Our government has decided to extort money from the smallest businesses and is trying to make a virtue of it. Imposing the 3 per cent turnover tax (TOT) on informal micro and small businesses is monstrous, and an insult to poor Kenyans. Though legal, TOT is IMMORAL. I echo the prophetic declaration: “Woe to those who make unjust laws, to those who issue oppressive decrees, to deprive the poor of their right and withhold justice…” (Isaiah 10:1 NIV)

The micro and small-scale businesses, which include kiosks, small grocery stores, hair salons and small market traders (generally those at the bottom tier of the informal sector) now have to pay TOT. TOT is a new tax demanded of any resident person whose turnover from business does not exceed or is not expected to exceed Sh5,000,000 ($50,000) during any year of income. It will be payable from 1st January 2020. This tax rate is on the gross sales/turnover and is a final tax.

Mrs. Elizabeth Meyo, the Commissioner of Domestic Taxes at the Kenya Revenue Authority (KRA), states that “from January 2020, if one operates a salon, butchery, or grocery store, you will be required to declare your sales online and pay the taxes on the 20th of each month.” And for one to get a business licence from one’s county government, one will have to pay an extra 15 per cent of the permit fees to KRA as presumptive tax. In complying to these new demands, Mrs. Meyo further claims, “the business owners will have fulfilled their patriotic duty for a better Kenya”.

Turnover Tax: Days of Extortion, Days of Revolt

By Francis Omondi
Various economic findings acknowledge the substantial contribution of the informal sector to GDP in most developing countries. The informal sector is one of the biggest employers in Kenya, and accounts for over 80 per cent of employment opportunities. It is a shame that attention is turning to this sector only for their moolah, and to bridge the gap resulting from dwindling revenue from the formal sector. According to a Kenya National Bureau of Statistics survey published in 2016, the monthly expenditure on salaries and wages for unlicensed micro small and medium enterprises (MSMEs) was Sh9 billion, which translates to 25 per cent of total outlays a piece.

**The neglected informal sector**

The colonial market design continues to define the contours of our economy, which conditions us to think of the informal sector as inferior to the formal sector. We still perceive it as “traditional”, marginal or peripheral, having no links to the formal economy and making no contribution to modern industrial development. We have therefore neglected this sector.

Some economists have argued that the informal sector is a dead-end for a pool of labour comprising workers who could not gain entry into the preferred formal sector. Others, like Jeffery Sachs, have even gone to pronounce the informal sector’s obituary, stating that it would cease to exist once Kenya achieves sufficient levels of economic growth and industrialisation.

The informal sector is one of the biggest employers in Kenya, and accounts for over 80 per cent of employment opportunities. It is a shame that attention is turning to this sector only for their moolah, and to bridge the gap resulting from dwindling revenue from the formal sector.

Others see the potential of the informal sector’s small businesses. In his book, *The Mystery of Capital* (2001), the Peruvian economist Hernando de Soto views these informal businesses as a sign of entrepreneurial dynamism, a real force in the market. They could also be useful in an industrial take-off due to their resilience and ability to withstand market shocks over the long haul, as Shem Watako observed in his doctoral studies of micro and small businesses in Kariobangi.

This hubris in the informal sector has got the taxman’s attention. But the challenge is in how they will implement the TOT. Mrs Meyo identifies this difficulty while responding to why Kenya resorted to TOT for small businesses. She explained that “lack of formal structures and a tax framework that suits the [informal] sector have been major drawbacks in the taxman's quest to tap revenue from this sector”.

The ethical reasoning of those calling for micro and small-scale businesses to pay taxes as demanded is implausible because it does not raise the second order question. Is it moral to make these demands on the poorest of Kenyan businesses? Is it moral to treat the poor with partiality when the new tax regime would disenfranchise them?

A turnover tax is like a sales tax or a value-added tax (VAT), with the difference being that it taxes intermediate and capital goods. It is on an ad valorem basis (based on the value of the good in question, rather than being flat taxes), applicable to a production process or stage. TOT makes the poor pay another indirect tax, while those whose turnover exceeds Sh5 million pay direct tax, which is a better tax plan for their businesses.

Let us consider a hypothetical case of Nyamulu Beauty Salon, a business run by Achieng’ in Kariobangi, a low-income area of Nairobi, to illustrate this point. With her revenue turnover of Sh100,000 for January 2020, she would enlist for TOT.
NYAMULU BEAUTY SALON, KARIOBANGI TRADER SCENARIO

<table>
<thead>
<tr>
<th>ITEM</th>
<th>REVENUE/COST</th>
<th>GOVT TAXES &amp;LEVIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue 100 clients @ 1000</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Less cost</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td>(5,000)</td>
<td>VAT +Levies (901)</td>
</tr>
<tr>
<td>Supplies (oils, hair pieces, etc.)</td>
<td>(30,000)</td>
<td>VAT @16% (4,800)</td>
</tr>
<tr>
<td>Rent for stall</td>
<td>(12,000)</td>
<td>Rent Tax @10% Incl (1,091)</td>
</tr>
<tr>
<td>Casual workers 2 @500 a day</td>
<td>(30,000)</td>
<td></td>
</tr>
<tr>
<td>Mshwari fees[1]</td>
<td>(5,850)</td>
<td></td>
</tr>
<tr>
<td>County license</td>
<td>(1,250)</td>
<td>county license (1,250)</td>
</tr>
<tr>
<td><strong>Operating Trade Profit</strong></td>
<td><strong>15,900</strong></td>
<td><strong>Total Taxes &amp; Levies (8,042)</strong></td>
</tr>
</tbody>
</table>

Assumptions

VAT is standard rated for all goods and services

**SCENARIO 1 - TOT**

Operating trade profit 15,900
Less Turnover Tax (3,000) Total Taxes & Levies (11,042)
**Net Profit** 12,900 11.04%

**SCENARIO 2- Personal Income Tax (PIT)**

Trade Profit 15,900
PIT - After Relief (362) Total Taxes & Levies (8,404)
**Net Profit** 15,538 Effective Tax Rate 8.4%

**SCENARIO 3 Personal Income Tax and VAT Registered[2] (PIT + VAT registered)**

Operating Trade Profit 15,900
Add-Input VAT recovered
Electricity 664
Supplies 4,800
**Net Profit/Taxable Income** 21,364
PIT - After Relief (1,182) Total Taxes & Levies (3,760)
**Net Profit** 20,182 Effective Tax Rate 3.76%

Scenario 3 encourages small traders to register for VAT, which is passed through to consumers; the net effect is increased transparency and increased VAT collection for KRA.

<table>
<thead>
<tr>
<th>TOT</th>
<th>PIT</th>
<th>PIT + VAT Reg</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit</td>
<td>12,900</td>
<td>15,538</td>
</tr>
<tr>
<td>Effective Taxes</td>
<td>11,042</td>
<td>8,404</td>
</tr>
<tr>
<td>Effective Taxes%</td>
<td>11.04%</td>
<td>8.4%</td>
</tr>
</tbody>
</table>

An alternative tax plan to TOT would give a different result. If the above scenario described her business, then under scenario one, where she paid TOT, her profit would be Sh12,900. Under
scenario two, where she pays personal income tax, her profit would be Sh15,538. And if she were registered for VAT and also pays PIT, she would have made profit of Sh20,182.

The individual tax plan would, therefore, be more favourable to the poor income business groups than the TOT. Notice also that her business has contributed indirectly to the government’s revenue by more than Sh8,042. Then, if subjected to the TOT of Sh3,000, she would have contributed Sh11,042 to the government coffers.

Is it moral for a tax regime to erode the business capital of the poor?

The start-up capital of small businesses usually comes from family resources. This tends to limit the size of the businesses, the number of workers they hire, and the level of profits they generate. So they have a limited amount available to reinvest.

In 2016, the Kenya National Bureau of Statistics found that licenced micro establishments reported spending 45.3 per cent of their net income on investments, either as reinvestment or investing in new businesses and investment in agriculture, while expenditure on household and family needs accounted for 44.5 per cent. In 2016, small and medium establishments spent a significantly large part of their net income on investment, at 63.4 per cent and 69.7 per cent, respectively.

The erosion of capital from small business via the TOT will delay their growth. Rather, by allowing them to grow capital we would help debunk the notion held by some, including the International Labour Organisation (ILO), that these businesses are doomed to remain small. Yet a significant number of entrepreneurs in the informal sector earn more, on average, than low-skilled workers in the formal sector, according to some studies.

It is immoral to deny the poor a fair chance to compete in the market by imposing a tax on their businesses.

Governments have used taxes to shut out a section of the economy. N. Cheeseman and R. Griffiths (2005)[31] point out that turnover taxes can also be punitive when designed to create a disincentive for buying particular products. They say that environmental regulations sometimes encourage this practice.

Despite the expansive nature of the informal sector, aiming at the bottom end of the pyramid is suspect. We must keep in mind that the current regime is struggling with a debt burden that is uncreative and evil. TOT could be an attempt to cut off informal sector traders from the market. There are 1.3 million micro and small enterprises in Kenya, which, according to a government survey, employed about 2.4 million people – 17 per cent of the total workforce in Kenya – in 2009. They were engaged in the following: close to two-thirds (64.1 per cent) of all enterprises were in the trade sector; retailing made up 62 per cent of all trading in Kenya; manufacturing comprised 13 per cent, while services accounted for 15 per cent.

It is immoral for the government to burden the poor.

In a liberal democracy, argues Prof. Nicholas Wolterstorff of Yale Divinity School, the state should act impartially when distributing burdens and benefits to its citizens. Our government is absent in the lives of poor citizens because of skewed development priorities. The poor live in squalour with children attending overcrowded schools. They have dismal access to healthcare and are the main users of public transport on what is left of roads.

But the government now finds it expedient to tax these businesses operating on the margins of our nation, either in the slums of our cities and towns or in the rural areas. Yet it is through their
businesses that low-income households have managed to improve their lot, not through any government subsidies or incentives.

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We can use taxes for the public good, to even out the inequalities in society and to provide essential services to all citizens. Eric Nelson, a Harvard professor, explains the idea that the state should coercively maintain an egalitarian distribution of property because it is the business of the state to engage in the redistribution of wealth through taxation, thus ensuring the welfare of the poor; this idea is the genesis of welfare states in many European countries.

Forcing a blanket tax without considering the business conditions of payees is reminiscent of the colonial administration’s hut and poll tax of the 1920s. Then, local leaders and community representatives defended their people against the colonial extortion. Responding to the tax demands, Luo leaders in Nyanza consulted and convened a general meeting at Lundha in Gem on 23 December 1921. About 9,000 people attended from all parts of Nyanza to discuss the hut tax. During the meeting, Chief Ogada Odera of Gem in Central Nyanza lamented: “As regards our taxes, they used to be 3 shillings. Mr John Ainsworth [the Nyanza Provincial Commissioner in Kisumu from 1906] told us that the amount would be increased to 5 shillings. We agreed. The government then increased it to 8 shillings. It is very heavy. Besides, we do not want our women taxed.”

Forcing a blanket tax without considering the business conditions of payees is reminiscent of the colonial administration’s hut and poll tax of the 1920s.

Chief Ogada made a perceptive comment: “As regards the word colony, the government came here and found us occupying the land and now it calls us ‘wasumbni’ [their slaves].”

Most commentators on TOT have sided with the government’s position and made a virtue of the extortion of poor businesses by calling the tax fair, patriotic, and easy to compute and complete. I think they are misguided. Kamotho Waiganjo reflected this distorted thinking when he commented in the Standard: “But the government was getting no tax benefit from these businesses...those who operate in the formal sector, and who are therefore in the taxman’s spotlight...cough up 30 per cent of annual profits as tax...businesses in the informal sector means that many of the operators in this expansive sector escape the taxman’s dragnet. Not anymore.”

This assumption – that the poor in the informal sector churn out a considerable volume of revenue but do not contribute to the tax pool – is erroneous. TOT is an indirect tax on businesses and not a tax based on income from business profits. Informal sector businesses already pay other indirect taxes that are levied on fuel, electricity, VAT on their goods and rent taxes collected from rental income. Shouldn’t their cost of goods, business expenses, and other costs also be considered, as they are with formal businesses?

Most commentators on TOT have sided with the government’s position and made a virtue of the extortion of poor businesses by calling the tax fair, patriotic, and easy to compute and complete. I think they are misguided.
Some argue that the cost of compliance is low and that all that these small businesses need to do is record their sales. Those paying turnover tax will not need to worry about tracking their expenses; their tax is only on turnover. They say keeping proper business records will benefit business owners because proper records would help them evaluate their business performance, monitor purchases and sales, and make crucial business decisions.

However, the consequences of eviscerating small businesses would be catastrophic owing to sector’s significance in the economy. It may arouse two major reactions from the poor:

First, if the small businesses sense extortion, they may disappear into thin air. These businesses are supersensitive to extortion by the authorities and would hibernate, adjusting their operations till conditions change. The damage in the wake of their disappearance could be devastating. Mr. Francis Atwoli, the Secretary-General of the Central Organisation of Trade Unions (COTU), warned that further taxation on small and medium businesses will not only destroy the fastest growing sector of the economy but also render many Kenyans jobless.

The 2016 Kenya National Bureau of Statistics survey shows that approximately 400,000 micro, small and medium enterprises do not celebrate their second birthday. Few reach their fifth birthday, leading to concerns about the sustainability of this vital sector.

Second, if poor business owners interpret this tax as oppression, they will revolt. Implementation of TOT will conjure up the pain of the colonial era. The colonial hut and poll taxes became a heavy burden on the people of Kenya in the 1920s. B A Ogot\(^4\) (2009:772) observes that it was made worse by the method of collection, which was ruthless and arbitrary. In Nyanza, the colonial regime collected the hut tax from all huts in a kraal, including the cattle sheds. When many people refused to pay these taxes, the colonial authorities, including chiefs and tax clerks, resorted to brutal methods of collection, ordering policemen, chiefs and sub-chiefs to raid villages, set houses on fire, and confiscate property or food stuff such as grains, bananas and cassava.

Since TOT will eat into the livelihood of these business owners, they will revolt. But the authorities will crush their revolt due to their lack the organisational capacity, unlike the UK’s anti-poll tax groups of 1990. Introducing an unpopular “poll tax” is credited for forcing Mrs. Margaret Thatcher out of office in November 1990. The Green Paper of 1986, *Paying for Local Government*, proposed the poll tax, which charged a fixed tax per adult resident for the services provided in their community, hence the term poll tax. It was a change from payment based on the worth of one’s house to a resident individual. The tax was, therefore, criticised as being unfair, and needlessly burdensome on those who were less well-off. What followed were protests and riots that prompted the abolishing of the tax following the change of government in November 1990.

**What should KRA do with poorer businesses?**

The government and the KRA, the implementing tax collection authority, can act morally and avoid hurting small-scale businesses. They can make it a priority to rationalise the informal sector rather than wipe it out through harsh tax policies.

Turnover tax, as currently enacted, is elective. Therefore, qualifying small businesses can opt to register for the standard tax system. This move would allow them to be recognised like other businesses. And with sound records, they may take advantage of comprehensive inclusion rules and a reduction process that requires maintaining proof of expenditure. We should make efforts in aiding small-scale businesses to maintain proper business records and wean them into an alternative tax regime.
The government and the KRA, the implementing tax collection authority, can act morally and avoid hurting small-scale businesses. They can make it a priority to rationalise the informal sector rather than wipe it out through harsh tax policies.

This government should heed the words of Hubert Humphrey, the former US Vice President, who on November 1, 1977, said: “The moral test of government is how that government treats those who are in the dawn of life, the children; those who are in the twilight of life, the elderly; those who are in the shadows of life, the sick, the needy and the handicapped.”

The tinders are there waiting for something to ignite them. If the poor interpret TOT as extortion, we may as well have ushered in days of revolt.

[1] Trader uses Mshwari for working capital, interests at 7.5% per month.

[2] Allow Voluntary registration for traders who are below the threshold for compulsory VAT registration.


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