Global Financial Integrity

ILLICIT FINANCIAL FLOWS (IFF) RISKS RELATED TO BENEFICIAL OWNERSHIP IN THE MINING SECTOR IN KENYA

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ACKNOWLEDGEMENTS

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EXECUTIVE SUMMARY

The risks associated with Illicit Financial Flows(IFFs) are particularly apparent when paired with the Beneficial Ownership concern especially in the Kenyan mineral sector. The Mining Act, which came into force in 2016, was a blueprint for reforming Kenya's mining sector before the moratorium that was introduced by the government that halted its progress. Kenya's mining industry has potential to contribute 4% to 10% of the country's gross domestic product, the industry now unfortunately contributes less than 1% of the country's GDP which is significantly low.[1]

This study was done through both descriptive analysis and systematic review to provide insights into the Illicit Financial Flows risks related to beneficial ownership disclosures in the mining sector in Kenya. The descriptive analysis provided insights on how Kenya is performing poorly in the mining sector in terms of revenue. The existence of the effects caused by IFFs is highlighted and expressed in the comparative analysis of the trend of Ores and metals exports against Mineral Rent (difference between the value and the cost of the minerals as a percentage of the GDP) and it shows that increased exports in some years do not translate to increased revenue.

From the systematic review, all the seven studies; Barasa (2018), Reuter (2017), Cobham, Davis, Ibrahim, & Sumner (2016), Nitsch (2016), Mengistu, Molla & Mascagni (2022), Garcia-Bernardo & Janský (2022), and Brandt (2023) used in the analysis provided instances of IFFs and risks that accompany it with respect to beneficial ownership. These IFFs scenarios include, mis-invoicing, undervaluing the amount exported minerals, tax evasion etc. This report also provides recommendations which include adjusting legal and policy related mitigation strategies.

[1]Reviving the mining sector - KNCCI, https://www.kenyachamber.or.ke/2022/06/29/reviving-the-mining-sector/ (accessed 13 January 2024).[1]

DEFINITION OF TERMS

IFF	Illicit Financial Flows
AML	Anti-Money Laundering
EITI	Extractive Industries Transparency Initiative
BO	Beneficial Ownership
CSR	Corporate Social Responsibility
FRC	Financial Reporting Centre
GFI	Global Financial Integrity
GDP	Gross domestic product
HMN	Hot Money Narrow Method
LOC	Low-income country
MNC	Multi-National Company
OECD	Organisation for Economic Co-operation and Development
WBR	World Bank Residual Method
CIT	Corporate Income Tax

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1 INTRODUCTION AND COUNTRY BACKGROUND

The debate around the extractive industries especially the mining industry has shifted in the last several years to emphasize the challenges brought about by illicit financial flows (IFF). The transfer of money across borders against legal and regulatory frameworks is a defining characteristic of these concealed financial operations, which represent a serious danger to national economies and sustainable development.[2] In Kenya, a relatively mineral-rich country, the risks associated with Illicit Financial Flows are particularly apparent when paired with the Beneficial Ownership disclosures concerns.

Beneficial Ownership, or discovering the identity of natural humans who own, control, or benefit from a legal firm, has arisen as a major issue in the global battle against financial crime and transparency. The complexity of beneficial ownership in Kenya's mining sector leads to an atmosphere ripe for many types of illegal financial activity.[3] This study digs into the subtle dangers connected with Illicit Financial Flows, specifically the opacity of beneficial ownership arrangements in Kenya's mining sector, and considers the ramifications for governance, economic fairness, and the larger socio-environmental context. Acknowledging and tackling these difficulties is critical for Kenya as it works towards appropriate and efficient management of resources.

Kenya's mining sector offers the potential to drive economic growth and development. Nevertheless, it confronts substantial obstacles and hazards, including illicit cash flows, adverse environmental effects, and regulatory deficiencies. The Mining Act, which came into effect in 2016, was a blueprint for reforming Kenya's mining sector. This new Act, viewed as a contemporary piece of law, was anticipated to change and develop the mining industry. The expansion of Kenya's mining sector had, however, been stifled by a moratorium that was imposed by the government in 2019.[4] While the moratorium caused some challenges within the period it was in place, the Ministry averred that it enabled it to complete a number of reforms.[5]

Among the notable accomplishments are the National-Wide Airborne Geophysical Survey, improved openness in the granting of mineral rights, the suppression of illicit mining activities, the encouragement of domestic mineral processing, and the formalization of artisanal miners.[6] The Ministry has also remodeled mineral testing facilities, established revenue-sharing arrangements, and partnered to develop capacity. The government has authorized several reforms in the industry, including the categorization of minerals, the gradual removal of the ban, and the introduction of rules to ensure compliance.

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[2] World Bank. (2017), "Illicit Financial Flows (IFFs)", Understanding Poverty, available at: https://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs[2]

[3] Important Developments Regarding Disclosure Of The Beneficial Ownership Of Companies In Kenya - Bowmans, https://bowmanslaw.com/insights/corporate-services/important-developments-regarding-disclosure-of-the-beneficial-ownership-of-companies-in-kenya/ [3]

[4] Kenya's Mining Outlook 2023 – Current Status & Future Possibilities - Bowmans. (n.d.). Retrieved January 13, 2024, from https://bowmanslaw.com/insights/mining/kenyas-mining-outlook-2023-current-status-future-possibilities/[4]

[5] Mvurya HONS. MINISTRY OF MINING , BLUE ECONOMY AND MARITIME AFFAIRS OFFICE OF THE CABINET SECRETARY MEDIA BRIEFS ON STATUS OF REFORMS IN THE KENYAN MINING SECTOR PRESENTED BY : 2023; 1–8. 5

[6] Ibid

The Moratorium also came along with challenges. It had limited the processing and issuing of licenses and renewal applications. This had a negative impact on the sector, preventing any new investments and slowing down operations and possible expansion of existing projects.

Notwithstanding these obstacles, Kenya's mining industry has been observed to have enormous development potential. Although it has the potential to contribute 4% to 10% of the country's gross domestic product, the industry now unfortunately contributes less than 1% of the country's GDP which is significantly low.[7] This suggests that there may be substantial room for expansion. A large portion of Kenya's wealth in natural resources is still untapped. The country has abundant natural resources, including coal, gold, titanium, copper, niobium, manganese, and rare earth minerals reserves which have been proven to be untapped. However, despite the natural resources existing within the nation, the efficiency of the process of collecting revenue is still questionable.

In the first quarter of 2022, Kenya's mining industry grew by 22.1%, pointing to a promising trend.[8] This pattern can only be substantial if the earnings generated by the mining industry are directed to priority areas from the onset . This also implies that there must be a comprehensive legal and regulatory framework that promotes the beneficial ownershipdisclosures. With the adoption of the Mining Act of 2016, it was anticipated that Kenya's mining industry would grow significantly. The Mining Act of 2016's provisions for small-scale and artisanal mining activities are in line with international standards and local community empowerment initiatives. The Act acknowledges and lays out precise procedures for setting up safe operations for small-scale and artisanal mining. As a result, the communities are given a way to profit from the mineral wealth on their own land whilst guaranteeing safer conditions for workers in the mining industry. The Act mandates that holders of mineral rights must give Kenyan labor, goods, services, as well as materials precedence in order to support local content as well as community empowerment through job creation and service delivery.[9] Giving local labor and resources priority is in line with guidelines for local economic development and empowering communities, which eventually benefits the local community.

The Mining Act of 2016 includes requirements pertaining to financial concerns and the administration of funds within the mining industry. The Act lays out the different taxes, royalties, and charges that holders of mineral rights must pay. The State will designate an account for the collection of payments, as well as royalties, and fees, to which these payments must be made. The Act also specifies that mineral rights holders will be required to pay an area-based annual charge. This annual charge is determined by the number of cadastral units that is; the product of the mineral right area and the area-based annual charge per cadastral unit for that specific mineral right. Additionally, the law specifies how royalties are to be distributed: 70% go to the national government and 20% to the County governments while 10% goes to the community where the mining operations occur.[10]

[7] Reviving the mining sector – KNCCI Op Cit. [6]
[8] Kenya: mining GDP growth rate 2019-2022 | Statista. (n.d.). Retrieved January 13, 2024, from https://www.statista.com/statistics/1283477/mining-quarterly-gdp-growth-rate-in-kenya/[7]
[9] KPMG. (2016). Analysis of the Mining Act 2016. July. https://assets.kpmg/content/dam/kpmg/ke/pdf/kpmg-mining-act-2016-analysis.pdf [8]
[10] The mining act, 2016. 2016(12).[9]

The Act lays forth tax standards, such as guidelines for transfer pricing and adhering to income tax laws. It also stipulates that holders of mineral rights must keep up employee health and safety insurance. They are also mandated to provide additional copies of their policies and other supporting evidence attesting to the insurance's suitability for hazards related to the mining process. In order to determine the royalties along with additional levies that must be paid to the government, the Act also mandates that dealers and holders of mineral rights maintain current records of their business dealings. These documents are subject to be audited.

Provisions intended to stop illegal financial flows in the mining industry are also found in Kenya's Mining Act of 2016. For example, in order to guarantee accuracy and openness in the reporting of financial operations, the Act mandates that holders of mineral rights file royalty returns regularly in accordance with regulations. Additionally, the law specifically mentions the requirement for proof of tax compliance in cases of mineral rights assignments and transfers, making sure that tax responsibilities are fulfilled in order to stop money laundering or other illegal financial actions.

The Act also creates guidelines for the National Mining Corporation, which has the authority to purchase stakes in mining companies, thereby enhancing accountability and openness in industry financial dealings. The Act seeks to illicit money flows within the mining industry by stipulating measures that encourage accountability, transparency, and compliance with tax requirements. As a result of this introduction, there has been a progressive change in exports from the extractive sector as observed from the data from the World Bank. Figure 1 illustrates the changes in the extractive sector from 2015 to 2022. It is important to note that in 2019 there was a moratorium against issuance of mining licenses in Kenya.

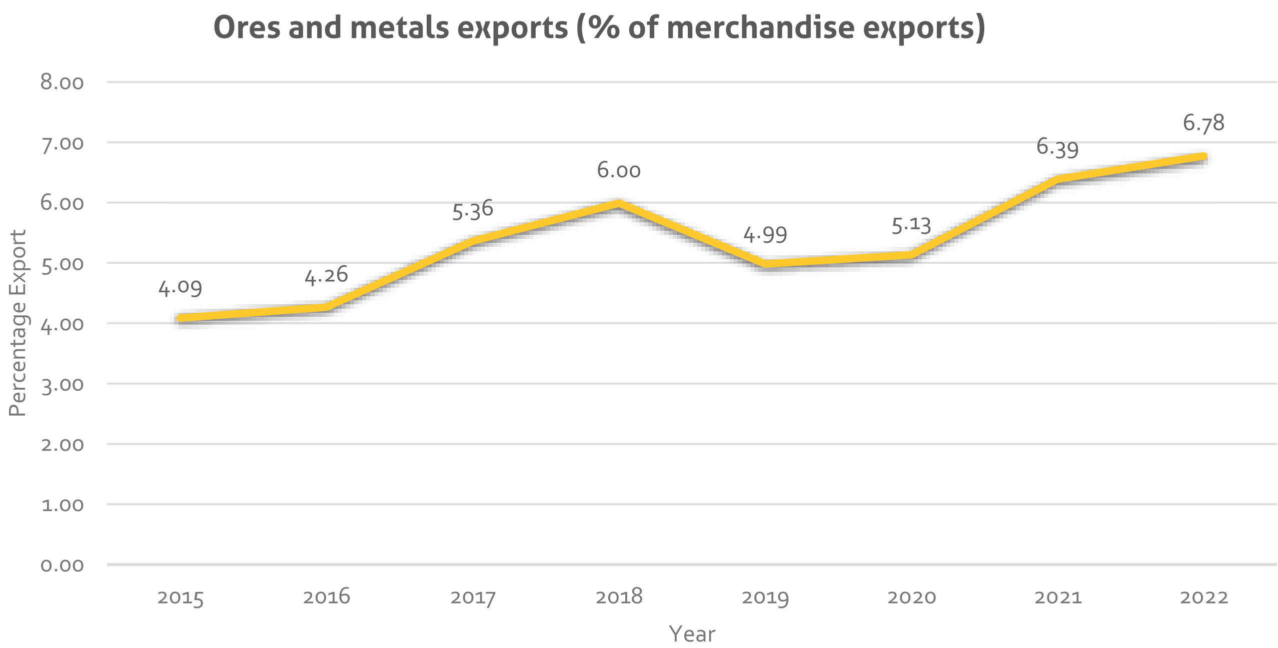

Figure 1: Ores and metals exports (% of merchandise exports)

Ores and metals comprise the commodities in SITC sections 27 (crude fertilizer, minerals nes); 28 (metalliferous ores, scrap); and 68 (non-ferrous metals).[11]

1.01 OBJECTIVE OF STUDY

The purpose of this report is to assess the IFF risks associated with beneficial ownership in the mining industry in Kenya and the steps the government and other stakeholders have taken to mitigate those risks. The extant literature on the subject will be examined, and the shortcomings and difficulties in the institutional and legislative framework, the ability and cooperation of the pertinent authorities, and the level of public knowledge and involvement in the governance of the mining industry will all be noted. Additionally, this report will analyze the data using the Extractive Industries Transparency Initiative (EITI) as a global standard for promoting the open and accountable management of natural resources and assessing the progress[12] even though Kenya is yet to ratify the EITI, its laws have been designed to mirror the standards under the iniative.

1.1 ILLICIT FINANCIAL FLOWS (IFF)

Illicit financial flows are funds that are earned, transferred, or utilized unlawfully from one country to another. Illicit financial flows are a range of practices that include tax evasion corruption, trade mis-invoicing, and crime. They also lower tax revenues and local finances used to finance anti-poverty programs as well as infrastructure.[13] As a result of the negative effects caused by IFFs, there is an enormous threat to the sustainability and well-being of developing countries. To ameliorate the risk posed by IFFs, there has been a number of coordinated actions among the developedand developing countries working in conjunction with Regional Economic Communities, businesses and civic society.[14]

[12] López-Cazar I, Papyrakis E, Pellegrini L. The Extractive Industries Transparency Initiative (EITI) and corruption in Latin America: Evidence from Colombia, Guatemala, Honduras, Peru, and Trinidad and Tobago. Resources Policy; 70. Epub ahead of print 2021. DOI: 10.1016/j.resourpol.2020.101907. [11]

[13]The IMF and the Fight Against Illicit Financial Flows, https://www.imf.org/en/About/Factsheets/Sheets/2023/Fight-against-illicit-financial-flows [12]

[14] Illicit Financial Flows in Kenya - Global Financial Integrity, https://gfintegrity.org/report/illicit-financial-flows-in-kenya/ (accessed 3 April 2024).[13]

Kenya has adopted a number of laws and Regulations that aim to prevent and combat illicit financial flows (IFFs), some of these laws include:

- The **Proceeds of Crime and Anti-Money Laundering Act of 2009**, the Act creates the offence of money laundering, defines proceeds of crime, designates the Financial Reporting Centre (FRC) as the central national hub for obtaining, evaluating, and sharing financial intelligence sources.[15] It provides a mitigation blueprint against money laundering, acquisition, possession, or use of proceeds of crime. It criminalizes failure to report suspicion regarding proceeds of crime, tipping off, and misrepresentation.[16]
- The **Anti-Corruption and Economic Crimes Act of 2003**, criminalizes several forms of corruption and economic crimes. It also provides for the recovery and forfeiture of the proceeds that have been obtained from such crimes.[17]
- The **Prevention of Terrorism Act of 2012**, forbids funding terrorism and places duties on reporting organizations to identify and report terrorist-related suspicious transactions.[18]
- The **Tax Procedures Act of 2015**, provides steps to improve tax compliance and discourage tax evasion, and it unifies the procedural processes involved in the administration of tax legislation.[19]
- The **Mining Act of 2016**, mandates the creation of a Beneficial Ownership E-Register and the publication of beneficial ownership information to mineral rights holders.[20]

These laws are complemented by other frameworks and policies including the National Action Plan on Illicit Financial Flows, the National Strategy to Combat Money Laundering and Terrorist Financing and the National Anti Corruption Policy. Despite these actions, Kenya's rules and regulations regarding IFFs remain ineffectively enforced. Such challenges include a weak political will, capacity, and coordination in the relevant departments and stakeholders.[21] Thus, increased efforts are required to strengthen the institutional and legislative framework in Kenya so as to minimize IFFs and encourage financial integrity.

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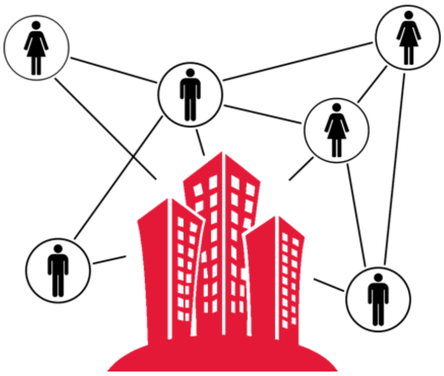
[15] Sentry Report: Kenya Illicit Finance Risks and Assessment - The Sentry, https://thesentry.org/2021/10/27/6393/sentry-report-kenya-illicit-finance-risks-assessment/ [14]
[16] Constitution of the Republic of Kenya. THE PROCEEDS OF CRIME AND ANTI-MONEY LAUNDERING ACT (2009) SUBSIDIARY LEGISLATION. [15]
[17] Illicit C, Flows F. Curbing Illicit Financial Flows and Tax Injustice in Africa A toolkit for [16]
[18] Conference Calls for Prompt Implementation of Laws to Curb Illicit Financial Flows in Kenya - Transparency International, https://tikenya.org/2021/03/29/conference-calls-for-prompt-implementation-of-laws-to-curb-illicit-financial-flows-in-kenya/ [17]
[19] Is Kenya really tackling illicit financial flows? | ENACT Africa, https://enactafrica.org/research/trend-reports/is-kenya-really-tackling-illicit-financial-flows [18]
[20] Exploring: A detailed look at Kenya's Mining Act, 2016 | Article | Chambers and Partners, https://chambers.com/articles/exploring-a-detailed-look-at-kenyas-mining-act [19]

1.2 BENEFICIAL OWNERSHIP



The idea of a natural person or people who eventually own or control a stake in a formal body or arrangement, such as a foundation, trust, or business, is known as beneficial ownership. In order to hide their identities or interests, beneficial owners may utilize middlemen, shell corporations, or offshore businesses. To prevent and fight against illicit financial flows such as tax evasion, money laundering, corruption, or financing of terror any beneficial ownership information is essential.[22] Beneficial ownership laws in Kenya determine publication and access to data for natural individuals who ultimately either own or control a business or other type of body corporate. These laws aim at curbing such financial crimes as tax evasion, money laundering, corruption, and funding of terrorism while promoting transparency in business operations.

Some of the key beneficial ownership laws in Kenya are:

- **The Companies Act of 2015,** as amended by the **Statute Law (Miscellaneous Amendments) Act** of 2019, mandates that all companies incorporated in Kenya create and maintain a beneficial owner register. Copies of the register must be filed with the Registrar of Companies within 30 days of the register's creation or 14 days of any amendments[1623] .

- **The Companies (Beneficial Ownership Information) Regulations of 2020,** as amended by the **Companies (Beneficial Ownership Information) (Amendment) Regulations of 2019** offer guidance on what beneficial owners are and who qualifies to be a beneficial owner; contents contained in a register that must always list all names connected with said enterprises.[24]

- **The Public Procurement and Asset Disposal Act of 2015** as amended by the **Public Procurement and Asset Disposal (Amendment) Act,** it stipulates that any company bidding for public procurements must disclose its beneficial ownership information to be made available to the procuring authority. This should be updated whenever there is a change.[25]

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[22] Important Developments Regarding Disclosure Of The Beneficial Ownership Of Companies In Kenya - Bowmans, https://bowmanslaw.com/insights/corporate-services/important-developments-regarding-disclosure-of-the-beneficial-ownership-of-companies-in-kenya/ [21]

[23] Kenya publishes additional regulations on beneficial ownership, https://taxnews.ey.com/news/2022-0680-kenya-publishes-additional-regulations-on-beneficial-ownership [22]

[24] Kenya: Beneficial Ownership frequently asked questions (FAQs) – Private Equity - Bowmans, https://bowmanslaw.com/insights/private-equity/beneficial-ownership-frequently-asked-questions-faqs-private-equity/ [23]

[25] Repiblic of Kenya. Public Procurement Act. The Kenya Gazette 2015; 59: 165 [24].

- **The Statute Law (Miscellaneous Amendment) No.2 of 2023, which amended the Trustees (Perpetual Succesion) Act,** requiring the registration, issuance of certificates , keeping, maintenance of the register and searches to be done under the Companies Act, 2015 effectively bringing trusts closer to the ambit of Beneficial Ownership disclosures if the requisite legal reforms are finalized.

Other policies and frameworks that supplement these laws are the National Strategy to Combat Money Laundering and Terrorist Financing, the National Action Plan on Illicit Financial Flows. On the other hand, notwithstanding these initiatives, Kenya continues to experience challenges with regard to efficient implementation and enforcement of its beneficial ownership laws and regulations such as limited capacity and coordination challenges among relevant authorities stakeholders. Thus, further measures are required to enhance Kenya's legal and institutional structure for combating illicit financial flows while fostering transparency in finances.

1.3 KENYA MINING INDUSTRY REGULATORY AND LEGAL FRAMEWORK

The key legal instrument governing the natural resource sector is the Constitution 2010. Article 10 outlines the national values and principles of governance which must bind all State organs, State officers, public officers and all persons whenever any of them applies or interprets the Constitution; enacts, applies or interprets any law; or makes or implements public policy decisions.[26] The national values and principles of governance include: patriotism, national unity, sharing and devolution of power, the rule of law, democracy and participation of the people; human dignity, equity, social justice, inclusiveness, equality, human rights, non-discrimination and protection of the marginalised; good governance, integrity, transparency and accountability; and sustainable development.[27]

Article 60 of the Constitution states that land in Kenya should be held, used and managed in a manner that is equitable, efficient, productive and sustainable, and in accordance with the following principles equitable access to land; security of land rights; sustainable and productive management of land resources; transparent and cost effective administration of land; sound conservation and protection of ecologically sensitive areas; elimination of gender discrimination in law, customs and practices related to land and property in land; and encouragement of communities to settle land disputes through recognised local community initiatives consistent with the Constitution.

The Mining Act of 2016 was enacted to give effect to Articles 60, 62 (1)(f), 66 (2), 69 and 71 of the Constitution in so far as they apply to minerals; provide for prospecting, mining, processing, refining, treatment, transport and any dealings in minerals and for related purposes.[28] Generally, it governs the mining sector in Kenya and establishes the legal basis for the exploration, development, and extraction of minerals and mineral oils inside the nation. The Act also creates the organizations and systems that will oversee and govern the industry, including the National Mining Corporation, the Mineral Rights Board, the Mining Tribunal, and the Cabinet Secretary for Mining.[29]

[26] Article 10(1), Constitution of Kenya 2010
[27] Article 10(2), Constitution of Kenya 2010
[28] Preamble of the Mining Act, 2016
[29] The Legal and Policy Framework for Mining in Kenya – The Lawyer Africa, https://thelawyer.africa/2023/10/05/legal-and-policy-for-mining-in-kenya/ [25]

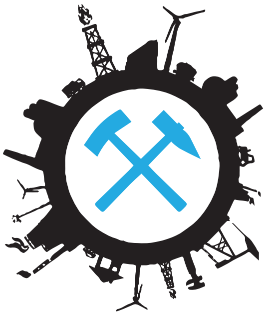
The Mining Act of 2016 is enhanced by a number of rules and directives that outline the processes and specifications for various mining-related activities, including dealing, licensing, permits, exploration, state participation, employment and training, reporting, and the use of assets.[30] Among the Regulations are;:

1. **Mining (Dealings in Minerals) Regulations, 2017:** These regulations control the exportation, importation and removal of minerals possessed by individuals holding mining rights mineral dealers or agents. They also specify the responsibilities, liabilities, and books of account mineral, dealers or their agents in relation to prescribing fees, royalties, and penalties for dealing with minerals.

These Regulations are meant to curb illegal dealings in extraction and/or sale of minerals in the country and specifically spells out the duties of the holder of a mineral dealer's licence which include to: commence or engage in the trading of a mineral in accordance with the terms and conditions of the licence within thirty days after the date of the issue of the licence; not trade in any mineral other than the mineral or minerals specified in the licence; not trade in minerals except in accordance with the terms and conditions set out in the licence; not knowingly engage in trading of a mineral with a person who has not acquired the minerals lawfully or is otherwise not lawfully entitled to deal in minerals; pay all taxes, charges or levies that are required under the terms and conditions of the licence, the Act or any other written law in Kenya; keep complete and accurate records of all activities conducted under the licence at the registered office and submit a true copy to the Cabinet Secretary in the manner as specified in the Act and these Regulations; permit the authorised officer of the Ministry to inspect any documents or records; and submit if any, the sales contract or agreement the holder may sign with a buyer, seller or holder of a mineral right.[31]

2. **Mining (Licence and Permit) Regulations, 2017:** These regulations include the applications and issuance processes, terms & conditions, fees & charges as well as renewals or transfers for various types of Mining Licences/Permits; such are reconnaissance licence; prospecting licences; retention licence, mines' license (mineral rights) etc., artisanal mining permit, dealer'.

The Regulations provide for an online application forum is a positive step towards establishing transparency as far as the application process is concerned so that regardless of whether one is a foreign or local investor, there is certainty on the process of seeking mining licenses and permits.



3. **Mining (Work Programmes and Exploration Reports) Guidelines, 2017:** These guidelines outline the minimum standards and content of the work program as well as exploration reports that are necessary to be submitted by holders of reconnaissance, prospecting, and retention licenses. They also state the report style, reporting frequency, and confidentiality.

The reports developed under this Guidelines are meant to enhance the right of access to information for the local people as far as the activities of the mining companies are concerned, but there is no evidence of any such reports being made public since 2017 or even any being filed with the government agencies at all. There is therefore lacking in transparency and accountability from the mining companies in the country.

4. **Mining (State Participation) Regulations, 2017:** The above laws prescribes the conditions and modalities of state participation in mining ventures which may include joint ventures, production-sharing agreements, royalties, or any other form of benefit sharing. They also provide for the opening and running of a Sovereign Wealth Fund, which is used to invest proceeds from mineral resource activities.Most importantly the Regulations designate the National Mining Corporation as the investment arm of the state in respect to mining operations which is a positive step towards ensuring that the mining companies declare all the deposits and profits accrued as well as safeguarding the interests of local communities at all stages of mining activities. The Corporation will further aid the state in ensuring that cases of non-disclosure and nondeclaration by the mining companies in the country are never experienced again in the Country.[32]

5. **Mining (Use of Local Goods and Services) Regulations, 2017:** These regulations stipulate that the holders of mining licenses and permits must give preference to local goods and services as may be available, quality assured based on technical specifications, and offered at competitive prices. They also require local content plans and reports, as well as the creation of local content committees to monitor compliance.

While the Regulations seek to ensure to uplifting of the lives of its people by not only creating employment opportunities but also jobs through creating markets for local goods todate there are no public records or any other form of evidence thus far to indicate if the companies have complied with these Regulations or any compliance reports from the Ministry.

6. **Mining (Employment and Training) Regulations, 2017:** These establishments require miners that hold licenses and permits to employ and train Kenyan citizens in their mining activities as well as submit reports on employment plans. They also make arrangements for the establishment of employment and training committees charged with monitoring compliance to regulations.

Despite the existence of these Rules, there are no publicly accessible records to indicate the level of compliance for the existing mining companies in the country. **Mining (Use of Assets) Regulations, 2017:** These regulations regulate the use, disposal, and transfer of assets by persons who hold mining licenses or permits as well NIMASA's fees charges for these services. They also make provisions for the inspection and valuation of assets by the Cabinet Secretary for Mining.

These regulations, if fully enforced, can be a useful tool in fighting IFFs and tax evasion by the mining companies as they seek to promote accountability and transparency on the income and expenses incurred by these companies. These Regulations, alongside other transparency and accountability measures and practices are useful for developing countries such as Kenya, where non-declaration or under declaration of profits by the multinationals has been happening. They can however work well where the authorities involved work with different stakeholders such as the revenue colleting agencies to get the actual figures.[33]

The Kenyan mining industry is also governed by other pertinent laws and policies, including the Public Finance Management Act of 2012, the Income Tax Act, the Value Added Tax Act, the Customs and Excise Act, the Land Act 2012, the Community Land Act 2016, and the Kenyan Constitution of 2010.[34] The goal of these laws and policies is to guarantee that the mining industry operates in a sustainable, transparent, responsible, and fair way and that investors, county governments, local communities, and the federal government all share in the sector's benefits.

1.4 CORPORATE INCOME TAXES, MINING ROYALTIES, AND OTHER MINING TAXES IN KENYA

1.4.1 Corporate Income Taxes:

For resident businesses, which include subsidiaries of foreign parent corporations, the CIT rate is 30% of taxable revenue.[35] The taxable income due to the Kenyan permanent establishment (PE) of non-resident corporations is subject to a 37.5% tax rate. A 15% income tax on repatriated revenue for PEs and branches of foreign corporations was implemented by the Finance Act, 2023. As a result, PEs and branches will now pay effective taxes at a rate of 40.5%, the same as a Kenyan business that has been formed and has non-resident owners.[36]

1.4.2 Mining Royalties

According to the Mining Act of 2016, owners of mining licenses and permits are required to pay royalties depending on the gross sales value of the minerals. The following are the different royalty rates based on the kind and class of minerals[37] :

Table 1:Mining Royalties

Type of mineral	Class of mineral	Royalty rate (%)
Metallic minerals	*Base metals*	*5*
Precious metals	*5*	
Strategic metals	*10*	
Industrial minerals	*Construction minerals*	*1*
Dimension stones	*2*	
Glass and ceramic minerals	*3*	
Other industrial minerals	*5*	
Gemstones	*5*	
Fuel minerals	*Coal*	*8*
Natural gas	*9*	
Crude oil	*12.5*	

[36] Kenya - Corporate - Taxes on corporate income, https://taxsummaries.pwc.com/kenya/corporate/taxes-on-corporate-income [29]
[37] Corporate Tax Comparative Guide - - Kenya Op. Cit. [28]

1.4.3 Other Mining Taxes

A variety of fees, charges, and penalties are also prescribed by the Mining Act 2016 and its regulations and guidelines for various aspects of mining activities, including dealing, licensing, permits, exploration, state participation, employment and training, reporting, and the use of assets. Value added tax (VAT), customs and excise duty, withholding tax, and stamp duty are some of the other pertinent taxes that apply to Kenya's mining industry.[38]

2 METHODOLOGY

The purpose of this report is to investigate the effect of illicit financial flows risks with respect to beneficial ownership within the mining sector in Kenya. To achieve this, the report used a combination of both systematic review and descriptive analysis. The data was collected from various studies within the mining industry that are related to Kenya in addition to secondary data obtained from the World Bank. For a complete study of the current body of knowledge, a systematic review was done, which included an exhaustive search of electronic databases such as PubMed, Scopus, and Web of Science, as well as relevant websites, using predetermined search keywords related to the subject. The search technique is intended to locate relevant research, reports, and scholarly papers produced between the beginning of databases and the present.The systematic review findings along with the descriptive analysis results offered a thorough picture of the study issue.

2.1 Scope

This analysis covers the mining industry and with respect to beneficial ownership within Kenya. The selected period will be between 2015 to the latest data on the mining sector for Kenya. The datasets enable an analysis of trends, variations, and developments within the mining industry. The research will focus on trade dynamics within the mining sphere: both bilateral and multilateral relationships, as well as policies shaped by regulation concerning mining-sphere affairs.

2.2 Data Analysis

2.2.2 Descriptive statistics

Table 2: Descriptive Statistics

Ores and metals exports (% of merchandise exports)	
Mean	5.374323501
Sample Variance	0.925346063
Range	2.690061863
Minimum	4.087410663
Maximum	6.777472526

The descriptive summary of "Ores and metals exports (% of merchandise exports)" reveals a relatively consistent distribution where on average, ores and metals exports constitute around 5.37% of merchandise exports from the year 2015. The range is from 4.09% in 2015 to 6.78% in 2022, which highlights the variability in these exports. It is also necessary to note that in 2019 there was a drop in the rate of exports hence possibly influenced by the moratorium issued by the government and 2020 by the pandemic. The data portrays a moderate level of consistency increase in the ores and metals export percentages except 2019 and 2020 datasets.

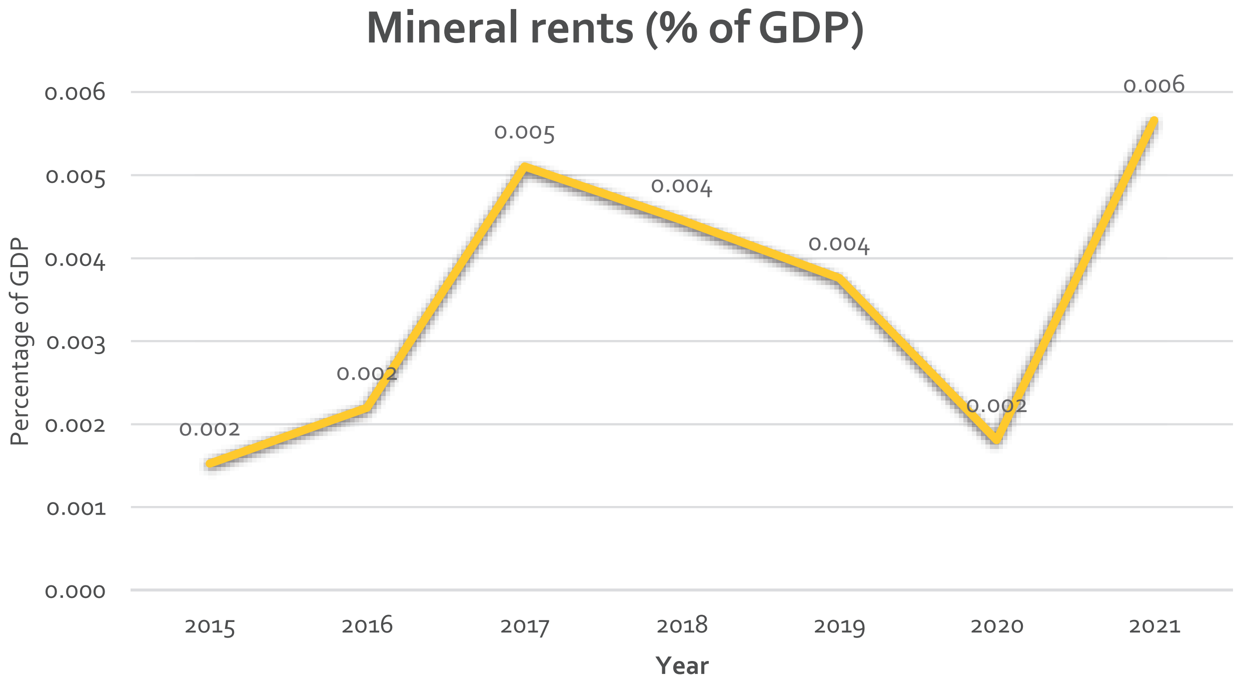


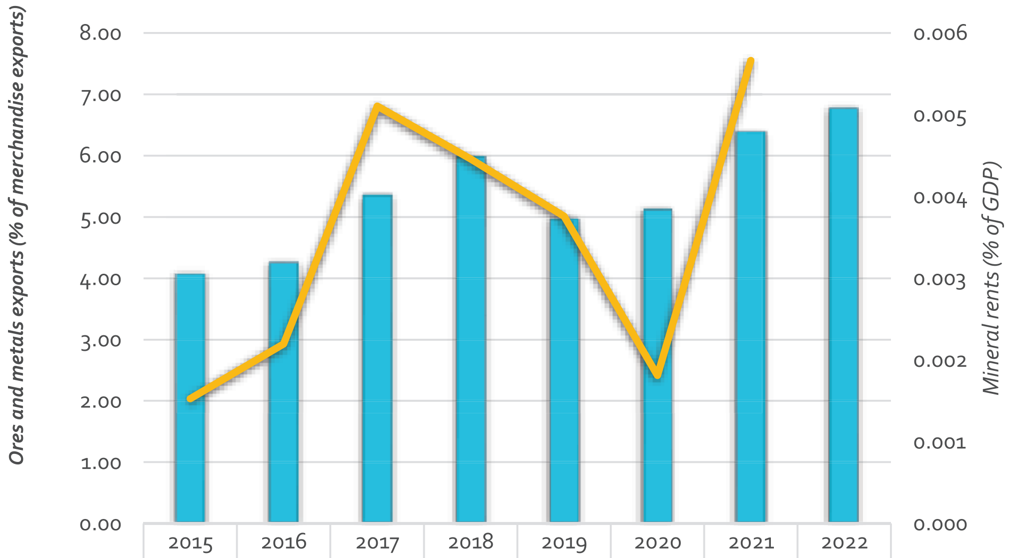
Figure 2: Mineral rents (% of GDP)

Mineral rents are the difference between the value of production for a stock of minerals at world prices and their total costs of production. Minerals included in the calculation are tin, gold, lead, zinc, iron, copper, nickel, silver, bauxite, and phosphate.[39]

Figure 2 provides a visual representation of the progress of the Mineral rent. It is necessary to note that Kenya is barely making the breakeven point in the mining industry comparing the cost and the value of the exported minerals. This is a significant issue that provides insight into the dire situation in this sector and gives the negative effect of Illicit Financial Flows (IFF). Combing the two variables as illustrated in Figure 3 focusing on the Ores and metals exports and Mineral Rent through a comparative analysis. The comparative analysis illustrates that there has been the irregular pattern in Mineral rent. For instance, despite the increase in exports in 2017-2018, the is a drop in the Mineral rent highlighting significant issues. There is a similar occurrence between 2019 and 2020 despite a slight increase in exports.

[38] Mineral rents (% of GDP) - Kenya | Data, https://data.worldbank.org/indicator/NY.GDP.MINR.RT.ZS?end=2021&locations=KE&start=2015&view=chart
. [30]

Ores and metals exports VS Mineral Rent



	2015	2016	2017	2018	2019	2020	2021	2022
Ores and metals exports (% of merchandise exports)	4.09	4.26	5.36	6.00	4.99	5.13	6.39	6.78
Mineral rents (% of GDP)	0.002	0.002	0.005	0.004	0.004	0.002	0.006	

Ores and metals exports (% of merchandise exports) Mineral rents (% of GDP)

Figure 3: Ores and metals exports VS Mineral Rent

2.2.2 Systematic Review

The illicit financial flows (IFFs) in Kenya are mainly driven by tax evasion, corruption, trade mis-invoicing, and crime-related activities. One of the critical issues in mining is the underreporting and undervaluation of mineral exports causing loss to government revenue. This is done by means of trade mis-invoicing and undervaluing the value amount exported minerals. Such policies enable firms to evade paying taxes commensurately on the real value of minerals exported, which contributes to IFFs. Besides, the relationship of MNCs involved in mining makes it possible for transfer pricing – manipulation of prices on commodities and services between affiliated entities within an MNC group consuming several countries to lower amounts of tax owed .[40]

Another pivotal issue concerning IFFs in the mining industry is the low transparency of beneficial ownership information, which results from hiding true owners behind assets and revenues. This opacity helps in the misuse of discretionary influence by economic and political elites, which may result in illicit fund transfers outside their country through rent-seeking and corruption. In addition, the inability to properly enforce AML laws and regulations surrounding mining presents a major problem for addressing IFFs resulting from mining activities. This leads to situations of money laundering and hiding the ill-gotten wealth from mining operations, causing IFFs [21].

[39] Tiberius Barasa M. Synthesis of the Evidence ILLICIT FINANCIAL FLOWS IN KENYA. Pasgr [31]

Along with Kenya, the terrorist funds to Somalia are often seen as a major destination of proceeds related to piracy in the Indian Ocean and transit for monies received from the mining sector. Even though there are initiatives such as setting up the Financial Reporting Centre (FRC) in 2012 to fight illicit financial acts, evidence of governmental corruption proves a challenge. This could include irregularities in contract awards and racketeering that lead to the outward flow of funds associated with mining. In addition, international corporations partaking in the mining industry may use abusive transfer classification shifting money out of the country to low tax jurisdiction creating IFFs. Furthermore, in Kenya, the absence of a capacity to administer complex laws and regulations is creating an opportunity for multinational corporations to benefit from loopholes hence outflows of funds associated with mining.[41]

For many countries, the estimates of IFF in Africa by Global Financial Integrity (GFI) are several times above the accounting threshold for materiality – 5% which indicates high financial flows from the continent. Statistics of illegal flow in the mining sector from WBR and HMN show high ranges.[42] Both methodologies are critical for detecting shifts in the international corporate tax base and current account, which would help illuminate IFF's scale regarding its impact on national income distribution. In relation to the Kenya mining industry, trade mis-invoicing and transfer pricing manipulation may lead to such practices as shifting undeclared income from which IFF is enabled. These IFFs can draw on subsidy regimes, avoid capital controls, or conceal income/profit producing considerable hidden outflow that represents the scale of unreported incomes[23].

The measurement of illicit financial flows is quite difficult in view of the difficulties associated with determining and measuring these activities such as unrecorded movement of cash from a nation, underreporting outflows and sales production transfer, mispricing as well as tax evasion. The estimates provided by GFI are based on different analytical approaches for the balance of payments and international trade data, thus facilitating the assessment of illicit financial flows from developing countries in terms of size. Based on the study "Trillion Dollar Estimate: The article "Illicit Financial Flows from Developing Countries" by Volker Nitsch, one can observe that calculating illicit financial flows (IFF) is a complex and difficult process.[43] First, identifying and quantifying illicit activities like money laundering by moving cash unrecorded out of a country is hard to ensure due to the absence of formal information as well as in the application for using economic tools towards statistical models that are performed on accessible data. On the other hand, there is assurance that IFFs exist and Kenya is not an exception among developing countries.

From the evidence presented in Ethiopia's study of Kenya trade, analysis of tax evasion and proper rate can be observed. This confirms a positive relationship between tax rate and evasion, with a comparably estimated elasticity of imports into Tanzania and close to zero elasticity for Kenya. This evidence indicates that the tax rate is involved in trade between Ethiopia and Kenya. In addition, the links between tax rates and evasion will vary depending on product attributes as well as ways through which importers from

[40] Reuter P. Illicit Financial Flows and Governance : The Importance of Disaggregation. 2017; 31. 32
[41] Cobham A, Davis W, Ibrahim G, et al. Hidden Inequality: How Much Difference Would Adjustment for Illicit Financial Flows Make to National Income Distributions? Journal of Globalization and Development; [7]. Epub ahead of print 2016. DOI: 10.1515/jgd-2016-0022 33
Nitsch V. Trillion Dollar Estimate: Illicit Financial Flows from Developing Countries. Darmstadt Discussion Papers in ECONOMICS 2016; 227: 16. 34
[42] Cobham A, Davis W, Ibrahim G, et al. Hidden Inequality: How Much Difference Would Adjustment for Illicit Financial Flows Make to National Income Distributions? Journal of Globalization and Development; [7]. Epub ahead of print 2016. DOI: 10.1515/jgd-2016-0022 33

Ethiopia avoid taxes.[44] Beneficial ownership is critical in the context of tax evasion and trade gaps. Beneficial ownership gives vital insights into the way in which trade tax avoidance is primarily defined; beneficial ownership allows one to observe and determine how individuals use different methods for evading taxes and manipulating differently determined gaps within particular countries.

A study shows that MNCs around the world transferred over $850 billion in profits, largely to countries with a tax rate below 10% in 2017[45]. The research shows that poor-income countries lose a major part of their total tax revenues to profit shifting thus uncovering one aspect concerning effective taxes. The study also offers a logarithmic function as an alternative model for the relationship between profits and tax rates which is non-linear. In the study, as presented based on OECD data, it is noted that profit shifting out of African nations such as Kenya for tax avoidance escalated with a misalignment model. This shows that there could be serious profit diversion from Kenya into other countries thereby causing financial flows out of the country in an illicit manner. However, the analysis of profit-shifting strategies shows that some countries such as Kenya witness a phenomenon known as outward profit shifting which probably drives illicit financial flows. Furthermore, the results indicate that when they shift profits LOCs like Kenya see higher revenue loss in relation to total tax revenues[26].

Illicit financial flows in low-income countries are a significant challenge discussed by Kasper Brandt in the article "A Review of Methods and Evidence". The article summarizes the relevant literature on IFFs, tax issues, and commercial practices; methods of estimating flows. In accordance with the research, IFFs is a significant development problem for low-income countries and are intrinsically connected to international trade . More specifically, the mining industry in Kenya has been shown to involve corporations and individuals using activities such as non-taxed profits; and tax evasion among other forms of financial secrecy. Evidence of possible rent-seeking behavior can be found by exploring how offshore bank deposits change post-windfall gains in the resources sector or aid disbursement. For instance, it was reported that an increase of 100% in oil prices causes a jump in offshore bank deposits by 22% which are held by individuals who live on autocratic countries with abundant resources. Additionally, using the Panama Papers revelation, the study revealed that firms whose managers or boardroom members were involved in the leakage reduced market value hence misleading financial practices[27].

The Illicit Financial Flows (IFF) risks related to beneficial ownership in the mining sector in Kenya have been proven by the combination of descriptive and systematic reviews to be significant. The analysis therefore provides enough evidence that there needs to be mitigation strategies to ensure that the beneficial ownership laws are more effective.

2.3 CHALLENGES AND GAPS IN IMPLEMENTING AND ENFORCING BENEFICIAL OWNERSHIP TRANSPARENCY

Kenya made a commitment in 2015 to: (a) join EITI, making it a part of a global multistakeholder program designed to increase the transparency of the financial windfall many resource-rich governments receive from developing their oil, gas and minerals. Kenya pledged to establish a government focal point for EITI implementations within six months; and (b) adopt a "transparent policy and legislative framework" for the oil and gas sector, including the adoption of a transparent process for licensing (or awarding) oil and gas blocks as well as publication of contracts between oil companies and the government .[47] To date Kenya neither compliant to the global initiative nor is it even a candidate state which would indicate its willingness to comply with the standards.

On the other hand, while kenya has made progress towards Beneficial Ownership Transparency including key policy and legal reforms and establishment of a central register, it continues to be faced by several obstacles and deficiencies in executing and upholding BOT including:

1. There are gaps and irregularities in the disclosure and validation of beneficial ownership data due to the absence of a precise and uniform definition of beneficial ownership across industries and jurisdictions.

2. The difficulties in confirming the timeliness and accuracy of beneficial ownership information provided by legal entities and arrangements, particularly when those involve intricate and varied legal structures and arrangements like partnerships, trusts, and foundations that can hide beneficial ownership.

3. The insufficient availability and interchange of beneficial ownership data among authorized authorities, financial institutions, and other relevant parties, as a result of legal, technological, and pragmatic obstacles including data security, confidentiality, interoperability, and compatibility.

4. The intricacy and variety of illegal financial flow strategies and tactics, including money laundering, tax evasion, trade misinvoicing, transfer mispricing, corruption, and other hard-to-find, hard-to-recover unlawful operations.

5. The absence of sufficient assets, capabilities, and knowledge on the part of the authorities and organizations in charge of gathering, confirming, and gaining access to beneficial ownership data as well as battling insider fraud in the mining industry.

6. The absence of efficient systems for keeping track of and assessing how the laws on beneficial ownership and IFFs are being implemented and enforced, as well as for guaranteeing accountability and compliance.

   Summarizing these gaps into technical and technological challenges, resistance to reform, and gaps and inconsistencies in legal framework.

Table 3: Gaps challenges and gaps

Category	Gap
Technical and technological challenges	For beneficial ownership data, Kenya lacks sufficient data security, verification, and quality control systems. Creating and upholding a publically searchable, free, and open beneficial ownership record is another challenge the nation faces. The inability to verify and access BO of foreign companies which are majorly the main players in the extractive sector remains a a big challenge in enforcing transparency and accountability.
Resistance to reform	In part because of an insufficient amount of political will and commitment, Kenya has had difficulties passing and implementing beneficial ownership laws. Concerns over the possible negative effects of decreased privacy and higher compliance costs have also been voiced by a number of stakeholders, including members of the commercial sector.
Gaps and inconsistencies in legal framework	Kenya's beneficial ownership disclosure laws are complicated and dispersed, which leads to ambiguities and gaps. The laws and regulations do not entirely conform to international best practices and standards, such as those recommended by the Financial Action Task Force (FATF).

3 CONCLUSION AND RECOMMENDATIONS

The process of identifying the natural individuals who eventually own, control, or profit from legal organizations and arrangements, such as businesses, trusts, foundations, or partnerships, that are engaged in mining operations is known as beneficial ownership transparency. The illicit transfer of funds or capital from one nation to another, sometimes through intricate and opaque procedures that avoid paying taxes, adhering to rules, and being held accountable, is known as an illicit financial flow (IFF).

In response to the IFF's negative effect on mitigation, it is required to develop suitable blueprints. Some possible recommendations to address the risks of illicit financial flows (IFFs) related to beneficial ownership in the mining sector in Kenya are:

1. To achieve greater transparency, Kenya needs to adopt and enforce the EITI principles on financial transparency likely to enhance accountability by government to its citizens on revenue streams and public expenditure as well as the companies or contractors involved. Joining the initive would in turn also create an attractive environment for investors.

2. Improve compliance with the current laws and regulations governing beneficial ownership disclosure, including the Companies Act, Companies (Beneficial Ownership Information) Regulations as well as Public Procurement and Asset Disposal Act from private companies to all participating stakeholders. It is necessary to improve the regulations and enforcement systems to make mining companies operating in Kenya reveal their beneficial ownership information. This transparency will help prevent individuals from hiding behind convoluted ownership structures.

3. Strengthen the capabilities and coordination among authorities and agencies participating in collecting, validating, and sharing beneficial ownership information such as the Registrar of Companies the Financial Reporting Centre, The Kenya Revenue Authority, and the Extractive Industries Transparency Initiative Secretariat. Enhance the quality and availability of the Beneficial Ownership E-Register, ensure its timely updating, and satellite this register to other databases; make it compatible with international standards. It is essential to implement robust due diligence procedures. Establish stringent due diligence procedures for companies involved in the mining sector. This includes thorough checks on the background and ownership of companies seeking licenses or permits for mining activities.

4. Improve public and civil society awareness of the significance behind positive ownership transparency, as well as provide them with opportunities to analyze obtainable data related precisely to beneficial knock-out properties for advocacy purposes. It is also important to encourage transparency through public disclosure of mining contracts, revenue-sharing agreements, and beneficial ownership information. Engage local communities in decision-making processes to ensure

that mining activities benefit the broader population.

5. Promote regional and global cooperation on beneficial ownership disclosure, and actively engage in the appropriate initiatives and networks including Africa Mining Vision, Open Government Partnership, and Global Forum on Transparency & Exchange of Information for Tax Purposes.

6. Corporate Social Responsibility (CSR) Requirements: Required mining firms to have beneficial Corporate Social Responsibility programs that involve local members. This contributes to the sustainable distribution of economic profits from mining activities.

7. Encourage Responsible Investment: Encourage ethical investments in the mining industry by attracting companies with good values. Consider implementing incentives for firms that follow a higher path of transparency, environmental sustainability, and social responsibility.

8. Establish Multi-Stakeholder Platforms: Design platforms for various stakeholders such as government, industry entities civil society, and the local community. These platforms can help with dialogue, sharing of information, and efforts to work together in dealing with the issues around beneficial ownership and illicit financial flows.

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