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Effect of Tax Reforms on Revenue Collection at Customs and Border Control Department of Kenya Revenue Authority

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Abstract : *Tax reforms play a vital role in an economy of any country by improving its tax systems. Kenya has experienced significant changes in its economy over the last four decades. The government needs to increase its tax revenues in order to meet social obligations. Despite the undoubted good intentions of the KRA, and a general increase in capacity within the organization as a whole, tax revenue has failed to show any signs of the dramatic increase hoped for. The study sought to establish the effect of tax reforms and modernization programs on tax revenue by the Customs and Border Control Department. In particular the study examined how reforms in customs enforcement affected tax revenue. The study reviews both the theories of public expenditure and optimum income taxation. The study adopted descriptive research design. The target population constituted the 126 employees working with the Customs and Border Control Department of Kenya Revenue Authority. A two stage sampling method was utilized. The purposive sampling was used to get the border posts that were sampled while the simple random sampling was used to get the 56 respondents from the selected border posts. A pilot study was conducted prior to the main study in order to assess the both reliability and validity of the research instrument. The data collected was analysed with the help of the Statistical Package for Social Sciences software. The predictive effect of customs department structure reforms on tax collection revenue was examined using the simple linear regression. The relationship between customs enforcement reforms and tax revenue collection is a weakly positively correlated but not statistically significant. The study recommended that the customs enforcement reforms leading to more tax collected per customer should be given more examination due to its high standard deviation.*

Key Words: *Tax Reforms, Revenue Collection*

I. Introduction

Tax reform is aimed at raising adequate revenues to finance public expenditures on social goods and services. The issue has grown in importance in light of the recent fiscal crises in most countries. According to Bird (2013) the fiscal crises have been proven to be the mother of tax reforms in most countries. The views of tax reform to mobilize tax revenues have been increasing in the field of public finance among the academia and international institutions because countries are faced with declining external assistance in general. The recent global crisis has put considerable strain on inflows of international resources which have effectively forced these countries to focus on domestic resource mobilization.

Actual empirical evidence on the impact of globalization on tax policy remains quite mixed. Although there have been some changes in tax policies along the predicted lines, to date these changes on the level of collections, the composition of revenues, the convergence in tax rates have been minimal, even when present (Bird, 2013). While the economics of these changes may well be plausible, the process by which they occur seems slow, erratic, and uncertain, and disentangling the empirical evidence remains difficult. Faced with these difficulties, some analysts have applied a standard tax competition model to globalization issues (Zodrow and Mieszkowski, 2006). Zodrow and Mieszkowski (2006) assume labour is taxed and capital is mobile, and that globalization adversely affects consumer welfare due to the externality imposed by capital mobility. In particular, increased tax competition (that is, globalization) leads to lower public good provision and inefficiently low tax rates on the mobile factor. By contrast, the Leviathan view of government argues that government competition is beneficial because it reduces the size of government and wasteful government bureaucracy. Janeba and Schjelderup (2009) combine these two strands of literature to examine the effect of increasing capital mobility (globalization) on the externality and the possible reduction of rents to politicians.

Sound fiscal responsibility is central to achieving macroeconomic stability and ensuring that the benefits of economic growth. On the revenue side, the Government must continue its efforts to broaden the tax base through tax policy reforms and modernization of domestic tax and custom administration (Bird, 2009). The key to successful public finance management is a matter of governance to balance the economic, managerial and political roles of public finances. When fiscal governance is poor has a little chance of succeeding the fiscal policy objectives. The Government will also pursue comprehensive civil service reforms aimed at improving the efficiency of delivery and quality of public services, improving taxation through payroll management and enhancing a regular auditing to create a further fiscal space. It is viewed that in most emerging economies fiscal governance is reflected only in how deep a country can cut into its fiscal deficit, rather promoting a better tax system to mobilize more revenue to prevent it (Djankov et al., 2010).

Ghana's tax reforms constitute the major policy instrument needed to accelerate growth and poverty reduction (Osei, 2006). Ghana's major changes in tax administration fiscal policies played a key role in improving the country's revenue mobilization and overall fiscal health. The prime factors cited for the increase in revenue are the expansion of tax base, the structure of taxation; and reorganization of the tax administer. The administrative reforms in Ghana centered on removing the revenue institutions from the Civil Service and granting them operational autonomy, with a view to improve efficiency through enhanced work and employment conditions. Two practical steps were taken in Ghana in 1985 to strengthen revenue administration in the country. These were the establishment of the National Revenue Secretariat (NRS) and the creation of the two major revenue organizations, the Customs, Excise and Preventive Service (CEPS) and the Internal Revenue Service (IRS), as autonomous institutions outside the civil service (Terkper, 2004). The three factors primarily cited for the increases in revenue are: the expansion in the bases of taxation as a result of liberalizing the economy; the changes made to the structure of taxation; and the extensive reorganization of the institutions that administer taxes in the country.

In Uganda, a key element of the administrative reform was to move the existing revenue department out of the Ministry of Finance into a semi-autonomous revenue authority overseen by an independent Board of Directors. The philosophy behind this move was mainly to provide incentives for the staff to improve their performance and thereby increase revenues. The reform appeared to be a success in URA's (Uganda Revenue Administration) as reported revenue increased sharply - from 7% of gross domestic product (GDP) in 2007 to around 12% of the GDP in 2013 (Fjeldstad, 2013). Corruption also seemed to decline. These circumstances necessitated policy makers to pursue a rapid increase in domestic revenue and a corresponding increase in public services; and rebuilding of government's revenues base has been of the key features of Uganda's economy recovery.

Fjeldstad (2006) noted that after marked success, revenue has dropped as a share of GDP and corruption is believed to be pervasive. People in such positions of power are expected to use that influence to help their kin and community of origin. This implies that such social relations may rule out the formal bureaucratic structures and positions. If these problems are rooted in social norms and patterns of behavior by administrative officers, as a consequence, reforms that otherwise seem consistent with principles of good public administration may be undermined. Kenya has experienced significant changes in its economy over the last four decades. One of the striking characteristics of Kenya at present is that unlike many other Sub-Saharan countries today, it is a high tax-yield country with a tax-to-GDP ratio of over 20 per cent. As a result, Kenya is able to finance a large share of its budget, while external donor finances are used to cover a much smaller share than in other countries of the region. Presently, external donors' aid forms a paltry 3.9% while the bulk of government expenditure is financed through taxation, which the government aims to keep at or above 22% of GDP (GoK, 2014). This however does not mean that Kenya has a high tax collection ration since its base is still extremely narrow. According to Murithi and Moyi (2013), like most developing countries, Kenya has had to contend and still contends with the common problems that plague tax systems of developing countries. These, they identify to include, the existence of tax systems, with rates and structures that are difficult to administer and comply with and that are unresponsiveness both to growth and discretionary tax measures hence offering low tax productivity. In addition, the tax collection strategy raise little revenue but introduce serious economic distortions as well as provide opportunities for differential treatment of individuals and businesses in similar circumstances, and that are selective with regard to tax administration and enforcement, and skewed in favour of those with the ability to defeat the system. This means that for the country to increase its revenue collection, it needs to modernize its collection policy and carry out the necessary tax reforms that will yield an increased tax base.

Even though the tax system has continuously changed, in pursuit of the objectives of the Tax Modernization Programme that came into force in 1986, the challenges that confront the tax authorities today are not much different from the pre-reform challenges. With Kenyan firms reporting that about 68.2% of profit is taken away in taxes, tax competitiveness is low and the country remains among the most tax unfriendly countries in the world. Tax evasion remains high, with a tax gap of about 35% and 33.1% in 2000/1 and 2001/2 respectively (KIPPRA, 2004). The tax code is still complex and cumbersome, characterized by uneven and unfair taxes, a narrow tax base with very high tax rates and rates dispersions with respect to trade, and low compliance (KIPPRA, 2004). Additional challenges include tax systems with rates and structures that are difficult to administer and comply with, are unresponsive to growth and discretionary policy hence low productivity, raise little revenue but introduce serious economic distortions, treat labor and capital in similar circumstances differently and are selective and skewed in favor of those with the ability to defeat the tax administration and enforcement system (KIPPRA, 2004).

II. Literature Review

Theoretical Review

The theoretical review was based on the theory of public expenditure, institutional theory, optimum income taxation, and theory of public expenditure. The theory of public expenditure was advanced by Peacock and Wiseman (1961) and was based on the political theory of public expenditure determination which states that the government likes to spend more money, citizens do not like to pay more taxes, and that government needs to be more attentive to the aspiration and wishes of its citizenry. The theory sought to explain the circular trend or time pattern of change in government expenditure in response to development in the political economy while at the same time, the taxable capacity of the citizens is a constraint (Kanyi, 2014).

The public expenditures theory further states that government expenditures are largely determined by government revenue and taxation. To this effect, the theorists opined that as the both economy and income grew, tax revenue would inevitably rise. This consequently enables the government expenditures to rise in tandem with Gross National Product (GDP). There is a feeling that the level of taxation that acts as a constraint is tolerated. Moreover, it is asserted that there may be discrepancies between a desirable level of taxation and government expenditure (Baghebo, 2012). In the context of customs reforms and modernization and tax revenue, the theory of public expenditure can be employed to explain the link between the government's efforts to raise the tax collected from its citizens in order to address its development agenda and its capacity to raise the desired tax revenue.

The optimum income taxation theory was pioneered by Mirrlees (1971) though in the recent past there are a number of theorists who have examined it including Creedy (2009), O'Brien (2009) and Sorensen (2010). The theory postulates that in any economic system where equality is valued, the assumption is, income taxation would be a vital instrument of policy. It is further stated that the redistributive progressive taxation is often linked to a man's income. Mirrlees observed that, due to the use of people's economic performance as evidence of their economic potentialities, absolute equality of social marginal utilities of income ceases to be desirable for the tax system that would bring about that result would completely discourage unpleasant work. The foregoing observation leads to a number of queries regarding the kind of principles that are supposed to govern optimum income tax, the nature of the tax schedule, and the degree of inequality upon the establishment of the tax schedule.

Recent advances in optimal tax theory have made the theory far much easier to apply and could possibly facilitate to explain some of the current trends in international tax policy (Sorenson, 2010). According to O'Brien (2009), the classical political economists came up with a normative analysis of tax policy which tended to follow a principles-oriented approach where it was stated that a good tax system ought to satisfy certain desirable criteria. According to this theory, tax system should be productive, computable, popular, equal, frugal, divisible, and incorruptible. It is exemplified that in the event that the social welfare issues implied by the current tax system are not monotonically decreasing with the taxpayer's level of income, it would presumably be difficult to defend such a system and as such reforming the system would be considered. The optimum income taxation theory can be adopted to explain the necessity of reforming the customs system with a view of maximizing tax revenue.

The institutional theory emerged in 1970s. The theory emphasizes on how modern organizations depend on their environments. From a linear perspective, it is postulated that this theory holds that organizations are affected by institutions built in much wider environments (Meyer, 2007). Amenta (2005) holds that all institutional theoretical claims identified at higher levels are used to explain processes and outcomes at lower levels of analysis. It is asserted that institutionalists are likely to avoid both individual-level explanations and explanations situated at the same level of analysis. The foregoing make them to be criticized as structural biased. Institutional theory is applicable to the Kenya Revenue Authority operations since KRA is influenced by different institutions; notably political institutions. As such, the systems put in place to administer tax and their implementation is partly politically instigated. The same must be in line with relevant legislations which imply that there exists legal institutions that influence the operations of the KRA.

Customs Enforcement Reforms

It is asserted that there are three crucial forces that impact on the role of customs administration in the 21st century. The first touches in revenue maximization; the second is a demand for customs to play a bigger part in facilitating trade in tandem with preferential trade agreements; and the third is the requirement for customs to assume more enforcement responsibilities. According to Buyonge's (2007) study that focused on Africa's customs issues, the future role of customs administration in Africa, particularly in regard to inevitable modernization and reform, will be required to respond appropriately to the demands for revenue optimization and enforcement of regulatory policies and practices. This will be achieved through adjustment to both national and international imperatives.

When studying reforming tax policies and revenue mobilization in East and West African countries, Kefela (2009) observed that simplicity and enforceable laws are part of any successful administrative reforms. It is argued that it is important to simplify procedures for taxpayers, for instance, by get rid of unnecessary information on tax returns and payment invoices. The author further says that, once the tax procedures are simplified, the customs officials can manage to focus on the core tasks which include facilitating compliance, monitoring compliance and dealing with non-compliance. It is asserted that customs enforcement is difficult particularly in developing countries due to the presence of large informal sector. Low literacy levels, low public morality, poor salary structure for civil servants, poor communication infrastructure, malfunctioning judicial systems and vested interests against radical reforms (Auriol & Warlters, 2002).

A study was conducted on responses by Kenya Revenue Authority to the challenges encountered in the implementation of the customs' reforms and modernization – CRM (Ondiek, 2013). In particular the study sought to establish how KRA implemented the CRM program, the challenges in the process of implementing the same, and how the Authority responded to those challenges. The study revealed that the greatest challenges encountered by KRA were resistance to change, lack of requisite skills, lack of resources, and also lack of a supportive telecommunication infrastructure. The Authority responded to the aforestated challenges through training and sensitization of the staff and stakeholders. More so, the challenges were addressed by hiring new employees with the requisite skills. Political support and management style were also key to the implementation of CRM initiatives.

Nada and Jack (2009) examined tax reforms in Kenya particularly in regard to policy and administrative issues. The study acknowledges that tax system in Kenya has undergone perpetual reform over the past two decades. For instance, from the policy perspective there has been rationalization and simplification of rate schedules, a new value-added tax introduced, and external tariffs brought on board in order to tally with those of East African countries. It is observed that it is imperative to have continued reform of both policy instruments and both administrative and enforcement capacity of the tax system. This is against the backdrop of the KRA's revelation that, there are certain entrepreneurs and members of certain professional bodies who are required to register their annual turnover independently; however, this requirement is hardly enforced. In addition, it is in the public knowledge that the KRA's major focus is tax collection and as such seeks to maximize revenue on behalf of the national government. Moreover, it is noted that refund payment is low on its list of priorities. Nevertheless, the authors argued that this policy may be self-defeating in the event that compliance falls or is not enforced.

III. Objective Of The Study

To examine the effect of customs enforcement reforms on tax revenue by customs and border control department in KRA.

IV. Research Question

What effect does customs enforcement reforms have on tax revenue by customs and border control department in KRA?

V. Methodology

The study adopted descriptive research design Descriptive research design according to Kothari (2004) is diagnostic in nature which means the study will seek to establish the relationship between each of the independent variables (customs enforcement reforms) and the dependent variable (tax revenue).). The target population constituted 126 employees working with the Customs and Border Control Department of Kenya Revenue Authority at the various border posts. These employees were targeted due to the fact that, they are the most conversant persons in regard to tax reforms and tax revenue. This study employed Nassiuma's (2009) formula to calculate the size of the sample. The formula to scientifically derive the sample from the target population is illustrated hereunder.

$$n = \frac{NC^2}{C^2 + (N-1)e^2}$$

Where

n = sample size
N =size of target population
C = coefficient of variation (0.5)
e = error margin (0.05)
Substituting these values in the equation, estimated sample size (n) will be:
n = 126 (0.5)2 / (0.52+ (126-1)0.052)
n = 56 respondents

The sampling method was done in two stages. The first stage was the purposive sampling of the border posts that were included in the study. There are eighteen border posts including Lamu, Kiunga, Kisumu Pier, Mandera, Liboi, Elwak, Dif, Moyale, Lokichongio, Busia, Malaba, Lwakhaha, Muhuru Bay, Isibania, Namaga, Loikotok, Taveta, and Lunga Lunga. The purposive sampling was used to derive three border posts that were extremely busy that is Namanga, Busia, and Malaba, hence ability to give the required information. The three border posts were also relatively closer to each other hence reducing on the logistical and cost challenges of data collection.The second stage involved the simple random sampling to derive the 56 respondents within the three border posts. This method was chosen because of elimination of bias as each respondent has an equal chance of being selected. The sample size of this study was 56 members necessitating distribution of 56 questions for the purposes of data collection. Out of the 56 distributed questionnaires, only 50 questionnaires were returned which constituted 89.28% of the total distributed questionnaires. A further 6 questionnaires were discarded due to partially filled questionnaires, and indication of identifiers such as names. Therefore the total number of the questionnaires that were analyzed were 44 questionnaires.

VI. Findings And Discussions

The examination of the customs enforcement reforms on tax revenue by customs and border control department in KRA were examined using five questions;

i. The customs enforcement reforms will lead to more overall tax being collected
ii. The customs enforcement reforms will lead more diversified ways of curbing tax evasion
iii. The customs enforcement reforms will enable best practices adoption in tax policies
iv. The customs enforcement reforms will lead to more customers paying up the required tax
v. The customs enforcement reforms will lead to more tax collected per customer

The likert scale of Strongly Agree (SA), Agree (A), Uncertain (U), Disagree (D), and Strongly Disagree (SD) was used. The means and the standard deviations of the customs enforcement were examined through use of the descriptors Strongly Disagree (SD), Disagree (D), Uncertain (U), Agree (A) and Strongly Agree (SA) represented as 1,2,3,4 and 5 respectively in the SPSS input spread sheet. The interpretation of the scores $1<\mu<1.5$, $1.5<\mu<2.5$, $2.5<\mu<3.5$, $3.5<\mu<4.5$, and $4.5<\mu\leq 5$ where μ represents the mean were that the respondents on average tended to strongly disagree, disagree, be uncertain, agree and strongly agree respectively in relations to the given metric. In this context, the customs enforcement reforms leading to more overall tax being collected, diversification of ways to curb tax evasion, adoption of best practices in tax policies, more customers paying up the required tax, and more tax collected per customer had means of 3.8864, 3.2727, 4.0682, 3.7045, and 3.0227 respectively. This meant that in respect to the customs enforcement reforms leading to more overall tax being collected, adoption of best practices in tax policies, and more customers paying up the required tax the respondents tended on average to agree with these metrics since their μ fell within $3.5<\mu<4.5$ bracket. On the other hand, in relations to customs enforcement reforms leading to diversification of ways to curb tax evasion, and more tax collected per customer had means of 3.2727 and 3.0227 since their μ fell on the $2.5<\mu<3.5$ bracket. In relations to the standard deviations, the customs enforcement reforms leading to more overall tax being collected, diversification of ways to curb tax evasion, adoption of best practices in tax policies, more customers paying up the required tax, and more tax collected per customer had standard deviations of 0.68932, 0.58523, 0.62497, 0.92960, and 1.13073 respectively. This indicates that the responses to the metrics were moderately distributed apart from the metric on more tax collected per customer which the responses were widely distributed.

Table 1; Customs Enforcement Reforms Descriptive Reforms

	N	Mean	Std. Dev
The customs enforcement reforms will lead to more overall tax being collected	44	3.8864	.68932
The customs enforcement reforms will lead more diversified ways of curbing tax evasion	44	3.2727	.58523
The customs enforcement reforms will enable best practices adoption in tax policies	44	4.0682	.62497
The customs enforcement reforms will lead to more customers paying up the required tax	44	3.7045	.92960
The customs enforcement reforms will lead to more tax collected per customer	44	3.0227	1.13073
Valid N (listwise)	44		

VII. Conclusion

The relationship between each of the independent variable on the dependent variable was examined using the linear correlation as illustrated in

Table . The objective was to check on whether there was a significant statistical relationship between the independent variable and the dependent variable.

Table 2; Correlation of Independent Variable on Dependent Variable

		Tax Revenue Collection
Customs Enforcement Reforms	Pearson Correlation	.062
	Sig. (2-tailed)	.691
	N	44

The relationship between customs enforcement reforms and tax revenue collection is a weakly positively correlated but not statistically significant.

VIII. Recommendations

The study recommended that the customs enforcement reforms leading to more tax collected per customer should be given more examination due to its high standard deviation.

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