POLICY BRIEF

# AUDITS AND TAX REVENUES IN AFRICAN TAX OUTLOOK (ATO) PARTICIPATING COUNTRIES: WHAT MORE MUST BE DONE?

ATAF Research Publications

African Tax Outlook - Policy Brief ATO.02| July 2020

## Introduction

While the primary goal of tax audits is to enhance tax compliance, they are also crucial in generating tax revenues. Though several studies have emphasized the compliance-enhancing objective of audits,[1] little attention has been directed towards the revenue-impact of audits.[2] At times, tax audit programmes have the potential to generate significant tax revenues. For instance, through the African Tax Administration Forum (ATAF)'s Country Programmes, the ATAF Secretariat has conducted 26 Transfer Pricing technical assistance missions to nine African countries. The technical assistance offered was twofold:

a) Through a series of workshops with the relevant tax administrations (hereafter TAs), carried out to build effective international tax auditing skills with a focus on transfer pricing auditing skills.

b) Through assisting the countries in reviewing existing regulations on transfer pricing, interest deductibility, and any other legislation relating to profit-shifting.

The key outcomes of these ATAF Country Programmes were as follows:

a) In one ATAF member country, US$5.1 million was collected out of US$14.38 million that was assessed in 2019. The assessed amount represents 0.1 percent of the country's Nominal Gross Domestic Product (GDP) for the year 2018.

b) In six ATAF member countries, US$1,085.57 million has been assessed in 5 years, while US$272.41 million has been collected in 5 years.

c) 186 audit cases were opened in 2019, and 57 audit cases closed in 2019.

This study seeks to complement the scant literature on audit revenue-impact by analyzing the impact of audits on domestic tax revenues in countries participating in the ATAF's African Tax Outlook (ATO) project,[1] using data spanning from 2010 to 2017.

A tax audit can affect tax revenues through two channels: direct and indirect effects (Chalu & Mzee (2018); Birskyte (2013); Gemmell & Ratto (2012)). The direct effect includes revenue assessments and audit yield following a tax audit. An indirect effect manifests itself in two rather contrasting ways: a deterrence effect (i.e. tax audit deters potential tax evasion) and a compliance enhancing effect (i.e. tax audit induces more compliant filing) (Chalu & Mzee, 2018). Thus, in direct cases, revenue arises following a revenue assessment while in the indirect cases, the revenue arises from increased compliance and reduced tax evasion.

[1] See Advani et al. (2017); Alm (2019); Almunia & Lopez-Rodriguez (2018); Ayers et al. (2019); Bérgolo et al.(2017); Carfora et al. (2018); D'Agosto et al.(2018); Feld et al.(2019); Mazzolini & Pagani (2017); Mendoza et al.(2017); Olaoye & Ekundayo (2019); Olaoye & Ogundipe (2018); Kuchumova (2017); Saw(2019)

[2] See Harelimana (2018); Moore & Prichard (2017); Olaoye et al.

(2018); Wuyah et al. (2018).

[3] These include ATAF member and non-member states. For more details on the ATO, please visit this link. The 2020 edition of the annual African Tax Outlook (ATO) publication which is currently under preparation will feature 37 countries using revenue and Customs data from 2010 to 2019.

Tax audits can be done on tax returns at the office, referred to as *desk audits*, or can also culminate into *field* or *comprehensive audits* where tax auditors visit the premises of a taxpayer (Olaoye & Ogundipe, 2018). If an audit is not routine but instead arising on-demand by the tax office from any tax issue, it is referred to as an *issue-oriented audit* or *issue audit*. While an issue audit may be done at the office or in the field, and a field audit may stem from a desk audit, the tax administration is able to report the data on the audits distinctly, across the three categories.

As aforementioned, in ATAF's African Tax Outlook (ATO) 2019 publication, 34 ATAF member and non-member states participating in the project (hereafter ATO countries) have reported data on tax audits for the period beginning from 2010 to 2017.[1] This research brief makes use of the ATAF's ATO Online Dataset from the years 2010 to 2017, to analyse the impact of tax audits on domestic tax revenues in selected countries. While adhering to the standards of econometric analysis, the study emphasizes analytical insights on tax audit and tax revenues in ATO countries to mainly inform policymakers and tax administrations.

## Evidence from the ATAF's African Tax Outlook (ATO) Countries

Figure 1 below shows the distribution of the various types of audits discussed in terms of frequency and revenue yield. In addition to the three categories of tax audits in the ATO online dataset, we include the category of *Other Audits* to cover any other variants and types of tax audits carried out in the ATO member countries.[5] Other audits include return examination; data matching; inspection actions; compliance advisory.[6]

In Figure 1 (a) we segment the audits based on the number of audits conducted on average over the 8-year period 2010 to 2017 in the ATO countries. On the other hand, Figure 1 (b) segments the audits based on the revenue yield over the same period.

[4] When running a balanced panel regression, some unbalanced observations were dropped resulting in a dataset with 11 countries spanning 6 years

[5] The composition of "Other Audits" varies by country. Examples include: return examination; compliance advisories; taxpayer self-health checks; Spot inventory audits; inspection actions and register cleaning. The Tax Administration Diagnostic Assessment Tool (TADAT) defines "Other Audits" as inspections of books and records, examination of VAT refund claims, and in-depth investigations of suspected tax fraud.

[6] This relates to cooperative compliance and tax ruling..

**Figure 1: Distribution of Tax Audits in ATO countries by Frequency and Revenue Yield, 2010-2017**

Figure 1 (a): Tax Audits by Frequency

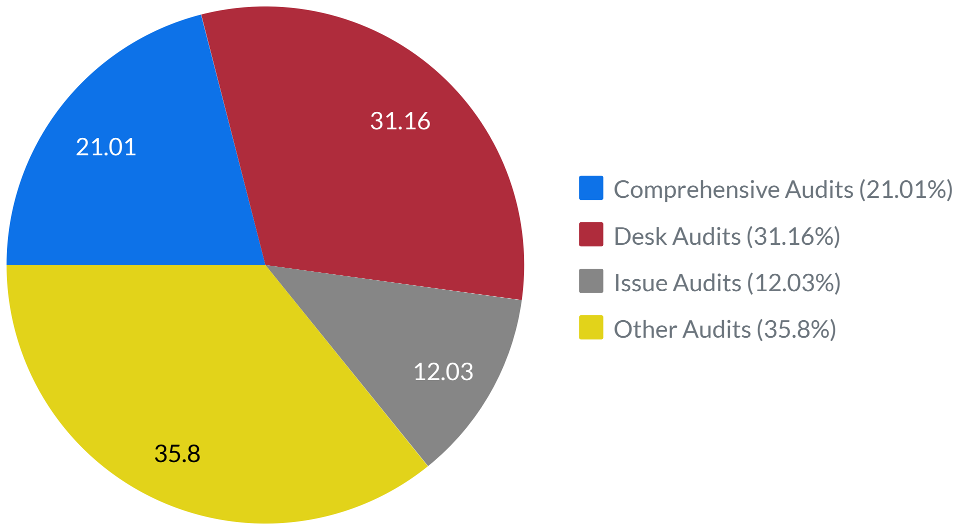


Figure 1 (b): Revenue Yield per Tax Audits