 393.

⁴¹⁵ Kirchler, Hoelzl and Wahl (n 346) 212.

this theory; the researchers explain that they do not find support for the proposition that trust in government policy and institutions affects compliance attitudes.⁴¹⁶

On the other hand, a 2009 study utilising Afrobarometer data found ‘considerable statistical evidence of a link between the extent of the trustworthiness of government and procedural justice and citizens’ willingness to defer to the police, courts and tax department in a number of African countries’.⁴¹⁷

3.5. THE SLIPPERY SLOPE FRAMEWORK

The foundational basis for the slippery slope framework is the view that the tax climate in society varies on a spectrum with an antagonistic climate at one end, and a synergistic one at the other.⁴¹⁸ The framework has two main assumptions:

- i. Where there is an *antagonistic climate*, the tax authority and taxpayers exhibit a ‘cops and robbers’ attitude- the tax authority perceives the taxpayers as continually trying to evade, while the taxpayers perceive the authority as persecutors from whom they should hide, and the consequence of this dynamic is negligible voluntary compliance.⁴¹⁹
- ii. In the *synergistic climate*, the tax authority and taxpayers demonstrate a ‘service and client’ attitude- the authority’s goal is transparent, respectful, and supportive treatment of the taxpayers, while the taxpayers perceive those in the tax authority as belonging to their community and providing a service to the community; this results in higher levels of voluntary compliance.⁴²⁰

⁴¹⁶ Ali, Fjeldstad and Sjursen (n 361) 838.

⁴¹⁷ Fjeldstad, Schulz-Herzenberg and Sjursen (n 12) 32 citing Margaret Levi, Audrey Sacks and Tom Tyler, ‘Conceptualizing Legitimacy, Measuring Legitimizing Beliefs’ (2009) 53 *American Behavioral Scientist* 354.

⁴¹⁸ Kirchler, Hoelzl and Wahl (n 346) 211.

⁴¹⁹ *ibid.*

⁴²⁰ *ibid.*

Building on these foundational assumptions, the proponents of this theory argue that ‘power’ of tax authorities and ‘trust’ in tax authorities interact to shape the tax climate and thus influence the level of tax compliance. For purposes of the framework, ‘power’ is defined as *‘taxpayers’ perception of the potential of tax officers to detect illegal tax evasion, for example by conducting frequent and thorough tax audits, and to punish evasion, for example by fining evaders to a noticeable extent’*.⁴²¹ On the other hand, ‘trust’ is defined as *‘the general opinion of individuals and social groups that the tax authorities are benevolent and work beneficially for the common good’*.⁴²² The main argument is that both power and trust can be used to achieve tax compliance, but the increased use of power results in *enforced compliance* while the increased use of trust results in *voluntary compliance*.⁴²³ Thus, according to the framework, while audits and fines lead to enforced compliance, trust and a good relationship between the tax authority and taxpayers, including services that make compliance easier and more convenient, lead to voluntary compliance.⁴²⁴

The framework, however, recognises that power can be perceived as legitimate and persuasive, or as unfair and coercive; the exercise of legitimate power increases trust in the authority as it confirms that wrongdoers will be punished while the exercise of coercive power destroys trust.⁴²⁵ In a theoretical extension of the framework, Gangl adds that establishing legitimate power is probably the first step towards increasing cognition-

⁴²¹ *ibid* 212.

⁴²² *ibid*.

⁴²³ *ibid*. However, one study showed 'severe sanctions increased compliance with the authority more than mild sanctions, but this effect was found only when authorities acted in a fair manner': Peter Verboon and Marius van Dijke, 'When Do Severe Sanctions Enhance Compliance? The Role of Procedural Fairness' (2011) 32 *Journal of Economic Psychology* 120, 127.

⁴²⁴ Aloys Prinz, Stephan Muehlbacher and Erich Kirchler, 'The Slippery Slope Framework on Tax Compliance: An Attempt to Formalization' (2014) 40 *Journal of Economic Psychology* 20, 21.

⁴²⁵ Ingrid Wahl, Barbara Kastlunger and Erich Kirchler, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the "Slippery Slope Framework"' (2010) 32 *Law & Policy* 383, 386.

based trust.⁴²⁶ The tax climate determines how power is viewed; where the climate is antagonistic, increases in power are viewed as procedurally unfair, and therefore coercive, while in a synergistic climate the same increase in power would be viewed positively.⁴²⁷

In research intended to develop and formalise the slippery slope framework, Prinz et al. conclude that because society consists of both 'compliance-minded' individuals and 'evasion-minded' ones, it is critical for the revenue authority to utilise both instruments of coercive and persuasive power as this combination will target the different groups.⁴²⁸

The slippery slope framework has been empirically tested in several studies in higher income countries. Wahl et al., using students in a laboratory experiment find that (i) high trust fosters voluntary compliance (ii) high power fosters enforced compliance (iii) high trust, both alone and in combination with high power, fosters the highest voluntary compliance (iv) a combination of low trust and high power fosters the highest enforced compliance.⁴²⁹ The authors identified a similar pattern in results based on an experiment involving self-employed taxpayers; additionally, they also found that instances of high power and low trust motivated the taxpayers to strategically look for ways to exploit loopholes, in order to evade tax.⁴³⁰ In a study using survey data collected

⁴²⁶ Katharina Gangl, Eva Hofmann and Erich Kirchler, 'Tax Authorities' Interaction with Taxpayers: A Conception of Compliance in Social Dilemmas by Power and Trust' (2015) 37 *New Ideas in Psychology* 13 cited in Georgia Kaplanoglou, Vassilis T Rapanos and Nikolaos Daskalakis, 'Tax Compliance Behaviour During the Crisis: The Case of Greek SMEs' (2016) 42 *European Journal of Law and Economics* 405, 433.

⁴²⁷ Wahl, Kastlunger and Kirchler (n 425) 387.

⁴²⁸ Prinz, Muehlbacher and Kirchler (n 424) 31.

⁴²⁹ Wahl, Kastlunger and Kirchler (n 425) 399.

⁴³⁰ *ibid.*

in the United Kingdom, the Czech Republic, and Austria, Muehlbacher et al. similarly find evidence in support of the framework.⁴³¹

Using students in an experiment to test the slippery slope framework in Austria, Hungary, Romania, and Russia, Kogler et al. find evidence confirming the central assumptions of the framework although, unlike the previous experiment, they do not find evidence of strategic evasion in an environment of low trust and high power.⁴³²

In a cross-sectional analysis using data from the World Values Survey, the World Bank, and the IMF, the main hypotheses of the slippery slope framework were empirically tested and confirmed; besides, the study concluded that *trust was more important than power* for compliance.⁴³³

Another study testing the slippery slope framework among the self-employed (based on an online survey of 1,729 self-employed taxpayers in Austria), also confirmed the underlying assumptions of the slippery slope framework; the study also found that emphasising procedural, distributive, and retributive fairness builds trust, thereby increasing voluntary compliance.⁴³⁴

The slippery slope framework has therefore been extensively tested and confirmed as valid in several high income or developed countries in Europe, Australia, and North America; however, these countries generally have much smaller informal sectors, smaller cash-based sectors, lower levels of corruption, higher tax morale, and

⁴³¹ Stephan Muehlbacher, Erich Kirchler and Herbert Schwarzenberger, 'Voluntary Versus Enforced Tax Compliance: Empirical Evidence for the "Slippery Slope" Framework' (2011) 32 *European Journal of Law and Economics* 89.

⁴³² Christoph Kogler and others, 'Trust and Power as Determinants of Tax Compliance: Testing the Assumptions of the Slippery Slope Framework in Austria, Hungary, Romania and Russia' (2013) 34 *Journal of Economic Psychology* 169, 176.

⁴³³ Gaetano Lisi, 'Testing the Slippery Slope Framework' (2012) 32 *Economics Bulletin* 1369, 1371.

⁴³⁴ Kogler, Muehlbacher and Kirchler (n 11) 138.

higher levels of service delivery than African states. The framework is not as extensively tested in such environments, although there are some exceptions.

One exception, although not in Africa, is a study involving self-employed taxpayers in Italy, a country with a large shadow economy, high levels of tax evasion, and where honest tax filling is not a strong social norm (although these vary from region to region).⁴³⁵ The study's aim was to distinguish between legitimate power and coercive power in testing the slippery slope framework; the researchers found evidence that (i) trust enhanced voluntary compliance (ii) coercive power affected enforced compliance (iii) 'there might be different strategies that taxpayers adopt. Some might be intimidated if they feel enforced and do not evade, while others feel defiant and due to reactance, they evade even more'.⁴³⁶ While the researchers found 'differences in absolute levels of trust, perceived power and propensity to evade taxes between the regions', generally they still found that the fundamental assumptions of the slippery slope framework held across the regions.⁴³⁷

A second exception, also outside Africa, is a study conducted on Greek small and medium-sized enterprises during the financial crisis. Greece has a very high number of difficult-to-audit SMEs and self-employed taxpayers, a large shadow economy, and widespread tax evasion.⁴³⁸ Also, the research was conducted during the financial crisis, when trust in the government was low. The research confirmed the central assumptions of the slippery slope framework; however, additionally, the researchers also found that taxpayers are less willing to pay taxes if the tax authority is perceived as weak and inefficient, even if the taxpayers trust that the government will use the taxes

⁴³⁵ Barbara Kastlunger and others, 'Powerful Authorities and Trusting Citizens: The Slippery Slope Framework and Tax Compliance in Italy' (2013) 34 *Journal of Economic Psychology* 36, 38.

⁴³⁶ *ibid* 43.

⁴³⁷ *ibid*.

⁴³⁸ Kaplanoglou, Rapanos and Daskalakis (n 426) 406, 409.

appropriately.⁴³⁹ In other words, an environment where the revenue authority is efficient and fair, and the government uses taxes sensibly, provides the best conditions for voluntary compliance. In addition, the research concludes that taxpayers' voluntary compliance is influenced by individual honest or morality, meaning that taxpayers will exhibit different behaviours despite similar external conditions.⁴⁴⁰ Because of this reality, it is essential for a revenue authority to strike the right balance when it comes to trust and power; trust alone is unlikely to lead to high levels of compliance. Legitimate and coercive power both play an additional and essential, role.

The third exception discussed here is an African one; a study conducted in Ethiopia, which argues that that 'procedural justice influences voluntary tax compliance particularly when the legitimate power of the tax authority is low (vs high) and when coercive power is high (vs low)'.⁴⁴¹ The authors further argue that 'the interaction effects of procedural justice with both types of power wielded by the tax authority on voluntary tax compliance are mediated by trust in the tax authority'.⁴⁴² The authors use data collected through questionnaires administered to 231 small and large business owners in Addis Ababa. Some of the questionnaires were filled by the business owners directly while others were filled by the accountants of the firms; this difference may have influenced the results of the study.⁴⁴³ Based on the evidence from their data, the authors conclude that (i) procedural justice leads to voluntary compliance only in an environment of low legitimate power and high coercive power (ii) cognition-based trust is a precondition for the procedural fairness of the revenue authority to result in voluntary tax

⁴³⁹ *ibid* 431.

⁴⁴⁰ *ibid* 432.

⁴⁴¹ Lemessa Bayissa Gobena and Marius Van Dijke, 'Power, Justice, and Trust: A Moderated Mediation Analysis of Tax Compliance among Ethiopian Business Owners' (2016) 52 *Journal of Economic Psychology* 24, 25.

⁴⁴² *ibid*.

⁴⁴³ *ibid* 33.

compliance (iii) coercive power predicts enforced compliance.⁴⁴⁴ Importantly, this research shows that both coercive and legitimate power have a role to play in shaping voluntary compliance.

The slippery slope framework provides a useful tool for analysing the relationship between taxpayers and tax authorities. Although the slippery slope framework does not form the theoretical basis for this research, it was utilised, alongside the other compliance theories discussed above, to analyse the data collected from the taxpayer respondents. More specifically, it proved useful in the process of analysing the effects of corruption and poor service deliver on the tax compliance attitudes of the professionals as is demonstrated in Section 5.2 of Chapter 5.

3.6. CONCLUSION

The goal of this chapter was to set out and discuss the various scholarly perspectives on why people evade taxes; these perspectives form the theoretical framework or lens through which the case study data collected for this thesis was analysed.

In law, tax statutes take cognisance of the fact that there are different motives for non-compliance, and these different motives are treated differently in respect of penalisation. The law recognises that some forms of tax evasion are merely mistakes, clerical errors or justifiable instances of misapprehension or ignorance of the law. Taxpayers may also fail to comply due to recklessness or failure to take reasonable care. The penalties for such failures are ordinarily, for fairness purposes, less stringent than penalties for intentional fraud, and deliberate acts intended to mislead the tax authority.

⁴⁴⁴ *ibid* 31.

Other disciplines, such as politics, economics and psychology, have developed more elaborate theories of compliance. The five main compliance theories have been discussed at length in this chapter. Economic deterrence or coercion theories view taxpayers as rational actors who weigh up the costs (risk of audit, penalties) and the benefits (more disposable income) of tax evasion and will opt for the path that costs less. The fiscal psychology or fiscal exchange theory posits that taxpayers view their relationship with the government as a quid pro quo relationship. The taxpayers give up their rights to a portion of their income, in exchange for public goods and services. If the government fails to meet its end of the bargain, taxpayers may choose to withhold their income in order to restore balance in the relationship.

According to the social psychology or influences theory, taxpayers' compliance decisions are influenced by their social interactions. If taxpayers believe that those within their circle of influence are complying, they are more likely to comply. If they believe that those others are evading, they are likely to choose to evade as well. The belief that others in their circle of influence are evading also affects taxpayers' perceptions of the risk of being detected, and the social cost of being labelled a tax evader. The equity theory suggests that taxpayers are more likely to comply with their tax obligations if they deem the tax system to be fair. If, for example, taxpayers believe that citizens from a different economic class or ethnic group are treated more favourable than they are, those taxpayers are less likely to comply with their tax obligations.

Finally, the political legitimacy theory posits that taxpayers are likely to be more willing to pay taxes to a legitimate political authority. If taxpayers believe that the government is good and benevolent, they are more likely to comply. Similarly, if they view the government as illegitimate and autocratic, they are more likely to try to evade. This theory also applies at the level of the tax authority. A legitimate tax authority, which

is viewed as part of the community and exists for the good of the community, is more likely to attract compliance.

The political legitimacy theory is closely linked to the last theory discussed in this chapter- the slippery slope framework. The proponents of the slippery slope framework have described this framework as a conceptual tool that can be used to study the other determinants of compliance. The proponents of this theory argue that power of tax authorities and trust in tax authorities interact to shape the tax climate, and thus influence the level of tax compliance; increases in trust result in increased voluntary compliance while increases in power result in increased enforced compliance.

There are many empirical studies investigating the validity of these theories, although most of the studies have been carried out in high-income countries. There is a smaller, but growing, body of empirical research testing the validity of these theories in African countries as well. The evidence from these African empirical studies is mixed, with some studies finding substantial evidence in support of the theories, and other studies finding little support for them. However, there are no empirical studies investigating the validity of these theories in the context of the compliance attitudes of professionals in Africa.

In the next chapter, the author will present the detailed findings of the case study of tax compliance attitudes of self-employed professionals in Kenya. The author will, thereafter, analyse these findings through the lens of the theories discussed in this chapter, and summarised above. The goal is to identify the main motives for non-compliance among hard-to-tax professionals in LMICs, using Kenya as a case study, and then determine the most appropriate tools for tax authorities wanting to increase compliance among these taxpayers.

4. A CASE STUDY OF TAX COMPLIANCE AMONG SELF-EMPLOYED PROFESSIONALS IN KENYA

4.1. INTRODUCTION

The focus of the previous chapters has been (i) describing hard-to-tax taxpayers and exploring arguments for and against making a genuine attempt to tax them; (ii) discussing the various administrative options, at the disposal of tax authorities in LMICs, for managing the hard-to-tax, and (iii) setting out the relevant theoretical framework for this research, i.e., the theories or determinants of tax compliance.

These chapters form the backdrop for this research, and lay the foundation for using the case study to answer the research question: what are the barriers to tax compliance by hard-to-tax professionals in LMICs, and how can revenue authorities in those countries effectively improve compliance among these taxpayers?

This case study presents three main opportunities. First, it presents an opportunity to collect unique empirical data and utilise that data to determine whether the determinants of tax evasion discussed in Chapter 3 accurately capture the compliance attitudes of self-employed professionals in Kenya.

Second, empirical evidence on the self-employed, in support of the slippery slope framework, has, to a large extent, come from high-income countries.⁴⁴⁵ Yet LMICs, particularly those in Africa, are distinct from these high-income countries; many LMICs have large informal sectors, a high number of cash transactions, high rates of government corruption, low tax morale, and weak taxpaying culture. This case study presents an opportunity to collect empirical evidence, from the self-employed in Kenya, a lower middle-income country, that would contribute to discourse on the slippery slope framework.

⁴⁴⁵ See, for example, Kogler, Muehlbacher and Kirchler (n 11).

Finally, the case study also presents an opportunity to determine the most appropriate administrative options for revenue authorities, in LMICs, trying to increase levels of compliance among self-employed professionals.

4.2. DESIGNING THE CASE STUDY AND COLLECTING THE DATA

In Chapter 1, the author set out the justifications for selecting Kenya as the case-country for the case study, and some background information regarding taxation of professionals in Kenya.⁴⁴⁶ In this section, the author focuses on elaborating on the case study design and the data collection process.

4.2.1. Selecting Respondents

To better understand the tax compliance behaviour of self-employed professionals, it was necessary to focus on taxpayers drawn from one or two professions and conduct an in-depth study of those professions sectors. The researcher settled on two professions; it was felt that conducting research on just one profession would not be sufficiently compelling or robust, while research on more than two professions would be too time-intensive, considering the limited time available to conclude a PhD. The two professions selected for this project were dentists working in the health sector in Nairobi and lawyers working in private legal practice in Nairobi.

A total of 31 respondents were interviewed for this research-22 taxpayers, 5 government officials and 4 experts. It is acknowledged that this is a small number of respondents from which it is not possible to make generalised conclusions to the whole population.⁴⁴⁷ However, the goal of qualitative research is not to achieve sample

⁴⁴⁶ See section 1.2 in Chapter 1.

⁴⁴⁷ Helen Rogers and Lynne Oats, 'Case Studies' in Lynne Oats (ed), *Taxation: A Fieldwork Research Handbook* (Routledge 2012) 29.

representativeness to generalise findings to the whole population. The worth of the qualitative data obtained from the small sample size lies in the fact that the researcher was able to conduct truly in-depth interviews, lasting one hour or more, during which the researcher was able to tease out critical, analytical, and in-depth insight. In line with the theoretical underpinnings of qualitative research, the goal of this research is not to generalise the findings to the whole population, but to build deep, rich, and thick narratives and analysis regarding the perceptions, attitudes, and patterns of thought of the respondents. Further, although these narratives and analysis cannot be utilized for statistical generalization, they have been used for empirical generalization by ‘contributing to and adding to theory’ in this field.⁴⁴⁸ In addition, towards the end of the interview process with the taxpayers, the responses mirrored each other to such a significant extent, that it is possible that further interviewing within the same professions would not have yielded widely varying data.

All the respondents were drawn from Nairobi. In light of the limited resources and capacity of KRA, the researcher prioritised Kenya’s cities, where the tax authority is most likely to collect the highest amount of income tax on the self-employment income earned by lawyers and dentists, i.e., Nairobi, Mombasa, and Kisumu. Nairobi was deemed large and diverse enough to represent the other two cities.

In addition, the dental profession in Kenya is not overwhelmingly large, as demonstrated in Figure 8 and 9 below. Virtually all dentists working in the cities have worked in the rural areas at some point in their career, particularly during their period of mandatory government service. Therefore, their circumstances, knowledge, and experience easily capture the data that would have been collected by interviewing dentists

⁴⁴⁸ *ibid* 31.

currently working in rural localities. Indeed, many dentists working in rural localities frequently travel to the nearby cities to take up locum positions; two of the dentists interviewed in this research work in a rural hospital but locum in Nairobi several times a week. It was therefore reasonable to assume that the information collected in Nairobi is quite representative of the national experience.

Dentists were an interesting case because of the highly informal nature of their engagements. The use of the term ‘informal sector’, in developing countries, typically conjures images of small-scale traders, roadside vendors, or public transport operators. This term is rarely associated with professionals such as dentists, yet the reality is that many of them operate very informally and are as difficult to tax as other informal sector taxpayers. Keen argues that professionals are responsible for the most serious instances of revenue loss and damage to the fairness of the tax system, particularly in developing countries, yet since they are so highly qualified and tightly regulated, it appears unnatural to refer to them as ‘informal’.⁴⁴⁹

Many dentists in Kenya work informally for other dentists, or for private hospitals or clinics, on a *locum* basis; some dentists are in full time formal employment with the government but have part time informal *locum* engagements as well. *Locum* refers to the practice of temporarily working in place of another dentist who may be on their off day, off-sick, or when the clinic or hospital is short-staffed. Other dentists are fully self-employed and the level of formality in those enterprises varies widely. Dentists on locum tend to earn much more than they would if they were on a fixed salary and it is therefore a very attractive financial option.

⁴⁴⁹ Keen (n 7) 16.

The legal profession presented a good comparison. To begin with, it is reasonable to assume that lawyers have much better understanding of tax law, and their compliance obligations, than dentists do; it was interesting to find out whether this would have any bearing on their attitudes towards tax compliance.

Second, the legal profession is much less informal than the dental profession. The concept of *locum* does not exist in legal practice in Kenya, and lawyers in private practice are either self-employed or in full time formal employment; there are hardly any grey areas.

Third, although the level of formality in law firms run by self-employed lawyers varies just as widely as enterprises run by self-employed dentists, law firms tend to attract more corporate clients as the firm grows, thereby significantly decreasing cash payments. Many large dental clinics, however, still receive a significant number of cash payments regardless of their stage of growth or size.

Fourth, revenue officials in Kenya, and across Africa, with whom the researcher discussed this project, were categorical in their view that lawyers evade tax more than any other profession. Whether this perception is anecdotal, or fact, is not particularly clear; but it was an observation that further buttressed the decision to select the legal profession as the second profession.

Profile of the Dental Profession in Kenya

The practice of medicine and dentistry in Kenya is regulated by the Medical Practitioners and Dentists Board, a statutory body established under the Medical Practitioners and Dentists Act (Chapter 253 of the Laws of Kenya). The Act provides for the registration of all doctors and dentists practising in Kenya; this registration permits such doctors and

dentists to work as employees of the government, or licensed private hospital. Doctors and dentists in self-employment are required to take out a further annual licence to engage in private practice.

According to an article published 2004, there were 700 registered dentists in that year.⁴⁵⁰ The country graduates approximately 20-25 dentists a year; it is therefore reasonable to assume that the current number of registered dentists stands at approximately 1,000. A newspaper article from March 2016 corroborates this; the article reports that there are approximately 1,000 registered dentists in the country.⁴⁵¹ Kaimenyi also explains that a majority, up to 80%, of dentists are working in urban centres.⁴⁵²

Table 1 Oral health public sector personnel in Kenya

| Category of personnel | Number |
|-----------------------------------|--------|
| 1. Dental specialists | 50 |
| 2. General dentists | 107 |
| 3. Dental technologists | 114 |
| 4. Community oral health officers | 97 |
| 5. Dental hygienists | 1 |

Figure 8: Oral Health Public Sector Personnel in Kenya⁴⁵³

⁴⁵⁰ Jacob T Kaimenyi, 'Oral Health in Kenya' (2004) 54 *International Dental Journal* 378, 379.

⁴⁵¹ Eunice Kilonzo, 'Dental Disease Affect About Nine in 10 Adults-Survey' *Daily Nation* <www.nation.co.ke/news/Kenya-suffers-from-acute-shortage-of-dentists-meet-told/1056-3131198-g7rc38z/index.html> accessed 16 July 2018.

⁴⁵² *ibid.*

⁴⁵³ Kaimenyi (n 450) 379.

Table 2 Breakdown of the number of dental specialists in various disciplines of oral health⁽²⁾

| Specialty | Number of oral health specialists |
|--|-----------------------------------|
| 1. Oral & Maxillofacial Surgery | 15 |
| 2. Oral Medicine and Oral Pathology | 4 |
| 3. Oral Biology | 1 |
| 4. Restorative Dentistry | 6 |
| 5. Prosthetic Dentistry | 4 |
| 6. Orthodontics | 3 |
| 7. Paediatric Dentistry | 6 |
| 8. Periodontology and Periodontics | 4 |
| 9. Biomaterials | 2 |
| 10. Community and Preventive Dentistry | 2 |
| 11. Public Health (MPH) | 10 |

Figure 9: Dental Specialists per Discipline in Kenya⁴⁵⁴

Table 6 in the Annex sets out the profile of the dentists, interviewed for this research, according to the nature of their practice, their level of specialisation, gender, and years of experience.

Profile of the Legal Profession in Kenya

The practice of law in Kenya is regulated by the Law Society of Kenya, a statutory body established under the Law Society of Kenya Act, 2014 (it was initially established in its present form under the repealed Law Society of Kenya Act (Chapter 18 of the Laws of Kenya)). All lawyers, practicing as such in Kenya, must be members of the Society and are required to take out an annual practicing certificate.

According to the Law Society of Kenya, its current membership, comprising all practicing advocates in Kenya, is 8,001.⁴⁵⁵ Kenya has a fused Bar, and therefore all

⁴⁵⁴ *ibid.*

⁴⁵⁵ Law Society of Kenya, 'Law Society of Kenya Membership' (*Law Society of Kenya*) <<http://www.lsk.or.ke/index.php/membership>> accessed 14 June 2016. No longer available.

advocates have the right to practice in both the lower and superior courts, if they possess a valid and current practicing certificate.

The legal profession in Kenya is also subject to the Advocates Act (Chapter 16 of the Laws of Kenya). This Act sets out the legal provisions governing qualification, remuneration and undercutting, discipline, admission to the Bar, admission to the Senior Counsel Roll, issuance of practicing certificates, professional conduct, and dispute resolution.

Table 3: Advocates Roll Summary

| Status | Number |
|---------------|---------------|
| Active | 7,965 |
| Deceased | 607 |
| Inactive | 3,567 |
| Struck Off | 59 |
| Suspended | 29 |
| Status | Number |
| Unknown | 1,077 |

Table 4: Advocates Roll by Gender

| Gender | Number |
|---------------|---------------|
| Female | 5,365 |
| Male | 7,106 |
| Undeclared | 226 |

Source: LSK website⁴⁵⁶

⁴⁵⁶ Law Society of Kenya, (*Law Society of Kenya*) <<http://www.lsk.or.ke/index.php/membership>> accessed 14 June 2016. No longer available.

Table 7 in the Annex sets out the profile of the lawyers, interviewed for this research, per the nature of their practice, their years of experience, the age of their business, and their gender.

Snowball Sampling

Sampling is challenging, particularly where the subject of the research is a sensitive one.⁴⁵⁷ Thus, researchers conducting fieldwork on sensitive topics have often ‘employed individual’s social networks’ through snowball sampling.⁴⁵⁸ The respondents in this research were identified and selected using snowball or referral sampling; each respondent referred the researcher to acquaintances, within their circle, who were willing to be interviewed. The first lawyer interviewed was known to the researcher through professional networks and that lawyer introduced the researcher to other self-employed lawyers, and so on. With respect to the dental profession, the researcher approached a dentist personally known to her, but did not interview that dentist; instead, the said dentist was instrumental in referring the researcher to other dentists fitting the selection criteria.

This sampling method was very useful in this context, because of the sensitive nature of the research topic. Potential respondents were understandably wary of being interviewed about tax compliance, and a good number went to the extent of inquiring about the researcher’s relationship with the revenue authority. It was much easier to access the population through referrals by their trusted professional colleagues. Their colleagues assured them that the researcher was ‘safe’, and that her questions did not pose

⁴⁵⁷ Kath Browne, ‘Snowball Sampling; Using Social Networks to Research Non-Heterosexual Women’ (2005) 8 *International Journal of Social Research Methodology* 47, 48.

⁴⁵⁸ *ibid.* Browne provides an extensive list of such research.

a risk to them. This approach facilitated easier access, and the researcher was able to gather even more sensitive data than she set out to collect.

This method of sampling does have its disadvantages; for example, because of sampling bias, it may not be clear whether the sample was sufficiently representative of the population. The initial respondents are likely to have referred the researcher to respondents who share their characteristics, for example age, sex, level of education, and size and nature of practice. There is a risk that respondents with different traits were not adequately represented and may have presented different and relevant data. However, the counterargument in this case is that the legal and dental professions in Kenya are significant, but not overwhelmingly large. The differences in traits and characteristics are not likely to be so large as to render the snowball technique redundant. In addition, the researcher took steps to vary the characteristics of the respondents interviewed, to ensure that they did not all fall into the same category; an attempt was made to ensure that the respondents varied in age, sex, and nature or size of their businesses or practice.

Profile of the Government Officials and Tax Experts Interviewed

Public Sector

- A Senior Commissioner at the Kenya Revenue Authority (herein referred to as SC-KRA)
- A Chief Manager at the Kenya Revenue Authority (at the time of the interview she held the title of Manager, but has since been promoted from that position) (herein referred to as CM-KRA)
- A Manager at the Kenya Revenue Authority (herein referred to as M-KRA)
- A Director at the National Treasury (herein referred to as D-NT)
- 2 Senior Managers at the National Treasury (herein referred to as SM-NT)

Private Sector

- A former Finance Secretary, now working as a private consultant (herein referred to as (FFS))
- A Senior Partner at one of the ‘Big Four’ audit and accounting firms in Nairobi- retired from the firm in 2018. (herein referred to as SP-B4)
- A Manager at on the ‘Big Four’ audit and accounting firms in Nairobi (at the time of the interview she was a Senior Tax Consultant, but has since been promoted from that position) (herein referred to as M-B4)

Academia

- Professor Attiya Waris- the leading tax law academic in Kenya.

4.2.2. Data Collection and Analysis

Interviews are an important source of data in interpretivist research and provide a window into people’s lived experiences.⁴⁵⁹ The empirical data for this research was collected through face-to-face semi-structured interviews conducted in 2015 and 2016; due to the unavailability of some respondents, three semi-structured interviews were conducted over the phone in 2018. In accordance with the theoretical underpinnings of qualitative research, the researcher went into the interviews with a flexible list of questions to address but left the interview process open to allow the respondents to bring in new ideas that were relevant to their contexts. As a result, the researcher was able to steer the interviews ‘away from broad generalisations to a more meaningful and concrete exchange’.⁴⁶⁰ This

⁴⁵⁹ Lynne Oats, ‘Gathering and Interpreting Qualitative Data’ in Lynne Oats (ed), *Taxation: A Fieldwork Research Handbook* (Routledge 2012) 19; Freedman, Loomer and Vella (n 19) 181.

⁴⁶⁰ Freedman, Loomer and Vella (n 19) 182.

approach allowed the respondents to be as open as they wished, and some willingly discussed sensitive topics while some spoke more generally about the actions of 'others'.

Tax evasion is a sensitive topic and the taxpayers were initially suspicious about the researcher's links to the tax authority; government officials in Kenya are also always very hesitant to go on official record, for fear that their words may be misconstrued or used against them. Thus, the researcher opted not to record the interviews to encourage candour from the respondents. This decision gave the respondents the space to be as honest and direct as they wished, without the intrusion of a recording device. To ensure the accuracy of the data, the researcher followed the recommended practice of taking extensive notes during the interviews and writing up the interviews 'as soon as possible after completion'.⁴⁶¹ The resulting compromise is that this thesis makes limited use of verbatim quotes, and where direct quotes are used, these are quotes from the researcher's notes. While this opens up room for error, it is hoped that conveying the richness and colour of the respondent's views and perceptions balances any misrepresentation of the exact words of the respondents.

The researcher then analysed the data using the thematic analysis method; this ensured a systematic approach to the analysis of the data and allowed for objectivity and consistency in the identification of recurrent themes.⁴⁶² Thematic analysis was selected for its flexibility in accommodating a wide range of research methodologies and philosophies; in analysing the data using this method, the researcher adopted a realist stance, i.e., the researcher assumed that the respondents' responses reflected their perceptions, 'thoughts, attitudes, or motivations'.⁴⁶³ The researcher coded the data by

⁴⁶¹ Oats (n 459) 21.

⁴⁶² Thematic analysis is a method for identifying themes and patterns of meaning across a dataset in relation to a research question.' Braun and Clarke (n 15) 175.

⁴⁶³ Onu and Oats, 'Tax Talk' (n 19) 935.

hand, and began by open-coding all the notes in the dataset. Labelling each comment according to its content ‘allowed the creation of a set of categories that were further refined...’ in an iterative process that resulted in several themes that captured the researcher’s interpretation of the fieldwork data.⁴⁶⁴

The themes that emerged from the data are discussed below and have been grouped into major and minor themes.⁴⁶⁵ The lawyers are abbreviated ‘ADV’ and assigned a number; the dentists are abbreviated ‘DEN’ and are similarly assigned a number.

4.3. THE MAJOR THEMES

4.3.1. Taxpayer Visibility

According to the economic deterrence models, when taxpayers believe that they, and their income, are visible and detectable by revenue enforcement officers through audits and similar measures, they are more likely to believe that the risk associated with evasion is high and therefore choose to comply.⁴⁶⁶ According to these theories, the belief that one is invisible, and that the authority is unaware of one’s income, seems to embolden those inclined to evade.

The Lawyers

There were mixed views about taxpayer visibility, and the risk of detection by KRA, among the lawyers. Generally, most respondents felt that small law firms were invisible. ADV7 put it this way: *‘there are 8,000 lawyers in Kenya and 4,000 law firms. KRA is not likely to come and audit me and even if they did we have ways of ‘destroying documents’*

⁴⁶⁴ *ibid* 934.

⁴⁶⁵ Tables showing the codes and themes that emerged from the data can be found in the Annex.

⁴⁶⁶ See Section 3.4.1 in Chapter 3.

or keeping two files.' ADV5 also observed that while lawyers' clients are routinely audited, lawyers are rarely audited.

However, the lawyers also acknowledged that firm growth, withholding tax on legal fees, geographical location, and size of the firm all increased the risk of detection and visibility. Large law firms were believed to be unable to hide from the revenue authority. While most respondents believed that small firms are hard to audit and may be able to get away with tax evasion, they also opined that was only a matter of time before the risk increased due to increased use of information technology in tax administration. ADV2 further suggested that the risk of detection had already increased moderately because, in her view, the revenue authority is facing significant revenue deficits and has, therefore, become more vigilant.

The Dentists

The dental practitioners were less cautious than the lawyers and were almost unanimous in their belief that their profession is invisible. These respondents believed that dentists are small taxpayers with a low risk of detection, and who could therefore get away with tax evasion. The dentists did not believe that the revenue authority actively monitors individual taxpayers and did not seem to fear audits or the possibility of detection. According to DEN3 *'there is very little fear of being caught or audited among dentists. I have not heard of a dentist being audited...'* One mentioned that self-employment, for professionals, is the easiest way to evade tax, and several respondents admitted that the ability to earn invisible untaxed income makes locum attractive.

Apart from DEN8, the other respondents believed that if a dentist did not remit taxes, the revenue authority was not aware of his or her existence; once the dentist began paying, however, the dentist became visible and the risk of detection increased.

The dentists earning locum income for which they knew, or suspected, the payer had not remitted withholding tax, surmised that this income was invisible and could 'safely' be hidden from the tax authority. DEN2 said:

If I can get away with not paying PAYE, I will. If the government does not have a way of knowing about my income, I will hide it. There is no motivation to be honest. I do not know any doctor, dentist or medical institution that has been pursued by KRA. In my view, the odds of being caught are very low. There is a higher chance of the medical board shutting you down for malpractice than KRA pursuing you...The government is lazy when it comes to monitoring taxpayers. it goes hard after big hospitals but ignores what it considers 'small clinics'. We attract very little surveillance, yet most health providers operate these boutique clinics.

The Introduction of iTax

Lawyers were also warier about the introduction of iTax, the tax authority's electronic filing and tax payment system; in comparison, there was more said by the lawyers, about the effect of iTax in increasing taxpayer visibility, than by the dentists. Majority of the lawyers spoke about iTax increasing taxpayer visibility, and that the use of information technology, by the revenue authority, meant that it would become harder to hide income.

Only DEN1 suggested that there was increased compliance, especially among practitioners running their own clinics and employing staff, because of iTax. According to DEN2, iTax did not pick up partial compliance; in his experience, even where the system indicated that withholding tax had been remitted on his behalf, he could still fill in his tax returns without declaring that income and paying income tax on it. The only other mention of iTax was by DEN3 who complained that iTax has increased the time it took to comply.

The professionals' perceptions of their visibility, vis-à-vis iTax, is interesting and important for three reasons. First, it appears that the use of information technology systems in the tax compliance process may improve some taxpayers' perceptions of the risk of tax evasion; this, in turn, is likely to encourage compliance. Second, from an administrative point of view, the system must work seamlessly, and effectively, otherwise its effect could be compromised. A good illustration is the realisation by DEN2 that the system did not pick up partial compliance, and he could therefore safely file returns without declaring some income, even where that income had been subject to third-party reporting. Third, even though the dentists and the lawyers are both classified as professionals, their knowledge and perceptions of iTax were very different. This difference in knowledge and perception points to a weakness in sensitisation by the revenue authority; perhaps the dental sector has not been sufficiently sensitised on the capability, and implications, of the new system. Uniform penetration of different groups of taxpayers, during taxpayer education initiatives, would ensure overall effectiveness of the system. Perhaps, the revenue authority should use different strategies to reach different groups of taxpayers and not assume that one approach works for all taxpayers.

General Observations

Who is to blame for the fact that taxpayers believe that they are invisible and can safely evade taxes because they attract little or no surveillance? The view of the Ministry of Finance officials was that the responsibility for non-compliance by self-employed professionals, and indeed for non-compliance in the country generally, lay squarely on the shoulders of the revenue authority. The argument, by a senior official in the Ministry of Finance was that the revenue authority had failed to adequately discharge its responsibilities of data collection, mapping of taxpayers and education of taxpayers; in addition, he argued that the revenue authority had not leveraged technology by using data to formalise the informal sector.⁴⁶⁷ Thus, the failure to improve compliance by the HTT was viewed as an administrative, and not a policy or legislative, failure for which the revenue authority must accept responsibility; ‘enforcement of the law, and not the law itself is the problem’.⁴⁶⁸

There is support, for the Ministry’s position, within the private sector. The revenue authority was viewed as inefficient and operating on the basis of outdated and incorrect records.⁴⁶⁹ The tax authority was also criticised for failing to link withholding tax payments to income tax payments, on iTax, thus enabling self-employed professionals to get away with undeclared income.⁴⁷⁰ A senior tax expert suggested that the revenue authority should employ temporary staff once a year, to review a random sample of tax returns as they are filed, in order to spot red flags.⁴⁷¹

⁴⁶⁷ Interview with D-NT, Director, National Treasury (Nairobi, Kenya, 17 September 2015).

⁴⁶⁸ Interview with D-NT (n 441).

⁴⁶⁹ Interview with SP-B4, a Senior Partner at a ‘Big Four’ Firm (Nairobi, Kenya, 13 May 2016)

⁴⁷⁰ Interview with SP-B4 (n 443).

⁴⁷¹ *ibid.*

The finger pointing by the Ministry of Finance was repeated recently, through an ultimatum by the Cabinet Secretary for Finance to the revenue authority; he was quoted, in a press report, stating that the government had given the tax authority all the resources it required to increase collections and meet its targets, and the failure to do so would not be tolerated.⁴⁷² This finger pointing has led to tensions between the revenue authority and the Ministry of Finance.

The reality is probably not as black and white as this. The fact is that most revenue authorities, even in high income countries, operate with inadequate financial, technology and human resources. KRA is no exception. A tax officer argued that, contrary to the Cabinet Secretary's assertion, Treasury's allocations to the tax authority have been falling for two years, despite a growing docket; the Tax Education Division, for example, was initially well funded but its budget has since been slashed, while its programs increased.⁴⁷³ The contra-argument to Treasury's assertion is that Treasury is 'expecting miracles and because it is more powerful than KRA', it puts the latter in an awkward situation.⁴⁷⁴

4.3.2. Perceptions of Consequences of Evasion

The lawyers did not speak much about their perceptions of the consequences of tax evasion save to state that, in most cases, one can 'sort it out' with a bribe. There was a general feeling that the revenue authority's real intention is to extort bribes rather than

⁴⁷² Neville Otuki, 'Rotich Warns Taxman on Missed Revenue Targets' *Daily Nation* <www.nation.co.ke/business/Rotich-warns-taxman-on-missed-revenue-targets/996-4345582-10ael39z/index.html> accessed 20 March 2018.

⁴⁷³ Interview with M-KRA, Manager at Kenya Revenue Authority (Telephone Interview, 22 March 2018).

⁴⁷⁴ Interview with M-KRA (n 447).

collect taxes and that, in any event, the cost of bribing would be lower than the cost of compliance.

The dental practitioners also believed that revenue authority officers were simply looking to collect bribes. The dentists were more expressive about their other perceptions as well. There was a general belief that there are no consequences of evading tax; for example, DEN2 expressly stated that, in his view, the consequences of not paying PAYE on his income were negligible since the fines are ‘minimal’, and it was therefore not worth it to comply. DEN4 stated that dentists would be encouraged to pay taxes if there were repercussions for not doing so and a strong likelihood of being discovered. This suggests that, in her view, there were no repercussions of evading tax. DEN5 was of the view that the revenue authority does not generally audit medics since, in his opinion, the revenue authority considers it ‘immoral’ to do so; in his view, the tax authority views clinics in the same way it does churches and would therefore not ‘harass’ them. He told the researcher that revenue officials once paid a surprise visit to his clinic and did not ask to audit any books of accounts—which were in shambles; they were more interested in seeing his licence to operate, which was proudly displayed on his wall. According to DEN6, there were no consequences for evading tax on income if the payer had not remitted withholding tax on it, and she would therefore not declare that income.

Another perceived consequence, by most of the dental practitioners interviewed, was that once you evade, you must always evade, otherwise you will be hit by heavy back taxes—in other words it becomes a vicious cycle from which it is impossible to escape. This fear of back taxes was expressed, by almost all the dental practitioners, as a major reason for continued tax evasion within the profession.

In general, it was evident that the dental practitioners were more relaxed in their assessment of the consequences of evasion; the lawyers were not as openly confident, save for their belief that any consequences could be mitigated through bribery.

As advocated by proponents of the economic deterrence or coercion theories, the belief that tax evasion has consequences plays an important role in motivating tax compliance. This role is perhaps even more important in jurisdictions where tax morale is already low. If taxpayers believe that the revenue authority will not take any action, there is reduced incentive to comply. The interview responses suggest that taxpayers need to believe that there is a reasonable chance of detection, and that once detected, there will be consequences that wipe out the benefits of evading the tax. In this case, in addition to being quite optimistic about the chances of getting away with evasion, taxpayers were also reasonably confident that the consequences were worth the risk in that, if on the off chance they were caught, they could pay their way out of trouble fairly easily.

From an administrative point of view, the revenue authority needs to address the belief that taxpayers are unlikely to be caught, and that if they are, bribery can be used to escape the consequences of tax evasion.

4.3.3. Low Levels of Financial and Tax Literacy

The Lawyers

The lawyers were in agreement that financial indiscipline and disorganisation among the profession's self-employed, coupled with the nature of self-employment, had exacerbated the evasion problem. Most respondents confessed that they tended to make haphazard cash withdrawals, and did not prioritise tax, thereby finding themselves with inadequate funds to meet their tax and other financial obligations. ADV5 explained that the discipline

of withdrawing money in a structured manner is difficult for sole proprietors; in his case, he would make monthly withdrawals for his upkeep and, occasionally, made large withdrawals when he received unusually large payments, making it difficult to plan for, and pay, his income tax.

In addition, the younger lawyers spoke about their lack of knowledge and expertise in accounting, numeracy, and tax computation, particularly when setting up their law firms; this was a recurrent complaint. These lawyers explained that their transition to self-employment was difficult, and shocking; they were completely unprepared for the changes in their tax obligations as a result of the transition. ADV6 was of the view that lawyers jump into setting up law firms without requisite training and knowledge, and with the mindset that the revenue authority is the enemy. ADV4 gave an example of an embarrassing experience with a client who withheld tax on payments according to the law; the respondent was unaware that this was a statutory requirement and therefore queried the action leading to an embarrassing discussion with the client. Other respondents explained that withholding tax and withholding VAT took them by surprise, and that overall, their total tax burden was more than what they expected when going into self-employment.

The accounting and tax illiteracy among lawyers, coupled with what the respondents described as inaccessible tax information, led to improper billing, inaccurate record keeping, and poor internal financial structures within their firms which subsequently hampered compliance. The tax authority found it difficult to believe that highly educated professionals, particularly lawyers, struggle with financial and tax literacy; in one respondent's view, professionals should be the most informed group in

society.⁴⁷⁵ However, as ADV3 put it, ‘I was aware of the taxes but did not know how to calculate and remit them; I never learnt how to do that as an employee...I know what the legislation says but I do not understand the technical aspects.’ The revenue authority seems to be blind to this distinction.

The lawyers explained that when they moved into self-employment, they did not appreciate the difference between filing returns as a taxpayer whose only source of income is employment income, versus filing returns as a self-employed individual running a business. The respondents explained that they were surprised by how different and difficult it was. Their response to these challenges, they said, was simply to ‘cook up’ numbers on their returns or file nil returns. While they readily admitted that there was a mix of both deliberate intent and ignorance in tax evasion among lawyers, they maintained that most tax evasion was inadvertent or a result of ignorance.

The emerging trend, from the data collected from these lawyers, was that most legal practitioners did not consciously develop their internal structures to enable or facilitate compliance. Those who were unable to afford skilled accounting professionals remained financially disorganised and found it hard to comply. Lawyers who chose, and could afford, to set up a proper fully functional in-house accounting department, kept proper financial statements and separate accounts for tax; that level of financial organisation encouraged and facilitated tax compliance.

The Dentists

I wish there was a starter pack for those starting to work in the private sector; for example, classes during the final year of university. We

⁴⁷⁵ Interview with SC-KRA, Senior Commissioner at Kenya Revenue Authority (Nairobi, Kenya, 10 September 2015).

*know how to treat patients, but we do not know how to run a business
let alone how to pay taxes. [DEN1]*

*Generally, medics lack business acumen. We are ignorant; I evaded tax
purely out of ignorance. Clinicians should be trained so that they
know...Money at hand is simply pocketed and actually this causes
many clinics to shut down. [DEN5]*

As evidenced by the statements above, the dentists expressed very similar challenges to those expressed by the lawyers. These respondents explained that they, and most of their peers, lacked the knowledge and skills required to run a business. The respondents generally believed that most dental clinics lacked financial accountability and proper internal financial structures, resulting in widespread mismanagement and tax evasion. According to several respondents, this financial mismanagement and illiteracy resulted in the collapse of many dental clinics. The medics explained that financial and management knowledge were not incorporated into their training program, and the Medical Board did not concern itself with ensuring, or at least encouraging, proper financial management structures and financial record keeping among its members' clinics.

Majority of the respondents did know the correct withholding tax rate due on payments that they received. As a result, some were over-taxed by unscrupulous clinics, and a majority did not receive, or demand, withholding tax certificates as proof that the amounts deducted from their pay were remitted to the revenue authority and not illegally retained by the clinic. In addition, many respondents were not aware that they were obligated to pay income tax on the remainder of their income; some found out after several years of noncompliance and were either too afraid, or not bothered enough, to

comply. Some respondents only discovered this tax obligation during the interview for this research.

The dentists were also unaware of the distinction between tax evasion and tax planning. Several dentists spoke about padding up their expenses, and including expenses that were not related their work, to reduce their taxable income; they referred to this as tax planning. They believed that this type of activity was not criminal behaviour but ‘legal tax avoidance’.

Most dentists seemed to believe that they could not comply with their tax obligations and still earn a living or run a successful business. One dentist explained that increasing knowledge about the available tax reliefs, and acceptable tax mitigation opportunities, would encourage compliance. In addition, the respondents opined that basic taxation and accounting knowledge should be publicly available, and that increased awareness of tax rules and financial management techniques would help dentists comply.

It seems, therefore, that financial and tax illiteracy is a significant contributing factor towards tax evasion among professionals in Kenya, despite the scepticism expressed by SC-KRA.⁴⁷⁶ Not only do these professionals struggle to comply without, what they deem, expensive professional assistance, they also lack basic accounting and management knowledge that is a prerequisite for proper record keeping, business management, and tax compliance.

General Observations

As demonstrated by the responses above, financial capability and tax literacy are intertwined; taxpayers who lack financial capability are unable to manage their tax

⁴⁷⁶ Interview with SC-KRA (n 449).

affairs, and once they become financially capable, their tax compliance behaviour changes. Tax payers engaged in tax evasion are also more likely to run financially disorganised businesses and, as some of the dentists pointed out, many of these businesses collapse due to mismanagement.

KRA has been charged with the mandate of addressing taxpayer illiteracy and disengagement. The evidence from the interviews with the tax experts, regarding the way KRA has discharged this mandate, was a mixture of positive and negative views. It is possible that part of the problem the professionals face is the perception, among some senior revenue and ministry officials, that financial and tax literacy is not a challenge within such a highly skilled and educated community.⁴⁷⁷ The assumption here is that higher levels of education result in greater financial and tax awareness, a view not supported by any credible research. An official from the tax authority did, however, admit that professionals in Kenya file inaccurate returns, have gaps in their record keeping, and are consequently extremely hard to audit.⁴⁷⁸

The revenue authority runs tax literacy programs through its Tax Education Division; the Division's current focus is on closing what it has described as four literacy gaps- (i) tax knowledge gap, (ii) tax attitude gap, (iii) tax perception gap and (iv) practice gap (i.e., those whose knowledge, attitude, and perception gaps have been closed but still do not comply).⁴⁷⁹

KRA has been criticised by both academic and private sector professionals for not commencing tax literacy programs at earlier levels of education.⁴⁸⁰ However, the tax

⁴⁷⁷ Interview with SC-KRA (n 449); interview with D-NT (n 441); interview with SM-NT, Senior Manager, National Treasury (Nairobi, Kenya, 24 September 2015).

⁴⁷⁸ Interview with SC-KRA (n 449).

⁴⁷⁹ Interview with M-KRA (n 447).

⁴⁸⁰ Interview with SP-B4 (n 443); interview with Attiya Waris, Professor of Law, University of Nairobi, School of Law (Telephone Interview, 22 March 2018).

authority is trying to remedy this. KRA's Tax Education Division has designed an outreach program that targets schools (in the form of tax clubs) and universities; the Division has set up tax associations in universities to act as the authority's ambassadors on social media and among university students. The tax authority is also trying to mainstream tax education into the new school curriculum.⁴⁸¹ It will be important to assess the success of this outreach program; the success, if any, will only be visible once the targets complete their education and begin earning a taxable income.

The Tax Education Division also runs an outreach program targeting the informal sector (also popularly known as 'jua kali'), agri-business, public transport, and artisans. Although many hard-to-tax professionals operate very informally, and are as invisible as other actors in the informal sector, there is no suggestion that they are part of this outreach program.⁴⁸² This omission is a good example of the criticism levelled against KRA, i.e., it has not made adequate targeted administrative effort and delivered sector-driven training, in its taxpayer education initiatives, and has instead assumed the homogeneity of taxpayers.⁴⁸³ This may explain why a frustrated revenue official wondered why, sometimes, the tax authority assumes it has successfully penetrated the formal sector, yet the latter will express dissatisfaction and complain that they are not adequately catered to.⁴⁸⁴

Based on the interviews conducted with KRA, it appears that the authority has chosen, particularly in the case of existing taxpayers, to focus on closing what it terms the knowledge gap; it has achieved this through a diverse range of approaches including revamping the authority's website to reduce the need for taxpayers to interact with tax

⁴⁸¹ Interview with M-KRA (n 447).

⁴⁸² *ibid.*

⁴⁸³ Interview with M-B4, Manager at a 'Big Four' Firm (Nairobi, Kenya, 18 May 2016).

⁴⁸⁴ Interview with M-KRA (n 447).

officials (in response to challenges with corruption and taxpayers' fear of the tax), as well as delivering customer support and information through social media.

Perhaps cognizant of the significant effect of corruption and socio-political discontent on tax morale, KRA has focused on closing the attitude and perception gaps among students and not done enough to close these gaps among existing taxpayers.⁴⁸⁵ Closing the attitude and perception gap among existing taxpayers is a challenge that the revenue authority cannot achieve without support from Treasury and government; Treasury can do more than the tax authority can in changing taxpayers' attitudes and perceptions, by ensuring proper management of public funds and creating awareness about how taxes are spent.⁴⁸⁶

4.3.4. Regulatory Failures

Several dentists and lawyers blamed failures by their regulators for continued tax evasion within their professions. Even in instances where the regulators were not blamed, responses to the interview questions can be construed as examples of regulatory failures.

The Lawyers

Rule 4 of the Code of Ethics and Conduct for Advocates expressly states, 'the practice of undercutting, that is, charging less than the scale fees for professional services rendered, constitutes professional misconduct' yet many respondents spoke about rampant undercutting within the legal profession.⁴⁸⁷ In addition, Rule 3 of the Advocates (Practice) Rules states that "no Advocate may hold himself out or allow himself to be

⁴⁸⁵ *ibid.*

⁴⁸⁶ *ibid.*

⁴⁸⁷ 'Law Society of Kenya Code of Standards of Professional Practice and Ethical Conduct' *The Kenya Gazette Special Issue, Gazette Notice No. 5212* <<http://lsk.or.ke/Downloads/Gazette%20Notice%20Law%20Society%20or%20Kenya.pdf>> accessed 16 July 2018.

held out directly or indirectly as being prepared to do professional business at less than the scales laid down by the Advocates (Remuneration) Order for the time being in force.”⁴⁸⁸ Despite these clear provisions, the lawyers explained that, many times, their peers would give heavy discounts to clients by ‘waiving’ VAT and taking cash payments to avoid detection, or evading income tax to compensate for the fees lost through the undercutting. The general feeling seemed to be that everyone was doing it and one had to join in to remain competitive in the market and earn a living. Most respondents complained about the Law Society of Kenya’s failure to act on undercutting and pointed out that this was one way in which the regulator could play a role in discouraging tax evasion within the profession.

Rules 5 and 7 of the Code of Ethics speak about client-advocate confidentiality, and the fiduciary duty over client funds.⁴⁸⁹ The upshot of these two rules, when read together with the Advocates Act and other subsidiary legislation, is that lawyers should keep their fees and other income separate from client funds, exercise a fiduciary duty over client funds, and extend the client-advocate confidentiality rules to information about funds in clients’ accounts. The general rule is that a lawyer may not legitimately reveal information about client’s funds or other property, to third parties, without the client’s authorization. Rule 7 of the Advocates (Accountants) Rules states that no money, other than the money required under the Rules to be paid into the client account, shall be paid into a client account.⁴⁹⁰ In addition, aiding and abetting financial crimes under the guise of these rules is classified as professional misconduct. However, almost all the lawyers confirmed that these rules are routinely breached in practice: lawyers hide their fees in their clients’ accounts because they know that these accounts are sacred and

⁴⁸⁸ Advocates Act (Chapter 16 of the Laws of Kenya).

⁴⁸⁹ ‘Law Society of Kenya Code of Standards of Professional Practice and Ethical Conduct’ (n 487).

⁴⁹⁰ Advocates Act (Chapter 16 of the Laws of Kenya).

protected by the law. Efforts by KRA to audit such accounts would meet stiff resistance due to the advocate/client confidentiality rules. These breaches amount to professional misconduct, yet it is an area in which the regulator has failed to intervene to ensure compliance.

Rule 3 of the Advocates (Accountant's Certificate Rules) provides that 'every advocate shall, once in every practice year, deliver to the Council a certificate signed by an accountant and complying with these Rules.'⁴⁹¹ Rule 5 explains the nature of the inspection that an accountant is required to undertake with a view to signing an accountant's certificate. The rationale behind this rule is to ensure that lawyers are keeping proper books of accounts, are complying with the Act and subsidiary legislation, and are discharging their fiduciary duty over client funds. Many respondents spoke about the open flouting of this rule and confessed that they, and others, simply 'pay for the certificate'. The accountants do not carry out any investigation and will issue the certificate whether the advocate has complied or not. This is an example of collaborative evasion (See Section 4.4.1) but is also an example of the regulator's failure to ensure that its rules are complied with.

The Dentists

The dentists also took their regulator, the Medical Practitioners and Dentists Board, to task. Several respondents described the Board in unflattering terms: in their view, the Board is inefficient, only interested in collecting members' fees, and does nothing for the members. The respondents felt that the Board had not carried out sufficient tax policy lobbying on their behalf and had left them at the mercy of the government.

⁴⁹¹ Advocates Act (Chapter 16 of the Laws of Kenya).

In respect of regulatory failures, one dentist explained that the Board did not require or, at a minimum, encourage proper record keeping, financial management, and tax compliance among medics. Some respondents felt that the Board should play a role in encouraging tax compliance among its members, while others felt that the Board lacks capacity to do this since it is not effectively carrying out its core responsibility of policing unqualified persons masquerading as qualified practitioners. A good number of respondents felt that dental ethics courses should incorporate lessons on tax compliance and financial management. While the Law Society of Kenya has, at least, an extensive array of rules on proper accounting practice and compliance to guide its members, the Medical Board has none. This lacuna leaves these practitioners, who already lack financial capability, in limbo.

Regulators cannot afford to turn a blind eye to tax evasion among their members, particularly in instances where such evasion touches on breaches of legislation and codes of conduct. Encouraging compliance ought to be a joint and multifaceted effort; tax authorities and policymakers ought to consider the role played by regulators, and how that role can be enhanced through legislation and policy. For example, should regulators play a greater oversight role by requiring members to comply with their tax obligations? What would be the extent of such a mandate? Should it simply be by ‘encouraging compliance’ on one end of the spectrum or, at the extreme end of the spectrum, declining to renew practicing certificates for members who cannot produce a valid tax compliance certificate from the revenue authority?

One suggestion is that the revenue authority’s strategy should include working with the entities that register and regulate the different professions to facilitate exchange

of information about members.⁴⁹² The counter argument to this is that involving these association or regulators would simply put off members and, in any event, there is no incentive for the associations or regulators and step in to compensate for the failures of the revenue authority.⁴⁹³

Another view is that the idea of using professional bodies or regulators to confirm the tax compliance status of members is an excellent one; they need to get more involved and go beyond simply encouraging compliance to actually confirming that one has a valid tax compliance certificate before issuing an annual practising licence.⁴⁹⁴ This approach, however, is not without its risks. In countries like Kenya, where taxpayer registration and data collection is unreliable and is often outdated or plainly erroneous, there is a real risk that professionals would be unfairly punished or denied their right to practice, solely because of errors or delays by the revenue authority in confirming compliance.⁴⁹⁵ Without proper records, checks, and legal protections in place, it would be foolhardy to demand such oversight from regulators and professional associations. These concerns are valid; ADV9 explained that his partnership had been unfairly targeted by the revenue authority after the firm took up a brief against a very senior politician in the country. They were slapped with a large and unjustifiable tax assessment, and denied a compliance certificate, meaning that they could not bid for work in the public sector. Eventually, the assessment was dropped, without any charges, when the political climate changed. There is therefore merit in Waris' argument that, without safeguards, and assurance of the legitimate exercise of power by the tax authority, regulators and associations ought to be careful about the extent to which they collaborate with the tax authority.

⁴⁹² Interview with SC-KRA (n 449).

⁴⁹³ Interview with M-B4 (n 457).

⁴⁹⁴ Interview with SP-B4 (n 443).

⁴⁹⁵ Interview with Attiya Waris (n 454).

Perhaps, at this stage, the most realistic contributions that regulators can make would involve stricter enforcement of their existing professional rules, enacting rules on financial management where none exist, and cooperating with the revenue authority by sharing information about their members-within legal limits- when called upon to do so.

4.3.5. Government Service Delivery & Corruption

Tax morale has been defined as ‘the motivation of a country’s citizens to paying taxes, in addition to legal obligations’.⁴⁹⁶ Oats and Onu view it as a collective term for the unquantifiable influences on a taxpayer’s compliance choices like ‘political, cultural, and personal influences such as a sense of what is morally right, integrity, selflessness, social norms, trust in the government/tax authority, levels of democracy, and a sense of fairness or justice’.⁴⁹⁷ The data collected from the interviews suggests that government corruption, and the failure to provide services that the professionals expect, have had an effect on tax morale among professionals. This finding supports the fiscal psychology or exchange theories (see Section 3.4.3 in Chapter 3).

Context

In 2013, Kenyans elected Uhuru Kenyatta in a hotly contested and contentious election; the election attracted global attention since Kenyatta, and his running mate, were undergoing trial at the International Criminal Court for crimes against humanity, allegedly committed during the 2007 election. The political issues surrounding that election aside, the candidates were elected on a change platform- they promised fresh young leadership, innovative ideas, job creation for the youth, and most important for

⁴⁹⁶ Daude CH Gutierrez and Ángel Melguizo, ‘What Drives Tax Morale?’ OECD Development Centre Working Papers, No. 315 9.

⁴⁹⁷ Diana Onu and Lynne Oats, “‘Cozy Deals,’ Social Media, and Tax Morale’ (2016) 84 Tax Notes International 69, 71.

most Kenyans, to fight corruption. In their party manifesto dubbed ‘Transforming Kenya: Securing Kenya’s Prosperity’, they stated:

*Corruption has been tolerated in Kenya for too long. It distorts our economy, frustrates our progress and damages our reputation. It is time to get tough on those who seek to use their positions of power for their own personal gain. The Coalition will clean up Government by introducing some of the toughest anti-corruption legislation in the world.*⁴⁹⁸

Kenyans, therefore, watched for strong action on corruption, after they won the elections. Unfortunately, President Kenyatta’s government has, instead, been plagued with over 20 alleged major corruption scandals, all widely covered in the media in the past six years; he has also been accused of failing to push for the conviction of senior and powerful officials. Further, he has been accused of evading his responsibility to fight corruption, particularly through a speech delivered at the ‘State House Summit on Governance and Accountability’ on the 18th of October 2016.⁴⁹⁹

The professionals interviewed for this research all expressed extreme dissatisfaction with government’s record on corruption and did not believe that enough had been done to stamp it out. The events that took place within the health sector in Kenya, after the interviews for this research were conducted, provide stark evidence of the tense relationship between professionals and the state.

⁴⁹⁸ Jubilee Party, ‘The Harmonised Jubilee Coalition Manifesto | Kenya | Trade’ (*Scribd*) <www.scribd.com/doc/123569244/The-Harmonised-Jubilee-Coalition-Manifesto> accessed 16 July 2018.

⁴⁹⁹ NTV Kenya, *Uhuru Rebukes Agencies Over Anti-Graft Fight* <www.youtube.com/watch?v=WgEFC2GI2CY> accessed 16 July 2018.

Professionals' dissatisfaction with the government was dramatically demonstrated by a 100-day nation-wide strike by all public sector medical practitioners (doctors, dentists, and pharmacists) in Kenya commencing on 5th December 2016. It was the longest strike by medics in the history of Kenya and paralysed over 2500 medical institutions. The strike was motivated by the refusal, by government, to recognise a Collective Bargaining Agreement (CBA) signed by the doctors' union and the government in 2013; the Agreement promised doctors, dentists, and pharmacists improved working conditions, proper functioning hospitals, and increased pay. During the 100-day period, medics published gruesome stories about their working conditions including using cell-phone torches to light their way through long surgical procedures, watching patients die because they lacked the most basic equipment and drugs, and emergency rooms that lack basic supplies. They also spoke about the long and inhumane hours that they work because of understaffing in hospitals.

The government, on the other hand, argued that it did not have the funds required to implement the CBA. The strike was dubbed 'Lipa Kama Tender', a Swahili phrase loosely translated to 'pay like a tender'; this slogan was intended to shut down the government's narrative by suggesting that if President Uhuru's government stamped out corruption, it would be able to deliver on the Agreement. The slogan was inspired by several major corruption scandals exposed in the media in which senior government ministers and officials allegedly benefitted from enormous questionable pay-outs under controversial government tenders, including allegedly corrupt deals at the Ministry of Health. There is a general perception in the country that inflated government tenders are the quickest way to make wealth; the slogan therefore reflected the medics' perception that the government is eager and quick to make payments under inflated government tenders, but not to provide basic health services.

The strike was long-drawn out and acrimonious, resulting in the temporary imprisonment of the medical union officials; this act of imprisonment angered the medical profession to the extent that even medics working in the private sector joined the strike in protest and solidarity with their peers.

It is within this context that the responses of the respondents should be viewed.

The Lawyers

From the interviews, it emerged that corruption and poor service delivery by government have influenced the compliance attitudes of the lawyers. For example, ADV7 explained:

I look at my relationship with the government organically. Each party has responsibilities and duties. We as people have donated power and responsibility to the government as an organising entity. I have an obligation to financially support this body politic so that they can discharge the responsibilities I have donated to them. It is a relationship and each side should meet its side of the bargain. Right now, the political side has run amok and cannot account for how its resources are used. It cannot account for the resources that we give because it is not providing services such as clean water, healthcare proper roads etc.

In his view, since the government is providing services at a lower level than obligated, citizens are well within their right to pay taxes at a lower level than obligated. One can infer from this response that the respondent viewed tax evasion as a way of altering his terms of trade with the government. ADV1 suggested that, in her view, if Kenyans had other channels for holding the government to account, compliance rates among lawyers would increase. Yet another respondent, ADV6, expressed the desire to hold the

government to account through tax evasion, without risking a prison sentence. However, according to a contrary argument by ADV9, lawyers should use the ballot, and not tax evasion, to hold the government accountable; he did however agree that corruption and poor service delivery has had a severe negative effect on the tax morale of lawyers.

There was a general feeling among the lawyers that the tax collected by the government does not translate into service delivery, and many repeatedly stated that they did not receive value for taxes paid. ADV1 argued that Kenyan citizens are cheated by the government because they do not know how their taxes are used; there is no transparency between the point of collection, and the utilisation of taxes. Taxpaying was therefore viewed as a painful exercise of throwing money down a dark bottomless pit. ADV6 felt that while tax collection had improved vastly since the 80s and 90s, service delivery had not. ADV8 was categorical that such corruption, and failure to provide services, has significantly affected tax compliance among lawyers.

ADV7 also argued that the Kenyan government seems to be collecting more revenue than it can account for, and that taxpaying, at a rate that supports government wastage, is unjustifiable. The respondent's comments were based on an Auditor General's report, released a few months before the interview took place, suggesting that up to a quarter of Kenya's budget could not be accounted for.⁵⁰⁰

Several lawyers also felt that the payment of 'facilitation fees'⁵⁰¹ to civil servants is an informal tax, and levying tax on income, after a taxpayer has already paid this informal tax, amounts to double taxation. To remedy this perceived unfairness, lawyers

⁵⁰⁰ Edith Honan, 'Quarter of Kenya's State Budget Unaccounted For -Auditor General' *Reuters* (Nairobi, 29 July 2015) <<https://af.reuters.com/article/investingNews/idAFKCN0Q31PZ20150729>> accessed 24 November 2016.

⁵⁰¹ A bribe paid to a government officer to 'motivate' them to serve you.

elect to evade tax since they cannot avoid corrupt civil servants if they want to receive services at government offices such as the Lands Office.

The Dentists

The dissatisfaction with government was a recurrent theme among the dentists as well. According to DEN1, 'if we saw value for taxes, we would pay voluntarily. We do not see how paying taxes helps us. If we felt impact and saw changes and accountability, we would be more encouraged to comply'.

Most dentists stated that they did not feel the impact or value for the tax that they pay, and that taxpaying does not benefit the taxpayer. Their argument was that the government does not provide the services it ought to provide using taxes, and the services most mentioned were health care, sanitation, sewer and waste management, and road infrastructure. Several respondents stated that the government's failure to provide these services forces taxpayers to incur extra expenses when engaging private service providers and causes undue suffering among those who cannot afford to do so. Paying privately for services like healthcare, while also contributing towards taxes, was perceived as unfair and painful; one dentist described it as 'double taxation'.

The dentists' responses suggest that citizens are unable to see the link between their taxes and the provision of public goods; one respondent described this as 'annoying'. All the dentists who had left public service, for private practice, stated that they did so because the public hospitals are under financed, poorly equipped, and working under such conditions had become untenable. These dentists were extremely dissatisfied with the government because of their perception that the medical field is underfinanced and politicised. DEN8 described the Kenyan budget process as a sham. In his view, the

system does not work, and the government only makes false promises but never delivers; by evading taxes, the citizens are merely meeting the standards set by the government.

These responses show that the feeling among these professionals, that the government has failed to meet its end of the bargain in its social contract with them, has significantly harmed their motivation to voluntarily pay their taxes.

General Observations

In answer to the question, ‘does corruption justify tax evasion within your profession?’, the dentists and lawyers had mixed responses. One group felt that corruption justifies tax evasion, a second group felt that corruption explains and mitigates evasion but does not quite justify it, and a third group felt that corruption does not justify tax evasion.

Those who felt that corruption does not justify evasion had two main reasons: (i) using corruption to justify evasion is unfair to other taxpayers, like the employed, who do not have that option, and (ii) professionals should not engage in such risky and illegal behaviour. Respondents who felt that corruption justifies tax evasion argued that the government does not promote honesty and paying taxes to a dishonest government is unjustifiable.

Despite these different views, virtually all the answers to the corruption question contained a variant of these phrases: (i) the government is corrupt, (ii) taxes are stolen, (iii) taxes are lost through corruption, (iv) taxes are misused by government, (v) taxpaying benefits others in government, but robs the taxpayer, (vi) corruption discourages compliance, and (vii) greater government accountability would encourage consistent honesty.

The revenue authority is aware that when taxpayers see the people at ‘the top’ behaving with impunity, and getting away with gross corruption, their tax morale is lowered; this results in a general culture of impunity in Kenya, and other LMCs.⁵⁰² The revenue authority is in a difficult position because it has no control over how taxpayer money is utilised, yet it is difficult to obtain an optimum level of collection without controlling corruption and restoring tax morale.⁵⁰³

The Ministry of Finance equally acknowledges that the fact that taxpayers know they can bribe revenue officials, if caught in tax evasion, significantly damages tax morale; the option of a bribe that would let one off the hook lowers the cost of non-compliance, since the bribe would be much ‘cheaper’ than the penalties and other legal consequences of tax evasion.⁵⁰⁴

4.3.6. The Influence of Peer Perception

A common sentiment expressed by virtually all the dentists and lawyers was the belief that their professional peers were engaged in tax evasion. In some instances, the respondents had witnessed the tax evasion, or directly benefited from it; in other instances, it was premised on ‘gut instinct’ and insider knowledge about ‘the way things are done’.

The Lawyers

All the lawyers believed that their peers evade tax; there was a general belief that the level of tax compliance in the profession is low. The lawyers mentioned various forms of

⁵⁰² Interview with SC-KRA (n 449).

⁵⁰³ Interview with CM-KRA, Chief Manager at Kenya Revenue Authority (Nairobi, Kenya, 18 May 2016).

⁵⁰⁴ Interview conducted with D-NT (n 441).

noncompliance including lawyers underreporting their income, filing nil returns, padding up expenses to pay little or no tax, keeping two sets of files, evading out of both ignorance and design, demanding payments in cash to avoid paper trails, demanding split cash and bank payments to avoid declaring the cash payment, and destroying physical evidence of noncompliance. Majority of the lawyers believed that the smaller firms were the worst offenders because they are invisible; but according to ADV2 and ADV6, the largest firms are engaged in the most evasion.

Virtually all the lawyers admitted to some form of tax evasion, in the past or present. A few confessed to keeping two sets of files and destroying evidence of income to avoid a paper trail. Three respondents also spoke about lawyers hiding revenue in clients' accounts, which are protected by law from scrutiny due to advocate-client privilege, as a common practice.

The Dentists

The dental practitioners were even more categorical and clear that there was very little compliance in their field. The perception of all the respondents was that medics evade tax and the methods most mentioned were padding up expenses to pay less tax, hospitals evading customs duties on medical equipment and other forms of evasion, and widespread underreporting of income among dentists. DEN3 believed that there was a lot of underreporting among dentists and DEN5 stated that he only knew one dentist who paid tax faithfully.

DEN2 told the researcher about his previous employer, a senior practicing dentist who is well known, within the profession, for openly engaging in tax evasion. The senior practitioner treated his employees as 'independent contractors', to avoid paying PAYE,

even though the nature of their engagement was that of employer-employee. To facilitate his noncompliance, the senior dentist remunerated the ‘employees’ in cash only, accepted only cash payments for treatment, and paid off revenue officials to avoid audits and prosecution.

Overall, the data from the dentists revealed that the dentists believed that majority of their peers were engaged in tax evasion and knew many other peers who were engaged in tax evasion. In both instances, the noncompliance was deemed successful because all the respondents, except DEN8, were unaware of a professional colleague who had been detected and successfully prosecuted.

This belief, that their peers are largely evading, has had an effect on dentists’ attitudes towards compliance. DEN2 argued that the law relies on a taxpayer’s personal morality for compliance, and it is unfair for one to pay tax when others are evading. The dental practitioners seemed to be emboldened by the fact that ‘everyone is doing it, and no one has been caught’. Tax evasion therefore seems to have become part and parcel of the ordinary course of business of these professionals. When asked about his perception of the risk of detection, DEN2 answered:

In my view, the consequences of not paying PAYE on my income are negligible. I was informed by someone who works as a self-employed research consultant that the fines payable if you are caught are so minimal that it is not worth complying. I believe them.

When the researcher asked him whether he believed that this was an accurate picture of the legal position, he responded that he believed her and felt no need to cross-check the legal position. This response demonstrates the power of social influences, and the fact that a false narrative within a reference group can easily hold the force of law and

influence the behaviour of members of the group. It also corroborates the existing research that taxpayers' perceptions about the probability of being detected can be influenced by social groups.

Lawyers, perhaps because of their training, were more cautious about the risk of detection, but were equally spurred on by the belief that other lawyers are engaged in the evasion game and it is simply just the way things are done.

In summary, this data lends credence to the social psychology or influence theories, i.e., that taxpayers who believe that other members in their reference group are not complying, will be less inclined to comply.⁵⁰⁵ Such taxpayers are less likely to fear informal sanctions from their peers and community that are associated with getting caught, more likely to believe that it is 'unfair' to comply when others in the reference group are not complying, and more likely to believe that the probability of being caught is low.

4.4. THE MINOR THEMES

4.4.1. Collaborative Tax Evasion

The Lawyers

Among the lawyers, collaborative tax evasion took three different forms:

- i. Collaboration with individual clients: clients are desperate for heavy discounts on legal fees and lawyers are desperate for quick and guaranteed payments from clients; therefore, lawyers 'waive' the VAT component of the fees in exchange for

⁵⁰⁵ See Section 3.4.2 in Chapter 3.

a cash payment which, in turn, they do not declare, thereby effectively evading both VAT and income tax;

- ii. Collaboration with corporate clients: some corporate clients, including banks, do not want to pay VAT. These corporate clients offer to pay the lawyer in cash, or to pay the fees into a client's account maintained by the lawyer and therefore subject to client-advocate privilege, in exchange for a 'VAT waiver'. These transactions effectively enable both parties to evade VAT, and the lawyer evade income tax;
- iii. Collaboration with other professionals: lawyers collude with auditors or accountants who are supposed to conduct an annual review of the lawyers' accounts, as a pre-requisite for renewal of practicing certificates. The auditors issue the lawyers with certificates of compliance despite the lawyers failing to keep proper books of accounts and pay all taxes. In addition, lawyers running small firms, with modest income, are unable to afford professional accounting and tax services. Many of these lawyers will engage poorly qualified bookkeepers to assist them with their day-to-day accounting, and these 'accountants' facilitate evasion by keeping poor records, keeping two sets of accounts, hiding income, and filing nil returns on their employers' behalf.

The Dentists

There was also evidence of collaborative tax evasion and dishonesty among dentists and the medical institutions or professional associates with whom they work. For example, the dentists spoke about clinics, hospitals, and professional peers deducting withholding tax from their fees, but not providing them with withholding tax certificates as proof. The

dentists were aware that this meant the clinics or dentists had pocketed the money⁵⁰⁶ and did not remit it to the tax authority; the dentists knew, therefore, that the revenue authority was not aware of the payments. This knowledge gave the dentists the courage to fail to declare that income, thereby evading income tax.

There were also cases of joint tax evasion among dentists employed by other dentists. Some dentists spoke about being engaged as ‘independent contractors’, subject only to withholding tax, and responsible for their own income taxes, which they did not pay. Factually, however, the nature of their engagements was that of employer-employee, and these ‘contractor’ arrangements were simply intended to facilitate both parties’ evasion of PAYE.

4.4.2. Unfairness

The Lawyers

The lawyers expressed their dissatisfaction with various aspects of the tax system, and described these aspects as unfair, either explicitly or by inference.

Value Added Tax (VAT)

Majority of the lawyers viewed VAT on legal services as unfair, an unnecessary burden, a barrier to accessing justice, and a barrier to competitiveness in the market. Some went as far as saying that the removal of what they termed, ‘this unfair tax’, would encourage their compliance with income tax; it seems that for some lawyers, their evasion of income tax was an act of rebellion against a tax that they consider unfair.

⁵⁰⁶ This action amounts to theft and goes beyond simple tax evasion. It is similar to lawyers pocketing VAT, instead of remitting the VAT to the authority.

VAT seemed to pose three challenges for lawyers. First, both corporate and individual clients did not want to pay VAT. Thus, these clients would push lawyers to give heavy discounts to compensate for the increased cost of legal services, as a result of VAT, or offer to pay in cash and not insist on an invoice, if the lawyer agrees to waive VAT. Failure to accommodate such requests would affect the lawyer's capacity to attract and retain clients. To retain clients and get paid, some lawyers would choose to waive VAT and then absorb the cost of the tax by paying it out of their own funds, thereby eating into their revenue.

Second, ADV7, who had a large portfolio of poor clients mostly pursuing land rights or constitutional and judicial review remedies, felt strongly that VAT on legal services was simply another barrier to justice for such clients. The lawyer explained that scale fees pose a barrier to legal services for most Kenyans and adding VAT to those fees was a big injustice.

Third, although VAT is a consumption tax and not a cost to the lawyer, it appeared from some of the interview responses that once the tax was in the lawyer's hands, it was difficult to resist the temptation to keep it, particularly if the client has already negotiated a large discount. Remitting the VAT to the tax authority felt like an unfair burden since the taxpayer has already lost income through the large discount. The respondents suggested that many lawyers would collect VAT from the client and retain it, an action that goes beyond 'simple evasion' since it amounts to theft.⁵⁰⁷

⁵⁰⁷ See note 442.

Other Unfairness in the Tax System

Apart from the perceived unfairness of VAT, the lawyers also expressed the sentiment that the tax system is generally unfair. First, there was a belief that the tax authority is only concerned with revenue collection and is blind to the cash flow problems that SMEs face. For example, once lawyers raise a fee note and issue the client with an Electronic Tax Receipt for VAT, they are forced to remit the VAT, whether the client has settled the fee note or not. If clients take time to process the fee note, the lawyer is forced to settle the VAT out of their own resources, resulting in cash flow problems. ADV4 explained that most self-employed professionals live from cheque to cheque and these tax payments significantly affect their businesses.

Another concern was the Withholding Tax threshold which, according to ADV2, is too low. Lawyers' fees fall under the category of professional fees and are subject to a withholding tax rate of 5%. ADV2 felt that a 5% tax on small amounts is unfair, punitive, and exorbitant; she was of the view that the threshold for amounts on which the tax is due should be raised from Kshs. 22,000 (approximately £162), to reduce the burden on small firms earning modest fees.

A third concern, expressed by more than half the respondents, was that the tax audit process is unfair, and revenue officials often have a pre-conceived agenda for victimising taxpayers and extracting bribes. Some lawyers also felt that the tax authority treats large taxpayers preferentially and have better relationships with them; these lawyers argued that all taxpayers should be treated the same without regard to their size.

The Dentists

The dentists also expressed dissatisfaction with the tax system and pointed out the following two cases of perceived unfairness.

VAT on Medical Equipment and Materials

Much in the same way that lawyers are vehemently opposed to VAT on legal services, and deem it unfair, dentists are strongly opposed to the imposition of VAT on dental equipment and materials. On 2 September 2013, Kenya's new VAT law- Value Added Tax Act No 35 of 2013- came into effect, repealing the old law. Amongst other significant changes, the law abolished the reduced VAT rate of 12%, incorporated what was previously contained in subsidiary legislation into the primary legislation, reduced the schedules to the Act from an eye-watering number of eight to two, and, most importantly, made items that were previously zero-rated or exempt, taxable. Dentists were one of the casualties of the revised rating; the following dental items were affected: Dental instruments, surgical instruments/equipment, X-ray films, X-ray equipment/machines, dental units, orthopaedic items, including artificial teeth, hearing aids, and artificial body parts.

The dentists felt that paying VAT on the materials that they use to earn an income which is, in turn, also taxed, amounts to double taxation and is unfair. These dentists felt that the medical sector, and medical professionals, are too highly taxed. They also argued that the taxation of dental materials and equipment is a barrier to earning a living as a dentist and a further barrier to accessing basic dental care, which they say was already inaccessible, for most, before the tax. Several respondents suggested that the evasion of

income tax and customs duties is justified because the government has also been unfair to medics.

The other oft repeated argument was that the taxes on medical equipment is unfair to new businesses because they cannot compete with dentists who set up their clinics before the introduction of the tax; the respondents argued that this unfairness affects their right to earn a living through their trade. One dentist argued that when tax rates begin to affect business viability, people begin to evade taxes.

The emerging trend from the responses of the professionals suggests that they perceive certain aspects of the tax system as unfair and are adjusting their behaviour in a bid to restore the situation to what they deem fair. This data corroborates the theory that taxpayers who believe that the tax system is fair and equitable, are more likely to comply.⁵⁰⁸ While this theory does not fully explain the tax compliance or evasion behaviour of self-employed professionals in Kenya, it is certainly necessary to consider issues of fairness, and perception of fairness, when designing strategies intended to encourage compliance within this group.

4.4.3. The Unintended Effects of a Court of Appeal Order

On the 8th of October 2004, the then Minister of Finance published Legal Notice No. 110 (the Value Added Tax [Electronic Tax Registers] Regulations 2004). Vide this notice, he exercised his powers, under Section 58 of the Value Added Tax Act, to prescribe the rules governing the use of electronic tax registers (ETRs) by taxpayers required to use them under paragraph 6(5) of the Seventh Schedule to the Act. Subsequently, on 16th March 2005, the Commissioner of Domestic Taxes and the Kenya Revenue Authority published

⁵⁰⁸ See section 3.4.2, in Chapter 2.

a newspaper advertisement stating that the effective date of buying the ETRs was 1st April 2005. The rationale behind the introduction of the ETRs was to bring into the tax net, traders who had hitherto been evading VAT, by electronically tracking their receipts and payments.

The Law Society of Kenya was aggrieved by these two decisions and filed an *ex-parte* application on the 12th of May 2005, seeking two substantive judicial review orders against the Minister of Finance, the Kenya Revenue Authority and the Commissioner for Domestic Taxes.⁵⁰⁹ The orders sought were as follows:

1. THAT a Judicial Order of Certiorari do issue to call up into the High Court and quash the decision and proceedings of the Minister of Finance on one side and the Kenya Revenue Authority and The Commissioner of Domestic Taxes on the other side dated 8th October 2004 and 16th March 2005 respectively.

2. THAT Judicial Review order of Prohibition do issue directed to the Minister of Finance, The Kenya Revenue Authority and the Commissioner of Domestic Taxes to prevent them jointly and severally by themselves and or their agents from implementing the Value Added Tax (Electronic Tax Registers) Regulations 2004 and or Legal Notice No 110 of 8th October 2004.

The application was based on 11 grounds, including, *inter alia*:

- i. The decisions were *ultra vires* and *intra vires* the VAT Act;

⁵⁰⁹*Republic v Minister for Finance & 2 others* HC Miscellaneous Civil Application No 644 of 2005 [2006] eKLR.

- ii. The confidentiality of the client/advocate relationship would be adversely affected by the implementation of the regulations;
- iii. The decisions would impose a monetary burden on the applicants without the authority of Parliament;
- iv. Not all transactions by lawyers would be capable of being keyed into the register
- v. The regulations were *ultra vires* the Advocates Act

It is unnecessary, for our purposes, to go into the detailed arguments submitted by the parties in court, and the *ratio decidendi*. What is relevant, in this case, is that by a judgment dated 24th February 2006, Nyamu, J dismissed the application with costs on the basis that the Law Society of Kenya's case was based on a serious misapprehension of the relevant tax law. The Law Society of Kenya was aggrieved by this judgment and immediately sought, and obtained, an order for stay of execution of the judgment, pending the determination of their appeal.⁵¹⁰

This stay of execution order remained in place from 2006 and was still in place when the interviews with lawyers, for this research, were conducted in 2016—a period of ten years; in that time, neither party had taken serious steps to fix the appeal for hearing. This is important for this research because the Court of Appeal stay of execution order essentially enabled lawyers to continue issuing invoices without the accompanying electronic tax receipt for VAT. This order inadvertently aided tax evasion of VAT, something many of the lawyers interviewed admitted.

ADV1 explained that in her experience, some corporate clients, like banks, would offer lawyers conveyance briefs, and offer to pay discounted legal fees, in exchange for

⁵¹⁰ *Law Society of Kenya v Minister for Finance & 2 others* Civil Appeal No 91 of 2006 [2017] eKLR.

not insisting on an invoice and ETR; this would enable the bank to evade VAT and the lawyer evade income tax.

ADV2 also admitted that it was easy to evade VAT because lawyers did not issue ETRs, on the strength of the stay of execution order. Therefore, lawyers would charge the client the VAT, but not remit it to the tax authority; she explained that to get away with it, her law firm maintained two sets of files.

ADV4 complained that the court order had created uncertainty because the revenue authority would still demand ETRs from lawyers' clients when those clients applied for VAT refunds. He said:

It took a year for us to get an ETR machine for example; at first, I relied on the court order protecting lawyers from issuing ETR receipts. Regarding VAT there is a disconnect between what the law is and what happens in reality. KRA puts pressure on our clients to produce ETR receipts when they try to claim VAT refunds. So, you either charge VAT and give the client the receipt or you don't charge (evade) and avoid the receipt debacle.

ADV7 also admitted that lawyers evade VAT 'a lot', since they collect VAT but do not have to issue ETRs.

The stay order, issued by the Court of Appeal, was intended to ensure justice for the applicants; however, the unintended consequence was that it facilitated the evasion of VAT within the legal profession. The duration of time for which such an important appeal, and matter of public interest, remained unprosecuted is also alarming and reproachable. Both parties, particularly the tax authority, should have taken steps to

ensure that the dispute was resolved quickly, to remove the legal uncertainty that the order created. The appeal was finally heard in 2017, and a unanimous decision dismissing the appeal was delivered on 16th June 2017. It would be interesting to carry out future research to interrogate how this decision has influenced VAT compliance among the legal practitioners.

4.4.4. Public Perception of the Revenue Authority

Overall, the respondents' perceptions of the revenue authority were negative. Only one dental practitioner, and one lawyer, reported positive experiences with the revenue authority; the rest had a negative perception shaped by either anecdotal evidence, or personal experience. One common complaint, across both professions, was that the revenue authority does not understand the nature of legal work, or dental work; consequently, the tax authority's actions, rules, and decisions, concerning taxpayers in these professions are arbitrary, inconsistent, and unfair. In addition, there was a general feeling that the authority is blind, and aloof, to the challenges that the self-employed employed professionals running small firms face, yet these challenges make compliance difficult and expensive. The professionals spoke about cash flow problems, the high cost of compliance, and the inability to keep proper records and understand their tax compliance obligations. The professionals felt that the revenue authority was more interested in enforcement than supporting SMEs.

The other recurrent theme was that the revenue authority was to be feared because it is, disrespectful, unreasonable, scary, aggressive, and has a pre-conceived negative agenda, among other adjectives. Most lawyers and dentists felt that the revenue authority deliberately generates this fear and is not interested in having a genuine relationship with taxpayers. The tax sensitisation workshops, often held by the authority, were viewed by

lawyers as ‘traps’. Most respondents viewed the revenue authority as an enemy to be feared and avoided. According to DEN6 her fear of the revenue authority was so great that she was unable to go to their offices to process some tax refunds that had been due to her for some years.

The respondents, particularly the lawyers, felt that the revenue authority is more interested in cultivating relationships with multinational enterprises and High Net-Worth Individuals, because those taxpayers help the tax authority realise its targets faster. The dentists also argued that the revenue authority is less interested in smaller boutique clinics, and more focused on larger hospitals. This led to unfairness concerns because the professionals believed that the revenue authority exists only for the good of large taxpayers. They surmised that the revenue authority is more interested in meeting the needs, and addressing the concerns, of these large taxpayers and ignores others.

The other public perception of the revenue authority, common across both groups, was that the revenue authority was more interested in collecting bribes than collecting taxes. The respondents generally believed that revenue authority audits were merely intended to intimidate taxpayers and push them into paying a bribe. Many respondents, particularly the lawyers, believed that if one was caught evading, one could always escape by paying a bribe. Most of the dentists believed that larger taxpayers pay bribes to the revenue authority in order to get away with evasion. Tax collection was viewed as a tool for harassing citizens and both groups construed the revenue authority’s work as ‘harassment’, ‘malicious’, ‘problematic’ or ‘interference’. One lawyer told the researcher that he once encountered what he described as a ‘gentle’ revenue officer, suggesting that revenue officers are believed to be either gentle, or rough. Informal businesses are cash-based, and always liquid, and can therefore easily issue bribes in instances of petty

corruption.⁵¹¹ The fact that one can ‘buy’ a tax compliance certificate defeats the whole purpose of the certificate, and further erodes tax morale.⁵¹² Corruption within the tax authority poses a considerable problem for tax morale; there is evidence that such instances of petty corruption have an adverse effect on tax morale, and trust in the tax authority, in sub-Saharan Africa.⁵¹³

The revenue authority was also viewed as inefficient; lawyers, who regularly interact with the revenue authority on behalf of their clients, believed that it is faster, and more efficient, to bribe revenue officers than to follow the proper channels. The proper channels were viewed as slow, bureaucratic, inefficient, and expensive; corruption was deemed to be faster and cheaper.

Finally, the revenue authority was also viewed, particularly by the dentists, as making insufficient use of technology. Both groups of respondents expressed dissatisfaction with the work that the authority is doing to sensitise and educate taxpayers about their tax mitigation options; taxpayers seem to view this as a critical component of the authority’s work, and one that it has failed to do.

4.4.5. Formalisation & Firm Growth

The lawyers admitted that, as early entrepreneurs, tax was not a priority; their firms were mostly informal and characterised by individual clients, cash payments for services, lack of financial knowledge, financial disorganisation and poor management practices, informal employment arrangements with their limited staff, and resulting low levels of tax compliance.

⁵¹¹ Interview with SP-B4 (n 443).

⁵¹² *ibid.*

⁵¹³ Jahnke (n 410) 18.

One lawyer who was exposed to a firm with a strong culture of compliance, early in his career, did say that because of that experience, he always had a desire to comply even when he did not. DEN8, a senior dental practitioner, expressed a similar sentiment; he was similarly exposed to a very financially organised and tax compliant dental practice in his first job, and he confessed that the experience has significantly influenced the management of his practice and compliance behaviour. He was the only dental respondent with a fully-fledged in-house accounting department, and it was evident that the department was run in a very professional manner.

Apart from these two outliers, other respondents shared the view that tax is low on the list of priorities of professionals when they are 'starting out'. ADV4 said that he knew nothing about tax compliance when he was starting out, because his first and only employer ran a financially disorganised firm and did not comply with most of his tax obligations.

The lawyers were also quite unanimous in the view that the level of tax compliance increases with the age of the law firm; one lawyer stated that tax compliance is a gradual process for lawyers. This seems to be the case because as the firms grow, they attract more corporate clients and are inevitably pushed toward formal processes and tax compliance. Corporate clients seemed to significantly influence the compliance behaviour of lawyers. The lawyers with firms that began small, but had begun to attract corporate clients, explained that securing corporate clients had forced them to formalise, get financially organised, switch from cash payments to cashless transactions, and comply with tax legislation. Besides, one lawyer explained that firm growth is accompanied by an increase in the number of employees, which, in turn, encourages

compliance because of staff demands for contracts, payslips, and proof that their income tax has been remitted to KRA.

While firm growth among lawyers led to formality, cashless transactions, and improved compliance, this was not the case among dentists. The picture drawn by the dental practitioners was of a highly informal dental sector; one respondent explained that dental practitioners prefer informality and were not keen on formal contractual arrangements. Both the locum market and some employment relationships were not subject to contract; the locum market was very unstructured and based on ‘gentleman’s agreement’. The informality spread to the payment for services as well; most dentists preferred to receive cash payments, and this facilitated tax evasion.⁵¹⁴

There are several possible explanations for this distinction between the two professions. First, lawyers, by virtue of their training and exposure to formal legal processes, are more likely to be drawn towards formalisation of their processes and engagements, with the passage of time. The nature of dental training is different, and they are probably more likely to remain comfortable with loose and informal arrangements if they work.

Second, while an increase in the number of employees resulted in compliance among lawyers, this was not necessarily the case among dentists. First, dental practices tend to remain reasonably small (regarding staff numbers) despite their growth, and so this is less likely to be a relevant factor. Secondly, it is possible that the staff in the law firms are more likely to demand formal contracts, payslips, and proof of payment of their income tax, because they are exposed to an environment where legal mechanisms and

⁵¹⁴ Unlike medical procedures, the insurance cover for dental procedures in Kenya tends to be quite limited and is characterized by low thresholds. As a result, most patients will pay privately for the full or partial cost of dental treatment, and thus the paper trail offered by insurance payments is avoided.

documents are essential and actively utilised. These employees are probably exposed to the negative consequences of informal or defective formal engagements on a daily basis, through their work, and are more likely to appreciate the importance of formalised engagements. A third possible explanation is that the growth of law firms is accompanied by an increased portfolio of corporate clients who, in turn, encourage formalisation and improved compliance; this is not the case among dental practitioners because of the inherent differences in the way the two professions work.

Most literature around formalisation and evasion focuses on the assertion that improved tax enforcement and compliance results in formalisation and growth of firms, which is viewed as a positive development. However, the converse is not often discussed, i.e., formalisation and growth, as a result of time and circumstance, may eventually result in improved tax compliance. The case of the lawyers suggests that this is a strong possibility, but the case of the dentists shows that this possibility is also dependent on other factors. For example, the factor driving or motivating the formalisation and growth can determine whether or not that formalisation and growth will result in improved tax compliance.

4.4.6. Legal Form

The Lawyers

There was consensus, among all the lawyers, that law firms run as partnerships had better compliance rates. According to the respondents, sole proprietors lacked accountability and tended to be financially undisciplined; for example, sole proprietors had significantly more opportunity to withdraw money from their business accounts in an unstructured manner. Partnerships, on the other hand, were viewed as having more accountability because the partners were answerable to each other; as a result, partnerships were more

financially organised, discouraged or prevented ad hoc withdrawals, and kept better financial records because the partners had to share profits and losses. Consequently, partnerships were deemed to be more likely to comply with tax legislation. ADV1 explained that, in her opinion, ‘larger partnerships have independent accounts offices; sole proprietors however just have an accounts clerk whom they rely on fully, and often do not know what they are doing.’

ADV5 observed that partners leveraged on each other’s technical strengths and therefore grew at a faster rate and such growth resulted in improved compliance. In the researcher’s view, it is also possible that the varied skills among partners in a law firm are likely to attract corporate clients and, as explained above, an increased portfolio of corporate clients results in increased tax compliance.

The Dentists

Legal form was not a significant factor among dental practitioners; there are two possible reasons for this. First, while the registration and legal form of law firms are highly regulated through primary and secondary legislation, and by the Law Society of Kenya, dental clinics are not required to take any particular legal form; even the simple registration of a business name will suffice. Second, most dental clinics tend to be run as sole proprietorships; partnerships do exist, for example between spouses, but unlike in legal practice, they are not common or preferred. The situation seems to be changing, however, as some younger practitioners are embracing the partnership route to share the costs of initial capital, leverage on each other’s expertise, and share expenses. Perhaps, in a few years, legal form will be as relevant a factor in tax compliance among dentists, as it is among lawyers.

4.5. CONCLUSION

This chapter serves several purposes. First, it provides a detailed account of the design of the case study, including important details about (i) the selection of Kenya as the case country, (ii) the selection of the professions for in-depth research, (iii) the identification of respondents, and (v) the analysis of data. The researcher intended to demonstrate that the case study design was scientific, rigorous, and reflective. The researcher has also identified the limitations of the case study design, and how these limitations were mitigated.

The second purpose of this chapter was to provide a comprehensive narrative of the data collected from the lawyers and dentists interviewed for this research. The interviews were transcribed, coded, and the codes were organised into themes.⁵¹⁵ The researcher has chronicled the key points under each theme, thereby providing an in-depth exposition of the most critical influences on compliance attitudes among self-employed professionals in Kenya. While this thesis does not purport to deliver data that is generalisable to the whole population, or prove causation, it does convey significant, and comprehensive, information about the patterns or trends in the compliance attitudes of professionals in Kenya.

The third purpose was to offer the perspective of the tax experts, from the private and public sector, and academia. For flow, context, and readability, these perspectives have been dovetailed into the relevant sections of the narrative on the taxpayers' views, with appropriate reference and citation.

⁵¹⁵ All the codes and themes are available for review, in the Appendix. Note that, for purposes of this chapter, some themes were merged, and those that were deemed to lack sufficient depth were discarded.

The overarching objective of this case study was to step back from the big-picture theoretical discussions on tax evasion by hard-to-tax professionals, and, instead, focus sharply on the case country to determine the influences on the compliance attitudes of self-employed professionals therein, and the perspectives of tax experts on tax evasion by hard-to-tax professionals. With this contextual data, the researcher was able to reflect on the administrative options, discussed in Chapter 2, and propose some administrative strategies, for tax authorities in LMICs, for dealing with hard-to-tax professionals. These strategies are presented in Chapter 7; however, in the next, and penultimate, chapter, the researcher discusses the key contributions, to existing knowledge, made by that the data presented in this Chapter.

5. IMPLICATIONS OF CASE STUDY FINDINGS AND CONTRIBUTIONS
TO PREVIOUS RESEARCH

5.1. INTRODUCTION

Chapter 1 was dedicated to describing the group of taxpayers referred to as the HTT and distinguishing them from other taxpayers; Chapter 1 also set out the justification for this study, and why it focuses on self-employed professionals rather than farmers, or SMEs. The chapter addressed various arguments in support, and against the use, of tax authorities' limited time, human, and financial resources, to ensure compliance by the HTT.

Chapter 2 was concerned with various options available to revenue authorities in relation to taxing the HTT, i.e., deliberately leaving some taxpayers out of the tax base, stronger enforcement, increased reliance on voluntary taxation, increased reliance on indirect taxation, and the use of simplified tax regimes; the benefits and drawbacks of these options were evaluated.

Chapter 3 addressed the broad theories that have been developed to explain why people evade tax, as well as a more recent and specific framework for analysing compliance behaviour- the *slippery slope framework*.

Chapter 4 was dedicated to (i) describing the design of the case study of tax compliance among doctors and dentists in Kenya and (ii) discussing, in detail, the data collected and the themes that emerged from the case study.

The goal of this fifth chapter is to highlight the implications, of the case study findings, for tax authorities interested in improving compliance by self-employed professionals, as well as demonstrate how these findings contribute to previous research on tax compliance and administration.

5.1.1 General Comments

Overall, this case study provides new, unique, and crucial qualitative data on compliance attitudes of hard-to-tax professionals in Kenya, a lower middle-income country, through the lens of both taxpayers and tax experts. As explained in Chapter 1, the body of research on compliance behaviour of the HTT in LMICs has focussed extensively on farmers and SMEs; professionals have received little attention. This research is the first qualitative case study that specifically interrogates and captures the compliance attitudes of self-employed professionals in LMICs and represents a significant step forward in addressing the gap in the literature. The qualitative data collected through this study answers several questions about the taxation of professionals in LMICs, but also opens up new questions and forms a sound basis from which future research on the topic may be built

Several themes, emerging from the interview data, have corroborated the existing theories on tax evasion. First, the evidence on the influence of perceptions of taxpayer visibility, the risk of detection, and consequences of tax evasion, on the professionals' compliance attitudes, corroborate the proposition that taxpayers who perceive tax evasion as costly are more likely to comply.⁵¹⁶

Second, the trends in the data also confirm the theory that social influences have a significant effect on compliance attitudes; the professionals' perceptions of their peers' behaviour influenced their attitudes towards tax compliance.⁵¹⁷ Peer evasion appeared to lower the fear of social sanctions if caught, and the knowledge that their peers were evading, with no apparent consequences, also affected the perception of risk of detection and punishment.

⁵¹⁶ See the economic deterrence theories in Section 3.4.1 of Chapter 3.

⁵¹⁷ See the social influences theories in Section 3.4.2 of Chapter 3.

Third, the patterns from the data, on the influence of perceptions of unfairness in the tax system, also corroborated the proposition that taxpayers are more likely to comply if they believe that the tax system is equitable.⁵¹⁸ The professionals' views on the unfairness of VAT affected their attitudes towards tax compliance.

Fourth, trends in the data also confirmed that the political legitimacy of the tax authority, government corruption, and poor service delivery by the government, could negatively affect tax morale.⁵¹⁹ The professionals' dissatisfaction with the tax authority, and anger towards the government over corruption and failure to deliver the services they expect, significantly influenced the professionals' tax morale and attitudes towards tax compliance.

These themes from the data also brought to fore new factors that influence compliance attitudes and tax morale, that are often overlooked in the literature or have not been considered before. These include regulatory failures by regulators and professional bodies, financial capability and tax literacy, and opportunities for collaborative evasion. Some of these influences are specific to self-employed professionals, such as regulatory failures, but others like financial capability and tax literacy apply to all hard-to-tax taxpayers.

The data also challenged some assumptions. For example: (i) firm growth does not always result in improved compliance, as demonstrated by the different effects of firm growth on the tax compliance of law firms and dental clinics; (ii) despite their high level of education, some professionals will still struggle with financial capability and tax

⁵¹⁸ *ibid.*

⁵¹⁹ See the fiscal psychology and political legitimacy theories in Section 3.4.3 and 3.4.4 of Chapter 3.

literacy; and (iii) the tax compliance challenges of some professionals are not dissimilar to the compliance challenges of other SMEs.

More specific thoughts and ideas on the contribution of this data, to the literature, are explored, in detail, below.

5.2 TRUST OR POWER?

The slippery slope framework, discussed at length in Chapter 3, explains the relationship between trust and power, in the context of tax compliance. The proponents of the framework argue that voluntary compliance increases when taxpayers believe ‘that the tax authorities are benevolent and work beneficially for the common good’.⁵²⁰

This thesis contributes to the body of literature on the slippery slope framework, by extending the framework to take into account the effects of government corruption, poor service delivery, weak taxpaying culture, and the preponderance of cash transactions in many LMICs, particularly in Africa. This thesis therefore proposes that *severe corruption and poor service delivery by government, particularly in countries where the taxpaying culture is already weak and there is a preponderance of cash transactions, result in low tax morale that limits the effectiveness of trust, in the revenue authority, in increasing voluntary compliance.* In such environments, stronger enforcement is a better tool for increasing compliance levels.

The data presented in Chapter 4 showed that the grand corruption scandals that have plagued the Kenyan government, coupled with the government's failure to provide services that taxpayers deemed to be important (or the failure to provide those services to a satisfactory level), had severe adverse effects on the tax morale of self-employed

⁵²⁰ Kirchler, Hoelzl and Wahl (n 346) 212.

professionals. Taxpaying was viewed as a pointless exercise, and taxpayers believed that their taxes served no purpose beyond lining the pockets of unscrupulous people in positions of power. The professionals were frustrated by their inability to hold the government accountable for its failures and viewed tax evasion as the only tool through which they could do so. The professionals believed that the government could not account for the taxes it collected, and the cost to taxpayers was that they had to dig deeper into their pockets to pay for what, they argued, the government should provide. Tax officials agreed that impunity at the top had seeped down to taxpayers and negatively affected compliance.⁵²¹

Corruption also provides avenues for tax evasion. There is significant tax evasion by ‘consultants’, some of whom are professionals like lawyers, who participate in unscrupulous deals aimed at facilitating or securing construction permits and government tenders for their politically connected ‘clients’, who will use that political power to protect the professionals.⁵²²

The relationship between corruption and tax morale has been explored in various studies showing that corruption severely damages the social contract thereby destroying tax morale and lowering compliance; corruption may also facilitate tax evasion when taxpayers collude with revenue officers.⁵²³ In addition, governments in countries with high levels of corruption, usually accompanied by poor delivery of public services, are likely to face greater resistance from citizens when they attempt to increase taxes.⁵²⁴ In many African countries, the “predominant forms of corruption such as grand corruption

⁵²¹ Interview with SC-KRA (n 449); Interview with CM-KRA (n 477); Interview with M-KRA (n 447).

⁵²² *ibid.*

⁵²³ Torgler, ‘Tax Morale, Rule-Governed Behaviour and Trust’ (n 410); Torgler, ‘The Importance of Faith’ (n 11); Feld and Frey (n 410); Fortin, Lacroix and Villeval (n 410); Alm, Martinez-Vazquez and McClellan (n 410); Baum A and others (n 410); Jahnke (n 410); Schlenther (n 46); Rosid, Evans and Tran-Nam (n 234). See also Section 3.4.4 in Chapter 3.

⁵²⁴ Besley and Persson (n 161) 114.

and state capture are driven by high level politicians, mainly through the natural resources sector and through abuse of procurement processes.”⁵²⁵ Despite numerous programs and regulatory frameworks intended to “eradicate” corruption in these countries, corruption persists because of lack of political will to eliminate it; Botswana’s success in this regard proves this point.⁵²⁶

Increasing tax morale is difficult because it is tied to deeply rooted attitudes and perceptions; it can, however, be achieved. Before 2003, KRA would collect very little tax; they experienced a significant spike in revenue collection after the 2003 national elections, deemed the first free and fair elections in 24 years, ushered in a popular government.⁵²⁷ Taxpayer attitudes changed, and citizens were willing to support the new government through taxation. This view is supported by Prichard, who explains that between 1998-2002, tax revenue in Kenya fell drastically from 20.5% of GDP in 1995-1996 to 15.7% of GDP in 2001-2002; he attributes this partially to the ‘declining legitimacy and popularity of the government’, with the President’s opponents deliberately withholding tax to frustrate and undermine the financial stability of his government.⁵²⁸

In 2004-2005, tax collection hit a figure of 21.8% of GDP, a remarkable jump from the 15.7%; this followed the 2002 election of Mwai Kibaki, under a coalition government, which ushered in a period of public goodwill and faith in government, increased levels of compliance, and little public resistance towards taxes.⁵²⁹ Prichard adds

⁵²⁵ Schlenther (n 46) 227.

⁵²⁶ *ibid* 236.

⁵²⁷ Interview with M-KRA (n 411).

⁵²⁸ Prichard (n 176) 134.

⁵²⁹ *ibid*.

that subsequent cracks in the coalition, in its third year, was accompanied by declining revenue collections in 2004-2005 and 2005-2006.⁵³⁰

In dealing with noncompliance, revenue officials in Kenya view audits and surveillance of individual taxpayers as expensive and time-consuming, opting, instead, to encourage voluntary compliance among these taxpayers and concentrate their limited enforcement resources on ensuring compliance by corporate entities from whom they can collect more tax.⁵³¹ KRA's rationale is that, a relationship based on trust with these individual taxpayers ought to translate into voluntary compliance, thus obviating the need to pursue costly and time-consuming mandatory enforcement. KRA's approach seems heavily influenced by the contemporary paradigms of tax administration such as the slippery slope framework and cooperative compliance.⁵³² It is, however, important to ask whether these approaches are suitable or effective in all contexts.

While KRA certainly has the power to shape its relationship with taxpayers, and even eliminate corruption among its officials to cultivate the trust of taxpayers in the authority, it has *no* control over two very important issues: (i) reducing/eliminating corruption in government, and (ii) the proper utilisation of the tax collected to deliver the services that citizens value. These two issues play a critical role in the process of building a relationship of trust, leading to voluntary compliance, between the revenue authority and the taxpayer. Taxpayers do not look at tax collection in isolation; in their assessment, they link collection and usage, even though the tax collector has no further role after facilitating the collection and remission of taxes to the executive. For example, citizens

⁵³⁰ *ibid.*

⁵³¹ Interview with SC-KRA (n 449); Interview with M-KRA (n 447).

⁵³² See the discussion in Section 2.4 in Chapter 2 and Section 3.5 in Chapter 3. See also Kirchler, Hoelzl and Wahl (n 346); Wahl, Kastlunger and Kirchler (n 425); Muehlbacher, Kirchler and Schwarzenberger (n 431); Verboon and van Dijke (n 423); Lisi (n 433); Kastlunger and others (n 435); Kogler and others (n 432); Prinz, Muehlbacher and Kirchler (n 424); Gangl, Hofmann and Kirchler (n 426); Kogler, Muehlbacher and Kirchler (n 11); Gobena and Van Dijke (n 441).

who leave comments on the posts by KRA's handle on Twitter, regularly respond to the tax authority's posts on taxation, posts intended to encourage compliance, or generally informative posts, by bringing up the numerous government corruption scandals or poor service delivery by government. A small sample of posts and comments have been collected to illustrate this point and are available in the Annex.

It is challenging to create an environment of trust in the tax authority, and voluntary compliance, when taxpayers believe that taxes are improperly utilised or 'stolen'.⁵³³ It is also difficult to tackle tax evasion and promote honesty when senior political leaders are perceived to be engaged in fraudulent activity that goes unchecked.⁵³⁴ Revenue officers in Kenya agree that corruption in government has severely hampered tax administration.⁵³⁵

In an ideal world, the government would tackle corruption aggressively, in order to further the revenue collection work of the tax authority. However, revenue authorities must work within the realities that they are presented with, which unfortunately, in many LMICs, includes improving compliance *despite* the corruption problem. Since these high levels of corruption are unlikely to be eliminated in the short term (and perhaps even in the midterm), the strategies that the tax authorities employ must take into consideration the limitations that government corruption present. This concession does not mean that governments in LMICs should not tackle corruption, neither does it ignore the very legitimate concerns of taxpayers. Instead, it is an acknowledgement that many of these

⁵³³ See the discussion on the political economy of taxation in Richard M Bird and Eric M Zolt, 'Tax Policy in Emerging Countries' (2008) 26 *Environment and Planning C: Government and Policy* 73, 84–85.

⁵³⁴ Vito Tanzi and Parthasarathi Shome, 'A Primer on Tax Evasion' (1993) 40 *Staff Papers* (International Monetary Fund) 807, 818.

⁵³⁵ Interview with SC-KRA (n 449); Interview with CM-KRA (n 477); Interview with M-KRA (n 447).

tax authorities are working in an imperfect environment, over which they have little control, and the solutions proffered must consider these realities in order to be effective.

The data from the case study seems to support this argument; it was evident that weak enforcement by the revenue authority influenced the professionals' compliance attitudes. Tax evasion was largely viewed as risk-free because most respondents did not know a peer who had been successfully prosecuted for tax evasion. One dentist explained that the revenue authority rarely audited medics since they are 'sacred' because of their service to humanity; and a lawyer stated that although lawyers' clients were regularly audited, lawyers were rarely audited. The attitude that pervades among these taxpayers is that 'everyone is doing it, and no one has been caught'. The cost of noncompliance is therefore judged to be minimal since even if one is caught, it is believed that a bribe can 'fix' the problem. One dentist explained that dentists would be encouraged to pay taxes if there were repercussions for not doing so, or a strong likelihood of being caught. These professionals believe that they are 'small', and the revenue authority is not interested in them; they believe that they are invisible, and the revenue authority is more concerned with large taxpayers.

Of course, this is not to say that taxpayers in higher income countries do not express dissatisfaction with the way their taxes are used, or with government's priority spending areas, or that corruption is absent in those countries. The tax morale of citizens in high income countries is also influenced by these factors. Instead, the argument here focuses on the *scale* of corruption, poor service delivery, and dissatisfaction with tax use in LMICs, and the resulting incomparable levels of tax morale in LMICs vis-à-vis high-income countries.

The researcher's proposition does not deny the importance of a trust relationship between the taxpayer and the tax authority; it simply adds that this relationship does not exist in a vacuum. The actions of the executive significantly reduce the effect that a relationship of trust, with the tax authority, has on the decision to voluntarily comply, much in the same way that sensible use of taxes by the executive would be of little benefit if the tax authority does not play its part.⁵³⁶ Since the tax authority has little control over the actions of the executive, it must align its administrative strategy with the realities of its environment; it may well be the case that in certain environments, the use of coercive power, rather than trust, is more effective in increasing voluntary compliance.⁵³⁷

Majority of the empirical work on the slippery slope framework provides ample evidence that trust in revenue authorities increases voluntary compliance in countries with much lower levels of corruption, better service delivery by government, and stronger taxpaying cultures than most African countries.⁵³⁸ There is not enough empirical research on the framework, outside Africa, particularly among self-employed professionals.⁵³⁹ Testing the framework in more diverse settings would provide much needed empirical data on the effect of government corruption on trust in revenue authorities. The data from this research, although not generalisable to whole populations, is helpful in demonstrating trends in the attitudes among self-employed professionals in an LMIC in Africa, in the context of corruption, trust and compliance.

⁵³⁶ Kaplanoglou, Rapanos and Daskalakis (n 426) 431.

⁵³⁷ Lemessa Bayissa Gobena and Marius Van Dijke, 'Power, Justice, and Trust: A Moderated Mediation Analysis of Tax Compliance among Ethiopian Business Owners' (2016) 52 *Journal of Economic Psychology* 24. In that study, for example, the researchers found that procedural justice led to voluntary compliance only in an environment of low legitimate power and high coercive power.

⁵³⁸ Kaplanoglou, Rapanos and Daskalakis (n 426); Kogler, Muehlbacher and Kirchler (n 11); Kastlunger and others (n 435); Kogler and others (n 432); Muehlbacher, Kirchler and Schwarzenberger (n 431); Wahl, Kastlunger and Kirchler (n 425).

⁵³⁹ There is one empirical study conducted in Ethiopia on small and large business owners. Gobena and Van Dijke (n 441).

This thesis, therefore, argues for stronger enforcement on self-employed professionals, and in the next chapter, some enforcement strategies for self-employed professionals in LMICs are discussed in greater detail.

5.3 PRESUMPTIVE TAXATION OF PROFESSIONALS

As explained in Chapter 2, presumptive tax regimes almost always exclude professional income from their application; academics are split on the suitability of presumptive regimes in general, and for professionals specifically.⁵⁴⁰ For example, Musgrave argues that presumptive taxes are unsuitable for professionals because they ‘are fully capable of filing adequate returns, and their income levels fall within the middle or even upper ranges of the taxable income scale’.⁵⁴¹ Others argue that presumptive tax regimes for professionals would help to ensure horizontal equity.⁵⁴² The experts interviewed for this research also expressed split opinions. Policy officials believed that it is ‘absurd’ to impose a ‘primitive’ presumptive regime on professionals who are highly educated and sophisticated;⁵⁴³ other experts expressed support for the introduction of a simplified tax regime for some professionals.⁵⁴⁴ The researcher’s proposal, in this section, is that *presumptive regimes can be a useful and partial solution for taxing self-employed professionals, if they are well thought-out, meticulously designed, and rigorously monitored.*

Bird and Wallace argue that, compared to farmers and SMEs, self-employed professionals are easier to track and find because they register with regulators or

⁵⁴⁰ For an excellent discussion on arguments against presumptive tax regimes for professionals, see Bird and Wallace (n 99); and Bird and Zolt (n 332); For recent arguments in support of presumptive taxation in general, see Pashev (n 332); Jaramillo (n 332); For older arguments in support of presumptive taxation, see Tadesse and Taube (n 7); Erbas (n 332) and; Jantscher and Tanzi (n 11).

⁵⁴¹ Musgrave (n 96) 307–308.

⁵⁴² Jantscher and Tanzi (n 11) 7.

⁵⁴³ Interview with D-NT (N 441); Interview with SM-NT (n 451).

⁵⁴⁴ Interview with SC-KRA (n 449); Interview with SP-B4 (n 443); Interview with Attiya Waris (n 454).

professional bodies, and their business premises are well-marked; for this reason, they argue against presumptive tax regimes for professionals and advocate, instead, for more stringent enforcement.⁵⁴⁵ While this argument is legitimate and essential, and indeed this thesis also argues in favour of stronger enforcement, the reasons behind non-compliance by self-employed professionals in LMICs are varied, complex, and interconnected, as evidenced by the data presented in Chapter 4. Identifying and registering professionals only solves one part of the problem. The use of several complementary options, rather than relying solely on surveillance and audits, would address the different barriers to compliance, and compensate for any inadequacies in enforcement.⁵⁴⁶ Thus, there is a place for both more stringent enforcement and the partial use of presumptive tax regimes.

Also, from a policy perspective, it is difficult to fully justify permitting SMEs access to presumptive regimes but making professional income ineligible, even when the professionals meet the other eligibility criteria of the regime. Many professional firms in LMICs exhibit characteristics that are very similar to other SMEs. Indeed, many respondents often referred to their firms as SMEs during the interviews. The image of a large professional firm with an extensive portfolio of clients, significant income, and financial access to accounting and tax services, is not an accurate representation of all professional firms in LMICs. There are professionals, particularly early career professionals, running small firms with modest turnover. These professionals face the same compliance challenges that SMEs face, including the high costs of compliance and inability to navigate complex compliance requirements. From a policy perspective, therefore, it is difficult to justify opting for a blanket ban on presumptive regimes for professionals.

⁵⁴⁵ Bird and Wallace (n 99) 7.

⁵⁴⁶ See Section 2.3 in Chapter 2 for a discussion on the barriers to effective enforcement in LMICs.

Where presumptive taxes are designed in line with the characteristics of a good tax regime, they can be of benefit to LMICs where professionals evade taxes because of complexity, social influence, and low levels of financial and tax literacy. Presumptive methods can also improve the public perception of and enhance trust in the revenue authority if they are preceded by open dialogue and fair negotiation between the revenue authority and taxpayer representatives and if they succeed in making compliance more manageable and cheaper.

Presumptive taxes are often criticised for being inefficient and inequitable, in comparison to ordinary income tax regimes. However, overloading presumptive taxes with equity objectives, or other dissimilar and often competing or contradictory objectives, results in a presumptive regime that does not meet its prime objectives. As pointed out in previous research, presumptive tax regimes cannot, and should not, compete with the standard tax regime; the two regimes serve very different purposes, with the former aimed at simplification, lowering compliance costs, ensuring that the self-employed also bear the tax burden, and facilitating cheaper enforcement.⁵⁴⁷ Presumptive regimes are not a standalone or long-term solution; instead, they are ‘a complementary instrument that can help the tax administration in transition countries in the short and medium-run to handle the challenges of...the large hard-to-tax sector’.⁵⁴⁸

This thesis advocates for the limited and targeted use of simplified tax regimes for self-employed professionals who are newly qualified, and just ‘starting out’ in self-employment; they face the greatest compliance challenges. This is the best target group for such a tax since they have less disposable income to engage professional help for their accounting and tax affairs, weaker internal and accounting structures within their firms,

⁵⁴⁷ Pashev (n 332) 417.

⁵⁴⁸ *ibid.*

and will often make haphazard withdrawals of cash from their businesses resulting in significant cash flow challenges. These factors contribute to tax evasion and delay the formalisation and growth of these firms.

The research data suggested that lawyers naturally outgrow this phase over time, as they attract more corporate clients and begin to streamline their businesses, but the extent to which this happens is likely to vary significantly since not all firms will attract the same number and calibre of corporate clients. Dental firms did not exhibit a similar pattern, and it is this latter trend that is likely to be replicated in most professions as well. The professionals also spoke about the difficulty of dropping bad compliance behaviour, and the long-lasting effects of good compliance behaviour, both acquired at the start of one's practice. Indeed, previous research shows that new members of an occupation are 'tax novices' but soon adapt to the taxpaying culture within their occupation-be it one of compliance or one of evasion.⁵⁴⁹ Presumptive tax regimes for these newly qualified professionals would ensure that they begin their professional life with good compliance behaviour that they can carry on as they grow their firms.

Further, if presumptive methods successfully encourage compliance by those prevented from complying because of complexity, the tax authority may also benefit from the knock-on effect on taxpayers who are influenced by the actions of their peers. Once simplicity encourages higher levels of voluntary compliance within the profession, the social influence of the complying peers may lead to even more compliance. It would, therefore, be a useful tool in professions where evasion is particularly rampant, and the tax authority's goal is to (i) reverse the pervading evasion culture and establish one of

⁵⁴⁹ Ashby, Webley and Haslam (n 373) 217.

compliance and (ii) urgently increase revenue collection in a country dealing with a significant budget deficit.

Perhaps this was the idea behind the introduction of presumptive taxes for professionals, as part of the fiscal reforms taken by Greece, pursuant to measures required by Article 2 (2) of the ECOFIN Council Decision 2010/320/EU on 10 May 2010.⁵⁵⁰ Greece has faced a significant problem with widespread tax evasion, especially among professionals; according to one study 43%-45% of self-employment income goes unreported and untaxed in Greece, and the primary tax evaders are professionals like lawyers, doctors and engineers.⁵⁵¹

To increase the effectiveness of presumptive regimes, the revenue authority, perhaps in conjunction with industry representatives, would have to proactively communicate information about the increased simplicity and levels of compliance within the profession, to influence the perceptions of those who have previously been non-compliant.

The current perception of KRA, by the respondents, is, *inter alia*, (i) the authority is blind to the challenges that SMEs face in complying; (ii) the authority is not keen on cultivating relationships with small business owners and is more interested in large taxpayers like multinational enterprises; and (iii) the authority does not understand the nature of the professionals' work and thus makes arbitrary, inconsistent, and unfair decisions. A presumptive method that simplifies the compliance process for some professionals may play a part in repairing the damaged legitimacy of the revenue

⁵⁵⁰ Commission, 'Communication from the Commission to the Council' COM (2010)439 final.

⁵⁵¹ Artavanis, Morse and Tsoutsoura (n 304).

authority. Taxpayers may begin to perceive the authority as understanding the costs and complexity that inhibit their compliance, and as taking steps to reduce these burdens.

Further, before introducing a presumptive method that would apply to a profession or several professions, the authority should engage industry representatives in a public participation process; this would provide a platform for dialogue through which the authority can begin to understand the unique needs and challenges of the professionals better and cultivate a relationship with them. If properly managed, this process can demystify the revenue authority and build the trust of taxpayers, i.e., the taxpayers will begin to believe that the authority is benevolent and working for the common good and increase the likelihood that they will voluntarily comply.⁵⁵²

Implementing a presumptive regime may inevitably result in a lower tax burden for these hard-to-tax professionals. One could argue that such a regime amounts to an unjustified government subsidy for the decision to enter into self-employment. However, this is not necessarily an adverse outcome in Kenya's case, and may be true for other LMICs as well. With one million births a year, Kenya is experiencing a significant bulge in the number of youths in its population.⁵⁵³ However, the country also has high unemployment rates, particularly among the youth; nine in every ten unemployed Kenyans are 35 years old and below.⁵⁵⁴ There are inadequate wage jobs in the formal sector; only two out of five wage jobs are formal, and only 6 per cent of youth entering working age are securing modern wage jobs.⁵⁵⁵

⁵⁵² Kirchler, Hoelzl and Wahl (n 346) 212.

⁵⁵³ United Nations Development Programme, 'Kenya's Youth Employment Challenge' (2013) 5.

⁵⁵⁴ Kenya National Bureau of Statistics, 'Kenya Integrated Household Budget Survey: Labour Force Basic Report 2015/2016' (2018).

⁵⁵⁵ World Bank, 'Kenya at Work: Energizing the Economy and Creating Jobs' (2012) 29–30 <<http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1335471959878/kenya-economic-update-december-2012.pdf>> accessed 30 November 2018.

With the introduction of free primary education, and an ever-increasing number of universities, there is a significant increase in the number of graduates; but many graduates struggle to secure formal employment. One of the main objectives of the current Kenyan government is to increase income generating-opportunities for unemployed youth. A presumptive regime for newly qualified professionals would ease the pathway for graduates who are unable to secure formal employment; they would be able to set up firms and enjoy the reduced cost and complexity of compliance for a few years, to allow their firms to grow.

It is important to point out, however, that while presumptive methods present many positive opportunities for increased tax compliance, they are not a panacea for all ills. They will not necessarily encourage greater compliance among self-employed professionals in LMICs if they are evading taxes because of dissatisfaction with government service delivery and corruption management. Taxpayers who believe that their social contract with the government has irretrievably broken down will not be motivated to comply simply because it is easier to do so. If these presumptive taxes are not properly designed and monitored, such taxpayers are more likely to abuse them even more. However, where there is a mix of reasons for high levels of evasion, presumptive methods, together with overall efforts to improve service delivery, manage corruption, improved taxpayer education, and better enforcement, are likely to be more successful.

How should a presumptive tax for professionals in LMICs be designed? This question, perhaps, is the most crucial question. This thesis does not purport to provide all the answers, but some useful ideas are presented in the next chapter.

5.4 THE ROLE OF FINANCIAL & TAX CAPABILITY IN TAX COMPLIANCE

The findings on the professionals' poor financial and tax capability are an essential contribution to research in the field of tax evasion. As demonstrated in Chapter 4, financial capability and tax literacy are intertwined; taxpayers who lack financial capability are unable to manage their tax affairs, and once they become financially capable, their tax compliance behaviour changes. Taxpayers engaged in evasion are also more likely to run financially disorganised businesses and, as some of the dentists pointed out, many of these businesses collapse due financial mismanagement.

Existing literature on taxation of self-employed professionals acknowledges that one of the challenges they pose, for revenue authorities, is their failure to keep proper books of accounts.⁵⁵⁶ Despite this acknowledgement, the effects of financial and tax capability on tax compliance behaviour are not captured in the major theories on tax evasion.⁵⁵⁷

Some tax scholars have attempted to explore the correlation between tax knowledge and compliance, both theoretically and through experiments. A quasi-experiment on the effects of tax knowledge on attitudes towards taxation compared the attitudes of tax law students who received specific teaching in tax law, to the attitudes of the control group- marketing students- who did not have any tax law teaching.⁵⁵⁸ The results showed that the acquisition of tax knowledge in class changed the law student's attitudes towards tax evasion, improved their tax ethics, and also improved their perception of the fairness of the tax system; no similar change was observed among the

⁵⁵⁶ Alm, Martinez-Vazquez and Schneider (n 2) 180.

⁵⁵⁷ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 3. See Fjeldstad's et al. 'five schools of thought' on reasons for tax evasion, discussed in Chapter 2.

⁵⁵⁸ Knut Eriksen and Lars Fallan, 'Tax Knowledge and Attitudes Towards Taxation; A Report on a Quasi-Experiment' (1996) 17 *Journal of Economic Psychology* 387, 387.

marketing students.⁵⁵⁹ The results of a survey conducted in Australia also suggested that the Australian Tax Office would see an increase in compliance among non-business taxpayers if it provided broader tax education programs aimed at improving tax competence and managing financial affairs.⁵⁶⁰ Similarly, a study of self-employed entrepreneurs in Austria found a positive correlation between knowledge of the tax rules underlying the Austrian tax system, and tax compliance.⁵⁶¹ Finally, Kirchler et.al use their '*slippery slope framework*' to argue, *inter alia*, that 'because tax laws are often criticized to be too complex to be fully understood, increasing taxpayers' literacy by simplification of the tax laws, by training, and education' will improve levels of trust in tax authorities and result in higher levels of voluntary compliance.⁵⁶²

Apart from those studies, the effects of poor financial and tax capability are not as extensively researched as the other theories of tax evasion. The literature on financial literacy and capability has also failed to address the importance of tax literacy and compliance. For example, following the financial devastation caused by the 2008 global financial crisis, there is a growing global interest in financial literacy, or what is referred to in the United Kingdom as *financial capability*; however, no theoretical connection has been made between financial capability and efforts to tackle tax evasion.⁵⁶³ The United Kingdom's Money Advice Service exists to enhance public understanding of financial matters and help people better manage their financial affairs. The Service led a

⁵⁵⁹ *ibid* 397-398. The improved perception of fairness had the effect of increasing compliance.

⁵⁶⁰ Pauline Niemirowski, Steve Baldwin and Alexander J Wearing, 'Tax Related Behaviours, Beliefs, Attitudes and Values and Taxpayer Compliance in Australia' (2003) 6 *Journal of Australian Taxation* 132, 162.

⁵⁶¹ Erich Kirchler and Boris Maciejovsky, 'Tax Compliance within the Context of Gain and Loss Situations, Expected and Current Asset Position, and Profession' (2001) 22 *Journal of Economic Psychology* 173.

⁵⁶² Muehlbacher, Kirchler and Schwarzenberger (n 431) 217.

⁵⁶³ The term financial capability is preferred in the U.K. because of the idea that although the term *financial literacy* is a key concept in financial capability literature, there is no universally accepted definition of the former with existing definitions extending from the very broad to the very narrow. The term financial capability is therefore considered closer to the mark.

collaboration of many actors from the financial capability sector in developing the 2014 UK Financial Capability Strategy, a Strategy intended to put in place a framework to improve the financial capability of people in the United Kingdom. The strategy defined financial capability as ‘people’s ability to manage their money effectively and make good financial decisions given their particular circumstances’.⁵⁶⁴ Financially capable people are viewed, in the Strategy, as able to tackle problem debt, pay their bills fully and on time, maximise their income, take out insurance policies, manage their day to day financial affairs including budgeting, income, and expenditure, and build financial resilience by saving for a rainy day or mid-term expenses.⁵⁶⁵ They are also able to prepare for life ahead by saving for pensions or planning for a long-term investment like a mortgage.⁵⁶⁶

The Strategy does not explicitly address tax obligations and, thus, it is not clear whether tax literacy is a demonstration of financial capability, or not. It has been argued ‘that measurements of financial capability should incorporate all those elements which potentially impact upon a person’s financial position and that an understanding of the taxation system should be one of these components.’⁵⁶⁷ Broadening the measurable aspects of financial capability to include basic knowledge of taxation, and the skills required for tax compliance, would mean that current efforts to increase financial capability would also result in increased tax literacy and compliance.

The global efforts to improve levels of financial capability have also stretched to LMICs, such as Kenya. There have been several donor-funded programs aimed at

⁵⁶⁴ Sally Bagwell and others, ‘Financial Capability Outcome Frameworks’ (New Philanthropy Capital under the commission of the Money Advice Service) 9 <www.thinknpc.org/publications/financial-capability-outcome-frameworks/> accessed 16 July 2018.

⁵⁶⁵ *ibid* 10.

⁵⁶⁶ *ibid*.

⁵⁶⁷ Toni Chardon, ‘Weathering the Storm: Tax as a Component of Financial Capability’ (2011) 5 *Australasian Accounting Business and Finance Journal* 53, 55.

improving financial literacy levels in Kenya, but these have mostly centred on poverty reduction projects aimed at poor women and youth who are, in any event, unlikely to fall within the taxable bracket. It would appear that the general assumption behind these financial literacy programs is that highly educated individuals, like professionals, are financially capable, and do not require intervention; such an assumption is not entirely accurate, as illustrated by the interview responses narrated in the previous chapter. In addition, financial literacy programs in Kenya have, similarly to the United Kingdom and Australia, focussed on budgeting, debt management, and saving; tax knowledge has not been considered.

Tax literacy is a challenge for all countries, to varying degrees, and for various reasons, not least because tax is generally a complex topic. There are also historical, political, and cultural explanations behind the gaps in tax literacy and tax engagement in different countries. For example, although both Kenya and Ghana are classified as LMICs, the levels of engagement in tax issues and tax bargaining by citizens in the two countries differ. One partial explanation, in the literature, for the low levels of tax literacy and tax engagement in Kenya, is a political one, i.e., it could be partially a result of deliberate design by both the colonial and post-colonial governments. The colonial government focused solely on the crystallisation of the link between tax revenue and tax expenditure among the European taxpayers, to the exclusion of the African and Asian communities.⁵⁶⁸ Instead, taxes such as the hut tax were used to ensure a steady supply of forced African labour. Just before independence, the colonial government attempted to remedy the situation but it was too late, and the effort was largely unsuccessful; as a result, at independence, Africans had a very negative perception towards taxes such as

⁵⁶⁸ Interview with Attiya Waris (n 454).

the hut or poll taxes which had been used to oppress and dominate them.⁵⁶⁹ Jomo Kenyatta's post-colonial government then embraced 'African socialism', and the government encouraged self-help with support from voluntary assistance; the government did not attempt to educate society on the re-distribution of state resources and develop a link between tax revenue and expenditure.⁵⁷⁰

The subsequent Moi government did not vary much from Kenyatta's approach. Moi famously stated that he intended to walk in the 'nyayo' (Kiswahili word for footsteps) of Kenyatta, earning him the nickname Nyayo. He was a big champion for self and community help through 'Harambee' (fundraising by communities for purposes of healthcare, education, and general development) and therefore the failure to link tax revenue and expenditure continued.

Addressing these historical failures by better highlighting how tax collection facilitates the provision of services that citizens value, as well as efforts to achieve an acceptable level of tax and financial literacy among all self-employed professionals, may significantly improve tax compliance in countries like Kenya. KRA has made significant progress with its taxpayer literacy programs in schools, and its social media campaign aimed at encouraging all adults with a Personal Identification Number (PIN) to file their tax returns on time. However, much work remains to be done to ensure that the self-employed understand their tax obligations and have the requisite knowledge and support to keep proper books of accounts and file accurate tax returns. The tax authority cannot assume a certain level of financial and tax capability, based purely on a taxpayer's profession, trade, or level of education; tax literacy programs ought to be broad in their coverage, and specific in their content, catering to the heterogeneity of the body of

⁵⁶⁹ *ibid.*

⁵⁷⁰ *ibid.*

taxpayers. The next chapter contains some specific proposals that the tax authority ought to consider when designing literacy and awareness campaigns for self-employed professionals.

5.5 REGULATORS AND PROFESSIONAL BODIES: AN UNTAPPED RESOURCE?

Professions, by their very definition, are subject to the oversight function of a body with a monopoly over the rights to admit members to the profession, maintain an up to date register of members, and discipline members who are in breach of the profession's code of conduct. The professional bodies may be statutory or set up by the profession (self-regulation). What role do these professional bodies play in ensuring tax compliance by their members?

In determining whether tax offences amount to professional misconduct, the deciding factor, for regulators and professional bodies, appears to be whether the offences touch on the taxpayer's professionalism thereby warranting suspension or dismissal. In Australia, for example, the Bar Associations initially insisted on divorcing what they viewed as a 'private responsibility' to pay tax, from the ethical standards required to be a member of the Bar, a huge disjuncture from public expectation.⁵⁷¹ In 2001, a media expose revealed that some prominent barristers, living lavish lifestyles, had either not filed tax returns for decades, or took advantage of bankruptcy and trust rules to avoid settling large tax assessments.⁵⁷² Following intense public backlash, the Associations changed the rules, recognising tax violations as a serious offence and grounds for

⁵⁷¹ Email correspondence with Brett Bondfield, Senior Lecturer in Business Law, the University of Sydney Business School (27 June 2018)

⁵⁷² Ross Ysaiah, 'Bankruptcy Isn't the End for Barristers' (The Australian Business Review, 6 September 2007) <<https://www.theaustralian.com.au/business/legal-affairs/bankruptcy-isnt-the-end-for-barristers/news-story/ef85fb81d9f3a9e9d964aa13ae985989>> accessed 29 August 2018.

disciplinary action; following the amendments, several barristers were struck off the bar for failing to file tax returns or concealing their income.⁵⁷³

In England, Nicholas Dean QC stated, in sentencing a GP who admitted to serious tax fraud, that he did not think the tax offences touched on the professionalism of the accused as a doctor and hoped that the accused would be able to practice medicine again in the future.⁵⁷⁴ The Medical Practitioners Tribunal Service were of a different opinion and chose to have him struck off for displaying persistent dishonesty which, although did not touch on patient safety, was nonetheless deemed to be incompatible with his registration as a doctor.⁵⁷⁵

In Ireland, two solicitors in partnership were engaged in complex and large-scale evasion involving (i) mixing of personal and client accounts, (ii) failure to disclose bank accounts, and (iii) irregular practices in relation to the requirements of the statutory regulations for the keeping of books as well as breaking numerous regulations.⁵⁷⁶ The Disciplinary Tribunal and the High Court (in a decision upheld by the Supreme Court), were of the view that although the tax offences were grave, they did not warrant striking the solicitors off the roll and that a 12-month suspension was adequate; the Law Society viewed the offences as touching on the solicitors' professionalism and sought, unsuccessfully, to have them struck off.⁵⁷⁷

In the U.K., the Bar Standards Board and Solicitors Disciplinary Tribunal have struck off members convicted of tax offences in order to preserve the integrity of the

⁵⁷³ *ibid.*

⁵⁷⁴ Clare Dyer, 'Tax Fraud GP Is Struck off for Persistent Dishonesty' (2015) 351 *BMJ* <<https://www.bmj.com/content/351/bmj.h4804>> accessed 29 August 2018.

⁵⁷⁵ *ibid.*

⁵⁷⁶ *Law Society of Ireland v Carroll and another* [2009] IESC 41.

⁵⁷⁷ *ibid.*

profession in the sight of the public; members are expected to act with honesty and integrity.

The empirical data collected during this research suggests that professional bodies and regulators in Kenya are not actively involved in tackling tax evasion among members, either by treating tax evasion as serious professional misconduct or ensuring that members are keeping proper financial records and meeting their tax obligations. The data suggests that, while the Law Society of Kenya has put in place robust rules governing accounting and professional conduct, these rules are not effectively enforced by the Society. Breaches of the accounting rules, and rules against undercutting, exacerbate tax evasion by members but are not adequately addressed by the Society; further, even though members feel that there is widespread tax evasion within the profession, the issue is not explicitly and adequately addressed in the various professional practice rules.

The failures by the other professional associations and regulators were even starker. The Constitution and bylaws of the Architectural Association of Kenya (which incorporates Architects, Quantity Surveyors, Town Planners, Engineers, Landscape Architects, Environmental Design Consultants and Construction Project Managers) provides, at bylaw 19 and 20, a list of the principles of professional conduct for the profession, and instances in which a member would be deemed to be guilty of professional misconduct and subject to disciplinary action. These bylaws do not cover the failure to keep proper financial records and comply with tax obligations. Similarly, the Kenya Medical Practitioners and Dentists Board of Kenya does not have specific rules governing the financial recording keeping or honesty in tax affairs of its members.

The failure, by professionals, to keep proper financial records and comply with tax legislation has severe ramifications for the integrity of a profession. Bondfield argues

that associations or regulators for professions that have demonstrated poor tax compliance should treat the evasion as a ‘profession problem’ warranting special tax rules and administrative obligations, rather than turn a blind eye or treat the evasion as a private problem in which the body has no interest or role to play.⁵⁷⁸ Encouraging compliance ought to be a joint and multifaceted effort and the role of regulators and professional associations ought to be enhanced through legislation and other channels of collaboration. The extent to which this can be done will vary from one context to another and requires careful contemplation. Should regulators and professional associations ‘encourage’ compliance or, more drastically, decline to renew practising certificates for members who cannot produce a valid tax compliance certificate from the revenue authority? The latter would be a very effective way of tackling evasion in theory; in reality, it would be complicated to enforce in many LMICs, particularly in Africa, where the tax authority's data on these professionals is scant and unreliable at best, and in the worst-case scenario, is absent. In countries plagued by high levels of corruption and poor tax administration records, such a system might also be abused by unscrupulous tax officials, or professionals who are intent on destroying their competitors.

Some practical ways in which tax authorities in LMICs can engage professional bodies and regulators are explored in the next chapter.

5.6 COLLABORATIVE EVASION

Although the opportunity for collaborative or joint evasion emerged as one of the themes from the case study data, this topic is not adequately anchored in theory in existing literature on tax evasion, and there is very little research available on the topic.

⁵⁷⁸ Email correspondence with Brett Bondfield (n 542).

A 1990 economics paper looked into the use of under the table discounted cash payments that enable the buyer to evade sales tax, and the seller evades income tax, thereby providing a link between the evasion of direct and indirect taxes, which is at the heart of many informal sector transactions.⁵⁷⁹

A subsequent paper in 2002 also discussed the fact that tax evasion studies usually assume that evasion involves an individual taxpayer responding to tax policies or legislation while, in fact, much tax evasion requires the collaboration of two or more taxpayers; they conclude that ‘when the discount factor is low enough, an increase in the sanction can increase the ability of an agent to commit to cooperate, and can lead to more tax evasion’.⁵⁸⁰

Chang and Lai also use sales tax to study the effect of deterrence on collaborative evasion; they explain that traditional literature has focussed on taxpayers and largely ignored the behaviour of other agents, such as customers, in enabling or facilitating evasion and conclude, in part, that more intensive tax enforcement may increase joint evasion, thereby reducing government revenue.⁵⁸¹

There is a more recent paper exploring the possible role of tax rebates, taxes on cash withdrawals, and an appropriate tax rate in curbing collaborative evasion.⁵⁸²

The literature contains no studies on collaborative evasion between professionals and other agents. Administrative measures targeted at making it harder to collaborate for

⁵⁷⁹ James PF Gordon, ‘Evading Taxes by Selling for Cash’ (1990) 42 *Oxford Economic Papers* 244.

⁵⁸⁰ Robin Boadway, Nicolas Marceau and Steeve Mongrain, ‘Joint Tax Evasion’ (2002) 35 *Canadian J Econ Canadian Journal of Economics/Revue Canadienne d’Economie* 417, 433.

⁵⁸¹ Juin-jen Chang and Ching-chong Lai, ‘Collaborative Tax Evasion and Social Norms: Why Deterrence Does Not Work’ (2004) 56 *Oxford Economic Papers* 344.

⁵⁸² Giovanni Immordino and Francesco Flaviano Russo, ‘Taxing Cash to Fight Collaborative Tax Evasion?’ (Centre for Studies in Economics and Finance (CSEF), University of Naples, Italy 2014) CSEF Working Paper <<https://econpapers.repec.org/paper/sefcsefwp/351.htm>> accessed 16 July 2018.

evasion, together with other initiatives, may help in increasing compliance by self-employed professionals. Some measures are suggested in the next chapter.

5.7 CONCLUSION

As stated at the outset, the goal of this chapter was set to review the implications of the case study findings for tax authorities interested in improving compliance by self-employed professionals in LMICs, as well as demonstrating how those findings contribute to previous research in this field. While the previous chapter covered the broad findings of the case study, this chapter focussed sharply on the findings that significantly contribute to previous research into tax evasion.

The section titled *trust and power* builds on previous research on the slippery slope framework by extending the argument to factor in the high levels of corruption, weak taxpaying culture, preponderance of cash transactions, and weak government service delivery in many LMICs.⁵⁸³ The proposition in this section is that *severe corruption and poor service delivery by government, particularly in countries where the taxpaying culture is already weak and there is a preponderance of cash transactions, result in low tax morale that limits the effectiveness of trust, in the revenue authority, in increasing voluntary compliance.*

The section on *presumptive taxation* contributes to existing literature on presumptive taxation, and taxation of professionals, by advocating for the limited and targeted use of simplified tax regimes for self-employed professionals who are newly qualified and just 'starting out' in self-employment, and who face the most significant compliance challenges. While the drawbacks of presumptive taxation, and the fact that

⁵⁸³ See the discussion on the slippery slope framework in Section 3.5 of Chapter 3.

they have not often been used for professionals, are acknowledged, the opportunities that they offer tax authorities in specific contexts means that presumptive taxes are worth considering, if they can be well thought-out, designed, and monitored.

The discussion on tax and financial capability is an important contribution to the literature on tax evasion which does not often examine the role that financial capability plays in encouraging tax compliance. It also challenges the misconception that highly educated and sophisticated self-employed professionals can meet their tax obligations without expert help and points out that taxpayer literacy programs ought to be broad in their coverage and specific in their content, catering to the heterogeneity of the body of taxpayers.

The penultimate section considers the role of professional bodies and regulators in ensuring tax compliance by their members. Tax evasion and poor financial management threaten the integrity and prestige of professions, and the growth and prosperity of professional firms, and ought not to be ignored in the rules and regulations governing professional misconduct.

Finally, the section on collaborative evasion briefly examines a phenomenon that is not adequately anchored in the theoretical literature on tax evasion, but which is nonetheless important. It is pointed out in that section that evasion does not merely involve unilateral actions by one taxpayer; it often involves collaboration with clients and other professionals in the same field, or a different field.

The implications identified above lead to several questions. For example, what enforcement tools can tax authorities in LMICs utilise in order to encourage compliance by self-employed professionals? How should a viable and robust presumptive tax regime for self-employed professionals in LMICs be designed? How can tax authorities make

better use of professional regulators and bodies to encourage compliance by their members? What types of tax literacy campaigns would best meet the needs of self-employed professionals in LMICs? How should tax authorities in LMICs address collaborative tax evasion in their enforcement strategies? The next chapter contains some recommendations for tax authorities and tax policymakers.

6. LOOKING FORWARD: RECOMMENDATIONS FOR FUTURE
ACTION

6.1. INTRODUCTION

The goal of the previous chapter was to evaluate the main implications of the case study findings, for tax authorities interested in improving compliance by self-employed professionals, as well as demonstrate how these findings fit in with, and contribute to, previous research. The main questions for revenue authorities in LMICs would now be what they ought to do with these findings and what tangible impact this research can have on their day to day administrative activities. How can we translate the findings of this thesis into practical action points for tax authorities that are working towards increasing compliance by, and tax collection, from self-employed professionals? The goal of this chapter is to propose, inter alia:

- i. how tax authorities in LMICs can design a viable and robust presumptive tax regime for self-employed professionals;
- ii. how tax authorities in LMICs can design tax literacy campaigns that would best meet the needs of self-employed professionals;
- iii. how tax authorities in LMICs can make better use of professional regulators and bodies to encourage compliance by their members;
- iv. enforcement tools that tax authorities in LMICs can utilise to encourage compliance by self-employed professionals; and
- v. ways in which tax authorities in LMICs can address collaborative tax evasion in their enforcement strategies.

Tax administration involves numerous activities including, but not limited to, identifying and registering taxpayers, processing tax returns and third-party information, examining the completeness and correctness of tax returns, assessing of tax obligations, collection of taxes, detecting and prosecuting tax evaders, imposing penalties and interest payments

on defaulters, and providing services to taxpayers.⁵⁸⁴ Each proposal made in this chapter will be discussed through the lens of the responsibility of tax authorities under which it fits best.

6.2. THE RESPONSIBILITY TO IDENTIFY TAXPAYERS

As discussed in Chapter 4 and 5, the invisibility of taxpayers has played an essential role in shaping the compliance attitudes of self-employed professionals in the case country; the pervading belief, among the research respondents, was that taxpayers who are small and invisible are inconsequential and can freely evade taxes with minimal, if any, consequences.

The collection of accurate and reliable data about taxpayers is a critical task in effective tax administration, yet one in which many revenue authorities in LMICs fail dismally. For example, Kenya has just over 19 million registered voters, yet only approximately 3 million people filed income tax returns for the 2017 financial year.⁵⁸⁵ All adults in Kenya, with a valid tax identification number, are expected to file their annual returns, whether or not they earn an income. Therefore, while this number was a significant improvement from previous years, it is still far from ideal. If tax authorities do not know who and where the taxpayers are, they cannot effectively enforce the law; if taxpayers know that the tax authority does not know who and where they are, there is little incentive to comply.

⁵⁸⁴ Matthjis Alink and V van Kommer, *Handbook on Tax Administration* (Second Revised Edition, IBFD 2016) 163–164.

⁵⁸⁵ Patrick Lang’at, ‘IEBC: 19.6m Kenyans Eligible to Vote’ *Daily Nation* (27 June 2017) <<https://www.nation.co.ke/news/politics/iebc-million-kenyans-are-eligible-to-vote/1064-3990230-eqyihlz/index.html>> accessed 2 October 2018; ‘More than 3.2m Kenyans File Income Tax Returns’ (*Standard Digital*, 5 July 2018) <<https://www.standardmedia.co.ke/article/2001286827/more-than-3-2m-kenyans-file-income-tax-returns>> accessed 2 October 2018.

Many LMICs face severe challenges in producing accurate data and statistics.⁵⁸⁶ Creating a reliable database of professionals, for tax administration purposes, is a difficult undertaking in LMICs where official data is either scant, unreliable, or is available but not synchronised. Further, professional rules in some professions, like law and medicine, traditionally bar members from advertising or marketing their services, meaning that one cannot readily identify professionals by looking at billboards, or in newspaper and magazine advertisements. How can tax authorities in LMICs better identify professionals, and more so self-employed professionals, who are responsible for filing their returns? How can they shine the spotlight on those invisible professionals who are determined to remain small and shadowy figures?

One advantage that tax authorities can leverage is the relatively small size of the professions in many LMICs. It is admittedly difficult, and expensive, for an under-resourced and technologically challenged tax authority to keep an up-to-date dedicated register of professionals when their numbers run into hundreds of thousands; however, where the tax authority is only dealing with hundreds or a few thousands of professionals, the exercise becomes much more feasible.

To illustrate this point, Table 5 below provides estimates of the membership of 6 professions in 7 LMICs, using data available from web pages of professional bodies or regulators, and other resources.

⁵⁸⁶ Daniel Runde, 'The Data Revolution in Developing Countries Has a Long Way to Go' (*Forbes*, 25 February 2017) <<https://www.forbes.com/sites/danielrunde/2017/02/25/the-data-revolution-in-developing-countries-has-a-long-way-to-go/>> accessed 4 October 2018; Donatien Beguy, 'Poor Data Hurts African Countries' Ability to Make Good Policy Decisions' (*Quartz Africa*, 20 August 2016) <<https://qz.com/africa/762729/poor-data-is-hurting-african-countries-ability-to-make-good-policy-decisions/>> accessed 4 October 2018; Morten Jerven, *Poor Numbers: How We Are Misled by African Development Statistics and What to Do About It* (Cornell University Press 2013).

Table 5: Statistics on Professionals in Some Low and Middle-income Countries

| | Doctors | Dentists | Lawyers | Architects | Engineers | Pharmacists |
|-------|---|---|-------------------------------------|-----------------------------|--|---|
| Kenya | 11,334 -registered; 6,394 -actively practising; 3,086 - private practice. ⁵⁸⁷ | 1,302 -registered; 683 -actively practising; 360 -private practice. ⁵⁸⁸ | Over 15,000 . ⁵⁸⁹ | 615 . ⁵⁹⁰ | 2,100 certified. ⁵⁹¹ | 3,499 as at 2013. ⁵⁹² |

⁵⁸⁷ Press Statement by the Chief Executive Officer of the Medical Practitioners and Dentists Board issued on 21 March 2018 and available at Alphonse Shiundu, ‘Is There Only One Kenyan Doctor for Every 16,000 People?’ (*Africa Check*) <<https://africacheck.org/reports/as-help-from-cuba-arrives-is-there-only-one-kenyan-doctor-for-every-16000-people/>> accessed 24 September 2018.

⁵⁸⁸ *ibid.*

⁵⁸⁹ ‘About Law Society of Kenya’ <<http://lsk.or.ke/membership/>> accessed 24 September 2018.

⁵⁹⁰ ‘The Board of Registration of Architects and Quantity Surveyors (BORAQs)’ <<https://boraqs.or.ke/registered/architects/>> accessed 24 September 2018.

⁵⁹¹ Wanzala Ouma, ‘Kenya Faces Shortage of Certified Engineers’ *Daily Nation* (8 June 2017) <<https://www.nation.co.ke/news/Kenya-faces-shortage-of-engineers/1056-3960396-l8gss0z/index.html>> accessed 24 September 2018.

⁵⁹² Dorothy Aywak and others, ‘Pharmacy Practice in Kenya’ (2017) 70 *The Canadian Journal of Hospital Pharmacy* 456.

| | Doctors | Dentists | Lawyers | Architects | Engineers | Pharmacists |
|--------|--|--------------------------------|----------------------------------|--------------------------------|--|----------------------------------|
| Zambia | 1,500. ⁵⁹³ | 312 as at 2016. ⁵⁹⁴ | 1,080 as at 2018. ⁵⁹⁵ | | | 1,159 as at 2016. ⁵⁹⁶ |
| Uganda | 6000- registered; 2876- government 2000-abroad; 1,124- private practice. ⁵⁹⁷ | 276 as at 2015. ⁵⁹⁸ | | 178 registered. ⁵⁹⁹ | 772 registered but only 494 practising, as at 2015. ⁶⁰⁰ | Just under 600. ⁶⁰¹ |

⁵⁹³ Rhoda Odhiambo, 'Zambia Hospitals Overwhelmed with Too Many Patients, Fewer Doctors' *DW.COM* (28 August 2017) <<https://www.dw.com/en/zambia-hospitals-overwhelmed-with-too-many-patients-fewer-doctors/a-40146334>> accessed 24 September 2018.

⁵⁹⁴ 'Global Health Observatory Data Repository| Dentistry Personnel' (*World Health Organisation*) <<http://apps.who.int/gho/data/view.main.DENTISTS>> accessed 2 October 2018.

⁵⁹⁵ 'Members – Law Association of Zambia' <<http://www.laz.org.zm/members/>> accessed 24 September 2018.

⁵⁹⁶ 'Global Health Observatory Data Repository| Pharmaceutical Personnel' (*World Health Organisation*) <<http://apps.who.int/gho/data/node.main.HWF3?lang=en>> accessed 2 October 2018.

⁵⁹⁷ Henry Wasswa, 'Uganda's Hospitals Doctors Strike Over Low Pay' (2017) 359 *BMJ* j5221.

⁵⁹⁸ 'Global Health Observatory Data Repository| Dentistry Personnel' (n 594).

⁵⁹⁹ Alice McCool, 'Is Uganda's Critical Shortage' of Architects Costing Lives?' *The Guardian* (14 June 2018) <<https://www.theguardian.com/cities/2018/jun/14/is-ugandas-critical-shortage-of-architects-costing-lives>> accessed 24 September 2018.

⁶⁰⁰ Michael Odongo, 'Why Engineers Are Still in Short Supply in Uganda' *www.newvision.co.ug* (14 April 2015) <http://www.newvision.co.ug/new_vision/news/1324170/engineers-short-supply-uganda> accessed 24 September 2018.

⁶⁰¹ The Council of Pharmacists & Subscribed Members of the Pharmaceutical Society of Uganda, 'Register of Pharmacists & Subscribed Members of the Pharmaceutical Society of Uganda' <<http://www.psu.or.ug/files/downloads/REGISTER%20OF%20PHARMACISTS%202018.pdf>> accessed 2 October 2018.

| | Doctors | Dentists | Lawyers | Architects | Engineers | Pharmacists |
|--------------|----------------------------------|------------------------------------|----------------------------------|------------|------------------------|-----------------------------------|
| South Africa | 45,515. ⁶⁰² | 6,433. ⁶⁰³ | 26,701. ⁶⁰⁴ | | 21,000. ⁶⁰⁵ | 15,267 as at 2016. ⁶⁰⁶ |
| Ghana | 3,016 as at 2015. ⁶⁰⁷ | 230-350 as at 2011. ⁶⁰⁸ | 2,500 as at 2010. ⁶⁰⁹ | | | 2,900 as at 2011. ⁶¹⁰ |

⁶⁰² ‘Statistics - HPCSA’ (*Health Professional Council of South Africa.*) <<http://www.hpcsa.co.za/Publications/Statistics>> accessed 25 September 2018.

⁶⁰³ *ibid.*

⁶⁰⁴ ‘Statistics for the Attorneys’ Profession’ (*Law Society of South Africa*) <<http://www.lssa.org.za/about-us/about-the-attorneys--profession/statistics-for-the-attorneys--profession>> accessed 25 September 2018.

⁶⁰⁵ Shirona Patel, ‘South Africa Urgently Requires Engineers for Development’ *The M&G Online* (17 March 2017) <<https://mg.co.za/article/2017-03-17-00-south-africa-urgently-requires-engineers-for-development/>> accessed 2 October 2018.

⁶⁰⁶ ‘Global Health Observatory Data Repository| Pharmaceutical Personnel’ (n 596).

⁶⁰⁷ Ghana Health Services, ‘The Health Sector in Ghana: Facts and Figures’ <https://www.ghanahealthservice.org/downloads/FINAL%20_23_06_2015%20Facts%20and%20figures.pdf> accessed 2 October 2018.

⁶⁰⁸ Marty Makinen and others, *Private Health Sector Assessment in Ghana* (The World Bank 2011) <<http://elibrary.worldbank.org/doi/book/10.1596/978-0-8213-8624-8>> accessed 2 October 2018.

⁶⁰⁹ Joe Debrah, ‘Being a Lawyer in Ghana’ (*Avocats Sans Frontieres*, 2010) <<https://www.asf.be/being-a-lawyer-in-ghana/>> accessed 2 October 2018.

⁶¹⁰ ‘Pharmaceutical Country Profile| Ghana’ <http://www.who.int/medicines/areas/coordination/Ghana_PSCPNarrativeQuestionnaire_03022012.pdf> accessed 2 October 2018.

| | Doctors | Dentists | Lawyers | Architects | Engineers | Pharmacists |
|-----------------------|---|----------------------------------|-----------------------------------|-----------------------|-----------------------|----------------------------------|
| Malawi ⁶¹¹ | 600. ⁶¹² | 10 as at 2015. ⁶¹³ | 416 as at 2018. ⁶¹⁴ | 40. ⁶¹⁵ | 1,300. ⁶¹⁶ | 200. ⁶¹⁷ |
| Sri Lanka | 25600; 2,500-3,000 private practice. ⁶¹⁸ | 1,340 as at 2015. ⁶¹⁹ | 18,756 as at 2018. ⁶²⁰ | 1,406. ⁶²¹ | 5,301. ⁶²² | 1,504 as at 2015. ⁶²³ |

⁶¹¹ is one of the poorest countries in the world, and that explains the small number of professionals.

⁶¹² John Greenberg, 'Does Malawi Have Just 300 Doctors for 16 Million People?' (*Africa Check*, June 2017) <<https://africacheck.org/reports/does-malawi-have-just-300-doctors-for-16-million-people/>> accessed 2 October 2018.

⁶¹³ Fatsani Gunya, 'Malawi Has Ten Dentists Only' *The Nation Online* (27 November 2015) <<https://mwnation.com/malawi-has-ten-dentists-only/>> accessed 2 October 2018.

⁶¹⁴ 'Malawi Law Society' <<https://malawilawsociety.net/>> accessed 2 October 2018.

⁶¹⁵ Feston Malekezo, 'Malawi Faces Architects' Crisis' *The Times Group* (5 March 2018) <<https://www.times.mw/malawi-faces-architects-crisis/>> accessed 2 October 2018.

⁶¹⁶ Grace Phiri, 'Malawi Needs More Engineers' *The Nation Online* (21 October 2016) <<https://mwnation.com/malawi-needs-more-engineers/>> accessed 2 October 2018.

⁶¹⁷ David Scott, 'Developing Pharmacy in Malawi' (*The Pharmaceutical Journal* | *A Royal Pharmaceutical Society Publication*, 4 July 2017) <<https://www.pharmaceutical-journal.com/opinion/blogs/developing-pharmacy-in-malawi/20202748.blog>> accessed 2 October 2018.

⁶¹⁸ 2016 figures from Indika Karunathilake and others, 'Is There an Urgent Need to Increase the Production of Doctors for Sri Lanka' (2016) 10 *South-East Asian Journal of Medical Education* 50.

⁶¹⁹ 'Global Health Observatory Data Repository | Dentistry Personnel' (n 594).

⁶²⁰ 'About - BASL' (*Bar Association of Sri Lanka*) <<http://www.basl.lk/about>> accessed 25 September 2018.

⁶²¹ 'Architect's Directory' (*Sri Lanka Institute of Architects*) <<http://www.slia.info/direct/directpublicpublicpublic/memdiclist.php?cmd=reset>> accessed 25 September 2018.

⁶²² 'Directory of Chartered Engineers' (*The Institution of Engineers Sri Lanka*) <<http://www.iesl.lk/page-1517689>> accessed 25 September 2018.

⁶²³ 'Global Health Observatory Data Repository | Pharmaceutical Personnel' (n 596).

Compiling these statistics was a challenging and time-consuming task, and this demonstrates the point, made above, regarding the unavailability and inaccessibility of data in many LMICs, particularly in Africa. While these statistics should be readily and centrally available, either from the government or professional bodies or regulators, most of them are dispersed in various websites ranging from international organisations such as the World Health Organisation to newspaper articles and blogs. Many of the statistics are also quite old, sometimes as old as ten years; some official statistics from the government or statutory bodies are listed as estimates, yet one would expect such institutions to hold the most accurate data. Therefore, tax authorities in countries with such sparse data face a challenging task when it comes to identifying self-employed professionals; however, it is time and effort worth investing. In any event, some professions will have very few members; the tax authority is likely to find that the taxpayers in those professions are already registered, and the only challenge would be to determine whether they have been underreporting their income.

Some web pages maintained by professional bodies and regulators have very detailed and useful directories containing the names, activity status and addresses of members, and these directories would provide a precious resource for a tax authority trying to develop a comprehensive database of professionals. Tax authorities can use these directories to crosscheck the names in the database against the data held by the tax authority, in order to identify non-filers.

Where details about the professionals are not readily available on the internet, the tax authority should request a detailed list of all members from the professional bodies or regulators. In some cases, tax administration statutes will give the tax authority the power to make such a request. Where the law does not provide such power, the tax authority may face stiff resistance from some professional bodies. For example, in

January 2018, the Kenya Revenue Authority wrote to the Law Society of Kenya requesting third-party data on lawyers, i.e., their names, I.D. or passport numbers, type of legal services they are engaged in, practice status over the last five years, and personal identification numbers.⁶²⁴ The Law Society has taken the view that the tax authority has no legal mandate to demand such data, and will use all the relevant legal challenges to resist the request which the Society views as an infringement on the privacy of its members.⁶²⁵ To date, the Society has not responded to the request, and the tax authority has not pursued the matter any further.⁶²⁶ Tax authorities facing such resistance ought to consider proposing legislative amendments that empower them to request any entity, including professional bodies and regulators, for a comprehensive list of members and their status,⁶²⁷ and compel the bodies to provide such information in a timely and complete manner.

Public bodies are another source of source of information for tax authorities, because many self-employed professionals provide services to the public sector.⁶²⁸ Tax authorities can request these public entities for a detailed description of the professionals or professional firms that have submitted bids for advertised tenders; these bids are ordinarily accompanied by comprehensive firm profiles containing detailed information regarding the firm owners, employees, previous clients, and in some cases, the value of work undertaken for other clients in the past. This information would be beneficial for a tax authority that is struggling to obtain such data from the taxpayer. The public bodies can also provide detailed firm profiles in respect of the professionals that they have contracted, including the value of the professional fees that they have earned; that

⁶²⁴ See a copy the letter in the annexe.

⁶²⁵ Information obtained from a senior officer within the Law Society of Kenya in November 2018.

⁶²⁶ *ibid.*

⁶²⁷ i.e., active/inactive and employed/self-employed/private practice.

⁶²⁸ Bird and Wallace (n 99) 130.

information can then be used to triangulate the information in the tax authority's possession, and assess the completeness of tax returns.

Creative approaches can also provide useful supplementary information, albeit non-definitive, where the collection, curation, and dissemination of data is weak; for example, tax authorities can supplement the limited data available with readily observable criteria. The Uganda Revenue Authority has been very successful in using lifestyle indicators to identify, and generate a database of, high net worth individuals.⁶²⁹ The value of taxpayers' bank deposits, motor vehicles that they purchase, loans that they can secure for personal use (mortgages) and investment in their firms, have all been successfully utilised in Uganda to identify high net worth individuals who either do not file their returns or underreport their income.⁶³⁰ Also, although the publicly available information in newspapers, magazines, and social media regarding the lifestyles of professionals cannot be used as conclusive proof of their wealth and income, such knowledge can be used to triangulate more reliable information or prod the taxpayer to produce evidence of their actual income.⁶³¹

The variations in the legal forms of professionals' firms emerged as a barrier to obtaining information about self-employed professionals, and it is possible that this is not just a problem for Kenya. While the legal profession does more to regulate the legal form of firms because of the fiduciary duty of lawyers, other professions are not similarly regulated. For example, dentists simply set up shop and begin to take in patients with no prior mandatory requirement to register a company, a partnership, or even a trading name.

⁶²⁹ Jalia Kangave, Susan Nakato and Patrick Lumala Zzimbe, 'What Can We Learn from the Uganda Revenue Authority's Approach to Taxing High Net Worth Individuals?' (2018) ICTD Working Paper Series No 72.

⁶³⁰ *ibid* 12–14.

⁶³¹ *ibid*.

Thus, while the tax authority would quickly look through the companies' registry to identify corporate taxpayers and their shareholders, there is no comparable registry containing information about unincorporated firms ran by professionals.

There are two possible solutions, and both would require legislative amendment outside of tax law and administration. One option would be to regulate all professions, by specifying in the legislation governing each profession, the legal form or range of legal forms that professionals are permitted to take when setting up their firms, and ensuring that a public, searchable, and regularly updated registry exists for each legal form.

Another option would be to create, and enshrine in legislation, a public registry dedicated to professionals; the registry should be searchable and regularly updated. In order to avoid the costs and challenges of creating and staffing a full-fledged physical registry, the registry could simply exist to collate and display data- perhaps only electronically if a physical registry is unattainable- that has been collected and processed by the respective professional bodies and regulators. The content and quality of data can be predetermined and agreed upon by the professional bodies and the tax authority, but ought to be such that it is possible to know with certainty the names, profession, status (active or inactive, employed/self-employed), physical locations of practice, years of practice, nature of practice (partnership or sole proprietorship), and number of employees. This information would then be readily accessible for the tax authority and would simplify the processes of identifying self-employed professionals and examining the accuracy of their tax returns.

Tax authorities may also opt to go physically, from one commercial building to another, identifying the professional firms housed therein; as Bird and Wallace argue, professionals' businesses premises are usually easy to find and they, conveniently, will

have a sign showing their presence.⁶³² This option may be out of reach for under-staffed and under-resourced tax authorities, and may also be difficult to coordinate in a large tax authority that lacks a dedicated Small Taxpayers Office. However, for tax authorities for which it is a feasible option, it is indeed worth pursuing. Also, it is important to note that not all professionals will have offices in commercial building; some may choose to carry out their work in a home office, where the nature of their work permits it, or in other less visible locations.

Finally, as indicated above, in Kenya, the number of taxpayers filing their returns falls far below the number of registered voters. One way of bringing in more professionals into the tax net, while bringing in other taxpayers at the same time, is to synchronise the process of voter registration with the process of tax registration. At the point of voter registration, or when updating the voter register, all voters who are not registered as taxpayers should be so registered and issued with a tax registration number. An alternative option would be to reconcile information held on the electoral register with the data held by the tax authority, and the tax authority should compulsorily register any voter who is not tax registered.

6.3. THE RESPONSIBILITY TO EDUCATE TAXPAYERS

The financial and tax capability of self-employed professionals was one of the major themes in the research findings. Professionals who transitioned from employment to self-employment, early in their career, were unprepared for the implications of their transition on their tax and financial obligations; many confessed that they resorted to filing nil returns, or paying a small amount to an unqualified but affordable bookkeeper, to ‘fix the

⁶³² Bird and Wallace (n 99) 130.

problem'.⁶³³ Thus, Bird and Wallace rightly point out that 'better taxpayer education and support services, especially at the lower end of the tax base distribution' are essential for improving compliance.⁶³⁴

Taxpayer education initiatives for self-employed professionals ensure that the exercise of tracking and identifying them is not a futile one. KRA's approach to disseminating tax information has focussed on using the following platforms: national television to televise special programs, local vernacular stations, national and regional newspapers, mobile tax services through roadshows, seminars, and workshops in schools, written publications including pamphlets and booklets, as well as collaboration with the media and the Ministry of Education.⁶³⁵

Interventions by the tax authority must, however, consider the heterogeneity of the taxpayers that it is serving. The tax authority's approach presupposes the homogeneity of taxpayers, an assumption that is likely to limit the effectiveness of its taxpayer education initiatives; in fact, this concern was highlighted by the tax experts from academia and the private sector. Professionals such as doctors, dentists, lawyers, architects, engineers, and pharmacists are highly educated, sophisticated, conversant with technology, and lead extremely demanding professional lives. Taxpayer education and awareness programs intended to reach such a group must consider these characteristics. The demanding nature of their professional lives means that they are unlikely to be drawn to a road show or tax authority's stand at a fair; they are also highly unlikely to look for tax advice on a radio show or advertisement by the tax authority. The tax education needs

⁶³³ See chapter 4 and 5.

⁶³⁴ Bird and Wallace (n 99) 130.

⁶³⁵ OECD/The International and Ibero-American Foundation for Administration and Public Policies (FIIAPP), *Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education* (OECD Publishing 2015) 96. KRA's customer care is also very active on Twitter and is very responsive to taxpayer queries on this platform. This platform has proved to be ideal for simple enquiries regarding locked PINs, resetting passwords, and system downtime.

of professionals are also unlikely to be adequately captured and addressed via a brief newspaper announcement. In any event, the tax authority has found the cost of such advertisements prohibitive.⁶³⁶

It also appears that the tax authority has placed very heavy emphasis on building tax literacy in school-age children and university students. A manager at the revenue authority, intimately familiar with the tax education initiatives of KRA, admitted that it is easier to run awareness programs among students because they are more amenable to learning about taxpayer obligations, and are not as frustrated by the government's poor performance.⁶³⁷ While tax literacy programs among children and students are undoubtedly worthwhile and critical to the inculcation of a taxpaying culture among the future generation of taxpayers, it cannot be at the expense of, or to the exclusion of, building tax literacy among income-earning taxable adults as well.

Finally, the assumption that the high level of education of professionals translates into knowledge about financial record keeping and technical aspects of tax compliance has been detrimental. It is also unwise to assume that all professionals can afford to engage highly qualified accountants or tax experts to assist them with these aspects of compliance. Tax evasion literature suggests that many professionals in LMICs keep poor financial records; the empirical evidence collected for this research confirmed that newly qualified professionals performed the most poorly in this area. Tax authorities ought to be cognizant of this when designing their education initiatives for these taxpayers.

⁶³⁶ *ibid.*

⁶³⁷ Interview with M-KRA (n 447)

By being cognizant of these issues, tax authorities can effectively meet the tax education needs of self-employed professionals by aiming for (i) convenience (ii) relevance and specificity (iii) collaboration, and (iv) evidence of taxes at work.

6.3.1 Convenience

Information intended for the education of self-employed professionals must be convenient to access and readily available whenever it is required. While this is true for all taxpayers, it is even more pertinent for professionals because of the demands on their time. How can under-resourced tax authorities in LMICs ensure that taxpayer information can be conveniently accessed?

Tax authorities can leverage relatively inexpensive platforms for mass communication like Vimeo and YouTube by uploading step-by-step ‘how to’ instructional videos for professionals. For example, uploading a short video targeting each profession or group of professions, providing relevant tax information, and showing them how to file returns if they are self-employed, would certainly be a convenient and cost-effective way of educating these taxpayers. The videos can be accessed at any time and eliminates the professional’s need to carve out time to search for and seek help from a revenue officer or engage costly expert assistance.

The wide but free publicization and dissemination of such instruction videos has also been made easier through free to use platforms like Twitter and Facebook, platforms that many revenue authorities now use, and which newly self-employed professionals will use regularly.

Using technology in this way is an excellent option in countries with high levels of corruption as it reduces the need for personal contact between taxpayers and revenue

officers since such contact can create a pipeline for unscrupulous collusion. Reducing such opportunities for corruption would result in higher levels of trust in the tax authority, which may affect compliance attitudes.

6.3.2 Relevance and Specificity

Taxpayer education initiatives must correctly respond to the needs of their audience, and not merely fit with an existing narrative of how these initiatives should look. While tax authorities in LMICs are investing heavily in creating a customer-centric positive image by activities such as, entertaining advertisements, customer appreciation celebrations, and taxpayer awards, the interview data suggests that what hard-to-tax professionals expect is support, education, and simplification. Tax authorities ought to ensure that their administrative efforts address taxpayers' real challenges; otherwise, those efforts are merely cosmetic.

Tax education involves showing 'citizens how to pay their taxes and why taxes should be paid'.⁶³⁸ When dealing with professionals, it is not sufficient to engage in an exercise of 'creating tax awareness', i.e., educating taxpayers on the importance of paying taxes. These professionals already understand that there is a social contract between citizens and government and their perception of the breach of this contract by the government has harmed their tax morale. What they need is to understand (i) *how* to comply with their tax obligations and (ii) *where* their taxes are being spent.⁶³⁹

The empirical evidence collected during this research shows that, while KRA has placed heavy emphasis on showing why taxes should be paid, particularly with their

⁶³⁸ OECD/The International and Ibero-American Foundation for Administration and Public Policies (FIIAPP) (n 635) 16.

⁶³⁹ This second point -the importance of understanding where their taxes are spent- is explored below.

school outreach program,⁶⁴⁰ it has not been as successful in showing self-employed professionals how to comply with their tax obligations. For example, the professionals explained that they expected KRA to provide information that would assist them in keeping proper records, understand what counts as legitimate business expenses, understand how to mitigate their tax exposure lawfully, and show them how to navigate the iTax system as self-employed taxpayers; they felt that KRA had not met those needs.

Self-employed professionals are classified as hard-to-tax partially because they do not keep proper financial records, and when they do, the records are in such poor shape that it is difficult to audit them. It is therefore in the tax authority's interest to educate taxpayers on the sort of records they should be keeping, and how they should do so. These seem to be significant concern for the self-employed generally, and not just in LMICs; in the U.K., for example, the second most-watched video on the HMRC YouTube channel is one providing information regarding the records that the self-employed should keep.⁶⁴¹

Creating a diverse menu of instructional videos that address issues specifically relevant for self-employed professionals is a relatively inexpensive but high impact way of educating self-employed professionals. For instance, the HMRC's YouTube channel provides a diverse range of valuable resources for self-employed taxpayers.⁶⁴² These include videos showing (i) what to bear in mind when choosing the right legal structure when setting up a business (ii) what sort of records the self-employed should keep (iii) tax facts for the self-employed, (iv) how the self-employed should file self-assessment returns, including what sort of information they need to file the returns (v) how to pay a

⁶⁴⁰ OECD/The International and Ibero-American Foundation for Administration and Public Policies (FIAPP) (n 635) 95.

⁶⁴¹ 'HMRCgovuk-YouTube Channel' (*YouTube*) <<https://www.youtube.com/user/HMRCgovuk/videos>> accessed 27 September 2018.

⁶⁴² *ibid.*

self-assessment tax bill (vi) facts about self-assessment penalties (vi) businesses expenses for the self-employed.

KRA does have a YouTube Channel, but the channel lacks information that would be relevant for a self-employed professional who is unsure about what financial records to keep, and how to file tax returns on iTax.⁶⁴³ The channel only has two ‘how-to’ instructional videos; one aimed at all taxpayers, showing how to retrieve a lost taxpayer's identification number, and another demonstrating how employees should file their tax returns, yet employees are a relatively low-risk group whose taxes are subject to third-party reporting and payment. KRA's website has improved significantly, in terms of functionality and accessibility, in the past five years. However, even there, the only instructional video on filing returns applies to those whose only source of income is employment, a very low-risk group. It is not clear why KRA is devoting so much effort towards taxpayers whose taxes have already been filed by their employers and are therefore a low-risk group.

Since KRA's taxpayer education unit is operating in an environment of shrinking budgets and increasing institutional pressure to deliver real impact in the form of increased tax collection, creative solutions such as inexpensive instructional videos catering to the specific needs of diverse taxpayers ought to be explored.

6.3.3 Collaboration

Collaboration is vital to the success and sustainability of taxpayer education initiatives. According to the OECD, ‘comparative experience demonstrates that for taxpayer

⁶⁴³ ‘Kenya Revenue Authority-YouTube Channel’ (*YouTube*) <<https://www.youtube.com/channel/UCbNSvsHFoQ4QnRj4K60eBhQ/videos>> accessed 27 September 2018.

education programmes to have a lasting impact they must work through partnerships...’⁶⁴⁴

In designing tax education material for professionals, collaboration with professional bodies and regulators is key to understanding how these professionals work, and how tax education material can be appropriately tailored for them. Evidence from the case study showed that professionals believed that tax officials did not understand the nature of their work, and that this has been an impediment to compliance. This gap in tax administration is related to the fallacious assumption that taxpayers are homogenous. Professionals owning unincorporated or family-managed firms are very different from corporate taxpayers, or those in employment; their costs of compliance and ease of access to professional accounting and tax services will vary widely. Also, self-employed professionals, although categorised as hard-to-tax alongside farmers and SMEs, have different needs and tax education initiatives must reflect this.

Collaborating with professional bodies in designing education material ensures that the material is fit for purpose and not merely generic guidance that will have little, if any, impact. Law societies, boards of medical practitioners, associations of engineers or architects, and other bodies, are best placed to partner with the tax authority in determining how to best advise their self-employed members on financial and tax compliance. These bodies can also assist the tax authority in the process of customising the tax return forms (whether digital or manual) to get the most useful and accurate data from the taxpayer.

⁶⁴⁴ OECD/The International and Ibero-American Foundation for Administration and Public Policies (FIIAPP) (n 635) 20.

Taxpayer telephone hotlines are also a good way of providing information to taxpayers; tax authorities can maximise the benefits of such hotlines by ensuring that those operating them have the technical skills required to provide timely, accurate, and relevant information. Tax authorities can work in partnership with professional bodies to train the officers who will answer these calls to equip them with the information required to answer questions from self-employed professionals adequately and direct them to further sources of education material.

The professional bodies can also assist in disseminating information regarding the availability of these telephone services, the instructional videos described above, and any other education initiatives that are relevant to their members.

6.3.4 Evidence of Taxes at Work

Empirical evidence from the case study showed that corruption, and the government's poor record in service delivery, have affected tax morale. Many professionals believed that their taxes achieved little, save for the enrichment of those in power. Tax morale in Kenya has weakened even further since the fieldwork for this research was conducted. Corruption, unsustainable state borrowing, and the wastage of public funds on non-viable projects have resulted in unmanageable public debt, forcing the government to introduce numerous and widely unpopular taxes through the Finance Act 2018. These taxes have been strongly resisted by Members of Parliament, from both the ruling party and the opposition, and citizens have been extremely vocal about their frustration and anger at the government. The standard argument is that it is unfair to pay more into the government purse without a corresponding increase in services and benefits.

As discussed extensively in the previous chapter, the tax authority has little control over how taxes are spent; the authority's role terminates once it remits the taxes

collected to the Treasury. However, an essential aspect of taxpayer education is the responsibility to highlight how taxes are used. While it is true that many LMICs struggle with corruption and wastage of state resources, a significant amount of the tax collected is put to legitimate use; further, although public services may fail to meet the standards that citizens expect, the services are available. Tax authorities should focus on highlighting what *works*, in order to counter the narrative that *nothing works*. It is particularly important to disseminate this evidence during the build-up to the annual tax filing deadline so that taxpayers have this information in mind as they file their returns.

What sort of information should the tax authority highlight? Evidence from the case study showed that professionals are most dissatisfied with government provision of particular services— health, education, road infrastructure, and waste management and disposal. Highlighting how taxes, from the just-concluded financial year, have been spent on these specific services, and the government's success stories, would assist to change the narrative from '*nothing works*' to '*some things work*' and may well result in improved tax morale.

Evidence of taxes at work can be disseminated through various platforms, and this is one area in which well-researched and designed newspaper and television advertisements work well. Tax authorities can also make use of videos and short documentaries disseminated through their social media accounts.

Where taxes are filed online, the tax authority can disseminate, via each taxpayer's registered email address, an annual breakdown of how the taxes paid in the previous tax year have been spent. Where taxes are filed manually, this information can be sent by post or disseminated in public areas like markets and churches. Where the tax authority has the data and resources, the breakdown can take the form of a personal tax

summary showing how much the taxpayer contributed by way of direct taxes and how that amount was spent. Otherwise, a simple a breakdown showing the public services funded by the taxes collected, with specific emphasis on services that taxpayers value the most, should suffice.

In order to continue to support and fund the government through their taxes, it is imperative that citizens see evidence that the money they are foregoing, for the benefit of the national purse, is worth the sacrifice. Although the tax authority cannot control how the government utilises the taxes it collects, it can play a part in highlighting instances in which the taxes have been spent well.

6.4. THE RESPONSIBILITY TO FACILITATE TAXPAYERS' COMPLIANCE

The evidence from the case study suggested that the tax authority was not doing enough to facilitate compliance by self-employed professionals. The professionals often complained about the lack of tax knowledge, tax complexity, and the high costs of compliance. Tax capability has already been addressed in the previous section on taxpayer education. This section focuses on reducing complexity and the high costs of compliance for professionals transitioning from employment to self-employment, particularly, those who are quite young in the profession.

In the previous chapter, presumptive taxation was offered as a partial short-term option for newly qualified professionals transitioning from employment to self-employment. This section presents ideas that may be useful for tax authorities designing such a regime.

Initially, it is necessary to determine which categories of income would be classed as 'professional income' and thus covered by the proposed presumptive tax. The tax should be restricted to professions in which self-employment is a ubiquitous employment

option. In the case of Kenya, and most LMICs, this would probably cover: lawyers, doctors, dentists, pharmacists, accountants, engineers, surveyors, architects, IT professionals, and consultants.

The next and significant action would be the identification of the relevant professional association or regulator, licensing each profession, and making a request for third-party data in the form of an updated register of members, their business addresses, date of admission to the profession, and personal identification numbers. As suggested, earlier in this chapter, a regularly updated register or database of all professionals would be ideal. Without this information, it would be difficult to design and implement a presumptive income tax effectively, monitor its uptake, and prevent its abuse. This data would additionally assist the revenue authority in the monitoring of taxpayers who are subject to the regular tax regime.

It would then be necessary to conduct a detailed study of the eligible professions in order to determine:

- i. the level of financial and tax capability of newly admitted members and whether, and how, this knowledge increases over their first seven years in practice;
- ii. the revenue potential of newly admitted members over the first seven years;
- iii. the amount of capital required to set up a business in each profession— for example, dentistry is much more capital intensive than accounting, and this determines how long the professional will wait to realise a return on their investment;

- iv. the nature of clients that the various professionals tend to attract in the first few years of practice (whether individual, corporate, or public sector) and how these trends change over the first seven-year period;
- v. the nature of transactions in the professions, i.e., cash or cashless, in the first seven years of practice;
- vi. specific professional rules and regulations, if any, governing financial record keeping and tax compliance, within each profession.

Bearing in mind the resource limitations of the revenue authorities in LMICs, the tax authorities can take a phased approach, tackling one profession at a time, before moving on to the next.⁶⁴⁵

With this data, revenue administrators and policymakers will have a sound basis for designing a presumptive regime that takes into consideration the subtle differences in each profession. For example, if accountants are highly sophisticated in their financial and tax knowledge, right at the start of their private practice, there is no need to include them in a presumptive tax regime. Insight into the varying levels of revenue potential in each profession is also necessary to determine how soon the self-employed professional can transition into the ordinary tax regime. Another critical consideration is the fact that some professions, like law, have professional rules and regulations governing the keeping of accounting and financial records. A presumptive tax regime permitting taxpayers in such professions to keep simple books, or to keep no books at all, would have to be

⁶⁴⁵ See, for example, the HMRC's approach to auditing professions in Her Majesty's Revenue & Customs, '2010 to 2015 Government Policy: Tax Evasion and Avoidance' (*GOV.UK*) <www.gov.uk/government/publications/2010-to-2015-government-policy-tax-evasion-and-avoidance/2010-to-2015-government-policy-tax-evasion-and-avoidance> accessed 6 August 2018.

designed in consultation with the relevant regulator. The rules on simpler record keeping should not result in breaking professional rules and standards; they must co-exist.

Eligibility for the presumptive regime should be based on the date on which one qualified to practice in the relevant profession, and not when one chooses to become self-employed. This distinction would prevent abuse of the system by those fully capable of complying with the ordinary tax rules. For example, if A was licensed to practice in 2010 but chose to go into self-employment in 2018, they are more likely to be capable of coping with the ordinary compliance requirements than B, who qualified in 2016 but went into self-employment in 2018.

The regime should contain a sunset clause that limits how many years the taxpayer is eligible, thus prodding the taxpayers towards self-assessment. The implementation should be accompanied by training and support from the revenue authority, thus preparing the eligible taxpayers for their eventual exit out of the presumptive regime. The goal would be to inculcate a taxpaying ethos early in one's career and encourage a fairly uniform path of growth towards formalisation for these small businesses, ensuring that none, or at least only a tiny number, are left behind.

The exit out of the presumptive regime also needs to be managed appropriately, to prevent the taxpayers from slipping into evasion and eroding the gains made. Revenue authorities should work closely with regulators and professional bodies in:

- (i) determining how long taxpayers can be deemed to be 'newly qualified' and eligible for the regime;
- (ii) determining whether there needs to be an 'intermediary' stage between eligibility for the presumptive regime and eligibility for the ordinary income tax regime, and what that intermediary stage should look like; and

- (iii) designing simple accounting software that newly qualified members can use to prepare them for their compliance obligations under the ordinary tax regime.⁶⁴⁶

Policy makers and tax authorities would also have to decide on the type of presumptive tax that would be suitable for professionals. The often-favoured turn-over tax, where the taxable income is ‘no less than a specified percentage of the gross receipts of the business’, may be simple to administer, but is likely to be ineffective among self-employed professionals whose gross receipts are easily hidden.⁶⁴⁷ This method has, however, been adopted in India, pursuant to the recommendations of a committee set up to consider simplification of income tax, that the presumptive tax regime should be expanded to include professionals.⁶⁴⁸ Under the Indian presumptive regime, the taxpayer's income is presumed to be 50% of their total gross receipts for the year, and since a deemed deduction for all expenses is applied, no further deductions are allowed; the presumption is a rebuttable one, and the taxpayer can produce audited books and receipts showing that their income was less than 50% of gross receipts.⁶⁴⁹

A presumptive regime, where the taxpayer pays a lump sum amount, may be an option for sectors where the turnover method would be unsuitable. Such a tax would operate as ‘maximum’ tax, i.e., the taxpayer would have the option to produce books of accounts proving a lower income. This method would relieve the tax authority of the burden of ascertaining a taxpayer’s actual income, through audits, and the taxpayer’s compliance cost would be negligible; if the taxpayer chooses to keep proper books of

⁶⁴⁶ Perhaps, to facilitate data collection that can be used to refine the system, the taxpayers can be required to generate a simple return from this software, and that return would be automatically submitted to the revenue authority. The taxpayer would still pay the tax due under the rules of the presumptive regime; this return would be purely used to collect data that would be useful for future administrative activities.

⁶⁴⁷ Thuronyi (n 249) 410.

⁶⁴⁸ Expert Committee on Income Tax Simplification (n 301).

⁶⁴⁹ Income Tax Department, Government of India (n 300).

accounts, their compliance costs would be no higher than it presently is. This method has been criticised for resulting in vertical inequity where the incomes within professions diverge widely, and proposed solutions have included the creation of bands within the lump sum, to make the tax less regressive.⁶⁵⁰ However, as Pashev points out, overloading presumptive tax regimes with these equity objectives seriously undermines their effectiveness in achieving simplicity.⁶⁵¹ Some level of inequity is a trade-off that must be accepted in order to achieve the other goals of simplification, horizontal equity, and cheaper compliance and audit.

The French *forfait* and the Israeli *tachshivim* are examples of lumpsum methods that may be considered. The forfeit method is a sort of 'contract' between the tax authority and the taxpayer; they agree on the estimated income that will form the basis for taxation for a fixed period, usually between 1-3 years. Since it involves negotiation and agreement between revenue officers and taxpayers, it is susceptible to abuse in countries where revenue officers are dishonest, or corruption is a challenge.⁶⁵²

In LMICs where corruption is a challenge, a better option would be to utilise the idea behind the *tachshivim*, which was subsequently replaced by *tadrihim*. Like the *forfait*, the *tachshivim* involves an advance 'agreement between taxpayers and the tax authorities', but unlike the *forfait*, 'the agreement is on the *tachshiv* in general (being negotiated with industry representatives), not on its application to particular taxpayers'.⁶⁵³

The in-depth study on average earnings among taxpayers in the different professions, mentioned above, would be vital in determining a suitable lumpsum amount

⁶⁵⁰ Tadesse and Taube (n 7) 15.

⁶⁵¹ Pashev (n 332) 417.

⁶⁵² Jantscher and Tanzi (n 11) 13.

⁶⁵³ Thuronyi (n 249) 424.

since this would likely vary from profession to profession. A good starting point would be to determine the revenue earned by professionals with similar years of experience in government service and determine whether the average income of the self-employed professionals would be comparable.

In conclusion, where presumptive taxes are well-thought out, backed by research, carefully designed and rigorously monitored, they can be of benefit to LMICs where newly-qualified professionals evade taxes because of complexity, peer influence, and low levels of financial and tax capability. Presumptive methods can also improve the public perception of and enhance trust in the tax authority if they are preceded by open dialogue and fair negotiation between the authority and taxpayer representatives, and if they succeed in making compliance easier and cheaper.

Careful attention must be paid to thresholds and the period for which a taxpayer is eligible for the presumptive regime, before they transition into the ordinary tax system. The tax should be designed with time-limits, encouraging the taxpayer to become increasingly formal, and specific effort made to develop the taxpayer's capacity and financial capability during the period of eligibility.

However, policymakers and tax authorities should not be bogged down with the task of achieving maximum equity within a presumptive tax regime, as this will merely result in complexity; instead the focus should be on achieving simplicity and reducing the costs of audit and compliance and graduating the taxpayer to the ordinary tax regime within a reasonable timeframe.

6.5. THE RESPONSIBILITY TO ENFORCE THE LAW

Better enforcement is critical for the success of all the initiatives proposed above. As argued in the previous chapter, better enforcement is particularly essential in countries with high levels of corruption, weak taxpaying culture, and a poor track record in government service delivery.⁶⁵⁴ However, in many LMICs, tax authorities are severely under-resourced, and enforcement, therefore, remains a significant challenge. The aim of this section is to review some mechanisms through which these tax authorities can increase enforcement among self-employed professionals. However, there is an opportunity for future research into cost-effective detection and enforcement mechanisms suitable for LMICs dealing with the HTT.

6.5.1 Profession-by-Profession Tax Campaigns

One way in which tax authorities in LMICs can increase enforcement among self-employed professionals is by running profession-by-profession tax campaigns. The tax authority would its way through the list of professions, tackling one profession at a time, requiring the professionals to voluntarily disclose unpaid tax or run the risk of audit and prosecution. A profession-by-profession tax campaign, run for a few years, would enable the authority to carry out comprehensive and effective audit and enforcement in one profession, before moving on to the next. This approach would be more financially feasible than attempting to audit all professionals at once.

HMRC successfully used this approach in the United Kingdom, to tackle evasion among various categories of self-employed taxpayers including medics and solicitors. The campaign dubbed, ‘Medics Tax Health Plan’, gave doctors and dentists the voluntary opportunity to pay any taxes they owed, together with a fixed penalty, or risk audit and

⁶⁵⁴ See the discussion under ‘Trust and Power’ in Chapter 5.

prosecution; that campaign closed on June 2010, and HMRC collected £70,961,034 as a result.⁶⁵⁵ In one instance, a doctor paid up the sum of £1,000,000, and a dentist paid the sum of £300,000 in unpaid taxes.⁶⁵⁶ HMRC ran a similar campaign for solicitors, and for professionals working in health and wellbeing such as psychologists, physiotherapist and chiropractors; the Revenue raised over £900,000 from the latter.⁶⁵⁷ In total, HMRC has raised over £612 million from voluntary disclosures through these targeted campaigns.⁶⁵⁸

Such campaigns would also have an additional positive effect on taxpayers in other professions or trades not yet targeted by the campaigns; they are likely to be prodded to voluntarily come forward, once they observe serious enforcement taking place in other sectors. HMRC reports that it collected over £5,000,000 from disclosures by individuals not targeted by any campaign, but who voluntarily come forward and used the campaigns disclosure hotline to tell them about undeclared income.⁶⁵⁹

Uganda's experience with the taxation of High Net-Worth Individuals also provides excellent lessons for tax authorities in LMICs, intending to design such a campaign.⁶⁶⁰ The Uganda Revenue Authority (URA) embarked on a campaign aimed at increasing the number of registered high net-worth individuals and ensuring that they were filing accurate tax returns. URA's experience shows that the success of such campaigns requires a multi-pronged approach characterised by (i) genuine political will, (ii) taxpayer information gathering from diverse sources, (iii) concurrent taxpayer education and facilitation, and (iv) concurrent research into the targeted sector or profession.⁶⁶¹ The Ugandan campaign also proves that a tax authority does not require

⁶⁵⁵ Her Majesty's Revenue & Customs (n 645).

⁶⁵⁶ *ibid.*

⁶⁵⁷ *ibid.*

⁶⁵⁸ *ibid* HMRC has also raised £395 million from a large number of follow-up activities.

⁶⁵⁹ *ibid.*

⁶⁶⁰ Kangave, Nakato and Zzimbe (n 629).

⁶⁶¹ *ibid* 22–23.

‘optimum’ conditions, i.e., adequate resources, staffing and data, to commence such initiatives; institutional will and commitment can compensate for less than ideal conditions.

6.5.2 Leveraging Technology

In LMICs, like Kenya, which have made significant progress towards using technology in tax administration, making more effective and strategic use of technology for risk assessment before an audit, and for capturing taxpayer data, would facilitate enforcement and discourage those who would otherwise want to evade taxes.

The lawyers who were interviewed for this project believed that the risk of detection increased exponentially with the increased use of the iTax system and that it would become increasingly difficult to evade taxes. Dentists were not as concerned about the introduction of iTax and did not express the fear that it would increase their visibility. These findings suggest that the increased use of technology to process taxpayer data may heighten some taxpayers’ perceptions of their increased visibility and corresponding increased risk of detection; this, in turn, is likely to encourage voluntary compliance. However, the mere existence of the technology is insufficient; if the system does not work seamlessly and intuitively, its effect can be reduced. A good example discussed in Chapter 4 case was the realisation by DEN2 that since the system did not pick up partial compliance, there was no need to disclose income simply because withholding tax had been paid on it. Furthermore, even though the dentists and the lawyers fall under one category of taxpayers, their knowledge and perception of iTax were very different. Thus, broad publicization to, and sensitisation of, a wide range of taxpayers, using different communication channels and methods, would help to ensure the overall effectiveness of the system.

6.5.3 A Greater Role for Professional Bodies/Regulators

Enforcement is difficult without clean and reliable data about taxpayers. As argued earlier in this chapter, professional bodies and regulators can play the critical role of supplying the tax authority with information regarding their members, which the authority can then utilise to cross-check tax return data and detect evaders and non-filers. In some countries, tax authorities are already empowered by statute to obtain this data from professional bodies and regulators; where this power is not enshrined in legislation, the tax authority may need to propose necessary amendments to tax administration statutes.

Poor financial management and tax evasion can seriously threaten the integrity and prestige of professions; therefore, greater collaboration between tax authorities and professional regulators and bodies would be mutually beneficial to both parties. These parties can work together in establishing and enforcing profession-specific financial and tax compliance regulations that facilitate better record keeping and compliance by professionals. Where those professional rules already exist, the collaboration should focus on how to ensure that they are enforced in such a manner that facilitates the work of the tax authority and, at the same time, preserves the integrity of the profession. As already mentioned above, the tax authority can also work with professional bodies and regulators to develop simplified accounting software for professionals who are struggling with proper record keeping. Encouraging the uptake of such software among taxpayers who were previously keeping poor records would facilitate the tax authority's work in audit and enforcement and assure the professional associations that their members are adhering to professional standards regarding tax and accounting.

Tax authorities should also work on encouraging professional bodies and regulators to consider explicitly linking tax evasion to professional misconduct that warrants the loss of one's practising licence. Professionals who are convicted on tax

evasion charges should lose their licence, or face other stiff disciplinary action, as a warning to their peers; the tax authority and professional association should ensure that such outcomes are widely publicised to enhance their deterrent effects. Tax evaders who enter into a settlement with the tax authority, following an authority-initiated audit, should face some form of disciplinary action within their profession as well.

It may also be helpful for tax authorities to work with professional bodies and regulators in identifying ‘ambassadors’ within each profession, who can exert positive pressure on their peers and promote the benefits of tax compliance for members of the profession. The effects of peer pressure on tax compliance decisions are extensively explored in the literature; Snavelly argues that one's social interactions influence the willingness to engage in tax evasion.⁶⁶² If a taxpayer knows many people who are engaged in tax evasion in groups that are important to them, including their professional circles, they are more likely to be willing to evade as well.⁶⁶³ Knowing that one’s peers are evading also removes the fear of informal sanctions from peers if one is caught evading, a fear that may encourage compliance.⁶⁶⁴ Existing research also suggests that taxpayers’ perceptions about the probability of being detected, when one engages in evasion, can be influenced by social influences.⁶⁶⁵ In selecting ambassadors, diversity is important; there should be a good mix of ambassadors in respect of age, gender, ethnic identity, geographical area of practice, professional achievement, and socioeconomic status. This diversity would enhance the chances of successfully influencing a wide range of professionals.

⁶⁶² Snavelly (n 367) 62.

⁶⁶³ Fjeldstad and Semboja (n 344) 2061.

⁶⁶⁴ McKerchar and Evans (n 208) 178.

⁶⁶⁵ Fjeldstad, Schulz-Herzenberg and Sjursen (n 178) 6.

6.5.4 Enforcement When Contending with Poor Records

In many LMICs, tax authorities have to contend with poorly kept financial records, that cannot fully be trusted, when they attempt to audit self-employed professionals. This situation is usually worsened by the widespread use of cash payments for professional services, meaning that there are insufficient paper trails for the transactions. Some professionals will specifically insist on cash, rather than card or cheque payments, in order to avoid a paper trail.

Unlike small-scale traders, however, many of these professionals will eventually bank this money. Tax authorities can triangulate banking data with details obtained from professional bodies and regulators to assess whether the professionals are underreporting, a measure that KRA has indicated it will begin undertaking.⁶⁶⁶ Banking data, including the value of deposits made, and information declared in loan, mortgage, and credit card applications, can reveal a wealth of information that the taxpayer may be hiding from the revenue authority. Taxpayers who are underreporting their income for tax purposes are likely to be declaring the correct amount of their income and wealth to maximise the amount of credit that they can secure from financial institutions. Information held by credit reference bureaus can also be used to determine how much credit a taxpayer has accessed over a period and compare that to the income that they have declared.

In 2010, the Commonwealth Association of Tax Administrators published a handy guide for tax administrators working in cash-based economies.⁶⁶⁷ The author considers the issue of under-reporting by professionals in cash-based economies and makes some helpful suggestions for tax auditors auditing such taxpayers. For example,

⁶⁶⁶ Moses Omusala and Otiato Guguyu, 'Surveillance: KRA to Track Bank and Mobile Cash Transactions' *Standard Digital* (2 October 2018) <<https://www.standardmedia.co.ke/article/2001297505/surveillance-kra-to-track-bank-and-mobile-cash-transactions>> accessed 2 October 2018.

⁶⁶⁷ Sheikh Sajjad Hassan, *Tax Audit Techniques in Cash Based Economies: A Practical Guide* (The Commonwealth Association of Tax Administrators 2010).

when auditing medics who dispense medication, such as pharmacists or in some cases, general practitioners, tax authorities can make enquiries from the supplier(s) of their medical supplies to determine whether they have understated sales in their financial records.⁶⁶⁸ Obtaining information from laboratories to which doctors refer their patients and private hospitals and clinics at which they locum, can also be useful ways of obtaining information.⁶⁶⁹

When auditing lawyers with poor records, revenue officers can obtain information about omitted clients from court cause lists that ordinarily contain the names of lawyers and the parties that they represent.⁶⁷⁰ Data regarding fees paid for legal services can also be obtained by auditing the lawyer's clients to determine whether the lawyer has underreported the fees.⁶⁷¹

Useful information about the work carried out by architects, quantity surveyors, and engineers can be obtained from building plans submitted for approval at the town planner's office.⁶⁷² In some countries, building sites are required by law to display visible signage containing the names of professionals providing services on the project; details about projects in which architects, engineers and quantity surveyors have been involved in can also be obtained from such signage. As with lawyers, information regarding the value of such projects can also be obtained by auditing or merely making enquiries from clients.

Finally, lifestyle audits can also be a useful tool for determining whether professionals are understating their income. Information about property ownership and

⁶⁶⁸ *ibid* 33–34.

⁶⁶⁹ *ibid* 34, 36.

⁶⁷⁰ *ibid* 37.

⁶⁷¹ *ibid* 38.

⁶⁷² *ibid*.

motor vehicle ownership can be easily obtained from government offices such as the lands and motor vehicles registries. Additional information regarding business assets, holidays, amounts paid in school fees, and club memberships would also provide insight into a professional's potential income. While information from lifestyle audits may not be conclusive, an assessment based on estimated income may prod a previously unwilling taxpayer to produce evidence showing their actual income.

6.5.5 Dealing with Collaborative Evasion

Successful taxpayer evasion is rarely an individual activity; as discussed in the two previous chapters, professionals will often 'collaborate' with clients, suppliers, or other professionals in the same or different profession. Lawyers collaborate with their accountants to 'cook' their books of accounts and breach the accounting rules of the profession. Some professionals collude with their clients to receive cash payments under the table, thus facilitating under-declaration of income. Professionals who procure goods from suppliers, such as doctors or dentists, may collude with their supplies to tamper with the evidence of the value of purchases made.

Since instances of collaborative evasion will vary, regarding participants and motive, tax authorities will have to adopt a mix of strategies to deal with them. Collaborative evasion involving professionals is quite likely to involve the breach of professional rules as well and is probably best handled in partnership with the relevant professional bodies or regulators. Collaborative evasion between professionals and clients, particularly corporate clients, can be detected and dealt with by auditing the corporate clients, who are more likely to be keeping better financial records than the professionals. Triangulating banking information and financial records of both parties (where available) may reveal instances of criminal activity. Where the professional's

client is an individual taxpayer, triangulating banking information for both parties may be insightful.

6.5.6 Strategic Prosecution

Prosecution of tax evasion cases is difficult and expensive for under-resourced tax authorities; in countries where courts are understaffed or dealing with a severe backlog of cases, it is also time-consuming. Tax authorities in some countries, like Kenya, have indicated a preference for alternative dispute resolution, arguing that it is cheaper, faster, and less detrimental to the taxpayer-tax authority relationship.

Resorting to prosecution should perhaps be an exception rather than a rule; an option utilised for the most hardened tax evaders. It is possible that with better identification of professionals, taxpayer education, limited use of presumptive taxation, tax compliance campaigns, and increased partnership with professional bodies and regulators, the instances requiring prosecution can be kept to a minimum. However, most respondents in the case study indicated that they had never heard of the successful prosecution of a peer and concluded that the risk of detection is low. It may be helpful for the tax authority to strategically audit and prosecute a small number of professionals from each profession, particularly those who have engaged in severe cases of evasion and make public the outcome of the successfully prosecuted cases. This strategy, coupled with the subsequent deregistration of such professionals, would send a strong message that tax evasion is a costly decision.



LOOKING FORWARD

1

Identify Taxpayers

- Leverage size of professions
- Data from professional bodies
- Online directories
- Clients including public bodies
- Dedicated professionals' registry
- Lifestyle indicators
- Physical search
- Electoral roll

2

Educate: Convenience

- Readily available information
- Convenient access
- Use of technology to develop and disseminate 'how-to' instructional videos

3

Educate: Relevant

- Respond to expressed needs
- Offer support
- Develop financial capability
- Implication of various legal structures
- Financial records to keep
- Relevant tax facts
- Business expenses
- How to file a self-assessment return and pay self-assessment tax

4

Educate: Collaborate

- Developing partnerships enhances impact of education efforts
- Work with professional bodies and regulators
- Ensure initiatives and information is fit for purpose
- Taxpayer hotlines

5

Presumptive Tax

- Tackle complexity and high cost of compliance for newly qualified self-employed professionals
- Partial solution
- Importance of sunset clause
- Initial detailed study of each profession
- Proper management of exit
- Lump-sum method

6

Tax Campaigns

- A phased approach
- Allows comprehensive and effective audit in one profession at a time
- Successful in other jurisdictions- Uganda and United Kingdom
- Knock-on effect on other taxpayers

7

Technology

- Use technology to process data
- Enhances perception of increased visibility and risk of detection
- System should work seamlessly and intuitively to enhance effect
- Broad sensitisation

8

Professional Bodies

- Source of critical data
- Establish and enforce profession-specific financial and tax compliance regulations
- Simplified accounting software
- Explicitly linking tax evasion to professional misconduct
- Tax ambassadors

9

The Cash Problem

- Triangulate banking data with other data
- Information about loans, mortgages, and credit cards
- Lifestyle audits
- Obtain information from clients, suppliers, government offices, courts.

10

Strategic Prosecution

- Use sparingly but effectively
- Effective use of other options to avoid many instances of prosecution
- Use as deterrence

6.6. CONCLUSION

The previous five chapters have focused on (i) describing the research problem, (ii) clarifying the theoretical underpinning of the research, (iii) reviewing the case study design and findings, and (iv) demonstrating how the findings confirm, challenge, and extend what we already know. The purpose of this chapter was to tie it all together by answering the question, ‘so what?’ What should revenue authorities in LMICs do with these findings? Why should professional associations and regulators be interested in this research? Of what utility are these findings for those working in, or researching, tax administration in Africa?

In answering these questions, this chapter has proposed ways in which tax authorities in LMICs can utilise the findings to:

- i. construct a taxpayer identification strategy for self-employed professionals;
- ii. generate tax literacy campaigns that would best meet the needs of self-employed professionals;
- iii. design a viable and robust presumptive tax regime for self-employed professionals;
- iv. make better use of professional regulators and bodies; and
- v. think about enforcement measures that would be effective for self-employed professionals.

The World Bank currently classifies over 130 countries as low and middle-income countries; they vary significantly in their levels of socio-economic and political characteristics, with 34 classified as low-income economies, 47 as lower-middle-income economies, and 56 as upper-middle-income economies.⁶⁷³ Thus, not all these suggestions

⁶⁷³ World Bank, ‘World Bank Country and Lending Groups’ (n 1).

will be relevant, viable, and within reach of every single LMIC. However, since self-employed professionals pose a challenge to many tax authorities, including those in high-income countries, it is hoped that these suggestions provide a useful starting point from which tax authorities can refine their compliance strategy for these taxpayers.

7. CONCLUSION

The purpose of this concluding chapter is to reflect on the discussions in the preceding six chapters. This Chapter will highlight the main claims, contributions, and implications of this thesis. It concludes with an evaluation of the thesis as a whole, identifying its main strengths, weaknesses, opportunities for future research.

7.1. MAIN OBJECTIVES AND RESEARCH QUESTIONS

In Chapter 1, the researcher set out the boundaries of the research, and the justifications for those boundaries. This thesis was concerned with the taxation of the hard-to-tax in LMICs; the term hard-to-tax is an umbrella term for taxpayers who are deemed very difficult to tax and comprises farmers, SMEs, and professionals. Chapter 1 contains an extensive discussion on the taxonomy of taxpayers, and how the term hard-to-tax fits in with other terms such as informal sector, shadow economy, and underground economy.

The taxation of farmers and SMEs in LMICs has been extensively researched and discussed in tax compliance literature; however, researchers in this field have largely overlooked professionals. The literature on taxation of professionals in LMICs is scant, with most researchers simply making a passing mention of these taxpayers. Thus, the main objective of this thesis was to interrogate the phenomenon of tax evasion among hard-to-tax professionals in LMICs. This objective was achieved by answering the primary research question: what are the barriers to tax compliance by hard-to-tax professionals in LMICs and how can revenue authorities in those countries effectively improve compliance among these taxpayers? The implicit question was, why does this problem arise, and what should we do about it?

7.2. THE RESEARCH METHODS

The researcher utilised several methods, and data sources, in answering this question. First, secondary sources of data such as books, journal articles, working papers, official reports, and policy documents provided useful data, specific to the hard-to-tax, on the options available to tax authorities dealing with these taxpayers. These secondary sources also provided valuable data on theoretical accounts of tax evasion by taxpayers in general.

Using the data gleaned from these secondary sources, the researcher, in Chapter 2, evaluated the five main options available to tax authorities dealing with the hard-to-tax: (i) exempting the hard-to-tax from taxation altogether, (ii) strengthening enforcement, (iii) increased reliance on voluntary compliance, (iv) increased reliance on indirect taxation, and (v) the use of presumptive taxes.

Exempting some hard-to-tax taxpayers from taxation is a prudent and inevitable decision, particularly in the case of those hard-to-tax taxpayers whose incomes fall below the taxable threshold. However, a blanket exemption of all hard-to-tax taxpayers is an undesirable policy decision with potentially adverse effects on the overall tax system. The arguments in favour of and against the taxation of the hard-to-tax were discussed at length in Chapter 1.

Strengthening enforcement plays a crucial role in improving compliance among the hard-to-tax but is not always an achievable goal for under-resourced and under-staffed tax authorities in LMICs. The researcher also questioned the effectiveness of certain compliance paradigms, such as cooperative compliance and customer-centric tax administration, in ensuring voluntary compliance by the hard-to-tax in LMICs dealing with high levels of corruption, cash transactions, and low tax morale. With respect to the

option of increased reliance on indirect taxation, the researcher highlighted the challenges that some LMICs in Africa are facing in administering indirect taxes such as VAT.

There is a vast body of academic research answering the question: why do people evade taxes? In Chapter 3, the researcher synthesised this research by identifying and discussing the different perspectives from various disciplines including law, economics, psychology, and political science. Although the law does not theorise tax evasion behaviour in the way these other disciplines do, tax statutes in all countries segment noncompliance by motive, and this segmentation is reflected in the proportionality of the applicable penalties. Tax statutes will often use different words to distinguish the ‘motives’ for evasion including mistake, misapprehension, recklessness, and intention to mislead. In addition, the law segments tax compliance on the basis of criminality, classifying some forms of non-compliance as evasion and others as avoidance.

The key theories of tax evasion from other disciplines were explored, including economic deterrence theories, social psychology or social influences theories, fiscal exchange or fiscal psychology theory, and political legitimacy. These theories have been empirically tested in diverse settings and Chapter 3 also highlights the findings of some of these empirical studies. The researcher also discussed Kirchler’s slippery slope framework and highlighted several empirical studies that have tested it.⁶⁷⁴ The researcher pointed out that the assumptions of the slippery slope framework have not been as extensively tested in LMICs with high levels of government corruption, poor service delivery, a preponderance of cash transactions, and weak taxpaying cultures.⁶⁷⁵

In order to enrich the data obtained from these secondary sources, the researcher conducted a qualitative case study, explicitly interrogating tax compliance among self-

⁶⁷⁴ See the discussion on the slippery slope framework in Section 3.5 of Chapter 3.

⁶⁷⁵ *ibid.*

employed professionals in Kenya, a lower middle-income country. Through the case study, the researcher was able to collect primary data via open-ended semi-structured interviews with taxpayers and tax experts. The researcher used this valuable primary data to contextualise and enrich the more general secondary data which, to date, has not adequately and explicitly addressed tax compliance by professionals in LMICs. The researcher then utilised the tax compliance theories, discussed at length in Chapter 3, to carry out a thematic analysis of the interview data. Chapter 4 contains a detailed narration of the major and minor themes that emerged from the interview data.

7.3. THE SIGNIFICANT FINDINGS AND CONTRIBUTIONS TO KNOWLEDGE

This thesis makes an original, significant, and substantial contribution to the research on taxation of the hard-to-tax by specifically interrogating tax compliance by professionals in LMICs, a group of hard-to-tax taxpayers that have been overlooked in the literature on taxation of the hard-to-tax. Self-employed professionals have a greater opportunity for evading taxes on their income and pose a particular problem for tax authorities in LMICs. This thesis asked, and answered, the novel question: why do professionals in LMICs evade taxes, and what can be done about it?

This is an important research question for tax researchers, tax authorities, and tax policymakers. The failure to make a legitimate effort to tax hard-to-tax professionals has several adverse implications for the tax system. Effectively taxing these professionals helps governments in LMICs raise much needed revenue, share the tax burden fairly and equitably among all taxpayers, enhance neutrality in the tax system, protect the tax morale of other taxpayers who are paying their taxes, and facilitate the growth of small firms. Bringing these taxpayers into the tax net also has governance and democracy implications; citizens who are paying their taxes are also more likely to demand

responsive leadership. Therefore, the findings of this thesis have important research, practical, and theoretical implications.

Several findings and themes corroborate the general determinants of tax compliance identified in the literature. First, the influence of perceptions of taxpayer visibility, the risk of detection, and consequences of evasion, on the professionals' compliance attitudes, corroborate the economic deterrence theories. Second, the patterns in the primary data also confirmed that that social influences have a significant effect on compliance attitudes. Third, the patterns from the data, on the influence of perceptions of unfairness in the tax system, also corroborated the proposition that taxpayers are more likely to comply if they believe that the tax system is equitable.

Importantly, this thesis has five significant findings that substantially contribute to research on the taxation of the hard-to-tax in general, and the taxation of hard-to-tax professionals in particular.

First, the proponents of the slippery slope framework argue that voluntary compliance increases when taxpayers believe 'that the tax authorities are benevolent and work beneficially for the common good'.⁶⁷⁶ The researcher extended the proposition of the slippery slope framework, by proposing that *severe corruption and poor service delivery by government, particularly in countries where the taxpaying culture is already weak and there is a preponderance of cash transactions, result in low tax morale that limits the effectiveness of trust in the revenue authority, in increasing voluntary compliance*. In such environments, stronger enforcement is a better tool for increasing compliance levels. This proposition is based on the argument that the professionals did not view tax collection in a vacuum; it was viewed within the larger context of the social

⁶⁷⁶ Kirchler, Hoelzl and Wahl (n 346) 212.

contract between the government and the citizen. Many tax authorities in LMICs are working in an imperfect environment, of severe corruption and misuse of public funds, over which they have little control; thus, the solutions proffered must consider these realities in order to be effective. It is difficult for a tax authority to build a relationship of trust with citizens, particularly one that translates into voluntary compliance, if citizens believe that the government is corrupt and that taxpaying is a waste of time. This proposition has significant implications for tax authorities in LMICs who need to find cost-effective ways of strengthening enforcement among hard-to-tax taxpayers.

Second, presumptive tax regimes are quite commonly used, by tax authorities in LMICs, to tax the hard-to-tax. However, professional income is rarely eligible for these tax regimes. SMEs and farmers are ordinarily eligible for these regimes because tax authorities acknowledge that they may be unable to cope with the cost and complexity of ordinary compliance requirements. Tax scholars and tax authorities often overlook the fact that some professionals, particularly early career professionals running small firms with modest turnover, face the same compliance challenges that SMEs face, including the high costs of compliance and inability to navigate complex compliance requirements. From a policy perspective, therefore, it is difficult to justify a blanket ban on presumptive tax regimes for professionals.

Tax scholars opposed to presumptive tax regimes argue that these regimes are undesirable because they breach principles of equity. However, this thesis argues that presumptive taxes fail when they are designed with overly ambitious goals in mind. Overloading a presumptive regime with too many divergent and potentially contradictory or conflicting objectives will certainly lead to failure. Presumptive taxes with clear and specific goals, when properly implemented and monitored, can be of benefit to LMICs

where professionals evade taxes because of complexity and low levels of financial and tax capability.

This thesis therefore proposed that *presumptive regimes can be a useful partial solution for taxing self-employed professionals, if they are well thought-out, meticulously designed, and rigorously monitored*. The researcher argued that the limited use of presumptive methods, together with overall efforts to improve service delivery, manage corruption, improve taxpayer education, and better enforcement, can be effective in improving compliance by self-employed professionals in LMICs. This proposition has significant implications for tax authorities which are ordinarily hesitant to open up eligibility for presumptive regimes to professionals.

Third, this thesis identified the important role of financial and tax capability, in facilitating tax compliance by self-employed professionals in LMICs. Existing literature on tax evasion does not adequately address the financial and tax capability of the self-employed, and financial capability literature has largely overlooked the importance of tax capability and compliance. While tax authorities assume that professionals are highly educated and perfectly capable of meeting their compliance obligations, the primary data suggested that some professionals, particularly newly qualified professionals and professionals who are unable to afford expert tax and accounting advice, struggle to meet their compliance obligations. This finding has significant implications for tax authorities designing taxpayer education programmes. *Taxpayer education programmes should be broad enough to cater to the specific tax education needs of self-employed professionals, and not assume their financial and tax capability*.

Fourth this thesis has made a substantial contribution to the study of taxation of hard-to-tax professionals by highlighting the effects of regulatory failures, by regulators

and professional bodies, on tax compliance. The failure by professionals to keep proper financial records and comply with tax legislation has severe ramifications for the integrity of a profession; this is a challenge for both high income countries and LMICs, as demonstrated in Section 5.5 of Chapter 5. In the case country, regulators and professional bodies have treated tax compliance as a personal problem, not touching on professional conduct, and have thus failed to explicitly address the issue in professional statutes, rules, and bylaws. This is despite the fact that some instances of tax evasion will also involve or result in breach of professional rules and regulations. *Regulators and professional bodies are an untapped resource that should play a much more active role in ensuring sound financial management and tax compliance in firms owned by their self-employed members.*

Finally, this thesis discussed the role of collaborative tax evasion, a phenomenon that is not adequately explored in the literature on the taxation of the hard-to-tax. Successful evasion by professionals is rarely an individual activity; these professionals will often ‘collaborate’ with clients, suppliers, or other professionals in the same or different profession. *Tax enforcement efforts and education campaigns should be aimed at professional groups alongside other taxpayers, to ensure a community-wide shift towards tax compliance.*

This thesis has contributed to practical knowledge by identifying some potential areas for action by tax authorities in LMICs. These proposals, sieved from the significant findings and contributions identified above, spanned the four main responsibilities of tax authorities: (i) the responsibility to identify taxpayers, (ii) the responsibility to educate taxpayers, (iii) the responsibility to facilitate taxpayers’ compliance, and (iv) the responsibility to enforce the law. The researcher concludes by acknowledging that the

diversity that exists among countries classified as LMICs means that not all these proposals will be relevant, viable, and within reach of every single LMIC. However, the proposals provide a menu from which LMICs can pick what best addresses their particular reality.

7.4. EVALUATING THE RESEARCH

The Strengths

The main strength of this research lies in the novelty of the research area, and the original data collected. Although there is extensive research on tax evasion by hard-to-tax farmers and SMEs, tax evasion by hard-to-tax professionals in LMICs is an under-researched area. This gap in knowledge gave the researcher an opportunity to draw from well-established literature to investigate an under-studied area.

Original empirical data collected via the case study enriched existing secondary data and enabled the researcher to provide a much more nuanced understanding of the phenomenon. Further, the researcher's insider knowledge of taxation in the case country is an added strength. The researcher's lived experience in the country of study, and professional experience in practising law in that country, facilitated access to crucial respondents and gave the researcher a richer understanding of the empirical data and the local context.

The Limitations

This thesis has two main limitations. First, the lack of official government statistics or reliable quantitative research data in the case country, Kenya, means that the researcher was unable to quantify the scale of tax evasion by self-employed professionals in the case country. As pointed out in Chapter 6, the unavailability of reliable statistics and data is a significant challenge in LMICs. However, tax authority officials from several African

countries, with whom the researcher personally spoke, confirmed that there is a high level of tax evasion by professionals. In addition, research from Costa Rica, Greece, and other general research on tax evasion by the self-employed in LMICs confirms that this phenomenon is a significant problem and poses a real challenge for tax authorities.

The second limitation is the small sample size of respondents for the empirical research. While the researcher was careful to select a diverse set of respondents, it is not possible to make generalisations to the entire populations, based on this data. However, this qualitative research has been used to demonstrate patterns and trends, and provide rich, thick data that would not be obtained through quantitative research. This rich qualitative data has been used to contribute to and generalise to existing theory.

Unanswered Questions: Opportunities for Future Research

The findings of this thesis raise some additional questions and offer several opportunities for future research.

First, to date, much of the empirical testing of the slippery slope framework has taken place in high-income countries with lower levels of corruption and higher levels of tax morale than most LMICs (particularly in Africa). Thus, the propositions made in this research would benefit from future quantitative testing of the slippery slope framework among the hard-to-tax in a low or middle-income country, with high levels of government corruption, and a weak taxpaying culture.

Second, this thesis advocates for stronger enforcement of the law in order to increase compliance among hard-to-tax professionals. However, the researcher also acknowledges the financial and human resource implications of surveillance and audits for under-resourced tax authorities in LMICs. There is an urgent need for more research and thought on cost-effective tax enforcement measures for tax authorities in LMICs,

since they are often short of the finances and skilled staff required to maintain effective audit rates.

Third, although the researcher proposes some ways in which tax authorities can design presumptive taxes for professionals, there is an opportunity for future research and academic debate on the design of such a tax regime. While presumptive taxes may always be plagued by equity concerns, interdisciplinary research by economists, psychologists, and lawyers would help to produce a well-thought out tax regime, with inbuilt safeguards to minimise distortions and abuse, that achieves the objectives of simplification and inexpensive compliance. There is room for future research on the effects of the recently introduced presumptive taxes for professionals in India and Greece; the findings of such research would help to inform the design of presumptive tax regimes for professionals in other countries.

Fourth, there is also a need for further reflection and research on the role of professional regulators and bodies in ensuring tax compliance by their members; and whether, and how, this role should be formalised in primary and subsidiary legislation. There is a need to reflect on the nature of the relationship between tax authorities and professional regulators and bodies, as well as the extent to which tax authorities ought to be empowered to exert influence over these entities, in order to achieve their tax administration mandate.

Fifth, further research on the financial and tax capability of professionals in LMICs also merits further study. It is necessary to interrogate the assumption that all professionals possess the necessary financial capability to meet their tax compliance obligations and determine the categories of professionals who do not fit within this

assumption. Such research would help to inform and shape vital tax education programs and initiatives, to ensure that they are relevant and fit for purpose.

This thesis represents an important first step in understanding tax compliance among hard-to-tax professionals in LMICs and there is scope for future comparative empirical research, in the form of national surveys, investigating the variances in determinants of tax compliance across different LMICs. Such comparative data would enrich and extend the findings of this thesis and further narrow the gap in knowledge on the hard-to-tax. It is hoped that this research brings us closer to completing the hard task of taxing the hard-to-tax in developing countries and achieving a more equitably shared tax burden in those societies.

ANNEXE

Table 6: Profile of Dentists Interviewed for the Project

| Identification | Nature of Practice | Level of Specialisation | Gender | Years of Experience |
|-----------------------|---|-------------------------|--------|---------------------|
| Dental Practitioner 1 | -Self-employed -Runs own practice -Previous locum experience | Specialist | Male | More than 7 |
| Dental Practitioner 2 | -Self-employed -Informal employment working for a self-employed practitioner -Previous locum experience | Non-specialist | Male | Less than 7 |
| Dental Practitioner 3 | -Formal employment (private) -Previous locum experience | Non-specialist | Female | Less than 7 |

| Identification | Nature of Practice | Level of Specialisation | Gender | Years of Experience |
|-----------------------|--|--------------------------------|---------------|----------------------------|
| Dental Practitioner 4 | -Self-employed -Runs own practice -Previous locum experience | Non-specialist | Male | Less than 7 |
| Dental Practitioner 5 | -Formal employment (government) -Engaged in locum | Specialist | Female | 7 |
| Dental Practitioner 6 | -Self-employed -Runs own practice -Engaged in locum | Specialist | Female | More than 7 |
| Dental Practitioner 7 | -Formal employment (government) -Engaged in locum | Non-specialist | Female | 7 |
| Dental Practitioner 8 | -Self-employed -Runs own practice -Previous locum experience | Specialist | Male | Less than 7 |
| Dental Practitioner 9 | -Self-employed -Runs own practice | Specialist | Male | More than 7 |

| Identification | Nature of Practice | Level of Specialisation | Gender | Years of Experience |
|---------------------------|--|------------------------------------|---------------|--------------------------------|
| Dental Practitioner 10 | -Formal employment (government) -Engaged in locum | Specialist | Female | More than 7 |

Table 7: Profile of Lawyers Interviewed for the Project

| Identification | Nature of Practice | Years of Experience | Age of Business | Gender |
|-----------------------|---|----------------------------|------------------------|---------------|
| Legal Practitioner 1 | Sole proprietor | > 10 | > 3 years | Male |
| Legal Practitioner 2 | Sole proprietor | < 10 | <3 years | Male |
| Legal Practitioner 3 | Partnership | < 10 | <3 years | Male |
| Legal Practitioner 4 | Partnership | < 10 | <3 years | Female |
| Legal Practitioner 5 | Sole proprietor | < 10 | 3 years | Female |
| Legal Practitioner 6 | Partnership | < 10 | < 3years | Male |
| Legal Practitioner 7 | Sole proprietorship | > 10 | > 3 years | Female |
| Legal Practitioner 8 | Self-employed | < 10 | N/A | Female |
| Legal Practitioner 9 | Partnership | > 10 | < 3years | Male |
| Legal Practitioner 10 | Sole proprietorship | < 10 | < 3years | Male |
| Legal Practitioner 11 | Partnership | > 10 | > 3 years | Male |
| Legal Practitioner 12 | Sole proprietorship (previously run as a partnership) | > 10 | > 3 years | Male |

RESEARCH QUESTIONS:

The researcher conducted open-ended semi-structured questions and allowed the respondents' respective responses to shape the questions posed in the interviewed. Thus, each interview was unique, and did not follow a rigid formula. However, the researcher had a set of guiding questions which set the context and scope of the interviews.

Guiding Questions for Interviews with Taxpayers

- What is the general view of professionals in the legal or dental sector on the taxation of their income?
- Are the professionals aware of the taxes due on their income and how to calculate these taxes?
- What is their view on the applicable rate of tax?
- What is the general experience of the professionals who have had any level of interaction with the revenue authority?
- In the respondent's view, do professionals in their sector generally comply with or evade their tax obligations?
- What may drive professionals in the respondent's sector to evade some, or all, of the tax due on their income?
- Do the professionals in Nairobi think that there are any circumstances that would legitimate or justify the evasion of taxes on their income?
- Do the professionals in Nairobi think that it is likely, reasonably likely, or not likely that a tax evader in their sector would be caught?

- What, in the view of these professionals, would motivate or encourage increased voluntary compliance in their sector and who should be responsible for these interventions?
- Should professional associations or regulators play a role in tax compliance?

Guiding Questions for Interviews with Tax Experts

- What is the level of compliance by self-employed professionals in Kenya? Are there any policy documents, revenue analysis reports, or government publications that trace the revenue collection or levels of evasion within this group of taxpayers?
- What challenges does KRA face when administering taxes applicable to self-employed professionals? What are the main reasons for these challenges?
- What specific interventions have been pursued to encourage compliance by professionals? Have these interventions been successful? What interventions ought to be pursued but have yet to be attempted?
- Should the government introduce a presumptive tax regime for self-employed professionals?
- Does tax evasion among self-employed professionals lead to a significant revenue loss for the country? Are some sectors more problematic than others?
- Are the current policies and legislation targeting the hard-to-tax, and particularly self-employed professionals, properly designed and effective?
- Is tax evasion among self-employed professionals in Kenya a tax policy, tax legislation or tax administration problem?

- What are the greatest barriers to effective taxation of self-employed professionals on the revenue authority's side, and what are the hindrances to compliance on the taxpayer's side?
- Should the tax authority spend its arguably limited resources in an attempt to improve taxation of self-employed professionals or should it pursue other priority areas? If it should target the self-employed, how would those resources be best spent?
- Is there an argument for increased cooperation between the revenue authority and professional associations in an effort to increase compliance among their members?

Table 8: Codes Drawn from the Interviews with the Dentists

| Financial Management | Peer Perception | Taxpayer Visibility | Ease of Compliance | The Evasion Circle | Perception of Consequences of Evasion |
|--|--|---|---|--|--|
| <p>Dentists do not know how to run businesses</p> <p>Lack of financial accountability and oversight leads to evasion</p> <p>Knowledge on financial management and tax rules encourage compliance</p> | <p>Medics pad up expenses to pay less tax</p> <p>Hospitals evade customs duties</p> <p>Medical institutions evade tax</p> <p>Tax evading employer normalises evasion</p> | <p>The risk of being caught is low</p> <p>Small taxpayer can get away with evasion</p> <p>Dentists are not visible</p> <p>Invisible income will not be declared</p> | <p>Tax compliance as an SME is difficult</p> <p>Tax compliance as an SME is time consuming</p> <p>Many people want to comply, but system impedes them</p> <p>Inability to comply without professional</p> | <p>Medical institutions abuse WHT rules encouraging locum evasion</p> <p>Dentists collude with employers to evade tax</p> <p>Clinics and dentists collude to evade tax</p> | <p>There are no consequences of evading tax</p> <p>The fines for evasion are minimal</p> <p>It is not worth it to comply</p> |

| Financial Management | Peer Perception | Taxpayer Visibility | Ease of Compliance | The Evasion Circle | Perception of Consequences of Evasion |
|---|--|---|---|--|---|
| <p>Medics lack financial management knowledge</p> <p>Lack of financial structures results in evasion</p> <p>Financial mismanagement leads to clinic collapse</p> <p>The Medical Board is not interested in proper structure and record keeping in clinics</p> | <p>Knowledge of others successfully evading tax encourages evasion</p> <p>Taxpayers believe anecdotal evidence about risk of evasion</p> <p>Majority of dentists evade tax</p> <p>There is no incentive to comply when peers evade</p> | <p>Inter-government connectivity leads to evasion</p> <p>Inter-government connectivity encourages compliance</p> <p>The government does not monitor taxpayers</p> | <p>help discourages compliance</p> <p>Using the KRA website is hard</p> <p>Filing tax returns is complex</p> <p>Tax is complicated</p> <p>Compliance requires expert assistance</p> <p>Self-reporting and complying is hard</p> | <p>Evasion by institutions encourage evasion by dentists</p> | <p>The fear of back taxes discourages compliance</p> <p>If one can get away with evasion one should not comply</p> <p>Malpractice is riskier than evasion</p> <p>The government is too lazy to find evading taxpayers</p> |

| Financial Management | Peer Perception | Taxpayer Visibility | Ease of Compliance | The Evasion Circle | Perception of Consequences of Evasion |
|---|---|--|--|---------------------------|--|
| <p>Financial organisation leads to compliance</p> <p>Record keeping enables compliance</p> <p>Full time in-house accountant enables compliance</p> <p>Financial and accounting transparency enable compliance</p> | <p>The law relies on one's morality</p> <p>It is unfair to pay tax when others evade</p> <p>There is a lot of underreporting among dentists</p> <p>Medics evade tax</p> | <p>Dentists do not fear audits or being caught</p> <p>Self-employment is the easiest way to evade tax</p> <p>The ability to earn invisible untaxed income makes locum attractive</p> <p>WHT increases visibility and</p> | <p>Tax information is not simple</p> <p>The cost of compliance is high</p> <p>iTax has increased compliance time</p> | | <p>The government does not monitor taxpayers</p> <p>Taxpayers need to be monitored</p> <p>Dentists do not fear audits or being caught</p> <p>Higher sanctions encourage compliance</p> <p>Dentists evade because KRA does not track them</p> |

| Financial Management | Peer Perception | Taxpayer Visibility | Ease of Compliance | The Evasion Circle | Perception of Consequences of Evasion |
|--|-----------------|---|--------------------|--------------------|---|
| <p><i>Taxpayer Knowledge</i></p> <p>Dentists lack knowledge on taxation of self-employment income</p> <p>Dentists lack knowledge about tax obligations</p> <p>Dentists lack knowledge about WHT rules</p> <p>Tax knowledge is inaccessible</p> | | <p>encourages compliance</p> <p>If you do not remit taxes KRA cannot see you</p> <p>Paying taxes increases one's visibility</p> <p>The risk of being caught is high</p> | | | <p>Fear of breaking the law encourages compliance</p> <p>Fear of being caught encourages compliance</p> |

| Financial Management | Peer Perception | Taxpayer Visibility | Ease of Compliance | The Evasion Circle | Perception of Consequences of Evasion |
|---|-----------------|--|--------------------|--------------------|---------------------------------------|
| <p>Taxpayers cannot distinguish between avoidance and evasion</p> <p>Taxpayers cannot tell criminal tax behaviour</p> <p>Lack of knowledge leads to evasion</p> <p>Entrepreneurs starting out would benefit from a starter pack</p> | | <p>Small taxpayers can get away with evasion</p> <p>iTax has led to increased compliance</p> <p>iTax has made evasion harder</p> <p>iTax does not pick up partial compliance</p> | | | |

| Financial Management | Peer Perception | Taxpayer Visibility | Ease of Compliance | The Evasion Circle | Perception of Consequences of Evasion |
|--|-----------------|---------------------|--------------------|--------------------|---------------------------------------|
| <p>Dentists do not know how to pay tax</p> <p>Dentists lack knowledge when transitioning from government service to self-employment</p> <p>Dentists should be taught tax planning</p> <p>Dentists believe that complying results in low income</p> | | | | | |

| Financial Management | Peer Perception | Taxpayer Visibility | Ease of Compliance | The Evasion Circle | Perception of Consequences of Evasion |
|---|------------------------|----------------------------|---------------------------|---------------------------|--|
| <p>Lack of knowledge about available tax reliefs encourages evasion</p> <p>Basic taxation and accounting knowledge should be widely available</p> | | | | | |

Table 9: Codes Drawn from the Interviews with the Lawyers

| Unfairness | Public Perception of the Revenue Authority | Legal Form of the Firm | Firm Growth and Formalisation | Social Contract | The V.A.T. Factor | Regulatory Failures |
|---|--|--|---|--|--|--|
| <p>Systemic unfairness encourages evasion</p> <p>The audit process is unfair</p> <p>There is unfairness in the tax system</p> <p>VAT is an unfair burden</p> <p>VAT on legal fees is unfair</p> | <p>KRA is blind to SME challenges</p> <p>Revenue officials want bribes</p> <p>KRA needs to utilise more technology</p> <p>KRA is inefficient</p> <p>KRA has a pre-conceived negative agenda</p> <p>KRA is unreasonable</p> <p>KRA is disrespectful</p> | <p>Partnerships have better compliance rates</p> <p>Sole proprietors evade more tax</p> <p>Sole proprietors lack accountability</p> <p>Partnerships are more accountable</p> <p>Partnerships have greater financial accountability</p> | <p>Early exposure to compliance culture encourages desire to comply</p> <p>Firm growth leads to compliance</p> <p>Tax is not a priority for early entrepreneurs</p> <p>The money-cost of compliance is high</p> | <p>The government misuses tax</p> <p>Tax does not translate into service delivery</p> <p>There is no value for tax paid</p> <p>There is no transparency in tax use</p> <p>Citizens are cheated</p> <p>Citizens do not know how tax is used</p> | <p>Evasion of VAT leads to evasion of IT</p> <p>Evading VAT is easy</p> <p>VAT is evaded by keeping two sets of files</p> <p>VAT is charged but not remitted</p> | <p>LSK accounting rules encourage compliance</p> <p>LSK should tackle undercutting</p> <p>LSK accounting rules are flouted</p> <p>LSK might help with compliance</p> |

| Unfairness | Public Perception of the Revenue Authority | Legal Form of the Firm | Firm Growth and Formalisation | Social Contract | The V.A.T. Factor | Regulatory Failures |
|--|--|--|---|---|--|---|
| <p>Facilitation fees paid to a public servant is a form of tax</p> <p>VAT is a barrier to access to justice</p> <p>Corruption + taxation= double taxation</p> <p>Corruption and taxation are the same</p> <p>WHT threshold is too high</p> | <p>KRA is aggressive</p> <p>KRA's aggressiveness promotes secrecy</p> <p>KRA is to be feared</p> <p>KRA is intimidating</p> <p>KRA's agenda is to penalise</p> <p>Tax sensitisation workshops are traps</p> <p>KRA needs to change public perception</p> | <p>Partnerships keep better financial records</p> <p>Partnerships are more financially organised</p> <p>Corporate clients encourage compliance</p> <p>Sole proprietors are financially undisciplined</p> <p>Partnerships are a vehicle for future compliance</p> | <p>Entrepreneurs lack knowledge when starting</p> <p>Corporate clients push towards compliance</p> <p>Level of compliance varies by firm age</p> <p>Firm growth increases visibility</p> <p>Tax compliance is gradual</p> | <p>Corruption does not justify evasion</p> <p>Corruption mitigates evasion</p> <p>Other channels for holding government to account might reduce evasion</p> <p>The government does not give value for tax</p> <p>Corruption justifies evasion</p> | <p>VAT court ruling creates uncertainty</p> <p>VAT court order enables evasion</p> <p>Clients resist VAT</p> <p>Evasion of VAT attracts or retains clients</p> | <p>LSK intervention might lead to more competition</p> <p>LSK compliance rules are abused</p> |

| Unfairness | Public Perception of the Revenue Authority | Legal Form of the Firm | Firm Growth and Formalisation | Social Contract | The V.A.T. Factor | Regulatory Failures |
|--|--|---|---|---|-------------------|---------------------|
| <p>The system is blind to the cash flow problems of SMEs</p> <p>The tax rate is unfair</p> <p>High tax rates encourage bribery</p> <p>Removal of unfair tax (VAT) will encourage compliance (IT)</p> <p>Evasion of VAT is a statement of</p> | <p>KRA is scary</p> <p>KRA doesn't understand legal business</p> <p>KRA is only interested in HNIs</p> <p>KRA is aloof to taxpayers' challenges</p> <p>KRA is feared</p> <p>Revenue officials don't pay helpful or friendly visits</p> | <p>Partnerships discourage or prevent <i>ad hoc</i> withdrawals</p> | <p>The cost of compliance encourages evasion</p> <p>Entrepreneurs lack knowledge about filing returns as a business</p> <p>Employment of staff encourages compliance</p> <p>Firm growth leads to formalisation</p> <p>Formalisation encourages compliance</p> | <p>Taxation has no benefit because of corruption</p> <p>There is no value for tax</p> <p>Tax collection has improved but services have not</p> <p>Evasion= holding the government accountable</p> <p>Taxpayers have donated power and</p> | | |

| Unfairness | Public Perception of the Revenue Authority | Legal Form of the Firm | Firm Growth and Formalisation | Social Contract | The V.A.T. Factor | Regulatory Failures |
|-------------------------------------|--|------------------------|--|---|-------------------|---------------------|
| <p>rebellion against unfair tax</p> | <p>KRA intends to generate fear</p> <p>KRA is more interested in bribes than tax</p> <p>KRA doesn't have a relationship with taxpayers</p> <p>A relationship with KRA=pardoning back taxes and penalties</p> | | <p>Lawyers set up firms without knowledge</p> <p>Lawyers rush into setting up firms</p> <p>Small firms do not keep proper accounts</p> <p>Small firms are difficult to audit</p> | <p>responsibility to government</p> <p>Taxpayers have a responsibility to financially support government</p> <p>The government has run amok</p> <p>The government cannot account for use of resources</p> | | |

| Unfairness | Public Perception of the Revenue Authority | Legal Form of the Firm | Firm Growth and Formalisation | Social Contract | The V.A.T. Factor | Regulatory Failures |
|------------|--|------------------------|--|--|-------------------|---------------------|
| | <p>A relationship with KRA= paying friendly helpful visits</p> <p>KRA's role viewed as interference</p> <p>KRA's work constructed as 'problematic'</p> <p>KRA harasses taxpayers</p> <p>There are gentle and rough officers</p> <p>If you are caught you can escape with a bribe</p> | | <p><i>The Cash Payment Factor</i></p> <p>Large cashless payments make you visible</p> <p>Cashless payments encourage financial organisation</p> <p>Lawyers with individual cash paying clients evade tax</p> | <p>The government is not providing services</p> <p>The government is not providing services at a lower level than obligated</p> <p>Citizens are justified in paying tax at a lower level to match services received</p> <p>Tax evasion is an attempt at achieving fairness</p> | | |

| Unfairness | Public Perception of the Revenue Authority | Legal Form of the Firm | Firm Growth and Formalisation | Social Contract | The V.A.T. Factor | Regulatory Failures |
|------------|---|------------------------|---|---|-------------------|---------------------|
| | <p>KRA is the enemy</p> <p>KRA doesn't offer sector-based training</p> <p>KRA should pay friendly visits</p> <p>KRA is to be feared</p> <p>KRA's role is to train on effective tax planning</p> | | <p>Corporate clients push lawyers towards compliance</p> <p>Cash payments make you invisible</p> <p>Bank payments make you visible</p> <p>Mobile technologies enable compliance</p> <p>Cash payments make it harder to comply</p> | <p>Government is collecting more tax than it requires</p> <p>Government is wasting tax</p> <p>Taxpaying at a rate that supports wastage is unjustifiable</p> <p>VAT is stolen</p> <p>Prudent use of tax encourages compliance</p> | | |

| Unfairness | Public Perception of the Revenue Authority | Legal Form of the Firm | Firm Growth and Formalisation | Social Contract | The V.A.T. Factor | Regulatory Failures |
|------------|--|------------------------|--|---|-------------------|---------------------|
| | | | KRA's access to bank accounts increases risk of getting caught | People in government are stealing tax money Taxpaying benefits others but robs the payer | | |

| Internal Financial Management | Peer Perception | Firm Visibility | Ease of Compliance | The Evasion Circle | Erosion of Professional Standards |
|---|---|--|---|---|---|
| <p>Financial indiscipline leads to evasion</p> <p>Financial disorganisation leads to evasion</p> <p>Lawyers lack financial knowledge and expertise</p> <p>A proper in-house accounting office encourages compliance</p> | <p>Lawyers are evading tax</p> <p>Lawyers pad expenses to evade tax</p> <p>Lawyers underreport their income</p> <p>Most lawyers evade tax</p> <p>Large law firms evade most tax</p> <p>Lawyers evade tax deliberately</p> | <p>Large law firms cannot hide from KRA</p> <p>KRA is aware of taxpayers</p> <p>Smaller law firms are invisible</p> <p>iTax leads to visibility</p> <p>The risk of getting caught is high</p> <p>Older firms are visible</p> | <p>It is hard to comply without expert help</p> <p>Tax information is not readily accessible</p> <p>Tax payment process is hard</p> <p>KRA is not digitally accessible</p> <p>Legal knowledge does not translate into</p> | <p>Lawyers collude with clients</p> <p>Lawyers collude with auditors and accountants</p> <p>One can get a TCC despite underreporting</p> <p>Evasion by clients leads to evasion by lawyers</p> <p>Lawyers abuse client account privileges</p> | <p>Inadequate remuneration encourages evasion</p> <p>Undercutting encourages evasion</p> <p>Erosion of professional standards encourages evasion</p> <p>Heavy discounts encourage evasion</p> |

| Internal Financial Management | Peer Perception | Firm Visibility | Ease of Compliance | The Evasion Circle | Erosion of Professional Standards |
|--|---|--|---|---|--|
| <p>Lawyers lack tax and accounting knowledge</p> <p>Proper financial statements encourage compliance</p> <p>Lack of internal structures hampers compliance</p> <p>Improper record keeping leads to evasion</p> | <p>Lawyers evade tax out of ignorance</p> <p>Tax compliance among lawyers is low</p> <p>Most evasion is out of ignorance</p> <p>Lawyers keep two sets of files</p> <p>Lawyers destroy tax related documents and paper trail</p> | <p>Risk of getting caught is moderate</p> <p>KRA cannot catch up with small firms</p> <p>Taxpayer's location determines the risk of being caught</p> <p>Lawyers' clients are audited but lawyers are not</p> | <p>technical tax knowledge</p> <p>The time-cost of compliance is high</p> <p>iTax is hard to use</p> <p>iTax is time consuming</p> <p>KRA taxpayer training is poorly marketed</p> <p>KRA does not communicate with taxpayers</p> | <p>Erosion of professional standards encourages evasion</p> | <p>Undercutting leads to evasion</p> |

| Internal Financial Management | Peer Perception | Firm Visibility | Ease of Compliance | The Evasion Circle | Erosion of Professional Standards |
|-------------------------------|--------------------------------------|---|---|--------------------|-----------------------------------|
| | Small firms underreport their income | <p>Small firms underreport their income</p> <p>Evasion among small firms is high</p> <p>WHT makes taxpayers visible</p> <p>Firm growth leads to visibility</p> <p>Small firms are hard to audit</p> | <p>There is insufficient information for tax compliance</p> <p>Tax compliance should be simplified and demystified</p> <p>KRA should increase general but direct communication with taxpayers</p> | | |

| Internal Financial Management | Peer Perception | Firm Visibility | Ease of Compliance | The Evasion Circle | Erosion of Professional Standards |
|-------------------------------|-----------------|--|---|--------------------|-----------------------------------|
| | | KRA's access to bank accounts increases risk of getting caught | <p>Lawyers have insufficient knowledge for compliance</p> <p>KRA should assist new entrepreneurs</p> <p>Ease of payment of encourage compliance</p> <p>Tax compliance is complex</p> <p>Tax compliance is expensive</p> | | |

| Internal Financial Management | Peer Perception | Firm Visibility | Ease of Compliance | The Evasion Circle | Erosion of Professional Standards |
|-------------------------------|-----------------|-----------------|--|--------------------|-----------------------------------|
| | | | <p>Lawyers know their tax obligations</p> <p>The cost of compliance is higher than the cost of a bribe</p> <p>Tax is mysterious</p> <p>KRA has not educated all sectors</p> <p>Filing nil returns is the solution to lack of knowledge</p> | | |

| Internal Financial Management | Peer Perception | Firm Visibility | Ease of Compliance | The Evasion Circle | Erosion of Professional Standards |
|-------------------------------|-----------------|-----------------|--|--------------------|-----------------------------------|
| | | | <p>Self-assessment for the self-employed is too hard</p> <p>Proper compliance channels are too slow</p> <p>Bribery & facilitation is efficient</p> <p>It is easy to bribe your way out when caught</p> | | |

Miscellaneous Codes

- Evasion is a crime
- Taxpayers fear back taxes
- Successful evasion encourages continued evasion
- Lifestyle pressures encourage evasion
- Facilitation increases the cost of compliance
- Tax is an overhead business wants kept low
- Taxpayers want incentives
- Christian faith motivates compliance
- Tax slows down firm growth
- Tax slows down personal growth
- Under declaring income enables firm and personal growth

Table 10: Codes from the Interviews with Tax Experts

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|---------------------------------------|--|--|---|---|---|
| Professionals are hard to tax because of they do not register with the RA | Professionals file inaccurate returns | Kenyans lack a tax paying culture | RA’s goal is voluntary compliance | RA’s long-term policy must focus on the HTT | KRA/Treasury need power to conduct studies on taxpayers & key revenue drivers | Presumptive tax is the best option for taxing the HTT |
| When pursued, professionals close shop and move | Professionals keep records with gaps | Tax morale is low in Kenya | Mandatory compliance is expensive | HTT are majority in the economy | No studies preceded turnover tax hence its failure | Constitutionality of presumptive tax is a concern |
| Weak infrastructure inhibits tax collection | Auditing professionals is hard | Low tax morale inhibits compliance in | Mandatory compliance drives people towards | Reducing the HTT leads to gains in | Lawmakers do not understand | Presumptive tax is very primitive |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|--|------------------------------------|---|--|--|---|--|
| | | Kenya & 3 rd world countries | avoidance & evasion | direct and indirect taxes | economics and tax law | |
| Interconnectivity of government databases enable collection of third-party information | Solution is taxpayer awareness | Impunity by high level officials lowers tax morale | Mandatory compliance is investment for relatively little collections | MNCs are over-taxed | Parliamentarians are bribed by stakeholders in tax policy | Enforcing presumptive tax on professionals is absurd |
| Taxpayers are hard to trace | Solutions is taxpayer segmentation | Impunity by high level officials encourages impunity among citizens | Government aiming for trust and facilitation | Overreliance on MNCs motivated by their predictability | A clear policy paper preceded turnover tax | Presumptive tax poses a constitutional challenge |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|--|--|--|--|--|--|
| The PIN doesn't work as well as it should | KRA needs dedicated standalone marketing and communication dept. | Taxpayers know they can bribe if caught | Mandatory compliance and penalties have not worked | RA needs to diversify its revenue base | Tensions and cross-speak between KRA and Treasury | Treating the HTT differently poses legislative and equity concerns |
| The solution to evasion is better technology infrastructure | Professionals are highly educated | Lack of support for government motivates evasion | Focused audits and investigations could encourage compliance | It is easier to pursue MNEs | KRA's lack of adequate resources and staff makes it hard to pursue professionals | Turnover tax is primitive and transitional |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|---|---|---|--|---|---|
| KRA needs intelligence-driven compliance management | Higher education should translate into greater tax awareness | Socio-political discontent among professionals motivates evasion | Stiffer penalties will encourage compliance | Pursuing small taxpayers is costly | KRA needs power to conduct studies on taxpayers and key revenue drivers | Professionals should not be subject to presumptive tax |
| Empowering small stations increases collections | Charging of varied fees enables evasion (harder to estimate income) | Mobile money, foreign accounts and cash businesses facilitate evasion | RA should conduct random inspection of WHT | Article 201 Constitution-fair distribution of tax burden | KRA needs increased manpower | Presumptive tax does not work for professionals because of the unpredictability of their income |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|---|---|--|--|------------------------------|--|
| Investing in partnerships and systems increases collections | Sole proprietor professionals are biggest evaders | Corruption exacerbates evasion | Going after tax payers, industry by industry, will reduce evasion | KRA attitude towards MNE compliance is wrong | | Implementation of presumptive tax is hard |
| Taxpayers do not comply because they know there are no consequences | Larger firms have checks and balances | Informal businesses are cash-based/liquid so can easily bribe | Increase in enforcement of rental; income tax=increase I collections | Kenya’s tax base is diminishing | | Professionals have a steady revenue stream and so presumptive tax is not ideal |
| RA has not leveraged technology | Tax system burden and complexity encourages evasion | Evasion by briefcase consultants *and maybe professionals* | It is worth engaging resources to | KRA’s targets are unrealistic | | Subjecting professionals to |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying 'Culture' | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|--|---|---|--|-----------------------|---|
| | | helping secure construction permits and government tenders etc protected by politicians | encourage voluntary compliance among self-employed professionals | | | presumptive tax is unconstitutional |
| Taxpayers in developing countries are invisible | Increased taxpayer education that begins earlier will reduce evasion | If one can 'buy' a compliance certificate, then it defeats the purpose | Enforcement is a big challenge and voluntary compliance is preferable | KRA focuses too much on top 20 corporate taxpayers | | Presumptive tax for professionals would be cumbersome |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|---|--|---|---|------------------------------|--|
| Integration of government databases increases taxpayer visibility | Taxpayer education efforts are insufficient | Corruption is a big impediment to compliance | | Over-focus on MNEs is a road to nowhere | | Professionals should be subject to presumptive tax |
| Stand-alone and disparate databases enable evasion | Need for sector-targeted training | Undocumented cash transactions and corruption facilitate evasion | | Medium taxpayers’ office has insufficient structures. | | |
| Digitisation is the solution | Targeted administrative | It is impossible to obtain optimum level | | There is a need for small taxpayers’ office. | | |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|---|--|---|---|------------------------------|---------------------------------|
| | efforts will increase compliance | of collection without controlling corruption | | | | |
| RA’s lack of capacity to capture data enables evasion | Lumping all taxpayers together is a barrier to compliance | | | Building structures for small taxpayers enables businesses to grow with a culture of compliance | | |
| Data collection can improve compliance | Lawyers comply only when they begin working for | | | Government is paying lip service | | |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying 'Culture' | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|--|--|---|--|------------------------------|---------------------------------|
| | large corporate clients/bid for work | | | to expanding the tax base | | |
| iTax can improve compliance | Self-employed professionals deduct PAYE and statutory deductions from employers and do not remit (theft) | | | KRA is lax and only interested in pursuing large taxpayers | | |
| ETR machines can improve compliance among providers | Challenge posed by poor record keeping by taxpayers | | | KRA has two conflicting objectives-meeting targets | | |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying 'Culture' | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|----------------------|-----------------------------------|----------------------------------|---|-----------------------|--------------------------|
| servicing large clients | | | | and expanding revenue base. Need to shift from one to the other | | |
| Net-worth assessments using PIN & linking details can help get accurate assessments | | | | Turnover of MNEs is going down | | |
| Effective taxpayer identification will reduce evasion | | | | KRA's collection from consumption corporate and | | |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying 'Culture' | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|--|----------------------|-----------------------------------|----------------------------------|--|-----------------------|--------------------------|
| | | | | customs is slowing down | | |
| Hard to tax informal sector because they are nomadic, and we lack advanced tracking data | | | | KRA and Treasury dishonest about saturation point with MNEs | | |
| Lifestyle audits are a good and simple idea | | | | KRA collections from TP not as much as they want the public to believe | | |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|-----------------------------|--|---|--|------------------------------|---------------------------------|
| PIN does not work as well as it should | | | | The law is invisible to SMEs/self-employed professionals | | |
| Lack of interface between government departments inhibits widening of tax net | | | | The law has insufficient incentives for SMEs/self-employed professionals | | |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying ‘Culture’ | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|--|-----------------------------|--|---|---|------------------------------|---------------------------------|
| Evasion thrives where there are few structures | | | | Tax policy does not favour SMEs/self-employed professionals | | |
| ITax & requirement for PIN for every transaction is pushing Kenya towards voluntary compliance | | | | | | |

| Data-Driven Compliance Management | Blaming the Taxpayer | Tax Morale & Tax Paying 'Culture' | Mandatory v Voluntary Compliance | Diversifying the Revenue Base | Our Hands are Tied... | Presumptive Tax...or not |
|---|-----------------------------|--|---|--------------------------------------|------------------------------|---------------------------------|
| Government interconnection will enable total visibility of taxpayer | | | | | | |

| Partnering with Professional Associations | 'It's Your Fault!': Pointing Fingers at the Revenue Authority |
|---|--|
| RA should partner with professional associations and regulators | HTT challenge is an administrative not policy/legislative problem |
| Professional associations/regulators have a role to play | Revenue authority has failed in data collection, mapping of taxpayers and education of taxpayers |
| Some professional associations like ICPAK help in compliance of their members | Revenue authority has not leveraged technology |
| Cooperation between central and county government can help with enforcement | Revenue has failed to formalise the informal using data |
| Professional associations should check compliance status of members | Enforcement of the law and not the law itself is the problem |
| Involving professional association /regulators will put off members | Without enforcement, good law is useless |
| What is the incentive for the association/regulator? | KRA is responsible for failure to enforce the law |
| Professional associations need to play a role in encouraging compliance | KRA is inefficient because they have outdated and incorrect records |

| Partnering with Professional Associations | ‘It’s Your Fault!’: Pointing Fingers at the Revenue Authority |
|--|---|
| There is no effort at all by professional associations to ensure compliance by members | Failure to link WHT payments to income tax payments on iTax is enabling undeclared income |
| Evasion should be deemed professional misconduct | KRA needs to employ temporary staff to review sample of tax returns as they are filed to spot red flags |
| | Previously KRA was not vigilant |
| | KRA website is not user friendly |
| | There is a lacuna in iTax when it comes to SMEs and self-employed |
| | The iTax return is a template for a manufacturing firm |
| | iTax is hard to navigate for common entrepreneur with little tax and accounting knowledge |
| | KRA’s assumption of homogeneity of taxpayers inhibits compliance |

| Partnering with Professional Associations | 'It's Your Fault!': Pointing Fingers at the Revenue Authority |
|--|---|
| | KRA's assumption of homogeneity of taxpayers inhibits effectiveness of taxpayer education and marketing |
| | KRA is too combative and always fighting with professional associations |
| | iTax will tell taxpayer they are not compliant but will not give clear instruction on what to do next |
| | KRA needs to make compliance easier |
| | Systems need to be simple enough for anyone to comply |
| | Tax is a competing expense and KRA has not made compliance easy enough to encourage it |
| | As a revenue official, even I find it hard to pay my taxes and file returns |
| | The law may be archaic but KRA should enforce the law whether it is good or bad |
| | Mobile platforms for tax payments would encourage compliance |

2. Tweet posted on 18 June 2018⁶⁷⁸

Kenya Revenue @KRACorporate · Jun 18
"Illicit trade in contraband goods continues to affect revenue collection immensely. Measures such as enforcement laws, stakeholder partnerships and new technology have been adopted to curb the menace" says Masoudi, KRA Chief Manager Excise

4 3 1

Mwananchi
@kenyacitizen11 [Follow](#)

Replying to @KRACorporate

Revenue collection.??? What of corruption?

9:30 PM - 19 Jun 2018

3. Tweet posted on 18 June 2018.⁶⁷⁹

KRA Care @KRACare · Jun 18
The 2018/19 budget proposals include measures to promote industrialization, encourage local investments, and create incentives in the agricultural and manufacturing sectors #BudgetKE2018 #BudgetBreakdown. Join the insightful conversation via #BudgetandTaxes2018

7 4 9

ashikmuhammad
@jinamr [Follow](#)

Replying to @KRACare

How much is budgeted for looting? Tell us the real stuff, we are sick and tired of the fallacious BS you call insightful conversation. There is nothing insightful in this hopeless nation.

1:18 AM - 18 Jun 2018

1 Retweet

1 1

⁶⁷⁸ 'Tweet Posted on 18 June 2018 by the Handle @KRACorporate. Response by the Handle @kenyacitizen11.' (Twitter, 19 June 2018) <<https://twitter.com/kenyacitizen11/status/1009292320079073283>> accessed 3 October 2018.

⁶⁷⁹ 'Tweet Posted on 18 June 2018 by the Handle @KRACare. Response by the Handle @jinamr.' (Twitter, 18 June 2018) <<https://twitter.com/jinamr/status/1008624890159816704>> accessed 3 October 2018.

4. Tweet posted on 18 June 2018.⁶⁸⁰



KRA Care @KRACare · Jun 18
The 2018/19 budget proposals include measures to promote industrialization, encourage local investments, and create incentives in the agricultural and manufacturing sectors #BudgetKE2018 #BudgetBreakdown. Join the insightful conversation via #BudgetandTaxes2018

7 4 9

Mike @GachuhiWainaina Follow

Replying to @KRACare

Kenyans rarely see value for the huge taxes you burden them with, taxing poor people to death so that corrupt scum can live in bliss. Budgets are mostly inflated to include a looting allowance, recurrent expenditure is not sustainable & only a small fraction goes to development

2:26 AM - 18 Jun 2018

4

⁶⁸⁰ 'Tweet Posted on 18 June 2018 by the Handle @KRACare. Response by the Handle @GachuhiWainaina.' (Twitter, 18 June 2018) <<https://twitter.com/GachuhiWainaina/status/1008642171778621440>> accessed 3 October 2018.

5. Tweet posted on 18 June 2018.⁶⁸¹



Kenya Revenue @KRACorporate · Jun 18
How often do you transfer money via mobile?.The 2018/19 budget proposes an increase of Excise Duty fees charged on money transfer services by cellular phone service providers from 10% to 12% @SafaricomPLC @AIRTEL_KE @TelkomKenya #BudgetKE2018 #BudgetandTaxes2018 #BudgetBreakdown

13 replies 10 retweets 10 likes

John Paul @itsJPMuli Follow

Replying to @KRACorporate @SafaricomPLC and 2 others

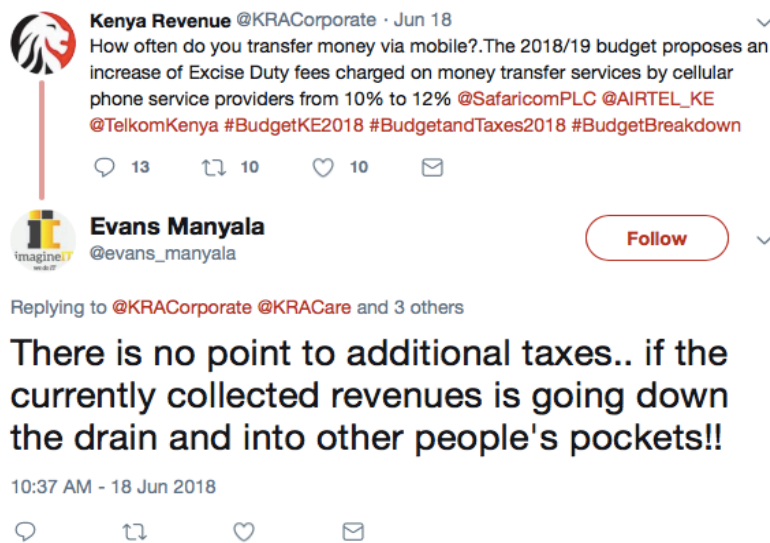
After collecting all this tax it's "eaten" up by corrupt politicians and public servants who will not even pay taxes on their ill-gotten wealth. A normal day in Kenya I suppose.

3:51 AM - 18 Jun 2018

1 Retweet 2 Likes

1 reply 1 retweet 2 likes

6. Tweet posted on 18 June 2018.⁶⁸²



Kenya Revenue @KRACorporate · Jun 18
How often do you transfer money via mobile?.The 2018/19 budget proposes an increase of Excise Duty fees charged on money transfer services by cellular phone service providers from 10% to 12% @SafaricomPLC @AIRTEL_KE @TelkomKenya #BudgetKE2018 #BudgetandTaxes2018 #BudgetBreakdown

13 replies 10 retweets 10 likes

Evans Manyala @evans_manyala Follow

Replying to @KRACorporate @KRACare and 3 others

There is no point to additional taxes.. if the currently collected revenues is going down the drain and into other people's pockets!!

10:37 AM - 18 Jun 2018

1 reply 1 retweet 1 like

⁶⁸¹ 'Tweet Posted on 18 June 2018 by the Handle @KRACorporate. Response by the Handle @itsJPMuli.' (Twitter, 18 June 2018) <<https://twitter.com/itsJPMuli/status/1008663573239877632>> accessed 3 October 2018.

⁶⁸² 'Tweet Posted on 18 June 2018 by the Handle @KRACorporate. Response by the Handle @evans_manyala' (Twitter, 18 June 2018) <https://twitter.com/evans_manyala/status/1008765691145617409> accessed 3 October 2018.

7. Tweet posted on 30 July 2018.⁶⁸³

Kenya Revenue @KRACorporate · Jul 30
We are at @KICC_kenya for day 2 of the #KenyaTradeWeek2018. If you're around, visit our tent to learn more about our services.



2 20 31

sammir ozil mwash @sammirozilmwash · Jul 31
Services? Seriously apart from taking people's cash what else do you do?

1

Matrix Cyber Cafe @matrixcyberc Follow

Replying to @sammirozilmwash @KRACorporate @KICC_kenya

They are also mandated to Account for the tax collected.

⁶⁸³ 'Tweet Posted on 30 July 2018 by the Handle @KRACorporate. Responses by the Handles @sammirozilmwash and @matrixcyberc.' (Twitter, 31 July 2018) <<https://twitter.com/matrixcyberc/status/1024289405245292544>> accessed 3 October 2018.

8. Tweet posted on 3 October 2018.⁶⁸⁴



⁶⁸⁴ 'Tweet Posted on 3 October 2018 by the Handle @KRACare. Response by the Handle @Erick248k' (Twitter, 3 October 2018) <<https://twitter.com/Erick248k/status/1047390021915951104>> accessed 4 October 2018.

9. Tweet posted on 1 October 2018.⁶⁸⁵

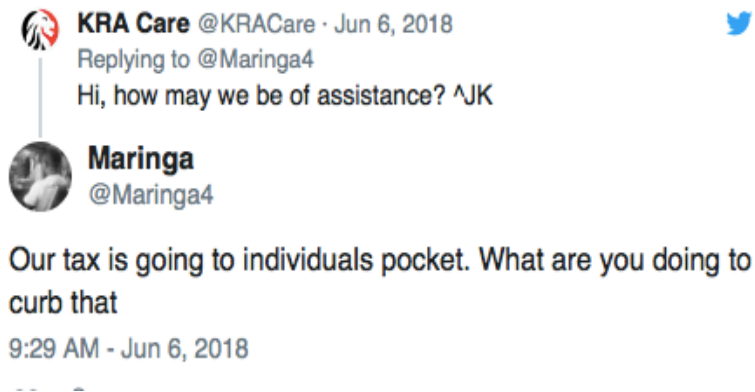


⁶⁸⁵ 'Tweet Posted on 1 October 2018 by the Handle @KRACorporate. Response by the Handle @kutswalemis16.' (Twitter, 1 October 2018) <<https://twitter.com/kutswalemis16/status/1046832112572207104>> accessed 4 October 2018.

10. Tweet posted on 28 May 2018.⁶⁸⁶



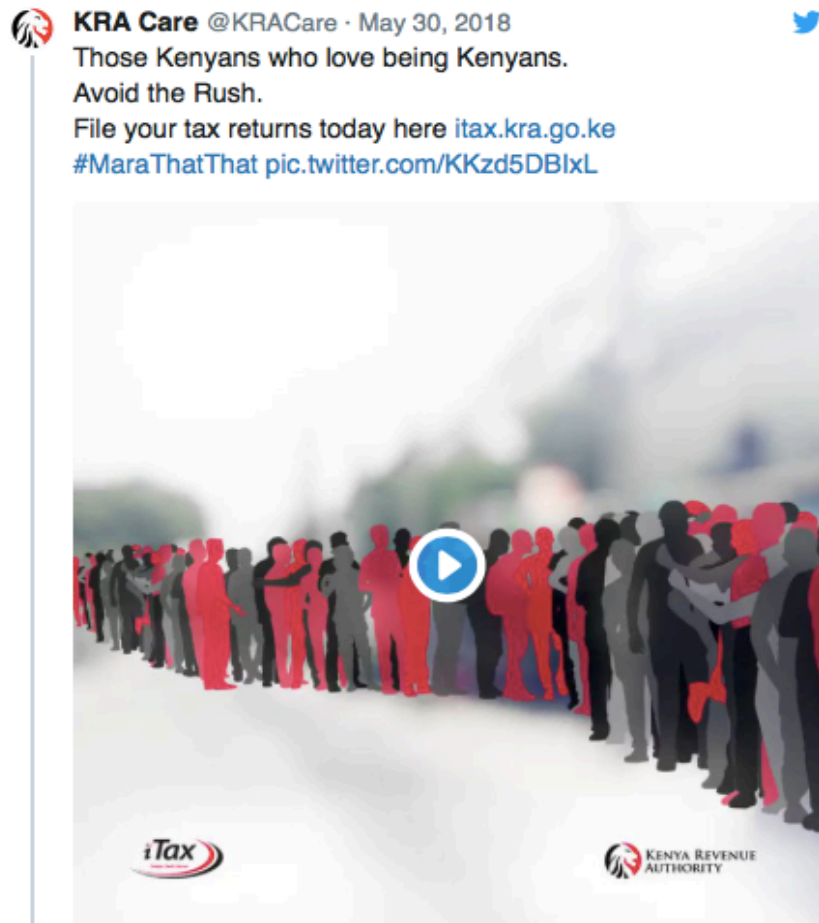
11. Tweet posted on 6 June 2018.⁶⁸⁷



⁶⁸⁶ 'Tweet Posted on 28 May 2018 by the Handle @KRACare. Response by the Handle @InsecurityKE.' (Twitter, 28 May 2018) <<https://twitter.com/InsecurityKE/status/1001025890002841600>> accessed 4 October 2018.

⁶⁸⁷ 'Tweet Posted on 6 June 2018 by the Handle @KRACare. Response by the Handle @Maringa4.' (Twitter, 6 June 2018) <<https://twitter.com/Maringa4/status/1004279205088190465>> accessed 4 October 2018.

12. Tweet posted on 30 May 2018.⁶⁸⁸



kiruja jason
@gkiruja

You also need to tweet anti-corruption message, there are those stealing our taxes

8:46 AM - May 31, 2018

⁶⁸⁸ 'Tweet Posted on 30 May 2018 by the Handle @KRACare. Response by the Handle @gkiruja.' (Twitter, 31 May 2018) <<https://twitter.com/gkiruja/status/1002094035857788929>> accessed 4 October 2018.

13. Tweet posted on 30 May 2018.

 **KRA Care** @KRACare · May 30, 2018 

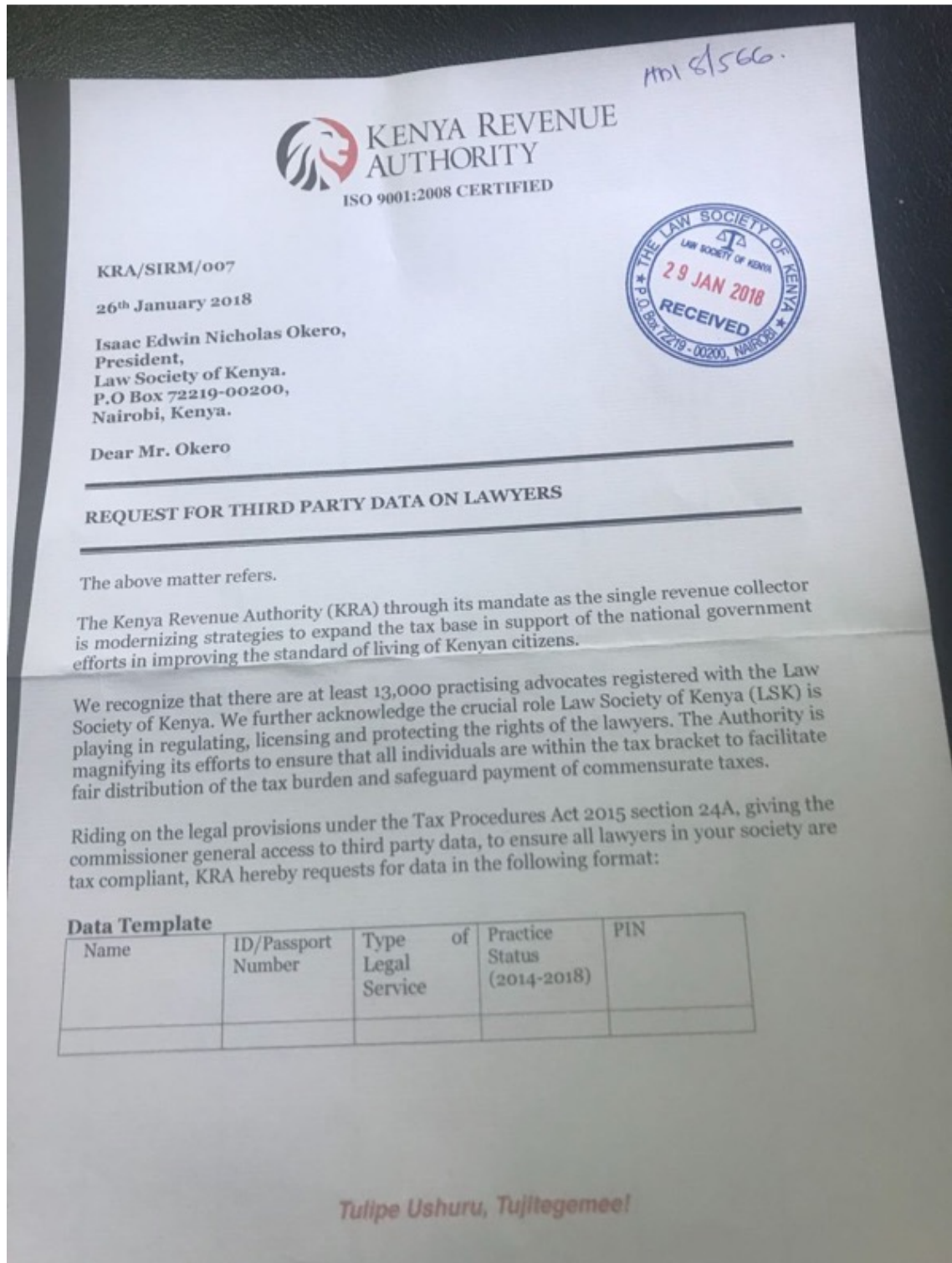
Those Kenyans who love being Kenyans.
Avoid the Rush.
File your tax returns today here itax.kra.go.ke
[#MaraThatThat](https://twitter.com/KKzd5DBIxL) pic.twitter.com/KKzd5DBIxL



 **ωεαρσησMasscreation**
@tonynjue

The fact that I choose to [#BoycottKRAreturns](#) doesn't make me less of a Kenyan. I just choose not to support a flawed system that thrives on [#CORRUPTIONke](#). Stop  this labelling. [@Maskani254](#) [@WanjikuRevolt](#) [@WanjeriNderu](#) [@bonifacemwangi](#) [@wmnjoya](#)

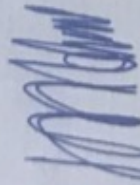
LETTER FROM KRA TO THE LAW SOCIETY OF KENYA REQUESTING THIRD-PARTY INFORMATION ON ITS MEMBERS



Kindly note that the data should be preferably in Word or Excel format. We would also like to engage LSK on how KRA can best facilitate this taxpayer group to address their challenges.

For any further information, kindly contact Janet Khainza janet.khainza@kra.go.ke or Mohamed Mahat mohamed.mahat@kra.go.ke or call Tel: +254 (0) 202 814025 / 4024

Yours Sincerely,



Dr. Mohamed Omar,
COMMISSIONER – STRATEGY, INNOVATION & RISK MANAGEMENT

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