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Residential Rental Tax Enforcement and Revenue Collection by Kenya Revenue Authority

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Abstract:

Objective: To investigate the effects of, filing monthly residential rental income, fines and penalties on residential rental income, tax amnesty on residential rental income and regular monitoring and audits of residential rental income on revenue collection by Kenya Revenue Authority.

Methods: This study adopted causal research design. The study targeted KRA records on residential rental tax enforcement documents and revenue collection records. Inferential techniques formed the basis of causality of the study variables through correlation and regression analysis. The testing of causality (cause-effect) was based on the assumption of significance being below 0.05.

Results: The study found that effect of enforcement of declaration of monthly residential rental income, regular monitoring and audit of residential rental income, tax amnesty of residential rental income and fines and penalties on residential rental income had a positive significant effect on revenue collection by Kenya Revenue Authority.

Conclusion: The study concludes that the implementation of the declaration of monthly residential rental income would have a significant impact on revenue collection by the Kenya Revenue Authority. Regular monitoring and auditing of residential rental income is crucial for ensuring that landlords are accurately reporting their rental income and paying the appropriate amount of taxes to the Kenya Revenue Authority. When tax amnesty is offered, it provides an opportunity for landlords who may have previously evaded paying taxes on their rental income to come forward and declare their earnings without facing penalties or prosecution. By enforcing fines and penalties on non-compliant property owners, the Kenya Revenue Authority can increase the amount of revenue collected from rental income.

Keywords: *Revenue Collection, Residential Rental Tax Enforcement, Revenue Collection, Kenya Revenue Authority*

1. BACKGROUND

Residential tax enforcement and revenue collection have significant effects on local and national economies. The collection of residential rental taxes generates revenue for governments that can be used for public services and goods like infrastructure, education, and healthcare (Urban Institute, 2021). The effectiveness of tax enforcement and revenue collection depends on various factors, including political will, administrative capacity, and public compliance. Governments must strike a balance between generating revenue and ensuring that taxes do not become a burden for low-income renters. Globally, the tax revenue from residential rental properties constitutes a significant portion of the overall tax base in many countries. For example, in the United States, local rental income taxes on residential properties accounted for 31.2% of total local tax revenue in 2019, according to the Urban Institute.

In the European Union, rental income taxes on residential properties generated 1.5% of GDP on average in 2019, according to the European Commission. In some cases, taxes can be passed on to renters in the form of higher rents, making it more difficult for low-income renters to afford housing. However, there are also programs aimed at reducing the tax burden on low-income renters, such as rental income tax relief programs in the USA. Regionally, the impact of residential tax enforcement and revenue collection can vary widely (European Commission, 2021). In some regions, such as Sub-Saharan Africa, the tax compliance rate is low, and tax administration is often inefficient, resulting in low revenue collection. However, there have been efforts in enhancing tax administration in the region, such as the use of technology to enhance tax compliance, as seen in Rwanda, which has one of the most effective tax administrations in Africa (Barenstein & Gupta,2019).

Locally, the enforcement of residential rental tax and revenue collection can have a significant impact on the affordability of housing for low-income renters. Kenya depends on taxes as key revenue source to fund its expenditure. KRA is responsible for tax revenue enforcement and collection from the different tax streams such as withholding tax, VAT, custom and import duty, Excise duty, Corporation tax and PAYE among other streams. During the period between 1995 and 2004, revenue collection accounted for 80.4% of the national revenue and 90 percent between 2015 and 2012 (KRA, 2019). Even though among other countries in African, Kenya has a much better and stable economic and political development demonstrated from gradual tax reform process.

KRA is unable to attain collection targets thus triggering the government to borrow externally as well as over on rely donor funding. In the fiscal year 2013/2014, for example, Ksh 800 billion were collected as opposed to the targeted Ksh 900 billion intended to finance the 1.6 trillion government budget. The shortfall was also observed in the 2018/2019 fiscal year, where the revenue generated were below the budget hence resulting in external borrowing by the government to finance that budget deficit (KRA, 2023). Real estate sector is a key tax base in the Kenya's revenue collection because of its role in developing economies. The real estate economic sector in Kenya has experienced growth in the last 20 years in correspondence to the growing economy (KNBS, 2019). Its ratio to the GDP has grown to 12.6% in 2012 from 11% in 2000. By 2018 the sector accounted for 15 % (Mbaka, 2019).

The growth has been driven by infrastructure development, a steady GDP averaging at 5.4% over the last 5 years, rapid urbanization and high investment returns averaging at 25% against 12.4% in the traditional asset classes. (KRA, 2023). The residential sector in Kenya which is primarily a rental market records the highest demand with an annual countrywide 200,000 units housing deficit, accumulation of over 2 million units deficit. This has attracted an influx of investors in the residential housing units with a good return of around 6% to 7%. The above notwithstanding, it is evident that taxation on the rental income has remained as one of the most complex areas of government policy and it further complicated by the advent of the digital era which enables business to operate in multiple jurisdictions without a physical footprint in them (KRA, 2020).

2. METHODS

2.1 Target Population

A research's target population comprises of events, objects and individuals to be studied by the investigator.The study population was the rental income tax collection in departments in Nairobi County. The department was targeted since they are directly involved in rental income collection and therefore best placed to provide the study data. Since the population was small and manageable, census approach was used where sampling was not done.

2.2 Data Collection Instruments

This research used a questionnaire presented in Appendix I to collect primary data. Five Point Likert scale measured the achievement of the study variables. Secondary data template from the financial records received from the KRA financial reports gathered secondary data. Secondary data was extracted from the KRA databases from the year the period 2016 to 2022 (7 years), to capture the data annually for the 7 years under study. Information on: withholding income, monthly residential rental income, tax amnesties, block management systems and revenue collected was obtained.

2.3 Statistical methods

SPSS version 28.0 was used to analyse the descriptive /inferential data obtained from the primary and secondary sources. This study made use of standard deviations (S.D), averages (Means), frequencies (counts) and percentages as part of the descriptive analysis. Likewise, inferential techniques formed the basis of causality (to infer the findings) of the study variables. This involved the use of correlation and regression analysis. Pearson's correlation (– r) ascertained the direction for the connection. Regression analysis on the other hand would give the extent/magnitude and/or degree to which the predictor variables affect the predicted variable. This was done by use of model of fitness (Coefficient of determination), ANOVA (to compare the means and form basis of significance test of the model) and the coefficients regression (beta coefficients and p values). The testing of causality (cause-effect) was based on the assumption of significance being below 0.05. The following is a representation of the multiple linear regression model:

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$

Where.

Y_t= Enhanced Revenue Collection by the KRA

β_0 = Model constant

β_i = Corresponding beta coefficients

X_1 = Enforcement on Declaration of residential rental income

X_2 = Regular monitoring and audit of residential rental income

X_3 = Tax amnesties of residential rental income

X_4 =Fines and penalties on residential rental income

ε = Error term and t = Period of study

2.4 Operationalization of Variables

Table 1 below shows the variables operationalization.

Table1. *Variables Measurement and Operationalization*

Variable	Category	Operationalization	Measurement
Enforcement on declaration of monthly residential rental Income	Independent variable	Monthly filling of rental returns Accuracy of the returns Rental tax agents	Five point Likert scale.
Regular monitoring & audit of residential rental income	Independent variable	Frequency of monitoring Auditing Third party collaborations	Five-point Likert scale.
Tax Amnesties of residential rental income	Independent variable	Interest waiver on taxes Penalties waiver on taxes Applications for waivers	Five point Likert scale.
Fines & penalties on residential rental income	Independent variable	Increase fines and penalties amounts Collection measures for penalties Reduced rate for final residential tax.	Five point Likert scale.
Revenue collection by Kenya revenue Authority	Dependent variable	Growth actual revenue collected Growth projected revenue collection. Reduced Tax Defaults	Five point Likert scale.

3. Results

3.1. Regression Analysis Results

The data displayed in Table 2 reveals that the adjusted R square value is 0.781 (78.1%), demonstrating the degree to which enforcement of declaration of monthly residential rental income, regular monitoring and audit of residential rental income, tax amnesty of residential rental income, fines and penalties affected the revenue collection by KRA.

Table2. *Model Summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.894	.799	.781	1.6315

Source: Research Data (2024)

As a result, other unstudied variables account for the remaining 21.9% of the revenue collection by KRA.

Table3. *Analysis of Variance*

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	125.015	4	31.254	44.237	.001
	Residual	81.248	115	0.707		
	Total	206.263	119			

Source: Research Data (2024)

The findings presented in Table 3 demonstrate the significance of the model, with a level of significance of 0.001, which is below the threshold of 0.05. Additionally, at the 5% significance level, the statistical F value was 44.237, surpassing the statistical mean value of 31.254. This further confirms the significance of the model.

Table4. *Coefficients*

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	.611	.254		2.405	.001
	Enforcement of declaration of monthly residential rental income	.709	.336	.506	2.110	.001
	Regular monitoring and audit of residential rental income	.833	.293	.415	2.843	.000
	Tax amnesty of residential rental income	.772	.406	.339	1.901	.002
	Fines and penalties	.791	.366	.282	2.161	.001

Source: Research Data (2024)

It is revealed that if enforcement of declaration of monthly residential rental income, regular monitoring and audit of residential rental income, tax amnesty of residential rental income and fines and penalties are held constant, the revenue collection by KRA would be 0.611. The regression coefficients obtained indicate that an improvement on enforcement of declaration of monthly residential rental income, regular monitoring and audit of residential rental income, tax amnesty of residential rental income and fines and penalties would improve revenue collection by KRA by 0.709, 0.833, 0.772 and 0.791 respectively. The resulting regression equation is as follows;

Revenue collection by KRA = 0.611 + 0.709 (enforcement of declaration of monthly residential rental income) + 0.833 (regular monitoring and audit of residential rental income) + 0.772 (tax amnesty of residential rental income) + 0.791 (fines and penalties)

3.2. Test of Hypotheses

Test of Hypothesis One

H_{01} Enforcement of declaration of monthly residential rental income has no significant effect on the revenue collection by KRA.

The study sought to test the hypothesis that 'Enforcement of declaration of monthly residential rental income has no significant effect on the revenue collection by KRA'. From the results obtained and presented in Table 4.16 is that the hypothesis was rejected and the study concluded that enforcement of declaration of monthly residential rental income has a significant effect on the revenue collection by KRA since the Enforcement of declaration of monthly residential rental income had a positive beta value with significance value less than 0.05 (β=0.506, p=0.001). The results are consistent with research by Kinyua (2014) on factors influencing voluntary rental income tax compliance. The study discovered that a person's attitude, high tax rates, unfair tax regimes, societal norms, gender, and educational attainment were the main factors influencing taxpayers' ability to comply with tax laws.

Test of Hypothesis Two

H_{02}: Regular monitoring and audit of residential rental income has no significant effect on revenue collection by KRA.

The study sought to test the hypothesis that 'regular monitoring and audit of residential rental income has no significant effect on revenue collection by KRA'. From the results obtained and presented in Table 4.16 is that the hypothesis was rejected and the study concluded that regular monitoring and audit of residential rental income had a significant effect on revenue collection by KRA since the regular monitoring and audit of residential rental income had a positive beta value with significance value less than 0.05 (β=0.415, p=0.000). The finding agrees with Brennan et al., (2020) who studied the impact of code enforcement on the collection of fees and fines related to rental housing in Baltimore, Maryland. The study found that a more aggressive code enforcement program led to a significant rise in fines and fees collection.

Test of Hypothesis Three

H_{03}: Tax amnesty of residential rental income has no significant effect on revenue collection by KRA.

The study sought to test the hypothesis that 'Tax amnesty of residential rental income has no significant effect on revenue collection by KRA'. From the results obtained and presented in Table 4.16 is that the hypothesis was rejected and the study concluded that tax amnesty of residential rental income had a significant effect on revenue collection by KRA since the tax amnesty of residential rental income had a positive beta value with significance value less than 0.05 (β=0.339, p=0.002). According to Marchese (2019), tax amnesty is a useful policy tool that is often used to coarse tax evaders to declare their incomes with no legal implications.

Test of Hypothesis Four

H_{04}: Fines and penalties on residential rental income have no significant effect on the revenue collection by KRA

The study sought to test the hypothesis that 'fines and penalties on residential rental income have no significant effect on the revenue collection by KRA'. From the results obtained and presented in Table 4.16 is that the hypothesis was rejected and the study concluded that fines and penalties on residential rental income have no significant effect on the revenue collection by KRA since the fines and penalties had a positive beta value with significance value less than 0.05 (β=0.339, p=0.002). Zoe, et al., (2019) examined the fiscal impact of fees and fines in the Texas justice system. The authors reported that fees and fines are a high revenue source for the justice system, but that there are significant disparities in the impact of fines and fees on low-income individuals.

4. CONCLUSIONS

The study comes to the conclusion that the application of the declaration of monthly residential rental income would have a significant impact on revenue collection by the KRA. It would increase transparency, broaden the tax base, reduce tax evasion, and promote fairness in the tax system. By capturing previously untaxed rental income, the government would be able to generate additional revenue that can be used for public services and infrastructure development, ultimately benefiting the entire population of Kenya.

The study concludes that regular monitoring and auditing of residential rental income is crucial for ensuring that landlords are accurately reporting their rental income and paying the appropriate amount of taxes to the Kenya Revenue Authority (KRA). By conducting regular audits and monitoring, KRA can identify any discrepancies or instances of tax evasion, ultimately leading to increased revenue collection for the government. The regular monitoring and auditing of rental income can help to deter tax evasion and non-compliance among landlords. Knowing that their income is being closely monitored and audited can act as a deterrent for landlords who may be tempted to underreport their rental income or engage in other forms of tax evasion.

The study concludes that when tax amnesty is offered, it provides an opportunity for landlords who may have previously evaded paying taxes on their rental income to come forward and declare their earnings without facing penalties or prosecution. This can result in a surge in the number of landlords voluntarily disclosing their rental income, leading to an increase in revenue collected by the KRA. Tax amnesty can play a crucial role in enhancing revenue collection from residential rental income by incentivizing landlords to declare their earnings and comply with tax regulations.

The study concludes that by enforcing fines and penalties on non-compliant property owners, the Kenya Revenue Authority can increase the amount of revenue collected from rental income. This additional revenue can then be used to fund essential government services and infrastructure projects, ultimately benefiting the country as a whole. The enforcement of fines and penalties sends a strong message to property owners that tax evasion will not be tolerated. This can help promote a culture of compliance and encourage more property owners to accurately report their rental income, leading to a more transparent and fair tax system.

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