An Assessment Of Tax Evasion And Revenue Collection In Kenya

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ABSTRACT
The development process of Kenya is currently impeded by a surge in fiscal0deficits and0huge0debt0service charges. While the fiscal deficits in the country remain high, the rate of tax evasion in Kenya has been increasing over the years. This study examines the effect of tax evasion on revenue collection in Kenya. The study was0anchored on economic deterrence theory and theory of planned behavior. Further, the researcher deployed descriptive research design. Moreover, study population was 226 employees working in Kenya Revenue Authority. Sample size was established using Yamane's Formula. Stratified random sampling was deployed to choose 144 respondents. Moreover, the researcher deployed primary data acquired via semi-structured questionnaires. Moreover, pilot test was done so as to ensure research instruments' validity and reliability. Semi structured0questionnaire produced quantitative0and0qualitative0data. Moreover, qualitative data was then analyzed via thematic analysis and results displayed in form of narrative. The analysis of quantitative research data was achieved by employing inferential and descriptive statistics with support of SPSS version 25. Descriptive0statisticsencompassedfrequency0distribution, standard0deviation, mean0and percentages. The researcher discovered that, tax evasion has significant positive influence on Kenyan revenue collection. Therefore, this research recommends that KRA should educate the members of the public on the possible consequences of tax evasion including penalties and imprisonment. In addition, the KRA should encourage the general public to volunteer information that can lead to the interception of tax evasion. The study also recommends that KRA should establish rules forcing businesses to disclose the amount of income they are making in every nation where they do business. This will make it feasible to identify businesses that move profits away from their home nations and into tax havens in order to pay less tax than they should.
Keywords: *Tax evasion, Illicit financial flows, Revenue collection, Kenya Revenue Authority*

I. Background of the study

When an individual or company evades their tax obligations in an illegal manner, it is called tax evasion (Akinfala, 2018). According to Cosmas (2019), tax evasion generally encompasses dishonest reporting of tax, disclosing less income, gains or earnings than the amounts generated, and exaggerating deductions utilizing bribes against tax officers. This is done to decrease the taxpayer's tax liability. Tax evasion has an adverse impact on society's well-being and the economy. Tax avoidance and evasion have a negative impact on government revenue. Tax evasion reduces government revenue, which can result in increased tax rates that are harmful to businesses and families. Folayan and Adeniyi (2018) suggest that tax evasion leads in income loss, which may inevitably divert the government from its potential performance in the public sector. Consequently, government's ability to finance public expenditures and legitimacy are threatened, which leads to a big budget imbalance.

Governments all over the world offers a variety of services, including education, water, security, roads, and social security among others to the citizens. In order to provide these services, governments collect tax revenues by way of direct and indirect taxes. Therefore, government expects all persons to pay taxes as specified in tax laws (Naicker & Rajaram, 2019). However, most of the organizations do not declare their revenue as required by law and hence are involved in various types of tax evasion (Twinomugisha, 2019). In addition, the most persistent challenges in developed and also developing nations, around the world, in relation to tax revenue collection are tax evasion. Tax evasion through illicit financial flows occurs mainly through tax evasion, trading in influence, smuggling of contraband and profit shifting. These forms of Illicit financial flows drain numerous resources from sustainable growth, and also worsen inequalities, undermine governance, fuel instability, and

undermine public trust (Dickinson, 2014). Barasa (2018) suggests that loses about US$88.6 billion, 3.7 per cent of GDP is lost annually by Africa in illicit financial flows (IFFs).

In the United Kingdom, Hearson (2014) established that tax-motivated illicit financial flows decrease revenue, lead to less fair tax system hence reducing public confidence within the system. If Illicit financial flows lower tax compliance in the general public by diminishing "tax morale," this could lead to vicious circle. Besides that, it promotes corruption and undermines effective government. In comparison to comparable countries without large illicit money flows, Alexandru and Sawadogo (2021) identified a major loss in tax revenue in Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the0Philippines, Singapore, Thailand0and0Vietnam. United0Nations (2017) revealed that inhibitory practices using IFFs and DRM are becoming more pervasive and intricate in nations like DRC, South Africa, Tanzania, and Zambia. Yet, compliance flaws in national institutional frameworks turn chances for tax evasion into damaging international IFFs. Thiao (2021) discovered that IFFs had adverse and considerable impact on government income in the nations that make up the WAEMU.

In Kenya, Mwaura and Olweny (2020) noted that tax evasion had negative significant influence on economic growth. In addition, Barasa (2018) observed that mis-invoicing, transfer pricing, the sale of illegal commodities, corruption, and the trafficking of people and drugs are the major ways that illicit financial flows commit tax evasion. In addition, Mwaura and Olweny (2020) found that tax evasion and money laundering influenced economic development in Kenya negatively. For developing nations, hundreds of millions dollars is lost or abandoned that could have been raised and utilized for promoting sustainable economic development, generating jobs, lowering poverty, and combating global warming.

II.   Problem Statement
The tax collections' main aim for governments is to promote economic0growth and guide social development0of0a0country (World Bank, 2018). Tax revenue provides the government with its means of subsistence, allowing it to provide the services necessary to promote economic progress. Similar to many developing nations, Kenya is currently dealing with enormous budget deficits and debt servicing costs that are negatively hurting the nation's development (Thiao, 2021). While the fiscal deficits in the country remain high, the rate of tax evasion in Kenya has been increasing over the years.

The revenue targets by the Kenya Revenue Authority have not been achieved over the last ten years necessitating the authority to enhance revenue collection. Kenya Revenue Authority (2021) report indicated that tax avoidance by multinational firms costs Kenya an estimated Sh639 billion yearly, severely impeding growth of the economy. In the year 2020, multinational corporations in Kenya declared a corporate tax of Ksh.102.9 million, but the profit shifting prevention initiative still managed to collect Ksh. 1.24 billion more. Additionally, the organization profiled 1,309 people and businesses, with a tax loss of about Kshs. 259 billion (Kenya Revenue Authority, 2021). Moreover, in financial year 2016 to 2017, KRA expected to receive revenue of Kshs. 1.415 trillion, however revenue collected by collecting organization was Kshs. 1.365 trillion hence the target was not reached (Ouko, 2020). In financial year 2017/2018 exchequer revenue of Kshs. 1.022 trillion was collected against Kshs. 1.065 trillion treasury target (Kenya Revenue Authority, 2019). In 2017/18, the taxman missed the target by Sh43 billion and Sh50 billion in 2016/17 (Ouko, 2020). According to the World Bank (2020), value added tax revenue as percent of the GDP reduced from 8.148% in 2016 to 7.720% in 2017. However, value added tax revenue as a percent of the GDP increased to 7.967% in 2018 before decreasing to 7.768% in 2019. It is against this backdrop that this study examined the nexus between tax evasion and revenue collection.

III.   Objective of the Study
The main objective of the study was to assess the effect of tax evasion on revenue collection in Kenya.

IV.   Research Question
What is the effect of tax evasion on revenue collection in Kenya?

V.   Theoretical Review
This assessment was guided by the economic deterrence theory. Becker coined the theory in 1968. According to Becker, the person who created it, they are less inclined to commit a crime if the harm caused surpasses the advantage received (Elbahy, 2019). The economic deterrence theory states that factors determining the cost and benefits of evasion including tax rate, penalties for fraud and possibility of detection influence the taxpayer behavior (Mbago, Ntayi & Muhwezi, 2016). This suggests that few persons will avoid taxes if detection is probable and consequences are harsh. Contrary, the feeling and probability that one will not be discovered increases the rate of tax evasion through illicit financial flows. Economic deterrence theory was employed to assess tax evasion impact revenue collection. Registered taxpayers in Kenya are expected by Law

to obey tax obligations. However, where they feel that they cannot be recognized or detected they tend to engage in tax evasion. According to this theory, taxpayer decides rationally whether to avoid taxes or not depending on the predicted benefit or expense of carrying out either activity.

VI.   Empirical Literature Review

The illegal underpayment or non-payment of taxes is called tax evasion. Often, this is done by knowingly providing false declaration to the tax authorities (Nurunnabi, 2017). Tax evasion involves false tax reporting, declaring less profit than the amounts earned, overstating deductions, using bribes in nations with increased rates of corruption, and hiding money in secret places. Often, tax evasion involves deliberate taxpayer's affairs misrepresentation to tax authorities so as to minimize tax liability (Ozili, 2020).

In Nigeria, Adeniyiand Folayan (2018) conducted research0on0the consequences of commercial tax0evasion on the production of government0income. Researchers used secondary and primary data. The results demonstrated that Internally0Generated0Revenue (IGR) between020110and02016 fell short of predictions and expectations. The business tax evasion has a negative impact on Oyo state government revenue generation, which often leads to revenue loss. This conform to Ozili (2020) argument that revenue collection is influenced by tax evasion. Nonetheless, this study was conducted in Nigeria, a country whose tax policies and economic environment differ from those of Kenya.

Using a systematic review of literature, Akinfala (2018) examined the origin of IFFs in Nigeria. One of the IFFs examined was commercial tax evasion. The results indicated that commercial tax evasion measured in terms of Abusive transfer pricing, mis-invoicing of intangibles and services, trade mispricing, and unequal contracts negatively and significantly influenced government revenues. These findings concur with Folayan and Adeniyi (2018) argument that commercial tax evasion affects government revenue. However, one of the limitations of systematic review of literature is that different studies used are not conducted with the researchers' objectives in mind. Therefore, systematic review of literature is characteristic by bias a low validity.

Using survey research design, Macharia (2017) aimed to determine how tax evasion affects Kenya's tax receipts. The Kenya Revenue Authority's investigation into 50 tax evaders was the focus of the study. The researcher used secondary data from KRA investigated cases, related publications from government agencies, groups like Network of Tax Justice, other researchers' and authors' work in form of journals, books, bulletins, and newspaper pieces, as well as online sources. Tax evasion has negative but considerable impact on Kenya's tax take. Tax evasion and avoidance influences government revenue negatively. This is in agreement with Akinfala (2018) and Folayan and Adeniyi (2018) observation0that tax evasion affects government0revenue.

In a Case0Study of the Tanga Tax Area, Magesa (2018) assessed how tax evasion influences performance of revenue collection in Tanzania. Documentary analysis, questionnaires, and interviews were deployed to gather data. Moreover, with the support of the SPSS application, descriptive statistics were utilized to examine quantitative data. Analyses of content were performed on qualitative data. The results demonstrated that from 2011 to 2013, the tax collected did not reach expected level. The findings agree with Akinfala (2018) findings that tax evasion affects revenue collection. According to the report, the Tanga tax region should increase access to information; offer chances for voluntary disclosure prosecute and sentence tax offenders, and publish tax criminals in order to combat tax evasion.

Nsemerirwe (2019) evaluated tax0evasion and performance of revenue0collection in Ugandan local0governments, with a focus on Kampala City Council. The researcher deployed descriptive survey design on a study sample of 30 participants who were chosen via simple random sampling from St. Balikudembe Market sellers and purposeful sampling from KCC officials. Secondary data from textbooks and dissertations was also added to the information from this source. The respondents were given questionnaires that had been created and delivered. The study showed that, among other things, the amount of taxpayers' income, their desire to pay their fair share, the quality of tax administration, and existence of numerous Acts are the main factors influencing revenue collection. Furthermore, it was discovered that inadequate record keeping, excessive tax rates, and taxpayers who do not understand the need of paying taxes are among the reasons for tax evasion. Moreover, it was established that there exists strong positive association, implying that tax evasion is mostly to blame for the low levels of tax receipts, with other factors bearing some of the blame. The results by Magesa's and Akinfala's (2018) claim that tax evasion reduces tax revenue. The findings support Magesa (2018) and Akinfala (2018) argument that revenue collection is influenced by tax evasion.

Khanal and Phil (2019) determined the root sources of tax evasion and determine how tax evasion affects Nepal. The researcher looked at the tax experts' perceptions of tax evasion with a particular emphasis on drivers of tax evasion and possible mitigation measures. In order to gather opinions on income tax avoidance, an interview schedule was created. According to the study, the primary factors contributing to tax evasion in Nepal are high tax rates, corruption in government agencies, a variety of tax rates, and ineffective tax authority. The findings agree with Nsemerirwe (2019) and Magesa (2018) findings that tax evasion affect revenue collection.

VII. Conceptual Framework

The conceptual framework shows that the relationship between tax evasion and revenue collection. Tax evasion was determined based on trade mis-invoicing, VAT evasion, customs tax evasion and fake payments. Rvenue collection was determined based on amount of revenue collected, timely payments and amount of tax debt paid. Figure 1 illustrates the relationship.
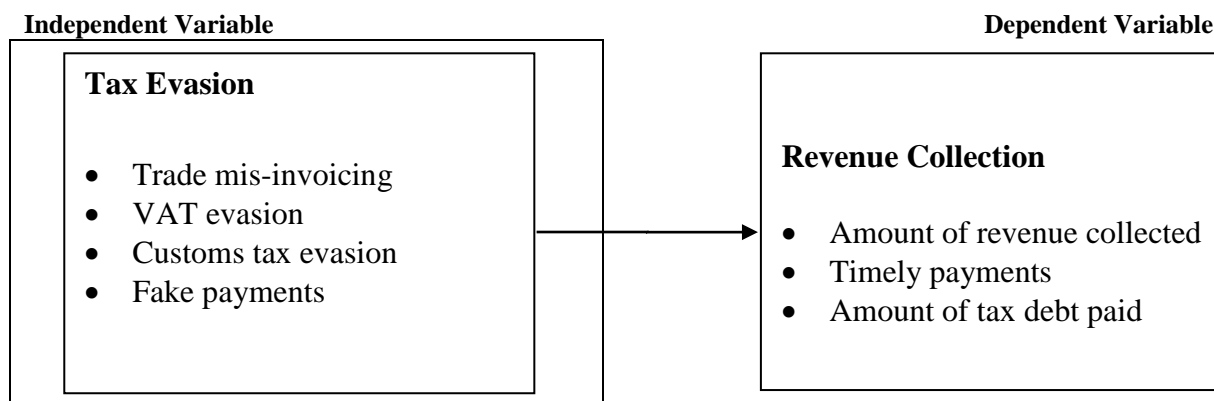
Independent Variable   **Dependent Variable**

Figure 1. Conceptual framework

VIII. Research Methodology

In assessing the relationship between tax evasion and revenue collection in Kenya, a descriptive design was employed. As stated by Williamson and Johanson (2017), descriptive research design helps in describing and observing a subject without making any changes to it. Features or characteristics of a population therefore answering the question what, when and how. A descriptive research method refers to the procedure of obtaining information concerning the present status of either phenomenon or an event to describe its existence in respect to variables and conditions at a particular time (Zikmund, 2017). In addition, descriptive research design explains features of a phenomena or population in a methodical and accurate manner.

The population target was 226 employees working in the Kenya Revenue Authority (KRA). Using Yamane's Formula, the sample size was calculated, allowing the researcher to survey the complete population while maintaining a reasonable margin of error (Kumar, 2019). In order to take into account the error margins and confidence levels, Kumar (2019) contends that a formula must be utilized to choose a sample from a target population. As a result, the study's margin of error was 0.05 and its confidence level was 95%. Table 1 shows the sample size.

Table 1: Population and Sample Size

Department	Study Population	Sample Size
1. Customs & Border Control	54	34
2. Domestic Taxes	39	25
3. Intelligence & Strategic Operations	29	18
4. Investigations & Enforcement	37	24
5. Strategy, Innovation & Risk Management	21	13
6. Corporate Support Services	28	18
7. Legal Services & Board Coordination	18	11
Total	**226**	**144**

Source: Researcher (2023)

The collection of data relied on the primary data. The data was collected using questionnaires. Structured questions were in form of a Likert and nominal scale. Moreover, the study used 5-point Likert scale to gather data on study variables. The usage of structured questions was made in effort to save time, money and make analysis simpler because they are available. The use of unstructured questions, on the other hand, was encouraged since it allows the respondents to express themselves fully and honestly without feeling constrained.

In effort to rephrase and identify misinterpreted, ambiguous, or even misunderstood questions, pilot study was done. Pilot test was done to facilitate research tools' validity and reliability. Typographical errors removal and determination of the relevancy and suitability of the questions was facilitated by pilot test. The

pilot study took place in West of Nairobi Offices of KRA. According to Devi (2017), sample size for a pilot study ought to be 10 percent of sample size. Pilot group involved 10 percent of sample size (14).

Measurement of Study Variables
Table 1 shows the measurement of the various variables employed in the study.

Table 2. Measurement of Variables

Variable	Type	Measurement
Revenue Collection (Y)	Dependent	• Amount of revenue collected • Timely payments • Amount of tax debt paid
Tax evasion (X1)	Independent	• Trade mis-invoicing • VAT evasion • Customs tax evasion • Fake payments

Source: Researcher (2023)

Data Analysis and Presentation
Data analysis was based on multiple regression analysis. Additionally, the analysis was aided by the SPSS. The model to be used is as follows;

$Y = \beta_0 + \beta_I X_I + \varepsilon$

$\quad$ Y = Revenue Collection (EPS)
$\quad$ X_1 = Tax Evasion
$\quad$ $\beta_0 =$ Constant
$\quad$ $\beta_1,$ =Regression Coefficients
$\quad$ ε = Error term

IX. Results and Discussion

$\quad$ This study analyzed the data collected from the targeted respondents. Out of 144 questionnaires that the researcher distributed, 136 questionnaires were dully-filled hence providing response rate of 94.44%. Babbie (2017) suggests that 75 percent response rate is enough for data analysis, drawing conclusions as well as making recommendation. This denotes that 94.44% response rate was enough for data analysis, making recommendation and drawing conclusions.

Descriptive Statistics
$\quad$ The essence of employing descriptive statistics in a research is to enable the researcher to give a description of the basic characteristics of the data used (Wooldridge, 2003). The participants were as requested to state their particular agreement level regarding tax evasion in Kenya. The findings were presented in Table 3.

Table 3 : Aspects of Tax Evasion

Statement	1	2	3	4	5	Mean	Std. Deviation
Our firm has witnessed increased cases in the import under-invoicing which has led to evasion of VAT taxes	1.5	5.9	2.9	89.7	0.00	3.809	0.603
Import over-invoicing has reduced income tax liability	2.9	2.9	8.8	60.3	25.0	4.015	0.852
Export under-invoicing has led to income tax evasion	0.00	4.4	1.5	83.8	10.3	4.000	0.544
There have been cases where the staffs charge a customer VAT and then pocket the cash without accounting	0.00	4.4	8.8	80.9	5.9	3.882	0.559
Our organization charges penalty to anyone involved in VAT evasion	4.4	7.4	5.9	79.4	2.9	3.691	0.830
Our organization consider deliberate evasion of VAT as an offence and is liable to imprisonment	2.9	5.9	7.4	63.2	20.6	3.927	0.883
Our organization has witnessed mis declaration of quantity and product-description of imported goods hence leading to lower or no duty rate	0.00	2.9	7.4	89.7	0.00	3.868	0.418
Importers attempt to evade customs duty by under-invoicing	5.9	4.4	4.4	85.3	0.00	3.691	0.812
Importer breaks a shipment up into multiple shipments claim that the shipments fall below the limit to avoid customs duties	7.4	7.4	4.4	61.8	19.1	3.779	1.073
Cases of fake payments has increased over the last years	11.8	8.8	4.4	44.1	30.9	3.735	1.307
At times corporate organization pretend to have made payments to other organizations and institutions	13.2	14.7	1.5	45.6	25.0	3.544	1.360

Source: Research Data (2023)

$\quad$ With mean of 4.015 (SD=0.852), respondents agreed that import over-invoicing has reduced income tax liability. Moreover, they agreed that export under-invoicing has led to income tax evasion as illustrated by

mean of 4.000 (SD=0.544). With mean of 3.809 (SD=0.603), they also agreed the organization has witnessed increased cases in the import under-invoicing which has led to evasion of VAT taxes. These findings conform to Akinfala (2018) discoveries that cases of mis-invoicing of services and intangibles in Nigeria have been increasing and have negatively influenced government revenues.

With mean of 3.927 (SD=0.883), respondents as well agreed that their organization consider deliberate evasion of VAT as an offence and is liable to imprisonment. Moreover, they agreed that there have been cases where the staffs charge a customer VAT and then pocket the cash without accounting as illustrated by mean of 3.882 (SD=0.559. With mean of 3.691 (SD=0.830) they also agreed that their organization charges penalty to anyone involved in VAT evasion. The findings agree with Magesa (2018) findings that to prevent tax evasion, more prosecution, incarceration, and publication capabilities should be granted to tax violators by the Tanga tax region.

With mean of 3.868 (SD=0.418), respondents agreed that the organization has witnessed misdeclaration of quantity and product-description of imported goods hence leading to lower or no duty rate. Moreover, they agreed that importer breaks a shipment up into multiple shipments claim that the shipments fall below the limit to avoid customs duties as presented by mean of 3.779 (SD=1.073).With mean of 3.735 (SD=1.307), respondents agreed that cases of fake payments has increased over the years. Additionally, with mean of 3.691 (SD=0.812), respondents also agreed that importers attempt to evade customs duty by under-invoicing. The results concur with Ozili (2020) discoveries that most of the importers engage in under-invoicing to evade customs duty. Furthermore, they agreed that at times corporate organization pretend to have made payments to other organizations and institutions as shown by a mean of 3.544 (SD=1.360).

The participants were further requested to specify how else tax evasion influences revenue collection in Kenya. The respondents noted that commercial tax evasion in terms of abusive transfer pricing, mis-invoicing of intangibles and services, trade mispricing and unequal contracts negatively and significantly influenced government revenues. In addition, the respondents revealed that tax evasion undermines revenue collection, distorts competition, and undermines a country's development prospects. The respondents also indicated that Tax evasion reduces revenue, which can lead to less beneficial governmental spending.Further, tax evasion makes it quite challenging for the tax authority for full and efficient collection of tax revenue from taxpayers. The respondents further noted that tax evasion is a severe loss of government revenues that restrain the government from providing smooth public services due to the decline of the state budget of public revenue.

Inferential Statistics
The inferential statistics in this section presents the correlation matrix and the regression analysis. Regression analysis is divided into model summary, ANOVA and regression output.

Correlation Matrix
Correlation is a statistical analysis method that shows how and if a pair of variables are strongly associated. . According to Bluman, (2005), values between -0.6 and -0.8 or +0.6 and +0.8 account for 36 percent to 64 percent of the variance, which shows a moderately strong to strong association. Values between -0.8 and -1.0 or +0.8 and +1.0 account for more than 64 percent of the variance, which might show a very strong relationship therefore exceptionally high values above 0.8 in absolute value imply that certain match ups of variables aren't giving independent information. This test was done using the Pearson's correlation and the findings are presented in Table 4.

Table 4: Correlation Matrix

		Revenue Collection	Tax evasion
Revenue Collection	Pearson Correlation	1	
	Sig.(2-tailed)		
	N	136	
Tax evasion	Pearson Correlation	.818[**]	1
	Sig.(2-tailed)	.000	
	N	136	136

Source: Research Data (2023)

From the findings in Table 3, Tax evasion had a significant positive relation between tax evasion and Kenyanrevenue collection (r=0.818, p-value=0.000). Further, p-value of 0.000 was below 0.05, thus the correlation was found to be significant. These results are in line with Ozili (2020) argument that tax evasion affects revenue collection.

Regression Analysis
This section presents the model summary, ANOVA and regression output.

Table 5: Model Summary

Model	R	R-Square	Adjusted R-Square	Std. Error of Estimate
1	.69[a]	.476	.432	.14835

a. Predictors: (Constant), Tax evasion
Source: Research Data (2023)

R-squared for the correlation between tax evasion and revenue collection was 0.432, which denotes that 43.2% of variation of dependent variable (revenue collection) could be explained by tax evasion.

Table 6: Analysis of Variance

Model		Sum of Squares	df	Mean-Square	F	Sig.
1	Regression	31.684	4	7.921	359.933	.000[b]
	Residual	2.883	131	.022		
	Total	34.566	135			

a. Dependent Variable: Revenue Collection
b. Predictors: (Constant), Tax evasion

F-calculated was 359.933 while F-critical from the F-distribution Table was 2.46. Because F-calculated was above F-critical and p-value of 0.000 was not more than 0.05, model used was deemed to be a good fit for research data.

Table 7: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std.Error	Beta		
1	(Constant)	0.467	0.103		4.534	0.000
	Tax evasion	0.240	0.087	0.211	2.759	0.002

a. Dependent Variable: Revenue Collection
Table 7 results into the following regression model;
$Y = 0.467 + 0.240X_1 + \sum i$
Where: Y is the Revenue collection
X_1 is the Tax evasion
The objective of the study was to assess the effect of tax evasion on revenue collection in Kenya. From the results in Table 7, tax evasion has significant positive effect on revenue collection ($\beta_2=0.240$, p-value=0.002). Moreover, p-value (0.002) was below 0.05, hence correlation was considered significant. These results concur with Folayan and Adeniyi (2018) argument that commercial tax evasion affects government revenue.

X.   Conclusion and Recommendations
Conclusion
        The research objective was to evaluate the effect of tax evasion on revenue collection in Kenya. The researcher therefore concludes that tax evasion has a significant positive effect on revenue collection in Kenya. The findings indicated that trade mis-invoicing, VAT evasion, customs tax evasion and fake payments influences revenue collection in Kenya. This means that reducing tax evasion (trade mis-invoicing, VAT evasion, customs tax evasion and fake payments) will have influence revenue collection.

Recommendation
        This study recommends that KRA management should employ modern technology to collect revenue in order to ensure that the staffs do not pocket any cash collected as revenue. In addition, the management should penalize, prosecute and imprison the staff who are found pocketing revenue collected. KRA should also educate the members of the public on possible consequences of tax evasion including penalties and imprisonment. In addition, the KRA should encourage the general public to volunteer information that can lead to the interception of tax evasion.

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