

CONTROLLING ILLCIT TOBACCO TRADE:



A GLOBAL REVIEW OF COUNTRY EXPERIENCES

KENYA: CONTROLLING ILLICIT CIGARETTE TRADE

TECHNICAL REPORT OF THE WORLD BANK GROUP
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KENYA

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Controlling Illicit Cigarette Trade

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Chapter Summary

In response to the presence of illicit cigarettes in the market in the early 2000s, Kenya implemented and tested various measures to control tobacco tax evasion. These measures had varying degrees of effectiveness, as documented in the literature (both published and unpublished), conference proceedings and related materials, online searches, and analyses based on data of the National Statistical Office of Kenya. The latest intervention, based on the modern data-driven technology in track and trace systems (TTSs), combined with electronic cargo monitoring of exports, seems to be the most effective, as it is more resistant to tampering and reduces reliance on human capacity. The tracing solution implemented in Kenya increased the size of the legitimate cigarette market, while being cheaper than the previous piecemeal solutions. The positive experience with the system had good spillover effects, allowing Kenya to expand the system to other excisable goods, as well as goods, from beer to cosmetics, subject to counterfeiting.

Despite these successes, Kenya needs to stay vigilant because of the ever-adapting methods of supplying the illicit cigarette market and because of the risks of lowering enforcement

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priorities in the tobacco market. Even though the new system brought in more tax revenue, the increase has been modest relative to the growing size of the legitimate market. Therefore, the current technological solution should be expanded to allow for proper tracking. In addition, the lack of an independent estimate of the size of the illicit tobacco market hinders the proper assessment of efforts to control the market. The estimates provided by the tobacco industry or commercial entities cannot be trusted for several reasons: lack of transparency in their methodology; frequent massive, suspect updates in the estimates that cannot be justified; and the well-documented efforts by the tobacco industry in a number of countries to exaggerate illicit trade to discourage tax increases. The government should therefore invest in regular assessments of the situation, including estimates of the size of the illicit tobacco market.

The experience of Kenya in addressing the illicit trade highlights the feasibility and importance of strengthening both the system and enforcement, including the related penalties and tobacco tax administration, although there are recommendations here for stronger action on both counts. The efforts of the government are all the more impressive, given Kenya's broader difficulties in addressing accountability issues in public-sector management. The improvement in the tobacco tax system and enforcement was not merely a technical endeavor. It involved consensus building, the participation of key stakeholders, and consistent and comprehensive approaches to address tax evasion, because piecemeal measures have only short-term effects.

The government should consider ratifying the Protocol to Eliminate Illicit Trade in Tobacco Products. This would contribute to sustained political commitment to a systematic effort to combat the illicit trade within Kenya and help the government secure regional collaboration that would reduce the illicit trade both domestically and in neighboring countries.

International evidence shows that tax administration is the main cause of illicit trade. Tobacco tax rates play a relatively modest role. The government of Kenya, with its system to control the illicit trade in place, should not allow the illicit trade to be used as an excuse for not pursuing more vigorous tobacco tax reform. Moreover, the tax reform should draw on the key reform elements recommended by the World Bank on the basis of evidence from a broad range of low-, middle-, and high-income countries. These include policies that are highlighted in catchwords and phrases, such as "go big, go fast"; "attack affordability"; "change expectations"; and "tax by quantity." The importance for the government of these points should not be underestimated, given the two-tiered system and the extremely large discrepancy between the rapid growth in the number of cigarettes sold and the slow growth and recent declines in real tobacco-tax revenues. It is important that the tax per cigarette be increased more quickly than inflation so that cigarettes become less, not more affordable over time. This will also bring fiscal and health benefits to the country.

1. Background

Globally, Kenya would be classified as a country with relatively low smoking prevalence. However, in the African context, the prevalence puts Kenya at the top of the pile. In the early 2000s, approximately 21.3 percent of men and 1.0 percent of women smoked tobacco.² The prevalence among youth was relatively low at that time (8.7 percent among boys and 4.7 percent among girls), but there were signs of a growing appeal of tobacco products to the young generation.³

By 2007, prevalence had increased both among adults (26.0 percent of men and 2.0 percent of women smoked⁴) and among youth (12.7 percent of boys and 6.5 percent of girls smoked⁵). However, the government managed to reverse this trend among both adults and young people by following some of the best tobacco control practices recommended in the Framework Convention on Tobacco Control (FCTC), even though the real tax and real price of cigarettes declined during this time. By 2014, 15.1 percent of men and 0.8 percent of women smoked,⁶ while 9.6 percent of boys and 4.0 percent of girls reported they were smokers. Measures adopted by the government to control the illicit trade in tobacco products also contributed to this positive trend.

2. Initial Assessment of the Illicit Cigarette Market

In the early 2000s, Kenya was perceived as an illicit cigarette transit point in East Africa, while Tanzania was the main source of the contraband,^{7,8} and the Democratic Republic of Congo, Sudan, and Uganda were the main target destinations.⁹ An increase in the availability and quality of illicit cigarettes was reported between 2000 and 2002.¹⁰

This prompted a government audit in 2003. The audit revealed serious cigarette tax avoidance and evasion schemes, such as the fraudulent declaration of cigarettes for export that were then sold tax free domestically, undeclared domestic production to avoid paying any tax, undeclared imports of raw tobacco and finished products to avoid import taxes, under-declared values of products to evade higher tax rates, and supplying counterfeit cigarettes to the domestic market.^{11,12}

² Tobacco Atlas, 2nd edition, 2006.

³ Global Youth Tobacco Survey, Kenya, 2001.

⁴ Atlas of Health Statistics of the African Region 2011. World Health Organization. Regional Office for Africa, 2011.

⁵ Global Youth Tobacco Survey, Kenya, 2007.

⁶ World Health Organization. 2014. Global Adults Tobacco Survey (GATS), Kenya Country Report.

⁷ ERC Group. World cigarettes. The 2009 Survey. Suffolk, ERC; 2009.

⁸ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015.

⁹ Euromonitor. Illicit trade in tobacco products 2012; 2013.

¹⁰ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015.

¹¹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

¹² ERC Group. World cigarettes. The 2009 Survey. Suffolk, ERC; 2009.

Table 1. Illicit Cigarette Trade in the Total Cigarette Market, Kenya, 2003–16

| | 2003* | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010* | 2011 | 2012 | 2013 | 2014* | 2015 | 2016 |
|----------|-------|------|------|------|------|------|------|-------|------|------|------|-------|------|------|
| ERC 2007 | | | | | 16.7 | | | | | | | | | |
| ERC 2010 | | | | | | | | 12.0 | | | | | | |
| ERC 2015 | | | | | 20.6 | | | | | 11.0 | | | | |
| BAT | | | | | | 8.12 | | 12.0 | 20.0 | 8.0 | | | | |
| EM 2012 | | | | 11.3 | 11.5 | 11.8 | 12.4 | 12.9 | 13.5 | | | | | |
| EM 2015 | 13.0 | 13.0 | 13.0 | 12.8 | 12.9 | 13.3 | 13.6 | 13.9 | 14.0 | 10.8 | 10.8 | 10.8 | | |
| EM 2016 | 30.8 | 30.9 | 30.8 | 30.3 | 30.7 | 31.3 | 32.0 | 32.4 | 32.6 | 26.5 | 26.5 | 26.6 | 26.6 | 27.3 |
| EM 2017 | 11.3 | 11.3 | 11.3 | 11.1 | 11.2 | 11.5 | 11.8 | 12.1 | 12.1 | 9.4 | 9.4 | 9.4 | 9.4 | 9.7 |
| KRA | 15.0 | | | | | | | | | | 12.0 | 5.0 | 5.0 | 5.0 |

Sources: ERC Group 2007, 2010, 2015; Eriksen, Mackay, and Ross 2013; Euromonitor International 2012, 2015, 2016, 2017a, 2017b; Gachiri 2012; Muthaura 2013; Nargis 2012; Ngeywo 2017.

Note: BAT = British American Tobacco, EM = Euromonitor International. ERC = ERC Group. KRA = Kenya Revenue Authority. Euromonitor estimates fluctuate tremendously and are not consistent across reports published in different years. Similarly, the two estimates generated by ERC for 2007 are not consistent. This casts a serious doubt on the reliability of these estimates.

* Indicates a significant change in policy to address illicit trade

The size of the problem was not clear (Table 1). Euromonitor International reported in various publications that the illicit market in 2003 represented between 11 percent and 31 percent of the total market, while the ERC Group (ERC) put that estimate at 20 percent–26 percent in 2007.

The Kenya Revenue Authority (KRA) estimate that the illicit cigarette trade deprives the country of about K Sh 1 billion (US\$11.3 million) in taxes annually.¹³ Another KRA estimate claimed that the illicit cigarette trade cost the country more than K Sh 70 billion (US\$790 million) in jobs, tax revenues, and investment losses.¹⁴ The methodologies used to generate these estimates are unknown.

¹³ Ngeywo CM. Senior Assistant Commissioner, Kenya Revenue Authority, Report of the meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling. Gaborone, Botswana; 3-5 June 2012. The World Bank, 2012.

¹⁴ Muchangi J. Kenya: cigarette smuggling in country. *Nairobi Star*; 7 March 2012.

3. First Measures to Address the Illicit Cigarette Market

The results of the 2003 audit prompted the government to take several actions to address cigarette tax avoidance and tax evasion. First, it changed the tax regime from an ad valorem system using the ex-factory price to a specific tiered tax system using retail prices to define the four progressive tax categories.¹⁵ This was supposed to eliminate tax evasion related to the under-declaration of the value of cigarettes.

In addition to the change in tax structure, the government introduced paper tax stamps on all cigarette packs sold in the domestic market. This measure was primarily aimed at local producers and was supposed to eliminate the under-declaration of production destined for the domestic market. Since a clear majority of cigarettes consumed in Kenya are domestically produced, only a small volume of imported products supplied by a few importers had to affix tax stamps to cigarette packs before they entered the Kenya market.¹⁶

The stamps provided by the KRA were affixed at the premises of the manufacturers (either in Kenya or abroad, in the case of imports) to serve as a proof of payment. Each stamp had a serial number as well as a unique identifier for a particular type of cigarette: an orange stamp was used for filter cigarettes, and a green stamp was used for nonfilter cigarettes. The manufacturers and importers were required to submit monthly reports on the usage and stocks of these stamps.¹⁷ The new tax stamp program was accompanied by regular compliance checks and audits by the Customs and Excise Department.¹⁸

Thanks to these measures, monthly excise tax revenue in 2003 increased from K Sh 230 million to K Sh 350 million,¹⁹ and legal cigarette and cigar sales rose by 52 percent from 2003 to 2004 (Figure 19.1). The ERC also noted in a later report that these government efforts reduced the illicit cigarette trade.²⁰ In light of the positive experience with tax stamps on cigarettes, the government extended the excise stamp regime to wines and spirits in 2007 and began to consider the use of the stamps on beer, water, and juices.²¹ The stamps were initially supplied to the KRA by De La Rue of the United Kingdom and the Canadian Bank Note Company and, since 2007, by an Indian security-printing firm, Madras, that charged K Sh 2 (US\$0.023) for the printing and the delivery of each stamp.²²

¹⁵ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

¹⁶ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015.

¹⁷ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

¹⁸ Vincent Kimosop, information obtained from the KRA on August 8, 2018.

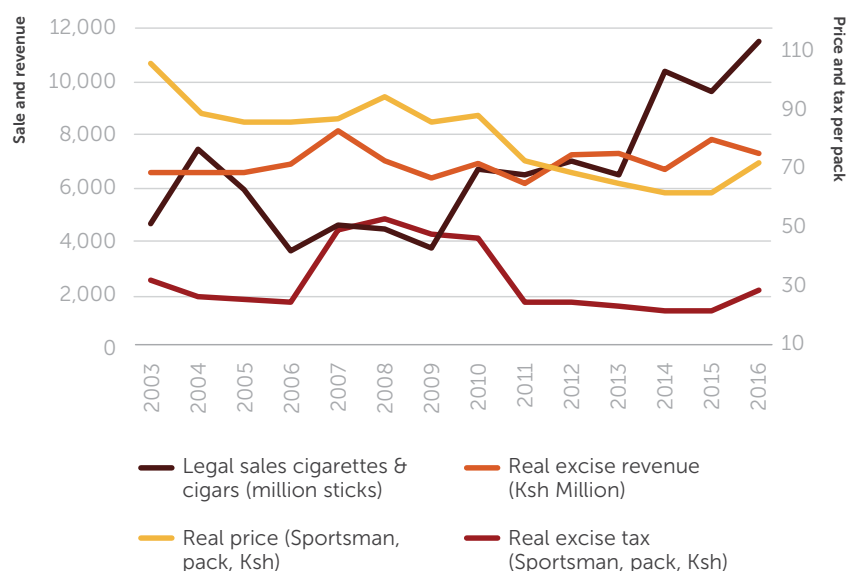
¹⁹ Ngeywo CM, Ministry of Finance. PowerPoint presentation to CTFK Uganda parliamentary partners held at Serene Hotel, Kampala; 4 March 2013.

²⁰ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015.

²¹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

²² Taxman targets contraband traders with new duty stamps; <https://www.businessdailyafrica.com/Taxman-targets-contraband-traders-with-new-duty-stamps/-/539546/1304018/-/14k7v9v/-/index.html>, January 11, 2012.

Figure 1. Legal Cigarette Sales, Excise Revenue, Price, and Tax, Kenya, 2003–16



Source: KNBS 2016, 2017.
 Note: The base year is 2009.

4. Evaluation of the 2003 Measures and the Decision to Upgrade to TTS

However, within a few years, the tax stamp regime revealed weaknesses. The tax stamps were easy to counterfeit or steal; they could not be linked to a particular brand or quantity of production; and they had to be counted manually, which led to inaccuracies. These shortcomings, together with the complex tiered tax structure, made the stamps inadequate for tax accounting and for enforcement purposes.²³ When the size of the legal market began to shrink again in 2005 and then even further in 2006, it became obvious that the methods in place were not adequate to control the illicit cigarette market (see Figure 19.1).²⁴

After a long deliberation and site visits to places with advanced solutions for controlling illicit trade, such as Brazil, the KRA proposed in 2008 to implement a track and trace system (TTS) and issued a tender for the supply of such a system.^{25 26} In preparation for the tender,

²³ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

²⁴ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

²⁵ Wahome M. Taxman targets contraband traders with new duty stamps. 11 January 2012. Available at: <http://www.businessdailyafrica.com/Taxman-targets-contraband-traders-with-new-duty-stamps/-/539546/1304018/-/14k7v9v/-/index.html>.

²⁶ Wahome M. New KRA unit sets sights on higher taxes from drinks. 13 January 2013. Available at: <http://www.businessdailyafrica.com/-New-KRA-unit-sets-sights-on-higher-taxes-from-drinks/-/539546/1664690/-/vhukr4/-/index.html>.

the KRA wrote a concept paper that assessed the availability of various technical solutions to address the system's loopholes and developed an effective technical specification, while paying attention to costs.²⁷

In the same year, excise tax rates were substantially increased in search of additional revenue in the midst of a political and economic crisis. Specific tax rates were increased by 40 percent and 25 percent, depending on the type of cigarette.²⁸ Even though the system still relied on specific tiered taxes, the tiers were now based primarily on the physical features of a pack and secondarily on price.²⁹

5. Temporary Measures and Cargo Monitoring

When it became obvious that selecting a TTS provider would be a lengthy process, the KRA decided to implement temporary measures. First, in 2010, it carried out a major review of the effectiveness of tax stamps.³⁰ The review strongly reaffirmed earlier concerns about serious weaknesses in the system: the stamps and serial numbers were easy to counterfeit; they were not useful for tax accounting because a stamp could not be related to a particular brand or quantity; they did not aid enforcement given the lack of universally available verification tools; and they had to be counted manually, which led to the theft of stamps in storage or in transit as well as ineffective stock management.

The KRA was ready to update the tax stamp system and was debating between the use of paper and digital technology.³¹ In the end, the agency opted for paper stamps with enhanced security features. The new stamps were serially numbered, had ultraviolet markings, the coat of arms, the KRA logo, Kenya Revenue Authority wording, and denoted the package size or products. The stamps had to be clearly visible when the pack was displayed for sale and placed on a pack in such a manner that the stamp was destroyed upon opening a pack.³² The stamps had to be verified at four points in the supply chain.³³

²⁷ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

²⁸ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

²⁹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³⁰ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³¹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³² Excise Duty. Kenya Revenue Authority. Downloaded from http://www.kra.go.ke/pdf/Excise_Duty.pdf 1/15/18

³³ Nargis N. Report on the economics of tobacco and tobacco control in Kenya. World Health Organization; 29 October 2012, draft; and Euromonitor, 2012.

These measures increased the cost of the tax stamp by K Sh 0.124 each, from K Sh 2 (US\$0.023) to K Sh 2.124 (US\$0.024), or K Sh 66.5 million (US\$750,000) a year.^{34 35} Thanks to the updated tax stamp regime introduced in 2010 and vigorous enforcement, the KRA closed three tobacco factories because of their failure to sell and distribute only duty-paid products and recovered at least US\$50 million in unpaid taxes.³⁶ This demonstrated the cost effectiveness of the newly adopted measures. Furthermore, the KRA closed 7 of 10 tobacco importers because of their failure to sell and distribute only duty-paid products.³⁷

The 2010 enhanced tax stamp regime was accompanied by a series of other measures designed to reduce tobacco tax evasion. As of 2010, all local cigarette manufacturers were required to be licensed, while all tobacco and cigarette importers were required to be registered with the KRA. The licenses had to be renewed annually³⁸ and required detailed disclosure of the identities of directors, inventories of the production plant and equipment, a list of all brands manufactured, information about input-output ratios, and details about accounting systems.³⁹ Failure to comply with the law was punishable by a fine of up to K Sh 1.5 million and a prison term not exceeding three years, as well as forfeiture of the goods in question.⁴⁰ In addition, the government overhauled its accounting system to track cigarette production more accurately and launched an electronic cargo tracking system (ECTS).

Newly established tax enforcement units⁴¹ deployed resident tax officers to conduct periodic checks of manufacturing facilities to determine how many production lines were active and what raw materials were being used and to compare input material with the actual output.⁴² These units discovered, for example, that Mastermind, the company with the second-largest market share in Kenya, engaged in brand misclassification to reduce tax liability. The KRA charged Mastermind K Sh 1.7 billion (US\$20 million) in outstanding taxes in August 2009.⁴³

To prevent the fraudulent declaration of cigarettes for export, any production destined for export was subject to a bond deposit in the amount of the excise tax and value added tax.

³⁴ Nargis N. Report on the economics of tobacco and tobacco control in Kenya. World Health Organization; 29 October 2012, draft; and Euromonitor, 2012.

³⁵ Wahome M. Taxman targets contraband traders with new duty stamps 11 January 2012 [14 October 2015]. Available from: <http://www.businessdailyafrica.com/Taxman-targets-contraband-traders-with-new-duty-stamps/-/539546/1304018/-/14k7v9v/-/index.html>.

³⁶ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³⁷ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³⁸ Excise Duty. Kenya Revenue Authority. Downloaded from http://www.kra.go.ke/pdf/Excise_Duty.pdf 1/15/18

³⁹ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁴⁰ Excise Duty. Kenya Revenue Authority. Downloaded from http://www.kra.go.ke/pdf/Excise_Duty.pdf 1/15/18

⁴¹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁴² Muthaura EK. Tobacco tax administration country experiences in Kenya. PowerPoint presentation. Workshop on Tobacco Tax Administration and Collection in Benin and Togo, 06-07 August 2013.

⁴³ ERC Group. World cigarettes. The 2010 Survey. Suffolk, ERC; 2010

The bond was only released once the goods had reached the intended destination and the excise tax had been paid according to local laws. Such country-level bilateral cooperation and information sharing also supported joint operations at the borders, including patrols.⁴⁴

The ECTS monitors cigarettes produced for export and goods in transit, with the help of new technologies. It involves oversight of the loading of all products, sealing the export vehicles to ensure that items intended for export exit the country, and tracking the cargo on route with the use of radio frequency identification to make sure that vehicles reach the intended destination without deviating from the established route. The authorities of both Kenya and the importing country jointly verify and clear all cargos at the border.⁴⁵ The ECTS also provides event information, including departure, long parking, arrival, and disarming of the seal.⁴⁶ The Chinese company Ascend provided electronic seals for the ECTS to secure container or truck doors.⁴⁷ The ECTS relies on global positioning system/general packet radio service technologies,⁴⁸ which enable data about the location of the vehicle to be sent or received at any time through digital cellular communication.⁴⁹ This ensures that trucks keep to the designated routes and reach the intended destination in a timely fashion. Any deviation in excess of 50 meters on either side of the route or tampering with the seal generates an alert sent directly to the revenue authorities.⁵⁰ Before the truck leaves the loading facilities, cargo dispatch information is sent to the relevant authority in the importing country. Any tax remissions or refunds of the excise and value-added tax are granted only after confirmation of imports is sent back by that authority to the KRA.⁵¹ The ECTS promotes intergovernmental collaboration, including joint border patrols.⁵²

⁴⁴ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁴⁵ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁴⁶ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁴⁷ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁴⁸ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁴⁹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁵⁰ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁵¹ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw; 9-11 December 2014.

⁵² Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

6. Impact of Cargo Monitoring and Temporary Measures

The ECTS reduces the number of checkpoints and the associated staffing needs, as well as insurance costs, thanks to improved security.⁵³ It generates an arrival report and allows revenue authorities to screen out companies that claim abnormally high tax refunds on exports.^{54 55} As a result of the ECTS, exports from Kenya to Côte d'Ivoire, Eritrea, Mali, and Sudan were discontinued⁵⁶ because some companies ceased to export cigarettes given their inability to provide evidence that the imports were received.⁵⁷ Additional evidence of the efficacy of the system was a substantial increase—up to 30 percent—in legal cigarette sales near the western border of Kenya, previously known for an illicit cigarette market supplied with products that had been declared for export.⁵⁸

The cargo monitoring system has become more important as Kenya has developed into a regional manufacturing center supplying markets in Mauritius, Rwanda, and Uganda, where British American Tobacco (BAT) had ceased local production in the 2000s. By 2013, about 26 percent of national production was being exported from Kenya.⁵⁹

The new measures addressing the illicit cigarette trade and introduced in 2008–10 paid off, as legal sales of cigarettes and cigars expanded by 67 percent in 2010 relative to 2009, and tax revenue went up as well, even though at a slower pace due to the poor tax structure and stagnating tax rates (Table 2; see Figure 1).

In July 2011, the government replaced the tiered specific tax regime with a single rate ad valorem tax regime with a specific floor set at 35 percent of the retail selling price, or K Sh 1,200 (about US\$10) per thousand cigarettes, whichever is higher.⁶⁰ The change was designed to reduce both tax evasion (the false declaration of the number of cigarettes produced in various tax categories) and tax avoidance (reducing the official retail selling

⁵³ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁵⁴ Ngeywo CM. Senior Assistant Commissioner, Kenya Revenue Authority, Report of the meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling. Gaborone, Botswana; 3-5 June 2012. The World Bank, 2012.

⁵⁵ Ngeywo CM. Presentation to CTFK Uganda parliamentary partners, Ministry of Finance. Serene Hotel, Kampala; 04 March 2013.

⁵⁶ United Nations. United Nations Comtrade Database 2015 [16 October 2015]. Available from: <http://comtrade.un.org/data/>.

⁵⁷ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁵⁸ Ngeywo CM, Kenya Revenue Authority. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. PowerPoint presentation at the World Bank meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling held in Gaborone; 3-5 June 2012.

⁵⁹ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015

⁶⁰ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

Table 2. Excise Duty Rates, Kenya, 2003–18

| INDICATOR | 2003–04 | 2005 | 2006 | 2007 | 2008–10 | JULY 2011– NOVEMBER 2015 | DECEMBER 2015 – MARCH 2017 | APRIL 2017–18 | |
|---------------|--|--|--|--|--|--|---|--|--|
| Rates | 450–1,400 | 495–1,540 | 495–1,650 | 500–2,000 | 700–2,500 | 1,200 or 35% of retail selling price | 2,500 for filtered | 2,500 for filtered; 1,800 for nonfiltered | |
| Tax system | 4 specific progressive tiers based on price | 4 specific progressive tiers based on price | 4 specific progressive tiers based on price | 4 specific progressive tiers based on price | 4 specific progressive tiers based on price | 4 specific progressive tiers based on price and pack's physical features | Uniform specific with minimum ad valorem floor | Uniform specific | 2 specific tiers based on a physical feature |

K Sh per 1,000

Sources: EM 2017a; ERC 2015; Government of Kenya 2015, 2017; Ngeywo 2013.

Note: July 2011: K Sh 1,200 per 1,000 or 35 percent of the retail selling price, whichever is higher (specific system with minimum ad valorem floor); the minister had the power to adjust the rates for inflation without parliamentary approval. The calculation of retail selling price has been legally challenged. December 2015: a uniform specific tax of K Sh 2,500 per 1,000. The specific rate of excise duty is to be adjusted for inflation at the beginning of every financial year. April 2017: reinstatement of the two-tiered system. The specific rate of excise duty is to be adjusted for inflation every two years.

price to qualify for a lower tax rate), while having a neutral impact on tax revenue.^{61 62 63 64} The change in the tax structure permitted a 45 percent drop in the excise tax rate on the popular mid-price brands, such as Sportsman. This caused an 8.7 percent decline in real tax revenue in 2011, while nominal revenue increased by only 4 percent. However, by 2012, revenue had recovered—a 14.2 percent increase in real terms and a 24.9 percent increase in nominal terms relative to 2011—because of reduced opportunities for tax avoidance. Legal sales rose by 0.7 percent and 3.0 percent in 2011 and 2012, respectively, while the tax yield per cigarette went up (see Figure 1). In the end, the 2011 tax reform, together with the anti-tax evasion measures, eliminated tax losses worth K Sh 1 billion (US\$11.3 million) in excise tax revenue.⁶⁵

⁶¹ Ngeywo CM, Kenya Revenue Authority. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. PowerPoint presentation at the World Bank meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling held in Gaborone: 3-5 June 2012.

⁶² Nargis N, Stoklosa M, Ikamari L, et al. Cigarette Taxation in Kenya at the Crossroads: Evidence and Policy Implications. Ontario, Canada: University of Waterloo, October 2015.

⁶³ Ngeywo CM, Ministry of Finance. PowerPoint presentation to CTFK Uganda parliamentary partners held at Serene Hotel, Kampala: 4 March 2013.

⁶⁴ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁶⁵ Ngeywo CM, Ministry of Finance. PowerPoint presentation to CTFK Uganda parliamentary partners held at Serene Hotel, Kampala: 4 March 2013.

In early 2012, even a representative of BAT Kenya, the market-dominant company, acknowledged a decline in the illicit cigarette market thanks to government efforts and placed the estimate of the illicit market share at 8 percent of the total market.⁶⁶ BAT particularly praised the simplified ad valorem tax system that made tax calculations easier and raised compliance.⁶⁷ Both the ERC and Euromonitor reported a drop in the share of illegal cigarettes on the market in 2012 relative to 2011. The ERC estimate was 12 percent of the total market, while Euromonitor⁶⁸ reported a range from 9 percent to 27 percent of the market (see Table 1).

7. Building up the Track and Trace System

By the end of 2012, the controls implemented by the KRA showed substantial progress in moving toward a strong TTS.⁶⁹ Excise stamps were now available in four colors to aid enforcement: orange for cigarettes longer than 72 millimeters and filtered cigarettes; light green for cigarettes equal or less than 72 millimeters and nonfiltered cigarettes; blue for imported cigarettes; and maroon for cigarettes destined for the Navy, Army, Air Force Institute, and the Armed Forces. The stamps were premarked with a unique identifier reflecting a particular type or brand of cigarettes.⁷⁰ Cigarette seizures were declining, and tobacco excise revenue was growing annually by about 20 percent.⁷¹ Nonetheless, integration into a single data-sharing point was still missing. In December 2012, after being delayed by legal issues for about five years, the KRA finally selected a provider of the TTS. A Swiss company, SICPA, won the tender and, in April 2013, signed a five-year contract with the KRA to control tobacco and alcohol products.⁷² The contract was worth close to K Sh 732 million (US\$9.5 million) annually. Other bidders included three Indian firms (Madras, Holistic, and Security Printing Press), De La Rue of the United Kingdom, Authentecs Inc. of the United States, and EDAPS of Ukraine.⁷⁴ ⁷⁵

⁶⁶ BAT does not disclose their method of estimating the size of the illicit market.

⁶⁷ Gachiri J. Agencies war on illicit cigarettes now gains ground. *The Business Daily*; 11 March 2012. Available at: <http://www.businessdailyafrica.com/-/539552/1363968/-/54i6pkz/-/index.html>.

⁶⁸ Euromonitor estimates fluctuate tremendously and are not consistent across reports published in different years. This casts serious doubt on the reliability of the Euromonitor estimates. Neither Euromonitor nor ERC discloses the method of estimating the size of the illicit market.

⁶⁹ Ngegywo CM, Kenya Revenue Authority. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. PowerPoint presentation at the World Bank meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling held in Gaborone: 3-5 June 2012.

⁷⁰ Customs And Excise Act. Subsidiary Legislation. Chapter 472. Revised 2014.

⁷¹ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁷² Wahome M. New KRA unit sets sights on higher taxes from drinks. 13 January 2013. Available at: <http://www.businessdailyafrica.com/-New-KRA-unit-sets-sights-on-higher-taxes-from-drinks/-/539546/1664690/-/vhukr4/-/index.html>.

⁷³ SICPA, personal communication with Pierre Viaud, Senior Director Public Affairs & Government Relations on 9/8/15.

⁷⁴ Wahome M. Taxman targets contraband traders with new duty stamps. 11 January 2012. Available at: <http://www.businessdailyafrica.com/Taxman-targets-contraband-traders-with-new-duty-stamps/-/539546/1304018/-/14k7v9v/-/index.html>.

⁷⁵ Wahome M. New KRA unit sets sights on higher taxes from drinks. 13 January 2013. Available at: <http://www.businessdailyafrica.com/-New-KRA-unit-sets-sights-on-higher-taxes-from-drinks/-/539546/1664690/-/vhukr4/-/index.html>.

SICPA set up the excisable goods management system (EGMS) for tobacco and alcohol products (see Annex A). The EGMS allows for production counting, tracking and tracing products, stock control, tax revenue forecasting, tax stamp forecasting and processing, accounts management, and the collection of other business intelligence.^{76 77} This facilitates the detection of counterfeit goods, prevents smuggling, and eliminates the falsification of production volumes. The EGMS also reduces the cost of brand protection and aids production monitoring among legitimate business.⁷⁸

Implementing the EGMS requires minimum infrastructure, such as high-speed broadband Internet and a reliable telecommunication network covering the areas of the country in which TTS equipment is installed (for example, tax authority headquarters, factories, warehouses, and ports). It also needs a reliable power grid with uninterruptible power supply equipment and backup power sources (generators and inverters) at each major site at which system equipment is installed.⁷⁹

The EGMS was implemented in three phases, relying on SICPA's previous experience in Brazil. The rollout of the system took approximately 11 months, up to March 2014.⁸⁰ The first phase involved the launch of electronic digital stamps in April 2013. Each stamp has a unique identifier using a standard data matrix code, as well as multiple material security layers (see Annex B), as follows: ^{81 82 83}

- » Overt security features for authentication by the general public, such as holograms and color shifting
- » Semicovert security features for authentication in the supply chain (retailers and distributors)
- » Overt security features, such as fluorescent fibers and security ink, exclusively for the use of the tax authority for authentication during random field verification and tracing
- » Forensic taggants for laboratory authentication to support prosecution

⁷⁶ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁷⁷ Muthaura EK. Tobacco tax administration country experiences in Kenya. PowerPoint presentation. Workshop on Tobacco Tax Administration and Collection in Benin and Togo, 06-07 August 2013.

⁷⁸ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

⁷⁹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁸⁰ SICPA, personal communication with Pierre Viaud, Senior Director Public Affairs & Government Relations on 9/8/15.

⁸¹ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁸² Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁸³ Contract between the KRA and SICPA, 2015.

- » Ultraviolet fluorescent features visible under ultraviolet light
- » Anti-Stokes fluorescent prints detectable by specialized devices
- » Minitext printing revealed with a magnifying glass
- » Ultraviolet fibers visible under ultraviolet light in dry paper stamps
- » Visible two-dimensional codes for product verification, activation, and traceability by smartphones
- » Human readable codes for verification by short message service and the KRA web portal
- » Tamper-proof security cuts

This phase was completed in December 2013.⁸⁴ Thanks to these features, the new tax stamp is difficult to counterfeit or to sell to third parties.

A tax stamp that serves as proof of payment of both excise and the manufacturer value-added tax⁸⁵ is permanently associated with the product and must be affixed to each pack in such a manner that removal would make it unusable.⁸⁶

The second phase involved the automation of the control and monitoring system. Manufacturers were required to install photosensitive readers (flow meters) on manufacturing lines that automatically send detailed production data in real time to KRA servers. Each individual tax stamp affixed on the production line is activated and associated with a brand and a package size.⁸⁷ A reader can electronically scan up to 200 containers of packs on a packing line and send data on the quantity and type of products being manufactured to the KRA every 15 minutes. Such automatic and detailed counting is designed to prevent the common practice of fraudulently declaring the production of lower-taxed inexpensive cigarettes, while manufacturing more expensive brands subject to a higher tax bracket. Production line monitoring represents a game changer that shifts the burden of proof in tax liability cases from the KRA to manufacturers. It also aids tax revenue forecasting and supports the ordering and delivery of stamps to manufacturers and importers. A lot of attention is paid to data security to protect data in the central database.⁸⁸ By the end of February 2014, 25 production lines were equipped with readers and monitored.⁸⁹

⁸⁴ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

⁸⁵ Vincent Kimosop, information obtained from the KRA on August 8, 2018.

⁸⁶ Ngeyo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

⁸⁷ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁸⁸ Ngeyo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

⁸⁹ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

The third phase consisted of setting up market surveillance. An enforcement unit with 300 members was supposed to be formed between 2013 and 2015.⁹⁰ Instead, a market surveillance unit consisting of 83 officers was formed, 59 of whom were employed permanently. The unit focuses on all excisable goods and carries out inspections at any time and at any place in the distribution channel; it has the power to seize illicit products and arrest the offender on the spot.⁹¹⁹² The unit is equipped with handheld devices that can swipe a hidden photomagnetic line embedded in the stamp and transmit real-time data to the central KRA server. The server checks the date of issue of the stamp, the producer's name, the product category, and the brand. Using this information, it automatically verifies the authenticity of the product and the tax compliance status. This takes the human element of manual checking out of the verification process, thus eliminating mistakes and enhancing speed and integrity. The handheld device can also be used offline for the authentication of the stamp and for tracking and tracing the stamp.⁹³

8. Enforcing the New Control System

Cigarette distributors and retailers have a device that allows for the authentication of any tobacco products before accepting them into their outlets.⁹⁴ Even though distributors and retailers are not licensed, they are criminally liable if they sell products without the appropriate excise tax paid. They can be fined up to K Sh 5 million (US\$48,000) and be imprisoned for up to three years.⁹⁵ All major supermarkets participate in the system and are connected to KRA servers. The KRA also released an app in 2016 known as the KRA Stamp Checker, which allows the public to verify the genuineness of cigarettes and alcohol using mobile phones.⁹⁶

The Excise Duty Act and the Tax Procedures Act adopted in November 2015 clarified the new obligations of the manufacturers, suppliers, and importers of excisable goods.⁹⁷ All cigarette manufacturers and importers must be licensed. Failure to obtain a license is punishable by fines up to K Sh 5 million (US\$48,000) or up to three times the excise duty on goods to which the offense relates. Violators can also be imprisoned for up to three years.⁹⁸ As of May

⁹⁰ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014.

Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

⁹¹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁹² The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

⁹³ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁹⁴ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁹⁵ The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

⁹⁶ Dennis. Hustle Yethu. How to Use KRA Stamp Checker To verify the Genuineness and Authenticity of a Product.

⁹⁷ The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

⁹⁸ The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

2018, only two cigarette manufacturers (BAT and Mastermind Tobacco) and 10 importers (Bridge Motivation Travel, Brockley Investments, Gemini Mart, Ibinda, Kevin International, Leaf Tobacco and Commodities, Nicentury Development Company, RG Tobacco, Simba Mbili, and Sunova Enterprises) were licensed in Kenya.

The EGMS is used for both domestic and imported products. Cigarette importers purchase electronic digital stamps in Kenya and send them to their facilities abroad, where they are affixed to each pack destined for Kenya.⁹⁹ All domestic producers and importers must activate the excise stamps online.¹⁰⁰ They become liable for excise duty at the moment of removal of the goods from the factory or at the time of importation.¹⁰¹ Tobacco products designated for export do not have tax stamps, but are marked according to the law of the importing country.¹⁰² Packs that are falsely exported and reimported into Kenya can thus be easily spotted in the Kenyan market. These goods are also subject to a tight electronic cargo monitoring system introduced in 2010.

To implement the EGMS, the KRA assembled a multidisciplinary technical team consisting of tax, information and communication technology, legal, and procurement experts.¹⁰³ Before and during the EGMS implementation, the KRA carried out critical consultations with the other two agencies that have a mandate to control the illicit tobacco trade—the Kenya Bureau of Standards (KEBS) and the Anti-Counterfeit Agency—as well as the Kenya Private Sector Alliance and other stakeholders to make sure they were kept informed and on board with the project.¹⁰⁴ This helped secure intergovernmental agency enforcement.¹⁰⁵

In 2013, the KRA signed a memorandum of understanding with the Ethics and Anti-Corruption Commission that expanded the scope of cooperation between the two agencies in combating and preventing corruption and economic crime.¹⁰⁶ In addition, the KRA developed an evaluation plan to assess the performance of the new system and a rapid intervention plan in case the rollout was not going as envisioned.¹⁰⁷

⁹⁹ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹⁰⁰ African Tax Administration Forum. African Tax Outlook. Hatfield, South Africa: 2016.

¹⁰¹ The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

¹⁰² The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

¹⁰³ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹⁰⁴ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014.

Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹⁰⁵ Ngeyo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹⁰⁶ Memorandum of Understanding Between the Kenya Revenue Authority (KRA) and the Ethics and Anti-Corruption Commission (EACC) on Combating and Preventing Corruption, Economic Crime and Unethical Practices at KRA. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹⁰⁷ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

9. Effectiveness of the EGMS

Implementing the EGMS turned out to be cheaper than the cost of the previous system, which relied on tax stamps without the track and trace capabilities.^{108 109} The total cost of printing and delivering the EGMS tax stamp was K Sh 1.50 per pack¹¹⁰ compared with K Sh 2.124 for the previous tax stamp.

The system is self-funding. Companies are paying for the photosensitive readers to be placed on their manufacturing lines and are allowed to expense this cost, thus reducing their tax liability.^{111 112}

In December 2014, the KRA introduced a 2 percent fee (the Solatium Compensatory Contribution) on the total prior year audited revenue of local manufacturers and importers according to Tobacco Control Regulations.¹¹³ This fee is used to fund tobacco control research and tobacco cessation and rehabilitation programs. BAT challenged the fee in court, but the final court decision in February 2017 sided with the KRA and allowed the fee to be levied on domestic manufacturers and importers.¹¹⁴

The EGMS was accompanied by the rollout of an iTax system, which facilitates online tax payments and helps improve income tax compliance.¹¹⁵ This reduced the cost of tax compliance and enhanced service delivery.¹¹⁶ Companies report better access to information and more rapid delivery of tax stamps.¹¹⁷

The implementation of the EGMS has led to an increase in tobacco tax revenue. The largest tax revenue rise was recorded in imported cigarettes, which increased by an incredible 4,728

¹⁰⁸ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹⁰⁹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹¹⁰ SICPA, personal communication with Jérôme Duperrut, Associate Director; Public Affairs & Government Relations on 1/22/18.

¹¹¹ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹¹² Ngeywo CM. Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. Presentation at the WCTOH, Abu Dhabi. 17 March 2015.

¹¹³ Euromonitor International. Tobacco in Kenya. Euromonitor International, 2017.

¹¹⁴ Tobacco Control Fund to be set up. Feb. 24, 2017, By John Muchangi, http://www.the-star.co.ke/news/2017/02/24/tobacco-control-fund-to-be-set-up_c1512630

¹¹⁵ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹¹⁶ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

¹¹⁷ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015

percent from July to December 2014.¹¹⁸ Overall, 2014 tax compliance expanded by 45 percent,^{119 120} while costs went down.¹²¹

The new KRA enforcement units seized more than 300,000 illegal products from about 900 outlets and prosecuted more than 150 offenders between February and June 2014 alone.¹²² Overall, the KRA reported the seizure of 20 million cigarettes in 2014.¹²³

The evaluation of the performance of the system over a longer period is complicated by simultaneous changes in the tax rates and the overall economy (see Table 2).

The Kenya National Bureau of Statistics reported a 76 percent increase in legitimate cigarette and cigar sales from 2013 to 2016 (see Figure 1), which is clearly a result of improved tax administration, given the declining trend in smoking prevalence,^{124 125 126} the limited population growth,¹²⁷ and the relatively modest per capita growth in gross domestic product (GDP) (3.2 percent a year during this period).¹²⁸

However, the excise tax revenue from cigarettes and cigars rose only modestly during 2013–16, 22 percent in nominal terms and by less than 1 percent in real terms despite a substantial increase in the excise tax rate in 2016 (see Figure 1). Excise tax collection on beer rose by 16 percent (6 percent in real terms) and on wine and spirits by 103 percent (36 percent in real terms) during the same period, with an unchanged tax rate during that time.^{129 130 131}

In fiscal year 2016/17 (July 2016–June 2017), excise tax revenue on beer and tobacco grew 13.3 percent, while excise tax revenue on spirits grew by 22.7 percent. The KRA attributes this

¹¹⁸ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹¹⁹ Euromonitor International. Tobacco in Kenya. Euromonitor International, 2015.

¹²⁰ African Tax Administration Forum. African Tax Outlook. Hatfield, South Africa: 2016.

¹²¹ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹²² World Health Organization (WHO). WHO Report on the Global Tobacco Epidemic, 2015: Raising Taxes on Tobacco. Geneva: World Health Organization, 2015.

¹²³ Ngeyo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹²⁴ Central Bureau of Statistics (CBS) [Kenya], Ministry of Health (MOH) [Kenya], Macro O, 2004. Kenya Demographic and Health Survey 2003. CBS, MOH, and ORC Macro., Calverton, Maryland.

¹²⁵ (KNBS) KNBS, International I. Kenya Demographic and Health Survey 2014. Calverton, Maryland: KNBS and ICF International. 2014.

¹²⁶ WHO report on the global tobacco epidemic, 2017: monitoring tobacco use and prevention policies. Geneva: World Health Organization; 2017.

¹²⁷ Kenya National Bureau of Statistics, Ministry of State for Planning, National Development and Vision 2030. 2009 Kenya National Population and Housing Census: Population Dynamics. Nairobi, Kenya: KNBS, 2012.

¹²⁸ Tradingeconomics. World Bank. Updated on June of 2018. <https://tradingeconomics.com/kenya/gdp-per-capita>.

¹²⁹ Kenya National Bureau of Statistics (KNBS). Economic Survey 2016. In: Production Statistics, Macroeconomic Statistics, Strategy and Development, Finance and Administration, Population and Social Statistics, Information and Communication Technology, editors. Nairobi: KNBS; 2016. p. 123.

¹³⁰ John M. Mutua. A citizen's handbook on taxation in Kenya. Institute of Economic Affairs, 2012.

¹³¹ Alcoholic Drinks in Kenya. Euromonitor International. August 2017.

growth to enhanced compliance thanks to the EGMS.¹³² The International Monetary Fund has also praised Kenya for the implementation of the EGMS and iTax, which contributed significantly to a marked improvement in fiscal year 2016/17 revenue collection.¹³³

Given this favorable performance, the EGMS was expanded on November 1, 2017, from tobacco, wine, beer, and spirits to bottled water, juices, soda in PET containers, energy drinks, other nonalcoholic beverages, food supplements, and cosmetics.¹³⁴

In the context of the extension of EGMS to other excisable products, the cost of an EGMS stamp charged by the system provider and collected from the tobacco industry increased from K Sh 1.50 per pack to K Sh 2.80 per pack.¹³⁵ However, this still represented only around 2 percent of the retail price of the most widely sold brand. The KRA continuously reviews the performance of the EGMS, ensuring the robustness and stability of the system.¹³⁶

In 2017, the KRA initiated the launch of a new state-of-the-art integrated customs management system. When fully implemented, the system will provide best-practice features, including cargo value benchmarking to address undervaluation, the self-adjustment of valuation, automatic stock management, the auto-upload of cargo import data from shipping manifests to prevent import falsification, and the auto-exchange of information with iTax to counter noncompliant traders. This will ensure that correct quantities are reported and that tax liabilities are properly assessed by integrating the data provided by various tax departments and the taxpayers.¹³⁷ Before the system is fully functional, the Simba system, supported by a few functions of the integrated customs management system, is handling cargo transactions.¹³⁸ These systems are helping the KRA to add a large number of new taxpayers into the database and strengthening the collection of other taxes.¹³⁹

The KRA has already deployed three more scanners to enhance the nonintrusive inspection of cargos at the port of Mombasa. The personnel managing the scanning function are not involved in the analysis and interpretation of the scanner images, to eliminate a motivation for undue influence.¹⁴⁰ The KRA plans to employ technology that both scans and objectively interprets the images.¹⁴¹

¹³² Annual Revenue Performance FY 2016/2017. KRA Press release 20th July, 2017. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹³³ Kenya. IMF Country Report No. 17/25, International Monetary Fund. January 2017

¹³⁴ Public Notice. Excise Stamps on Bottled Water, Juices, Soda, other Non-Alcoholic Beverages and Cosmetics. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>.

¹³⁵ SICPA, personal communication with Jérôme Duperrut, Associate Director; Public Affairs & Government Relations on 1/22/18.

¹³⁶ Ngeyo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹³⁷ Annual Revenue Performance FY 2016/2017. KRA Press release 20th July, 2017. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹³⁸ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹³⁹ Kenya. IMF Country Report No. 17/25, International Monetary Fund. January 2017.

¹⁴⁰ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁴¹ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

Despite these efforts, the KRA reported a rise in illicit tobacco trade activities in April–December 2017.¹⁴² The KRA attributes this increase to the prolonged election campaign and related political tensions, coupled with an economic slowdown. During the election campaign, the police were focusing on maintaining the overall peace, thereby paying less attention to the enforcement of anti-illicit trade measures. As a result, excise revenue declined by 9.9 percent in July–December 2017 compared with the same period in the previous year.¹⁴³ This points to the importance of constant vigilance and enforcement in the fight against illicit trading.

10. Discussion

Even though the government faces public management challenges in general, it was able to harness political support to adopt and implement the strengthening of tobacco tax administration. Its approach to controlling illicit trade evolved from piecemeal measures to a comprehensive system of controls. This was an important development because addressing various aspects of the illicit market in isolation had only a short-term effect.¹⁴⁴ In addition, the costs of the EGMS were lower relative to the costs of the previous disjointed system.

The implementation of a comprehensive system required a systematic approach, stakeholder participation, and an initial investment in infrastructure and enforcement.¹⁴⁵ However, the costs of the system, including the upfront costs, were covered by the tobacco industry.

It was important to communicate the benefits of the system to all stakeholders and to demonstrate that the system protects various interests, including business interests, because it aids brand protection and production monitoring for legitimate businesses.¹⁴⁶

It was vital that the EGMS should create a permanent association between the product and the code and the stamp and that this stamp should be unusable after first use. Expanding enforcement beyond the KRA by facilitating the participation of the public and retailers and distributors helped in monitoring the system's performance and reduced the opportunities to distribute illicit products. Conducting frequent enforcement checks and the ability to obtain evidence of violations on the spot without a requirement for additional authentication promote efficient and cost-effective enforcement.

¹⁴² Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁴³ Revenue data 2016 – 2017. Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁴⁴ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

¹⁴⁵ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹⁴⁶ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

Another important feature of the system is the limited human involvement in daily operations and data security. For example, production data are gathered without any input from manufacturers, and the data collected during an inspection are automatically transmitted to the central server once a product code is scanned. This prevents errors and system manipulation.

The system is continuously monitored and reviewed to ensure its robustness, stability, and ability to deal with possible mutations in tax evasion schemes.¹⁴⁷ It also provides input for future system upgrades such as tracking and aggregation, which are not currently supported.¹⁴⁸

The EGMS has limitations. It has a restricted capacity to check counterfeit cigarettes unless they are distributed over official retail channels. This is exacerbated by the fact that the Anti-Counterfeit Agency has sufficient resources to operate only in three cities: Kisumu, Mombasa, and Nairobi.¹⁴⁹ However, counterfeit products are responsible for only about 10 percent of the tax evasion in Kenya.¹⁵⁰

To address this weakness, the KRA recommends that the track and trace solution be extended to cover the whole cigarette supply chain up to retail. The KRA also wants to explore the feasibility of using the TTS on individual cigarettes instead of packs.¹⁵¹ Such measures should improve excise revenue growth, which seems to be lagging behind the growing size of the legal market.

There is weak coordination and limited data sharing between the three government agencies in charge that have overlapping mandates (the KRA, the Anti-Counterfeit Agency, and the Kenya Bureau of Standards).¹⁵² These institutions should be allowed to prosecute on behalf of each other given that they perform similar roles in dealing with the illicit tobacco trade. They should also harmonize their penalties: they are currently applying different penalties for similar offenses.¹⁵³

The law does not allow for penalties that are sufficiently punitive to deter the illicit trade. Most of the laws tie fines to the value of seizures or fail to define minimum fines. For example, illicit traders engaging in small-quantity, but high-volume trade may receive only small fines. This lack of punitive fines constrains efforts to curb the illicit cigarette trade in Kenya.¹⁵⁴ To correct this, the law should be amended to follow the principles outlined in the Protocol to Eliminate Illicit Trade in Tobacco Products.

¹⁴⁷ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹⁴⁸ Contract between KRA and SICPA, 2015.

¹⁴⁹ Kenya Institute for Public Policy Research and Analysis. Factsheet: illicit trade in tobacco products in Kenya. May 2014.

¹⁵⁰ Ngeyo CM, Ministry of Finance. PowerPoint presentation on April 18th, 2017, Washington DC.

¹⁵¹ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁵² Euromonitor International. Cigarettes in Kenya. Euromonitor International, 2016.

¹⁵³ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁵⁴ Kenya Institute for Public Policy Research and Analysis. Factsheet: illicit trade in tobacco products in Kenya. May 2014.

The KRA should also receive more funding and other support in carrying out enforcement operations. For example, the originally envisioned 300-member enforcement unit was shrunk to 83 officers, and only 59 of these officers are employed permanently. These officers are in charge of all excisable goods, not only tobacco.

Kenya and its neighbors would clearly benefit from a region-wide solution. The KRA is therefore engaging in a dialog on possible collaboration within the East African Community. The KRA has proposed tax harmonization within the community that has both short-term and long-term components, such as the harmonization of tax structures (that is, adopting specific tax regimes and a single tax description for all types of cigarettes) and the harmonization of rates to avoid disparities in tax incidence.¹⁵⁵

Even though the KRA reports that the illicit cigarette market declined from 15 percent of the total market in 2003–13 to 5 percent after the implementation of the EGMS,¹⁵⁶ the methodology of generating these estimates is not publicly available. The KRA would benefit from the regular generation of estimates of the size of the illicit cigarette market using a transparent methodology. Because a pack of cigarettes in Kenya carries distinctive and secured features, there are multiple methods available to study the size of and changes in the illicit cigarette market.¹⁵⁷ Such a study could be outsourced to an academic or interdisciplinary research institution not associated with the tobacco industry. Given that each of the methods has strengths and weaknesses, two or more methods should be simultaneously employed to cross-verify the results. Estimating the size of the illicit cigarette market would enhance the capacity of the government and others to evaluate the EGMS's performance.

TTSs such as the one adopted in Kenya are the key requirement of the World Health Organization's (WHO) FCTC Protocol to Eliminate Illicit Trade in Tobacco Products. Even though Kenya is not a party to the Protocol (although the government signed the Protocol in December 2013), its experience demonstrates that even a lower-middle-income country has the capacity to implement such a system successfully. This can encourage other countries to sign and ratify the Protocol, which came into force in September 2018 after being ratified and acceded to by more than 40 states. The presence of TTSs in more countries will only enhance the effectiveness of such systems.

The government of Kenya must remain vigilant to protect the country's market from illicit tobacco products and to continue to reduce smoking prevalence. Despite the recent successes on both fronts, there is room for improvement. The excise tax structure and the excise tax level still do not comply with the FCTC Article 6 guidelines. Given the system

¹⁵⁵ Ngeywo CM, Ministry of Finance. PowerPoint presentation to CTFK Uganda parliamentary partners held at Serene Hotel, Kampala: 4 March 2013.

¹⁵⁶ Ngeywo CM, Ministry of Finance. PowerPoint presentation on April 18th, 2017, Washington DC.

¹⁵⁷ Hana Ross. Understanding and measuring tax avoidance and evasion: A methodological guide. Washington DC 2015. DOI: 10.13140/RG.2.1.3420.0486 http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Publications/reports/Understanding-and-measuring-tax-avoidance-and-evasion-A-methodological-guide1.pdf

established to control the illicit trade, the government should not allow the existence of illicit trade to be used as an excuse for not pursuing more vigorous tobacco tax reform. That tax reform should draw on the key reform elements recommended by the World Bank on the basis of evidence from a broad variety of low , middle-, and high-income countries. These policies are highlighted in catchwords and phrases, such as go big, go fast; attack affordability; change expectations; and tax by quantity.

If these principles are followed, the tobacco-related death toll will eventually start declining. Such statistics draw attention to the public-health aspects of tobacco control that should not be neglected, despite the importance of the revenue-generating potential of many tobacco control measures such as the fight against the illicit trade.

COVER QUOTE SOURCES

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ⁱⁱ World Health Organization Press Release, July 19, 2017.
<https://www.who.int/en/news-room/detail/19-07-2017-who-report-finds-dramatic-increase-in-life-saving-tobacco-control-policies-in-last-decade>

ⁱⁱⁱ Combatting illicit trade in tobacco products: Commissioner Andriukaitis' Statement on the EU's adoption of an EU-wide track and trace system. European Commission Press Release, December 15, 2017.
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^{iv} How to design and enforce tobacco excises? International Monetary Fund, October 2016
<https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2016/12/31/How-to-Design-and-Enforce-Tobacco-Excises-44352>

^v World Bank Group: "Global Tobacco Control: A Development Priority for the World Bank Group", Preface of WHO Global Tobacco Report 2015.
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“To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation.”ⁱ

– **Dr. Vera Luiza da Costa e Silva**
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

“Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences.”ⁱⁱ

– **Dr. Tedros Adhanom Ghebreyesus, Director-General**
World Health Organization

“Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade.”ⁱⁱⁱ

– **Commissioner Vytenis Andriukaitis**
Health and Food Safety / European Commission

“Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions.”^{vi}

– **Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)**
Fiscal Affairs Department / International Monetary Fund

“Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year.”^v

–**Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)**
Health, Nutrition and Population Global Practice / World Bank Group

