TAXATION OF AID FUNDED PROJECTS IN KENYA: LAW, POLICY, PROBLEMS AND PROPOSALS FOR REFORM

BY:

CHERUIYOT CAROLYNE JEPKOECH

G62/87113/2016

A THESIS SUBMITTED TO THE SCHOOL OF LAW, UNIVERSITY OF NAIROBI, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF LAWS (LLM) OF THE UNIVERSITY OF NAIROBI

2019

DECLARATION

I, CHERUIYOT CAROLYNE JEPKOECH, do hereby declare that this Thesis is my original work, which has been done in line with the requirements and regulations of the University of Nairobi for the degree of Master of Laws (LLM). This Thesis has not been submitted for a degree in any other university.

Signature:………………………………………….. Date: …………………………

CHERUIYOT CAROLYNE JEPKOECH

This Thesis is submitted for examination with my knowledge and approval as University Supervisor.

Signature:…………………………………………. Date:…………………………

MR. BOSIRE NYAMORI

SCHOOL OF LAW

UNIVERSITY OF NAIROBI

ACKNOWLEDGEMENTS

I thank the Almighty God for the chance, resources and strength to pursue my dream to achieve a Master of Laws (LLM) degree.

I acknowledge and appreciate the guidance and dedicated supervision of my Supervisor, Mr. Bosire Nyamori. Mr. Bosire's prompt review facilitated the finalization of this Thesis without delay. His guidance and valuable corrections made this Thesis what it has become. I appreciate my Panel that helped refine and fine-tune the Thesis.

I also appreciate and acknowledge my family. To my husband, Hillary and daughters, Abigail and Annabel, and son Asaph, I thank you for your patience and moral and financial support during the period of my study. You sacrificed so much for me.

DEDICATION

I dedicate this work to my parents, Mr. Michael Yatich Rono and Mrs. Zipporah Targok Rono, who sacrificed so much to ensure that I had a solid academic foundation and instilled in me the value of hardwork and an unwavering spirit in pursuit of my dreams.

TABLE OF CONTENTS

ABBREVIATIONS/ACRONYMS

AFPs..Aid-Funded Projects

AfDB..African Development Bank

EAC..East African Community

WHT..Withholding Tax

VAT...Value Added Tax

ITA...Income Tax Act

KRA...Kenya Revenue Authority

KeNHA..Kenya National Highways Authority

KENGEN...Kenya Electricity Generating Company Limited

IDA...International Development Authority

CoK...Constitution of Kenya

KURA...Kenya Urban Roads Authority

IMF..International Monetary Fund

OECD..Organization for Economic Co-operation and Development

UN...United Nations

SGR...Standard Gauge Railway

NT..National Treasury

KEEP...Kenya Electricity Expansion Project

EEHP..Eastern Electricity Highway Project

GoK..Government of Kenya

EXIM...Export-Import

US...United States

IFC...International Finance Corporation

WB...World Bank

ATAF...African Tax Administration Forum

TMP...Tax Modernization Programme

ABSTRACT

Foreign aid contributes largely to the development expenditure of developing countries. Tax treatment of foreign aid has been a subject of discussion in the global and regional arena. The United Nations Committee of Experts on International Cooperation on Tax Matters and the African Tax Administration Forum have in their past sessions and publications advocated for a coherent policy on the treatment of taxes in aid funded projects (AFPs). Kenya's tax legal regime provides for several tax exemptions for AFPs. Tax exemptions as a form of tax expenditure has its merits and demerits hence there is need for their evaluation as to their cost and benefit before they are granted. Tax treatment of AFPs requires a comprehensive and clear policy and legal framework to avoid tax disputes. In Kenya, this has been a challenge. Based on primary and secondary data, this research interrogates the nature of the problems in tax treatment of AFPs, the adequacy of the existing policy and legal framework, the effects of the problems and makes recommendations.

CHAPTER ONE

1. INTRODUCTION

1.1 Background

The estimated external funding portion of Kenya's development expenditure for the period 2016/2017 amounted to Kshs. 413 billion. This comprises loans and grants from various foreign donors.[1]Tax treatment of foreign aid is therefore of significance to Kenya's economy due to the huge amounts involved. Donors and development partners have often demanded for exemption of aid funds from taxation.[2]Donors decline to cover the tax portion of aid funded projects (AFPs) because of their desire to maximize the use of aid funds for the intended projects. This has been observed in instances where donors target specific sectors or projects.[3]The broad tax exemptions granted in AFPs have led to problems such as domestic revenue reduction in developing countries.[4]On the other hand, donors who agree to pay the tax portion of projects concern themselves with the public expenditure management system and the reasonableness of the tax policy of the recipient country.[5]

Kenya commenced major tax reforms in 1986 when the government adopted the Tax Modernization Programme (TMP).[6] One of the key objectives of the TMP was to enable the

[1]2016/2017 Estimates of Development Expenditure of the Government of Kenya for the Year Ending 30 June 2017 Volume II xii available at http://www.cabri-sbo.org/en/documents/2016-2017-estimates-ofdevelopmentexpenditure-of-the-government-of-kenya-for-the-year-ending-30th-june-2017-volume-ii accessed on 3 March 2018.

[2] Victor Thuronyi, 'Tax aspects of donor-financed projects' Paper submitted to the United Nations Social and Economic Council Committee of Experts on International Co-operation in Tax Matters on 22 November 2005, 5 available at <www.un.org/esa/ffd/**tax**/firstsession/ffd**taxation-tax**%20**aspects**.doc>accessed on 6 February 2017.

[3] ibid.

[4] United Nations Committee of Experts on International Co-operation in Tax Matters Report on the Fifteenth Session 17 -20 October, 2017, Economic and Social Council Official Records, 2018. Supplement No. 25, 18-19 available at http://www.un.org/esa/ffd/documents/tax-committee-documents.html accessed on 6 November 2018

[5] Thuronyi (n 2) 5.

[6] Moses Kinyanjui *et al*, 'Tax reforms and revenue mobilization in Kenya' AERC Research Paper 131 May 2003, 3 available at erepository.uonbi.ac.ke/.../Muriithi_Tax%20Reforms%20and%20Tax%20Mobilizatio... accessed on 9 November 2018.

government enlarge the revenue base.[7] The key changes that took place during this period were restriction of custom duty exemptions, introduction of Value Added Tax (VAT) exemption on inputs of AFPs and restriction of non-governmental organization exemptions.[8] Another objective of the TMP was organizational reform, which led to the establishment of Kenya Revenue Authority (KRA) in 1995 so as to strengthen revenue collection and administration.[9] Prior to this reform period, tax administration was undertaken by different departments in the Ministry of Finance.[10]

Kenya's current tax legal framework provides for several tax exemptions in AFPs. These are provided under the VAT, customs duty, income tax and excise duty regimes.[11]Despite the above reforms, further improvements are needed particularly in the area of reduction of exemptions.[12]This can be done through the ongoing tax reforms such as the Income Tax Bill, 2018.This will ensure that the objective of enlargement of the revenue base is achieved.

International finance and economic organisations like the African Development Bank (AfDB) and Asian Development Bank have no obligation to withhold, collect or pay taxes or duty.[13]Therefore, tax deduction and remission by donors is not always possible.[14]In instances where donors make direct payments to contractors or suppliers involved in an AFP, it becomes

[7]ibid.
[8]ibid 7.
[9] Kinyanjui (n 6) 10.
[10]ibid.
[11] Section 114 and Part A Fifth Schedule, The East African Community Customs Management Act, 2004; First Schedule VAT Act No. 35 of 2013; Second Schedule Part A Paragraph 9 Excise Duty Act No. 23 of 2015; Section 13 of the Income Tax Act and First Schedule Part 1 Paragraph 27 Income Tax Act.
[12]Kinyanjui (n 6) 21.
[13]Michael Lang *et al* (eds), *Tax Rules in Non-Tax Agreements* 18 available at https://books.google.co.ke/books?id=JOu8R4gQzQ8C&pg=PA138&lpg=PA138&dq=African+Development+Bank+on+Taxation+of+aid+funded+projects&source=bl&ots=FaoWIWxxeo&sig=ESE4Fd60VEfbWAwfnPLzhHmAJYw&hl=en&sa=X&redir_esc=y#v=onepage&q=African%20Development%20Bank%20on%20Taxation%20of%20aid%20funded%20projects&f=false accessed on 3 February 2017.
[14]Starlings Muchiri, 'Tax and Regulatory Compliance' Seminar Presentation on Tax Management for Public Benefit Organizations available at https://www.icpak.com/wp-content/uploads/2016/08/ICPAK-Tax-Management-Seminar-for-PBOs-by-CPA-Starlings-Muchiri.pdfaccessed on 27 January 2017.

challenging to tax authorities such as the Kenya Revenue Authority (KRA) as to who to pursue to ensure that taxis withheld.[15] In the context of Kenya, this issue arose in a tax dispute between the Kenya National Highways Authority (KeNHA) and the Kenya Revenue Authority (KRA).[16] In this case, KRA issued agency notices demanding WHT which KRA considered due from KeNHA, in respect of payments made to Shengli Engineering (Group) Limited, a contractor for the development of part of the Nairobi-Thika Road project. The project was funded by the People's Republic of China, a Development Partner, and the funds were administered by the Export - Import (EXIM) Bank of China. KeNHA was of the view that the EXIM Bank paid the contractor directly and that no funds passed through it hence it was impossible for it to withhold any taxes in respect of payments made to the contractor. KRA on the other hand was of the view that KeNHA was responsible to withhold the tax as the beneficiary agency of the funds.

The main issue for determination by the court in this case was the treatment of withholding tax (WHT) in instances where payments subject to deduction of tax are made directly to contractors by foreign donors. The matter was settled out of court and KRA withdrew the agency notices. The arguments by the parties on this issue illustrates that treatment of WHT in AFPs in Kenya is at times problematic.

Foreign aid takes various forms, which include support of investment projects, budget support and technical assistance of projects.[17]These comprise costly investments such as roads, railways and electricity which can attract a substantial amount of government revenue in the form of tax. Therefore, without a clear legal and policy framework on the taxation of AFPs in

---

[15] Judicial Review Case No. 250 of 2014 High Court of Kenya at Nairobi (Unreported).
[16] Judicial Review Case No. 250 of 2014 High Court of Kenya at Nairobi (Unreported).
[17] Niyonkuru F, 'Failure of Foreign Aid in Developing Countries: A Quest for Alternatives' Business and Economic Journal 1 available at https://www.omicsonline.org/open-access/failure-of-foreign-aid-in-developing-countries-a-quest-for-alternatives-2151-6219-1000231.php?aid=80040 accessed on 7 November, 2018.

Kenya, a substantial amount of government revenue may be lost. This research seeks to analyse the problems that the tax legal regime faces in AFPs in Kenya, evaluate the effectiveness of the policy and legal framework and make appropriate recommendations.

1.2. Statement of the Problem

The main goals of taxation are for the government to raise revenue, redistribute resources and reorganize the economy by way of a financial policy.[18] In order to achieve these, taxation should be predictable and not arbitrary. The exact amount payable by a person and the method of payment should be clearly stipulated.[19] Therefore, tax legislation and policy guidelines should provide for the taxes payable, the persons who should pay the tax, the manner of assessing the amounts payable and the method of collecting the tax.

The Income Tax Act (ITA) does not provide for the treatment of WHT in instances where the payer is a non-resident, such as a foreign donor. This is despite the fact that the constituent instruments of donor agencies often expressly exempt the donor agencies from acting as withholding agents.[20]This results in the income of non-exempt entities going untaxed as no tax is withheld on payments made by such donor agencies.[21] The Income Tax Bill, 2018 has also not addressed this issue.[22]This gap in the law has led to problems that the tax system has had to bear with in AFPs. It has also led to tax disputes such as the one between KeNHA and KRA.[23] The resultant uncertainty violates the fundamental principle of predictability in

---

[18]Musonda Kabinga, 'Principles of Taxation', Jorg Alt SJ *et al* (eds) Paper 5 of the Introduction to the Project 'Tax, Justice and Poverty' (2006) 4-5 available on<www.**tax**justice-and poverty.org/fileadmin/Dateien/**Tax**justice.../05_**Principles**.pdf>, accessed on 14 November 2016.
[19]'Canons/Principles of Taxation By Adam Smith', available at <http://economicsconcepts.com/canons_of_taxation.htm> accessed on 3 November 2016.
[20]Iain Steel *et al* 'The taxation of foreign aid' African Tax Administration Forum Briefing Note May 2018, 9 available at https://www.odi.org/sites/odi.org.uk/files/resource-documents/12191.pdf accessed on 9 November 2018.

[21] ibid.
[22]See Income Tax Bill, 2018 available at www.treasury.go.ke/tax/finance-bills.html?download=781:draft-income-tax-bill-2018 accessed on 7 November 2018.
[23]See n16.

taxation. This research contrasts this lacuna in the law with the WHT provisions in Ethiopia's Federal Income Tax Proclamation.[24]The comparison points out the provisions on WHT in Ethiopia's legislation that Kenya can borrow to seal the gap in the ITA.

Donors are often reluctant to fund the tax portion of AFPs.[25]This has led to developing countries granting tax exemptions in AFPs.[26] Kenya's tax legal framework provides for certain tax exemptions in AFPs. These are provided under the East African Community Customs Management Act, 2004, VAT Act and the VAT (Remission) (Official Aid Funded Projects) Order, 2003. The administration of tax exemptions has merits and demerits. This research seeks to analyse the problems that arise from tax exemptions granted in AFPs in Kenya.

The challenges posed by the tax treatment of AFPs lead to loss of revenue and increased tax administration costs, which negatively affect the economy.[27]In the circumstances, there is need for legal reform or policy guidelines to guide KRA in the collection of taxes in AFPs and to address the existing uncertainty.

1.3. Theoretical Framework

The broad theory that provides a framework for this research is the social contract theory. The tax expenditure theory also provides a good theoretical framework for the analysis of tax exemptions in AFPs in Kenya. These theories are discussed below.

1.3.1 Social Contract Theory

The research relies on the social contract theory as advanced by John Locke and Thomas Hobbes. Thomas Hobbes argued that in the primitive times, man lived in a state of nature.[28]

---

[24]Article 93 3/ of the Federal Income Tax Proclamation No. 979/2016 available at http://www.erca.gov.et/index.php/proclamation/39-income-tax#faqnoanchor accessed on 5 July 2017.

[25] Thuronyi (n2) 5.

[26]ibid 3-5.

[27] Thuronyi (n2) 5.

[28]Manzoor Elahi, "Social Contract Theory by Hobbes, Locke and Rousseau" 1 available at https://www.academia.edu/3138759/Social_Contract_Theory_by_Hobbes_Locke_and_Rousseau?auto=dowload accessed on 6 February 2017.

There were no laws regulating human conduct and activity and that man's life was full of hardships and brutality. People needed protection of their lives and property.[29] As a result, man surrendered his rights to some authority so as to achieve self-protection and self-preservation.[30] The authority was charged with the responsibility of protecting man's property and life.[31] Men agreed to be governed by common laws and a government with law enforcement mechanism was created.[32]

According to John Locke, man's property was not secure in a state of nature.[33] Man surrendered his rights to a civil government which was charged with the responsibility of enforcing the law to protect man's property.[34] Therefore a social contract was created between man and the government.[35]Men subsequently had laws and the government provided the executive power needed for the enforcement of the laws and protection of men and their property.[36]

Due to an existing social contract, the government provides services such as security, development of infrastructure and the administration of justice to the citizens.[37]In exchange, the citizens surrender a portion of their property rights to the government in the form of taxes. Tax is a source of government revenue and thus enables it provide services to the citizens.

In instances where the government is unable to provide particular services required by citizens, it grants tax incentives such as tax exemptions to ensure provision of such services.[38]The government uses tax incentives to spur economic growth in specific sectors or to achieve

[29]ibid.
[30]ibid.
[31]ibid 1-2.
[32]ibid.
[33]Elahi (n 28) 3-4.
[34]ibid.
[35]ibid.
[36] ibid.
[37]John Hill, 'Taxes, the Social Contract, and Adam Smith', available at <http://masshumanities.org/ph_taxes-the-social-contract-and-adam-smith/> accessed on 3 November 2016.
[38]'Tax Incentives and exemption regime in Kenya: is it working?' The Budget Focus, A Publication of IEA Budget Information Programme 1-2 available at https://www.ieakenya.or.ke/downloads.php?page=Budget-Focus-30.pdf accessed on 7 November 2018.

particular policy objectives for the benefit of the citizenry.[39]This would include granting exemptions to AFPs to encourage development in sectors such as the infrastructure sector. Thus, aid complements government efforts in the provision of services to its citizens.

1.3.2 Tax Expenditure Theory

The concept of tax expenditures was developed by Stanley S. Surrey, a former US Assistant Secretary of the Treasury.[40]Tax expenditure is revenue that is deliberately not collected and not reflected as public spending.[41] They are revenue foregone due to preferential provisions of the tax structure. [42]Tax expenditures include tax reliefs and tax exemptions and are used by governments to favour certain groups or as incentives to certain activities. They are also used to achieve specific public policy objectives.[43]

Tax expenditures have positive and negative characteristics. On one hand, they reduce the need for government scrutiny of such spending. On the other hand, they distort the neutrality of the tax system. Neutral tax systems operate on the basis of standard taxation without any exemptions.[44] Neutrality makes taxation simple resulting in reduced tax administration costs. Tax expenditures also reduce the transparency of the tax system because they are not subject to the system of internal controls and approval like other kinds of expenditures.[45]Unlike tax expenditures, direct government spending programmes are more transparent because the cost and efficiency of the spending programmes are subjected to scrutiny prior to their approval.[46]

---

[39] ibid.
[40]Leonard E. Burman, 'Is the Tax Expenditure Concept Still Relevant?' available at http://webarchive.urban.org/publications/410813.html accessed on 5 January 2018.
[41]Vjekoslav Bratic' 'Tax Expenditures: A Theoretical Review' 115 available at https://hrcak.srce.hr/file/9199accessed on 5 January 2018.
[42]ibid.
[43]ibid 113 -114 & 124.
[44]Zhing Li Swift *et al*, 'Tax Expenditures: General Concept, Measurement and Overview of Country Practices' in Hana Polackova Brixi *et al* 'Tax Expenditures—Shedding Light on Government Spending through the Tax System- Lessons from Developed and Transition Economies' 5 available at https://openknowledge.worldbank.org/handle/10986/15067accessed on 5 January 2018.
[45]ibid.
[46]ibid.

Tax expenditure schemes are inefficient because they are a response to particular interest groups rather than actual needs. They favour particular sectors and projects thus weakening overall investment. They also lead to erosion of tax bases, increased complexity of tax laws and cost of their enforcement.[47] Therefore, it is important for governments to make an analysis of costs and benefits involved before introducing tax expenditures in their tax systems.[48]

Governments face the challenge of ensuring proper use and administration of tax expenditure. This is because the revenue lost is not accounted for and there is no cost and benefit analysis of tax expenditures due to lack of reporting.[49]Tax expenditure reporting has been used in some countries to enhance fiscal transparency. It began in the US and Germany in the 1960s.[50]Tax expenditure reports are also used to assess the effects of tax expenditure schemes on the tax system and the economy. Some countries have put ceilings and other constraints for spending by way of tax expenditures.[51]There is therefore need for caution in the management and control of tax expenditure programmes.[52]

Surrey was of the view that by analyzing the efficiency of tax expenditures, tax policymakers would recognize that they were inconsistent with the goal of fair, simple and efficient tax systems.[53]Some of his critics believed that budget pressures made it difficult to advance policies through the appropriations process hence policymakers embrace tax expenditures as an alternative means of implementing policy goals.[54] Tax expenditure analysis has however

[47]ibid.
[48] Bratic (n 41) 114 & 125.
[49] Li Swift (n44) x.
[50]Bratic (n 41) 116.
[51] Li Swift (n44) 6-9.
[52]Bratic (n41) 125.
[53]Edward Kleinbard, "Rethinking Tax Expenditures" Address to the Chicago-Kent College of Law Federal Tax Institute, May 2008, 2 available at www.jct.gov/Rethinking_Tax_Expenditures.pdfaccessed on 5 January 2018.
[54]ibid *3*.

been useful as a tool for determining the implications of tax proposals and judging their equity, simplicity and efficiency.[55]

Tax exemptions common in AFPs is a form of tax expenditure. The Kenyan tax system provides for VAT, customs duty and excise duty exemptions in AFPs.[56]The tax expenditure theory therefore provides a good theoretical framework for analyzing tax exemptions granted in AFPs in Kenya.

1.4. Literature Review

There is existing literature on taxation aspects in AFPs from a global perspective. Tax exemptions in AFPs cover mainly VAT, custom duties and excise duties.[57]Victor Thuronyi asserts that some AFPs enjoy tax exemption under domestic legislation or treaties, which exemption may extend to both direct and indirect taxes.[58]

Donors such as the World Bank (WB) originally had a policy that was against the use of its loans to finance taxes in recipient countries, but it later changed it to allow financing of reasonable tax costs.[59] Recipient countries could then not have to provide tax exemption where the WB considered the taxation reasonable. The reasonableness is determined by the WB and therefore the recipient countries are not able to predict whether the Bank will cater for the tax aspect of the funded project or not.[60]This creates some uncertainty in respect of tax aspects of WB funding.

Victor Thuronyi points out that it is unlikely that all donors will accept unlimited taxation of AFPs and that it is also likely that many AFPs may eventually become subject to the domestic

---

[55] Kleinbard (n53) 5-6.
[56]See n 11.
[57]Sumedh Rao, 'Tax Reform: Topic Guide, 2014' 23 available at http://www.gsdrc.org/wp-content/uploads/2015/07/GSDRC_Tax_Reform_Topic_Guide.pdf accessed on 1 February 2017.
[58] Thuronyi (n 2) 3-4.
[59] ibid.
[60]ibid.

tax regimes. [61]He is also of the view that there is no definite answer as to whether AFPs should be taxed because there are different categories of taxes and transactions.[62] He suggests that there is need for co-ordinated discussions between donors and recipient countries on how taxes should be treated in AFPs.[63]

Sumedh Rao argues that taxation in AFPs can either enhance or undermine tax systems and tax cultures. On one hand he argues that by paying tax on projects, donors enhance a culture of tax compliance in the recipient countries and strengthen the quality of tax systems.[64]On the other hand, he points out that tax exemption in AFPs helps to ensure that donor funds achieve the intended purpose.[65] Rao further notes that tax exemptions in AFPs has been discussed in the international arena and found to be undesirable and that attempts towards their removal require co-ordinated action by all donors to avoid price, access and cost disadvantages that are likely affect development outcomes.[66]However, attempts towards a common approach on the treatment of taxes in AFPs could be slowed by the fact that AFPs involve several donors with varying demands.

Wilson Prichard *et al* on the other hand were of the view that many aid funded goods and services are tax exempt and that this may affect the quality of tax systems in developing countries.[67]They recognize the fact that tax exemptions lead to a reduction in government revenue in the recipient countries and has been considered *"an apparent case of donor*

[61] Thuronyi(n2)7.
[62] Thuronyi (n2) 8.
[63]ibid.
[64]Rao (n 57) 22.
[65]ibid.
[66]ibid 22-23.
[67]Wilson Prichard *et al*, 'Donors, Aid and Taxation in Developing Countries: An Overview' ICTD Working Paper 6 September 2012, 24-25 available athttp://www.ictd.ac/publication/2-working-papers/6-donors-aid-and-taxation-in-developing-countries-an-overview accessed on 1 February 2017.

hypocrisy".[68]This is because the donor offers financial aid to the recipient country while at the same time denying it revenue in the form of tax.

The other literature on taxation in AFPs is by Ismailla Diallo. He is of the view that the policy of most donors is that donor funds should not be used to pay tax in beneficiary countries.[69]Diallo also recognizes that this pursuit for tax exemptions leads to foregone revenue and increased tax administration costs in the recipient countries.[70]Donors impose such conditions with the aim of ensuring that the funds are fully utilized in the projects to which they were allocated[71]This argument applies only at the project level because if a project's imported goods are taxed, then for a given project fewer goods will be provided.[72] At the national level, the argument is weaker as the tax collected goes into the national budget of the recipient country and is still beneficial to the recipient country.[73]Furthermore, where donors use both project and budget support, then the case for exempting aid becomes less valid. This is because if aid is taxed, donors can offset the taxation by minimizing budget support accordingly.[74] Therefore, donors providing both budget support and project aid should not be concerned if project aid is taxed.[75]

The United Nations Committee of Experts on International Co-operation in Tax matters has also in its past sessions discussed tax treatment of AFPs. These discussions have led to the

[68]ibid.
[69]Ismaila Dialo, 'Tax exemptions for aid-funded projects: Reasons for Change" available at <http://www.ictd.ac/tax-exemptions-for-aid-funded-projects-reasons-for-change>, accessed 11 November 2016.
[70]ibid.
[71] Steel (n 20) 7.
[72]ibid
[73]ibid.
[74]ibid.
[75]ibid.

formulation of draft guidelines on the issue.[76] The guidelines are intended to be applied by donors and recipient countries in determining the appropriate tax treatment of AFPs.[77]

The guidelines set out the general considerations that should be taken into account in tax treatment of transactions relating to AFPs. Firstly, donors should not require tax exemptions with respect to AFPs unless there are serious weaknesses in the tax system of the recipient country.[78] Secondly, officials of the Ministry of Finance or tax administration of the recipient country should participate in the negotiation and drafting of the rules and regulations on the tax treatment of transactions in AFPs.[79] Thirdly, the recipient countries should make sure that the legal requirements needed to give legal backing to agreements dealing with tax treatment of AFPs are complied with.[80] Finally, where tax exemptions are granted for AFPs, countries are advised to use measures that minimize tax administration burdens and reduce fraud.[81]

So far, the guidelines have changed the approaches of some donors such as Norway and Netherlands.[82]These donors have changed their approach to paying taxes on the projects they finance, following the example set by the WB.[83]During the International Tax Compact/Addis Tax Initiative conference held in June 2017 it was suggested that tax treatment of development projects should be addressed. It was also suggested that the draft guidelines should form a basis for further discussion between donor agencies and tax administrations of developing countries. This will lead to a decision on the way forward on the issue.[84]

[76]United Nations Economic and Social Council Committee of Experts on International Co-operation in Tax Matters Third Session 29 October-2 November 2007, 3 Tax Treatment of Donor-Financed Projects Draft Guidelines prepared by the International Tax Dialogue Steering Group.
[77]ibid 3 & 5.
[78]United Nations Economic and Social Council Committee of Experts on International Co-operation in Tax Matters Third Session (n 76) 5.
[79]ibid 6.
[80]ibid.
[81] ibid.
[82]United Nations Committee of Experts on International Co-operation in Tax Matters Report (n 4) 18.
[83]ibid.
[84] ibid 18-19.

The African Tax Administration Forum (ATAF) has in its recent publications contributed to the debate on the tax treatment of foreign aid by setting forth arguments for and against tax exemptions granted in AFPs.[85]In support of taxation of AFPs, it has pointed out that taxation of aid funds reduce the funds available for AFPs.[86] However, the validity of this argument has been questioned because tax collected in AFPs contributes to the state budget of the recipient country and still benefits the recipient country.[87]It has also suggested that removal of exemptions attracts renegotiation costs and that aid should not be taxed because of its charitable nature.[88] However, the argument against tax exemption of aid because of its charitable nature is weak as it disregards the importance of resource mobilization for national development.[89]

As against tax exemptions in AFPs, ATAF argues that they complicate the tax systems of the recipient countries, lead to significant reduction in government revenue and create pressure for future exemptions.[90] They also undermine the local tax system on the recipient countries because donor agencies are often exempted from acting as withholding agents.[91]This results in the income of non-exempt entities being untaxed as no tax is withheld on payments made by such agencies to non-exempt entities.[92]ATAF recommends that donors and implementing agencies with long-term physical presence in a recipient country should comply with the tax system and withhold tax on payments to non-exempt entities.[93]They should withhold and remit the tax to revenue authorities to support domestic resource mobilization in the recipient country.[94]

[85] Steel (n 20)3.
[86]ibid 7.
[87]ibid.
[88] Steel (n 20) 8.
[89]ibid.
[90] Steel (n 20)9-10.
[91]ibid.
[92]ibid.
[93] Steel (n 20) 14
[94]ibid

Many developing countries do not estimate revenue foregone from tax expenditures in general and this makes it difficult to evaluate the impact of tax exemptions on government revenue.[95]It is for this reason that ATAF recommends that donors and recipient countries should assess and publish the revenue foregone and the administrative costs for all AFPs.[96] This will help assess the impact of tax exemptions in AFPs on revenue capacity.[97]Developing countries to some extent however believe that the revenue foregone from tax exemptions in AFPs is good value for money because it helps support important development projects.[98]

ATAF recognizes that there is no single and uniform system of taxation of aid as aid comprises of a range of activities in several countries performed by different entities under various legal instruments[99]This leads to incoherence in the tax treatment of AFPs, an issue which recipient countries have had to deal with in AFPs funded by various donors.

From the above analysis, the literature on tax treatment of AFPs shows that it is a controversial issue which has elicited attention globally. The literature focuses on treatment of taxes in AFPs and tax exemptions and how they affect the recipient countries of donor funds. However, the literature is general and has no geographical scope. This research seeks to address the issue from a Kenyan perspective. It seeks to address the challenges in taxation of AFPs and whether the tax legal regime has been effective. It also addresses the effects of the challenges in the Kenyan context.

---

95 Steel (n 20) 9.

96 Steel (n 20) 14.
97ibid.
98 Steel (n 20) 10.
99 Steel (n 20) 4.

1.5. Objectives of the Study

The principal objective of this research is to evaluate the effectiveness of Kenya's tax regime in regulating taxation of AFPs.

The specific objectives of the research are –

i. To examine how Kenya's tax regime treats AFPs.
ii. To identify the gaps in Kenya's tax legal framework in respect to taxation of AFPs and how they have led to challenges in the collection of taxes in AFPs.
iii. To identify and analyse the problems borne by Kenya's tax system in AFPs.
iv. To identify the effects of the problems on Kenya's economy.
v. To make appropriate recommendations on how to address the problems in the administration of taxes in AFPs in Kenya.

1.6. Hypothesis

The research tests the hypothesis that there are gaps in Kenya's tax legal framework with respect to taxation of AFPs. The research also tests the hypothesis that the gaps have led to problems in taxation of AFPs in Kenya and have negatively affected the economy.

1.7. Research Questions

The research seeks to answer the following key questions –

i. How does Kenya's tax regime treat AFPs?
ii. What are the gaps in Kenya's tax legal framework and how have they led to challenges in the collection of taxes in AFPs?
iii. What are the problems borne by Kenya's tax system in AFPs?
iv. How have the problems in taxation of AFPs affected Kenya's economy?
v. How can the challenges in the administration of taxes in AFPs in Kenya be addressed?

1.8. Scope of the Study

This research focuses on the problems borne by Kenya's tax regime in AFPs and the effectiveness of the tax laws. It also assesses how the challenges have affected Kenya's economy and makes appropriate recommendations.

1.9. Justification of the Study

This research seeks to generate new knowledge on the nature of the challenges and the taxation aspects in AFPs in Kenya. It adds to the existing literature on the tax aspects of AFPs. The research has also evaluated the effectiveness of the existing tax legal framework in dealing with the challenges in taxation of AFPs.

The study findings will assist the Government of Kenya in legal reform, particularly reform of the existing tax legal framework. The findings will also assist tax policy makers in the formulation of a policy framework on taxation of AFPs. The research has also highlighted the tax issues faced by government agencies such as KRA and KeNHA with respect to AFPs. This will in the long run minimize tax disputes between KRA and the implementing agencies of AFPs.

1.10 Research Methodology

The research sites were the National Treasury (NT), KRA and KeNHA. This was to ensure that taxation aspects of AFPs are addressed from the perspectives of KRA as the tax collecting agency, NT as the tax policy formulator and signatory to donor funding agreements and KeNHA as one of the implementing agencies of AFPs. KeNHA was the preferred implementing agency because it has recently experienced problems with regard to WHT aspects of AFPs resulting in a tax dispute with KRA.[100]

[100]See n16.

The research is qualitative in nature. The target population were officers of the NT, KRA and KeNHA. Questionnaires were administered to officers from the three entities. Purposive sampling technique was used. This is because the information required was specific in nature.

The research relies on primary data collected by way of questionnaires administered upon officers of KRA, KeNHA and the NT. This is because KRA officers possess first-hand information on challenges in collection of tax in AFPs. The officers of the NT have information on the effects of the taxation challenges in AFPs and the tax policies that could be implemented. The NT is a signatory to donor funding agreements and therefore its officers possess relevant information on tax aspects in AFPs in Kenya. Primary data was also collected from Finance Department of KeNHA. The department has information on treatment of taxes in AFPs from the implementing agencies' point of view.

The research also relies on the use of secondary data collected from library research and internet sources. The research design used is the descriptive design. The same questionnaire was administered to the respondents with the aim of collecting information required to answer the research questions. A descriptive state of affairs as to the challenges in taxation of AFPs, efficiency of the existing laws and proposals for reform are provided.

The research also contains a comparative study of the WHT provisions under the Ethiopian Federal Income Tax Proclamation and Kenya's ITA.

1.11 Limitations of the Study

The research sampled three government agencies which handle tax aspects of AFPs in Kenya. This may not be a broad sample but the findings in the study are useful in identifying the problems borne by Kenya's tax regime in AFPs, evaluating the effectiveness of the tax laws and in making appropriate recommendations.

CHAPTER BREAKDOWN

Chapter One is the introduction part which sets out the background of the study, the problem under investigation, objectives, scope and justification of the study and the research methodology.

Chapter Two highlights the nature and sources of aid funding, selected AFPs in Kenya and the problems and benefits of aid funding.

Chapter Three covers the treatment of AFPs under Kenya's tax regime. It discusses tax treatment of AFPs under the regimes of VAT, customs duty, excise duty and income tax.

Chapter Four provides an analysis of the problems borne by Kenya's tax regime in AFPs. These include problems arising from tax exemptions and gaps in law and policy. Some tax aspects of the Standard Gauge Railway (SGR) project are discussed in this Chapter. The Chapter also highlights the effects of the problems borne by Kenya's tax regime in AFPs.

Chapter Five contains the conclusion and recommendations. Recommendations that can assist in legal reform and policy formulation are set out in this Chapter.

CHAPTER TWO

2. AID FUNDING IN KENYA

2.1 Introduction

This Chapter discusses the nature of aid funding, the main sources of foreign aid in Kenya and the benefits and problems associated with foreign aid. It also highlights some projects in Kenya that have been funded through foreign aid.

2.2 Nature of Aid Funding

Foreign aid can be derived from donors or development partners. Donors refer to those countries or agencies which provide financial assistance to developing nations and attempt to improve governance by attaching policy conditions to the aid.[101]Development partners on the other hand provide financial assistance without attaching policy conditions on the basis of co-operation and mutual benefit.[102]

Aid funding comprises both bilateral aid that flow directly from donors to recipient countries and multilateral aid that flows through an intermediary lending institution such as the WB.[103] Foreign aid includes loans and grants.[104]

Aid is given to developing countries to help them accomplish their development projects.[105] It can be given as budget support, support of investment projects or technical support of various

---

[101]Nkunde Mwase, 'IMF Survey: When Resources Come from 'Partners' instead of 'Donors' available at <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sopol061912a> accessed on 14 November 2016.
[102]ibid
[103]Nasma Cheboi, ' The Effect of Donor Funding On The Organizational Performance Of Government Ministries In Kenya' A Research Project Presented in Partial Fulfillment of the Requirements For the Award of the Degree of Master of Science in Finance, School of Business, University of Nairobi, October, 2012, 3 available at http://chss.uonbi.ac.ke/sites/default/files/chss/NASMA%20MSC%20PROJECT.pdf accessed on 3 February 2017.
[104]Elphas Ojambo *et al*, 'Aid Unpredictability and Economic Growth in Kenya' African Development Bank Working Paper Series No. 2, 26 July 2017, 7.
[105]Niyonkuru (n17) 1.

projects.[106]Aid can take the form of grants or loans payable at a lower interest rate over an extended period of time.[107] It can come from United Nations institutions, International Monetary Fund, WB or regional banks.[108]

Foreign aid can be directed to promotion of social welfare, protection of the environment or support of non-governmental organizations.[109] Aid helps the local population in different sectors such as health, education and housing.[110] It also supports civil society organizations to promote good governance, protect human rights and protect natural resources.[111]It is also given in the form of humanitarian aid intended to offer quick intervention to minimize human suffering in the event of disasters.[112]

Aid can fully or partially fund projects.[113] Some AFPs are partially funded by aid with the counterpart portion originating from the governments of the recipient country while others are fully funded by donors.[114]

2.3 Sources of Aid Funding in Kenya

External aid contributes significantly to the development expenditure of developing countries. Development expenditure consists of all expenditure for development projects, which in Kenya has become increasingly reliant of foreign aid.[115]The main donors to Kenya have in the past been the WB, AfDB, Japan, Germany, United Kingdom, among others.[116]

---

[106]ibid.
[107]ibid(n17) 1-2.
[108]ibid
[109]ibid (n17) 2.
[110]ibid
[111]ibid
[112]ibid
[113]Projects Summary Fiscal Year 2013/14 available at www.treasury.go.ke/.../other.../69-development-projects.html?...projects...project... accessed on 12 November 2018.
[114]ibid
[115]James Njeru, 'The Impact of Foreign aid on Public Expenditure: The Case of Kenya' AERC Research Paper 135, 1 & 6 available at https://www.africaportal.org/documents/6537/rp135.pdfaccessed on 5 January 2018.
[116]ibid 11.

In Kenya, foreign aid is mainly focused on capacity building.[117]Bilateral donors lead in the provision of assistance for project financing, followed by multi-lateral donors and private voluntary organizations.[118] The largest multi-lateral donor is the WB, which during the financial year 2014-2018 had plans to invest over USD one billion annually in Kenya through organizations such as the International Development Association and the International Finance Corporation (IFC). IDA supports projects which include those in the infrastructure sector.[119]

AfDB has also been an active multi-lateral donor in Kenya. It provides financial assistance to African governments in forms such as loans and equity investments for socio-economic development of the member countries in the region.[120]China has in the recent past largely contributed to improve the infrastructure sector of African countries. In Kenya, aid from China increased after 2002, when a new regime took over power.[121]

2.4 Selected Aid Funded Projects in Kenya

The selected projects are the Standard Gauge Railway (SGR) project and the Nairobi Outer Ring Road Improvement Project. The projects are recent and costly AFPs in Kenya. Tax aspects of AFPs are also observed in these projects and thus considering their huge cost, they demonstrate that tax treatment of AFPs in Kenya need to be addressed comprehensively to avoid adverse economic effects.

[117]Kenya Country Commercial Guide available on https://www.export.gov/article?id=Kenya-project-financing accessed on 29 November 2017.
[118]ibid.
[119] ibid.
[120] ibid
[121]Francis Mwega, 'A Case study of Aid Effectiveness in Kenya- Volatility and Fragmentation of Foreign Aid, with a Focus on Health' Wolfensohn Centre for Development Working Paper 8.

2.4.1 The Standard Gauge Railway (SGR) Project

The SGR project is part of Kenya's Vision 2030 Development Plan which cost Kshs. 327 billion to construct the first phase.[122]The project is expected to promote commerce in the region by providing an alternative means of transport to commuters and cargo transporters who mostly rely on road transport. The project is expected to aid in reduction of transport costs and save time thus leading to reduced prices of commodities.[123]

The project is being funded by the Export-Import (EXIM) Bank of China and the Government of Kenya. The EXIM Bank's share of the funding is ninety per cent (90%) while the Government of Kenya's contribution is ten per cent (10%).[124] The project's implementing agency is the Kenya Railway Corporation (KRC).[125] The project contractor is the China Roads and Bridges Corporation.[126]

The SGR funding agreement provided that the project is exempt from import duty and VAT.[127] The VAT Act, 2013 however only allows VAT exemptions for supplies to be used in AFPs upon authorization by the Cabinet Secretary.[128] To avoid the risk of non-compliance with VAT obligations by the SGR suppliers which could interfere with the performance of the project, the government entered into an arrangement with KRA where it agreed to pay the VAT

---

[122]Uchukuzi, Issue 1 June 2014 available at www.transport.go.ke/downloads/transport%20newsletter%20.pdf accessed on 21 March 2017.
[123]ibid
[124]ibid
[125]ibid;
See also KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project on 4 February 2015 available at www.kra.go.ke/.../Remarks%20by%20the%20Commissioner%20General%20At%20T... accessed on 16 February 2017.
[126] KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project on 4 February 2015 available at www.kra.go.ke/.../Remarks%20by%20the%20Commissioner%20General%20At%20T... accessed on 16 February 2017.
[127]ibid.
[128] First Schedule, VAT Act.

component of the project.[129] Therefore, the SGR project illustrates the context in which taxation aspects of AFPs in Kenya can arise.

2.4.2 Nairobi Outer Ring Road Improvement Project

This project forms part of Kenya's Vision 2030 Development Plan which requires an increased investment in transport infrastructure so as to enhance an internationally competitive and inclusive economy.[130] The project seeks to address the congestion problem in the country's capital, ease accessibility to Nairobi's Industrial Area and populous residential areas.[131]The project also seeks to create a conducive environment for private sector investment.[132]

The project is co-financed by the AfDB Group and the Government of Kenya. The AfDB's financing is through African Development Fund loan and a grant representing 89.8% of the total project cost while the Government of Kenya counterpart contribution amounts to 10.2% of the total project cost.[133] The implementing agency of the project is Kenya Urban Roads Authority (KURA).[134]

The project is expected to comply with all policies of the AfDB. [135]This means that one such applicable policy is the policy which precludes the use of AfDB's funds to pay local taxes in the recipient countries.[136]This implies that the government either pays the tax component of

---

[129]KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project (n125).

[130] African Development Fund Nairobi Outering Road Improvement Project Appraisal Report p iii available athttps://www.AFDB.org/.../Project.../Kenya_-_Nairobi_Outer_Ring_Road_Improvement.... accessed on 16 February 2017.

[131]ibid

[132] ibid 1.

[133] ibid (n 130) 5.

[134] ibid (n 130) 13.

[135] Ibid (n 130) 16.

[136] General Conditions Applicable to Loan, Guarantee and Grant Agreements of the African Development Bank and the African Development Fund, February 2009, Section 8.01 available at https://www.AFDB.org/en/documents/document/general-conditions-applicable-to-loan-guarantee-and-grant-agreements-of-the-AFDB. accessed on 16 February 2017 ; Agreement Establishing the African Development Bank (2016 edition) Article 57(1) available at https://www.AFDB.org/en/document/document/agreement-establishing-the-african-development-bank-2016-edition-92045/ accessed on 16 February 2017.

the project or exempts the project from taxes. This is despite the challenge of budgetary constraints which the government can be faced with as it strives to fund the tax component of such projects.[137]

The above highlighted projects demonstrate the contribution of foreign aid to the improvement of Kenya's infrastructure sector. It also illustrates that AFPs in Kenya can be costly investments and thus can result in significant tax implications. Therefore, tax treatment of AFPs is of importance to Kenya's economy.

2.5 Benefits and Problems of Foreign Aid

Foreign aid aims at promoting socio-economic development in the recipient countries.[138]It enhances economic development, advances investment and fosters bilateral and multi-lateral relations.[139]

However, aid is sometimes unpredictable. This makes aid-dependent countries vulnerable when committed funds are not disbursed or are delayed thus affecting proper planning and budgeting.[140] Donors also apply complex and inconsistent conditions and dictate how the funds should be used.[141] This makes foreign aid unreliable.

More often than not, aid conditions are inconsistent with the priorities of governments and could be harmful to the welfare of citizens.[142]Aid also creates over-dependence on donors.[143]The over-dependence may in the long-term be detrimental to the growth of the

---

[137]Kenya Public Expenditure Review Vol. 1 December 2014 'Decision Time: Spend More or Spend Smart?' 25 available at http://documents.worldbank.org/curated/en/230971468254049239/pdf/940210WP0v10Bo0ort0Vol01201400FNAL.pdfaccessed on 16 February 2017.

[138] Cheboi (n 103) 3

[139]Peter Muiruri, 'Role of Foreign Aid in Kenya's Economic Development (1992-2012)' Abstract available at http://idis.uonbi.ac.ke/node/1404 accessed on 17 October 2017.

[140]Ojiambo (n104) 7

[141]ibid

[142]Kelvin Gitaru, 'Impact of Foreign Aid on Economic Growth' 5 available at https://mpra.ub.uni-muenchen.de/68145/ accessed on 5 January 2018.

[143]ibid 4- 5.

recipient countries. The repayment and servicing costs of foreign loans is also high.[144] It is also important to note that aid passes through long bureaucratic processes and may result in mismanagement.[145] As a result, the aid may end up not achieving the intended purpose.[146]

Developing countries have revenue constraints and are often unable to achieve their growth targets. This makes them rely on aid to fill the gap and contribute to the achievement of their targeted growth rates.[147] This is despite the problems associated with aid funding.

2.6 Conclusion

Kenya has been a beneficiary of both multi-lateral and bilateral aid. Foreign aid contributes significantly to the country's development expenditure as seen in the major developments in the infrastructure sector. The highlighted AFPs illustrate the context in which taxation aspects of AFPs in Kenya arise. There are several problems faced by recipient countries of aid funds. These include donor conditions which are at times inconsistent with the government's priorities. Despite the problems, developing countries such as Kenya have continued to rely on foreign aid due to revenue constraints.

---

[144]Njeru(n115) p 2.
[145]Niyonkoru (n17) 2.
[146]ibid.
[147] Gitaru (n142) 3.

CHAPTER THREE

3. TREATMENT OF AID FUNDED PROJECTS UNDER KENYA'S TAX REGIME

3.1 Introduction

This Chapter discusses the treatment of taxes in AFPs as provided under Kenya's tax regime. It highlights the constitutional basis for taxation and how the regimes of VAT, income tax, customs duty and excise duty treat AFPs. VAT is administered under the Value Added Tax Act and the Value Added Tax (Remission) (Official Aid Funded Projects) Order, 2003. Excise duty, customs duty and income tax are governed by the Excise Duty Act, the East African Community Customs Management Act, 2004 and ITA respectively. This chapter also highlights some tax disputes that have arisen in AFPs in Kenya.

3.2 The Constitution of Kenya, 2010

Article 201(1) of the Constitution of Kenya provides that no tax may be imposed, waived or varied except as provided by legislation. Based on this provision, tax exemptions for AFPs should not be granted except in the manner set out in legislation. Certain exemptions for AFPs are provided in Kenya's tax laws. These are provided under the VAT Act, Excise Duty Act, EAC Customs Management Act and the ITA.[148]The Constitution also provides that the national government has powers to impose income tax, VAT, custom duties and excise tax.[149]The treatment of AFPs under these tax regimes is discussed in the next section.

[148]See n 11.
[149] Article 209 (1) and 209(3).

3.3. VAT Act and VAT (Remission) (Official Aid Funded Projects) Order, 2003.

VAT is levied on taxable supplies and importation of taxable goods and services.[150]The VAT Act provides that taxable goods and services, imported or purchased for direct and exclusive use in the execution of official aid funded projects are exempted upon approval by the Cabinet Secretary responsible for the NT.[151]Official aid funded projects are projects funded through a grant or concessional loan in line with an agreement between the Government of Kenya and any foreign government, agency, institution, foundation, organization or any other aid agency.[152]The Act also exempts from tax goods supplied to non-governmental organizations for emergency relief for use in a specific area within a specific period. [153]Social welfare services of a charitable nature provided by charitable organizations are also exempted under the Act.[154]

The Value Added Tax (Remission) (Official Aid Funded Projects) Order, 2003 also exempts taxable materials, equipment and services for use in official aid funded projects from payment of VAT. This is subject to the condition that the agreement between the government and the foreign government or aid agency provides for remission of tax on taxable services, materials and equipment.[155] Therefore, the Act provides for tax exemption of goods and services purchased or imported for use in AFPs.

3.4 Excise Duty Act

Excise duty is levied on imports.[156]Excise duty is also charged on excisable goods made in Kenya by a licensed manufacturer, excisable services supplied by a licensed person and excisable imported goods.[157]The Excise Duty Act exempts goods imported or purchased

[150]Section 5 (1).
[151]First Schedule, VAT Act.
[152]Section 2 (1), VAT Act.
[153]First Schedule Part I Section A Paragraph 100.
[154]First Schedule Part II Paragraph 11 (b).
[155]Rule 2 & 3.
[156] Nelly Nyaga, 'Investor's Guide to Kenya's Tax Law' available at https://www.matchdeck.com/article/6119-investors-guide-to-kenya-s-tax-law accessed on 6 February, 2017.
[157]Section 5 (1) Excise Duty Act No. 23 of 2015.

locally for the implementation of official aid-funded projects to the extent provided in the financing agreement.[158]It also exempts excisable goods imported into Kenya by an aid agency or international organization to the extent provided under an international agreement between the government and the aid agency or international organization.[159]

3.5 Custom and Excise (Remission) (Aid Projects) Order, 1992

This Order is a subsidiary legislation to the Excise Duty Act. It provides that import duty payable on supplies intended for use in the implementation of an aid project being carried out pursuant to an agreement between the Government and an aid agency is remitted.[160] This is subject to the condition that the agreement provides for remission of duty on the materials and equipment, among other conditions. However, remission of duty does not apply to fuels, oils and lubricants for use in vehicles and equipment, whether or not expended in the implementation of the project.[161]

3.6 The East African Community Customs Management Act, 2004

Customs duty is tax levied on the movement of goods across territorial borders of a country.[162]The EAC Customs Management Act, 2004 exempts goods and equipment for use in AFPs from payment of customs duty.[163]The Act also exempts goods imported by non-governmental organizations for use in emergencies in specific areas where natural disasters have occurred in a Partner State.[164]

---

[158] Second Schedule Part A paragraph 9.
[159]Second Schedule Part A paragraph 3.
[160] Rule 2.
[161] Rule 2 &3 Customs and Excise (Remission) (Aid Projects) Order, 1992
[162] Nyaga (n 156).
[163] Section 114 and Part A Fifth Schedule.
[164]Fifth Schedule Part B Paragraph 20.

3.7 Income Tax Act

The ITA provides for the collection and payment of income tax, which is tax chargeable on income such as gains or profits from business, employment or services provided.[165] The Act provides that the Minister may through a notice in the gazette exempt from tax any income accrued in or derived from Kenya. Such a notice should be laid before Parliament without unreasonable delay. In the event that the notice is not approved by Parliament, it is henceforth deemed to be void.[166]

Persons making payments of any taxable amounts are under an obligation to deduct tax. However, such deductions do not apply to payments which are exempt from tax.[167] The Act specifies income accrued in or derived from Kenya that is exempt from tax.[168]These include emoluments payable out of foreign sources in respect of duties performed in the country in relation to an agreement for development purposes to which the government is a party. The agreement in question should provide for the exemption of such emoluments.[169]

Unlike the exemptions granted by the Minister through gazette notices, the Act does not require the exemption granted through the agreements to be approved by Parliament. This therefore means that AFPs in Kenya are not exempted from income tax unless the exemption is provided for in financing agreements or the Minister exempts the payments in respect of the projects by way of gazette notices.

---

[165]Section 3.
[166]Section 13.
Section 2 – 'Minister' refers to the Cabinet Secretary responsible for matters relating to finance.
[167]Section 35 ITA.
[168]First Schedule Part 1.
[169] First Schedule Part 1 Paragraph 27.

The Act also exempts from tax income of non-governmental organizations on condition that such income is spent for the purposes of relief of poverty or distress of the public or advancement of religion or education for the benefit of Kenyans.[170]

3.8 Tax Disputes in AFPs in Kenya

Tax treatment of AFPs has in the past been a major issue in tax disputes in Kenya. Some of the disputes are discussed below.

3.8.1 Kenya National Highways Authority (KeNHA) versus Kenya Revenue Authority

In the case of KeNHA vs KRA,[171]KRA issued agency notices directing KeNHA's bankers to pay Kshs. 273,739,805.00 being WHT which KRA considered due from KeNHA. The WHT was demanded in respect of payments made to Shengli Engineering (Group) Limited, a contractor for the development of part of the Nairobi-Thika Road project. The project was funded by the People's Republic of China, a Development Partner and the funds were administered by the Export - Import (EXIM) Bank of China. KeNHA stated that the Bank paid the contractor directly and that no funds passed through it.

KeNHA was of the view that it was impossible for it to withhold any taxes in respect of payments made to the contractor. It argued that the funds were within the full control of the NT as the authorized signatory to the funding arrangement and that KeNHA could not instruct the financier on the application of the funds. KeNHA stated that its role in the project was limited to certification of executed works and processing of payment vouchers while making provision for 3% WHT and submission of the payment vouchers to the NT through the parent Ministry for eventual payment by EXIM Bank. KeNHA further stated that there are no existing policy guidelines governing payment of WHT by development partners.

[170] First Schedule Part 1 Paragraph 10.
[171] See n16.

KRA on the other hand was of the view that KeNHA was responsible to withhold the tax as the beneficiary agency of the funds and having made a provision for 3% WHT in the payment vouchers. The issue in this case was the treatment of WHT in instances where payments subject to deduction of tax are made directly to contractors by foreign donors. The matter was settled out of court, with KRA withdrawing the agency notices and foregoing the demanded sum.

WHT is tax on a third-party recipient of payments such as the contractor and not on the People's Republic of China, the foreign donor, making the payment in this case.[172] Therefore, where the third-party recipient is not tax exempt, the donor should withhold the tax and remit to KRA to avoid the non-exempt contractor's income ending up being untaxed and thus negatively affecting domestic resource mobilization in Kenya.[173] However, where donors are exempted in their constituent instruments or project financing agreements from acting as withholding agents, then the law on the treatment of WHT in AFPs in Kenya should be made comprehensive enough to prevent such tax disputes. Currently, the ITA does not provide for the treatment of WHT in AFPs in such instances.[174]This case illustrates a dilemma that KRA and implementing agencies of AFPs face when dealing with WHT aspects of AFPs. Such disputes lead to avoidable litigation costs borne by KRA and implementing agencies of AFPs and loss of revenue in instances where KRA has had to withdraw the agency notices and forego the demanded sum, as it was in this case.

[172] Steel (n 20) 14.
[173]ibid.
[174]See ITA.

3.8.2 Kenya Electricity Generating Company Limited (KENGEN) versus Commissioner of Domestic Taxes

In the case of KENGEN vs Commissioner of Domestic Taxes,[175] KENGEN constructed the Olkaria II Geothermal Power Project in Naivasha, which project was funded by foreign financiers which included the International Development Authority (IDA). KENGEN objected to a tax demand of Kshs. 289,957,877/= by the Commissioner of Domestic Taxes. The demand was in respect of WHT. The Local Committee held that KENGEN was liable to pay the demanded amount hence the appeal by KENGEN. KENGEN argued that it was irrational for the Local Committee to conclude that KENGEN had the obligation to deduct WHT in respect of payments made to contractors by IDA.

KENGEN also argued that the proper entity which ought to have deducted WHT from the payments made to the contractors was IDA. The court ruled that the project was undertaken by KENGEN and the contractors and consultants were working on the project for KENGEN. It also took the view that as the contractors and consultants were being paid for the work done, they were being paid on behalf of KENGEN. The court's interpretation was that IDA did not give work to the contractor and consultants but KENGEN did.

In upholding the decision of the Local Committee, the court considered IDA to have made the payments on behalf of KENGEN and therefore had no independent legal obligation to deduct WHT. Based on this decision, implementing agencies have a responsibility to withhold and remit WHT in AFPs irrespective of the fact that payment of suppliers and contractors can be made directly by donors. It may however be practically impossible for implementing agencies to withhold tax from payments that have not been made by them. The ITA provides that the

[175] Income Tax Appeal No. 6 of 2010 (2015) eKLR available at http://kenyalaw.org/caselaw/cases/view/106951 accessed on 16 February 2017.

payer of income should withhold tax on payments made.[176]The Act however does not provide for the treatment of WHT when the payer is a foreign donor.[177]Also, recent tax legislative efforts such as the Tax Procedure Act and the Income Tax Bill, 2018 do not address the issue.[178]The conflicting views held by the parties in this case on the treatment of WHT in instances where donors make direct payments to contractors in AFPs, shows that it is a controversial subject that Kenya's tax law and policy framework should address.

3.9 Conclusion

The Constitution provides the basis for levying of taxes in Kenya. It provides for the levying of income tax, VAT, excise duty and custom duty by the national government. The VAT Act, Excise duty Act and the East African Community Customs Management Act, 2004 exempts from tax goods and equipment for use in the implementation of AFPs. The overall cost and benefit of these exemptions should be evaluated. This is considering the problems associated with tax exemptions discussed in the next Chapter. The ITA has no such blanket exemption. Despite the existence of a wide spectrum of tax laws, tax treatment of AFPs has led to tax disputes in Kenya. This can be attributed to gaps in the legal and policy framework.

[176]See n167.
[177]See ITA.

CHAPTER FOUR

4. A CRITIQUE OF THE REGIME OF TAXING AID FUNDED PROJECTS IN KENYA

4.1 Introduction

Governments in developing countries experience challenges in collecting and mobilizing tax revenue.[179] These challenges lead to tax gaps[180], which is the difference between the tax collected and what could have actually been collected.[181]The causes of tax gaps include tax evasion, tax avoidance and tax exemptions.[182] This Chapter highlights the attitude of some donors towards taxation of their funds and provides an analysis of tax law and policy regime on treatment of AFPs in Kenya. Some unique provisions of Ethiopia's income tax legislation are also discussed in this Chapter and contrasted with Kenya's regime. It also considers tax treatment of the SGR project, a major AFP in the country.

4.2 The attitude of some donors towards taxation of AFPs

The general conditions that apply to loans and grants of the AfDB provide that the loan or guarantee agreements and any other agreement entered into with AfDB shall be free from any taxes levied by member states which are borrowers. [183] The agreement establishing the AfDB also provides that the bank is exempted from any obligation relating to payment, withholding or collection of taxes or duty.[184] This means that when the borrower country borrows from AfDB for a project, it either has to provide tax exemption for supplies procured under the

---

[179] Giulia Mascagni *et al*, 'Tax Revenue Mobilization in Developing Countries: Issues and Challenges' (2014) 1available athttp://www.ids.ac.uk/publication/tax-revenue-mobilistation-in-developing-countries-issues-and-challenges accessed on 16 February 2017.
[179] ibid 1&4.
[180] ibid.
[181] Mascagni (n 179) 4.
[182] ibid.
[183] General Conditions Applicable to Loan, Guarantee and Grant Agreements of the African Development Bank and the African Development Fund, February 2009 (n 136) Section 8.01.
[184] Agreement Establishing the African Development Bank (n 136) Article 57(1).

financed project or the government contributes to the tax component of the project.[185]Tax exemptions as a form of tax expenditure have merits and demerits.[186] Recipient countries of AfDB funding should therefore engage in cost and benefit analysis before committing itself to the provision exempting AfDB funds from taxes.

The agreement establishing the AfDB exempts the Bank from acting as a withholding agent.[187] Therefore, the recipient country should in its legal and policy framework provide for the treatment of WHT on payments made by AfDB directly to project suppliers or contractors. In the absence of a clear policy guideline or legal provisions on the treatment of WHT, there is a possibility of a problem in taxation of projects financed by AfDB in the recipient country. This can result in disputes such as the one between KRA and KeNHA.[188]

The WB policy on the other hand allows financing of reasonable tax costs thus recipient countries with reasonable tax systems do not have to provide exemptions for financed projects.[189]In light of the WB policy, countries like Kenya should reconsider the several exemptions granted for AFPs under the VAT, excise duty, customs duty and income tax regimes. This is because some donors like the WB could be willing to pay the tax component for the projects they fund in Kenya.

Recipient countries may not be in a position to predict whether or not their tax systems would be considered reasonable by the WB at any particular time and this leaves room for uncertainty as to tax treatment of WB funded projects. Based on the attitude of the above two donors, it is

[185]Thuronyi(n 2) p 3.
[186] Li Swift *(*n 44*)* 5.
[187]Agreement Establishing the African Development Bank (2016 edition) (n 136) Article 57(1).
[188]See n16.
[189] World Bank Operational Policy (OP 6.00) April 2004 available at http://web.worldbank.org/archive/website01541/WEB/0__C-766.HTM accessed on 15 November 2018.

clear that the treatment of taxes in AFPs vary from donor to donor. This has led to incoherence in the treatment of taxes in AFPs in recipient countries, Kenya included.

4.3 The Problems Borne by the Tax Regime in AFPs

4.3.1 Tax exemptions

Kenya government policy allows tax exemptions for foreign loans for investment in the energy, road, railway and infrastructure sector.[190] Pursuant to this policy, the Cabinet Secretary for NT has in exercise of the powers conferred under section 13 of the ITA exempted from tax interest paid on foreign loans for investing in the infrastructure sector.[191]Instruments executed in respect to the transactions relating to loans from foreign sources received by investors in the infrastructure sector are also exempted from payment of stamp duty.[192]

Some donor funding agreements provide that such aid shall be exempt from taxes. [193]An example is the Memorandum of Understanding between the Government of Kenya (GoK) and the Government of the United States of America (USG) signed in July, 2014.[194]The USG agreed to support the GoK to increase its energy generation capacity to enable Kenya achieve its Vision 2030. [195]The Memorandum of Understanding provides that the resources from the USG agencies are tax exempt. It particularly provides that, "*The GOK expresses its support for the resources (including human, in-kind, and financial) that USG agencies intend to make available through Power Africa and intends that such resources provided hereunder shall be free from taxes imposed under laws in effect in Kenya*."[196]This therefore implies that no VAT,

[190] Legal Notice No. 91 of 2015.
[191] ibid.
[192]Legal Notice No. 106 of 11 June 2015 available at http://kenyalaw.org/kl/index.php?id=5201 accessed on 16 November 2018.
[193] Co-operation Framework between the Government of Kenya and the Government of the United States of America Regarding Power Africa available at https://www.usaid.gov/sites/default/files/documents/1860/Kenya-MOU.pdf 2-3 accessed on 14 December 2017.
[194] ibid.
[195] ibid.
[196] ibid 3.

income tax, custom and excise duty shall be levied on such resources. Recent infrastructure projects reflect this government policy. Tax exemptions are a form of tax expenditure and have merits and demerits.[197]There is need to evaluate the implications of these tax exemptions on the tax system *vis-a-vis* their benefits.

The tax legal framework also provides for various exemptions in AFPs. This is seen in the regime of VAT, excise duty, income tax and customs duty, which exempts from tax goods and equipment for use in the implementation of AFPs.[198] These exemptions pose problems to the tax regime and recipient countries of aid funds.[199]Firstly, tax exemption creates a possibility of its abuse. The abuse is more likely for indirect taxes such as VAT. Abuse occurs where exempt goods find their way into the domestic market for sale.[200] Fraud in customs departments also leads to non-exempt goods entering the country without payment of customs duty.[201] Given the huge size of foreign aid in Kenya, the potential for tax fraud can adversely affect the tax system because significant amounts of tax revenue can be lost.

Secondly, tax exemptions impose costs on tax administration of recipient countries, which keep track of the exemptions and administer them. This problem is worsened by the diversity of donor practices and expectations of several donors which recipient countries deal with.[202] Therefore, KRA incurs costs in monitoring and administering the various exemptions granted to different donors in AFPs. Tax administration should not attract excessive costs as this would reduce the net tax revenue.

[197] Li Swift (n 44) 5.
[198]See n11.
[199] United Nations Economic and Social Council Committee of Experts on International Co-operation in Tax Matters Third Session (n 76) 10.
[200]ibid.
[201] ibid.
[202] ibid.

Thirdly, granting of exemptions can lead to legal problems. This occurs when the exemption is granted on the basis of agreements or notices that lack the force of law.[203]Section 13 of the ITA confers upon the Minister power to grant any exemption on income by way of a gazette notice. The gazette notice should however be approved by Parliament, failing which the validity of the exemption can be challenged in a court of law.

Fourthly, tax exemptions can cause economic imbalances which are unfavourable to domestic production in recipient countries. For instance, if imported goods for use in AFPs are exempt, but no exemption is granted for local purchases, then there will be an alteration in favour of imports.[204]It is noteworthy that governments rarely exempt their supplies from taxes as doing so would create an unequal and anti-competitive playing field.[205]Finally, granting tax exemptions may create pressure for further exemptions, that is, it facilitates a tax exemption culture.[206]

The problems that tax exemptions pose to recipient countries often affect the development objectives that the aid was intended to serve, and any increase in aid amplifies these problems.[207]In Kenya, costly AFPs like the SGR project would amplify these problems. Therefore, Kenya's tax regime should take into account these problems in its treatment of AFPs. This is because allowing blanket tax exemptions without regard to its negative implications may be detrimental to the economy in the long run.

---

[203]ibid

[204] United Nations Economic and Social Council Committee of Experts on International Co-operation in Tax Matters Third Session n 76) 11.

[205] Steel (n 20) 12.

[206] United Nations Economic and Social Council Committee of Experts on International Co-operation in Tax Matters Third Session (n76) 11.

[207] ibid.

Abolition of tax exemptions granted to donors would assist in strengthening the credibility of donors and governments in regard to developing a taxpaying culture.[208] It would also lead to a widened revenue base and a simplified tax system.[209]Therefore, tax exemptions should be minimized or be avoided particularly when donors are willing to provide direct budgetary support.[210]They should however be maintained in situations where the cost of removing them is higher than the gain derived.[211]Removal of tax exemptions may come with a renegotiation cost.[212] Removing them can also distort the allocation of aid hence an aid recipient country that removes exemptions may lose out to those that maintain them.[213]There is also need for reforms to ensure coherence in aid policy management and to make tax management system simpler and cheaper.[214]

4.3.2 Law and Policy Gaps

The ITA does not provide for the treatment of WHT in fully AFPs where donors make direct payments to suppliers.[215]The respondents in this research stated that where donors settle suppliers' bills directly and in full, the implementing agency of the project does not have the opportunity to recover WHT for onward remission to KRA. They also stated that there are no policy guidelines governing tax treatment of AFPs in such instances. This is problematic because donors such as AfDB have no obligation to withhold or remit taxes, and thus cannot be pursued for payment of taxes.[216]

---

[208] Odd-Helge Fjeldstad, 'Tax and Development: Donor Support to Strengthen Tax Systems in Developing Countries' 186 available at http://onlinelibrary.wiley.com/doi/10.1002/pad.1676/epdf. accessed on 16 February 2017 p 186.
[209]ibid.
[210] IMF, OECD,UN and World Bank Report to the G- 20 Development Working Group 'Supporting The Development of More Effective Tax Systems' 25 available at www.**oecd**.org/ctp/48993634.pdf.accessed on 16 February 2017.
[211] Steel (n 20) 8.
[212] ibid.
[213]ibid.
[214] Dialo (n 69)
[215] See ITA; The issue arose KeNHA –vs- KRA case.
[216]Agreement Establishing the African Development Bank (2016 edition) (n 136) Article 57(1).

Budget ceilings for AFPs lead to insufficient budgetary allocation, penalties and interest charges for delayed tax payments.[217]Insufficient provision for the GoK counterpart contribution where required in financing agreements has been observed in some projects.[218]As a result, implementing agencies often argue that they do not have budgetary allocation to pay the tax component of projects partially funded by the GoK.[219] The issue of insufficient budgetary allocation arose in the Kenya Electricity Expansion Project (KEEP) and the Eastern Electricity Highway Project (EEHP), where the project goods lay at the Mombasa port for a long time due to taxation challenges.[220]The respondents in this research held a similar view. They stated that where a project is not fully funded by the donor but partially funded by GoK, the GoK counterpart contribution is not always sufficient to pay the tax component of the projects. It has been proposed that there is need for the NT to issue guidelines on how budgetary allocation for AFPs should be handled to avoid the delays in project implementation and interest charges on delayed tax payments.[221]

4.3.3 Non-compliance with the law

The respondents also pointed out that the NT is sometimes reluctant to issue tax exemption certificates during actual implementation of tax-exempt projects. An example cited was a case where a consultant was engaged in the provision of services for an AFP whose project contract sum did not include VAT. The NT failed to issue an exemption certificate but instead issued a letter recognizing the project as an AFP. After years of project implementation, KRA sought payment of VAT in respect of the project. Such non-compliance with the law by the NT lead to tax disputes in AFPs and should be addressed.

[217]See n137.
[218]ibid.
[219]ibid.
[220]ibid.
[221]ibid.

The respondents were also of the view that at times the relevant Ministry grants exemptions without concurrence of the Cabinet Secretary, NT. This poses a challenge in the implementation of the exemption. Therefore, the problems that arise in the tax treatment of AFPs in Kenya have been as a result of the various tax exemptions, gaps in the legal framework, absence of policy guidelines and non-compliance with the law.

The next section compares the withholding tax provisions in Kenya's ITA and Ethiopia's Income Tax Proclamation, in an attempt to explain the gaps in the ITA. Unlike Kenya's ITA, Ethiopia's income tax legislation is a recent legislation and has provided for the treatment of WHT where the payer is a foreigner, such as a donor. Kenya can borrow these provisions to seal the gap in the ITA on the treatment of WHT is AFPs where foreign donors make direct payments to contractors thus minimizing taxation challenges in AFPs in the country.

4.4 The Ethiopian self-withholding income tax provisions

The Federal Income Tax Proclamation governs the administration of income tax by the Federal Government in Ethiopia. The Proclamation came into force on 8th July, 2016 and repeals the Income Tax Proclamation No. 286/2002 and its subsequent amendments.[222] The Proclamation provides that every person deriving income shall pay income tax as required under the Proclamation.[223] The tax is levied on among others, employment income, rental income and business income.[224]

[222] Articles 100 & 102 of the Federal Income Tax Proclamation No. 979/2016 available at http://www.erca.gov.et/index.php/proclamation/39-income-tax#faqnoanchor accessed on 5 July 2017.
[223] Article 9.
[224] Articles 10, 13 and 18.

The Proclamation also has comprehensive provisions on WHT.[225]It provides for self-withholding of WHT. It provides that when a payer of income is a non-resident without a permanent establishment in Ethiopia, the resident of Ethiopia deriving the income shall withhold tax from the income in the same manner a resident payer would have withheld.[226] This tends to limit the possibility of loss of revenue due to complexities of pursuing a foreign payer for WHT.

The Kenyan ITA has no provisions on self-withholding. It only places the obligation to deduct WHT on the payer upon payment of certain income to resident and non-resident persons.[227] It does not address how tax will be withheld in cases where the payer is a non-resident, such as foreign donor. The Income Tax Bill, 2018 has also not resolved this issue. It is this gap in the Act that led to the dispute in KeNHA –vs- KRA, where a non-resident financier, EXIM Bank of China made direct payment to the Nairobi-Thika Superhighway contractor, Shengli Engineering (Group) Limited.[228] Provisions on self-withholding would have obligated the contractor to withhold the tax since the payer was non-resident and KRA would have been legally justified to pursue the contractor and not KeNHA, the implementing agency for payment of the WHT.

In the SGR project, the GoK was cautious of the potential taxation problems and carefully handled the tax aspects of the project. This is discussed in the next section.

4.5 The Precautionary Taxation Measures undertaken in the SGR Project

The project contractor for the SGR project is the China Roads and Bridges Corporation.[229]The agreement between the Kenya government and the SGR contractor provided that forty per cent

[225] Part 10.f of the Proclamation
[226] Article 93 3/.
[227] Section 35 ITA.
[228] See n16.
[229] KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project (n 125).

(40%) of the construction material be procured locally.[230]This was in agreement with the provisions of the Public Procurement and Asset Disposal Act, 2015 which requires foreign tenderers to source at least forty per cent (40%) of their supplies locally.[231] This was to ensure sustainable promotion of Kenya's local industry.[232]The agreement also provided that both imported and locally produced material be purchased tax free.[233]This shows that the government was keen to ensure equal tax treatment for locally produced goods and imports as exempting imports only would have created an unequal and anti-competitive playing field, which would have negatively affected the domestic industry.[234]

By providing that the supplies would be purchased tax-free, the agreement was however against the provisions of the VAT Act, 2013 which does not provide for automatic VAT exemption. The government and KRA agreed on a framework governing taxation of the project funds so as to allow smooth performance of the project without tax hurdles involving suppliers and KRA.[235]The suppliers were required to charge VAT to the contractor. However, the contractor did not pay the VAT component. The Government through the NT paid the VAT component.

As in the case in most externally funded projects, the project funding agreement precluded the use of the project funds for payment of local taxes such as import duty and VAT levied on locally purchased goods and services. [236] The VAT Act, 2013 however exempts goods and services procured for donor-financed projects subject to the authorization of the Cabinet Secretary.[237] The arrangement between the government and KRA made the implementation of

---

[230] Margaret Njuguna' Local Procurement in SGR Stands at 10 Billion' available at http://www.industrialization.go.ke/index.php/media-center/blog/220-local-procurement-in-sgr-stands-at-10-billion accessed on 6 June 2017.
[231]Section 157 (9) Public Procurement and Asset Disposal Act, 2015.
[232]ibid
[233] Njuguna (n 230).
[234]Steel (n 20) 12.
[235] KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project (n 125).
[236] ibid.
[237] First Schedule, VAT Act No. 35 of 2013.

the project smooth by eliminating the risk of non-compliance with VAT obligations by SGR suppliers.[238]

KRA has noted that as Kenya implements more projects of huge magnitude, there is need to continually review the tax process to match the new demands.[239] In this project, tax issues were handled carefully. A framework to ensure that the project complied with Kenya's tax laws was agreed upon between KRA and the government.[240]

KRA dedicated one of its units to specifically handle taxation issues on the SGR project and to perform monitoring functions in regard to the project.[241] The contractor was placed with the responsibility of ensuring that SGR supplies do not leak into the open market failing which they face legal sanctions.[242] This indicates that KRA was cognisant of the fact that there was the possibility of SGR supplies leaking into the open market leading to tax fraud.

The government allocated Kshs 7 billion to cater for VAT in respect of the project. Before this allocation, there was a dispute where major suppliers were required to pay VAT as exemption is not automatic under the VAT Act. The dispute threatened to delay the construction of the SGR.[243]Tax disputes in other AFPs have in the past not elicited immediate government response.[244] In other instances, the project materials have been held at the Port of Mombasa due to non-payment of taxes.[245] In the SGR project, the government responded with speed because of the magnitude of the project. The response though considered to be a temporary

[238] KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project (n 125).
[239] ibid.
[240] ibid.
[241] ibid.
[242] ibid.
[243]ibid.
[244] Patrick Thuita, 'Outering Road Project Runs Behind Schedule" available athttp://www.constructionkenya.com/3351/outering-road-expansion-nairobiaccessed on 21 March 2017.
[245]Kenya Public Expenditure Review Vol. 1 December 2014 (n 137) 25.

measure was an indication that the government was keen to facilitate the construction of the SGR.[246]

4.6 The Socio-economic Effects of the Taxation Problems in AFPs in Kenya

Taxation problems in AFPs in Kenya have often led to negative social-economic effects. These include delays in the implementation of projects and loss of revenue.[247]This section discusses these effects.

4.6.1 Delayed Implementation of Projects

Project implementation delay refers to the late completion of works as compared to the planned schedule.[248] Delay in completion of infrastructural projects lead to increased construction costs due to the extension of time of completion of the project.[249] It also leads to disruption of workflow and project abandonment.[250]

Many developing countries in Sub-Saharan Africa experience huge losses due to delayed completion of infrastructural projects.[251] This undermines the efforts made towards poverty reduction.[252] Costs that arise as a result of such delays take the form of accumulated interest on loans, costs of maintaining project management staff and continuous increase in costs of wages and construction materials.[253]

---

[246]KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project (n 125)
[247]Kenya Public Expenditure Review Vol. 1 December 2014 (n137) 25.
[248]Abebit H. Mariam, 'Causes and Effects of Project Implementation on Loan Recovery Performance: The Case of Selected Projects Financed By Development Bank of Ethiopia' (Abstract) available at https://opendocs.ids.ac.uk/opendocs/handle/123456789/7903 accessed on 23 February 2017.
[249] Paul Okeyo *et a l*'Effects of Delayed Payment of Contractors on the Completion of Infrastructural Projects: A Case of Sondu-Miriu Hydropower Project, Kisumu County, Kenya' p 327 available at www.davidpublisher.org/Public/uploads/Contribute/56382a7a55c7f.pdfaccessed on 23 February 2017.
[250] ibid.
[251] ibid.
[252] ibid.
[253] ibid.

Delayed completion of government projects has heavy budgetary implications. [254]It may lead to budgetary overruns, which in turn may stall projects thus delaying their contribution to national development. [255]Project delays and the resultant wastage of resources are unfavourable for developing countries where large portions of the population are poor.[256] Infrastructural projects should alleviate rather than increase poverty.[257]

Donor funded infrastructural projects are considered successful when they are completed within the scheduled time, allocated budget and are of the expected quality.[258]Delays in completion of infrastructural projects in Kenya have been caused by factors such as inadequate budgetary allocation to cover for the tax component in AFPs. This has been occasioned by construction materials being held at the port of Mombasa due to non-payment of tax thus delaying the implementation of projects.[259] Delayed payment of taxes leads to increased costs due to tax penalties and interest.[260]

Projects are core to the achievement of development plans.[261] Therefore, the Government needs to address the taxation hurdles in AFPs that are likely to hinder the achievement or timely completion of its Vision 2030 infrastructural developments. This is considering that most major infrastructural developments in Kenya form part of the AFPs.[262]

---

[254] ibid 334.
[255] ibid.
[256] Okeyo (n 249) 334-335.
[257] ibid.
[258] Regina Kisilu *et al* 'Determinants of Successful completion of Donor Funded Projects in Kenya: A Case for Turkana County' The Strategic Journal of Business and Change Management Vol 3 Issue 4 Article 3, 652 available at http://strategicjournals.com/index.php/journal/article/view/338/371 accessed on 23 February 2017.
[259]Kenya Public Expenditure Review Vol. 1 December 2014 (n137) 25.
[260] ibid.
[261] Mariam (n248) 3.
[262]Examples are the SGR Project and the Nairobi Outer Ring Road Improvement Project.

4.6.2 Litigation costs

Some of the tax disputes between KRA and the implementing agencies of AFPs such as KeNHA and KENGEN have ended up in court. This leads to the government incurring costs in the form of legal fees and court fees paid by the agencies.

4.6.3 Commitment fees

Government loans are financed with money collected from taxpayers hence the loan burden is pushed to the taxpayer. After successful negotiation for loans, donors have to reserve the funds for the government projects.[263] As a result, the donors charge a commitment fee on the undrawn balances. [264]To reduce the level of the commitment fees, the government should utilize the committed funds as quickly as possible.[265]Delays in the implementation of AFPs in Kenya lead to the payment of commitment fees by the government thus escalating costs.[266]

4.6.4 Loss of Government Revenue

Tax exemptions in AFPs if not properly administered can lead to tax fraud.[267]This in turn leads to huge amounts of revenue being lost considering the magnitude of projects such as the SGR project. In the SGR project, the contractor was placed with the responsibility of ensuring that supplies meant for use in the project do not leak into the market.[268]Tax exemptions also impose

---

[263]Kenya National Assembly Official Record (Hansard)available at https://books.google.co.ke/books?id=oPcCgsEH93AC&pg=RA4-PA939&lpg=RA4-PA939&dq=commitment+fee+donor+funded+projects+Kenya&source=bl&ots=8FAJ5q8STw&sig=08S74PlofjQRLtlm1M1tpf6whUg&hl=en&sa=X&redir_esc=y#v=onepage&q=commitment%20fee%20donor%20funded%20projects%20Kenya&f=false accessed on 28 May 2017.

[264]ibid.

[265]ibid.

[266]Khalividzi A. Dorcas," Factors Influencing Loan Effectiveness In Donor Projects In Kenya: A Case Of Rural Health Project "A Research Project Submitted In Partial Fulfilment Of The Requirement For The Degree Of Master Of Arts In Project Planning And Management, University Of Nairobi available at http://erepository.uonbi.ac.ke/bitstream/handle/11295/90425/Khalividzi_Factors%20influencing%20loan%20effectiveness%20in%20donor%20projects.pdf?sequence=1accessed on 27 May 2017

[267]Thuronyi (n 2) p 7.

[268] KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project (n 125).

costs in terms of monitoring and administration costs. This therefore makes aid costly for recipient countries.[269]

4.6.5 Strained relationships between Government Agencies

Some tax disputes between KRA and the implementing agencies of AFPs end up in court.[270] The disputes can strain the relationship between government agencies. The co-operation and co-ordination of the agencies as stakeholders is necessary if a policy framework governing taxation aspect of AFPs in Kenya is to be developed and implemented.

The respondents in this research were of the view that the problems in taxations of AFPs negatively impact revenue collection thus affecting socio-economic and political development of the country. They cited effects such as delayed completion of projects which lead to escalation of project costs. They were also of the view that tax disputes involving foreign consultants and contractors also affect the relationship between the government of Kenya and foreign governments.

5.0 Conclusion

AFPs are identified with tax exemptions as the policy of most donors, such as the AFDB provide that their funds shall not be used to finance taxes. This has led to a tax exemption culture in the recipient countries of donor funds. Tax exemptions also lead to increased administrative costs and tax fraud. Tax fraud arises where project goods which are mostly VAT exempt leak into the open market.

The respondents in this research were of the view that the gaps in the law and the absence of clear policy guidelines governing taxation in AFPs are the cause of the taxation problems in AFPs. Delays and reluctance by the NT in the issuance of tax exemption certificates in the

[269]Thuronyi (n 2) p7.
[270] See n16.

projects was also cited as a challenge that affects the timely implementation of AFPs. Therefore, as Kenya continues to implement AFPs of huge magnitudes, it is necessary to address such problems as their effects negatively affect the economy. There is need to streamline the legal and policy framework governing taxation of AFPs in Kenya in the light of the prevailing challenges. This will ensure that the country derives maximum benefit from donor funding, thus enhancing socio-economic development.

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

Foreign aid forms a huge portion of Kenya's development expenditure. This renders tax treatment of AFPs significant. Foreign aid is derived from donors and development partners. It comprises bilateral and multilateral aid and can be in the form of loans and grants. Development projects in Kenya heavily rely on foreign aid. The main donors include the WB and AfDB. Foreign aid promotes economic development in the recipient countries.

Aid helps in promoting social welfare, protecting the environment and supporting non-governmental organizations in the recipient countries. However, they pose a number of problems such as unreliability and over-dependence on aid. Repayment and servicing costs of foreign loans is also high. Despite these problems, developing countries still rely on aid due to revenue constraints.

Donors often insist on tax exemption in AFPs. Some donors such as the AfDB have no obligation regarding collection or payment of taxes.[271] In Kenya, supplies for use in the execution of official aid funded projects are exempt from VAT, customs duty and excise duty as provided under the relevant legislations.[272] Under the ITA, AFPs are only exempt if the financing agreements provide for exemption or if exemptions are granted by the Minister by way of gazette notices.[273]Tax exemptions granted in AFPs pose a number of problems in aid recipient countries, such as Kenya. These include tax fraud and economic distortion. It also facilitates the creation of a tax exemption culture.

[271]Agreement Establishing the African Development Bank (2016 edition) (n 136) Article 57(1).
[272]First Schedule Value Added Tax Act No. 35 of 2013; Second Schedule of the Act, Part A Rule 9; Section 114 and Part A Fifth Schedule, The East African Community Customs Management Act, 2004
[273] Section 13 ITA and First Schedule Part 1 Paragraph 27 of the Act

The ITA is silent on the treatment of WHT in instances where payments are made by non-resident payers such as donors. The Income Tax Bill, 2018 has also not resolved this issue in its proposals. There is also no policy guideline on the issue. This gap in the law and policy has led to tax disputes in AFPs. Non-compliance with the legal provisions on tax exemptions by the NT and government ministries has also been cited as a cause of taxation problems and disputes in AFPs.

Budget ceilings in AFPs have led to the challenge of insufficient budgetary allocation to cater for the tax portion of partially AFPs. This occurs in projects partially funded by the GoK and where the government is required to bear the tax burden of the project.

The challenges in the taxation of AFPs in Kenya have had far-reaching socio-economic implications. These range from delayed implementation of projects, unnecessary expenses to the government in the form of litigation costs, loss of tax revenue due to complexities of multiple exemptions, payment of commitment fees by the government and strained relationships due to tax disputes.

5.2 Recommendations

Based on this research, the following recommendations can be adopted in Kenya to address and limit taxation challenges in AFPs:

5.2.1 Development of a Policy Guideline

There is need for participatory engagement amongst stakeholders comprising KRA, implementing agencies of AFPs, NT and representatives of donor agencies and development partners with the aim of formulating a comprehensive policy guideline on tax aspects of AFPs. The policy guideline should provide clarity on applicable exemptions, remittance obligations and dispute resolution, among others.

5.2.2 Amendment of the tax laws

The tax legal framework should be amended to address the tax aspects of AFPs in Kenya. There is need to consider incorporating provisions on self-withholding of WHT to ensure that no tax revenue is lost in instances when non-resident donors make direct payments to resident suppliers or contractors in AFPs. Such provisions place responsibility of withholding and remitting the WHT on the resident recipient of the income. The VAT Act should also be amended to stipulate the time period within which decisions on requests for approval of exemptions for supplies for use in the implementation of AFPs should be made. This will eradicate delays by the NT in granting such approvals which in turn slows down performance of AFPs.

The ongoing review and overhaul of the Income Tax Act through the Income Tax Bill, 2018 presents an opportunity for reform of tax provisions in regard to AFPs.

5.2.3 Sensitization on the effects of the taxation challenges in AFPs

The stakeholders should be sensitized on the negative socio-economic effects arising from the problems in taxation of AFPs. This will enlighten them and assist in the creation of the goodwill to co-operate and develop appropriate policy guideline to address the challenges.

5.2.4 Dealing with the tax exemption culture

Tax exemptions have negative implications on recipient countries of aid funds. Exemptions weaken a country's tax system as they can be abused leading to loss of revenue and they also discourage the establishment of a tax paying culture. There is need to evaluate the exemptions on the basis of social, economic and administrative considerations and reduce them. Engagements with donor agencies to deliberate on the problems of exemptions and the need to lift some exemptions will be necessary. This is considering that some donors and development partners such as the World Bank, Norway and Netherlands have acknowledged the negative effects of tax exemptions and relaxed their policies to allow payment of tax portions of funded projects.[274]

5.2.5 Parliamentary approval of exemptions

The tax exemptions granted by the Minister through gazette notices should be approved by Parliament as provided under the ITA. In the absence of Parliamentary approval, the legality of the exemptions can be challenged. Parliamentary approval should be obtained for the exemptions. This is because a huge sum of revenue is foregone in the form of exemptions and therefore the decision to exempt should not be left to one government department.

[274] United Nations Committee of Experts on International Co-operation in Tax Matters, Report on the Fifteenth Session (n4) p 18-19.

APPENDIX

TAXATION OF AID-FUNDED PROJECTS IN KENYA: LAW, POLICY, PROBLEMS AND PROPOSALS FOR REFORM

QUESTIONNAIRE

FEBRUARY 2017

I am Carolyne Jepkoech Cheruiyot, a Master of Laws student at the University of Nairobi. As part of my Masters Programme, I am undertaking a research that seeks to establish the taxation problems that arise in Aid-Funded Projects in Kenya, the effectiveness of the existing legal framework and the effects of the challenges. The research also seeks to make appropriate recommendations.

I therefore request you to take part in the research by answering the questions set out below.

Profession: ……………………………………………………………………………......

Employer:..

Position:...

Date: ………………………………………………………………………………

1. Are all donors/development partners willing to pay the tax portion of Aid-Funded Projects in Kenya?

   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   …………………………………………………..

2. What are the reasons that have been given by donors/development partners for their unwillingness to pay the tax component of funded projects?
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………

…………………………………………………………………………………………
……………………………………………………………………………….

3. What are the problems encountered in taxation of Aid- Funded Projects in Kenya?

…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
……………………………………………………………………………….

4. How do the problems in taxation of Aid-Funded Projects in Kenya arise?

…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
……………………………………………………………………………….

5. Are there practical situations where the problems have manifested themselves? Please cite the situations.

....
....
....
....
....
....

6. How have the challenges been addressed so far?

…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
……………………………………………………………………………….

7. How is taxation dealt with in situations when a fully aid funded project is not tax exempt and the donor is unwilling to pay the tax portion of the project?

   ....
   ....
   ....
   ....
   ....
   ....

8. Is it possible to pursue tax payment from a donor? Please give a reason for your response.

   ....
   ....
   ....
   ....
   ....

9. Has the existing tax legal framework been effective in addressing taxation of Aid-Funded Projects in Kenya? Please point out the identified gaps in the tax laws.

   ....
   ....
   ....
   ....
   ....

10. How have the problems in taxation of Aid-Funded Projects affected the country socially, economically and politically?

    ....
    ....
    ....
    ....

11. How can the problems faced in taxation of Aid-Funded Projects in Kenya be addressed?

    ....

    ....

    ....

    ....

    Are tax exemption clauses in Donor Funding Agreements always tabled before Parliament for approval?.......................

    Thank you.

SELECTED READINGS

LEGISLATIONS

1. The Constitution of Kenya, 2010
2. East African Community Customs Management Act, 2004.
3. Excise Duty Act No. 23 of 2015.
4. Income Tax Act, Cap. 470 of the Laws of Kenya.
5. Income Tax (Withholding Tax) Rules, 2001.
6. Public Procurement and Asset Disposal Act, 2015.
7. Value Added Tax (Remission) (Official Aid Funded Projects) Order, 2003.
8. VAT Act No. 35 of 2013.
9. Ethiopian Federal Income Tax Proclamation No. 979/2016.

BOOKS

1. Odd-Hedge Fjeldstad *et al*, 'Tax Reform and State-Building in a Globalized World' in "*Taxation and State-Building in Developing Countries: Capacity and Consent*" Deborah Brautigam *et al* (editors).
2. Lang M *et al* , (Eds)"Tax Rules in Non-Tax Agreements" available at https://books.google.co.ke/books?id=JOu8R4gQzQ8C&pg=PA138&lpg=PA138&dq=African+Development+Bank+on+Taxation+of+aid+funded+projects&source=bl&ots=FaoWIWxxeo&sig=ESE4Fd60VEfbWAwfnPLzhHmAJYw&hl=en&sa=X&redir_esc=y#v=onepage&q=African%20Development%20Bank%20on%20Taxation%20of%20aid%20funded%20projects&f=false accessed on 3 February 2017.

CASES

1. KeNHA –vs- KRA, Judicial Review Case No. 250 of 2014, High Court of Kenya at Nairobi (Unreported).

2. Kenya Electricity Generating Company Limited (KENGEN) –vs- Commissioner of Domestic Taxes (2015) eKLR , Income Tax Appeal No. 6 of 2010 available at http://kenyalaw.org/caselaw/cases/view/106951eKLR accessed on 16 February 2017

ARTICLES

1. Bratic V, "Tax Expenditures: A Theoretical Review" available at https://hrcak.srce.hr/file/9199 accessed on 5 January 2018.
2. Burman L, "Is the Tax Expenditure Concept Still Relevant" available at http://webarchive.urban.org/publications/410813.html accessed on 5 January 2018.
3. Carnahan M, 'Taxation Challenges in Developing Countries' Asia & Pacific Policy Studies January 2015 Vol 2 No. 1 available at http://onlinelibrary.wiley.com/doi/10.1002/app5.70/epdf accessed on 16th February, 2017.
4. Cheboi N, " The Effect of Donor Funding On The Organizational Performance Of Government Ministries In Kenya", A Research Project Presented in Partial Fulfillment of the Requirements For the Award of the Degree of Master of Science in Finance, School of Business, University of Nairobi, October, 2012 available at http://chss.uonbi.ac.ke/sites/default/files/chss/NASMA%20MSC%20PROJECT.pdf accessed on 3 February 2017.
5. Dialo I, 'Tax exemptions for aid-funded projects: Reasons for Change" available at <http://www.ictd.ac/tax-exemptions-for-aid-funded-projects-reasons-for-change> accessed 11 November 2016.
6. Elahi M, "Social Contract Theory by Hobbes, Locke and Rousseau" available at https://www.academia.edu/3138759/Social_Contract_Theory_by_Hobbes_Locke_and_Rousseau?auto=dowload accessed on 6 February 2017.

7. Fjeldstad O H, “Taxation and Development: A Review of Donor Support to Strengthen Tax Systems in Developing Countries” available at https://www.cmi.no/publications/file/4720-taxation-and-development.pdf accessed on 6 February 2017.
8. Fjeldstad O-H, ‘Tax and Development: Donor Support to Strengthen Tax Systems in Developing Countries’ available at http://onlinelibrary.wiley.com/doi/10.1002/pad.1676/epdf. accessed on 16 February 2017.
9. Gray JW, ‘Ethical Realism’, available at <https://ethicalrealism.wordpress.com/2011/04/26/three-theories-of-justice/>accessed on 3 November 2016.
10. Hill J, ‘Taxes, the Social Contract, and Adam Smith’, available at <http://masshumanities.org/ph_taxes-the-social-contract-and-adam-smith/> accessed on 3 November 2016.
11. Kabinga M, ‘Principles of Taxation’, Jorg Alt SJ *et al* (eds) Paper 5 of the Introduction to the Project ‘Tax, Justice and Poverty’ (2006) available at <www.**tax**justice-andpoverty.org/fileadmin/Dateien/**Tax**justice.../05_**Principles**.pdf>, accessed on 14 November 2016.
12. Khalividzi A. Dorcas,” Factors Influencing Loan Effectiveness In Donor Projects In Kenya: A Case Of Rural Health Project “A Research Project Submitted In Partial Fulfilment Of The Requirement For The Degree Of Master Of Arts In Project Planning And Management, University Of Nairobi available at http://erepository.uonbi.ac.ke/bitstream/handle/11295/90425/Khalividzi_Factors%20influencing%20loan%20effectiveness%20in%20donor%20projects.pdf?sequence=1 accessed on 27 May 2017.

13. Kinyanjui M *et al,* 'Tax reforms and revenue mobilization in Kenya' AERC Research Paper 131 May 2003, 3 available at erepository.uonbi.ac.ke/.../Muriithi_Tax%20Reforms%20and%20Tax%20Mobilizatio... accessed on 9 November 2018.

14. Kleinbard E, "Rethinking Tax Expenditures" Address to the Chicago-Kent College of Law Federal Tax Institute, May 2008 available at www.jct.gov/Rethinking_Tax_Expenditures.pdf accessed on 5 January 2018.

15. Mariam A, 'Causes and Effects of Project Implementation on Loan Recovery Performance: The Case of Selected Projects Financed By Development Bank of Ethiopia' available at https://opendocs.ids.ac.uk/opendocs/handle/123456789/7903 accessed on 23 February 2017.

16. Mascagni G, *et al*, 'Tax Revenue Mobilization in Developing Countries: Issues and Challenges' (2014) available at http://www.ids.ac.uk/publication/tax-revenue-mobilistation-in-developing-countries-issues-and-challenges accessed on 16 February 2017.

17. Moyi E *et al*, 'Taxation and Tax Modernization in Kenya: A Diagnosis of Performance and Options for Further Reform', Report Submitted to the Institute of Economic Affairs (2006) available at <www.iea**kenya**.or.ke/downloads.php?page=**Tax**-Revenue-Performance-in **Kenya**.pdf accessed on 23 November 2016.

18. Muchiri S, "Tax and Regulatory Compliance", Seminar Presentation on Tax Management for Public Benefit Organizations available at https://www.icpak.com/wp-content/uploads/2016/08/ICPAK-Tax-Management-Seminar-for-PBOs-by-CPA-Starlings-Muchiri.pdf accessed on 27 January 2017.

19. Mwase N, 'IMF Survey: When Resources Come from 'Partners' instead of 'Donors' available at<https://www.imf.org/en/News/Articles/2015/09/28/04/53/sopol061912a> accessed on 14 November 2016.

20. Nyaga N, “Investor’s Guide to Kenya’s Tax Law”, available at https://www.matchdeck.com/article/6119-investors-guide-to-kenya-s-tax-law accessed on 6 February 2017.
21. Okeyo P*et al*, ‘Effects of Delayed Payment of Contractors on the Completion of Infrastructural Projects: A Case of Sondu-Miriu Hydropower Project, Kisumu County, Kenya’ available at www.davidpublisher.org/Public/uploads/Contribute/56382a7a55c7f.pdfaccessed on 23 February 2017.
22. Prichard W*et al*, “Donors, Aid and Taxation in Developing Countries: An Overview” ICTD Working Paper 6 September 2012 available athttp://www.ictd.ac/publication/2-working-papers/6-donors-aid-and-taxation-in-developing-countries-an-overview accessed on 1 February 2017.
23. Rao S, “Tax Reform: Topic Guide, 2014 “available at http://www.gsdrc.org/wp-content/uploads/2015/07/GSDRC_Tax_Reform_Topic_Guide.pdf accessed on 1 February 2017
24. Regina Kisilu *et al* ‘ Determinants of Successful completion of Donor Funded Projects in Kenya: A Case for Turkana County’ The Strategic Journal of Business and Change Management Vol 3 Issue 4 Article 35 available at http://strategicjournals.com/index.php/journal/article/view/338/371 accessed on 23 February 2017.
25. Richard M. Bird, ‘Tax Challenges Facing Developing Countries’ available at https://pdfs.semanticscholar.org/5fbe/db522c3c60ff2d9afc26cc0dd3b63e390e31.pdf accessed on 19 June 2017.
26. Salunke A *et al* ‘Effect of Construction Delays on Project Time Overrun: Indian Scenario’ available at http://esatjournals.net/ijret/2014v03/i01/IJRET20140301091.pdf accessed on 6 June 2017.

27. Steel I *et al* 'The taxation of foreign aid' African Tax Administration Forum Briefing Note May 2018, 9 available at https://www.odi.org/sites/odi.org.uk/files/resource-documents/12191.pdf accessed on 9 November 2018.

28. Sunjka B.P et al 'Significant Causes and Effects of Project Delays in the Niger Delta Region, Nigeria" available at www.scribd.com/document/174950005/**SIGNIFICANT**... accessed on 6 June 2017.

29. Swift Z, *et al*, 'Tax Expenditures: General Concept, Measurement and Overview of Country Practices' in Hana Polackova Brixi*et al* " *Tax Expenditures—Shedding Light on Government Spending through the Tax System- Lessons from Developed and Transition Economies*" available at https://openknowledge.worldbank.org/handle/10986/15067 accessed on 5 January 2018.

30. Thuita P, 'Outering Road Project Runs Behind Schedule" available at http://www.constructionkenya.com/3351/outering-road-expansion-nairobi accessed on 21 March 2017.

31. Thuronyi V, 'Tax aspects of donor-financed projects **',** Paper submitted to the United Nations Social and Economic Council Committee of Experts on International Co-operation in Tax Matters on 22 November 2005 available at<www.un.org/esa/ffd/**tax**/firstsession/ffd**taxation-tax**%20**aspects**.doc>accessed on 6 February 2017.

32. Vito Tanzi *et al*, 'Tax Policy for Developing Countries' available at https://www.imf.org/external/pubs/ft/issues/issues27/ accessed on 19 June 2017.

WEBSITES & OTHERS

1. IMF, OECD,UN and World Bank Report to the G- 20 Development Working Group 'Supporting The Development of More Effective Tax Systems' 25 available at www.**oecd**.org/ctp/48993634.pdf.accessed on 16 February 2017.

2. 'Kenya Public Expenditure Review Vol. 1 December 2014 'Decision Time: Spend More or Spend Smart?' 25 available at http://documents.worldbank.org/curated/en/230971468254049239/pdf/940210WP0v10Bo0ort0Vol01201400FINAL.pdf accessed on 16 February 2017.

3. Margaret Njuguna' Local Procurement in SGR Stands at 10 Billion' available at http://www.industrialization.go.ke/index.php/media-center/blog/220-local-procurement-in-sgr-stands-at-10-billion accessed on 6 June 2017.

4. Kenya's Recent Tax Changes and Regulations, 2016 Oxford Business Group available at https://www.oxfordbusinessgroup.com/overview/duties-detail-look-tax-regulation-and-recent-changes accessed on 6 February 2017.

5. Canons/Principles of Taxation by Adam Smith', available at <http://economicsconcepts.com/canons_of_taxation.htm> accessed on 3 November 2016.

6. African Development Fund Nairobi Outering Road Improvement Project Appraisal Report available at https://www.AFDB.org/.../Project.../Kenya_-_Nairobi_Outer_Ring_Road_Improvement... accessed on 16 February 2017.

7. Agreement Establishing the African Development Bank (2016 edition)) available at https://www.AFDB.org/en/document/document/agreement-establishing-the-african-development-bank-2016-edition-92045/ accessed on 16 February 2017.

8. Co-operation Framework between the Government of Kenya and the Government of the United States of America Regarding Power Africa available at https://www.usaid.gov/sites/default/files/documents/1860/Kenya-MOU.pdf accessed on 14 December 2017.

9. General Conditions Applicable to Loan, Guarantee and Grant Agreements of the African Development Bank and the African Development Fund, February 2009,available at

https://www.AFDB.org/en/documents/document/general-conditions-applicable-to-loan-guarantee-and-grant-agreements-of-the-AFDB. accessed on 16 February 2017.

10. http://www.ikm.co.ke/news/articles/2015/tax-update-september.html accessed on 3 March 2018.
11. **https://www.globallegalinsights.com/practice-areas/energy-laws-and-regulations/kenya** accessed on 3 March 2018.
12. Kenya National Assembly Official Record (Hansard)available at https://books.google.co.ke/books?id=oPcCgsEH93AC&pg=RA4-PA939&lpg=RA4-PA939&dq=commitment+fee+donor+funded+projects+Kenya&source=bl&ots=8FAJ5q8STw&sig=08S74PlofjQRLtlm1M1tpf6whUg&hl=en&sa=X&redir_esc=y#v=onepage&q=commitment%20fee%20donor%20funded%20projects%20Kenya&f=false accessed on 28 May 2017.
13. KRA's Commissioner General's Remarks at the Sensitization Workshop for Suppliers to the SGR Project on 4 February 2015 available at www.kra.go.ke/.../Remarks%20by%20the%20Commissioner%20General%20At%20T... accessed on 16 February 2017.
14. Uchukuzi, Issue 1 June 2014 available at www.transport.go.ke/downloads/transport%20newsletter%20.pdf accessed on 21 March 2017
15. United Nations Committee of Experts on International Co-operation in Tax Matters Report on the Fifteenth Session 17-20 October 2017, Economic and Social Council Official Records, 2018. Supplement No. 25.
16. United Nations Economic and Social Council Committee of Experts on International Co-operation in Tax Matters Third Session 29 October-2 November 2007, Tax Treatment of

Donor-Financed Projects Draft Guidelines prepared by the International Tax Dialogue Steering Group.