



## IMPACT OF ENHANCED TAX LITERACY LEVELS ON REVENUE MOBILIZATION: A CONCEPTUAL ANALYSIS

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### Abstract

*Taxation plays an important role in Kenyan economy as it enables mobilization of public resources for provision of essential services to citizens and enhancing national development. It is in the best interest of both the tax authorities and citizens that adequate revenue is raised. However, for a taxpayer, tax takes away their revenue and would wish to avoid it at all costs. Tax education serves create appreciation of the role of tax hence enhance cooperation. In the recent past, tax there has been enhanced tax literacy gained from online platforms, advertisements, tax clinics, professional bodies like ICPAK, tax publications, tax agencies and so on. The enhanced tax literacy may as well have counterproductive effect as taxpayers may have use such literacy, for instance, to exploit the loopholes. It is not clear however, whether, the overall enhanced tax literacy has significant influence on revenue mobilization in Kenya. The purpose of this paper was to investigate the impact of tax literacy levels on revenue mobilization. This is a conceptual paper which utilizes secondary data and information through review of literature to gain an understanding of this phenomenon. The paper found that revenue mobilization through enhanced literacy can be achieved when the authorities focus on the long-term rather than short-run strategies. Also, literacy should not only focus on the existing taxpayers but as well include the would-be tax payers in order to inculcate the tradition of taxpaying*

*well in advance. Additionally, the paper finds that there is increased digital space globally and the tax authorities should exploit these channels in enhancing tax literacy among both the potential and current taxpayers. Finally, further examination is paramount on the aspect of 'tax literacy' other than tax knowledge, in regard to its role in taxpayer compliance.*

*Keywords: Taxation, tax literacy, tax compliance, revenue mobilization, digital economy, Kenya*

## **INTRODUCTION**

Tax is generally defined as compulsory contribution by the citizens to the state to enable the state carry out its functions and provide essential services to the citizens. The state levies such taxes through an agency, in case of Kenya, the Kenya revenue Authority (KRA). The compulsion aspect perhaps emanates from the fact that, the amount contributed by the tax payer need not be commensurate with the services enjoyed from the state. In fact, in many instances, those who pay the least tax may be the greatest beneficiaries of those services. It would therefore be difficult to convince a taxpayer to voluntarily make contribution if you cannot assure them of commensurate service. However, for the government to function well and meet its obligations and objectives, it must raise sufficient revenue from taxes. Taxes are usually levied on the basis of ability to pay so as to achieve some form of equity.

Even if tax is a compulsory contribution, the tax payer has a right to know how much the tax obligation is, and how that amount was arrived at. The tax payers are increasingly becoming sensitive on tax matters and seek for information and clarification where necessary. Apart from the taxpayer education forums organized by the education department of KRA, there is increased knowledge space created by the media, both the mainstream and social media. Taxpayers can now access whatever tax related information they need with very little ease than ever before, which contributes to a great extent on tax compliance.

The benefit of enhanced taxpayer knowledge is of course the potential to increase tax revenue from voluntary compliance. According to Adam (2012), tax knowledge is an essential element in a voluntary compliance tax system, particularly in determining an accurate tax liability. It is argued that tax knowledge is the most influential factor in determining taxpayers' compliance behaviour under the self-assessment system (Wadesango *et al.*, 2018). Tax education helps the tax payers to appreciate that by making contribution to the state, they are taking part in the economic and social development of the state, which in turn would benefit the general citizenry, including themselves. This will in turn motivate self-compliance. However, behavioural science theorists hold the view that, a taxpayer would be reluctant to pay their tax

obligations unless the probability of being caught is high and the penalty outweighs the gain of failure to comply (Allingham and Sandmo, 1972).

Together with the reasonable tax rates and simple filing procedures, it is one of the major principles governing a good tax system. Further, it is an essential determinant with significant influence on tax compliance (Wadesango and Mwandambira, 2018). Proper tax literacy on the taxpayer weeds out distrust as well as negative attitudes towards tax, with previous studies observing close association between the taxpayer's ability to comprehend tax laws and regulations and their ability to comply. However, the general understanding of the common tax policy concepts, for example the progressive taxation is not adequate (Roberts, Hite and Bradley, 1994). Some of the studies carried out in United States and United Kingdom relating to the citizens' attitudes, perceptions, understanding of taxes as well as tax policy, observed that public are "indeed remarkably misinformed and/or confused" (Fauziati, Minovia, Muslim and Nasrah, 2016)

In order to achieve revenue generation targets, tax compliance by all the tax payers is paramount. Saad (2014) defined tax compliance as filing all the necessary tax returns at the appropriate period and that the returns accurately as well as reliably report tax liability as per the tax laws applicable at the time of filing the returns. Typically, it can be conceptualized to mean, actual disclosure of the tax base, proper or accurate calculation of tax liability, timely returns filing as well as remission of the amounts due. According to Franzoni (2000), tax compliance can as well be construed to mean an individual act of filling the Income Tax Form, disclosing all taxable income (s) accurately, as well as distributing all taxes payable within the set out period without having to wait for follow-up actions from the authority. Tax compliance scope as asserted by Alm, McClelland and Schulze (2012) incorporates disclosure of income as well as remitting all taxes based on the relevant applicable laws, regulations together with the decisions of the court. However, tax compliance emanating from improved tax knowledge is only effective in an economy with reasonable tax rates. Increased tax literacy coupled with high tax rates and complicated filing procedures worsens on tax compliance with Fierre-Seren and Panades (2013) arguing that knowledgeable taxpayers do not necessarily pay more taxes.

Previous studies on revenue mobilization emanating from tax compliance provided mixed results. In the United States of America, Australia and Singapore, Bobek, Robin and John (2007) experimental study that applied a hypothetical tax scenario investigated the taxpayer's noncompliance attitude found that Singaporean taxpayers had the lowest noncompliance rate at almost 26 percent, with the Australian taxpayers leading at 45 percent. In addition, the findings suggested that total compliance was highest in Singapore (at 54 percent) and lowest in Australia (at 30 percent). The United States was in the middle both in terms of compliance as

well as noncompliance rates. An exploratory cross cultural study in Hong Kong and Australia on tax fairness perception and tax compliance behavior observed that the taxpayers in Australia were generally more tax compliant as compared to the Hong Kong ones.

In addition, Eriksen and Fallan (1996) quasi-experiment study on tax knowledge and attitudes towards taxation observed significant changes in respect to the taxpayer's attitudes and behavior towards tax, which was attributed to the enhanced degree of tax knowledge. In agreement to the findings was Palil (2010) self assessment tax system study in Malaysia, that observed positive significant relationship between tax knowledge and tax compliance. In USA as well, Jones (2009) found that several factors contributed towards understanding and improving use-tax compliance among the taxpayers, among them the fairness of the use tax as well as the perceived knowledge of the use tax by the individual taxpayer.

Other studies that observed positive impact of tax knowledge on the tax compliance includes that of Mukhlis, Utomo and Soesetio (2015); Oladipupo and Obazee (2016); Ali and Ahmad (2014). However, contrary results by Fauziati, Minovia, Muslim and Nasrah (2016) survey study in Indonesia on small and medium enterprises (SMEs) indicated that tax knowledge is not a determining factor on tax compliance. Cvrlje (2015) reported a weak correlation between tax knowledge and attitudes towards tax compliance. Also, as per Brainnyah (2013) tax knowledge aspect that comprises of general knowledge, legal knowledge as well as technical knowledge in the study did not significantly affect tax compliance behavior of SMEs. Nevertheless, Hofmann, Voracek, Bock and Kirchler (2017) meta-analysis on the association between compliance and particular socio-demographic categories indicated inconsistent outcomes, in terms of the association direction as well as its magnitude.

Moreover, studies carried out in first and second world economies have observed positive relationship between tax knowledge and enhanced revenue generation. For instance in Malaysia, tax knowledge was considered as the most influential aspect in determining taxpayers' compliance behavior under the self-assessment system (Loo, 2016). In the United Kingdom (UK), Harris (2013) investigation about tax knowledge acquired through formal education as well as one specifically targeted towards possible loopholes to evade tax, found that tax payers were tax literate in regard to the tax laws and regulations. The formal tax education, it is gained through public lectures In effect, it contributed greatly towards revenue mobilization, from both formal and informal sectors. Past studies have indicated that general tax understanding has a very close association with taxpayers' ability to understand the tax laws and regulations, as well as their ability to comply with them (Singh, 2003).

With the provided evidence that tax knowledge has an effect towards understanding of taxpayers, one of the questions that has been raised by past researchers (Eriksen and Fallan,

1996; Harris, 1989; Singh, 2003) is if indeed enhancement of tax knowledge results into increased revenue collection through tax compliance. Further, in developing economies, what remains unclear is the level of tax literacy among the tax payers especially in the informal sector vis-à-vis tax compliance, manifested through revenue generation.

This paper makes several original contributions. First, while appreciating the role of education, it argues that, tax payer education should have certain focus to achieve enhanced revenue mobilization objective. Secondly, the paper suggests that some education avenues are more productive than others. This paper expounds on the role of justice, equity and fairness in the taxpayer education. Finally, this paper recognizes the widened digitalized economy and argues that this can leverage and optimize tax literacy and hence revenue mobilization.

## **THEORIES ON TAX LITERACY AND REVENUE MOBILIZATION**

### **Theory of Planned Behaviour**

The theory of planned behaviour (TPB), as originally discussed by one of the founders of the theory of reasoned action, Icek Ajzen, argues that the key determinant of whether an individual will involve him/herself in a particular behavior is the purpose to undertake the behavior itself, that is, the more the intention to carry out the behavior, the higher will be the likelihood of an individual towards engaging in the behavior (Ajzen, 1991). Another key aspect behind TPB is the suggestion of three major determinants related with an individuals' intention to undertake an action: social factors (referred to as subjective norms), an individuals' attitude towards the questioned behavior, as well as perceived behavioral control. The social factors relates to how the society impacts on a person's behavior. For the perceived behavioral control, it concerns with the level of control an individual believes he/she has over a specific action (Beck and Ajzen 1991; Taylor and Todd 1995). Previous research that has applied the TPB theory is Bobek and Hatfield (2003) study on TPB and the role of moral obligation in tax compliance. The results were in agreement with the TPB model's predictions for the USA federal tax compliance intentions.

The TPB theory has been applied together with the theory of reasoned action towards explaining the taxpayer's decision choice (Mauldin and Arunachalam, 2002) as both are appropriate towards explaining on the taxpayer compliance behavior. Also, they act as a good starting point for an integrated tax compliance decisions model. However, recent studies have utilized the TPB over its predecessor, the theory of reasoned action. A generalized diagrammatical representation of the TPB model is shown in Figure 1.

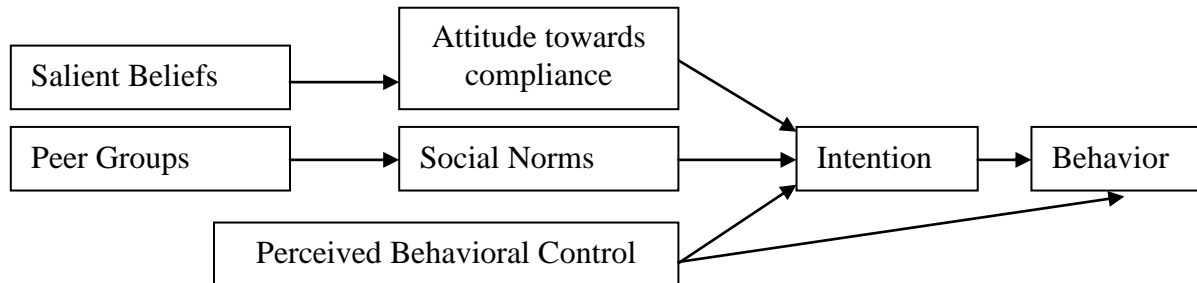


Figure 1: General model of the theory of planned behavior

Source: Adopted from Jones (2009)

### Theory of Reasoned Action

The theory of reasoned action (TRA) as brought forward by Martin Fishbein and Icek Ajzen in 1967 was derived from past studies in social psychology, persuasion models, and attitude theories. It helps to understand a person's voluntary behavior through examination of the underlying basic motivation to perform a certain action. The theory can be traced on the taxpayer's behavioral situations, where the behavioural performance in the theory as argued by Fishbein and Ajzen (1975) can be predicted from people's intentions. TRA focus is on behavioural intention as antecedent to actual behaviour. The theory major focus is on behavioural aspirations as a precursor to the actual behavior (Zainol, Faridahwati and Zainudin, 2014). In order to comprehend a certain person's behavior (such as the taxpayer behavior), it is paramount first to know the factors behind the behavioral intentions. The TRA provides two independent determinants of an individual behavior: attitude towards behavior as well as the subjective norms. Attitudes are influenced by certain belief regarding an outcome where its level will be measured based on the outcome evaluation. The subjective norms (underlies normative belief) is influenced by one's belief on a referent other or group, that is, a person will attempt to perform an action when he/she believes it has got the approval of other people (Ajzen & Fishbein, 1980; Ajzen, 1991). The theory has been applied in several studies under behavioral situations (such as Chu and Wu, 2004) as well as used towards explaining human behavioral performance (predicted from people's plans) as a dominant theoretical framework (Fishbein and Ajzen, 1975). The TRA has been diagrammatically indicated in the Fig. 2.

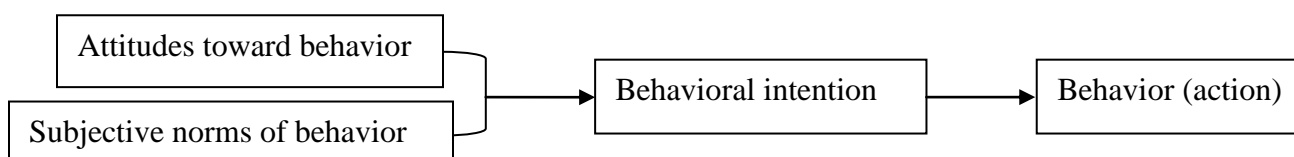


Figure 2: Theory of reasoned action

Source: Adopted from Ajzen and Fishbein (1980)

The theory has been applied in various studies such as Hanno and Violette (1996) who applied the theory of reasoned action in a tax compliance environment and results indicated that the theory explained on the taxpayer compliance decisions. Murphy (2003) postulated that the perceptions regarding unfair tax burdens can affect taxpayers' opinion about tax payment and consequently their compliance behavior. Further, based on the theory aspect of attitudes and behavioural intention, Remetse and Yong (2009) observed that a lot of SMEs taxpayers do not like paying goods and services tax (GST) as a result of bureaucratic documentations that needs to be prepared, resulting to noncompliance. In addition, the theory's dimension on subjective norms and behavioral intention as put forward by Zainol et al. (2014) emerged as the most significant determinant that dictated on GST compliance intention behavior on producers in Malaysia, implying that referent group or social pressures have a significant role they play towards influencing producers in complying with GST.

## **METHODOLOGY**

This paper seeks to establish the role of enhanced taxpayer literacy and revenue mobilization. To achieve this goal, the paper takes two approaches; first, it considers the taxpayer attitudes through the lens of relevant tax theories and secondly by reviewing empirical literature of related studies. It is argued that, taxpayers decision to pay tax depends on their inherent attitudes which can be explained by relevant theories. Indeed, most taxation literature has been coined around one or more of these theories. Effectiveness of tax literacy in revenue mobilization is expected to be influenced by their behavior. Empirical review was used to obtain secondary data and information on wide spectrum of studies globally to ensure convincing conclusion is drawn.

## **TAX LITERACY AND REVENUE MOBILIZATION**

Many economies across the world, Kenya included, rely on self-assessment system (SAS) of income tax assessment. Under this system, tax literacy is of paramount importance (Loo *et al.*, 2009). This argument has been supported by several empirical studies which established that tax literacy would lead to higher compliance rates and that conversely, the absence of tax knowledge may lead to noncompliance behaviour among taxpayers, either intentionally or unintentionally (Saad, 2014; Kasipillai and Jabbar, 2003; Kirchler *et al.*, 2006). This is not however to say, that tax literacy will always result to higher compliance because other studies have shown the contrary. For instance, Harris (2012), found that tax literacy has no direct significant effect on taxpayers' compliance behaviour. Wetsango *et al.* (2018) attributes this contradiction in findings to the difference in tax jurisdictions of study. Nyamwanza *et al.* (2014),



also found that SMEs in Zimbabwe do not comply with legislation despite having the relevant information. It appears that, the level of tax knowledge among the large tax payers and SMEs varies significantly.

Synthesis of the reviewed literature suggests significant positive relationship between tax literacy and tax compliance, hence revenue mobilization. This is true for self-assessment regimes and for most large scale taxpayers. The positive contribution is attributed to enhanced self-compliance triggered by the knowledge. It would be worth recommending at this point that for this category of taxpayer, focus of tax literacy should be sustained as opposed to enforcement. However, for small scale tax payers most of whom comprise the SMEs, enforcement should be used hand in hand with tax education in order to achieve revenue mobilization objective. Table 1 presents the summary of tax payer category, literacy levels and required revenue mobilization strategies.

Table 1: Taxpayer category, Tax Literacy and Focus in revenue mobilization

Tax payer Category	Level of Tax literacy	Focus in Revenue mobilization	
		Mobilization Strategy	Focus levels
Large Tax Payer	High	Tax education	More focus
		Enforcement	Moderate focus
Medium Scale Taxpayer	Moderate	Tax education	More focus
		Enforcement	Moderate Focus
Small Scale Tax Payer	Low	Tax education	More Focus
		Enforcement	More Focus

*Source: Adopted from Kasipillai and Jabbar (2003)*

While, coercion and enforcement may be an alternative where education and self-compliance fails, this should be exercised with care because over time, it has been established that compliance strategies based solely on coercion have may have counterproductive results among taxpayers as it may lead to shadow economy. Coercion often translates into high monitoring costs, may be only effective in short-term and it can drive many honest taxpayers into the shadow economy. Therefore, there is need for an adequate mixture of cooperation through literacy enhancement and coercion, with emphasis on the former, simply because national budgets are better off when authorities enact compliance strategies extensively built on cooperation (Kirchler, 2007). It is fair to conclude that coercion should only be used when it is necessary and imperative.



## EFFECTIVE REVENUE MOBILIZATION LITERACY CHANNELS

One of the most unexplored tax literacy channels in most developing countries is raising tax literacy levels among very young and soon-to-be taxpayers rather than current taxpayers. Nichita (2015) argues that focusing the potential contributors makes them accustomed to the requirements of tax systems before entering the economic market as employees, self-employed or employers. This avenue is not well exploited in Kenya. While the business a discipline is well structured as entrenched in school curriculum where students (potential taxpayers) are taught business models where profit is the ultimate goal. To maximize profits, they are taught to increase turnover and minimize costs. At this point tax is introduced as a cost. The soon-to-be taxpayers create cold feet on taxation and the spirit of tax evasion creeps in. It is only in history studies that students are reminded that it is a duty of citizen to pay tax. There are limited avenues currently available informing the young that paying tax is not only a duty but is a good thing for them and for the society they live in. It is our argument here that taxation should be incorporated in the schools and colleges curriculum. Secondly, many youth are in social media and other digital platforms. These channels can be exploited to reach to as many youth as possible in order to create responsible citizens.

Several tax authorities including KRA have also invested in increasing tax literacy among actual taxpayers through different programs, workshops and seminars. In order to properly register profits and facilitate income tax collection, small and micro business owners, Nichita (2015) argues that SMEs should take part in bookkeeping workshops. The use of media campaigns and online filing systems are included among widely used strategies. Taxpayers should be taught and encouraged to declare income via an e-tax return. Revenue authorities can enhance taxpayer's literacy via TV advertising, printed press, official webpage and social media.

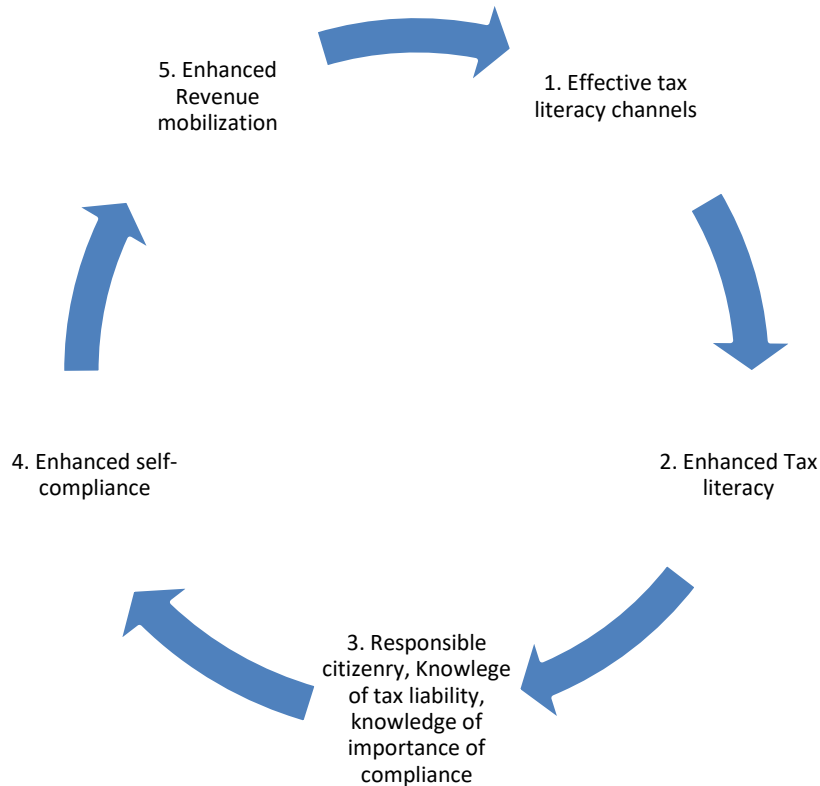


Figure 3: Tax literacy and revenue mobilization

Source: Adopted from Ajzen and Fishbein (1980)

## TAX LITERACY AND DIGITAL ECONOMY

Digital economy (also known as new economy) can be construed as summarized from Tapscott's definition to mean "information in digital form, facilitated by the digital devices (which) allows the free movement of vast amounts of information in the shortest time possible between people in different parts of the world" (Babu, n.d.). It is about dynamic rather than static economy. Researchers have further enumerated digital economy to be a platform where service providers and the consumers do their transactions over the internet using electronic products only (Hojeghan and Esfangareh, 2011). As the use of devices and internet change the nature of goods and services, their way of production, marketing and selling, it as well provides the taxpayers an access to new income streams through "virtual transactions" (Marina and Marianne, 2018), that can be finalized in the form of real money or virtual currencies (Switzer and Switzer, 2014).

However, these transactions may have a taxation effect for the taxpayer, thus necessitating taxation knowledge in order to account for these transactions in their tax returns. Because taxation of digital transactions may be bureaucratic when it comes to where the

transaction will be taxed in situations involving the transaction processing server and different locations for the shipping and destination of products, the taxpayers thus requires tax knowledge as well as understanding towards identifying where and when tax repercussions will be triggered (Marina and Marianne, 2018; Basu, 2001). Further, Marina and Marianne (2018) note that deficiency of such tax knowledge and understanding may result to tax noncompliance for the persons affected by the digital economy.

## CONCLUSIONS

Modern-day tax authorities take into account that state budgets are better off when revenue mobilization strategies are grounded more on cooperation and self-compliance rather than coercion. The rationale behind this reality is that cooperation strengthens mutual trust between authorities and taxpayers; it ensures support for the parties. It also decreases significantly monitoring expenses and, most importantly, it produces long-term compliance among taxpayers. Enforcement puts high pressure on state budgets, because it might deepen the social distance between contributors and tax authorities, it demands increased monitoring expenses and generates only short-term results. The current article sheds light on how tax literacy influences tax revenue mobilization. Revenue mobilization through enhanced literacy can be achieved when the authorities focus on the long-term rather than short-run strategies. We argue in this paper that literacy should not only focus on the existing tax-payers but should also include the would-be tax payers in order to inculcate the tradition of taxpaying well in advance. Further, this paper finds that there is increased digital space globally and the tax authorities should exploit these channels in enhancing tax literacy among both the potential and current taxpayers. Finally, the aspect of 'tax literacy' is however postulated to be a wider concept than tax knowledge alone and therefore requires further examination in regard to its role in taxpayer compliance.

## RECOMMENDATIONS

Tax authorities need to create a friendly environment that enables two-way communication between them and the taxpayers such that the taxpayers are freely to engage them towards ways of improving on various revenue mobilization strategies.

Accountability by the tax authorities on revenue collected is paramount as it will create trust and confidence on the taxpayers that the taxes are not misused.

Adoption of new technologies meant to enhance on revenue collection, which are not only economical to the tax authorities but also convenient and friendly to the taxpayers.

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