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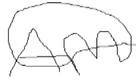
Illicit Financial Flows: A Legal Analysis of Tax Avoidance by Financial Institutions in Kenya

JULY 2021

DECLARATION

I OBAGA ASENATH MORAA, do hereby declare that this is original work and has not been submitted and is not currently being submitted for a degree in any other University



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This Thesis is submitted for examination with my approval as University Supervisor:

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Dated at Nairobi this ___16th_____ day of __December___________________ 2021

DEDICATION

This thesis is lovingly dedicated to my Father, Jeremiah Obaga Atancha, and Mother, Mary Bochere Ondeyo, for their constant love, continued support, encouragement, and care that has always sustained me.

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ABSTRACT

Illicit Financial Flows and exchequer revenue loss through aggressive tax avoidance by financial institutions are two sides of the same coin. In Kenya, many financial institutions avoid paying taxes through these illicit financial flows. Illicit financial flow (IFF) is an umbrella term that refers to the transfer of illegally obtained monies or the transfer of funds for criminal purposes.

The dilemma in tax avoidance rests in the competing interests between individuals' desire to save as much as possible and the state's right to taxes to meet government costs. Tax avoidance becomes more critical to companies, as entities that are at their centre business organisations, and as such, are profit-driven. In recent times, large technology companies such as Google and Apple have been on the spot due to their aggressive tax avoidance techniques such as creative accounting, thin capitalisation, the use of tax havens, and treaty shopping.

Kenya loses billions to capital flight through illicit financial flows. This revenue loss is significant in driving Kenya's big four agenda, including enhancing manufacturing from 9.2% to 20%, 100% food security, 100% Universal health coverage, and affordable housing. Illicit Financial Flows are the cross-border transfer of illegally obtained money. This could be through illicit trade, bribery, money laundering, tax evasion, and aggressive tax avoidance. Aggressive tax avoidance leads to revenue loss, which would aid in achieving the country's economic agenda instead of focusing on foreign aid. Aggressive tax planning hinders these efforts and leads to revenue loss. Amongst the perpetrators who aid in illicit financial flows through aggressive tax planning include lawyers, accountants, and tax auditors. The dilemma

in tax avoidance rests in the competing interests between entities' desire to save as much profit as possible and the state's right to taxes to meet government costs.

This research focuses on the possibility of financial institutions aiding in aggressive tax avoidance by its clients, or even the directors, leading to the country bleeding economically. Laws in place are analysed, and the limitations in the enforcement of these laws, with the help of a case study. Lessons from the case study are then sought to determine whether the laws in Kenya are adequate to deal with illicit financial flows and what recommendations can be made, if any, to combat illicit financial flows in Kenya and strengthen the framework for detection and deterrence of aggressive tax avoidance in Kenya.

LIST OF ABBREVIATIONS

CBK- Central Bank of Kenya

CoK - Constitution of Kenya

DTA- Doube Tax Administration

FI - Financial Institutions

FDI - Foreign Direct Investment

IAS- International Accounting Standards

IFF- Illicit Finacial Flow

ICTD- International Center for Tax and Development

ITA- Income Tax Act

FATF - Financial Action Task Force on Money Laundering

GAAR- General Anti-Avoidance Rules

GAAP- General Anti-Avoidance Provisions

KRA- Kenya Revenue Authority

LCD- Least Developed Country

SAAR- Specific Anti-Avoidance Rules

SPV- Special Purpose Vehicles

TP- Transfer Pricing

TCMP- The Internal Revenue Service's Taxpayers Compliance Management Programme

OECD- Organisation for Economic Cooperation and Development

STATUTES AND INTERNATIONAL LEGAL INSTRUMENTS

Constitution of Kenya, 2010

Companies Act, 2015

Banking Act, 2012

Income Tax Act, 1973

Kenya Revenue Act, 1995

Proceeds of Crime and Anti-Money Laundering Act, 2009

Tax Procedures Act, 2018

The Income Tax (Transfer Pricing) Rules, 2006; Legal Notice No. 67

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CHAPTER ONE

1.0 BACKGROUND

1.0.1 Evolution of Banking Transactions in the Modern Era

Globalisation and digitisation have transformed modern society through the information revolution with near-instantaneous operability characterising digital transactions. In the financial world, this revolution transformed banking transactions, significantly easing the transfer of financial assets among financial service providers and across states.[1] This new modus operandi precipitates one of the contemporary challenges in the financial industry and tax administration, illicit financial flows. The term illicit financial flows (IFF) is an umbrella term that refers to the transfer of illegally obtained monies, the transfer of funds for criminal purposes, or the illegal movements of money or capital across jurisdictions.[2] [3] The financing of unlawful activities and proceeds of illegal operations such as drug dealing are the most frowned upon forms of illicit financial flows. In many instances, these funds facilitate heinous crimes both at the national and international stage, such as arms trade, drugs trade, facilitate a large-scale operation of transnational criminal organisations, and financing commodities war such as precious minerals.[4] For instance, the funding of terror activities is linked to the spate of high-profile terror attacks that characterised the early 2000s. To stem the risk of terrorism,

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[1] Lenuţa Carp, "Financial Globalization and Capital Flows Volatility Effects on Economic Growth" Procedia Economics and Finance (2014) 15 350-356

[2] OECD, 'Illicit Financial Flows From Developing Countries: Measuring OECD Responses' (Oecd.org, 2014) <https://www.oecd.org/corruption/illicit_financial_flows_from_developing_countries.pdf> accessed 3 May 2021

[3] Peter Chowla and Tatiana Falcao, 'Illicit Financial Flows: Concepts And Scope' (Un.org, 2016) <https://www.un.org/esa/ffd/wp-content/uploads/2017/02/Illicit-financial-flows-conceptual-paper_FfDO-working-paper.pdf> accessed 6 May 2021.

[4] Ibid.

world leaders agreed to stifle the financial support of terror groups, targeting transnational illegal movements of money due to its facilitative role. These efforts culminated in the Financial Action Task Force on Money Laundering (FATF), a synchronised inter-governmental policy approach against anti-money laundering (AML).[5]Besides making funds available for criminal activity, IFFs corrode governance structures, weaken a states' governance capacity, and deny countries, particularly developing countries, the much need finance to engender development. IFFs are responsible for the loss of millions of dollars from least developed countries (LDC), denying these jurisdictions access to funding for development programs and service delivery. Consequently, illicit financial flows are linked to stalled development programs in LCD, undermining social justice, promoting and sustaining kleptocracy, and bolstering international and national criminal activities.[6]

1.0.2 The Nexus Between Tax Avoidance and Illicit Financial Flows in Modern Banking Transactions

1.0.2.1 The Nature of Tax Avoidance

IFFs precipitate both serious and relatively innocuous illegal activity. Tax evasion and avoidance schemes are part of the comparatively lesser evil attributable to IFFs. The former connotes illegal strides purposeful orchestrated by a taxpayer avoiding their tax obligation, while the latter defines legal strategies intended to lower a taxpayer's tax rate.[7] Taxpayers' impetus to reduce their tax burden and resultant techniques and systems are not entirely new.

[5] Giuseppe Schiavone, "Financial Action Task Force on Money Laundering (FATF)" (2005)
[6] Peter Reuter, “Draining development? Controlling Flows of Illicit Funds From Developing Countries” (2012) The World Bank
[7] Blaufus, Kay, Jochen Hundsdoerfer, Martin Jacob, and Matthias Sünwoldt. "Does legality matter? The case of tax avoidance and evasion." Journal of Economic Behavior & Organization 127 (2016): 182-206.

As early as the Roman era, the difficulty in ascertaining tax avoidance or evasion was apparent. Wealthy Roman families hide their jewellery or gold coins to elude luxury tax, while freeholders in eighteenth-century England bricked off fireplaces temporarily hoodwinking tax collectors.[8] Modern iterations of lessening one's tax burden, therefore, are not novel. However, it may be successfully argued taxpayers in the contemporary era enjoy access to broader and more sophisticated tax avoidance or evasion techniques with a more significant demography participating in these techniques and a greater volume of taxable income sheltered from the taxman.

International tax avoidance and evasion is a prevalent and highly sophisticated enterprise that directly impacts government revenues, state capacity to finance service delivery and offer welfare services and threatening international and national peace and security. In principle, the consequence of both tax evasion and tax avoidance are twofold firstly, denying the state access to revenue, and secondly, propagating taxation inequality with parties engaged in these activities not paying their fair share of taxes while enjoying equal access and benefit to government service similar to compliant taxpayers.[9] The actual impact of tax avoidance lies in the realm of macroeconomics. Governments desire to bridge the gulf between actual taxes collected and the potential government revenue. This is the quintessential example of a dilemma in public finance, raising legal, practical, and moral issues. The challenge for governments lies in balancing competing interests between individuals' desire for a lighter tax burden and the state's right to taxes as revenue to fund government projects and fund welfare

[8] Valerie Braithwaite, "Tax evasion" In The Oxford Handbook of Crime and Public Policy (2009): 10
[9] Alex Cobham, "Tax Evasion, Tax Avoidance and Development Finance." Queen Elizabeth House, Série Documents de travail 129 (2004): 11-18

services. The uncertainty of public finance expenditure further exacerbates the government's precarious position. According to Wagner's law, public spending in industrial economies is predictably always going to rise, yet the rate of increase remains uncertain.[10] Tax lessening schemes threaten governments' access to revenue and directly impact their capacity to execute their mandate. Consequently, tax avoidance and evasion have attracted the attention of governments, and tax equality and anti-money laundering crusaders. As a result, through collaborative efforts nationally and internationally, governments are taking a stand against tax avoidance and IFFs.

Conversely, tax avoidance is an opportunity for strategic financial management for rational citizens who seek to maximise their value through financial capital while lowering their tax costs. Two primary techniques underpin tax avoidance, base erosion, and profit shifting: reducing one's tax rate and transferring the jurisdiction taxation to a jurisdiction with a lower tax rate. According to behavioural economics, this premise is sufficiently accurate and generalisable as a predictor of human behaviour[11], applying to human-driven enterprises such as businesses that are primarily profit-driven. From a business perspective, taxes are an expense that thins the bottom line; reducing a business's tax burden increases its overall profit margin. Interestingly, reducing one's tax burden is not the only reason for tax avoidance; in some instances, the taxation-benefit equilibrium plays a vital role. Citizens, be they artificial or natural persons, are less willing to pay taxes to inefficient governments that lack the fiscal restraint and skill to utilise taxes properly. Under these conditions, taxpayers perceive

[10] Henrekson, Magnus. "Wagner's law-a spurious relationship?." Public finance 46, no. 3 (1993): 3
[11] Mullainathan, Sendhil, and Richard H. Thaler. Behavioral economics. No. w7948. National Bureau of Economic Research, 2000. 1-10

governments as underserving of taxes paid therefore logically gravitate towards denying the state access to their income. Tax avoidance is not limited to MNEs; individuals are equally party to the illegal activity. Evidence from the Panama Papers in 2016 exposed the wealthy and politicians across the world as part of a complex web of tax avoidance and fraud.

1.0.2.2 The Nexus Between Tax Avoidance And Illicit Financial Flows

Demand for tax avoidance and IFF services has attracted professionals who offer facilitative services. Tax avoidance is both an art and a science; an enterprise very few can successfully engage in while it is a service in demand. Professionals across different files work in concert, offering services that circumvent banking and tax regulations. Lawyers, accountants, and tax consultants are part of the elite group of professionals that help run the tax avoidance machinery.[12] Lately, financial institutions worldwide have also been cited as offering unique services for preference clients to help avoid taxes.[13] A banking service provider may counsel multinational MNEs tax avoidance schemes with the highest possibility of reducing taxes: treaty shopping. According to a report by ActionAid in 2013, Barclays Britain, among the largest banks in Africa at the time, advised its client to redirect their investment in Africa through Mauritius owing to the country's 'favourable tax climate' and 'the extensive network of tax treaties that Mauritius has with many countries'.[14] Multinational Banks, particularly those located within tax havens, have access to a vast arsenal of tools used in tax avoidance

[12] Prem Sikka, "Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance" In Accounting Forum vol. 34, no. 3-4, (2010) 153-168.
[13] Prem Sikka and Mark P. Hampton, "The Role of Accountancy Firms in Tax Avoidance: Some evidence and issues" In *Accounting Forum*, vol. 29, no. 3, *(*2004). 324-343.
[14] Export.Gov' (Export.gov, 2018) . 'Kenya - Trade Agreements <https://www.export.gov/article?id=Kenya-trade-agreements> accessed 26 August 2018

and IFFs such as offering banking or asset management services from foreign territories with banking secrecy laws or using business tools such as special purpose entities (SPE) to create anonymity and veil beneficial ownership.[15] A taxpayer's ability to transfer funds anonymously and maintain access to the funds is a critical component of tax avoidance; it offers taxpayers the option of a lower tax burden without the risk of penalty for non-compliance with tax laws. The transnational illegal movement of funds or capital is, therefore, a facilitator of tax evasion. For MNE and wealthy individuals, with the latter facing stiffer income tax in LDC, access to these facilitative services and technical know-how increases their likelihood of successful tax avoidance is a mouthwatering prospect.

Government policy is equally a contributor to tax avoidance and illegal movement of funds. Firstly, poor government policies passively promote both tax avoidance and IFFs.[16] Poorly drawn tax treaties and non-participation by some jurisdictions in AML agreements provide legislative loopholes for tax evasion and IFFs. DTAs are part of international cooperation among countries in easing the cost of doing business, easing the process of allocating international tax base and for purposes of facilitating transnational tax administration within different jurisdictions.[17] Also, proponents, DTAs argue the treaties encourage trade while protecting expatriates from double taxation.[18] However, many of the popular tax havens or

[15] Ibid.

[16] Yadong, Luo, Qiuzhi Xue, and Binjie Han. "How Emerging Market Governments Promote Outward FDI: Experience from China." Journal of world business 45, no. 1 (2010): 68-79.

[17] Hearson, Martin. "Tax-motivated illicit financial flows: A guide for development practitioners." U4 Issue (2014) 11.

[18] Steenkamp, Lee-Ann. "The permanent establishment concept in double tax agreements between developed and developing countries: Canada/South Africa as a case in point." International Business & Economics Research Journal (IBER) 13, no. 3 (2014): 539-552.

offshore financial centres are structured to encourage tax avoidance. These jurisdictions are characterised by low taxation rates, a mechanism that hinders information exchange, financial services uneven to the local economy, and minimal regulatory supervision. For instance, Kenya is in DTAs with the UAE, Mauritius, and Seychelles, all identified as top tax havens by the Tax Justice Network in the 2018 secrecy indexes.[19] Under DTA with tax havens, there is a real risk of taxpayers taking advantage of the treaty to lower their tax burden. Under these agreements taxing authorities are in constrained in tax administration. As an appendage of the state, the revenue authority cannot act contrary to government policy; however, at the same time, the policy impedes the execution of its mandate.

1.0.2.3 The Challenge with Tax Avoidance Motivated Illicit Financial Flows

1.0.2.3.1 Loss of Government Revenue

IFFs and tax avoidance are not new to the world, with the practice denying countries around the world billions in revenue. According to the Organization for Economic Co-operation and Development (OECD), an estimated 240 billion dollars is lost annually through tax avoidance techniques.[20] In recent times, large ICT companies such as Google and Apple have been on the spot due to their aggressive tax avoidance techniques. Such practices include creative accounting, thin capitalisation, the use of tax havens, and treaty shopping, resulting in base erosion and profit shifting actions. For example, Google stands accused of using the Double Irish and Dutch Sandwich options to avoid paying taxes in the US, alternatively remitting its

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[19] Tax Justice Network, 'Narrative Report on Mauritius' (2018) <http://www.financialsecrecyindex.com/PDF/Mauritius.pdf> accessed 20 September 2018.

[20] Eric Bartelsman and Beetsma Roel, “Why Pay More? Corporate Tax Avoidance Through Transfer Pricing in OECD Countries” (Journal of Public Economics 2013) 87.

revenue to Ireland that offers lower taxes.[21] The business community is not shy about leveraging the benefits of globalisation and digitisation as strategic business tools to improve their profits by lowering taxes. While companies are at liberty to play within the rules, businesses and high-earning individuals deploy aggressive techniques that diminishes their tax obligation. Consider Apple, arguably the world's largest and most profitable mobile phone manufacturers; between 2009 and 2012, the company reported a profit of 74 billion dollars, yet it paid virtually zero taxes. The company attributed its sales to subsidiaries in Ireland, a jurisdiction with a corporate tax of 1%.[22] From an accounting lens, Apple would have paid 26 billion in taxes had it reported its taxes in the USA; instead, paying a paltry 6 billion in 2012.[23] To put Apple's tax avoidance into perspective, in 2011, the company amassed an eye-watering 103 billion dollars in profits offshore; however, in the USA, the company has a tax rate of 7.3%, paying a total of 2.3 billion dollars in tax.[24] This example brings into sharp focus the primary criticism for tax avoidance. It illustrates the magnitude of the denied revenue to tax avoidance by drawing on the volume of taxes governments miss through the practice. The OECD describes this form of tax competition as harmful since it is essentially undercutting tax rates in the hope of securing higher revenue collections.[25] It is instructive to appreciate that the example refers to a scenario in the USA which fortunately has superior financial, administrative, and human resource capital to enforce tax liability. It, therefore, follows

[21] Robert Wood, "How Google Saved 3-6 Billion Taxes From Paper Dutch Sandwich" (2016) Forbes.com Accessed 26 August 2018.
[22] Carl Levin and John McCain, 'Offshore Profit Shifting And The U.S. Tax Code - Part 2 (Apple Inc.)' (Americansfortaxfairness.org, 2013) <https://americansfortaxfairness.org/files/EXHIBIT-1a-Subcommittee-Memo-on-Offshore-Profit-Shifting-Apple-May-21-2013.pdf> accessed 6 May 2021.
[23] Ibid.
[24] Ibid.
[25] Hearson, Martin. "Tax-motivated illicit financial flows: A guide for development practitioners." U4 Issue (2014) 20.

countries such as LDC with fragile tax enforcement capacity lose significantly more taxes through tax avoidance. While the sums lost may not numerically equal in value of sums lost by more developed countries, the development value of the funds is more significant for these cash-strapped economies. Essentially, tax avoidance in source states that are the victims of capital flight, the voluminous exodus of financial assets from one jurisdiction to another, denies these governments access to revenues generated utilising these source states' homegrown resources.

1.0.2.3.2 Distortion of National Economic Policy

1.0.2.3.2.1 Abuse of State Sovereignty

Tax avoidance secondarily negatively impacts recipient states while eroding international security. To fully appreciate these cons, it is imperative first to understand tax havens and secrecy jurisdictions. International law recognises state sovereignty [26] which some states leverage to offer wealth and financial asset sanctuaries. These jurisdictions materialise as either secrecy jurisdictions or tax havens. The former is a jurisdiction that offers a sanctuary for non-compliant taxpayers from the income source country, usually through tax shifting or base erosion.[27] The OECD identifies tax havens as a jurisdiction with the following four elements: nominal taxes, absence of data sharing, lack of transparency, and minimal activity on the financial market.[28] The Tax Justice Network distinguishes between tax havens and secrecy

[26] Henkin, Louis. "Human rights and state sovereignty." Ga. J. Int'l & Comp. L. 25 (1995): 31.
[27] Nicholas Shaxson, 'Tackling Tax Havens' (IMF.org, 2019) <https://www.imf.org/external/pubs/ft/fandd/2019/09/tackling-global-tax-havens-shaxon.htm> accessed 6 May 2021.
[28] Hakan Narci, 'Tax Havens & The OECD Campaign Against Them' (Uniset.ca, 2012) 8. <http://uniset.ca/microstates2/narci.pdf> accessed 6 May 202.

jurisdictions, noting the latter denotes jurisdictions that specialise in enabling individuals to evade capital taxes in their source jurisdictions in contrast to the former, which aid MNEs shift tax out of the source countries to pay less tax in the alternative jurisdictions.[29] Experts on the subject agree tax sanctuary jurisdictions rely on anonymity and transactional opacity to protect banking information and details about participants and beneficial ownership by characterising such information as private.[30] The laws in these jurisdictions prohibit financial institutions from sharing this information with local or international law enforcement. Moreover, these jurisdictions are not a party to international agreements on data sharing in banking information.

1.0.2.3.2.2 Economic Impact of IFFs in Tax Havens

Capital flight into destination jurisdictions colour these economies, presenting an accounting-based pseudo-economic growth. Economic and accounting statistics tainted by the voluminous inflow of capital distort these statistics and devalues their informative value—this waters downs governments' economic decision making. Distorted economic statistics is one of the problems Ireland is forced to grapple with as a result of its preferential corporate tax regime.[31] Considering the Apple example discussed above, outwardly, there is the impression Ireland through its tax policy, priced Apple from the USA, emerging victorious from the tax competition between the two countries by offering a more attractive tax rate. Therefore, Apple's taxation in Ireland boosts its economy and revenues, with the country securing revenues it would have otherwise not had access to. Critics argue the large sums of money hidden in tax havens through creative accounting creates the illusion of tremendous domestic

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[29] Tax Justice Network, 'What Is A Tax Haven? - Tax Justice Network' (Tax Justice Network, 2021) <https://www.taxjustice.net/faq/what-is-a-tax-haven/> accessed 6 May 2021.
[30] Ibid.
[31] Stewart, Jim. "Is Ireland a tax haven." Dublin: TCD (2013) 11-18.

economic growth, a phenomenon dubbed leprechaun economics.[32] Paul Krugman explains that tax-driven accounting inflows in tax havens distort these countries' economic data in the long run, presenting governments with inaccurate economic data that governments rely on when formulating economic policies. This predisposes the countries' economies to failure to failure and non-responsiveness because of poor decision making.[33] Under these conditions, governments are blind and deaf to the actual economic outlook within their jurisdictions and the population's economic challenges.

The Vicious Tax Avoidance-Illicit Financial Flows Cycle

Finally, tax avoidance offers fodder that contributes to the sustainability of the IFFs ecosystem. Parties engaging in tax avoidance use the same systems, institutions, and techniques utilised by terror groups, organised criminals, and kleptocrats to hide illegally acquired funds or fund their operations. This creates a vicious cycle; a vibrant market for illicit financial enabled transactions incentivises product innovation in the market, inadvertently attracting more participants. Since some of IFFs users are violent criminals, such as terror groups and organised criminals, their ability to anonymously engage in banking transactions with minimal risk of arrest facilitates their criminal activities. Criminals' reliance on IFFs is founded on the systems' impediment to investigations and prosecution of tax malpractices and IFFs. This element of non-discoverability offers participants in the scheme the confidence and motivation

[32] Szczepaniak, Małgorzata. "Factors of economic growth in Ireland." Economic Miracles in the European Economies. Springer, Cham, 2019. 79-97.
[33] Ibid.

to continue engaging with the primary enterprise, such as tax avoidance. This cyclic relationship, in turn, jeopardises national and international security.

1.0.2.4 Tax Avoidance and Illicit Financial Flows in Africa

Data and research into IFFs in Africa paints a picture of intense use of IFFs in the region and a corresponding array of negative consequences. Many African countries rely on corporate tax as their main tax base.[34] Corporate tax in most sub-Saharan countries is among the world's highest, ranging between 30-34%.[35] The region's comparatively high corporate tax is an incentive for creative approaches of lessening the tax burden, invariably leading to tax avoidance facilitated by IFFs. Capital flight through IFFs contributes to the region's slow rate of development and the governments' ability to offer essential services due to lost revenue.

Léonce Ndikumane provides an insightful perspective into the effect of IFFs in Africa. Various quotas in Africa use the different permutations of IFFs for their different needs, which is aided by the region's weak government capacity. Between 1970 to 2008, Ndikumane estimates that up to 700 billion dollars fled from the 33 sub- Saharan states.[36] To provide context, if the sum of money lost gained interest at market rates in 2008, the amount would have accrued to 999 billion dollars. In comparison, the entire GDP of sub-Saharan African at the same time stood at 997 billion dollars.[37] Ndukumane's assertions are not isolated. Research by Dev Kar and

[34] Wood, R. W. "How Google Saved $3.6 Billion Taxes From Paper'Dutch Sandwich'. Forbes, December 22." (2016) 5-15.
[35] Abbas, SM Ali, and Alexander Klemm. "A partial race to the bottom: corporate tax developments in emerging and developing economies." International Tax and Public Finance 20.4 (2013): 596-617.
[36] Sihlongonyane Mfaniseni Fana, "Africa's Odious Debts: How Foreign Loans and Capital Flight Bled the Continent." (2012): 1147-1149.
[37] Ibid.

Devon Cartwright-Smith illustrates that both normalised (conservative) and non-normalised (robust) IFFs increase in LDCs.[38] The situation is getting worse as more funds are fleeing developing nations. According to recent studies, IFFS in the sub-Saharan region stood at 1.1 trillion dollars.[39] Worst still, these figures are considered conservative statistics, as they do not consider bulk cash transfers among other forms of IFFs. Effectively, IFFs contribute to the loss of billions of dollars from LDCs, funds that would be used to fund government services and projects at the heart of the well-being of the countries.

1.0.3 Tax Avoidance and Illicit Financial Flows in Kenya

The Kenyan context on IFFs is no different from the grim picture painted of Sub-Saharan Africa. Regionally, Kenya is a conduit of illegal capital from neighbouring countries to the international market. The countries comparatively robust banking industry and geographical proximity have contributed to the country's role in channelling illicit financial flows in the region.[40] By way of example, Kenya is reported to provide an entry point for illegal capital looted by military leaders in South Sudan.[41] Concomitantly, Kenya is a victim of tax avoidance and IFFs as part of corporate cost structuring. Companies in the country, both international and local, are the subject of tax avoidance and IFFs incentives coupled with access to a supportive environment and relatively weak financial and tax law enforcement. According to experts,

[38] Kar Dev and Devon Cartwright-Smith, "Illicit financial flows from developing countries: 2002-2006." (2009)
[39] Kar Dev and Joseph Spanjers, (Gfintegrity.org, 2018) <https://www.gfintegrity.org/wp-content/uploads/2014/12/IFF-Update_2014-Final-1.pdf> accessed 13 August 2018.
[40] Barasa, Tiberius. "Illicit Financial Flows in Kenya: Mapping of the Literature and Synthesis of the Evidence." (2018).
[41] Institute of Economic Affairs, 'Why Reduction Of Illicit Financial Flows That Fuels South Sudan'S War Economy Is In Kenya And Uganda'S Interest' (Ieakenya.or.ke, 2018) <https://www.ieakenya.or.ke/publications/bulletins/why-reduction-of-illicit-financial-flows-that-fuels-south-sudana-s-war-economy-is-in-kenya-and-ugandaa-s-interest> accessed 6 May 2021.

Kenya loses billions in the different permutations of IFFS.[42] The lost revenue is of particular importance for East Africa's biggest economy, with the Jubilee Government driving its big four agenda: aptly themed "Creating Jobs, Transforming Lives and Sharing Prosperity in driving development projects including the Jubilee."[43] However, the Kenyan government's policies are hampered by a strained budget. The 2018/2019 budget estimate was the highest ever for the country. The Exchequer is expected to borrow up to 400 billion both domestically and internationally, while the budgetary deficient stood at about 700 billion shillings.[44] As late as 2014, it is estimated that Kenya lost up to 4 billion dollars in one form of IFFs: trade misinvoicing.[45] To contextualise the magnitude of the problem, the amount lost from trade misinvoicing is three times the countries national health budget for the fiscal year 2014/2016. Apart from the conventional challenges associated with IFFs that deny governments revenue, analysis of the Kenyan budget points to a different challenge. Since the state cannot meet its budgetary needs through taxation, it is forced to borrow or increase taxes. For instance, in the 2018/2019 budget estimates, an increase in taxes is expected to raise the cost of living for a large population. Similarly, the government has resorted to local borrowing to fund the national budget leading to high market loan rates, which experts identify as hurting economic development.[46] Thus, lost revenue due to tax avoidance and banking transactions facilitated

[42] Olawale Atanda, "Tax Avoidance and Evasion as a Cause of Underdevelopment in Africa: A Study of Corporate Tax Evasion" (2015).
[43] Bitange Ndemo, "Uhuru'S Big Four Agenda: How to Achieve Greater" (2018) Daily Nation, <https://www.nation.co.ke/oped/blogs/dot9/ndemo/2274486-4329178-6lp377z/index.html> accessed 26 August 2018.
[44] Budget Statement FY 2018/2019: Creating Jobs, Transforming Lives and Sharing Prosperity. The National Treasury and Planning
[45] Alvin Mosioma, "Tax Incentives Denying Kenya Money it Needs to Improve" (Business Daily, 2018) <https://www.businessdailyafrica.com/analysis/Tax-incentives-denying-Kenya-money/439448-2763946-4necfj/index.html> accessed 19 August 2018.
[46] Caspah Lidiema, 'Effects Of Government Borrowing On Private Investments In Kenya' (Kba.co.ke, 2017) <https://kba.co.ke/downloads/Working%20Paper%2022.pdf> accessed 6 May 2021.

through IFFs jeopardises the country's economic well-being and is linked with entrenching kleptocracy in government, eroding governance structures, and threatening regional peace.

1.0.4 Transnational Banking In Kenya

Banking, in its modern sense, is largely a foreigner-driven enterprise in Africa. Pre-colonial and immediately post-colonial eras, foreign banks enjoyed dominance of the sub-Saharan banking market.[47] However, protectionist policies by African governments and liberalisation of the African markets in the following years reduced dominance by foreign banks in the region.[48] Nonetheless, in some countries, the dominance of foreign banks waned but did not weaken, while in others, they were vital in the restructuring of the banking sector.

With banking services becoming a necessity in the modern world, foreign banks have enjoyed a strong presence in Kenya. Foreign banks introduced commercial banking in the country, with the National Bank of India[49] and the Standard Bank of South Africa establishing the first banks in the country at the tail-end of the 19th century. The dominance of the sector by foreign-owned banks persisted. In 1993, two-thirds of the biggest banks, foreign-owned, in the country accounted for 38% of the market.[50] About 13 banks in Kenya are currently foreign-owned, with many service providers being locally owned outfits. Kenyan banks also adopted an expansionist ideology in the early 2000s. To this end, banks such as KCB and Equity aimed to

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[47] Thorsten Beck and Robert Cull, "Banking in Africa" (In The Oxford Handbook of Banking, Second Edition. 2014) 15-30.
[48] Ibid.
[49] CBK, 'Bank History' (2018) <https://www.centralbank.go.ke/bank-history/> accessed 20 September 2018.
[50] Ibid.

move to other East African countries.[51] Therefore, the banking industry in the country is characterised by both international players with a local presence and locally owned outfits with a presence in East Africa. Consequently, a significant portion of banking institutions in the country have the capacity and market share to transact in large money transfers across several jurisdictions. Karuoro estimates the countries financial industry transacts between 12 to 15 billion dollars per month.[52] The large volume of data on industry transactions creates a favourable environment for bank non-disclosure of internal transactions and strained oversight capacity due to limited financial, human resource, and technical capacity among over sigh agencies. In essence, banks in Kenya have both the incentive, opportunity, and clientele interest in tax avoidance and IFFs as either complementary or separate services.

1.1 STATEMENT OF PROBLEM

Citizens and governments are in a symbiotic relationship; citizens pay taxes, and governments utilise collected revenue to fund public services and welfare programs. Taxation procedures provide the framework for tax collection, which are premised on several principles, among other things, equitable taxation. To this end, the government formulates a tax rate and tax burden commensurate to the taxpayers' ability to pay and the level of benefit they derive from public resources. Under ideal conditions, the various classes of taxpayers shoulder their fair share of the tax burden. The code equally adopts preemptive strategies to ensure taxpayers comply with the law and do not engage in either tax avoidance or evasion as means of

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[51] Pietro Calice, Victor M. Chando and Sofiane Sekioua, 'Bank Financing To Small And Medium Enterprises in East Africa: findings of a survey in Kenya, Tanzania, Uganda and Zambia' (2012) 34-47.

[52] Mutahe Kuruoro, 'THE RELATIONSHIP BETWEENINTERBANK TRANSACTIONVOLUME AND EXCHANGE RATE VOLATILITYIN THE KENYAN SHILLING AGAINST THE US DOLLAR' (Su-plus.strathmore.edu, 2018) <https://su-plus.strathmore.edu/handle/11071/5808> accessed 9 May 2021.

circumventing their tax obligations. Deterrence strategies inform these preemptive tactics, with taxing authorities relying on punitive measures complemented by a high risk of identification and prosecution to ensure compliance.

The reality is, however, far from the ideal scenario. The OECD estimates as much as 240 billion dollars are lost annually in taxes through tax avoidance, which motivates those avoiding tax to use illicit financial flows as a conduit to tax havens.[53] MNEs and wealthy persons possess an avaricious appetite for aggressive tax avoidance with self-interest as the primary motivating factor for paying lower taxes. Demand attracts supply, and several parties are available to offer services and technical know-how that facilitates tax-motivated IFFs. The financial industry, specifically banks, owing to their prominent role in capital transactions, are part of tax avoidance schemes and, in some cases, advocate for aggressive measures both for their gain and for their clientele which include MNEs and wealthy individuals. The access to expertise in law, accounting, and taxation increases the probability of successful tax-motivated illicit financial flows with minimal risk of detection and prosecution. The practice goes beyond not paying one's taxes but has far-reaching consequences. At the surface level, tax avoidance denies governments the much-needed revenue to fund government operations. The consequence of a gap between expected revenue and actual revenue is poor quality public service and inability to fund social welfare. The situation is exacerbated further by the fact that government expenditure is unique volatile, and therefore unpredictable. The effect of tax avoidance on revenue collections is more significant among LDC, such as Kenya. These

[53] OECD Technology Tools to Tackle Tax Evasion and Tax Fraud (2017) <https://www.oecd.org/tax/crime/technology-tools-to-tackle-tax-evasion-and-tax-fraud.pdf> accessed 29 August 2018.

countries are heavily dependant on corporate income tax, while their revenue streams are insufficient to meet their expenditures. Therefore, lost revenue among LDC has a higher negative impact because of the lost developmental value attached to the lost revenue. Moreover, tax avoidance aggravates taxation inequality. Firstly, tax avoidance is legally and morally wrong since it burdens compliant taxpayers with a greater tax burden than the non-compliant taxpayer.[54] Secondly, tax avoidance exacerbates an imbalanced tax mix in LDCs that rely on indirect taxes more than direct taxes, where most low-income earners shoulder the latter. This precipitates a vicious cycle in these countries of revenue deficiencies, poor public service delivery, underfunded welfare programs, poverty, and stifled economic growth.

Also, tax avoidance motivates the use and growth of illicit financial flows. Tax avoidance, while not outright illegal, is the gaming of the system for personal interest. This requires the use of innovative accounting techniques and application of the law that utilise illegal schemes and procedures to facilitate the movement of capital from one jurisdiction to another. To contextualise the problem, developing nations worldwide lost an estimated 6.6-trillion dollars due to illicit outflows from 2004 to 2014. Sub-Saharan Africa itself lost the most, a whopping 4.4% of its GDP through illicit flows.[55] Tax-motivated IFFs do contribute to the blossoming of the IFFs industry, which directly promotes booming criminal activity while eroding good governance. Kenya is not immune to the challenges of tax avoidance and IIFs that characterise

[54] Ibid

[55] Aumeerun B, B Jugurnath and H Soondrum, 'Tax Evasion: Empirical Evidence From Sub-Saharan Africa' Journal of Accounting and Taxation 8, no. 7: (2016) 70-80.

the region. According to estimates, Kenyan bleeds an estimated 60 million dollars annually in IFFs, yet the national budgetary estimates are perpetually in deficit.[56]

Tax motivated illicit financial flows, impedes economic growth, erodes governance, promotes kleptocracy, limits government capacity to fund welfare programs, and waters down the quality of public services offered in the country. The situation is untenable, necessitating clamping down on tax avoidance motivated IFFS to improve tax administration in the country. Concomitantly, preventing tax avoidance complements anti-money laundering and counter-terrorism financing administration in the country. To this end, the research proposes the country's use of deterrence technique to prevent and identify incidences of tax avoidance motivated IFFs. The existence of anti-tax avoidance procedures and systems are insufficient in tackling the problem. The modalities in place need to be effective and efficient. This requires building up existing structures by identifying and remedying existing weaknesses. To this end, this research explores a case study of tax avoidance, IFFs and banking transactions to identify weaknesses in the tax administration regime that actors in the case studies exploited to their benefit and consequently propose remedial measures.

1.3 JUSTIFICATION OF STUDY

IFFs generally refer to criminal and outright illegal transfer of funds across jurisdictions, usually through money laundering, corruption, and the theft of state assets. Other than funding illegal activities and regularising illegal income, IFFs also perpetuate both corporate and

[56] Lilian Ochieng, 'Kenya 'Loses Over Sh 600bn To Tax Evasion Annually'' *Business Daily*, (2014) <https://www.businessdailyafrica.com> accessed 29 August 2018.

individual tax avoidance, usually through aggressive planning. In the taxation sphere, IFFs are thus a means through which the KRA misses its mandate of tax mobilisation while the country's development and governance are hampered through tax avoidance. The study, therefore, intends to explore the relationship between tax avoidance and tax avoidance motivated IFFs and multinational banking. Equally, the research aims to offer recommendations on how to reign in tax avoidance within the financial sector.

1.4 STATEMENT OF OBJECTIVE

This study aims to undertake a legal analysis of tax avoidance via IFF in the context of banking transactions.

1.4.1 Research Questions

- Does Kenya have appropriate laws to regulate, minimise and prevent tax-motivated-illicit financial flows in banking transactions?
- What are the main limitations of tax administration against tax avoidance in the country?
- What recommendations, if adopted, will strengthen the capacity of the KRA in the detection and prevention of tax-motivated-illicit financial flows in banking transactions?

1.5 THEORETICAL FRAMEWORK

1.5.1 Theory of Public Expenditure

The government wants more taxes while the citizens abhor the idea of taxation, seeking to minimise their tax burden. The Peacock Wiseman Theory of Public Expenditure (PWTPE)

though engendered in public expenditure studies,[57] offers an insightful perspective in understanding taxation theory, tax avoidance, and evasion, and IFFs. The theory's central precept is that public finance is a balance between the government's desire to fund its expenditure and the willingness of the public to pay its taxes.[58] PWTPE elaborates the interplay between these two competing interests leads to the predictable consequence of an ever-increasing tax burden. This is a factor of three unique characteristics of public finance: displacement effect, inspection effect, concentration effect.[59] These public finance dynamics result from a variety of permutations that cause a heavier tax burden driven by increased demand for public service and the corresponding need for higher revenues, normalisation of higher taxes, and increase in government expenditure. In essence, the PWTPE predicts an ever-increasing tax burden, a fact when consider considering taxpayers' desire to lessen their tax burden is instructive in understanding tax avoidance and IFFs. From the PWTPE lens, tax avoidance and IFF are the natural consequences of rational choice among taxpayers.

Simply put, taxpayers pursue strategies that fewer taxes, on the one hand, an incentive for tax avoidance that is even greater when states provide little welfare goods. On the other hand, tax owners of capital are in the market investment opportunities that offer a greater return on investment. This latter point is essential; it expresses PWTPE's lesser discernable explanation for tax avoidance and IFFs. Compared to LDC, more advanced economies are a more attractive

[57] Alan Turner Peacock, 'The growth of public expenditure' In The Encyclopaedia of Public Choice, Springer, Boston, MA, (2004) 594-597.
[58] Magazzino Cosimo, Lorenzo Giolli and Marco Mele, "Wagner's Law and Peacock and Wiseman's Displacement Effect in European Union Countries: A Panel Data Study" (2014) 1-8.
[59] Gërxhani, Klarita, and Ronald Wintrobe. "Understanding tax evasion: combining the public choice and new institutionalist perspectives." The Palgrave Handbook of Comparative Economics (2021) 785-810.

investment destination. This crucial considering tax avoidance through IFFs channels is inherently capital flight. Capital destinations such as tax havens and secrecy jurisdictions offer sanctuary for IFFs, usually through robust anonymity transactional banking laws in addition to offering access to investment opportunities around the world. Therefore, the Peacock Wiseman Theory of Public Expenditure explains the push and pull factors that drive tax avoidance and IFFs. In essence, The Peacock Wiseman Theory of Public Expenditure explains the origin and prevalence of tax avoidance and IFFs.

1.5.2 The Neoclassical View of Capital Flight

Capital flight is the result of portfolio choices by the individual agent or at the aggregate level. Neoclassic theory presupposes that an agent in the market is a rational being keen on maximising any utility available to them.[60] From this premise, capital flight is a means to an end, a way for owners of financial assets to maximise the actual value of assets or avoid devaluation.[61] According to Paul et al., capital flight occurs firstly within a specific demography, individuals who possess sufficient access to financial assets, with the incentive to consider ways of increasing the value of their portfolio.[62] The "Lucas paradox' accounts for the higher flight of capital from LDCs to more developed countries. Reinhardt et al. explain more developed countries offer persuasive incentives to invest financial assets while LDCs disincentive the holding of financial assets in these jurisdictions due to the risk of losing

[60] Paul Collier, Anke Hoeffler and Catherine Pattillo, "Flight capital as a portfolio choice." The World Bank Economic Review 15, no. 1 (2001): 55-80.
[61] Dennis Reinhardt, Luca Ricci and Thierry Tressel, 'International Capital Flows And Development: Financial Openness Matters' (IMF, 2010) <https://www.imf.org/external/pubs/ft/wp/2010/wp10235.pdf> accessed 9 May 2021.
[62] Paul Collier, Anke Hoeffler and Catherine Pattillo, "Flight capital as a portfolio choice." The World Bank Economic Review 15, no. 1 (2001): 55-80.

value.[63] Consequently, Capital transfer to jurisdictions with immense investment potential, flight from unfavourable government policies such as comparatively higher taxes and volatile markets are some of the motivating factors for the flight of capital out of LDCs.[64] The neoclassic perspective on capital flight offers an in-depth perspective on individual motives for capital flight complementing Peacock Wiseman Theory of Public Expenditure on the reasons for tax avoidance and tax avoidance motivated IFFs.

1.5.3 Deterrence Model Of Taxation

Human behaviour scholarship identifies motivators as key in understanding and predicting behaviour. Motivating factors are categorised as either positive or negative: inspiring and deterring, respectively. Both the Peacock Wiseman Theory of Public Expenditure and neoclassic theory of economics identified the positive factors that inspire tax avoidance and tax avoidance that motivate IFFs. On the opposite end of the spectrum, the research relies deterrence theory in understanding deterring factors from tax avoidance and how these factors positively or negatively impact the prevalence of the practice.

Deterrence theory is predicated on the presupposition that humans as rational beings who maximise benefits and minimise negative consequences. The theory leverages this human condition as a tool for social engineering. To this end, deterrence theorists argue imposing sanctions-specific actions discourages these acts. Individuals prefer compliance to the punitive

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[63] Dennis Reinhardt, Luca Ricci and Thierry Tressel, 'International Capital Flows And Development: Financial Openness Matters' (IMF, 2010) <https://www.imf.org/external/pubs/ft/wp/2010/wp10235.pdf> accessed 9 May 2021.

[64] Paul Collier, Anke Hoeffler and Catherine Pattillo, "Flight capital as a portfolio choice." The World Bank Economic Review 15, no. 1 (2001): 55-80.

costs of non-compliance.[65]The theory's ingenuity, simplicity, and ease of application led to its mass adoption across different fields, including taxation.

The economic theory of deterrence is the predominant theory of tax administration regimes globally. The theory's application in tax administration remains faithful to the theory's core tenets. To this end, the theory predicts taxpayer's behaviour is a balance between competing interests of pro and cons of non-compliance and the prospect of detection and punishment for non-compliance.[66] It follows a high probability of detection, and severe penalties serve as a deterrence for tax non-compliance. In contrast, a low probability of audit and corresponding penalties culminate in a high return of non-compliance. [67] Essentially, a high probability of detection and severe penalties is a negative motivator, while the absence of these determinants has the opposite impact, morphing into motivating factors. This theory complements the above-identified theories on the cause of tax avoidance and participation in tax avoidance motivated IFFs. It offers an alternative lens, legislative and administrative perspective, in the study of contributing factors to tax avoidance and IFFs.

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[65] Harvey, Frank P. "Rational Deterrence Theory Revisited: A Progress Report." Canadian Journal of Political Science/Revue canadienne de science politique (1995) 403-436.

[66] Merima Ali, Odd-Helge Fjeldstad and Ingrid Hoem Sjursen, 'TO PAY OR NOT TO PAY?CITIZENS' ATTITUDES TOWARDS TAXATION IN KENYA, TANZANIA, UGANDA AND SOUTH AFRICA' [2013] AFROBAROMETER WORKING PAPERS <https://www.cmi.no/publications/file/5026-1-to-pay-or-not-to-pay.pdf> accessed 9 May 2021.

[67] Chauke, K. R., and M. P. Sebola. "Reflection on the deterrence theory of taxation in the context of revenue collection by municipalities and the South African Revenue Services." (2016).

1.6 RESEARCH METHODOLOGY

This research relies on qualitative research methodologies since qualitative research is primarily aimed at exploring phenomenon, concepts, and experiences. The study is exploratory, and thus qualitative methods are the best design. The primary purpose of this research is to explore the nature of tax avoidance by MNEs in the banking industry, the use of IFFs to this end, and the interplay between these phenomena and the law in Kenya. Thus, the research utilises qualitative data and research methods better to understand reasons, phenomena, and motivations for circumstances.[68]

Qualitative data collection is generally semi-structured, adopting a variety of methods that offer descriptive data. One of the qualitative methods of data collection is a case study: an in-depth investigation of a particular phenomenon, unlike a general study statistical study.[69] Rashid describes a qualitative case study as a tool for in-depth evaluation of a complex phenomenon within a definite context.[70] Proponents of qualitative case study design identify several reasons for its relevance and applicability in research; however, its top advantage is its flexibility in design and expected outcome. Researchers enjoy freedom in the type of research questions available for use. This characteristic allows for more in-depth and spontaneous exploration of the research subject that takes advantage of recently acquired information. Unlike statistical models, the case study does not intend to disapprove or prove specific facts. In fact, it aims to understand better the factual circumstances informing a specific phenomenon,

[68] Robert Yin "Case study research: Design and methods (applied social research methods)" London and Singapore: Sage (2009) 83-89.
[69] Ibid.
[70] Rashid, Yasir, Ammar Rashid, Muhammad Akib Warraich, Sana Sameen Sabir, and Ansar Waseem. "Case study method: A step-by-step guide for business researchers." International Journal of Qualitative Methods 18 (2019).

and as such, presents an opportunity to disabuse a researcher's preconceptions as false. Thus the research outcomes may be different from the expected outcome.[71] These two benefits are particularly beneficial in the existing research context, where the nexus between taxation, tax avoidance, and IFF has received limited academic scrutiny. The research, therefore, through a qualitative case study, bridges this information gap. Moreover, a case study usually considers a smaller sample size than other models and, as such, provides a more detailed perspective on the research subject. However, this is often criticised for resulting in generalisations and hence an inferior design. Pearson disapproves of this notion arguing qualitative case study is sufficiently rigorous to be credible and generalisable.[72] In essence, qualitative case studies offer relevant and applicable information.

The nature of the research question is founded on "what" and hence is exploratory. The research questions what the laws on tax avoidance, IFFs, and tax avoidance in Kenya are, what are the limitations of the law, and what recommendations can be made. At its core, the research is thus exploratory and therefore appropriate for the qualitative research case study. Moreover, the topic under investigation is narrow; it focuses on the nexus between tax avoidance and IFFs within the financial sector. These circumstances are unique and particular to a specialised niche in the financial industry. As such, the findings of a case study should are credible and generalisable. The following criteria were set for determining the case study of choice:

- Relevance to the area under investigation (financial sector)
- Based on recent events, not more than five years from the time of the research
- Evidence of tax avoidance schemes

[71] Simon Phelan, "Case study research: design and methods" (2011) 221-222.

[72] Pearson, Marion L., Simon P. Albon, and Harry Hubball. "Case study methodology: Flexibility, rigour, and ethical considerations for the scholarship of teaching and learning." Canadian Journal for the Scholarship of Teaching and Learning 6, no. 3 (2015) 12.

- Evidence of IFFs
- Evidence of possible tax avoidance
- The primary parties, financial institutions, fall within the Kenyan jurisdiction

1.7 LITERATURE REVIEW

1.7.1 Positive Enablers of Tax Avoidance and Illicit Financial Flow Transactions

1.7.1.1 Technology as an Enabler

The proliferation of technology through the digital revolution has promoted capital flight and IFFs globally. The digital revolution expanded beyond communications, significantly altering organisational procedures and processes. Digitised operations added a new dimension to tax administration and the risk of taxation non-compliance. Incidences of tax avoidance, tax evasion, and IFFs transactional structures are on the rise, more accessible to wider demography while impeding detection and prevention efforts.[73] According to Tropina, tax non-compliance through transaction banking is easier, faster, and less likely to be detected. [74] Villasenor et al. aptly note technology facilitates a myriad of new ways to enable financial opacity.[75] By way of example, technology-based modes of money transfer such as mobile banking, electronic payments, cryptocurrencies, and e-commerce offer a wide range of opportunities for financially opaque transactions that are more likely to go undetected.[76] The OECD reinforces Tropina's warning noting, anonymity mainly transactional opacity, provides a conducive set of

[73] UNODC, 'UNODC Counters Illicit Financial Flows In Africa' (United Nations : Office on Drugs and Crime, 2021) <https://www.unodc.org/unodc/en/frontpage/2020/November/unodc-counters-illicit-financial-flows-in-africa.html> accessed 3 May 2021.
[74] Tatiana Tropina, "Do Digital Technologies Facilitate Illicit Financial Flows?" (2016) 1-12.
[75] Villasenor, John, Cody Monk, and Christopher Bronk. "Shadowy figures: tracking illicit financial transactions in the murky world of digital currencies, peer-to-peer networks, and mobile device payments." (2011) 6-15.
[76] Ibid.

systems that promote illicit financial transactions.[77] In response to these challenges, governments implemented diverse preemptive strategies. The Financial Action Task Force proposes best practices in mitigating the risk factors of technology-induced illegal transactional banking; however, compliance, particularly among LDCs, is low. Moreover, existing administrative and legal regimes are outdated and therefore non-responsive and ill-equipped to keep up with the demand of digitised transactional banking. Latif opines digitisation renders existing AML regulations and systems obsolete since the laws were formulated without the novel dimensions of digital financial transactions in mind.[78] The absence of regulation, enforcement laws, and compliance creates a favourable environment for tax avoidance and inadvertently IFFs.

Digitisation creates an enabling environment for tax avoidance and tax-motivated IFFs by exploiting existing administrative weaknesses and broadening and providing more effective non-compliance techniques. To illustrate, digital transactional banking facilitates the expansion of existing and emergence of new financial centres, including tax havens and offshore financial centres, which expanded individuals' access to transactional instruments, making tax avoidance much easier. Moorman explains distinct but concurrent roles as "potential sources of funds, bribery facilitators, kleptocrats, secrecy facilitators, or fund storage

[77] OECD, 'Illicit Financial Flows From Developing Countries: Measuring OECD Responses' (Oecd.org, 2014) <https://www.oecd.org/corruption/illicit_financial_flows_from_developing_countries.pdf> accessed 3 May 2021.

[78] Lyla Latif, 'Do Digital Economies Facilitate Illicit Financial Flows?' (Panconfifftax.net, 2019) <http://panconfifftax.net/wp-content/uploads/2019/09/PAC-2019.-Illicit-Financial-Flows-and-the-Digital-Economy-copy.pdf> accessed 3 May 2021.

and investment" characterise FFs.[79] Entities under these broad categories of diverse services with the common theme of guaranteed transactional and beneficial ownership anonymity while offering convenient and accessible sanctuary for the transferred financial assets.

1.7.1.2 The Banking Industry: An Intermediary

Chernykh and Sergey Mityakov identify banks as intermediaries for IFFs. The risk of banks' facilitative role is substantially high when a banking institution operates both in a local and foreign jurisdiction. The risk increases further where one of the bank's jurisdictions of operations is located within an offshore financial centre.[80] Such banks are under parallel tax and AML regimes. Often, the two jurisdiction's laws conflict on data sharing and privacy 0n banking transactions and cross-border cooperation in the enforcement of tax laws. This creates a veil of secrecy and administrative red tape that banks are quick to exploit through IFFs. Consequently, transnational banks are at risk of concealing IFFs of cross-border banking transactions at the behest of preferential clients. The accessibility banking intermediary services are not only available to external clients but equally to the bank's high profile employees and members of management. Thus, banks offer an opportunity for potential non-compliant taxpayers to actualise their motivations to engage in tax avoidance and IFFs.

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[79] Ted Moorman, 'Kleptocracy And Foreign Corruption Manifesting In Illicit Financial Flows | Emerald Insight' (Emerald.com, 2018) <https://www.emerald.com/insight/content/doi/10.1108/JFC-02-2017-0008/full/html> accessed 3 May 2021.

[80] Lucy Chernykh and Sergey Mityakov, "Offshore schemes and tax evasion: The role of banks" (2017) Journal of Financial Economics 126, no. 3: 516-542

1.7.1.3 Tax Regimes as Enablers

While banks act as intermediaries in IFFs, kleptocrats and secrecy jurisdiction are identified as key instigators and enablers of IFFs. Goredema concurs with Chernykh and Sergey Mityakov on the wide range of actors participating in IFFs, providing several sources and modes of shifting capital through IFFs.[81] The proliferation and success of IFFs are attributable to weak administrative and governance structures. Mihir et al. identify a correlation between IFFs and national and international corruption and tax mispractice.[82] The findings illustrate the link between the quality of governance structures, government capacity, and increased tax evasion and avoidance by companies within a jurisdiction. High incidences of IFFs characterise countries with governments with weak government capacity. Essentially, these countries lack sufficient deterrence capacity. Besides, kleptocrats game poor legal regimes and take advantage of weak governments creating corruption syndicates that thrive of the capital shifting capacity of IFFs. Tiberius offers a local perspective on kleptocracy, identifying the lack of political will to grow government capacity, the existence of weak institutions, political patronage, and systemic corruption as a critical driver of tax evasion and IFFs in Kenya.[83] Makumbe et al., however, clarifies the challenges Tiberius identified in Kenya are not unique to the country but are a microcosm of the enablers of IFFs in Africa.[84]

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[81] Charles Goredema, 'U4 ISSUE Combating Illicit Financial Flows And Related Corruption In Africa: Towards A More Integrated And Effective Approach' (Academia.edu, 2011) <https://www.academia.edu/14035466/U4_ISSUE_Combating_illicit_financial_flows_and_related_corruption_in_Africa_Towards_a_more_integrated_and_effective_approach> accessed 3 May 2021.

[82] Mihir A Desai, Alexander Dyck and Luigi Zingales, "Theft and taxes" (2007) Journal of financial economics 84, no. 3: 591-623.

[83] Barasa, Tiberius. "Illicit Financial Flows in Kenya: Mapping of the Literature and Synthesis of the Evidence." (2018) 2-9.

[84] Daglous Makumbe and Ruth Charumbira, 'Democracy, Security And The Risks Of Illicit Financial Flows In Natural Resource Africa: Challenges And Costs' (International Journal of Recent Research in Social Sciences and Humanities (IJRRSSH, 2018) 21-33.

Similarly, government policies and laws create sanctuaries that promote tax avoidance and enable capital flight through IFFs. Government policies that establish secrecy jurisdictions facilitate anonymous incorporation and beneficial ownership. Such jurisdictions are equally characterised by intense corporate tax diversion as companies take advantage of legal lacunas to maximise profits.[85] Hearson notes that tax havens and secrecy jurisdictions that adopt harmful preferential tax regimes as part of these jurisdictions' regulatory framework offer participants in tax avoidance and IFFs a safe landing place.[86] These enabling jurisdictions rely on the allure of financial opacity within local jurisdictions of financial transactions as the main attraction for IFFs participants in exchange for economic growth.

Enforcement instruments, including the audit rates and the punishment function, are also determinants of tax compliance, although these variables are rarely available for empirical studies.[87] The probability of audit significantly affects tax compliance, whereas there is no proof of a substantial deterrent effect based on the pure existence of penalty. The Internal Revenue Service's Taxpayers Compliance Management Programme (TCMP) observed that even high penalties have no noticeable impact on compliance due to the low probability of

<https://www.paperpublications.org/upload/book/Democracy,%20Security%20and%20the%20Risks-1105.pdf> accessed 6 May 2021.

[85] Ibid.

[86] Hearson, Martin. "Tax-motivated illicit financial flows: A guide for development practitioners." U4 Issue (2014) 5-23.

[87] Slemrod, Joel, and Shlomo Yitzhaki. Integrating expenditure and tax decisions: the marginal cost of funds and the marginal benefit of projects. No. w8196. National Bureau of Economic Research, 2001.

detection.[88]Weak taxation laws foster tax avoidance, money-laundering activities, and drive IFFs.[89]

1.7.1.3 Taxation Culture

Similar to motivating factors enabling factors are categorised as positive and negative. Positive enablers, the ones discussed immediately above, represent opportunities available for leverage, while negative enablers are weaknesses amenable to exploitation. Unfortunately, factors that influence taxpayer behaviour remain understudied.[90] A country's tax culture, the general compliance or non-compliance of the population, is a significant determinant of tax mobility's success within a jurisdiction. A sample of factors affecting tax compliance in a selection of African countries, Kenya included, reveals a high affinity towards non-compliance.[91] These findings align with Kar and Smith's conclusion on the role of cultural influence on taxpaying behaviour. Investigations by Kotut and Menjo offer empirical evidence supporting Kar and Smith's findings.

Kotut and Menjo studied tax buoyancy and tax elasticity from 1986 to 2009, concluding the Kenyan tax system is neither tax elastic nor buoyant.[92] Leuthold and Tchetche N'Guessan

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[88] Pommerehne, Werner W., and Hannelore Weck-Hannemann. "Tax rates, tax administration and income tax evasion in Switzerland." Public choice 88.1 (1996): 161-170., 161-170.
[89] Andreoni, James, Brian Erard, and Jonathan Feinstein. "Tax compliance." Journal of economic literature 36.2 (1998): 818-860.180.
[90] Lumumba, Martin, S. Wanjohi Migwi, and Obara Magutu. "Taxpayers attitudes and tax compliance behaviour in Kenya (How the taxpayers attitudes influence compliance behaviour among SMEs Business Income Earners)." (2010). 112
[91] Ali, Merima, Odd-Helge Fjeldstad, and Ingrid H. Sjursen. "Factors affecting tax compliant attitude in Africa: evidence from Kenya, Tanzania, Uganda and South Africa." Centre for the Study of African Economies 2013 Conference, Oxford University. 2013. 818
[92] Samwel, Kotut Cheruiyot, and Menjo Kibiwot Isaac. "Elasticity and buoyancy of tax components and tax systems in Kenya." Research Journal of Finance and Accounting 3.5 (2012): 205-231.

explain tax buoyancy and elasticity are measures of tax revenue responsiveness to changes in national income or GDP.[93] A buoyant and elastic tax regime's revenues ebb and flow with changes in income and vice versa. Therefore, an interpretation of Kotut and Menjo's finding is that Kenya has experienced a negligible increase in revenue collection over the year despite growth in GDP and national income. Two possibilities account for the low revenue collections: poor revenue mobilisation or a culture of taxation non-compliance. The latter is the only viable explanation since the former fails on account of the country undergoing extensive legal and administrative reform to improve revenue collections. Furthermore, Kotut and Menjo's researcher disclosed the public's disillusion with government expenditure of public revenue attributing the country's poor culture of tax compliance to the government's lack of accountability. [94] From the above, human behaviour emerges as a component of culture or behavioural response to the prevailing economic and legislative taxation ecosystem or pursuit of self-serving interests within a defined context.

1.8 LIMITATIONS

A single case study research design presents unique challenges. Firstly, the research's data is from a single source. In these circumstances, the approach is lacking external validity. This predisposes the study to generalisability due to the research method's inherent inability to account for uncertainty. [95] Secondly, the research is subject to extraneous circumstances beyond its control. The specific challenge is best illustrated in the research's limitation securing

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[93] Leuthold, Jane H., and Tchetche N'Guessan. "Tax buoyancy vs elasticity in developing economy." BEBR faculty working paper; no. 1272 (1986). 1-30

[94] Kotut S and Menjo I, 'Elasticity and Buoyancy of Tax Components and Tax Systems in Kenya' Research Journ.

[95] Easton, Geoff. "Critical realism in case study research." Industrial marketing management 39.1 (2010): 118-128.

detailed information about the case study subject. Sources of information are imperfect, considering the bank is under receivership and the unwillingness to divulge potentially incriminating evidence by key figures within the organisation. Moreover, banking transactions are private, and therefore there is little data on transnational banking and the prevalence of tax avoidance or IFFs within or from the country. Access to information remains one of the study's top challenges. Another iteration of the challenge materialises in the form of researcher bias which may affect the form of data collection and interpretation. Despite these challenges, the research remains academically sound and relevant. Geoff notes the novelty of the phenomenon and interpretive capacity of case study through data analysis discerning causality.[96] As such, due to the novelty of tax avoidance motivated IFFs within the context of banking transactions in Kenya, is because of limited local data on the phenomenon, a case study research design is an opportunity for an insightful perspective on the subject and a source of actionable information on legislative and administrative pre-emptive reforms.

1.9 HYPOTHESIS

It is hypothesised that limitations in Kenya's tax regime facilitate tax avoidance and tax avoidance motivate IFFs through international banking transactions.

[96] Ibid.

CHAPTER TWO
THEORETICAL FRAMEWORK

2.1 INTRODUCTION

Chapter one of the paper presented the background of tax avoidance and tax avoidance that motivate IFFs. The chapter also introduced various theoretical frameworks. This chapter delves further into the Tax Deterrence Model to relate the theory to the analysis of tax avoidance-motivated IFFs through banking transactions in Kenya.

2.2 ANALYSIS OF THE TAX DETERRENCE MODEL

The tax deterrence model as a theory is a hybrid of the classical and contemporary perspectives on deviant behaviour. The traditional theory of tax prevention focuses on the economic aspect of a revenue system. According to proponents of the theory, an act of paying taxes is a transaction between the taxpayer and the government.[97] Since the process is funded, draining from the taxpayers' perspective, the taxpayers adopt an economic perspective to taxation. Consequently, in response to one's tax burden, the taxpayer weights between paying taxes versus not paying taxes, with an overlying assumption that a rational taxpayer will more likely than not prefer not to part with his income.[98] In response, governments adopted a punitive approach to ensure taxes are paid. Nevertheless, punitive measures are not the only mode as persuasive channels are also available.[99] From the economic deterrence point of view, persuasion does not hold value. According to Becker, one of the earliest scholars to put forward

[97] Dell'Anno Roberto, "Tax Evasion, Tax Morale and Policy Maker's Effectiveness" (2009) *The Journal of Socio-Economics* 38, no. 6: 988-997
[98] Ibid
[99] Ibid

the theory, two key components characterise the economic deterrence model: severity of punitive measures and the rate of detection.[100] The theory also assumes that the taxpayer is a "perfectly moral, risk-neutral or risk-averse individual who seeks to maximise their utility, and chooses to evade tax when the expected gain exceeded the cost."[101] Therefore, the challenge for the government is dealing with people who simply do not like paying taxes; hence it uses severe punishment and an increased rate of detection to ensure compliance.

Punitive measures and the rate of detection are so intertwined that there is not one without the other in deterrence. Punishment by an authority is meant to deter the public from engaging in certain activities or risk suffering some unwanted consequences. By nature, punishment is not effective since it depends on whether or not one is "detected" and brought to book.[102] Hence, detection is a vital part of deterrence. High rates of detection bring the unwanted consequences of punishment closer home to the would-be perpetrator who consequently follows the rules thought involuntarily. For many LDCs, the rate of conviction is equally important though the same may be equated with the detection stage. However, the would-be perpetrator must know that their chances of escaping the punitive measures are slim to none.

Most of the tax systems globally are punitive-based. The structure of most tax codes in the world mimics the penal codes that are hinged on deterrence. Consequently, these systems adopt a punitive and detection-based approach to ensure compliance. Kenya is no different; the Income Tax Act identifies the KRA as a body tasked with the collection and receipt of all

[100] Ibid
[101] Sando Agnar, "The theory of tax evasion: A retrospective view" *National Tax Journal* (2004): 643-663
[102] Michael Allingham and Agnar Sandmo, "Income tax evasion" (1972): 359-74.

revenue.[103] Cap 470 enshrines the provisions of articles 209 and 210 of the constitution on a collection of taxes. The act further declares the forms of taxes expected and provides punitive measures under part XI of the act. Several punitive measures are available to the authority if one does not meet their tax obligation. These include fines as follows:

1. Failure to register – fine not exceeding Kshs.20 000 or imprisonment for a term not exceeding six months or both
2. Enforced registration – default penalty of Kshs. 100,000
3. Failure to submit a return on or before the due date or submit a payment return without paying the tax due – default penalty of Kshs.10 000 and an additional tax of 2% compounded.
4. Failure to keep proper records – a default penalty of between Kshs.10 000 to Kshs.200, 000
5. Fraudulent Accounting – a fine not exceeding Kshs.400, 000 or double the tax evaded, whichever is greater, or imprisonment for a term not exceeding three (3) years or both.[104]

The recent development through the Tax Procedures Act aims to reign in modern means of tax avoidance. Section 84 of this act penalises tax avoidance schemes to the tune of double the tax due.

Kenya's tax system is a carbon copy of the economic deterrence model of tax. Legislation in the country identifies the authority mandated with the collection of taxes. In the event of default by a party, the authority enjoys the tools for detecting and implying fines.[105] The system, therefore, suffers from the inherent challenges of the deterrence model. Firstly, the model only

[103] Kenya Revenue Act, Section 4.
[104] Kenya Revenue Authority, 'Offenses and Penalties' (2018) <http://www.kra.go.ke/index.php/domestic-taxes/vat/offenses-and-penalties> accessed 30 August 2018
[105] Kenya Revenue Act, Part XI

works if a rational taxpayer considers not paying taxes and the subsequent punishment as more punitive than paying taxes. The law is thus very mechanic in its approach in ensuring tax compliance. Tax defaulters in the various forms are usually fined with penalties by the commissioner. It is no surprise hence that Kenya is classified as a low-tax compliant country.[106] This ranking speaks volumes to the efficacy of the economic deterrence theory in the country. The large volume of capital flight in the form of IFFs and, in particular, tax avoidance measures is a testament to the asymmetrical nature of the Kenyan tax code. Overall, the economic deterrence theory provides a theoretical mechanism through which the relationship between the state and taxpayers is understood.

The second limb of the deterrence tax model is the fiscal and psychological model of taxation. Deterrence need not only be through punitive means. Scholars of taxation in the early 2000s noted that persuasion played a significant role in guaranteeing compliance with tax obligations.[107] Persuasion may be understood as the process of changing someone's beliefs, attitudes, and behavior towards some idea. The process may take a myriad of forms, including the transfer of information or reasoning—the fiscal psychological approach to deterrence concentration in its efforts to influence the taxpayer's belief systems. In essence, it challenges the assumption that the taxpayer's decisions are only based on the utility theory. Over the years, various scholars contributed to the model with the most notable personalities, including Schmolders, Strumpel, and Spicer.[108] The current model, therefore, is an amalgamation of

[106] Ali Merima, Odd-Helge Fjeldstad and Ingrid Hoem Sjursen, "To pay or not to pay? Citizens' attitudes toward taxation in Kenya, Tanzania, Uganda, and South Africa" (2014) *World Development* 64: 828-842
[107] Michael Allingham and Agnar Sandmo, "Income tax evasion" (1972): 359-74
[108] Ibid

ideas from various schools of thought. Hence, the main ideas encompassed in the model are tax mentality, willingness to co-operate, and exchange equity.[109]

The taxpayer is more than a person with self-interest only. Schmolder noted that the taxpayer's affinity towards taxation included their 'tax mentality".[110] That is their affinity towards social cooperation vis-à-vis their interest. However, one's tax mentality does not grow out of a vacuum but is the byproduct of social and cultural beliefs about taxation by a community. Communities with an inclination for cooperation with the tax mobilisation program are practically more willing to meet their tax burdens, while the opposite is equally true.

Willingness to co-operate with a tax authority is proportionate to compliance. Strumpel stated taxpayers who are willing to work together with the tax authority are more likely to be compliant.[111] For instance, a willingness to file one's taxes on time is one of the ways the KRA uses to ensure conformity with the tax code. Nevertheless, it seems that a willingness to co-operate enjoys a duality relationship with "rigidity of assessment." The authority's amenability to accommodate taxpayers' challenges also improves compliance. Tax codes are characterised by bundles of regulations that are tiresome to read, difficult to understand, and confusing. It is common for one reason or another for a taxpayer to fail to meet their obligations or face challenges in complying with the law. Authorities that are alive to these factors enjoy more

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[109] Spicer Michael W and Lee A Becker, "Fiscal inequity and tax evasion: An experimental approach." (1980) *National tax journal* 171-174

[110] Lewis Alan, "An empirical assessment of tax mentality" (1979) Public Finance - Finances Publiques 34, no. 2 244-247

[111] Strümpel Burkhard, "The Disguised Tax Burden Compliance Costs of German Businessmen and Professionals." (1966) *National Tax Journal* 19, no. 1: 70-77

harmonious relations with taxpayers and a proportionate increase in compliance. An instance of a flexible assessment includes the adoption of inquiry services and ADR facilities. Countries adopting ADR processes that are less acrimonious in taxation disputes experience higher tax compliance and dispute resolution levels.

The final pillar in the fiscal, psychological model of deterrence is ex-change equity. Money is attached to a return on investment variable in its use. Once someone gives out a part of the income, a reciprocal expectance of benefit arises, from economic, emotional, or psychological. The idea of a return on invested money encapsulates the notion of exchange equity by Spicer.[112] Taxpayers expect a somewhat proportional service delivery and public goods offered by the government in exchange for paying taxes. In the absence of a sense of exchange equity, more taxpayers develop feelings of non-conformity with the tax code.

Evaluation of the fiscal, psychological variables is inherently difficult. The model relies entirely on social concepts that are not easily studied quantitatively. In Kenya, these variables suffer from inadequate study within the Kenyan tax ecosystem. A testament to the country's reliance on the old model of taxation as an economic transaction. Juxtaposing the fiscal, psychological model with the current tax code in Kenya paints the latter negatively. The Kenya tax code is hopeless when considering the new age wisdom of persuasion in taxation.[113] Anyone would be forgiven for saying; Kenyan's possess a negative tax mentality. From the

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[112] Spicer Michael W and Lee A Becker, "Fiscal inequity and tax evasion: An experimental approach" (1980) *National Tax Journal* : 171-174

[113] Lumumba, Martin, S. Wanjohi Migwi, and Obara Magutu. "Taxpayers attitudes and tax compliance behaviour in Kenya (How the taxpayers attitudes influence compliance behaviour among SMEs Business Income Earners)." (2010). 112

onset, the country seems to be a separate entity from a large part of the population. It is not surprising that with the promulgation of the new constitution, a clear declaration under article one states, sovereignty belongs with the people.[114] For many Kenyans, taxation seems like a means for those in government to enrich themselves. Unfortunately, this culture is not recent. The colonial era set a bad precedent for taxation as the British used taxes to control the natives. As a result, an oppressive mentality developed then and still exists today. A mentality that seeps and finds itself within MNEs with local personnel. These assertions are confirmed by a study conducted by Michael Ng'ang'a Thiga and Dr. Willy Muturi that the countries tax mentality is averse to tax mobilisation.[115]

The investigation defined four variables that determined tax compliance in the country: tax understanding, tax rates, tax penalties, and tax compliance costs.[116] The countries compliance rate stood at 42% due to the high tax rates, penalties, and compliance costs that negatively affect compliance.[117] Kenya's low rating in terms of tax compliance and the domination of punitive measures to ensure taxes are paid is a testament to the countries poor tax mentality.

The Institute of Economic Affairs, Kenya published a tax handbook to break down Kenya's complex tax system into a user-friendly form for consumption by the average person culminating in, "A citizen's handbook on taxation in Kenya.".[118] Are Kenyan's willing to co-

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[114] Constitution of Kenya 2010

[115] Ng'ang Michael and Dr Willy Mutury, "Factors That Influence Tax Compliance with Tax Laws among Small and Medium Sized Enterprises in Kenya" (2014) *International Journal of Scientific and Research Publications* 4, no. 6

[116] Ibid.

[117] Ibid.

[118] Mutua John M, "A Citizen’s Handbook on Taxation in Kenya" (2012) Nairobi: Institute of Economic Affairs

operate with the tax authority? According to parliamentary records, with parliament as the people's voice, the answer is no. In a review of the 2003[119] and 2008[120] official Hansards, records parliamentarians openly attested to the fact that Kenyans are not willing to pay taxes. Sentiments from parliament were echoed by Nikhil Hira, a tax advisor at Deloitte, an expert in the third Annual Kenya Revenue Authority (KRA) Tax Summit.[121] Hira points out that the complexity and ambiguity of many MNEs are a major contributing factor to aggressive tax avoidance planning systems. The Income Tax Act contains 130 sections, 13 schedules, and over ten subsidiary legislations. Understanding the code is a tall order for members of the legal profession while the common person is either ignorant or has no interest.

The complexity of the system and the government's poor record of accomplishment in accounting for public funds increase the publics' wariness in their willingness to comply with tax mobilisation. Moreover, the code is punitive, as discussed above—a departure from the modern state of affairs where tax disputes are handled through ADR. The influence of ADR mechanisms within the Kenyan legal systems is held in high regard. So much so, those ADR procedures are recognised within the constitution as a viable and lawful means of dispute resolution.[122] The embodiment of the spirit of the law comes to fruition through the Tax Appeal Tribunal Act[123] and the Tax Procedures Act[124] that allow for the use of ADR in tax

[119] Kenya National Assembly Official Record (Hansard) 2 Dec 2003.
[120] Kenya National Assembly Official Record (Hansard) 2 Dec 2012.
[121] Lee Mwiti, 'Income Tax Act Has Loopholes Companies Exploit to Avoid Paying Taxes' (*The Standard*, 2017) <https://www.standardmedia.co.ke/business/article/2001261879/bad-laws-aiding-firms-in-tax-evasion> accessed 30 August 2018.
[122] Muigua Kariuki and F Kariuki, "ADR, Access to Justice and Development in Kenya" (2014) In *Strathmore Annual Law Conference 2014 held on*, vol. 3
[123]Tax Appeal Tribunal Act, Section 28
[124] Tax Procedures Act, Section 44

disputes in the country. The USAID's 2013 report on Leadership in Public Financial Management shows that the country's adoption of ADR in tax disputes is below international standards at a paltry 36%.[125] The details were before the adoption of the Alternative Dispute Resolution Framework in 2014 by the KRA. In 2018, a total of 140 cases stood resolved with 64 million dollars recovered in tax dispute from an initial estimate of 340 million dollars.[126] Despite improvements in the use of ADR, Kenya's tax dispute resolution mechanism is a major impediment to collecting taxes, inadvertently promoting tax avoidance due to a large number of unresolved cases.

A review of the Kenyan taxpayer's perception of exchange equity is also poor. The Jubilee government's second term suffers under the weight of major corruption scandals. Corruption cases within the National Cereals Board, National Youth Service, and the Nation Tree Planting Program are just a few examples. Amounts lost in these scandals are 0.19 billion, 90 million, and 20 million dollars, respectively. The massive corruption scandals in the country are finally becoming more personal. In the middle of 2017, an unfit sugar scandal rocked the nation. However, the most shocking part of the event was the misuse of public funds by parliament in the investigative process. The relevant committee set up to probe the affair stands accused of doctoring the report to protect certain key individuals. Feelings of dissatisfaction are the only logical response under this set of circumstances. For the KRA, the result is a poor tax mentality within the populace that inadvertently permeates the core of MNEs. When the country’s tax

[125] US Agency for International Development 'USAID Forward Progress Report 2013' (2013) <https://reliefweb.int/sites/reliefweb.int/files/resources/2013-usaid-forward-report.pdf > accessed 21 August 2018. accessed 9 May 2021.
[126] George Maina and Micheal Ikiara, 'Tax Dispute Resolution In Kenya' (Roedl.com, 2018) <https://www.roedl.com/insights/tax-dispute-resolution-kenya-kra> accessed 9 May 2021.

mentality and a mechanism to avoid taxes come together, the result is high levels of tax avoidance: an avenue the banking sector offers.

A holistic view of the deterrence tax model paints taxation as an economic transaction and a socio-psychological act. It is an economic transaction, however, not purely. There are numerous psychological and social factors influencing the rate of tax compliance in a country. Tax conformity in itself is a difficult term to define.[127] Compliance may be payment compliance, filing compliance, or reporting compliance.[128] Tax avoidance may encompass either one or all. A review of Kenya's code from the microscope of the deterrence tax model shows the tax code as archaic and ineffective. Its performance in terms of adherence to tax administration is low, while the legal regime does rest within the old framework of the economic deterrence model.

2.3 CONCLUSION

There is a compelling argument that the tax deterrence model is the most appropriate theory for this study. The model is the most advanced conceptual model on taxation relating to both the taxing authority and the taxpayer. Its dualist approach to combining economic elements and social elements creates a deeper and holistic understanding of the tax ecosystem. Understanding the model is thus pivotal to understanding aggressive tax avoidance, fighting the vice, and protecting revenue by preventing illicit financial flows from Kenya.

[127] Lumumba, Martin, S. Wanjohi Migwi, and Obara Magutu. "Taxpayers attitudes and tax compliance behaviour in Kenya (How the taxpayers attitudes influence compliance behaviour among SMEs Business Income Earners)." (2010). 112
[128] Ibid.

CHAPTER THREE

LEGAL REGIME ON TAX AVOIDANCE AND ILLICIT FINANCIAL FLOWS LAWS IN KENYA

3.1 INTRODUCTION

In chapter two, the research delved into the deterrence tax model. The model provided the best, most comprehensive system of understanding the interaction between the key stakeholders in the taxation matrix. The theory, most importantly, explains the motives and factors that affect tax compliance and therefore influence tax avoidance.

This chapter examines the tax code in Kenya with a specific focus on tax avoidance. In this chapter, the legal regime on tax avoidance is studied to explain the strengths and weakness of the legal regime in fighting tax avoidance among financial institutions and the place of IFFs in the bigger picture. The analysis is based on the facts of the case study. The case study serves as the benchmark through which the tax regime is assessed on its efficacy in preventing tax avoidance, the challenges, and the possible interventions in the law to comb tax avoidance via IFFs in the country.

3.2 CHASE BANK LIMITED UNDER RECEIVERSHIP

On the 7th of April 2016, the CBK put Chase bank under receivership[129]. The CBK's move came after it emerged that Chase bank could not meet its financial obligations as per the

[129] Central Bank of Kenya, 'CHASEBANK LIMITED (IN RECEIVERSHIP)' (2016) <https://centralbank.go.ke/images/docs/media/2016/ChaseBankLimited-20042016.pdf> accessed 9 May 2021.

Banking Act. The bank's external auditor, Deloitte, blew the whistle on the bank's Musharaka services. Deloitte gave the bank a clean bill of health in 2014, a financial statement (Annexure 1). However, in 2015, the auditor altered the bank's financial statements that moved the Chase bank's assets under Islamic banking, previously under other assets, to the bank's loans folio. Consequently, the move increased the firm's debt, including 80 million dollars previously under assets. The same is evidenced under the bank's third-quarter financial statement (Annexure 2), where the other assets folio was debited accordingly while the liability folio increased correspondingly.[130]

Chase bank, like many FI in the country, waded into offering Islamic banking services. Among the products offered was Musharaka. The services offered adhered to the Islamic jurisprudence on lenders of money not making a profit from the transaction. Musharaka is a profit and sharing scheme where each party provides investment. Profits and losses are subsequently shared according to the ratios provided[131]. It is a common vehicle in the purchase of real estate. Chase bank used the Musharaka system to offer huge sums of money to various directors of the company. When queried by the external auditor, they explained that the transactions amounted to Musharaka joint ventures and the assets purchased by the loanees, many of whom were company directors, were similar to the assets held by the bank.[132]. The loans were transferred to Camelia Investments Limited, Cleopatra Holdings Limited, Golden Azure Limited and

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[130] Business Daily, 'CBK, Deloitte On The Spot Over Change Of Chase Bank Results' (Business Daily, 2018) <https://www.businessdailyafrica.com/bd/markets/cbk-deloitte-on-the-spot-over-change-of-chase-bank-results--2118886> accessed 3 May 2021.
[131] Rammal, Hussain Gulzar. "Financing through musharaka: principles and application." Business Quest (2004).
[132] Genghis Capital, 'Ex-Bank Directors In Sh1.6B Fraud Case Charged Again – Genghis Capital' (Genghis-capital.com, 2018) <https://www.genghis-capital.com/newsfeed/ex-bank-directors-in-sh1-6b-fraud-case-charged-again/> accessed 3 May 2021.

Colbrook Holding Limited: all foreign companies.[133] However, there was no proof on the bank's accounting books that illustrated the bank acquired a different form of asset in the form of real estate property.

In essence, the bank engaged in special purpose vehicles (SPV) with its directors. An SPV is a legal relation either as a company or partnership aimed for a specific venture that is usually high risk. As such, the parties form separate entities to shelter themselves from the risk of the venture. Chase bank, therefore, offered loans for the purchase of property but then used the new property as their insurance, which transferred the risk of the venture straight back to the bank, beating the purpose of securitization. Musharaka served as a means to cover up the improper use of SPV.

Chase banks financial woes raised concern over the banking sector's stability; however, that is not the only point of reference. Various taxation issues arise from the bank's conduct. To begin with, in the simplest form, the bank's conduct amounts to creative accounting. By shifting 80 million dollars through, Musharaka to cover and SPV, the bank avoided paying tax on income from the process. The bank made losses in 2014 and 2015, how the findings are a smoking gun on creative accounting within FI. Secondly, the alteration of the report by Deloitte and approval by the CBK happen in 2015 after Chase Bank’s 2014 financial statements were published and approved. This illustrates a more salient feature in understanding and applying products and adherence to the tax code. There are numerous financial solutions offered worldwide, such as

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[133] Daily Active, 'Revealed: How Insiders Sunk Chase Bank - Daily Active' (Daily Active, 2018) <https://www.dailyactive.info/2019/02/18/revealed-how-insiders-sunk-chase-bank/> accessed 3 May 2021.

SPVs and Musharaka. However, these systems provide an opportunity for misuse and misapplication for tax avoidance purposes. Since 2009, Chase bank offered Islamic banking solutions that Deloitte approved of. However, analysis of the 2014 report clearly illustrated a misuse of the bank's assets and the use of Musharaka to sanitize misappropriation of funds. Effectively, the happenings at Chase bank illustrate tax avoidance through IFFs in the banking sector by both banks and individuals.

3.3 LAWS RELATING TO ILLICIT FLOWS

Generally, Kenya has extensive legislation on various taxation matters, including tax avoidance. However, there is little focus on forms of illicit financial flows and tax avoidance, especially those perpetrated by the multi-nationals in the finance sector. In general, the ITA aims to charge the income of any person, whether resident or non-resident, which was derived or accrued in Kenya.[134] Income is a question of fact constituting gains or profits from a business or employment, rents, premiums, dividends, interest, royalties, pensions, or any other periodical payment?[135] Other than the general anti-avoidance provisions (GAAP),, a few selected provisions in the Income Tax Act relate to illicit flows. The current corporate rate is 30% p.a. for resident companies and 37½% p.a. for non-resident companies.[136] Individual rate is progressive up to a maximum of 30%. Kenya also recently introduced a tax known as "turnover tax"[137] for small and micro enterprises to ease assessment for tax for such businesses.

[134] Income Tax Act, Section 3.
[135] Ibid.
[136]Third Schedule to the Income Tax Act.
[137]Section 19A of the Income Tax Act.

Effectively, the country adopts a hybrid nature of the rule-based and standards-based approach to regulating taxation in the country with different laws in the country.

3.3.1 The Constitution

The CoK is the mother law in Kenya; article 2 of the document has aptly titled the Supremacy of The Constitution, with further reading of the Article adding flesh to the declaration's pre-eminence.[138] Chapter 12, titled Public Finances, is part of the document that tackles matters taxation and public expenditure. Despite the enormous size of the chapter, with a total of 7 parts and 30 articles, only Articles 209 and 210 touches on taxation. According to the two Articles, the power to impose taxes is the exclusive purview of the national government.[139] Thus, the executive part of the branch is the only organ of the state that may alter or make any imposition of tax. Article 10 of the Constitution elaborates the national values and principles.[140] Sub-Article 2 (a) and (d) list these values as human dignity, equity, social justice, inclusiveness, equality, human rights, non-discrimination, and protection of the marginalized, and sustainable development.[141] Therefore, the government as a public organ must impose taxes equitably. Equity is also a canon of taxation that may be loosely translated to proportionality.[142] Paying taxes is based on how much income or revenue of profit one earns from the community they accrue their benefits from. Illicit financial transactions and tax avoidance are an abrogation of the principle of equity in taxation. MNC's attempt, at times, successfully at paying less tax

[138] The Constitution of Kenya 2010 Article, 2.
[139] The Constitution of Kenya 2010 Article, 209.
[140] The Constitution of Kenya, Article 10.
[141] Ibid.
[142] Attiya Warris, "Taxation without Principles: A Historical Analysis of the Kenyan Taxation System." *Kenya Law Review* 1 (2008): 272-304

than their proportionate value. By this very act, such firms enter an unequal relationship with society. Essentially, limiting the ratio of social justice, in the traditional sense, of individuals within a society by not fulfilling the societal obligation.

3.3.2 General Anti-Avoidance Provisions (GAAP)

General Anti-Avoidance Provisions are an umbrella term of regulations that aim to prevent tax avoidance by being cross-cutting. Sections 23 and 24 of the Income Tax Act are the sections that deal with tax avoidance. Section 23 relates to transactions designed to avoid tax. The Section is a 'general anti-avoidance provision that provides that the tax activities by a firm/individual that shows that tax is being avoided grants the commissioner for domestic taxes the power to direct for adjustment of the tax liability of the firm regarding that transaction for tax assessment. The commissioner may charge the individual/organization based on the tax liability accrued to the person/organization.[143]

This is a general provision, which gives the Commissioner power to exercise their discretion on the main purpose or one of the main purposes for which a transaction was affected was tax avoidance. If he forms such an opinion, he can direct adjustments to be made to counteract the avoidance or reduction of taxation. As stated, the provision is too general, and unlike countries that have rules on how such an opinion can be formed, there are no rules or guidelines to guide the Commissioner on how to form the opinion or the basis of forming such an opinion. Whereas the section provides that if the commissioner determines it to be just and reasonable, the

[143] Income Tax Act, 23(1,2,3).

Commissioner may direct that such adjustments be made. There are no parameters within which the Commissioner's determination of "just and reasonable" can be arrived.

In contrast, countries with GAAR adopt a more detailed approach to how the commissioner ascertains as a transaction as intended for tax avoidance. For example, where general anti-avoidance rules have been promulgated. Some factors have been legislated that must be satisfied before an opinion can be formed that a transaction had been effected for purposes of tax avoidance, and include a determination on whether there was a scheme, and if a tax advantage was obtained from the creation of such a scheme, having regard to the overall practical financial consequences of the scheme and whether the same outcomes (other than the tax advantage), could be realised in a more direct, ordinary or expedient way than how the scheme achieved them. In arriving at the determination, there are eight factors to be considered, which have also been legislated.[144] Section 24 relates to tax avoidance and provides that a company that does not issue dividends within twelve months is assumed to have avoided paying tax. This may attract a charge on the income that was not paid out as dividends by companies[145]. There are various reasons why foreign companies may decide not to distribute dividends to shareholders. These reasons may include a decision to put aside money for expanding or replacing an almost obsolete plant. Suppose the company decides not to distribute dividends. In that case, it may not be doing so for the reason that it wants to avoid paying withholding taxes on dividends payable to shareholders, but for economic, expedient, and bona

[144] These factors are listed at section 1770 of Part IV A of the Australian Income Tax Assessment Act 1936.
[145]Income Tax Act, 24(1,2,3,4,4).

fide reasons. As such, in Australia, the commissioner of tax enjoys a structured system in determining whether a transaction aimed to avoid tax.

In 2014, president Uhuru Kenyatta ascended to the Tax Procedures bill. As the long title states, the intention of the bill is "intended to harmonize and consolidate the procedural rule for the administration of tax laws in Kenya, and connected proposes."[146] The Tax Procedures Act attempts to seal administrative loopholes that existed within the tax code. It provides a structure through which the KRA administers taxation to ensure its effectiveness.

3.3.2 Specific Anti-Avoidance Rules (SAAR)

Despite the inadequacies in the general anti-avoidance provisions (GAAP) and the lack of general anti-avoidance rules (GAAR), there are some specific anti-avoidance rules (SAAR) contained in the Income Tax Act. Among the issues, the SAAR deal with is thin capitalization, exchange gains, and losses, transfer pricing, and specified income sources. Unlike general anti-avoidance rules, the specific anti-avoidance rules apply to specific issues for which they are designed to frustrate.

The rule to counter thin capitalizations states that no deductions are alloweable regarding interest payments in proportion to the extent that the highest amount of all loans held by the company in a financial years is higher than[147] thrice the total revenue reserves and share capital of all classes of shares of the company or credits acquired by the company. A company is thinly

[146] Ibid.
[147] Income tax Act, 1974 (16(2) J.

capitalized when its capital composed a greater debt than equity. Where this happens, it means that the shareholder's debt exceeds equity with the consequence that more interest will be allowed against its taxable profits than the amount of dividend that will be distributed to shareholders. This is an avoidance scheme since the company's profits will be reduced, and the company will pay less tax, and at the same time, no tax will be paid on dividends. To counter this is a specific anti-avoidance rule prohibiting the deductibility of interest in the ratio of 1:3 of the debt and equity[148].

3.3.3 The Transfer and Pricing Rules of 2006

Kenya introduced Transfer pricing rules in 2006 to complement the provisions of section 18 (3) of the Income Tax Act (ITA) 2006, Cap 470, due to the amendment of the Income Tax rule, 2012 and Income Tax rule, 2014. Section 18(3) of the Income Tax Act vests the Commissioner with authority to correct the returns accruing to a resident party from intercompany transactions with non-resident parties to mirror such earnings that would have ensued if independent parties at arm’s length conducted the transaction. The cabinet secretary is also authorized to publish guidelines regulating arm’s length worth of a business transaction, whether in goods or services and to stipulate additional obligations to promote the TP provisions, especially the documentation prerequisites.

[148] Income Tax Act , section 16 (2).

3.3.4 Court Precedence's

The courts are an important source of law within the common law system. In antiquity, the court held a vital role. Not only were they adjudicators, but they also functioned as sources of law. According to Blackstone's law dictionary, the phrase common law means, "The body of law derived from judicial decisions, rather than from statutes or constitutions."[149] This is the case more so due to a lack of sufficient legislation to direct courts in dispute resolution. Uncertainty shadows tax law, with stakeholders often not clear on their obligation. It is not uncommon to have the taxman and the taxpayer espouse different opinions on the tax payable a taxpayer ought to remit. The complexity and large numbers of legislation perpetuate uncertainty that the courts are set to resolves. In *Republic vs. Kenya Revenue Authority, ex parte Bata Shoe Company (Kenya) Limited [2014]* eKLR, Justice Korir adopted the UK position on tax law interpretation set out in *Mangin v Inland Revenue Commissioner* [1971] AC 739 by Lord Donovan.[150] The court "is under a duty to adopt an approach that produces neither injustice nor absurdity; in other words, an approach that promotes the purpose or objects underlying the particular statute albeit that such purpose or object is not expressly set out therein."

The learned judge in the case reiterated the importance of the role of the court as a source of law in taxation. The case took cognizance of the possibility of the uncertainty of tax legislation or the impracticality in their application to novel and circumstances.[151] Under such conditions, the interpretative role of courts is pivotal in ensuring justice. In Kenya, the case of Unilever

[149] Black's Law Dictionary (14th ed. 2014).
[150] Bata Shoe Company (Kenya) Limited [2014] eKLR.
[151] Ibid.

Kenya best exemplifies the effect of uncertainty in tax law and the significant role of the courts: in the interpretation of section 18 of the ITA. At the Milimani courts, the Commercial and Tax division is exclusively set aside to handle tax cases. The exclusivity of departments highlights the importance and courts in handling tax cases and the large volume of disputes before courts. As such, jurisprudence on taxation is set to grow with court decisions.

3.3.4 International Law: A Case of Bilateral Treaties

One would be forgiven for thinking that Kenya transformed itself from a dualist state to a monist by constitutional fiat. Article 2 (4) of the Constitution provides: “the general rules of international law shall form part of the laws of Kenya; (b) Any treaty or convention ratified by Kenya shall form part of the law of Kenya under this Constitution.”[152] To this end, parliament enacted the Treaty-Making and Ratification Act, No. 44 of 2012. International taxation is concerned with how tax structures of sovereign nations intermingle amongst each other. International laws adopt one of two positions as either multilateral or bilateral agreements. For tax purposes, bilateral agreements are the most common form as double tax agreements (DTA). Kenya is a member of the international community and is part of numerous international agreements. Some of the treaties that the country is part of bilateral agreements in the form of DTAs. Signed DTAs by the government include treaties with Mauritius, Qatar, the UK, and the UAE.[153] Other than these bilateral agreements as a member of the East African Community (EAC), the country’s tax laws are also subject to the EAC treaty. In Kenya's example, DTA’s are just as part of domestic legislation as internally derived laws. Article 94 ensures that

[152] Constitution of Kenya, Article 4.
[153] 'KRA - Large Taxpayers Office' (Revenue.go.ke, 2018) <http://www.revenue.go.ke/lto/ltodta.html> accessed 25 September 2018

through parliament, these laws gain legitimacy by Article one of the Constitution. Considering the architecture of the DTA and the provision of the TPA on tax avoidance, it is difficult to see how the local Act will be implemented. In practice, however, DTAs are given prominence over local legislation by the taxman. The commission of tax is a member of the executive. As such, there is a sense of collective responsibility[154] and political influence that guarantees that tax authorities do not enforce local legislation trumping DTAs.

The Organisation for Economic Cooperation and Development (OECD) in 1976 published the Guidelines for Multinational Corporations. The guidelines constitute the 1976 Declaration of International Investment and Multinational Enterprises. To remain relevant, the guidelines are reviewed after a seven year cycle that appraises voluntary principles and standards for responsible business conduct in various areas, including labourlaws, human rights, environment, access to information, and fight against bribery, and taxation.[155] The legal environment in which multinational banks operate demands a clear definition of the changing nature of banking transactions as catalysts for economic growth, development, and stability;[156] and socio-politically acceptable ownership arrangements; corporate structure and scope of banking regulation; oversight gared towards safe banking; ethical business practice and corporate governance in banking; international cooperation in regulation; and amicable dispute resolution in banking among World Trade Organization members. Overall, internationally no effective regulation of MNCs exist as of yet.

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[154] Schmidtz, David. "Taking responsibility." Social welfare and individual responsibility: For and against (1998). 111-132,

[155] Leipziger, Deborah. The corporate responsibility code book. Routledge, 2017.: 5-12

[156] Ibid.

3.4 ANALYSIS OF LEGAL REGIMES IN LIGHT OF THE CASE STUDY

3.4.1 The Constitution of Kenya

A distinction ought to be made between standards of taxation and rules of taxation. The difference between the two approaches lies in when the taxing authority must intervene in tax avoidance: ex-post or ex-ante. The constitutional provision under Articles 209 and 210 of the Constitution fall under the former. The prerequisites are not clear but offer a blanket authority by the government for taxes and a corresponding duty by citizens to pay the prescribed taxes.

The significance of this constitutional provision may be overlooked in some quotas as basic tenets. Considering the elaborations provided by the deterrence model of taxation, the right by the government to impose taxes and, in the event of failure to pay one's taxes to impose punitive measures is critical.[157] The necessity for the unequivocal right for taxes comes to the fore through the case study. Through creative accounting, wilful or unintended misinterpretation of the law, and misapplication of business systems, banking institutions in Kenya exhibit taxpayers' propensity not to meet their taxation obligations. Hence, the provisions of the constitution are an important part of the taxation regime as the seed from which every other taxation law grows from. Its effectiveness is not measured in reducing tax avoidance but also allowing for an authority to demand taxes unequivocally.

[157] Lewis Alan, "An Empirical Assessment of Tax Mentality" Public Finance-Finances Publiques 34, no. 2 (1979): 245-257.

3.4.2 The General Anti-Avoidance Provisions (GAAP)

The GAAP, unlike the constitutional provisions, is ex-post. GAAP is an instance of taxation rules that aim to provide strict regulation of what ought to be done. The main requirements of GAAP in the country are in sections 23 and 24 of the ITA and section 86 of the TPA. These particular legislations proscribe measures that are intended to primarily avoid taxes. The commissioner enjoys the power to recover the said taxes and impose punitive measures at the same time. The main challenge to these rules is that they are hinged on detecting tax avoidance schemes by the regulator. The idea that the KRA has the power to note tax avoidance schemes is a statistical unlikelihood. The number of taxpayers in the FI sector only are numerous. Secondly, the nature of FI business is specialized, and as such, an understanding of the various business models is a challenge. For example, Islamic banking is novel to the Kenyan market, and hence analysis of Islamic services in the country is a challenge. The provisions of the Act are more curative than preventive and, as such, rely on other entities to bring to light cases of tax avoidance. Such reliance proves ineffective, as exhibited by the Chase bank case study. The Musharaka banking service runs for some years before the external auditor noticed something amiss in the bank's financial statements. Moreover, little regulation of banking transactions in tax havens and offshore financial centres impede the process of information access. For instance, Kenya's DTA with Mauritius does not include an information-sharing clause.[158] The laws are thus always playing catch up with modern means of tax avoidance. Nevertheless, there are available tools for the swift action of the authority in cases of novel tax avoidance schemes for the country, such as special project vehicles.

158 Tax Justice Network, 'Narrative Report On Mauritius' (Fsi.taxjustice.net, 2018) <https://fsi.taxjustice.net/PDF/Mauritius.pdf> accessed 3 May 2021.

3.4.3 Specific Anti-Avoidance Rules (SAAR)

SAARs are designed for a definite scope of taxpayers to ensure compliance. These forms of regulations are an instance of a rule-based approach in tax administration. They provide clear and specific circumstances under which a tax violation is presumed. To this extent, they are an example of ex-ante regulations. The SAARs are a challenging proposition in their applicability simply because regulating every single specialized field is an impossible and impractical task. The process of regulation would result in large volumes of tax codes and hence hamper the rate of compliance. Nevertheless, it is a necessary evil as in some circumstances it is essential. The realm of FI exists as a duality between company regulation and regulation of the finance industry. As such, there two different dimensions of SAAR that are applicable. In Kenya, SAAR focus on the regulation of companies through thin capitalization, for instance, and trade in goods in TP. The regulation of services is, however, a daunting task. Consequently, there are not SAAR regulations for the financial industry in the country. This is not due to lack of effort but due to the impracticality of the process. Additionally, there are other soft law mechanisms that the regulator relies on to regulate financial institutions to regulate the sector, such as the supervision of the CBK and external auditors. In the Chase bank study, the report by the external auditor, Deloitte, on Musharakah's business model exposed the bank's nefarious activities. Internal regulation measures are hence a pivotal part as pointers to suspicious activities for the KRA.

3.4.4 International Law

International law is by nature a form of soft law. Due to the sovereignty of nations, international law lacks a concrete enforcement agent as municipal law as the government. Moreover, there is no internationally accepted law within the realms of tax law with a sense of universality like the United Nations Charter on human rights. Most treaties are bilateral treaties in the form of DTA agreements, through multilateral treaties are also inexistent. Kenya is a party to several DTAs, including some with Mauritius and UEA. Treaties in tax law are a poisoned chalice for the tax authority. The major con with DTA, especially those with tax haven states, is that they provide both an incentive and a means towards tax avoidance by individuals and corporations alike. For instance, the bank's former chairman, Zafrullah Khan, received funds from the bank to his accounts in the UAE, a known tax haven. Concerted efforts are in place internationally to improve cooperation in the exchange of information to combat tax avoidance. The UN Model Convention is a non-binding instrument that guides countries in designing double tax treaties and their interpretation.[159]

3.5 CARDINAL ISSUES ARISING FROM THE CASE STUDY

3.5.1 A Unique Environment within the Financial Sector That Promotes IFFS

The study concluded that the financial sector faces a substantial risk of IFFs. The inherent risk the industry faces is not new. Through efforts by the (Financial Action Task Force on Money Laundering) FATF efforts at both the international and municipal levels were taken to curb

[159] United Nations 'Model Double Taxation Convention between Developed and Developing Countries' Capacity Development (2011). 2-37 <https://www.un.org/development/desa/capacity-development/tools> accessed 30 August 2018.

money laundering and terror funding.[160] The approach considered the risk that emanated from the transactions by certain individuals, from certain locations, unique enterprises, and unusual transactions.[161] However, the results from the case study point to a rather ignored area of IFFs, which is inward generated IFFs. The most generic form is creative accounting.[162] In recent times, the role of business has come under sharp review, with the debate raging between an enterprises' duty to the shareholders versus that to other stakeholders.[163] The traditional conception of a business is to create profits for the owners. The management is thus tasked with devising and effectuating strategies and policies that achieve maximum profit.

Research from various fields equally supports the notion by managers of making a profit at whatever cost. For instance, creative accounting is legal in some jurisdictions, while in others, it is frowned upon. Even among scholars, there is debt as to whether it is a tool that helps companies out of crisis or into one.[164] According to Dr. Syed Zulfiqar Ali Shah and Dr. Safdar Butt, there are several motivating factors for managers to engage in creative accounting. These include meeting internal targets, meeting external targets, tax avoidance or evasion, window dressing for an IPO or a loan, and providing income soothing.[165] Since creative accounting

[160] Primorac, Damir, Nenad Miletic, and Marko Pilic. "Safety and legal framework on preventing of use of the financial system for money laundering according to solutions of directive (EU) 2015/849." Economic and Social Development: Book of Proceedings (2018): 67-78In Economic and Social Development (Book of Proceedings, 2018), 31st International Scientific Conference on Economic and Social, p. 67

[161] Central Bank Of Kenya, 'Guidance Note: Conducting Money Laundering/ Terrorism Financing Risk Assessment' (2018).

[162] Sahiti, Arbana, and Muhamet Aliu. "Creative Accounting-Nature, Usage, Labor and Relation with the Own Crisis Consequences in Practice in Kosovo." European Journal of Economics and Business Studies, Jan-Apr 201, no. 7 (2017).

[163] Fatma, Mobin, Zillur Rahman, and Imran Khan. "Building company reputation and brand equity through CSR: the mediating role of trust." International Journal of Bank Marketing (2015)840-46

[164] Shah, Syed Zulfiqar Ali, and Safdar Butt. "Creative accounting: A tool to help companies in a crisis or a practice to land them into Crises." International Conference on Business and Economics Research. Vol. 16. 2011.

[165] Ibid.

practices are frowned upon it does not mean that it always attracts punitive consequences.[166] Shah and Butt note that in some instances, creative accounting offers enterprises the opportunity to increase access to credit and investor confidence, thus are an opportunity to grow or improve a poor bottom line. Effectively, Shah and Butt's research validates that financial institutions' proactive mechanism in IFFs is a product of herd mentality within the business plane.

Culture is a people's way of life. What is Kenya's tax culture? According to Nerre, a country has a tax culture that is the entirety of its formal and informal institutions and their connection to the national tax systems and the practicality of execution of the tax regime.[167] The interaction between politicians, taxpayers, tax experts, academicians, and tax officials collectively and individually with that tax code results in the tax culture.[168] In Kenya, there is little empirical data on these interactions.

Nevertheless, one may not be faulted for describing the relationship between taxpayers and tax officials as close to negative than positive. The situation gets worse concerning taxpayers and tax experts, and academicians alike. There is very little, if any, sensitization about tax in the country, with the process reserved for when necessary or within the limits of the academic enterprise. Therefore, the tax culture may be described as one of indifference. The taxpayers

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[166] Vyas, Asmita H., Rupali Ambadkar, and Jyoti Bhargava†. "True and Fair View-A Fact or Illusion in the World of Creative Accounting." International Journal of Multidisciplinary and Current Research 3.3 (2015): 572-575.572-575.

[167] Nerré, Birger. "Tax culture: A basic concept for tax politics." Economic Analysis and Policy 38, no. 1 (2008): 153-167..

[168] Ibid.

do not seem to look forward to paying their taxes. This assertion is not far-fetched. A quick look at the Kenyan tax regime illustrates the use of deterrence theory in achieving tax compliance.[169] For instance, failure to file one's tax returns results in a fine of 20,000 K.Shs, which is almost double the countries minimum wage. The same principles are applied to tax avoidance strategies among MNEs.

Behavioral models of tax evasion seem to offer the best explanation of the financial industry's unique environment. It is not one thing; it is a myriad of factors that perpetuate IFFs. For instance, according to the slippery slope theory, the Kenyan society has low levels of trust while the KRA equally struggles to ensure compliance. As a result, a culture of indifference to taxation arises. A more sector-specific approach alternatively is provided by the social influence theory. The actions and choices of companies in the country show an affinity for creative accounting while the company seems under pressure to perform. It is not surprising that the Companies Act 2014 requires company management to make profitable decisions in the long term and avoid the pressure of immediate gratification of shareholders.[170] The challenge with reigning on IFFs within the financial sector seems not to be a lack of legislation or awareness of legal responsibility but rather a willingness by the industry to engage in the activity and gamble with the likelihood of facing the law.

[169] Ndumia, Samuel K. "The effect of enforcement measures on value added tax revenue for firms in the large corporate taxpayer category in Kenya." PhD diss., University of Nairobi, 2015.
[170] Companies Act 2015, section 142.

3.5.2 Banking Industry Ownership Structures Loopholes

Ownership structures within the financial sector are a massive point of concern. The potential for abuse based on ownership within the financial industry was a surprising result. The Banking Act, the Microfinance Act, and the Companies Act all provide detailed regulations on ownership and its effect on various transactions. For instance, directors under the Banking Act cannot receive loans or credit by a bank above a certain amount. However, the same acts provide the directors enjoy unbridled authority within organizations. The board of directors, for instance, is responsible for ensuring anti-money laundering procedures are created and subsequently receive information from the money laundering reporting officer before taking appropriate action.[171] The board of directors is equally expected as the mind of a company exercises its decisions on sensitive matters. However, as a consequence, directors enjoy social proof that they are not subject to normal rules of investigations, inquiry, and suspicion over their actions by persons tasked with this role in their respective entities as they are their juniors.[172] IFFs by top management officials and directors in financial institutions often go unnoticed or unreported. All banking transactions are subject to flagging by the bank if the dealing is considered irregular or suspect. Nevertheless, how does a financial institution employee flag a transaction by senior staff members or by a director? For instance, the Anti Money Laundering Act creates the office of the money laundering reporting officer who is an employee of the financial institution. Who then reports his findings on money laundering that may include members of the organization to the board of directors. In essence, the reality on the ground is that banking officials will look away when transactions come from within their

[171] Proceeds of Crime and Anti-Money Laundering Act No. 9 OF 2009, sec 10.
[172] Milica, Djordjevic and Tadija Đukić. "Contribution of Internal Audit in the Fight Against Fraud." Facta Universitatis, Series: Economics and Organization (2016): 297-309

organizations while remaining vigilant when the transaction is by a person outside the organisation's "inner circle."

The nature of banks is that they are owned by other banks that are either local entities or foreign entities. The ownership structure of financial institutions in the country illustrates a connection between the various companies. It is not surprising anymore for banks to equally run microfinance enterprises. Moreover, some of the local banks are part of other international institutions. It thus not uncommon or unusual for capital to flow from one of these institutions to another. Such transactions are regarded as internal transactions and raise lower levels of concerns and scrutiny within the staff. Such transactions, therefore, create an avenue through which corporations within the sectors may transfer funds while circumventing the mechanism to detect IFFs.[173] Moreover, company directors and other top-level officials in the financial industry may use their clout to embezzle funds or transfer payments without remitting the tax.[174] The challenge these structures pose is not the absence of the law but rather that the only line of detection is the entity participating in the nefarious activity. Even if the illegal actions are undertaken would be red-flagged by internal structures, the unbridled influence of directors cannot be understated. The Chase Bank study and the inquiry into the billions in payment that one of the directors received illustrates the influence that directors have in the sector and the potential for abuse. Moreover, the collapse of the bank is not a one-time event, and two other

[173] Lucy Chernykh and Mityakov Sergey, "Offshore Schemes and Tax Evasion: The Role of Banks." *Journal of Financial Economics* 126, no. 3 (2017): 416-442

[174] Mihir A Desai, Alexander Dyck and Luigi Zingales "Theft and Taxes." Journal of Financial Economics 84, no. 3 (2007): 491-623

banks failed under similar circumstances. Hence, it is safe to presume director's use of financial institutions as conduits of IFF equally took place in the latter circumstances.

The Kenyan case study illustrates how financial institutions may serve as intermediaries to IFFs while promoting tax avoidance. The picture drawn so far is that of individual personalities within the bank using their positions for personal gain. The opportunity to use banks as tax avoidance intermediaries raises the question of voluntary activities by banks as tax planning entities. The law currently prohibits all efforts by companies to avoid tax. The legality of the section of the law is yet to be tested within the Kenyan jurisdiction. Nevertheless, studies by other scholars have shown that banks are well-positioned to be tax avoidance intermediaries.[175] One of the strategies employed by banks is "tax arbitrage." The scheme involves transferring ownership of shares about to receive dividends to owners in regions with low tax obligations, such as tax havens, and the share is returned to their original owners right after dividends are paid.[176] Tax avoidance mechanisms by banks are not new within the financial sector and thus pose a real option for tax avoidance.

According to the OECD, banks enjoy certain advantages as tax evasion intermediaries. Firstly, banks have access to financial instruments and the responsibility of creating complex implementing tax complex transactions.[177] Structured finance groups offer banks the

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[175] Gallemore, John, Brandon Gipper, and Edward Maydew. "Banks as tax planning intermediaries." *Journal of Accounting Research* 57, no. 1 (2019): 169-209.
[176] Kuzniacki, Blazej, Alessandro Turina, Thomas Dubut, Addy Mazz, Natalia Quiñones, Luís Eduardo Schoueri, Craig West, Pasquale Pistone, and Frederik Zimmer. "Preventing Tax arbitrage via Hybrid Mismatches: BEPS Action 2 and Developing Countries." *WU International Taxation Research Paper Series* 2017-03 (2017).
[177] Gallemore, John, Brandon Gipper, and Edward Maydew. "Banks as tax planning intermediaries." *Journal of Accounting Research* 57, no. 1 (2019): 169-209.

advantage of offering more than just plain vanilla transactions that generate greater fees. Banks can hence, realize greater regulatory, bookkeeping, and the commercial result that comprises tax avoidance.[178] Secondly, other than being conduit mechanisms for IFFs, banks can also be a mode of transfer of IFF through the connection between firms. Sharing of information between enterprises or access to unique financial institutions allows access to techniques developed for the purpose of IFFs. Some of the improvements may require the collaborative effort of the various institution to come to fruition. Finally, globalization within the financial sector equally increases the risk of IFFs. The case study already illustrated that banks are used as intermediaries for tax avoidance. With access to data and information and the speed of light, strategies by banks that may increase turnover figures and clientele affinity may also include services that result in IFFs. Close investigations into modern means of banks as intermediaries must be undertaken to evaluate the Kenyan situation better.

3.5.3 Nature of Transactions

Illicit financial flows take different forms. There are three main forms of IFFs, including funds from illegal activities, funds set for illegal activities like terrorism, and legal funds transferred for tax avoidance reasons. The prominent forms of IFFs from the research were funds subjected to tax evasion procedures and money from illegal sources. The nature of IFFs from the findings, however, represented a peculiar character. Sources of income from illegal activities were not expected to account for a large section of IFFs. However, tax avoidance seemed to dominate IFFs from the financial sector. A review of the findings based on research by other

[178] Ibid.

scholars on the nature of IFFs in the financial industry reaffirms the dominance of tax evasion and avoidance.[179] Research by Chernykh confirms that tax avoidance among employees is predominant among bank workers with operations in tax havens.[180] The study shows that banks involved in offshore relations make less profit from traditional banking practice. Moreover, employees from such company's including top management officials, are characterized by lower reported earnings but more expansive vehicles. Access to luxury vehicles is a sign of a higher source of income. According to the paper, "if a company has offshore exposure above 1% of employees are considerably lower (by 24-34%), and car values are higher by 2% than in companies connected to banks with no transactions in offshore financial centers."[181]

Banks as an intermediary of IFFs in the form of tax avoidance is a novel challenge for tax collection authorities. The law, therefore, is not yet up to date on these new techniques. Moreover, in Europe, such methods only come to the fore with academic research into these areas still in their infancy. It follows, Kenya's preparedness is equally inadequate as tax officials are also not well informed on these new strategies. The complex nature of these modern forms equally makes it a challenge to be identified, let alone investigated and brought to book. The nature of IFFs within the financial sector is internally the same, while the outward appearance has changed significantly to fool law enforcement agents.

[179] Tatiana Tropina, "Do Digital Technologies Facilitate Illicit Financial Flows?" (2016) 1-12.
[180] Chernykh, Lucy, and Sergey Mityakov. "Offshore schemes and tax evasion: The role of banks." Journal of Financial Economics 126, no. 3 (2017): 516-542
[181] Ibid.

3.6 CONCLUSION

This chapter has looked at the legal framework for the regulation of tax avoidance and IFFs, within the Financial Institutions in Kenya, with a specific focus on Chase Bank Limited (A case study approach). The weakness in the tax laws is analysed to show the legal and practical challenges that perpetuate tax avoidance among FI. It is my view that the current tax laws in Kenya are not up to date in dealing with the modern-day taxpayer, whose aim is profit-oriented. Every taxpayer aims to maximize profits as much as possible and avoid so many expenses that include taxes, even if it means coming up with tax planning ideas that include creative accounting and special purpose vehicles as was the case with Chase Bank. The current tax laws, as they are, cannot cover all these. This shows that it is impractical to regulate each and every specialized tax planning field that come up in this modern day.

CHAPTER FOUR

4.1 RECOMMENDATIONS AND CONCLUSION

In the first chapter, the research introduced the legal problem as being tax avoidance among FIs that are perpetuated through IFFs. I also stated the objectives, the hypothesis, justification, and limitations of the study. I as well discussed the theoretical framework of the study and the research methodology as well as the literature review.

In the second chapter, the research related the tax deterrence model with tax avoidance. Finally, illustrating why the model was the most appropriate for the study.

In chapter three, the research focused on the legal framework on tax avoidance in the country. The main objective of the chapter was to analyze and criticize the tax code in the regulation of tax avoidance. The research employed a case study approach in the process to highlight some of the weaknesses of the tax code and the challenges the process faces.

The last chapter gives some recommendations that should be implemented to strengthen the legal framework for dispute resolution in the financial sector.

4.2 RECOMMENDATIONS

4.2.1 Naming and Shaming

The impact of social punishment is often overlooked. The adoption of the naming and shaming mechanism provides a social mechanism through which tax avoiders may be punishment.

Public shame and ridicule are powerful tools that the state may be used to reign in on Financial Institutions engaging in Illicit Financial Institutions.

Non–Governmental organisations have been very vocal in the fight against illicit financial flows in developing countries. [182] Adopting the approach of naming and shaming by players such as NGOs and Investigative Journalists would play an important role in fighting illicit financial flows in financial institutions considering the unique nature of such transactions.
In the recent past, the president of Harare named and shamed corporates and individuals that failed to return USD 1.4 Billion that had been externalized in the past years. This led to the recovery of USD 591.1 Million was recovered under amnesty. [183]

Considering financial institutions are profit-making organizations, they would be at a loss when they are named and shamed, as they might lose their credibility. Naming and shaming perpetrators in the sector that deal or enable illicit financial flows out of Kenya would assist in detecting and preventing capital flight.

[182]Pan African Lawyers Union, 'PALU Newsletter, Issue No. 25, March 2015' (Us6.campaign-archive.com, 2016) <https://us6.campaign-archive.com/?u=f961a4382d60625bafd982436&id=3b995e0d51&e=a49b5f11ca#1.1> accessed 3 May 2021.

[183] The Herald, 'UPDATED: President Names, Shames Looters • Nearly $1Bn Remains Outstanding • Funds Stashed In China, Botswana, SA' (*The Herald*, 2018) <https://www.herald.co.zw/president-mnangagwa-exposes-externalizers/> accessed 3 May 2021.

4.2.2 Amnesty and Reparation

The use of the olive branch mechanism is equally an effective strategy. Adoption of an amnesty and reparation approach by tax authorities offers a less abrasive approach as a form of ADR. Reparation and amnesty offer tax avoiders the opportunity to begin on a clean slate.

The Government of Kenya has previously provided tax amnesty for various categories of taxpayers, including those that earn foreign income. [184]Tax amnesty works because taxpayers are given a clean slate to begin on. With the view that taxpayers invest their funds outside the country, through the use of financial institutions as a conduit to transfer these funds, as a way to avoid taxes, the use of amnesty may encourage financial institutions and/or their customers to reinvest the monies back to the economy and disclose their correct tax positions without any repercussions such as prosecution or being assessed to tax on the amounts not disclosed. Such amnesty would provide a conducive environment to facilitate correct tax disclosures, [185]considering Kenya's tax regime is a self-assessment regime.

4.2.3 Fight Corruption

This research intended to investigate the effectiveness of tax regimes primarily to reign on IFFs and the challenges faced in the sector. A review of the findings and the subsequent discussion illustrates not necessarily a lack of law or regulation but an evolution of IFFs generally and the

[184] Kenya Revenue Authority , 'The Finance Bill 2016' <https://www.kra.go.ke/images/publications/> accessed 3 May 2017.

[185] Daniel Ngumy and Kenneth Njunguna, 'AN INDEPTH LOOK AT THE TAX AMNESTY ON FOREIGN INCOME' (Africalegalnetwork.com, 2016) <https://www.africalegalnetwork.com/wp-content/uploads/2016/08/Tax-Amnesty-on-Foreign-Income-Alert.pdf> accessed 3 May 2021.

unique nature of the financial sector that are a challenge. As a response to these challenges, the fight against IFF in the financial industry would be of importance in fighting IFFs.

IFFs are usually a ‘get-away car’ for corruption; the players in the industry include lawyers, accountants, and financiers (which include financial institutions). Kenya has come a long way in the fight against corruption which includes the implementation of international and local anti-corruption initiatives. Kenya did not have ways to identify IFFS, but through the World Bank Institutes research, it is now easier to focus on the crimes generates through IFFs, mechanisms through which IFFs flow, the destination, and the consequences of the same in Kenya and Africa at large. [186]

In fighting illicit financial activities by fighting corruption, Kenya established the Financial Reporting Centre in 2012. Little has, however, changed[187] , and as it is seen from this research, illicit financial flows are on the rise through creating accounting and special purpose vehicles in the financial sector. Aggressive tax planning through these methods is not easy to detect, and the government needs to do more.

4.2.4 Increased Intergovernmental Sharing of Data on Financial sector players

The Income Tax Act is specialised, and therein lies its strength and weakness. The Act as legislation exclusively focuses on a matter relating to taxation and income. However, it is limited as to the scope of the investigation the tax authority enjoys. Investigations by the KRA

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[186] Ibid.

[187] Emile Van Der Does De Willebois, 'Illicit Financial Flows (Iffs)' (World Bank, 2016) <https://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs> accessed 3 May 2021.

are only foreseen in the event of suspected tax evasion. The approach adopted is more geared towards rectification after the fact. The Chase bank case study illustrates this point, as the facts of the case raised concern over possible tax evasion. To better manage IFFs within the sector, information sharing between various government authorities that evaluate and police financial institutions must be timely, regular, and informed. To this end, the relevant public bodies, including the DCI, the Central Reporting Agency, and the CBK, must all be sensitized on IFFs. The education program must include the basics and evolution of IFFs in the modern world. The intention is to empower these authorities with the technical skills to identify questionable transactions and activities by financial institutions and bring these finds to the KRA in time for investigations. Sharing of data, however, must be regularly for several reasons. The findings by complementary agencies are speculative, and the efforts of the KRA are necessary to ascertain possible tax avoidance. Moreover, the are numerous banking institutions, and this regular information sharing ensures that the bulk of the organizations are reviewed while ensuring entities remain vigilant. The process is part of the deterrence theory that adopts an increased likelihood of detection to prevent further nefarious activities.

4.2.5 Public Sensitization on IFFs

The negative effects of IFFs on developing economies are well documented. Governments miss out on billions in taxes from IFFs, money that could be used for development projects. Unfortunately, a majority of the population is unaware of what IFFs are. As such, the fight against the vice is fought with limited workforce and awareness resources. Sensitization is known as not only an informative tool but an empowering one as well. Participants are known

to take proactive steps in fighting the vice sensitized about. By including the public in the sensitization campaign, good things can be expected.

In the financial sector, as evidenced in the case study, the players are sometimes in the financial institutions. Sensitization of what IFFs are and how to detect them, and their adverse effects on the economy. This assists enforcement procedures such as FRC to curb IFFs. The public, after being sensitized can report any suspected illicit dealings. [188]

4.2.6 Increased Capacity of Investigative Officers on IFFs in the Financial Sector

At the moment, the KRA investigative unit boasts of 40 members. These 40 individuals are tasked with intelligence gathering to support investigations, coordinating prosecution of cases in courts of law or tax appeals tribunal, and adoption of alternative dispute resolution and asset recovery schemes.[189] The number of organizations subject to investigations runs into the thousands while individuals run into the millions. The nature of the operations is equally becoming more complex. By increasing the number of officers in the department, the quality and quantity of investigations can only improve. The review of cases is currently a human-based exercise; thus, the process is subject to human resource limitations such as fatigue, a lack of motivation, and labour rights limitations. Effectively, an increase in human resources in the department will increase the efficiency of the department due to increased resources.

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[188] François Godbout, Grace Mbogo and Paradzai Garufu, 'Advocacy Manual For Lawyers' Associations In The Global South' (Cbgaindia.org, 2020) <https://www.cbgaindia.org/wp-content/uploads/2020/03/Module-3_Advocacy-Manual-for-Lawyers-Associations-in-the-Global-South.pdf> accessed 9 May 2021.

[189] KRA, 'Investigations And Enforcement' (2018) <http://www.kra.go.ke/index.php> accessed 30 June 2018

4.2.7 Study into the Evolution of IFFs in the country

In the past 60 years, humanity underwent an evolution. Developments in communication and transport resulted in a global village. Accessibility of information gives rise to the internationalization of ideas. As such, good concepts spread, benefiting the world while bad ideas equally mushroom. Novel and new schemes are constantly coming to the surface. The new frontier includes the study of banks as intermediaries in IFF through their unique positions, and association with other financial institutions, association with non-fiscal services providers, and access to tax havens. Research into the field so far points to constant and repeated efforts by the financial industry to develop and implement tax avoidance mechanics. Most of these mechanisms seem like everyday transactions but, on close inspection, reveal ulterior motives. A few of the tactics identified thus far are dividend arbitrage, tax arbitrage, and currency arbitrage.

4.4 CONCLUSION

The impact that IFFs have on economies is not in doubt. They bleed economies of large amounts of taxes while still opening a door for nefarious activities to thrive. The financial sector is at the heart of events leading IFFs. However, perceptions on the matter focused on the abuse of the system by users of financial services. Close inspection illustrates that entities in the sector also have the opportunity to use their unique position for further IFFs. Moreover, powerful individuals within the same institution also can leverage their position for personal gain. A more worrying trend is the emergence of greater ingenuity by banks, particularly as intermediaries of IFFS. Ownership structures and close relations with tax havens offer more complex modes of IFFs. The convolution of the situation includes the difficulty in detection of

these new systems of tax avoidance. The research shows tax avoidance as the main form of IFFs; however other forms are suspected of benefiting from revolutions in the sectors equally. If it cannot be measured, it cannot be improved. A summary of the recommendations is an increased understanding of the new nature of IFFs within the financial sector. As illustrated, the industry enjoys unique advantages in detection avoidance, access to systems, and incentives to engage in IFFS. To better handle the situation, an understanding of the market and modern developments are necessary to develop effective and local approaches to solving the problem rather than the common approach of copying and pasting legislation from foreign jurisdictions. The result of which has proved to lead to poorly understood laws and subsequent inadequate enforcement.

4.5 SUGGESTIONS FOR FURTHER RESEARCH

The research identifies financial institutions as potential intermediaries for IFFs in the country. In the process, only one form of IFFs is identified. As such, there is room to explore whether Kenyan banks are taking part in modern IFF models that are already identified. Thus far, the banks are not implicated in actions that promote tax avoidance. However, the absence of evidence is not proof of lack. Hence, future research may evaluate the role of banks as parties to IFFs within the sectors.

The relation studies so far are close-knit relations. The nuclear family of banking institutions, including subsidiaries, holding companies, and staff, has been reviewed. However, the external relation between that financial institutions have with non-finance companies, and tax havens

in the form of countries with DTA with Kenya should also be investigated as they have the potential for abuse.

Appendix 1

PRESS RELEASE

CHASE BANK LIMITED (IN RECEIVERSHIP)

With the endorsement of the Central Bank of Kenya (CBK), the Kenya Deposit Insurance Corporation (KDIC) has today reached understandings with the KCB Bank Kenya Ltd (KCB) on modalities to reopen Chase Bank Ltd (In Receivership)(CBL) in the next few days and the eventual acquisition of a majority stake in the bank.

This involves KDIC as "the Receiver" appointing KCB as "the Manager" under the provisions of Sections 44(2)(b) and 44(3) of the Kenya Deposit Insurance Act, 2012 to carry out the business and manage the assets and liabilities of CBL. KCB's credentials as a strong bank with a solid brand, adequate human resources, and wide experience in the country, will facilitate safeguarding the interests of CBL's depositors and creditors, and the wider public interest. CBK will continue to monitor closely developments in CBL. Accordingly:

- All Chase Bank Ltd (In Receivership) branches will open by Wednesday, April 27, 2016. The online and mobile banking services will also become available. However, branches may initially offer limited banking services.
- CBL customers will have immediate access to their deposits up to a maximum of Ksh.1 million. On this basis, 167,290 accounts (equivalent to 97 percent of accounts or 6 percent of total deposits) will have their funds available in full. Any new deposits will thereafter be immediately available.
- Deposits in excess of Ksh.1 million will be made available in a structured manner, details of which will be released in the near future.
- The moratorium on payments to creditors and lenders remains in place. However, the Manager will correspond with them in the near future with details of how these would be dealt with.

Appendix 2

Chase Bank (Kenya) Limited

0730 175000 | 0709 800000 atyourservice@chasebank.co.ke

ChaseBankKenya @chasebankkenya 0773758196 skype ChaseBankKenya

AUDITED FINANCIAL STATEMENTS AND DISCLOSURES AS AT 31ST DECEMBER 2014

			BANK 31st Dec '13 Kes. '000' Audited		GROUP 31st Dec '13 Kes. '000' Audited
I	**BALANCE SHEET**				
A	**ASSETS**				
1	Cash (both Local & Foreign)	3,803,171	1,403,150	3,891,840	1,726,833
2	Balances due from Central Bank of Kenya	7,105,986	3,014,503	7,105,986	3,014,503
3	Kenya Government and other securities held for dealing purposes	-	-	-	-
4	Financial Assets at fair value through profit and loss	-	-	-	-
5	Investment Securities:	-	-	-	-
	a) Held to Maturity:				
	a. Kenya Government securities	6,740,637	4,932,678	6,740,637	4,932,678
	b. Other securities	202,618	238,479	202,618	238,479
	b) Available for sale:				
	a. Kenya Government securities	4,785,000	3,365,000	4,785,000	3,365,000
	b. Other securities	-	-	-	-
6	Deposits and balances due from local banking institutions	7,320,064	9,098,911	6,084,383	9,098,911
7	Deposits and balances due from banking institutions abroad	7,758,772	5,505,037	7,758,771	5,505,037
8	Tax recoverable	-	-	17,210	20,789
9	Loans and advances to customers (net)	53,821,223	39,564,255	57,236,098	41,429,897
10	Balances due from banking institutions in the group	484,402	363,646	-	-
11	Investments in associates	-	-	-	-
12	Investments in subsidiary companies	765,000	390,000	-	-
13	Investments in joint ventures	-	-	-	-
14	Investment properties	-	-	-	-
15	Property and equipment	1,661,507	1,110,183	2,040,602	1,517,208
16	Prepaid lease rentals	-	-	-	-
17	Intangible assets	702,065	449,218	718,800	476,527
18	Deferred tax asset	20,551	-	36,484	859
19	Retirement benefit asset	-	-	-	-
20	Other assets	11,941,473	7,133,870	12,540,195	7,442,117
21	**TOTAL ASSETS**	**107,112,469**	**76,568,930**	**109,158,624**	**78,768,838**
B	**LIABILITIES**				
22	Balances due to Central Bank of Kenya	-	-	-	-
23	Customer deposits	79,124,210	51,941,729	79,853,887	53,361,000
24	Deposits and balances due to local banking institutions	-	8,661,407	-	8,234,835
25	Deposits and balances due to foreign banking institutions	-	1,407,718	-	1,407,718
26	Other money market deposits	-	-	-	-
27	Borrowed funds	15,501,192	5,874,732	16,458,923	6,632,564
28	Balances due to banking institutions in the group	-	-	-	-
29	Tax payable	294,826	180,139	300,199	183,303
30	Dividends payable	-	-	-	-
31	Deferred tax liability	-	2,814	0	11,272
32	Retirement benefit liability	-	-	-	-
33	Other liabilities	1,126,598	1,013,349	1,424,074	1,433,853
34	**TOTAL LIABILITIES**	**96,046,826**	**69,081,888**	**98,037,083**	**71,264,545**
C	**SHAREHOLDERS' FUNDS**				
35	Paid up /Assigned capital	10,000,000	7,000,000	10,000,000	7,000,000
36	Share premium/(discount)	-	-	-	-
37	Revaluation reserves	(60,835)	(122,835)	(60,835)	(122,835)
38	Retained earnings/Accumulated losses	363,276	119,402	413,426	110,115
39	Statutory loan loss reserves	763,202	490,475	768,950	517,013
40	Other Reserves	-	-	-	-
41	Proposed dividends	-	-	-	-
42	Capital grants	-	-	-	-
43	**TOTAL SHAREHOLDERS' FUNDS**	**11,065,643**	**7,487,042**	**11,121,541**	**7,504,293**
44	Minority Interest	-	-	-	-
45	**TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS**	**107,112,469**	**76,568,930**	**109,158,624**	**78,768,838**
II	**PROFIT AND LOSS ACCOUNT**				
1.0	**INTEREST INCOME**				
1.1	Loans and advances	11,627,544	8,078,947	12,232,019	8,271,626
1.2	Government securities	1,068,580	631,434	1,068,580	742,793
1.3	Deposits and placements with banking institutions	181,548	88,663	272,941	88,663
1.4	Other Interest Income	-	-	-	-
1.5	**TOTAL INTEREST INCOME**	**12,877,672**	**8,799,044**	**13,573,540**	**9,103,082**
2.0	**INTEREST EXPENSE**				
2.1	Customer deposits	4,887,405	3,221,097	4,980,358	3,159,160
2.2	Deposits and placement from banking institutions	1,308,595	711,725	1,385,332	794,013
2.3	Other interest expenses	-	-	-	-
2.4	**Total Interest Expenses**	6,196,000	**3,932,822**	6,365,690	**3,953,173**
3.0	**NET INTEREST INCOME/(LOSS)**	**6,681,672**	**4,866,222**	**7,207,850**	**5,149,909**
4.0	**NON-INTEREST INCOME**				
4.1	Fees and commissions on loans and advances	512,218	351,455	537,507	354,171
4.2	Other fees and commissions	1,043,614	584,967	1,314,976	712,787
4.3	Foreign exchange trading income/(Loss)	838,576	362,467	838,576	362,467
4.4	Dividend Income	-	-	-	-
4.5	Other income	4,133	54,550	97,605	177,820
4.6	**Total Non-Interest Income**	**2,398,541**	**1,353,439**	**2,788,664**	**1,607,245**
5.0	**TOTAL OPERATING INCOME**	**9,080,213**	**6,219,661**	**9,996,514**	**6,757,154**
6.0	**OTHER OPERATING EXPENSES**				
6.1	Loan loss provision	757,087	390,751	794,904	414,920
6.2	Staff costs	1,902,247	1,169,982	2,213,756	1,397,217
6.3	Directors' emoluments	3,856	7,943	4,602	7,943
6.4	Rental charges	274,097	170,527	367,582	220,946
6.5	Depreciation charge on property and equipment	382,201	213,475	354,263	240,728
6.6	Amortisation charges	124,178	124,178	[illegible]	128,137
6.7	Other operating expenses	2,334,698	1,891,594	[illegible]	2,060,189
6.8	**Total Other Operating Expenses**	**5,778,364**	**3,968,450**	**6,642,573**	**4,470,080**
7.0	**Profit/(loss) before tax and exceptional items**	**3,301,849**	**2,251,211**	**3,353,941**	**2,287,074**
8.0	Exceptional items	-	-	-	-
9.0	**Profit/(loss) before tax after exceptional items**	**3,301,849**	**2,251,211**	**3,353,941**	**2,287,074**
10.0	Current tax	985,248	681,306	993,455	700,275
11.0	Deferred tax	-	-	-	-
12.0	Profit/(loss) after tax and exceptional items	2,316,601	1,569,905	2,360,486	1,586,799
13.0	Minority Interest	-	-	-	-
14.0	**Profit/(loss) after tax, exceptional items and Minority Interest**	**2,316,601**	**1,569,905**	**2,360,486**	**1,586,799**
15.0	**Other Comprehensive Income**	-	-	-	-
15.1	Gains/(Losses) from translating the financial statements of foreign operations	-	-	-	-
15.2	Fair value changes in available for sale financial assets	62,000	(114,968)	62,000	(114,968)
15.3	Revaluation surplus on Property,plant and equipment	-	-	-	-
15.4	Share of other comprehensive income of associates	-	-	-	-
15.5	Income tax relating to components of other comprehensive income	-	-	-	-
16.0	**Other Comprehensive Income for the year net of tax**	**62,000**	**(114,968)**	**62,000**	**(114,968)**
17.0	**TOTAL COMPREHENSIVE INCOME FOR THE YEAR**	**2,378,601**	**1,454,937**	**2,422,486**	**1,471,831**
	Earnings per Share - Basic & Dilluted	**Kes. 0.25**	**Kes. 0.22**	**Kes. 0.25**	**Kes. 0.22**
III	**OTHER DISCLOSURES**				
	NON-PERFORMING LOANS AND ADVANCES				
1.0	(a) Gross Non-performing loans and advances	3,196,164	2,012,566	3,415,401	2,012,566
	(b) Less: Interest in Suspense	913,410	983,108	914,930	986,873
	(c)Total Non-Performing Loans and Advances (a-b)	**2,282,754**	**1,029,458**	**2,500,471**	**1,025,693**
	(d) Less: Loan Loss Provision	1,102,734	489,400	1,176,878	525,727
	(e) Net Non-Performing Loans and Advances(c-d)	**1,180,020**	**540,058**	**1,323,593**	**499,966**
	(f) Discounted Value of Securities	1,180,020	540,058	1,323,593	499,966
	(g) Net NPLs Exposure (e-f)	-	-	-	-
	INSIDER LOANS AND ADVANCES				
2.0	(a) Directors, Shareholders and Associates	1,367,153	1,081,591	1,367,153	1,081,591
	(b) Employees	1,870,948	492,620	1,870,948	492,620
	(c)Total Insider Loans and Advances and other facilities	**3,238,101**	**1,574,211**	**3,238,101**	**1,574,211**
	OFF-BALANCE SHEET ITEMS				
3.0	(a)Letters of credit, guarantees, acceptances	7,665,951	6,781,485	7,665,951	6,781,485
	(b) Forwards, swaps and options	5,577,760	2,690,154	5,577,760	2,690,154
	(c)Other contingent liabilities	-	-	-	-
	(d)Total Contingent Liabilities	**13,243,711**	**9,471,639**	**13,243,711**	**9,471,639**

			BANK 31st Dec '13 Kes. '000' Audited
4.0	**CAPITAL STRENGTH**		
	(a) Core capital	9,613,276	6,595,923
	(b) Minimum Statutory Capital	1,000,000	1,000,000
	(c) Excess/(Dificiency)(a-b)	8,613,276	5,595,923
	(d) Supplementary Capital	763,202	490,475
	(e) Total Capital (a+d)	**10,376,478**	**7,086,398**
	(f) Total risk weighted assets	**67,948,090**	**47,133,294**
	(g) Core Capital/Total deposits Liabilities	12.1%	11.7%
	(h) Minimum statutory Ratio	8.0%	8.0%
	(I) Excess/(Deficiency) (g-h)	4.1%	3.7%
	(j) Core Capital / total risk weighted assets	14.1%	14.0%
	(k) Minimum Statutory Ratio	8.0%	8.0%
	(l) Excess (Deficiency) (j-k)	6.1%	6.0%
	(m) Total Capital/total risk weighted assets	15.3%	15.0%
	(n) Minimum statutory Ratio	12.0%	12.0%
	(o) Excess/(Deficiency) (m-n)	**3.3%**	**3.0%**
14	**LIQUIDITY**		
14.1	(a) Liquidity Ratio	46.4%	40.5%
14.2	(b) Minimum Statutory Ratio	20.0%	20.0%
14.3	**(c) Excess (Deficiency) (a-b)**	**26.4%**	**20.5%**

The above audited full year financial statements and disclosures are extracts of financial records of the Bank and have been approved and signed on behalf of the Board by:

Z. Khan	D. Kabui	P. Njaga
Chairman	Group Managing Director	Chief Executive Officer

RELATIONSHIPS MATTER.

It is because of the relationships we build within our selves, with our customers, our partners, our investors and in the communities we serve in, that we are able to move forward.

If it matters to you, it matters to us.

Let us talk to start a relationship today.

THE RELATIONSHIP BANK

Chase Bank is regulated by the Central Bank of Kenya.

Appendix 3

Chase Bank (Kenya) Limited

AUDITED FINANCIAL STATEMENTS AND OTHER DISCLOSURES
AS AT 31ST DECEMBER 2015

		BANK		GROUP	
	BALANCE SHEET	31 Dec 15 Kes. '000' Audited	31 Dec 14 KES. '000' Audited	31 Dec 15 Kes. '000' Audited	31 Dec 14 Kes. '000' Audited
A	**ASSETS**				
1	Cash (both Local & Foreign)	2,395,668	3,803,171	2,879,289	3,891,840
2	Balances with Central Bank of Kenya	8,756,428	7,105,986	8,756,428	7,105,986
3	Kenya Government & other Securities held for dealing purposes	-	-	-	-
4	Financial Assets at Fair Value through Profit & Loss	-	-	-	-
5	Investment Securities:				
	(i) Held to Maturity:				
	(a) Kenya Government Securities	8,139,189	6,740,637	8,139,189	6,740,637
	(b) Other Securities	864,667	202,618	864,667	202,618
	(ii) Available for Sale:				
	(a) Kenya Government Securities	3,912,700	4,785,000	3,912,700	4,785,000
	(b) Other Securities	-	-	-	-
6	Deposits and Balances due from Local Banking Institutions	8,057,638	7,320,064	7,514,273	6,084,383
7	Deposits and Balances due from Banking Institutions Abroad	1,744,349	7,758,772	1,744,349	7,758,771
8	Tax Recoverable	1,116,782	-	1,128,119	17,210
9	Loans and Advances to Customers (Net)	99,036,730	53,821,223	103,304,956	57,236,098
10	Balances due from Banking Institutions in the Group	916,600	484,402	-	-
11	Investments in Associates	-	-	-	-
12	Investments in Subsidiary Companies	765,000	765,000	-	-
13	Investments in Joint ventures	-	-	-	-
14	Investment Properties	-	-	-	-
15	Property, Plant and Equipment	2,361,344	1,661,507	2,531,568	2,040,602
16	Prepaid Lease Rentals	-	-	-	-
17	Intangible Assets	1,103,109	702,065	1,135,605	718,800
18	Deferred Tax Asset	273,704	20,551	313,279	36,484
19	Retirement Benefit Asset	-	-	-	-
20	Other Assets	2,898,424	11,941,473	3,571,138	12,540,195
	TOTAL ASSETS	**142,342,332**	**107,112,469**	**145,795,560**	**109,158,624**
B	**LIABILITIES**				
21	Balances due to Central Bank of Kenya	-	-	-	-
22	Customer Deposits	92,628,494	79,124,210	94,274,100	79,853,887
23	Deposits and Balances due to Local Banking Institutions	11,573,090	-	11,573,090	-
24	Deposits and Balances due to Foreign Banking Institutions	-	-	-	-
25	Other Money Market Deposits	-	-	-	-
26	Borrowed Funds	26,396,968	15,501,192	27,362,217	16,458,923
27	Balances due to Banking Institutions Group Companies	-	-	-	-
28	Tax Payable	-	294,826	16,503	300,199
29	Dividends Payable	-	-	-	-
30	Deferred Tax Liability	-	-	-	-
31	Retirement Benefit Liability	-	-	-	-
32	Other liabilities	765,780	1,126,598	1,218,654	1,170,710
	TOTAL LIABILITIES	**131,364,332**	**96,046,826**	**134,444,564**	**97,783,719**
C	**SHAREHOLDERS' FUNDS**				
33	Paid Up/ Assigned Capital	10,960,188	10,000,000	10,960,188	10,000,000
34	Share Premium (Discount)	1,158,682	-	1,158,682	-
35	Revaluation Reserves	(618,284)	(60,835)	(618,284)	(60,835)
36	Retained Earnings/Accumulated Losses	(1,790,149)	363,276	(1,758,529)	413,426
37	Statutory Loan Reserves	1,267,563	763,202	1,348,209	768,950
38	Other Reserves	-	-	-	-
39	Proposed Dividends	-	-	-	-
40	Capital Grants	-	-	-	-
	TOTAL SHAREHOLDERS' FUNDS	**10,978,000**	**11,065,643**	**11,090,266**	**11,121,541**
41	Minority Interest	-	-	260,730	253,364
	TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS	**142,342,332**	**107,112,469**	**145,795,560**	**109,158,624**
	STATEMENT OF COMPREHENSIVE INCOME FOR PERIOD ENDED				
	INTEREST INCOME				
1	Loans and Advances	11,880,527	11,627,544	12,754,070	12,232,019
2	Government Securities	1,783,248	1,068,580	1,783,248	1,068,580
3	Deposits and Placements with Banking Institutions	651,932	181,548	629,076	272,941
4	Other Interest Income	-	-	-	-
	Total Interest Income	**14,315,707**	**12,877,672**	**15,166,393**	**13,573,540**
	INTEREST EXPENSE				
5	Customer Deposits	8,572,776	4,887,405	8,558,085	4,980,358
6	Deposits and Placement from Banking Institutions	1,959,450	1,308,595	2,017,507	1,385,332
7	Other Interest Expenses	-	-	-	-
	Total Interest Expenses	10,532,226	6,196,000	10,575,592	6,365,690
	NET INTEREST INCOME /LOSS	**3,783,481**	**6,681,672**	**4,590,801**	**7,207,850**
	NON INTEREST INCOME				
8	Fees and Commissions on Loans and Advances	798,416	512,218	354,171	537,507
9	Other Fees and Commissions	1,395,444	1,043,614	2,194,424	1,314,976
10	Foreign Exchange Trading Income (Loss)	1,505,814	838,576	1,505,814	838,576
11	Dividend Income	-	-	-	-
12	Other Income	30,380	4,133	148,466	97,605
	Total Non-Interest Income	**3,730,054**	**2,398,541**	**4,202,875**	**2,788,664**
	TOTAL OPERATING INCOME	**7,513,535**	**9,080,213**	**8,793,677**	**9,996,514**
	OPERATING EXPENSES				
13	Loan Loss Provision	2,093,063	757,087	2,175,646	794,904
14	Staff Costs	2,300,636	1,902,247	2,767,467	2,213,756
15	Directors' Emoluments	9,921	3,856	10,941	4,602
16	Rental Charges	380,267	274,097	488,362	367,582
17	Depreciation Charge on Property and Equipment	392,612	382,201	420,901	354,263
18	Amortisation Charges	291,622	124,178	305,216	201,573
19	Other Operating Expenses	3,147,631	2,334,698	3,632,790	2,705,892
	Total Operating Expenses	**8,615,752**	**5,778,364**	**9,801,323**	**6,642,572**
	Profit/(Loss) Before Tax and Exceptional Items	**(1,102,217)**	**3,301,849**	**(1,007,646)**	**3,353,942**
20	Exceptional Items	-	-	-	-
	Profit/(Loss) After Exceptional Items	**(1,102,217)**	**3,301,849**	**(1,007,646)**	**3,353,942**
21	Current tax	(253,153)	985,248	(222,316)	993,455
22	Deferred tax	-	-	-	-
	Profit/(Loss) After Tax and Exceptional Items	**(849,064)**	**2,316,601**	**(785,330)**	**2,360,487**
23	Minority Interest	-	-	7,366	5,238
	Profit/(Loss) After Tax, Exceptional Items & Minority Interest	**(849,064)**	**2,316,601**	**(792,696)**	**2,355,249**
	Other Comprehensive Income:				
24	Gains/(Losses) from Translating the Financial Statements of Foreign Operations	-	-	-	-
25	Fair Value changes in Available-for-sale Financial Assets	(557,449)	62,000	(557,449)	62,000
26	Revaluation Surplus on Property, Plant and Equipment	-	-	-	-
27	Share of other Comprehensive Income of Associates	-	-	-	-
28	Income Tax Relating to Components of other Comprehensive Income	-	-	-	-
	Other Comprehensive Income for the Year Net of Tax	**(557,449)**	**62,000**	**(557,449)**	**62,000**
	TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**(1,406,513)**	**2,378,601**	**(1,342,779)**	**2,422,487**
	EARNINGS PER SHARE- BASIC & DILUTED	(0.10)	0.30	(0.10)	0.31
	DIVIDEND PER SHARE -DECLARED	80	14	80	14

		BANK		GROUP	
III	OTHER DISCLOSURES	31 Dec 15 Kes. '000' Audited	31 Dec 14 Kes. '000' Audited	31 Dec 14 Kes. '000' Audited	31 Dec 15 Kes. '000' Audited
1.0	**NON-PERFORMING LOANS AND ADVANCES**				
1.1	(a) Gross Non-performing loans and advances	11,361,505	3,196,164	11,875,307	3,415,401
1.2	(b) Less: Interest in Suspense	1,278,218	913,410	1,289,061	914,930
1.3	**(c)Total Non-Performing Loans and Advances (a-b)**	**10,083,287**	**2,282,754**	**10,586,246**	**2,500,471**
1.4	(d) Less: Loan Loss Provision	1,773,718	1,102,734	1,919,602	1,176,878
1.5	**(e) Net Non-Performing Loans and Advances(c-d)**	**8,309,569**	**1,180,020**	**8,666,644**	**1,323,593**
1.6	(f) Discounted Value of Securities	8,338,503	1,180,020	4,973,847	1,323,593
1.7	**(g) Net NPLs Exposure (e-f)**	**(28,934)**	**-**	**3,692,797**	**-**
2.0	**INSIDER LOANS AND ADVANCES**				
2.1	(a) Directors, Shareholders and Associates	2,612,149	1,367,153	2,612,149	1,367,153
2.2	(b) Employees	2,630,799	1,870,948	3,106,456	1,870,948
2.3	**(c)Total Insider Loans and Advances and other facilities**	**5,242,948**	**3,238,101**	**5,718,605**	**3,238,101**
3.0	**OFF-BALANCE SHEET ITEMS**				
3.1	(a)Letters of credit, guarantees, acceptances	13,446,904	7,665,951	14,374,450	7,665,951
3.2	(b) Forwards, swaps and options	10,725,096	5,577,760	11,400,810	5,577,760
3.3	(c)Other contingent liabilities	-	-	-	-
3.4	**(d)Total Contingent Liabilities**	**24,172,001**	**13,243,711**	**25,775,260**	**13,243,711**
4.0	**CAPITAL STRENGTH**				
4.1	(a) Core capital	9,572,721	9,613,276		
4.2	(b) Minimum Statutory Capital	1,000,000	1,000,000		
4.3	(c) Excess/(Deficiency)(a-b)	8,572,721	8,613,276		
4.4	(d) Supplementary Capital	6,089,963	763,202		
4.5	**(e) Total Capital (a+d)**	**15,662,684**	**10,376,478**		
4.6	(f) Total risk weighted assets	103,777,036	67,948,090		
4.7	**(g) Core Capital/Total deposits Liabilities**	**9.2%**	**12.1%**		
4.8	(h) Minimum statutory Ratio	8.0%	8.0%		
4.9	(i) Excess/(Deficiency) (g-h)	1.2%	4.1%		
4.10	**(j) Core Capital / total risk weighted assets**	**9.2%**	**14.1%**		
4.11	(k) Minimum Statutory Ratio	10.5%	8.0%		
4.12	(l) Excess (Deficiency) (j-k)	-1.3%	6.1%		
4.13	**(m) Total Capital/total risk weighted assets**	**15.1%**	**15.3%**		
4.14	(n) Minimum statutory Ratio	14.5%	12.0%		
4.15	(o) Excess/(Deficiency) (m-n)	0.6%	3.3%		
5.0	**LIQUIDITY**				
5.1	(a) Liquidity Ratio	31.0%	46.4%		
5.2	(b) Minimum Statutory Ratio	20.0%	20.0%		
5.3	(c) Excess (Deficiency) (a-b)	11.0%	26.4%		

MESSAGE FROM THE DIRECTORS

The above audited full year financial statements and disclosures are extracts of financial records of the Bank and have been approved and signed on behalf of the Board by:

Z. Khan — Chairman
D. Kabui — Group Managing Director
P. Njaga — Chief Executive Officer

RELATIONSHIPS MATTER.

It is because of the relationships we build with our staff, with our customers, our partners, our investors and in the communities we serve in, that we are able to grow.

If it matters to you, it matters to us.

Let us talk to start a relationship today.

Rafiki microfinance bank

CHASE ASSURANCE

CHASEBANK

Chase Bank (Kenya) Limited is regulated by the Central Bank of Kenya.

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