The Effect of Desk Tax Audit Practice on Tax Revenue Collection among Medium and Large Size Enterprises in Kenya

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Abstract

Purpose: Tax is a major issue of discussion for both developed and developing countries. For there to be significant progress in any nation, the government should look for ways of raising income to meet the needs of its citizens. The main objective of the study was to determine the effect of desk tax audit practice on Tax revenue collection among medium and large size enterprises in Nairobi region, Kenya. The study was guided by Lending credibility theory.

Methodology: The target population was 562 employees in the Medium Taxpayer Office and Large Taxpayers Office Nairobi region, out of which 234 was sampled, and 167 respondents managed to fill and return the questionnaires implying a 71.4% response rate. Primary data was collected using structured questionnaires that was filled by employees in Medium Taxpayers Office and Large Taxpayers Office in Nairobi region. The study employed an explanatory research design. Data was then analyzed using descriptive statistics, Pearson's correlation &regression model and finally Multiple regression model.

Results: The study further found that Desk tax audit had a positive and significant effect on tax revenue collection β =0.329 p-value =0.0000<0.05.

Recommendation: Based on the findings, the government should consider strengthening desk tax audit practices to enhance tax revenue collection. Policies could be developed to ensure regular and comprehensive desk audits are conducted to identify and address tax compliance issues promptly.

Keywords: *Medium and Large Size Enterprises, Desk Tax Audit Practice and Tax Revenue Collection*

1.0 Introduction

Tax revenue is described as funds collected from incomes of individuals and businesses categorized into direct and indirect taxes (OECD (2018). Tax revenue can speed up growth in the economy and fund government programs intended for the well-being of the citizens. When the government meets its annual tax revenue target, it is capable of funding budgeted expenditures for development programs in the fiscal budget (Andrejovska & Pulikova, 2018; Etim et al., 2020).

Revenue Collection refers to the process by which governments or other authorized entities gather money, typically in the form of taxes, fees, fines, or other charges, from individuals, businesses, or organizations. This revenue is used to fund public services, infrastructure, and other governmental functions. Revenue collection ensures that the government has the necessary funds to operate and provide for the needs of its citizens (OECD, 2019).

Revenue collection is a fundamental segment of financial policy and organization in any economy due to its impact on national government operations. It is the fuel of each government as it is the fundamental instrument through which government financing is guaranteed (Komolo, 2018). Government of Kenya raises most of its revenue by enhancing elasticity of the existing tax system that is, rationalizing and regulating expenditure through strict fiscal controls (Muriithi, and Moyi, 2020). The tax structure generally consists of the direct and indirect taxes. Regarding direct taxes, the factors that produce the incomes are assumed to pay the taxes, while for indirect taxes, households, families and firms that consume the taxed items pay the associated taxes (Chan, 2020). Direct taxes often include corporate tax, personal income tax, withholding tax, rental income tax, tax on interest in banks and presumptive income tax. An example of indirect tax is Value Added Tax.

Desk tax audit refers to a type of tax audit conducted by tax authorities where the examination of an individual or business's tax return is done remotely, typically at the tax authority's office, rather than through an in-person visit to the taxpayer's premises. This audit is mainly conducted through mail, email or phone (Mulyana, 2023). In this kind of audit, there is no official notice and the taxpayer only gets to know about it when he receives official letters requesting certain documents or explanations. The main reason for this is to ensure some level of compliance with the tax laws, rules and regulations as well as perform administrative checks on the returns submitted. (MUSA,2022).

The Kenya Revenue Authority (KRA) was established by an Act of Parliament, the Kenya Revenue Authority Act, which became effective on 1 July 1995. The Authority is charged with collecting revenue on behalf of the Government of Kenya. Kenya Revenue Authority (KRA), is an agency of the Government of Kenya that is responsible for the assessment, collection and accounting of all revenues that are due to the government in accordance with the laws of Kenya. The Authority is charged with the responsibility of collecting revenue on behalf of the Government of Kenya. A Board of Directors, consisting of both public and private sector experts, makes policy decisions to be implemented by KRA Management. The Chairman of the Board is appointed by the President of the Republic of Kenya. The Chief Executive of the Authority is the Commissioner General who is appointed by the Minister for Finance.

1.1 Problem Statement

Over 90% of the annual national budget funding in Kenya comes from the local taxes collected by the Kenya Revenue Authority (Kirchler, Kogler &Muehlbacher,2018). Therefore, since 1st July 1995, the Kenya Revenue Authority was charged with a responsibility of collecting revenue by an act of parliament (Muia and Afande, 2015). Revenue collection has varied from one year to the other for instance, KRA, FY 2017/2018 target was Ksh. 1.4 trillion and it managed 1.17 trillion (KRA performance review for 2017/2018), in the financial year 2018/2019, the authority collected 1.58 trillion representing performance rate of 87.9 % (KRA Performance Review 2018/2019). Despite the fact that there has been improvement in revenue collection, KRA has at times not been able to meet its target because of tax evasion especially among medium and large taxpayers.

Tax audit remains one of the major contributions to the improvement of voluntary tax disclosure and payment, hence raising more revenue despite research being done in this particular sector, there is a need for more research to be done so the study will focus on the effect of KRA tax audit practice on the Tax revenue collection among medium and large enterprises in Nairobi County.

2.0 Literature Review

2.1 Theoretical review

According to Olagunju & Owolabi, (2021) the lending credibility theory explains the primary function of auditing being addition of credibility to the financial statements by taking actions that demonstrate their commitment to thorough and unbiased auditing practices. In essence, they seek to establish their credibility by engaging in activities or behaviors that signal their dedication to providing accurate, reliable, and independent assessments of financial statements and internal controls in a way that stockholders, governments and creditors can make their decisions from the information with the faith that the information is true and fair and this increases their confidence in management.

Through this theory, auditors demonstrate their commitment to credibility by conducting a thorough examination of the client's financial records, transactions, and internal controls; They avoid conflicts of interest, undue influence, or bias that could compromise their ability to provide impartial assessments of the client's financial statements; Auditors enhance credibility by maintaining transparent communication with stakeholders, including clients, regulators, and shareholders; they adhere to established professional standards and guidelines to ensure the quality and integrity of their audit engagements by following recognized auditing practices, such as those set forth by organizations like the International Auditing and Assurance Standards Board (IAASB) or the Public Company Accounting Oversight Board (PCAOB); they maintain confidentiality, integrity, and professional competence, avoiding actions or behaviors that could undermine trust in their audit findings or compromise their ethical obligations and they also incorporate feedback, adopt best practices, and stay informed about emerging trends and developments in auditing to ensure the effectiveness and relevance of their audit engagements. (Olagunju & Owolabi, 2021).

According to Alardah, (2023), the theory is important because: It emphasizes actions that demonstrate sincerity, reliability, and commitment, therefore by taking tangible steps to signal credibility, individuals, organizations, or states can build trust and confidence among their stakeholders, counterparts, or citizens; in compliance contests, the theory suggests that credible enforcement efforts can promote compliance with rules, laws or standards; The theory also helps mitigate risks associated with uncertainty, mistrust or conflict by building credibility through actions that reduce ambiguity, uncertainty, or distrust, actors can mitigate risks, build resilience, and enhance their ability to navigate complex or challenging situations and finally Investing in credibility-building efforts can yield long-term benefits, including enhanced reputation, trust capital, and relationship resilience. (Oyinkansola, & Omodero, 2023).

Therefore, the theory provides a framework for tax authorities to enhance their credibility by conducting thorough and comprehensive desk tax audits through examining taxpayer records, transactions, and compliance with tax laws and maintaining transparency in their audit procedures. This will in turn increase the revenue as more taxpayers will be more compliant.

2.2 Empirical review

2.2.1 Desk Audit

D'Agosto et al. (2018) did research that provided an empirical contribution to deterrence analysis by assessing the influence of desk tax audits on revenue collection spanning the period from 2004 to 2009. Utilizing two distinct datasets—the Tax Return Register (Anagrafe Tributaria) and audit data from the Italian Revenue Agency (IRA) the study focused on self-employment and sole proprietorships. Employing a difference-in-differences approach, the research evaluated the effectiveness of three IRA audit policies: on-site audits (termed soft audits), desk audits (referred to as deep audits), and a combination of both. The findings indicated an overall positive impact of tax audits on deterrence, with the concurrent implementation of soft and deep audits demonstrating the most pronounced effect on revenue collection.

Ogutu, (2019) did research aimed establishing the impact of tax audits on excise duty tax in Nairobi, guided by specific objectives including assessing the effect of tax audits on excise duty collection in Kenya, determining the effectiveness of desk audits in this regard. A comprehensive review of existing literature was conducted to identify theoretical frameworks and empirical evidence, highlighting gaps in the research. Descriptive statistics and regression analysis were employed to ascertain the significance level. Spanning five years, from 2013 to 2018, the study utilized secondary data for analysis. Results indicated a positive correlation between tax audits and excise duty collection, suggesting a necessity for Kenya Revenue Authority's enhancement of tax audit procedures, particularly for excisable goods and services. The study demonstrated that tax audits contributed to 71.8 percent of excise duty collection and revealed a strong positive relationship among the study variables. Employing a descriptive research design, the study primarily relied on secondary data and employed stratified random sampling techniques within each stratum.

Magothe, (2019) did research on the effects of tax audits on value added tax revenue collection in manufacturing firms in Kenya. The target population was manufacturing sector in KRA Medium taxpayer office and study employed a descriptive research design. Secondary data was collected and the study adopted a time series data collection method, data was analyzed using SPSS software and multiple regression model. The study concluded that tax audit has a significant level of positive effect on VAT revenue collection.

2.2.2 Tax revenue collection

Tax revenue collection serves as the lifeblood of governments worldwide, providing the necessary funds to finance public services, infrastructure development, social welfare programs, and other essential functions. According to Gituma, (2017), tax revenue collection Refers to gathering of various government incomes from different sources. Sources of tax revenue include: income tax, PAYE, VAT, import duty, excise duty and other sources for payment of public or social goods provided by the government.
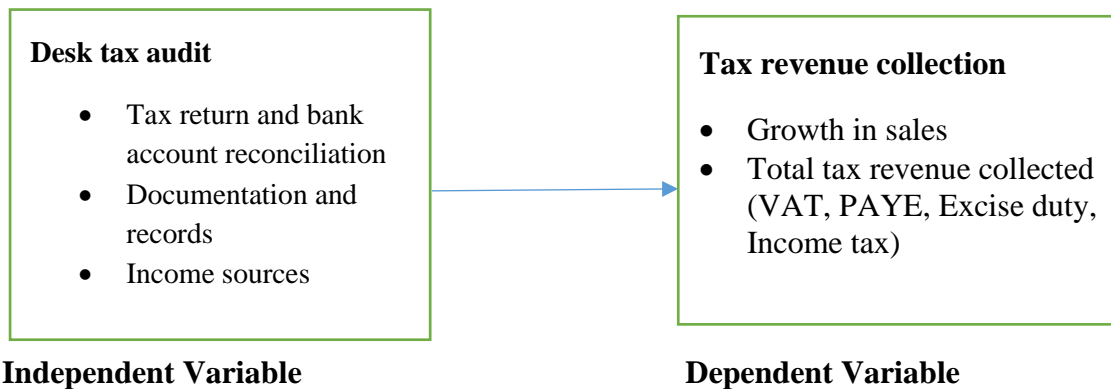
Tax revenue is a primary source of government funding, enabling the provision of public goods and services essential for societal well-being. Taxes fund education, healthcare, transportation, public safety, and other vital sectors, fostering economic development, social cohesion, and quality of life. Effective tax collection is crucial for maintaining fiscal stability, promoting long-term sustainability, and fulfilling government responsibilities (Guptac & Sharma, (2021).

Most governments employ various strategies to enhance revenue collection such as enacting tax policies that broaden tax base, putting into place strong administration and enforcement

mechanisms, international cooperation and advances in data analytics and technology. This particular study will focus on the impact of tax audit practice on revenue collection. Tax revenue collection will be measured by Growth in sales and Total tax revenue collected (PAYE, VAT, Excise duty and Income tax).

2.3 Conceptual Framework

This refers to a written or visual product that explain either in narrative or graphically the main things to be studied, variables or the concept, key factors, and the presumed relationship among them. It therefore presents a preferred approach to an idea or thought and outlines possible causes of action (Wong & Wai-Yee,2015). A conceptual framework is important in that it shows the relationship between independent variables and the dependent variable. As shown in figure 1, the independent variables will be desk tax audit practice tax audit and the dependent variable was Tax Revenue collection.

Desk tax audit

- Tax return and bank account reconciliation
- Documentation and records
- Income sources

Tax revenue collection

- Growth in sales
- Total tax revenue collected (VAT, PAYE, Excise duty, Income tax)

Independent Variable   **Dependent Variable**

Figure 1: Conceptual Framework

3.0 Methodology

Research design refers to a plan or a blueprint specifically created for collection, measurement, and analysis of the data; whereby the design can be influenced by available knowledge in the specific area being researched (Akhtar, 2016). This study employed an explanatory research design. The target population was 562 KRA Medium and Large Taxpayers office employees. Out of targeted 234 respondents, 167 managed to fill and return the questionnaires, the remaining 67 didn't respond.

The study through table 2 found that tax revenue collection had a Cronbach's α of 0.852>0.7, for desk tax audit practice Cronbach's α of 0.795>0.7, The study found that each of the responses for each of the items were reliable.

Table 1: Test of Reliability of Questionnaire

Factor	Number of Items	Cronbach Alpha score	Conclusion
Tax Revenue Collection	8	0.852	Reliable
Desk Tax Audit Practice	7	0.795	Reliable

4.0 Results and Discussion

4.0 Descriptive Statistics

Table 2: showed that the statement "Medium and large taxpayers have been responding to all the queries and concerns that have been raised to them" received a mean score of 4.01 (SD = 0.728), For the statement "The income sources stated in the taxpayer's iTax account match with the exact taxpayer's income source" received a mean score of 3.99 (SD = 0.957). The taxpayer provided all the information that I had asked him to provide, received a mean score of 4.06 (SD = 1.028), Desk tax audit practice by the KRA has greatly improved revenue collection among medium and large taxpayers" received a mean score of 3.92 (SD = 1.012), The item "The amounts in the bank statement match with the amounts of the invoices provided by the taxpayers" received a mean score of 4.07 (SD = 1.015), The item "The additional documents that I asked the taxpayer to present to KRA provided true and exact position of the business and were in line with the returns filed" received a mean score of 3.92 (SD = 0.677). The taxpayer had registered for all the tax obligations that are required of them" received a mean score of 3.97 (SD = 0.698).

Table 2: Desk Tax Audit Practice

Statements	N	Mean	SD	Skewness	Kurtosis
Medium and large taxpayers have been responding to all the queries and concerns that have been raised to them.	167	4.01	.728	-.018	-1.099
The income sources stated in the taxpayers Itax account match with the exact taxpayers' income source.		3.99	.957	-.853	.268
The taxpayer provided all the information that I had asked him to provide		4.06	1.028	-.795	-.559
Desk tax audit practice by the KRA has greatly improved revenue collection among medium and large taxpayers.		3.92	1.012	-.584	-.613
The amounts in the bank statement match the amounts of the invoices provided by the taxpayers.		4.07	1.015	-.984	.184
The additional documents that I asked the taxpayer to present to KRA provided true and exact position of the business and were in line with the returns filed.		3.92	.677	.095	-.798
The taxpayer had registered for all the tax obligations that are required of them		3.97	.698	.041	-.927

Table 3: found that the statement "Medium and large enterprises have voluntarily registered on ITax and voluntarily pay their taxes" had a mean response of 4.09 and a standard deviation of 0.877, The item "There has been significant growth in sales among medium and large taxpayers' enterprises" had a mean response of 4.04 and a standard deviation of 0.884, For

"Frequent desk, field, and automated tax audits conducted by KRA have greatly impacted the level of revenue Collection in the country" had a mean response of 4.01 and a standard deviation of 0.854, "According to the response received from the taxpayers, most organizations understand their responsibilities and adhere to them" had a mean response of 3.83 and a standard deviation of 0.833 "The current tax system is clear and fair among all the taxpayers" had a mean response of 4.02 and a standard deviation of 0.891, "There has been a significant increase in tax collection from medium and large taxpayers as a result of pre and post-audit practices" had a mean response of 4.08 and a standard deviation of 0.753, The statement "Fines and penalties payable by any organization after additional assessment have caused many companies to be voluntarily compliant" had a mean response of 4.01 and a standard deviation of 0.715.

Table 3: Tax revenue collection

Statements	N	Mean	SD	Skewness	Kurtosis
Medium and large enterprises have voluntarily registered on Itax and voluntary pay their taxes.	167	4.09	.877	-.582	-.449
There has been significant growth in sales among medium and large taxpayers' enterprises.		4.04	.884	-.547	-.542
Frequent desk, field and automated tax audits conducted by KRA have greatly impacted the level of revenue collection in the country.		4.01	.854	-.541	-.348
According to the response received from the taxpayers, most organizations understand their responsibilities and adhere to them.		3.83	.833	-.497	.165
The current tax system is clear and fair among all the taxpayers		4.02	.891	-.564	-.505
There has been significant increase in tax collection from medium and large taxpayers as a result of pre and post audit practices		4.08	.753	.000	-1.224
		3.98	.725	.157	-1.076
Fines and penalties payable by any organization after additional assessment have caused many companies to be voluntary compliant		4.01	.715	-.044	-1.026

4.2 Correlation Analysis

The correlation analysis was used to determine the relationship between each of the variables of the study and the significance of the relationship. Table 4 shows that the Desk Tax Audit Practice shows a strong positive correlation with Tax Revenue Collection, with a Pearson correlation coefficient of 0.588 and a significance level of p 0.010 < 0.05. This indicates that as Desk Tax Audit Practice increases, Tax Revenue Collection tends to rise significantly.

Table 4: Correlations Statistics

	Value added tax Compliance	Court Suits
Tax Revenue Collection	1	0.588**
Desk Tax Audit Practice	0.588**	1

**. Correlation is significant at the 0.05 level (2-tailed).

4.3 Regression Analysis

Table 5 showed that desk tax audit practice had a positive correlation with Tax Revenue Collection up to 58.8% or (R= 0.588). The results reveal that desk audit practice caused a variation of 34.5% or (R^2=0.345 and adjusted R^2 =0.337) on Tax Revenue Collection.

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.588a	.0345	.337	.43298

a. Predictors: (Constant), Desk Audit Practices _mean

Table 6 showed that there was a F statistic of 158.258 and p-value of 0.000<0.05, which indicates that the model was significant in explaining the variance caused by tax revenue collection.

Table 6: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	98.120	1	98.120	158.258	.000b
	Residual	102.456	165	.620		
	Total	200.576	166			

a. Dependent Variable: Tax revenue collection
b. Predictors: (Constant), Desk tax audit practice

Table 7 showed that unit change in desk tax audit practice caused a 0.329 increase in tax revenue collection. The study found that Desk tax audit had a positive and significant effect on tax revenue collection β =0.329 p-value =0.0000<0.05. The hypothesis was rejected.

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Table 7: Regression Coefficient analysis

Variable	Standardized β	Std. Error	t-Statistic	Unstandardized β	Prob.
constant	0.668	0.258	2.589		0.0105
Desk Tax Audit Practice	0.329	0.076	4.329	0.342	0.0000

4.4 Discussion of the Findings

The study's objective sought to determine the effect of desk tax audit practice on Tax revenue collection among medium and large size Enterprises in Kenya. The study's correlation analysis found that Desk Tax Audit Practice had a strong positive correlation with Tax Revenue Collection, with a Pearson correlation at 58.8%, $p = 0.010 < 0.05$. This indicates that as Desk Tax Audit Practice increases, Tax Revenue Collection tends to rise significantly. The study further found that Desk tax audit had a positive and significant effect on tax revenue collection β =0.329 p-value =0.0000<0.05. The study concurred with Musa, (2022) who researched the impact of desk audits on tax revenue generation in Nigeria. The study adopted quantitative research and sampled 384 respondents out of 9448 employees of federal Internal Revenue Service in Nigeria and the findings revealed that desk audit has a positive and significant effect on revenue generation in Nigeria.

5.0 Conclusion

The study sought to determine the effect of effect of desk tax audit practice on Tax revenue collection among medium and large size Enterprises in Kenya., the study concluded that desk tax audit positively impacted tax revenue collection.

6.0 Recommendations

Based on the findings, the government should consider strengthening desk tax audit practices to enhance tax revenue collection. Policies could be developed to ensure regular and comprehensive desk audits are conducted to identify and address tax compliance issues promptly. Future research should explore the effects of tax system automation on tax revenue collection

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