

An Evaluation of Taxpayer Relations with the Tax Authorities in Kenya.



OXFAM





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Abbreviations



ADR

Alternative Dispute Resolution

GDP

Gross Domestic Product

KRA

Kenya Revenue Authority

MNE

Multinational Entity

SME

Small and Medium Enterprises



Executive Summary

Tax revenue is essential in providing the resources needed to finance sustainable development. The success of any state in collecting taxes while maintaining low cost of compliance is determined to a large extent by the effectiveness of the strategy employed in tax collection. An effective tax collection strategy promotes voluntary compliance due to the high costs associated with enforced compliance.

Voluntary compliance necessitates a certain level of trust in the relationship between the tax authority and the taxpayers. Recognizing the key role of trust in this relationship, the KRA began its organization transformation journey in 2015 to enhance compliance by building trust through facilitation. The new approach by the KRA signalled a shift from traditional use of coercive power, which often results to conflict and expensive litigation to focusing on building trustful relationships, first with staff internally, and with the citizens to ensure compliance.

Despite the KRA effort, the relationship with taxpayers remains laced with mistrust with the KRA perceiving taxpayers (both large and SMEs) as being driven by financial gains thus actively engaging in tax avoidance and evasion. This perception by the KRA is towards all taxpayers and informs the KRA's insistence on tax audits especially large taxpayers. Taxpayers on their part perceive the tax audits as inefficient and the tax dispute resolution process available as lacking in independence. the KRA

On the positive side, both taxpayers and revenue authority acknowledge the technical competence of the other which sets a good foundation for collaboration in design of sound tax policies and when resolving disputes. In addition, there is willingness on both parties to foster a good relationship. the KRA has taken a lead in this through improved customer care, more stakeholder engagement and education, adoption of technology to ease compliance and increased capacity in the Alternative Dispute Resolution (ADR) department to ensure prompt resolution of disputes.



1.0

Background

Kenya's ability to mobilize its domestic resources and in particular, collect taxes in a progressive and equitable manner, is key to unlocking the finances needed for sustainable development. Taxes provide reliable and sustainable revenue flows for economic development, encourage good governance, address income and wealth inequality and promote social justice

The country's Tax to GDP ratio of 18.3% in (FY 2017/2018) is above Africa's average rate of 15% but still below 20-22% which is the average of comparable middle-income economies. Thus, Kenya continues to struggle to finance its development agenda resulting in increasing budget deficits and increased debt.

Key sectors which would play a key role in alleviating poverty and inequality such as health and education remain underfunded. An increase in the tax to GDP ratio would result in increased funds available for these key areas. Calculations done by Oxfam for example, indicate that if Kenya had increased its Tax to GDP ratio by 3 percentage points to 20.9 in 2014 it could have raised enough additional funds to guarantee Universal Health Coverage for the entire population. This illustrates the great benefits that would result in an increase in the tax to GDP ratio.

Low tax capacities (referring to various economic conditions impacting tax revenues) and inefficiency in tax collection (which refers to poor fiscal policies and poor governance) are some of the factors that contribute to lower than expected tax revenues in Kenya. Whereas tax capacities are dependent on the structures of the economy and are therefore more difficult to tackle, issues of governance and fiscal policies that result in tax leakages, corruption and weak enforcement of tax laws provide a good starting point for increased tax collection efficiency. Governance is defined as "the traditions

and institutions by which authority in a country is exercised". It is about how citizens, leaders and public institutions relate to each other. Public opinion or perception is critical to governance as power draws legitimacy from public opinion.

People base their actions on perceptions and thus where public perception is poor it impacts legitimacy and is likely to result in non-compliance. The Kenya Revenue Authority (KRA) is tasked with collecting taxes and implementing tax laws in Kenya.

The KRA thus, as an agent of the executive government, provides a means through which taxpayers interact with the executive.

It is through these interactions that the citizens experience the power of the executive. Thus, where the interaction is less than positive, the result is a negative perception not only of the KRA but also of the government.

Therefore, for a country like Kenya whose tax system is based on voluntary compliance, a good relationship where transparency and mutual trust exist between taxpayers and tax revenue authorities is key. This relationship, and consequently compliance rates, can be fostered or undermined by the perceptions and attitudes of taxpayers and the revenue authority towards each other.

This study is an initial step to providing insight to both the KRA and Kenyan taxpayers of the current state of their relationship and the likely impact of that relationship on revenue collection.

The study also evaluates the role of the tax advisors in shaping the perception of the taxpayers towards the tax authorities, as well as taxpayers' behaviour towards tax compliance. The results of the study are expected to not only give insight into the current state of relationship but will also provide recommendations on how the relationship can be improved.

2.0

Rationale for the study

The importance of the public goods and services provided by the government is not lost on citizens. However, raising the public resources needed to finance them often presents a social dilemma, where individual citizens prioritize their personal financial gains through minimizing taxes instead of the long-term collective benefit to society through paying taxes. The success of any state in collecting taxes while maintaining low cost of compliance is determined to a large extent by the effectiveness of the strategy employed in tax collection.

Hofmann and Kirchler argue that power and trust are not mutually exclusive, and both are essential determinants of compliance. They further argue that tax authorities who use coercive power are likely to lose taxpayers' trust and consequently erode taxpayers' willingness to comply voluntarily. Many authorities in the past relied mostly on coercive power - where those who fail to comply are punished by sanctions, penalties and interest - to insure and increase compliance levels among its citizenry. This approach assumes that economic factors are the main drivers of taxpayers' behaviour i.e. taxpayers are entirely motivated by profits and will evade taxes if the expected profits exceed the likelihood of being caught and resulting penalties.

Although penalties, sanctions and audits do play a role in compelling compliance, they are not the only reason why people comply.

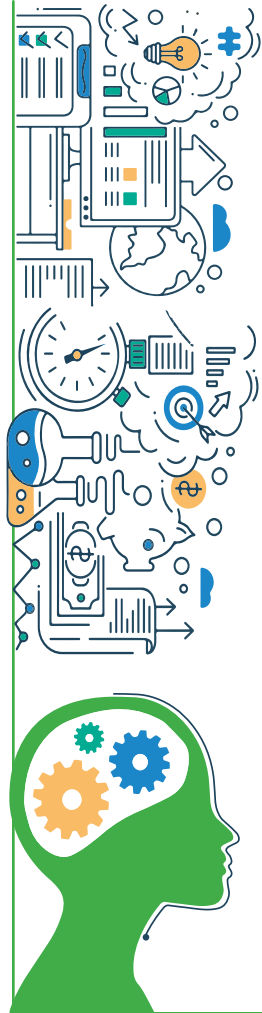
Subsequent research indicates that the decision by taxpayers to comply or not is a result of multiple and complex factors including social and psychological reasons and not just economic considerations and hence the need for authorities to build trust. The response to power and trust is measured in terms of the perception by taxpayer.

In the case of power, the taxpayer's perception of whether the tax authority has the capacity to detect and enforce offenders plays a key role in compliance. In the case of trust, taxpayers are concerned with procedural justice which deals with whether they are treated fairly by the revenue authority.

This feeling of fairness, is enhanced by being treated politely, with dignity and respect, and having genuine respect shown for one's rights despite their social status.

This is what ultimately gives legitimacy to that authority and warrants obedience and consequently, compliance. When used together, power and trust can work in tandem to ensure compliance through enforced and voluntary compliance respectively. Taxpayer attitude and perception have a direct bearing towards the level of compliance. Where the taxpayers feel that they have been treated with respect, dignity and therefore fairly, then they have a positive attitude towards the revenue authority and are more likely to comply.

Where however, the taxpayers have a negative perception of the revenue authority i.e. perceive them to be unfair, inconsiderate, unsupportive and disrespectful, then they are likely to resist attempts to make them comply. In such cases, the use of threats and coercion can produce opposite behaviour from what was intended.



3.0

Research objectives

This study is based on the premise that a good and trustful relationship between taxpayers, tax administration and tax advisors positively impact tax compliance resulting to efficiency in tax collection.

The research seeks to evaluate the current state of relationship between the KRA and private sector taxpayers and the role of tax advisors in shaping this relationship.

To achieve this, the research sought to:

A.

Evaluate the behaviour of corporate taxpayers and that of the KRA, and how this varies across different taxpayers;



B.

Evaluate the role of tax advisors in shaping the relationship;



C.

Using the information collected above, evaluate the overall relationship between the KRA and private sector taxpayers to determine the weaknesses, strengths, opportunities and trends; and



D.

Provide recommendations for improving behaviour and relations of the two parties in order to influence more effective, responsive and efficient tax collection and cooperative compliance on the part of taxpayers.



4.0

Methodology

Data collection for this study involved both qualitative and quantitative methods as discussed below.

A. Survey Questionnaires

The main methodological tool used in the study was review of feedback obtained from survey questionnaires of

96

respondents comprising of;

44

taxpayers (23 large taxpayers and 21 small and medium taxpayers);

23

tax advisors from local and international advisory firms;

36

officials from the Kenya Revenue Authority from Domestic Taxes, Legal and Policy Units.

The survey questions were prepared in two sets; one was tailored to the taxpayers and advisors while the other questionnaire was tailored to the tax authority.

The survey questions were based on the standards used in the Tax Administration Diagnostic Tool designed by the Africa Tax Administration Forum (ATAF) to evaluate the health of tax administrations, but with slight variations.

The questionnaire for taxpayers and advisors was aimed at obtaining feedback on their perception of the KRA with respect to

- (i) provision of adequate support and information to taxpayers,*
- (ii) provision of adequate training to taxpayers by the KRA,*
- (iii) effectiveness of the initiatives by the KRA to ease tax compliance,*
- (iv) efficiency of tax audits,*
- (v) technical competence of the KRA officials,*
- (vi) integrity of tax officials,*
- (vii) independence in tax disputes resolution process, and*
- (viii) level of engagement of taxpayers/ advisors in the design of tax policies by the KRA.*

The survey questions to the KRA officials sought to obtain feedback of the Authority's perception of taxpayers with respect to

- (i) competence of staff handling tax matters,*
- (ii) willingness of taxpayers to comply voluntarily,*
- (iii) taxpayers engagement in deliberate tax evasion and avoidance,*
- (iv) willingness of taxpayers to cooperate with tax authorities,*
- (v) transparency in financial reporting by taxpayers, and*
- (vi) integrity of taxpayers.*

The survey questions were presented on a scale of 1 to 7 where; 1 was strongly agree and 7 was strongly disagree. Two sections were provided for respondents to provide general comments and recommendations.

Limitation

To ensure quality of the responses, the survey questionnaires were targeted at corporate taxpayers and tax advisors who had actively engaged with the KRA to ensure that feedback was based on direct experience with the KRA.

While this was easy to achieve with large taxpayers, the study observed that a substantial number of small and medium taxpayers had not directly engaged with the KRA.

B. Focus group discussion with taxpayers and tax advisors

The study further convened a round table discussion attended by taxpayers and advisors (20 respondents in total). The round table discussion was aimed at obtaining more information and clarification on the subject under review.

Results from the questionnaire survey were shared with the taxpayers and advisors who provided very useful feedback on the same.

C. Literature review

Various literature including research papers, journals, reports from non-governmental organizations and published books relevant to the study were reviewed.

5.0

Findings

5.1 Behaviour of corporate taxpayers and their relationship with the KRA

Kenya's tax system is based on voluntary compliance and is a key determinant of the overall taxes that government is able to collect from its citizens due to the high cost associated with coerced/enforced compliance.

Like taxpayers in any other jurisdiction, Kenyan taxpayers consider taxes a business cost that should be managed in order to maximize returns on shareholder value. Kenya's voluntary compliance rate is estimated at 54% which is close to the 51% voluntary compliance rate as per the KRA's internal survey.

The lower than expected compliance rate may explain the findings by the Global Financial Integrity that Kenya lost approximately Ksh.90b in 2013 from tax evasion through trade mis-invoicing.

From the survey, a higher proportion of the KRA officials in the large taxpayers' unit perceive taxpayers as unwilling to comply voluntarily compared to officials in other units. This negative perception of taxpayers, especially large taxpayers offers insight as to why the KRA often defaults to using audits which are a form of coercive power in enforcing compliance.

5.1.1 Technical competence of taxpayers

Most large taxpayers in Kenya have inhouse tax managers, and in addition, often engage tax advisors when filing tax returns, during tax disputes and where technical tax advice is needed on complex transactions or areas where the law is uncertain.

Medium and small taxpayers on the other hand, often do not have an inhouse tax expert and neither do they engage tax advisors unless in cases of tax audits. Tax matters in such organizations are handled by accountants. The.

Perception of taxpayer's technical competence was higher among the KRA officials working in the large taxpayer's unit compared to officials working in other units.

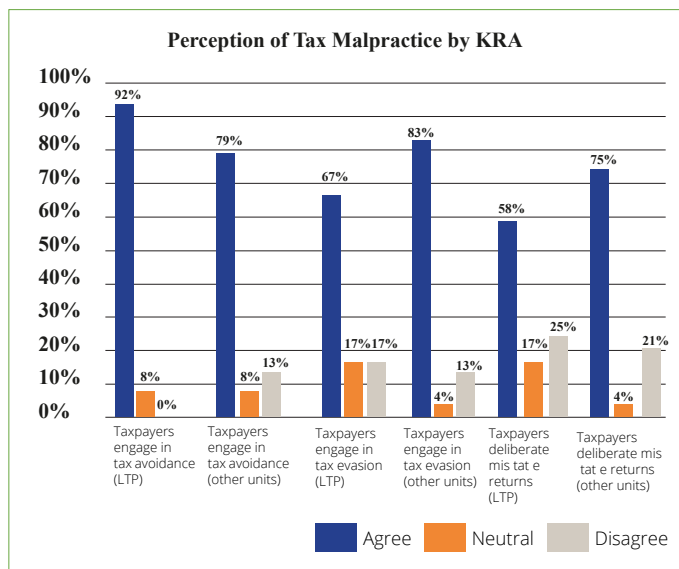
Despite this view, the large taxpayers still faced more tax audits as compared to Small and Medium Enterprises (SMEs). Perhaps one may conclude that the KRA views the presence of technically trained staff as a sign that the taxpayer might be engaging in tax avoidance schemes.

5.1.2 Involvement in tax malpractice

Some taxpayers, especially multinational entities (MNEs), have been accused of tax malpractice, both tax evasion and avoidance by the media.

For instance, in 2018, the media reported that the KRA had recovered Sh9.3 billion from auditing close to 150 MNEs over a four-year period, with another Sh6.1 billion being in contest. KRA further alleged that only one out of 10 MNEs can support the heavy expenditures they claim to have incurred in procuring services and eight out of 10 MNEs grossly under-declare salaries paid to expatriates, by splitting remuneration paid to expatriates into local and offshore portions. In such cases, only a small portion is paid in Kenya, resulting to low PAYE being paid.

The KRA also claimed that some MNEs had frustrated tax audit processes by failing to provide requested information or by providing the information in their local languages instead of the Kenyan national languages. The media reports are consistent with survey results indicating a negative perception by the KRA of Kenyan taxpayers as summarized below



In responding to the negative perception by the KRA with regard to tax avoidance and evasion by MNEs, taxpayers present during the roundtable discussions maintained that such claims are false. In their view, the KRA's allegations of tax avoidance and evasion were often a result of differences in technical interpretation of the law especially in the area of transfer pricing, and this was expected.

5.1.3 Cooperation with tax authorities and transparency

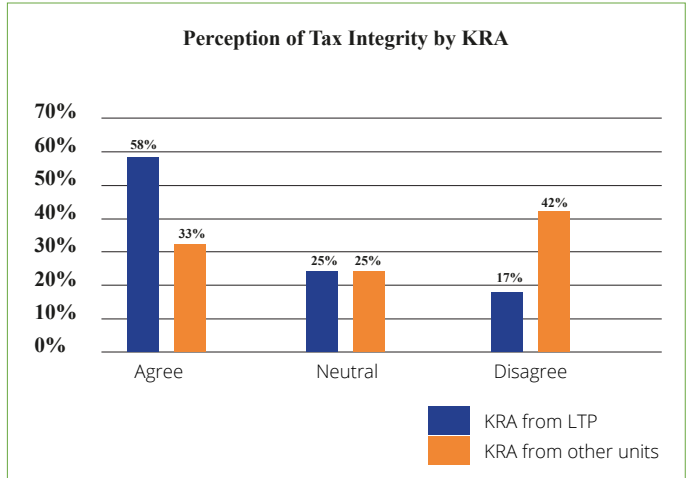
Officials in the large taxpayer unit perceived taxpayers as more willing to cooperate compared to officials from other units. (58% of officials in large taxpayer unit agree taxpayers are willing to cooperate compared to 50% in other units).

While perception for willingness to cooperate was more positive for large taxpayers, it is relatively low, and this may support the adverse media reports of some large taxpayer's frustrating tax audit processes by failing to provide required information. Lack of adverse media reports of SMEs reflects a bias against large taxpayers possibly due to the higher impact on revenues from non-compliance of large taxpayers.

Half of the KRA officials surveyed were of the view that taxpayers are not transparent in their financial reporting with the other half viewing taxpayers as being transparent. Interestingly, the views were similar with regards to their views of both SMEs and large taxpayers.

5.1.4 Integrity of taxpayers

Most telling of the level of trust in the relationship between the KRA and taxpayers is the response to the question of taxpayer's integrity especially among the SMEs. While 58% of officials in the large taxpayer's unit believe taxpayers have integrity, only 33% of officials in other units agree.



A substantial number of respondents (25%) were neutral on this issue, which may indicate unwillingness to provide feedback in light of indictments of the KRA officials for corruption during the period of the survey.

5.1.5 Taxpayer's engagement in building an effective tax system

From the survey conducted, large taxpayers are more involved in stakeholder engagement forums organized by the KRA (83% of large taxpayers had attended a stakeholder forum compared to 38% of the SMEs).

During the roundtable discussion, taxpayers acknowledged they have a role to play in building an efficient tax system. They identify themselves as critical players in the Kenyan economy who need to be more engaged in the design of tax policies since they are directly impacted.

For instance, most taxpayers observed that they have contributed to a poor tax system by complying with incorrect technical positions taken by the KRA for fear of ending up protracted and expensive litigation procedures.

During the roundtable discussion taxpayers acknowledged that they can also contribute to a more effective tax system by cooperating with revenue authorities especially during audits, attending stakeholder engagement forums (and ensuring they collaborate in order to speak as one voice) and providing constructive feedback to the KRA.

In addition, taxpayers agreed that there is need to undertake more research on tax policy issues to support sound decision making.

5.2 Behaviour of the KRA towards corporate taxpayers based on their units

In recognition of the need to enhance trust between itself and taxpayers, the KRA began what it referred to as its organization transformation journey in 2015 by launching a new vision, mission and values to reflect its new strategic direction in revenue collection in its 6th Corporate Plan themed 'Building Trust through Facilitation so as to enhance Tax Compliance'. The KRA acknowledged that the new strategy was necessitated by the changing tax landscape in Kenya where the Kenyan taxpayers are now more educated, well informed of their rights and obligations and thus demanding quality services from the Authority.

The new approach by the KRA was supposed to shift the authority from traditional use of coercive power, which often results in conflict and expensive litigation to focusing on building trustful relationships, first with staff internally and with the citizens to ensure compliance. The new approach sought to ensure that staff were professional, courteous and proactive in addressing issues of taxpayers.

Other measures that the KRA would focus on to improve services to taxpayers included engaging customers online through social media and their website, decentralizing tax service centres (these would be availed at county level and through Huduma centres), embracing technology to ease compliance by providing fully automated self-services to taxpayers and availing multiple options to pay taxes.

These customer focused initiatives were expected to achieve an 80% customer satisfaction rate. Whether these changes achieved the desired impact can be analysed based on the taxpayer's perceptions and attitudes towards the KRA.

5.2.1 Evaluation of the KRA behaviour by taxpayers

According to the respondents, the adoption of technology by the KRA has had a significant impact in easing compliance on both large taxpayers and SMEs, with higher large taxpayers perceiving it as having a greater impact (91%) compared to 71% of the SMEs.

5.2.2 Support to taxpayers

Both the large and small taxpayers view the KRA as providing relevant information to aide compliance though more SMEs (62%) compared to 48% large taxpayers held this view. This is likely due the fact that large taxpayers rely more on tax advisors for relevant information and sensitization while SMEs rely more on information from the KRA due to lack of resources to engage tax advisors. The survey revealed a bias on the part of the KRA as it indicates that the KRA provides more administrative support to large taxpayers (65% agree) compared to 52% of the SMEs.

The disparity in views is likely to have an adverse impact on compliance among SMEs as it goes to question procedural justice and lack of facilitation to SMEs willing to comply but not able to due to capacity constraints. Such difference in treatment based on what seems to be social status (income and revenue) is likely to cause perception of unfairness which ultimately has a negative impact on tax compliance.

5.2.3 Tax audits

Procedural justice as discussed earlier, is enhanced by feelings of fairness.

From the survey, the large taxpayers felt unduly targeted by the KRA with all the large taxpayers surveyed having been involved in an audit.

Of note

57%

of large taxpayers think that the KRA officials are technically competent,

70%

of them considered the tax audit process as inefficient.

On the other hand,

19%

of SME respondents had no prior direct interaction with the KRA

38%

had not been involved in any the KRA audit

62%

had not participated in a tax dispute resolution process.

5.2.4 Dispute resolution

The KRA operationalized the Alternative Dispute Resolution (ADR) process in 2015 which has since resolved 191 cases. The ADR is a voluntary mediation process that taxpayers and the KRA can opt for instead of litigation, which is more expensive and takes longer to conclude. Tax matters referred to ADR are required to be concluded within 90 days.

ADR has been embraced mostly by large taxpayers, and a majority of the respondents from the large taxpayer's unit (87%) had participated in a tax dispute resolution process.

However, only 30% of the large taxpayers perceive the ADR process as impartial. The perceived lack of independence of the ADR may be attributed to among other things, the fact that it is hosted within the KRA and facilitated by the KRA employees instead of independent parties.

This perceived sense of partiality in the dispute resolution process impacts the trust in the process and may explain why only a dismal 39% were satisfied with the outcome of a tax dispute resolution process they had participated in. Research indicates that satisfaction with the outcome of decisions is not necessarily pegged on whether the decision was in the taxpayer's favour. Rather, it is based on the perception that the decision-making procedure was fair and neutral.

In an attempt to create the perception of fairness and transparency, KRA recently introduced changes to the ADR process where the team handling objections is different from the audit team.

Though intended to create some level of independence, taxpayers expressed concern that the new process is likely to exacerbate the already inefficient tax audit process.

Taxpayers expressed fear that they may have to provide the same

information and explanations already provided to the audit team to the objection team unless KRA put in place internal mechanism to share information received from taxpayers.

5.2.5 Integrity of officials

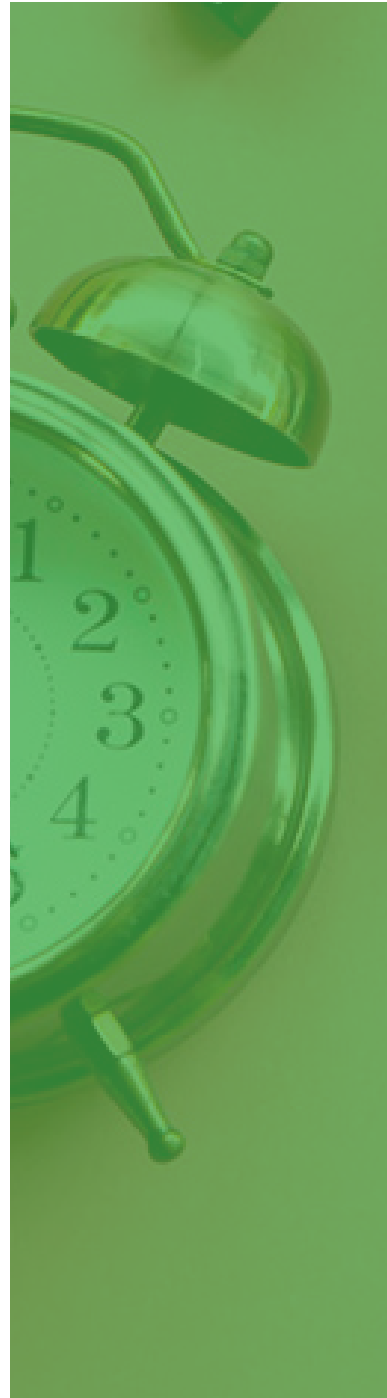
Remarkably, the KRA is perceived to have integrity especially by large taxpayers. 83% of large taxpayers affirmed that they had not interacted with an official who solicited for a bribe. On the other hand, only 33% of SME respondents perceive the KRA to have integrity, 38% disagreed, 10% were neutral and 194% could not provide feedback since they had not interacted directly with the KRA. These findings are consistent with a survey carried out by Transparency International indicating that the poor are twice as likely to pay a bribe than the rich.

This is because poverty results in lack of resources which incapacitates people making them vulnerable to corrupt behaviour by bureaucrats. SMEs often do not have resources required to ensure compliance or resolve tax disputes when they arise. As such, they are more likely to give or offer bribes to have their tax issues "resolved".

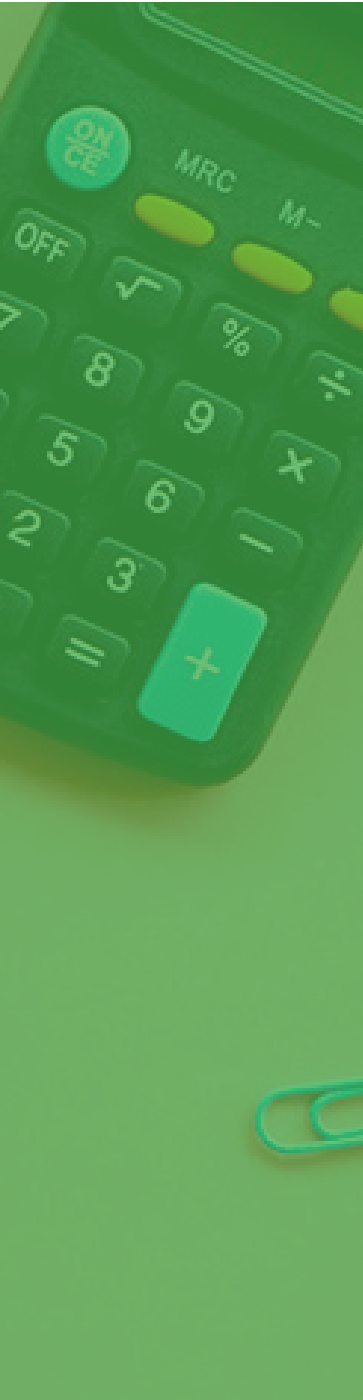
5.2.6 Interaction with taxpayers

Taxpayers sentiments during the tax round table discussion was that despite the challenges and sometimes frustrations with the KRA, they have more confidence in the Kenyan administration and judicial system compared to other systems across Africa.

Most taxpayers agreed that the KRA has made substantial progress over the past decade by changing their attitude from the traditional militant approach and are more approachable. They further observed that the KRA has increased resources to handle taxpayer issues and put in place structures to improve the efficiency of the institution.



5.3 Evaluation of Boundary Stakeholders (tax advisors) and how they influence this relationship



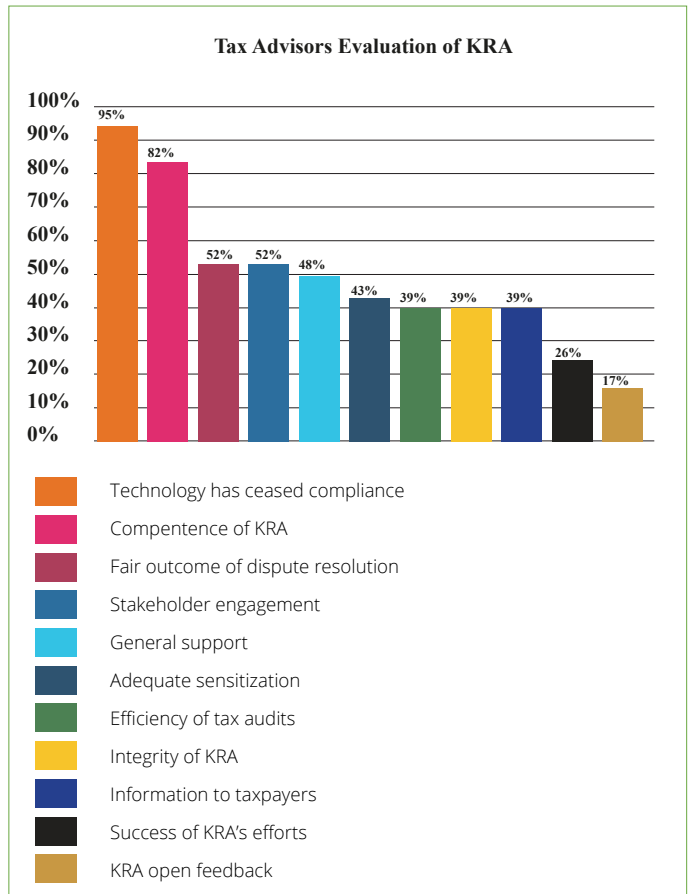
Tax advisors in accounting and law firms are critical stakeholders in a tax system. They are considered as authorities in technical matters in the area of tax and help taxpayers understand and comply with their tax obligations especially in the ever-increasing complex operating environment.

They assist in tax dispute resolution and in ensuring taxpayers comply with their internal tax risk management processes as part of corporate governance .

The relationship between tax advisors and the tax authority tenuous at best and is much harder to cultivate since a tax advisor's primary obligation is to

their clients and not to the KRA. Tax advisors prioritize the interests of their clients and their contribution in policy matters often leans in favour of maximizing tax savings for their clients.

Despite being subject matter experts in taxation, a comparatively lower number of tax advisors had been invited and participated in any stakeholder engagement forum organized by the KRA (52% tax advisors compared to 78% of the large taxpayers and 62% SMEs). The low engagement of tax advisors may explain the rather critical perceptions that they have towards the KRA.



On the positive,

82%

f tax advisors perceive the KRA as technically competent. Although the tax advisors' perception on efficiency of audits and independence of tax dispute process was slightly better than that of taxpayers, it was still poor.

The advisors from legal and accounting firms noted that though their relationship with the KRA has improved and is generally professional, it is often frustrating and has not translated to efficiency in resolving tax disputes for clients mainly because the KRA are unwilling to take positions on uncertain tax issues. Other concerns highlighted by the tax advisors included:

- capacity constraints within the legal team at the KRA due to high volume of cases, resulting in delays in the KRA meeting their legal timelines to respond to taxpayers' issues;
- the KRA's non-responsiveness to applications for private rulings within the stipulated time therefore delaying business decisions;
- Lack of clarity on persons responsible for issuing tax assessments at the KRA. In some cases, relationship managers have issued tax assessments to taxpayers;
- Perceived lack of coordination within the KRA. There have been instances where the compliance team have issued agency notices when appeals are on-going, and without involving the KRA legal team thus frustrating fairness in the judicial process.





5.4 Overall evaluation the relationship

Despite the challenges faced in the relationship between the KRA and taxpayers all parties agree that the relationship has improved over the years.

From the survey, 83% of the KRA officials expressed the view that the relationship has improved and attributed the improvement to increased transparency on the part of KRA, increased engagement of taxpayers in policy matters and increased taxpayer education. Some of the positive comments from taxpayers on the KRA included:

"the KRA are great professionals. And very helpful especially the relationship management team"

*"the KRA are headed in the right direction with customer care"
"The officials are professional"*

Despite the improvement, the current state of the relationship is still laced with mistrust.

Kenyan taxpayers perceive the KRA as primarily driven by the need to meet revenue targets and is thus aggressive. Despite most of the officials being technically competent, some officials are perceived as unwilling to help address taxpayers concerns and lacking in empathy. Some of the comments from taxpayers were:

"the KRA officers need to stop assuming that everyone is trying to evade paying tax. That mindset will go a long way in shaping the type of relationships they cultivate."

"Most of them are under a lot of pressure to collect taxes and this makes them unreasonable when handling tax issues"

"the KRA is obsessed with collection and targets, they are completely ignoring taxpayer concerns. The KRA contact centre is not helpful and are rather rude. Calls to the KRA lines go unanswered"

"They are smart but are guided by very strict targets and the voice of reason

is sacrificed at the altar of revenue collection"

"My representatives found them not willing to go out of their way"

On the other hand, a majority of the KRA officials perceive taxpayers as driven by financial gains thus unwilling to voluntarily comply and often engage in tax avoidance and evasion activities.

It was commendable that a majority of the KRA officials recommended increased stakeholder engagement and facilitation of taxpayers through education, provision of information and support as the solution to address the current state of relationship with taxpayers.

There were, however, comments from some tax officials which indicate a bias for use of coercion to ensure compliance as sampled below:

"It's about time we go back to the constant monitoring and in-depth audits to guard against loss of revenue."

"Kenya is not yet in the trust and facilitation era where taxpayers are at free will to do as they please and there is very minimal or lack of monitoring from the office."

The taxpayers present at the round table discussion were unaware and thus surprised at the view by the KRA that they engage in tax avoidance and evasion. This view may explain the perceived aggression by taxpayers and the extensive audits especially those targeted at MNEs.

On the positive side, both taxpayers and the KRA acknowledge the technical competence of the other which sets a good foundation for collaboration in design of sound tax policies and resolving disputes. In addition, there is willingness on both parties to foster a good relationship.

The KRA has taken a lead in this through improved customer care, more stakeholder engagement and increased capacity in the ADR department.

6.0

Conclusion and recommendations



A tax system with a high voluntary compliance rate is a more efficient tax system due to the high costs associated with enforced compliance. Use of both power and trust to ensure compliance is necessary. However, power, especially coercive power should only be used on taxpayers who are unwilling to comply to ensure perception of fairness in the tax system while trust and facilitation should be used for taxpayers who are willing to voluntarily comply

Building a trust relationship between the KRA and taxpayers requires input from both parties. The KRA has a responsibility towards taxpayers in helping them comply with the tax system and making processes efficient. The audit process, for example, can be made efficient through the use of data analytics to guide tax audits. Data analytics provides objective basis for identifying non-compliant taxpayers. This approach provides credible basis for tax audits instead of conducting arbitrary audits mostly targeted at large taxpayers. The size of and scope of operation of an entity should not be the main basis for suspicion of tax evasion and avoidance hence continuous audits. The KRA should also establish a framework to conduct tax audits to address current inefficiencies.

There should be a standard audit framework outlining the audit approach, required information, expected timelines and responsibilities of the taxpayer as well as the KRA officials. The audit framework should be communicated to all taxpayers in advance and followed by all officials and the KRA

officials should be required to issue reports of all concluded audits. To give taxpayers an opportunity to give feedback, the KRA should develop a platform where taxpayers and tax advisors can electronically submit feedback and proposals on tax policy matters to create a proper database. The feedback received should be acknowledged and responded to. Currently, majority of taxpayers and advisors do not perceive the KRA as open to receiving feedback which breaks trust required to effectively engage in tax policy matters.

The KRA should create a service level agreement (SLA) outlining the time that it will take officials to respond to taxpayer queries. These include advance rulings, applications for tax compliance certificates, applications for waivers of penalties and interest among others. The agreement should provide for recourse if the stated timelines are not kept. The SLA should be made publicly available so that the taxpayers can know what to expect when they have queries or make applications to the KRA. The current state is not transparent and does not foster trust thereby negatively impacts the relationship with taxpayers.

Further, the dispute resolution processes should be transparent, independent and fair. This, as already discussed enhances the feeling that justice is served and thus creates trust in the system. This encourages compliance with the decisions made. Where people feel that the adjudication system is not fair, then they are likely to defy the system



and, in some cases, disengage from the tax system as a whole. Such people instead seek to ways to completely avoid dealing with the revenue authority and paying taxes in general. The result is lower compliance rates and increased corruption as taxpayers attempt to defeat the system. The KRA should ensure independence of tax dispute resolution processes such as the ADR to build trust with taxpayers. The current measure to have the team handling objections is different from the audit team is a good starting point at creating independence.

However, the KRA should consult taxpayers so as to address the valid concerns they have raised. Further, to ensure expediency, the KRA should ensure that the ADR team has capacity to handle the volume of the cases submitted. This may include training more staff to handle the cases. Finally, the views of the taxpayers indicate that the SMEs in particular, have trouble accessing the KRA to receive administrative support. The recently enacted regulation declaring KRA offices to be protected zones that are only accessible with the authority of the Commissioner General further make the KRA inaccessible to the common mwananchi and draws back on the KRA strategy to build trust by facilitating compliance. The law should be repealed.

On the other hand, taxpayers need to play their role by being responsible citizens and voluntarily paying correct taxes. This requires an appreciation by taxpayers of the role of taxes in the growth

of their businesses. In addition to taxes being a legal requirement, they are an investment in the development of societies that allows businesses to thrive. Taxes are necessary for building societies that are peaceful, politically stable, with an educated, healthy and gender balanced labour force, good infrastructure and a consumer base with high purchasing power all of which are necessary for growth of any business.

It is thus imperative for taxpayers to be proactive in the design of a good tax system which would entail engaging tax authorities using legitimate channels, not using their economic resources to lobby for self-centred tax laws, providing constructive feedback on proposed tax policy measures since they best understand the impact and cost of applying a tax law, cooperating with tax authorities and helping them understand their business and ensuring transparency in reporting financial and tax information.

As stated, the traditional use of power to compel compliance has its limitations. Thus, if the KRA seeks to widen the tax base in Kenya then it must work on its trust relationship with the taxpayers. Ultimately, the legitimacy of the KRA is pegged upon the public's perception. If the taxpayers view it as being an unfair opaque, unempathetic entity, then they are unlikely to voluntarily comply. However, where trust in the relationship is fostered by ensuring procedural justice is upheld, then the use of coercive power, which is expensive, can be limited.



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