DETERMINANTS OF VALUE ADDED TAX PERFORMANCE AMONG SMALL AND MEDIUM ENTERPRISES IN NAKURU CENTRAL BUSINESS DISTRICT-KENYA

JANE SHAGA SORA

RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR POST GRADUATE DIPLOMA IN TAX ADMINISTRATION OF JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY

2021

DECLARATION

This project is my original work and has not been presented for a post graduate diploma in any other academic or non-institution

Signature _____**Date** _____

Jane Shaga Sora

HDB-336-C016-0440/2018

This project has been submitted for examination with my approval as the Supervisor

Signature_____Date_____

DR. BRUCE OGAGA

KENYA SCHOOL OF REVENUE ADMINISTRATION (KESRA)

ACKNOWLEDGEMENT

I would like to first thank God for the wisdom, health and perseverance that He has bestowed upon me before and during this research proposal. I also thank my Supervisor, Dr. Bruce Ogaga for his steadfast support, guidance and encouragement during the entire period.

DEDICATION

This research project is a special dedication to my family for their undivided support that they have always extended to me during my academic pursuit

ABSTRACT

Small and Medium Enterprises have always been a factor of concern among tax policy makers all over the world. On one hand, since they constitute the largest universe of taxpayers and on the other their importance in the collection is very small. Taxation of Small and Medium Enterprises is a burden they must bear to sustain their government since the government has certain activities for the benefits of Small and Medium Enterprises. The current research will seek to determine the factors affecting value added tax performance among Small and Medium Enterprises in Nakuru Central Business District. The dependent variable was Value Added Tax performance while the independent variable was tax literacy, cost of compliance and tax audits. The specific objectives were to determine the effect of tax literacy, compliance costs and tax audit on Value Added Tax performance in Nakuru Central Business District. The study was pegged on three theories namely; Contract theory, Transaction Cost Economics Theory and agency theory. The study used descriptive research design. The target population in this study comprised of 578 Small and Medium Enterprises in Nakuru Town registered in the department of trade where a sample of 236 respondents were selected using stratified random sampling. The primary data was collected by use of a questionnaire where the collected data was sorted, corded and fed into statistical package for social sciences after which the relevant descriptive statistics such as standard deviation, mean, variance, and mode output was generated along with correlation and regression analysis for subsequent model testing. The data was analyzed at 5% significant level and 95% confidence level. The descriptive findings show that several tax trainings conducted by Kenya Revenue Authority through workshops and seminars in Nakuru central business district has equipped Small and Medium Enterprises with basic understanding of tax laws. Also, the results show that Small and Medium Enterprises have an access to tax education through media advertisements, magazines and from the Kenya Revenue Authority website. However, concerning access to information on the aggregate taxes collected and how they are spent, the results show that Kenya Revenue Authority rarely share the information concerning collections and how they are spent. Also, regression analysis and correlation analysis established a positive and significant relationship between tax literacy and tax audit with value added tax performance. However, a negative and significant beta coefficient and person correlation coefficients were established between cost of compliance and value added tax performance. The study concludes that tax literacy, reducing cost of compliance and regular tax audit can help improve value added tax performance. The current study recommends that Kenya Revenue Authority need to establish ways of sharing information on value added tax performance and usage to the taxpayers. Lastly, similar studies can be done in other towns in Kenya to establish whether similar findings will be obtained. Also, similar study can be done in Nakuru but in a different sector like real estates and see if same findings will be obtained.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS AND ACRONYMS

CBD   Central Business District

EPS   Earnings per Share

GDP   Gross Domestic Product

GOK   Government of Kenya

KRA   Kenya Revenue Authority

PAYE   Pay as You Earn

ROI   Return on Equity

SMEs   Small and Medium Enterprises

SPSS   Statistical Package for Social Sciences

VAT   Value Added Tax

DEFINITIONS OF SIGNIFICANT TERMS

Value Added Tax: Defined as a tax on the value added to the supply by the last seller (Radhakrishanan, 2008)

Small & Medium Enterprises: SMEs includes those enterprises that are either formally registered business, with an annual turnover of between Kenya Shilling 8 to 10 million, with an asset base of at least Kenya Shillings 4 million or employ between 5 to 150 employees. (World Bank 2007).

Tax Penalty: Is the imposition of fines on non-compliance of taxpayers in carrying out tax administration obligations and with the existence of tax sanctions are expected to improve taxpayer compliance (Pranata and Setiawan 2015)

Taxpayers knowledge: This is how much tax payers understand the prevailing tax laws, regulations and how they can carry out the procedure and of submitting the tax correctly (Andreas & Savitri, 2015)

Tax compliance: Is defined as compliant behaviour of taxpayers to fulfil their tax obligations based on tax laws without any forces from government such as fear of getting punishments (James, et al 2002)

Cost of compliance: Cost of compliance defines all the costs that must be incurred by the tax payers in the process of compliance including cost of tax computation, tax remittance and filing of tax returns (Wayan, 2012)

Audit: Audit is defined as the examination or inspection of various books of accounts by an auditor followed by physical checking of inventory to make sure that all departments are following documented system of recording transactions. It is done to ascertain the accuracy of financial statements provided by the organization.

CHAPTER ONE

INTRODUCTION

1.1 Background of The Study

Tax non-compliance, has always been a problem to tax administrative system in any countries, either in developed countries, or in emerging countries. The problem of tax non-compliance is as old as the institution of tax system (Wentworth & Rickel, 2005). Tax non-compliance can be differentiated into unintentionally and intentionally (Alabede, Ariffin, & Idris, 2011). Tax evasion is categorized as the most frequent and extreme form of tax non-compliance. It is important for taxpayers to comply with tax laws. This is because income tax payment received from taxpayers is one of the incomes to increase the government revenue. With these tax collections, government may upgrade and construct public goods and services such as national defense, infrastructures like roads and educations, and also to meet any societal objectives and public welfares.

1.1.1 Global Perspective

Value added tax (VAT) as a concept was first introduced in France in 1954, and has over time been embraced by well over 100 countries. The VAT rate adopted by different countries and qualification for registering for VAT vary from one country to another. In the EU, all but two countries (Spain and Sweden) have registration thresholds. The UK's threshold of £81,000 is the EU's highest, and is perceived as a way for the government to reduce the compliance costs of small businesses not wishing to register for VAT.

However, thresholds are generally much higher in countries that have introduced VAT more recently, such as Singapore, which currently has a threshold of about €540,000. Despite the potential detrimental effects of size-dependent thresholds, there is only limited evidence on the effects of VAT threshold on the behavior of small businesses (Decker, Haltiwanger, Jarmin

and Miranda 2014). In Finland, firms with annual sales below 8,500 euros are not liable to pay VAT and separately report sales to the Tax Administration. Relatively low VAT thresholds are common. Half of the EU countries apply thresholds below 25,000 euros, including for example Germany, Belgium and Denmark. In general, small firms comprise a large share of all businesses (Decker, Haltiwanger, Jarmin and Miranda 2014).

Gilligan et al (2005) studies on "perception of tax fairness and tax compliance in Australia and Hong Kong" concluded that there seem to be no universal relationship or pattern that exist cross culturally between the different facets of tax fairness perceptions and tax compliance behavior. Faridy (2015) studied on Value Added Compliance costs and Value Added Tax evasion of the SME sector in Bangladesh. It was concluded that analyzing tax evasion is a difficult exercise and taxpayers have a very strong incentive of concealing their tax evasion schemes.

1.1.2 Regional Perspective

In the developing world, it has also been seen as a source of change in tax and economic policy (Ebrill et al., 2001; Bird & Gendron, 2007; Keen, 2009, Keen & Lockwood, 2010). The introduction of VAT over the past few decades has been the most visible tax reform undertaken by developing countries (Tanzi & Zee, 2000). There is some evidence, particularly in the Third World, that those countries that have adopted VAT raise more revenues (Keen & Lockwood, 2010). VAT was introduced in to its tax system as a replacement sales tax in 2002 which came into force as of January, 2003 with the objective of enhancing economic growth; and enhancing saving and investment.

To sustain Value Added Taxes revenue role in the government's finance, it is important to ensure that the revenue generated by this tax is raised as efficiently as possible (Wollela, 2008). However, researches reveal that in Ethiopia revenues raised by Value Added Tax are usually garnered at the expense of erosion in its salient features. This may be caused by factors including poor Value Added Tax administration and poor culture of paying tax of the tax payers i.e., the incapacity of tax authorities to implement the attributes of the tax in practice. A good tax administration is essential in achieving government's policy objectives at large and fully implementing the design features of Value Added Tax (Yesegat 2008).

In Nigeria, VAT has been a major source of government revenue from January 1994 when the VAT act was enacted to replace the existing sales tax (Ajakaiye 2000). According to Ajakaiye (2000), VAT revenue in the year of its inception (1994) was N8.194 billion, which was 36.5 percent greater than the projected N6 billion for that year. In 1995, the actual VAT revenue for was N21 billion compared to the projected N12 billion. VAT accounted for about 4.06 % of total revenue in 1994 and 5.93% of total revenue in 1995. In a span of 10 years, VAT revenue has grown to N404.5 billion representing 5.1% of total revenue in 2008 (Adereti, Adesina, & Sanni, 2011). Aruwa (2008) did a study on the relevance and the problems of Value Added Tax (VAT) in Nigeria and He established that businesses treat VAT as a cost contrary to the expected practices. Due to the lack of proper records, unqualified FIRS staff and low level of education among the taxpayers, VAT collection was below average and finally there was a perception among the citizens that there was underutilization of the VAT collected by the government.

1.1.3 Local Perspective

In Kenya, registered persons acting as agents of government of Kenya collect VAT at designated points and then submit to the Kenya Revenue Authority (KRA) (Simiyu 2003). According to

KNBS (2014) VAT contributed about 23% of the total tax revenue collection by the government in 2013. Other empirical studies conducted by Moyi and Ronge (2016), indicates that VAT contribution is estimated to an average of 5.4% of GDP between the year of its introduction (1990) and the year 2015. The average of total tax contribution to gross domestic product (GDP) for the same period was 19.8%. This clearly indicates that in Kenya, VAT contributes substantially to the growth of the economy.

Suppliers of exempt goods & services (VAT Act 2013, first schedule) do not charge VAT on their supplies and cannot claim credit for VAT paid on their purchases. The VAT system also contains zero rated goods and services (VAT Act 2013, 2nd schedule). Businesses charge VAT at a rate of 0% on their supplies and are allowed to deduct the input tax paid on the purchase of those zero rated goods and services (VAT Act 2013 Sec 17). The government formulates policy and VAT laws, KRA oversees implementation of the laws, professionals offer services to ensure tax compliance, businesses act as agents in collecting VAT & remitting it to the government and the general public is concerned about the VAT rate which influences their spending and how the government is utilizing the VAT revenue collected. VAT contributes about 23% of the total tax revenue collection by the government (KNBS 2014).

1.1.4 Determinants of VAT performance

Gilligan et al (2005) studies on "perception of tax fairness and tax compliance in Australia and Hong Kong" concluded that there seem to be no universal relationship or pattern that exist cross culturally between the different facets of tax fairness perceptions and tax compliance behavior. Faridy (2015) studied on Value Added Compliance costs and Value Added Tax evasion of the SME sector in Bangladesh. It was concluded that analyzing tax evasion is a difficult exercise and taxpayers have a very strong incentive of concealing their tax evasion schemes.

In sub Saharan Africa, literature have confirmed that most tax payers do not comply with tax provisions because of lack of trust and even sometimes inability to meet certain obligations (Oyedokun, 2015). Furthermore, some studies affirmed that majority of those that complied partially did so perhaps because of likely penalty that could arise if liability arises after tax audit (Nyaga, 2014; Oyedokun, 2015). Besides, some comply because of fear of possibility of being audited by tax auditors (Anyaduba & Mogudu, 2013; Ladi & Henry, 2015). According to Kirchler (2007), noncompliance may take any of the following; not filing of tax return all, understatement of income and overstatement of allowable expenses with the intension of reducing tax liabilities. in Ethiopia has been the most visible tax reform undertaken (Tanzi & Zee, 2000). There is some evidence that after adopting VAT has been able to raise more revenues (Keen & Lockwood, 2010).

A report by UNCTAD (2010) suggests that taxpayers with higher level of tax knowledge through training tend to have positive attitude towards adoption of VAT in the social commerce. Resmi (2013), said that knowledge and understanding of tax laws is the process by which taxpayers understand about taxation and apply knowledge to pay taxes. Knowledge about tax law or tax regulation is assumed to be an important element for attitudes towards taxation. Tax education is very essential in order to increase level of tax compliance (Richardson, 2006). Jones and Rhoades (2011) aver that little knowledge on VAT regulation by taxpayers can result to evasion or unwillingness to comply and vice versa. Taxpayers' knowledge is viewed as a function of tax compliance (Lumumba et al, 2010). Also, other studies show that tax compliance costs are major determinants of compliance. Tax compliance costs tend to be regressive in nature (Schoonjans, van Cauwenberge, Reekmans, & Simoens, 2011).

In fact, SME taxpayers may face economic hardship as a result of proportionately higher compliance costs (Schoonjans et al., 2011) and their tax compliance levels may be lower (Arachi

& Santoro, 2007). High tax compliance costs may explain why SMEs' tax compliance levels are lower than expected, as many of these business entities may perceive the tax systems to be unfair.

Beekman (2010) suggests perceptions of the fairness of the tax system play a role in VAT compliance behavior. If tax system is perceived as fair, the social norms against VAT compliance in social commerce will be strengthened (Mukti, 2010). VAT evasion, then, becomes costlier by incurring a higher stake of bad reputation if caught and bad conscience if not caught. In other words, adoption of VAT in social commerce should be higher with a fairer tax system that led the society to perceive evading tax as a bad thing to do (Tigre and Dedrick, 2008).

Cost of compliance could also be a reason for noncompliance. Taxpayers incur two main types of compliance costs: gross monetary compliance costs and psychological costs. Gross monetary compliance costs include both actual money paid and opportunity costs relating to the time and other resources expended when complying with tax laws (Evans et al., 2014). Psychological costs, on the other hand, involve the estimation of stress and anxieties resulting from complying with tax laws, normally measured using a Likert scale (Evans et al., 2014). Some researchers have calculated net compliance costs which deduct cash flow benefits, tax relief and managerial benefits resulting from tax obligation from the gross compliance costs (Tran-Nam, Evans, Ritchie &Walpole, 2000).

1.1.5 Small and Medium Enterprises

According to Organization for Economic co-Operation and Development (OECD) (2005), small and medium-sized enterprises (SMEs) are non-subsidiary, independent firms, which employ less than a given number of employees. This number varies across countries. The most frequent upper limit designating an SME is 250 employees in most countries.

The SME's sector plays a crucial role in maintaining high employment and income generation and is therefore critical for a country to achieving sustainable growth. To enhance their role, SME's need to focus on a number of key business challenges such as reducing costs, improving employee productivity and building competitive advantage through producing quality products and services and other entrepreneurial interventions (UNCTAD, 2005). SMEs represent over 90% of private businesses and they contribute to more than 50% of employment and GDP in most African countries (UNIDO, 2009).

However, despite their contribution in terms of employment, statistics indicate that a high proportion of new SMEs fail within three years of start-up. For example, a study done by Cressy and Storey (2006) found that 30 per cent of new firms appear to cease training by the third year and 50 per cent by the fifth year. Also, Official figures show that less than 55 per cent of new VAT registrations survive for longer than three years, and less than 40 per cent survive for longer than five years. Cressy and Storey, using an independent database, claimed that less than 30 per cent of new firms survived longer than six years. Another study report by Mnewa and Maliti (2008), indicate that majority of small businesses are less likely to attain or maintain their growing profitability due to factors including tax policies. This implies that as a policy maker and regulator, Government must consider the factors that could affect the competitiveness of the small enterprises.

A more recent Economic survey 2019 report by Kenya National Bureau of Statistics (2019), shows that Small enterprises experienced an average decline of 4% points from 5.85 million to 5.616 million while medium enterprises experienced an average increase of 7% from 1.56 million to 1.669 million. Some of the major reasons given for these decline was increasing business expense. With previous studies having shown that taxation has some significant effect to profitability, there

is need to carry out a research in Kenya to establish whether these taxes could be part of these business expenses causing declines in SMES. The current research will be aimed at establishing the relationship that exist between the corporate taxes and the profitability of small and medium enterprise in Nakuru Town.

1.1.4 Nakuru Central Business District

According to Kenya National Bureau of Statistics (2019), Nakuru is the fourth-largest urban area in Kenya after Nairobi, Mombasa and Kisumu. It is the capital of Nakuru County and former capital of the rift valley province. Its population is 570,674 inhabitants according to the 2019 census, making it the largest urban Centre in the Kenyan mid-west with Eldoret in Uasin Gishu following closely behind. Nakuru lies about 1,850 m above sea level. Nakuru is Kenya's 4th largest urban center with a population of 570,674. (The modern town, as with many others in Kenya, derives its name from the 'Maasai' speaking people of Kenya.) Nakuru was established by the British as part of the white highlands during the colonial era and it has continued growing into a cosmopolitan city. It received township status in 1904 and became a municipality in 1952.

1.2 Statement of the problem

Value Added Tax was first introduced in France in 1954, and has over time been embraced by well over 100 countries. In the EU, most member states have registration thresholds. The UK's threshold of £81,000 is the EU's highest, and is perceived as a way for the government to reduce the compliance costs of small businesses not wishing to register for VAT. In Africa, introduction of VAT in Ethiopia has been the most visible tax reform undertaken (Tanzi & Zee, 2000). There is some evidence that after adopting VAT has been able to raise more revenues (Keen & Lockwood, 2010). In Kenya, VAT was introduced in to its tax system as a replacement of sales

tax in 2002 which came into force as of January, 2003 with the objective of enhancing economic growth; and enhancing saving and investment (Simiyu 2003).

Despite empirical studies showing the factors that affect compliance, financial reports have for a period of time shown revenue shortfalls as KRA miss its VAT targets. For example, the 2018/2018 annual revenue performance report by KRA shows that KRA managed to collect only Ksh. 409.5 billion from VAT against a target of Ksh. 464.2 billion (KRA 2019). In 2019/2020 financial year, the 2019/2020 revenue performance reports show that VAT reduced from Ksh. 464.2 billion in 2018/2019 to Ksh. 380.8 billion in 2019/2020 (KRA 2020). These revenue shortfalls have been blamed on tax evasion and other behaviors of tax non-compliance by SMEs and other small taxpayers. It is this worrying trend that warrants a research to be done in this area, and thus the current study will seek to establish the determinants of value added tax performance among small and medium enterprises in Nakuru Central Business District.

Tax evasion is categorized as the most frequent and extreme form of tax non-compliance. The level of compliance with existing tax laws depends on several factors which can be categorized into economic factors, social factors and demographic factors (Tanzi & Zee, 2000). Researchers across the world have studied these factors into details. For example, in Yemen, Helhel & Ahmed, (2014) established that attitudes, high tax rates and partial tax systems were the two major factors related to low tax compliance rate. In Malaysia, Normala and Obid (2013), confirmed that there is a significant relationship between the level of tax education and the level of VAT compliance. Locally, Jemaiyo and Mutai (2016) found that tax compliance cost, tax knowledge, tax penalties and tax audit had significant effect on level of tax compliance in real estate sector in Eldoret, Kenya. These studies though related to the current topic are out of context, and thus the need to

carry out the current study to establish the determinants of value added tax performance among small and medium enterprises in Nakuru Central Business District.

1.3 Objective of the Study

1.3.1 General objective

The general objective of the study was to establish the determinants of value added tax performance among small and medium enterprises in Nakuru Central Business District-Kenya.

1.3.2 Specific Objectives of the Study

The specific objectives of the study are;

    i.   To determine the effect of tax literacy on value added tax performance among small and medium enterprises in Nakuru Central Business District-Kenya.

    ii.   To establish the effect of compliance costs on value added tax performance among small and medium enterprises in Nakuru Central Business District-Kenya.

    iii.   To establish the effect of tax audit on value added tax performance among small and medium enterprises in Nakuru Central Business District-Kenya.

1.4 Research Questions

The study sought to answer the following questions:

    i.   What is the effect of tax literacy on value added tax performance among small and medium enterprises in Nakuru Central Business District-Kenya.?

    ii.   What is the effect of compliance cost on value added tax performance among small and medium enterprises in Nakuru Central Business District-Kenya.?

iii.   What is the effect of tax audits on value added tax performance among small and medium enterprises in Nakuru Central Business District-Kenya?

1.5 Significance of the Study

1.5.1 To KRA

The findings of this study is helpful to KRA in that, it was able to establish the effect of tax literacy, cost of compliance and incentives on VAT performance. They will thus be able to put in strategies to ensure proper tax education and reduce compliance cost.

1.5.2 To policy makers

The county government of Nakuru may benefit from the research in that the information was crucial in establishing tax regulation that will boost the growth of small businesses in the central business District of Nakuru County and the country at large. This business help improves so much on the revenue the government collect to use in developing other sectors in the nation.

1.5.3 To researchers

Academicians and researchers may also benefit greatly. The report is important to academicians who may wish to carry out further research in the taxation and this will add more to the existing body of knowledge. The results of the study provide useful information for researchers regarding taxation of Small, Medium Enterprises, and serve as preference for further studies.

1.6 Scope of the study

The research laid its primary focus on the determinants of value added tax performance among small and medium enterprises in Nakuru Central Business District. The variables under study was tax literacy, cost of compliance and tax audit. The study relied on primary data collected by means

of structured questionnaires administered to a sample of 236 respondents. The data collected was limited to Tax literacy, tax compliance costs, tax audit and VAT performance in Nakuru Central Business District. The study was covering 2019/2020 financial year.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the literature review on theories and empirical review linking VAT performance of SMEs in Nakuru Central Business District. Theoretical and empirical review helps in getting in-depth understanding of the current body of knowledge on the research topic and understanding studies that have been done on the same area by other researchers and the recommendations therein. Conceptual framework based on those theories, literature review and objectives was developed.

2.2 Theoretical review

The theoretical review of this study was based on the following theories that try to link the VAT performance by SMEs in Nakuru Central Business District. The three theories reviewed were Contract Theory, transaction cost economics theory and agency theory.

2.2.1 Contract Theory

Thomas Hobbes, John Locke and Jean-Jacques Rousseau are the best known proponents of contract theory (Hobbes et el. 1985). In economics, contract theory studies how economic actors can and do construct contractual arrangements, generally in the presence of asymmetric information. Information asymmetry deals with the study of decisions in transactions where one party has more or better information than the other. This asymmetry creates an imbalance of power in transactions, which can sometimes cause the transactions to go awry, a kind of market failure in the worst case (Wilson 2008).

A study by Schmidt and Keil (2013) has revealed that the presence of private information asymmetry within firms influences normal business activities. Firms that have a more concrete understanding of their resources can use this information to gauge their advantage over competitors. In Ozeml, Reur and Gulati's (2013) study, they found that 'different information' was an additional source of information asymmetry in venture capitalist and alliance networks; when different team members bring diverse, specialized knowledge, values and outlooks towards a common strategic decision making event, the lack of homogenous information distribution among the members leads to inefficient decision making.

Information asymmetry has been applied in a variety of ways in management research ranging from conceptualizations of information asymmetry to building resolutions to reduce it (Bergh, Ketchen, Orlandi, Heugens, Boyd, 2018).

According to this theory, the availability of information about existing tax laws to the SMEs can be of great help when it comes to reduction of cost of compliance.

Desai and Dharmapala (2006) argue that when an information asymmetry exists between managers and shareholders. A research done in US has suggested further costs, in the form of agency costs, lead shareholders to discount the value of firms (Desai & Dharmapala, 2006). They argue the lack of transparency provides managers with a "screen" or cover to hide self-serving actions (Desai et al., 2006).

A survey by Henderson Global Investors (2005) found a reluctance on the part of managers to disclose tax related risk management information to shareholders. This lack of awareness on the part of shareholders can lead to information asymmetry between managers and shareholders facilitating moral hazard. A related concern of shareholders is that managers who are "aggressive" with respect to tax planning may also be "aggressive" in their financial reporting decisions (Frank,

Lynch & Rego, 2009). Against this setting it is also relevant to consider the role of corporate governance mechanisms in moderating any relationship between tax compliance and firm value (Desai et al., 2006). The SMEs need to be equipped with this knowledge to assist them in doing tax planning. By doing tax planning, SMEs can greatly reduce taxes payable and the cost of compliance and improve compliance.

2.2.2 Transaction cost economics theory

The idea that transactions form the basis of an economic thinking was introduced by the institutional economist Commons (1931). These individual actions are really trans-actions instead of either individual behavior or the "exchange" of commodities. In economics and related disciplines, a transaction cost is a cost in making any economic trade when participating in a market (Pessali , 2006).

Pessali (2006), explains that Ronald Coase who is the proponents of modern transaction cost economics theory based it on the following assumption: that transaction costs depend on the frequency of transaction, specificity of the buyer and seller, uncertainty of the transaction, limited rationality and opportunistic behavior of the parties involved. Thus small and frequent transactions are costly than large and few transactions since most of transaction costs are fixed costs in nature. On the other hand, if the seller has more information about the market price of the property been transacted, there is likelihood that he will take the advantage of the information asymmetry to charge more price to the buyer.

Together, the compliance costs and administrative costs are defined as the operating cost of taxation (Evans, 2001). According to the study by Economic Commission for Africa (2001), the policy and regulatory environment in many African countries was still wanting in many respects, the policies impose high costs of doing business (Beyene, 2002). As well, complicated tax systems

make it difficult and expensive for some taxpayers to comply with policies and procedures owing to the costs associated with record keeping and the need for specialized information to comply with complex tax laws (Bird & Wallace, 2003) .This has placed more pressure upon small enterprises in developing countries to operate outside official reporting system (Kayaga, 2007), since the tax rules increase the labor costs which in turn provide a great incentive to avoid costs by working in the shadow economy of non-reporting (Schneider & De soto, 1989).

Borrowing from economics, high compliance costs results in a deadweight resource costs on society, distorted production decisions, reduced investment, higher deficits, reduced tax equity and adverse price movements; consequently, resentment of high compliance cost may lead to increased noncompliance and lower tax yields (Chattopadhyay and Das-Gupta, 2002). They further suggest that large compliance costs could be responsible for the high tax gap in developed countries given the fact that such economies relatively have efficient tax administration.

Generally, any tax paid is an expense to the business. In addition to the tax paid, there are other cost known as tax compliance costs that are incurred by tax payers. They include the costs of making online returns, involving a tax consultants or agents for advices on taxes, legal costs involving tax disputes among others. According to Roeck, Sternberg and Hofmann, (2019) most of these transaction costs are fixed costs in nature unlike the tax itself which is variable cost. SMEs in Nakuru need to reduce the frequency in which they hire the services of these consultants so as to avoid these fixed costs. This had the effect of reducing the cost associated with tax payment, and thus increase tax compliance.

2.2.3 Agency theory

In social science, agency is defined as the capacity of individuals to act independently and to make their own free choices. By contrast, structure are those factors of influence (such as social class,

religion, gender, ethnicity, ability, customs, etc.) that determine or limit an agent and their decisions (Barker 2005). Karl Marx, the proponent of agency theory argued that in modern society, people were controlled by the choices based on their own selfish desires, or the "will to power" (Littlejohn & Foss 2009).

Hewson, (2010), an associate at the York Centre for International and Security Studies, York University, describes three types of agency: individual, proxy, and collective. Individual agency is when a person acts on his/her own behalf, whereas proxy agency is when an individual act on behalf of someone else (such as an employer). Collective agency occurs when people act together, such as a social movement. An agency relationship occurs when one or more principals such as the owner engage another person as their agent to complete a task on their behalf. In order to be effective, this task implies the delegation of some decision-making authority to the agent.

This theory is associated with conflicting interests of shareholders and management of organizations, suggesting that the less informed party will have to demand for information that monitors the behaviour of better informed manager (Akinbuli, 2010). According to Hayes et al (1999), assumptions are made that agency theory can be used to explain the supply side of the audit market. The contribution of an audit to third parties is basically determined by the probability that the auditor will detect errors in the financial statements and the auditor's willingness to report these errors. Then independence is emphasized in auditing.

The Audit Quality Forum by the Institute of Chartered Accountants in England & Wales (2005) refers to other cases in the same manner with a "tendency for agents to be more optimistic about the economic performance of an entity of their performance under a contract than the reality would suggest". What is more, agents are likely to be more risk averse than principals. Correspondingly of these differing interests, agents can be encouraged to distort information flows. Moreover,

principals may also formulate concerns about information asymmetries in which agents possess information to which principals do not have access (Forum, 2005).The Audit Quality Forum (2005) thus concluded than a simple agency model involves that, " as a result of information asymmetries and self-interest, principals lack reasons to trust their agents and will seek to resolve these concerns by putting in place mechanisms to align the interests of agents with principals and to reduce the scope for information asymmetries and opportunistic behaviour ".

Based on this theory, the SMEs can be assumed to be the agents since they have been entrusted with the duty of collecting taxes on behalf of the tax authorities in their jurisdiction. The SMEs are assumed to have more knowledge on the quantity of taxes collected on behalf of the tax authorities, who are the principals. With this tax asymmetry, the SMEs are like to disclose their income partially with an aim of reducing their tax liabilities. The principal who is the KRA in this case need to audit the books of the SMEs whom they suspect to be evading tax payment. SMEs thus declare correct income if they suspect that the tax authorities may audit them leading to increased tax compliance by the SMEs.

2.3 Conceptual Framework

Conceptual framework is a set of broad ideas and principles that are taken from relevant fields of enquiry to be used to structure a subsequent presentation (Kombo and Tromp 2009). It comprises the Independent variable which is the presumed cause of the changes of the dependent variable and the dependent variable which the researcher wishes to explain (Kothari 2014).

The independent variables were tax literacy, cost of compliance and tax audit while the dependent variable was VAT performance. The indicators of tax literacy were tax trainings, tax seminars and media advertisements while those of costs of compliance was professional costs, filing costs and

record keeping costs. For tax audits the measures was desktop audit and field audit while VAT performance was tax payment and return filing.

```
┌─────────────────────────────────┐
│        TAX LITERACY             │
│                                 │
│  ❖ Tax trainings               │─────────┐
│  ❖ Tax seminars                │         │
│  ❖ Media advertisements        │         │
│                                 │         │
└─────────────────────────────────┘         │
                                            ▼
┌─────────────────────────────────┐   ┌──────────────────────────┐
│     COSTS OF COMPLIANCE         │   │   VAT PERFORMANCE        │
│                                 │   │                          │
│  ❖ Professional costs          │   │  ❖ Tax Payment          │
│  ❖ Filing costs                │──▶│  ❖ Return Filing        │
│  ❖ record keeping costs        │   │  ❖ Amount paid          │
│                                 │   │                          │
└─────────────────────────────────┘   └──────────────────────────┘
                                            ▲
┌─────────────────────────────────┐         │
│          TAX audits             │         │
│                                 │         │
│  ❖ Desktop audit               │─────────┘
│  ❖ Field audit                 │
│  ❖ Registration audit          │
│                                 │
└─────────────────────────────────┘
      Independent variables              Dependent variable
```
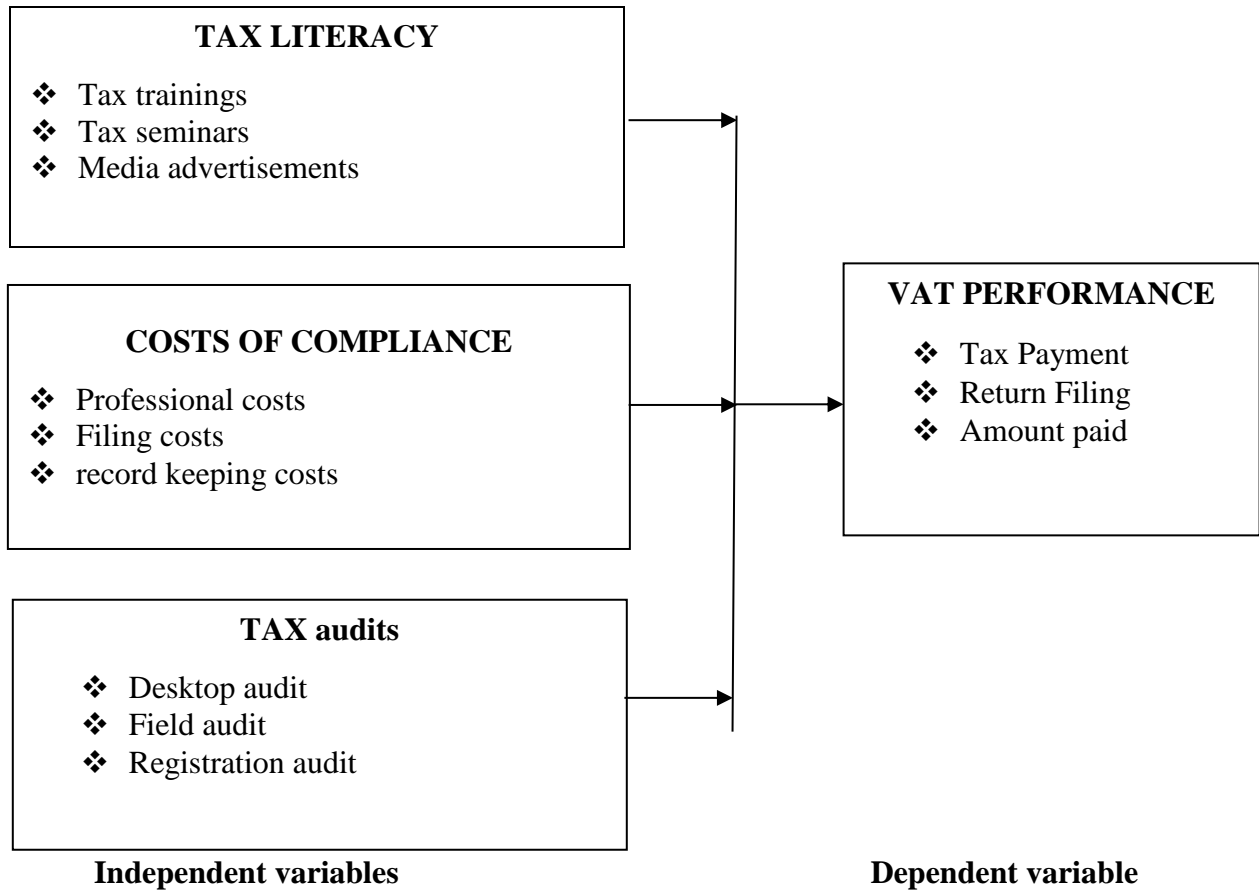
Figure 2.1: Conceptual Framework

The relationship between tax literacy, tax compliance cost, tax audit and VAT performance of small and medium enterprises was discussed using the dependent and independent variables. These variables were helpful in understanding the way they relate with each other, and how that affects the performance of small and medium enterprises in the Kenyan economy, particularly in Nakuru Central business district.

2.4 Empirical Reviews

This section reviews previous research and debates around the determinants of value added tax performance, mainly focusing on the literature on compliance behavior. It contains literature on research undertaken within Kenya and the corresponding literature in the rest of the world.

2.4.1 Tax Literacy and VAT performance

Kwok and Yip (2018) evaluated on the tax education good or evil for boosting tax compliance in Hong Kong. This was to clarify suggestions from many researchers who viewed that tax education foster compliance while others argued that tax knowledge inspires tax evasion. The analysis explored on tax education and whether it improves tax compliance using 600 respondents from Hong Kong. The research model consolidated on the information and findings showed that taxpayers comply if they are able and willing to positively perceive tax system as being fair and morally believe that is right to comply.

Oxley and Yeung (2010) cross-border survey of VAT compliance finds that taxpayer training level does influence their decision making in effecting the adoption of VAT in the social commerce. Kenny (2009) empirical evidence indicates that uncertainty of VAT systems via social commerce reduces compliance whilst information or knowledge has a positive impact on compliance. Tax administrations are encouraged to use communications as an effective tool to deliver relevant tax knowledge and continuous tax education programs to encourage taxpayers to comply and at the same time will deter them from non-compliance while using social commerce.

Otieno (2011) studied the effect of taxpayers' education on VAT performance among Small and Medium Sized Enterprises in Kenya and established that, despite the increased number of Micro and Small Enterprises in Kenya, majority (72%) of them are not compliant to VAT. It was noted that most of the industry players were willingly dodging to submit their VAT due to inappropriate

mechanisms to monitor and track business transaction. However, it was noted that the study was confined to one variable and concentrated on Small and Medium Sized Enterprises in Mavoko Municipal Council.

2.4.2 Cost of compliance and VAT performance

Luca, Richard and Jaime (2012) found a positive correlation between the gaps in Value Added Tax and Value Added Tax compliance cost among the European member states but disputed the causality relationship between tax compliance cost and tax compliance. The data used were sourced from the world bank which matched tax compliance cost with VAT gaps in the European Union. While acknowledging the established association, they argued that data was skewed with regard to VAT and compliance cost among the European Union member states. They urged for further research to test causality with more reliable data.

While the cost of compliance is a factor across the board, Pope et al (2008) in their study of the cost of tax compliance in Malaysia, concluded that it is heavier on medium and small enterprises. In a separate study in Zimbabwe, Maseko (2014), it was revealed that unlike large companies, MSEs face different business conditions, which make them to endure a high tax compliance load. Razak and Adafula (2013) assert that this had an effect on the attitude of taxpayers and subsequently, their compliance citing the relatively high tax rate in Ghana. On the positive side, awareness of how the collected revenue was utilized tended to impact positively on the decision to comply (Razak & Adafula, 2013).

Locally, Abdul and Wang' ombe (2018), carried out a study to examine the influence of measures of tax compliance costs on tax compliance behaviour among medium and large corporate taxpayers in Kenya. The study used Structural Equation Modelling (SEM) technique to establish the key cost drivers built using survey data, while controlling for key attributes of the tax system as well as

firm characteristics. The results indicate that tax compliance in Kenya significantly declines with increase in tax compliance costs, particularly those related to understanding of the existing complex tax laws, changes in tax rules as well as general costs of meeting the compliance and regulatory requirements. The model constructs account for about 40% of variations in tax compliance behavior in Kenya, which is above the empirically accepted minimum for exploratory studies.

2.4.3 Tax audit and VAT performance

Adediran, Alade and, Oshode, (2013) conducted a study with the title the impact of tax audit and investigation on revenue generation in Nigeria. The data for this study were generated from primary sources through the use of 500 questionnaires administered to the staff of the Federal Inland Revenue Service (FIRS) and Edo State Board of internal Revenue, Edo State of Nigeria. The data was then analysed using Pearson's correlation coefficient with the Statistical Package for Social Sciences (SPSS). The study established that Tax Audit and Investigation can lead to an increase in that Tax audit and investigations can help to curb the problems of tax evasion and tax avoidance to a great extent. Tax audit and investigations serve as motivating factors to the tax payers in carrying out their tax obligations in Nigeria and that tax audit and investigation can be regarded as the solution to Nigeria tax problems.

A study carried by Olatunji and Temitope (2018) to establish the effects of tax audit on tax compliance in Ekiti state, Nigeria established that tax audits are yet to make any substantial effect on tax compliance culture in Ekiti State, Nigeria. Study consisted of 30 staff of the Ekiti State Board of Internal Revenue and 30 Federal Inland Revenue Service, Ekiti State They recommended that the relevant tax authority at all levels should improve the standard of tax audit employed for

effectiveness and efficiency and equally, relevant tax authority should provide a policy that would allow the tax payers to cooperate during the period of tax audit.

Using 613 respondents from Federal Inland Revenue Service (FIRS) office in Port Harcourt, Amah, & Nwaiwu (2018) did a study with the title tax audit practice and down south tax revenue generation in Nigeria. The study established that tax audit provides a window for increasing government tax revenue.

Locally, a study done by Nyakamba (2014), to establish the effects of tax audit on revenue collection, case of Kenya Revenue Authority established that tax audit actually has an effect to revenue collection. The t – tests showed a significance in the correlation between tax collected before the audit and after the audit. study was carried out among the 58 taxpayers audited in 2010 located in Nairobi West.

2.4 Critique of the Literature

The findings from the study by Aoki (2014) show that awareness of taxpayers due to tax compliance is not significantly related to financial performance, however, it recommended that, rate of tax affect performance in terms of tax collection and financial performance of commercial banks. This has created gap to examine the impact tax awareness among other sectors which have been increasingly affected by taxation. Also, it is a contradiction for the theory to suggest that tax awareness has no influence on financial performance of firms, and still go further and suggest that tax rate has influence in performance of commercial banks. It is expected that a tax payer should be aware of existing tax rate, tax point and even the type of tax that he should pay. This shows that tax awareness is key for tax payers to do tax incentives.

The bulk of the literature reviewed classifies taxpayers as a 'micro and small enterprises' based on the definitions in developed economies whereby a 'micro and small enterprises' means a different thing when defined in a developing Country like Kenya. The inferences and comparisons relied on in the review are dominated by surveys conducted by KPMG (2006) and Shaw et al (2008) study in the United Kingdom, Philip et al, (2012) and Lignier and Evans (2014) in Australia, Evans & Tran-Nam (2014) in New Zealand and Lederman (2018) work among the US tax payers. The lack of harmony in the definitions renders inconsistent, the conclusions drawn in Shekidele (1999) study of tax compliance in Tanzania, Razak and Adafulla (2013) study in Ghana and Maseko (2014) study of Zimbabwe's small and medium sized enterprises.

2.5 Summary of literature

The study by Kenny (2009) established that uncertainty of VAT systems via social commerce reduces compliance whilst information or knowledge has a positive impact on compliance while Normala and Obid (2013) confirmed that an increase in tax knowledge would increase the level of voluntary tax compliance. The descriptive statistic results of a study by Armah- Attoh and Awal (2013) implied that, the integrity of Ghana Revenue Authority officials is very low in the eyes of Ghanaians while Porcano (2013) showed that the probability of detection through audit was statistically significant

The Kenya's study by Abdul and Wang' ombe (2018), indicate that tax compliance in Kenya significantly declines with increase in tax compliance costs, particularly those related to understanding of the existing complex tax laws, changes in tax rules as well as general costs of meeting the compliance and regulatory requirements while Jemaiyo and Mutai (2016) found that tax compliance cost, tax knowledge, tax penalties and tax audit had significant effect on level of tax compliance

2.6 Research Gaps

Kwok and Yip (2018) used tax evasion as a dependent variable while Amah, & Nwaiwu (2018) used tax revenue generation. Locally, Nyakamba (2014), used revenue collection as dependent variable. These studies created a conceptual gap. The current study bridged that gap by using VAT performance as the dependent gap.

Oxley and Yeung (2010) used cross-border survey while Abdul and Wang' ombe (2018) used Structural Equation Modelling (SEM) technique. Adediran, Alade and, Oshode, (2013) used Pearson's correlation. A methodological gap is created as the current study used descriptive research design.

The study by Otieno (2011), Luca, Richard and Jaime (2012) creates a contextual gap as the study were either done 10 years ago or were done in other countries. A local more current study was necessary hence the current research will bridge the gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the plan and methodology the researcher used in order to reach the required population, collect and analyze data to achieve the research objective. In particular, this chapter shows the design of the study, target population, sampling designs and procedures, and show how the research findings was presented.

3.2 Research design

The study used descriptive research design. This was used to describe the state of affairs, as it exists at present to describe variables and situations and to establish the relationship between variables. Descriptive research design provide opportunity for considering many different aspects of the study. Descriptive designs are not only restricted to fact-findings but also may often result in formulation of important principles of knowledge and solutions to significant problems. According to Mugenda and Mugenda (2003), descriptive research seeks to establish factors associated with certain occurrences, outcomes, conditions or type of behavior. Descriptive design was used in this research because of its appropriateness in establishing relationships between variables and facilitating the collection of information for determining the population parameter. The descriptive studies are the most appropriate for this research because in the research, the researcher collected information on the state of affairs of small and medium enterprises due to indirect taxes, without manipulating any variables.

3.3 Target population

According to Cooper and Schindler (2011), population is the total collection of elements about which one wish to make some inferences. The target population should have some observable characteristics, to which the study intends to generalize the results (Mugenda and Mugenda 2003). According to Kenya Revenue Authority (2020), there are 578 Small and Medium Enterprises registered in the i-Tax system which formed the target population of the current study.

3.4 Sampling size and Sampling Technique

According to Särndal, Swensson and Wretman (2003) a sampling frame is the source material or device from which a sample is drawn. It is a list of all those within a population who can be sampled, and may include individuals, households or institutions. Considering that this is a probability sample, the most effective sampling frame is to ensure it enlists the entire cases from the derived samples.

3.4.1 Sample Size

A sample size must be large enough to be representative of the universe population (Kothari, 2012). Creswell (2014) stresses that sample size chosen by the researcher should be capable of giving enough information about the population and one which can be analyzed with ease. Slovin's formula was adopted in this study to determine the sample size. The formula was adopted in the calculation of sample size (n) when the size of the population (N) and an error of margin €. The formula is a scientific technique that is use in the estimation of the sample size. This Formula was chosen because it considers the size of the population.

$$n = \frac{N}{1 + NE^2}$$

Where by:

n = number of samples

N = target population

E = margin of error (0.05)

$$n = \frac{578}{1 + 578 * 0.05^2}$$

$$n = 236$$

3.4.2 Sampling Technique

According to Kiss and Blomquist (2009), the sampling frame for a particular sample is evidently a representative population from where it is derived from. Sampling procedure is the process of selecting a sample size. Stratified random sampling was used to select 236 respondents from a target population of 578. Thus the population was classified into strata based on the sectors where they operate. A sample of 236 participants was proportionately selected from each strata using the formula n/N where n is the sample size and N is the target population.

Table 3.1: Sample Size

Sector of economy	Target population	Sample
Telecommunications	81	34
Tourism and hospitality	88	36
Manufacturing	133	54
Transport	131	53

Agriculture	145	59
Total	**578**	**236**

3.5 Research instruments

This study used primary data and it was collected using a closed ended questionnaire. According to Chandran, (2004) primary data is first-hand information received from a respondent. According to Cooper and Schindler (2011), self-administered questionnaires are used in descriptive studies because they cost less. The questionnaire used is shown in appendix II.

3.5.1 Piloting of the instruments

A pilot study also known as pilot test or pilot experiment is a small scale preliminary study conducted before the actual study with an aim evaluating the feasibility, time, cost, adverse effects in order to improve upon the study design prior to the actual research (Hulley 2007). The questionnaires were pilot tested in the ideal environment under which the study was conducted by issuing a few questionnaires to individuals in each stratum. The questionnaire had a statement at the end requiring the participants to suggest any improvement that they think needs to be done on the questionnaire. Based on the respondents' feedback, appropriate changes to the questionnaire were made. This helped ensure that the administered questionnaires used for data collection were relevant and applicable in realizing the desired objectives.

3.5.2 Validity test

Validity is the degree to which results obtained from the analysis of the data actually represents the phenomenon under study. Validity was ensured by having objective questions included in the questionnaire and by pre-testing the instrument used to identify and change any ambiguous, awkward, or offensive questions and technique as emphasized by Cooper and Schindler (2003).

29

Expert opinion were requested to comment on the representativeness and suitability of questions and gave suggestions of corrections made to the structure of the research tools. This helped to improve the content validity of the data that was collected.

3.5.3 Reliability test

According to McMillan & Schumacher, (2010) reliability of research instruments means the repeatability, stability or internal consistency of a questionnaire. Reliability on the other hand refers to a measure of the degree to which research instruments yield consistent results (Mugenda & Mugenda, 2003). The reliability of the measures used in the questionnaire was established using Cronbach's alpha. According to Ritter (2010), the theoretical value of alpha varies from 0 to 1, since it is the ratio of two variances. Bryman (2008) suggests that where Cronbach's alpha is used for reliability test, alpha values for items included in a study should not be lower than 0.70.

3.6 Data collection procedure

The researcher used primary data. The primary data was collected by use of a questionnaire. In order to know the relationship between corporate tax and the profit levels of SME's, questionnaires were distributed or provided to the top managers of the selected firms. The questions were close ended. The reason for choosing questionnaires is because it is less costly, convenient and not biased. Enough copies of questionnaires were prepared and the researcher personally administer the questionnaires to the sample of Small and Medium Enterprises in the Nakuru Town. This was to ensure high response rate. Enough time was allowed to fill the questionnaires and after one week, they were collected. One of the ways to maximize questionnaires response as well as the return rate is by sending a preliminary notification about the questionnaires and writing passionate requests for cooperation by the respondent. To this end, the researcher made passionate appeals to

the owners or managers of these selected SMEs to cooperate by filling the questionnaires' and then alerting the researcher for collection.

3.7 Data analysis

After editing for consistency and completeness of the information the data was transformed for subsequent analysis by means of a computer software in which case, IBM SPSS was used as suggested by Sekaran & Bougie (2016). The relevant descriptive statistics such as standard deviation, mean, variance, and mode output was recorded along with correlation and regression analysis for subsequent model testing.

3.7.1 Regression model

According to Hosmer and Stanley (2000) for any data analysis, which is concerned with describing the relationship between a dependent variable with the independent variables, regression models have become an integral component. The estimated model used is as below:

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

Where:

Y = VAT Performance

X_1 = Tax literacy

X_2 = Cost of compliance

X_3 = Tax audits

β_0 = Constant term

β_1 = regression coefficients for X_1

β_2 = regression coefficients for X_2

β_3 = regression coefficients for X_3

ε = the error term

3.8 Ethical considerations

The researcher informed each respondent about the purpose and objectives of study and sought written consent from respective respondents. In working with the respondents, the researcher assured protection by informing the respondent did not disclose their identities or names in the instrument and in the publication of this particular study.

3.9 Operationalization and measurement of variables

The variables of concern in this research were compliance costs, tax literacy and tax audits. These variables cannot be directly measured hence the need to identify measurable indicators to take the place of the variables. The measurements of the variables were measured by the Likert Scale points as shown in table.

Table 3.2 Operationalization and measurement of variables

Variable	Indicator	Source	Data collection instrument	Measure	Data analysis
Tax literacy	Level of education	Vermeulen (2006)	Questionnaire	5-point Likert scale	Multiple regression analysis
	Media Advertisements	Aoki (2014)	Questionnaire	5-point Likert Scale	Multiple regression analysis
	Seminars	Aoki (2014)	Questionnaire	5-point Likert Scale	Multiple regression analysis

Cost of compliance	Professional costs	Jens and Schwellnus (2008)	Questionnaire	5 Point Likert scale	Multiple regression analysis
	Filling costs	Rohaya, Nor'Azem and Bardai, (2010)	Questionnaire	5-point Likert scale	Multiple regression analysis
	Record keeping costs	Mwangi and Nganga (2007)	Questionnaire	5 - point Likert Scale	Multiple regression analysis
Tax audits					
	Desktop audit	Nyakamba (2014)	Questionnaire	5-point Likert scale	Multiple regression analysis
	Field audit	Nyakamba (2014)	Questionnaire	5-point Likert scale	Multiple regression analysis
VAT Performance	Tax Payment	SenHadji (2012)	Questionnaire	5-point Likert scale	Multiple regression analysis
	Return Filing	Al-Timid (2011)	Questionnaire	5-point Likert scale	Multiple regression analysis

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION OF FINDINGS

4.1 Introduction

The chapter gives the results for a study whose objective was to establish the determinants of value added tax performance among small and medium enterprises in Nakuru Central Business District-Kenya.

4.2 Reliability Test Results

A pilot test was done using 10 SMEs randomly selected in Eldoret town to ascertain the dependability of the research instrument. The results are shown in table 4.1.

Table 4.1: Reliability of research instrument

Variable	Cronbach's Alpha	Number of Items
Tax Literacy	.78	4
Cost of compliance	.71	4
Tax audit	.76	4
VAT Performance	.81	4

A Cronbach's alpha coefficient was used to assess the instrument's reliability. That is to ascertain the repeatability, stability or internal consistency of a questionnaire used in the research. Cronbach's alpha coefficient for the four items, which include tax literacy, cost of compliance, tax audit and VAT performance had Cronbach's alpha coefficients of 0.78, 0.71, 0.76 and 0.81

respectively. Each of the Cronbach's alpha coefficients is above 0.7 suggested by Bryman (2008). These results shows that the questionnaire could be used to collect data for the four variables.

4.3 Response Rate

A total of 236 questionnaires were distributed to the SMEs in Nakuru CBD. After they were filled, the questionnaires were collected them for subsequent analysis. The results are as shown in table 4.1.
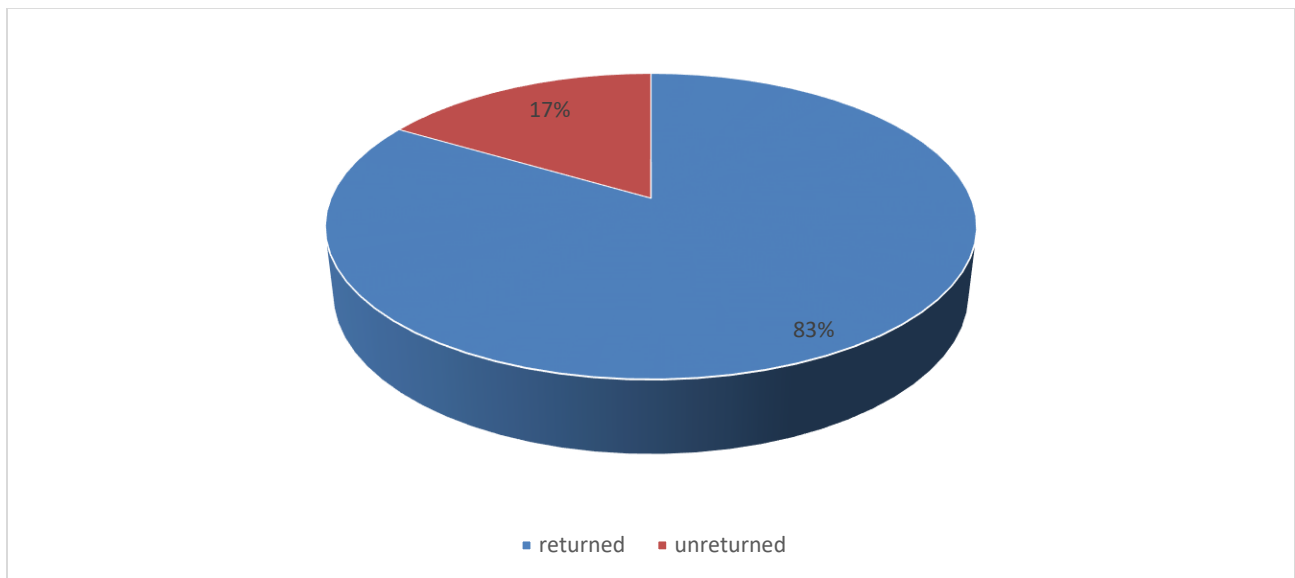
Figure 4.1: Response Rate

Out of 236 questionnaires distributed to the respondents, 197 questionnaires were fully filled and returned for subsequent analysis. This represented a response rate of 83%. The response rate is considered adequate for data analysis as suggested by Kothari (2014) who stated that response rate of 60% and above is good while over 70% was very good. Only 17% of the total respondents never responded or never filled their questionnaires.

4.3 Demographic Analysis

Demographic analysis of the respondents and their businesses was then done. The demographic analysis includes the gender of the respondent, the education level and the period their SMEs have been in operation.

4.3.1 Gender distribution of the respondents

The respondents were required to state their gender. The responses from the 197 respondents was recorded in figure 4.2.
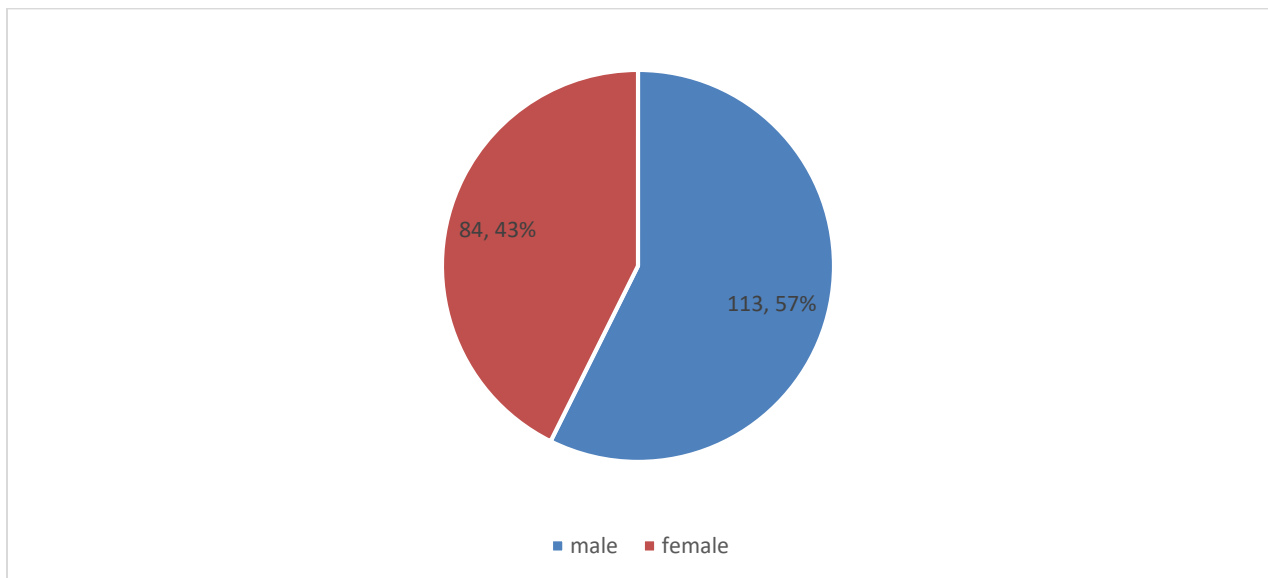
Figure 4.2: Gender of Respondent

From these results, 113 (57%) of the respondents were male while 84(43%) were female. The indication is that majority of SMEs in Nakuru CBD are owned by men. This depects the scenarial in all sectors where men dominate every sector of the economy. However, the number of women in informal sector seem to be increasing of late which can be attributed to availability of capital for women enterprises from both government and non-governmental organizations like Kenya

Women Finance Trust and the capitation given by the office of women representative in the counties.

4.3.2 Education level

The respondents were also required to state their highest educational level. The results from 197 respondents who fully filled and returned their questionnaires were analyzed and presented in figure 4.3.
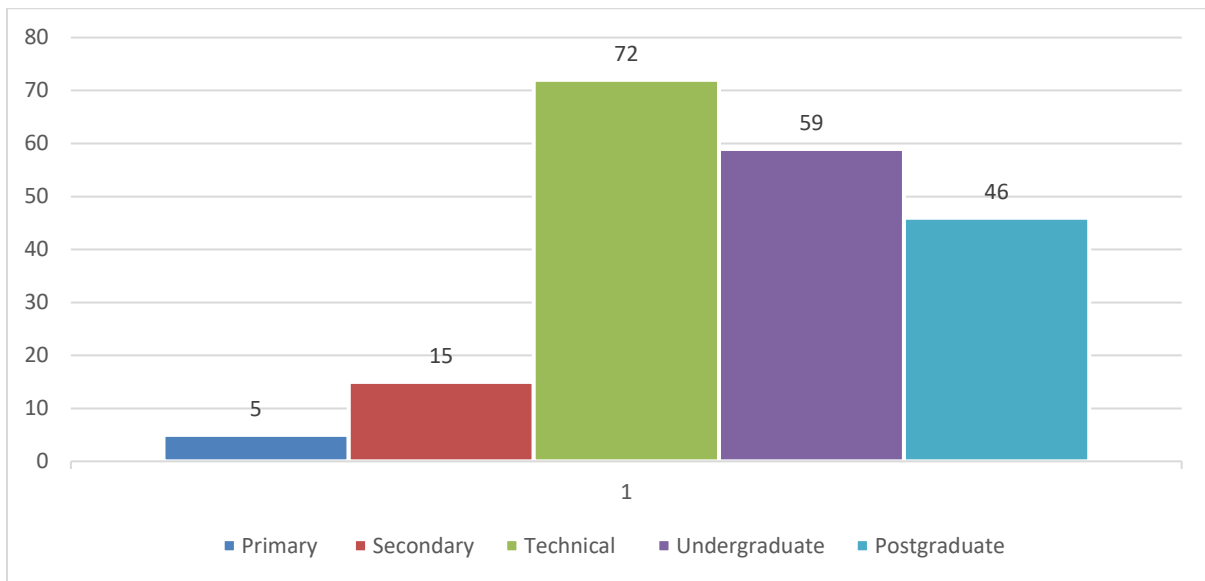
Figure 4.3: Education level

The results presented in figure 4.3 shows that out of 197 respondents, 5 had primary school education as their highest academic level, 15 had their highest level of education as secondary school certificate. Majority (72) stated that their highest level of education was technical education, which includes college diplomas and certificates. Undergraduate level was 59 while post graduate level were 46. The study established that most respondents had formal education and thus they could respond to the questionnaires on concerning VAT performance without need of an interpreter.

4.3.3 Period SME has been in operation

Period that an SME has been in operation was also of importance. The results from 197 responses were presented in figure 4.4 below.
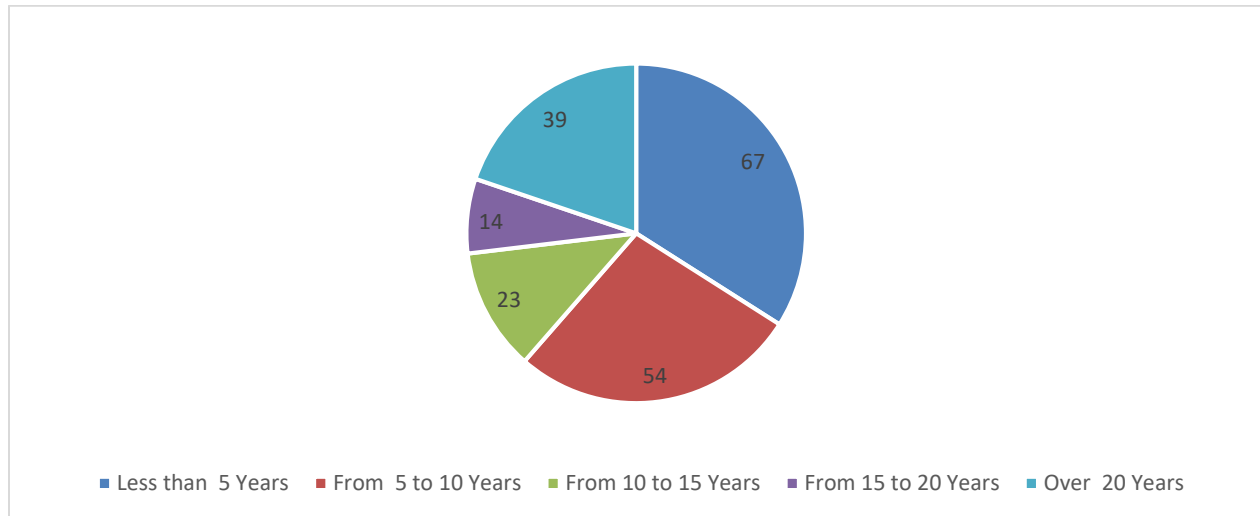
Figure 4.4: Period SME has been in operation

Figure 4.4 shows the number of years the SME has been in operation. The study indicated that majority of SMEs (67) have been in operation for less than 5 years, 54 SMEs have been in operation for between 5 and 10 years, 23 SMEs having been in operation for between 10 and 15 years, 14 SMEs have been in operation for between 15 to 20 years and those SMES that have been in operation for over 20 years were 39.

These results shows that majority of SMEs are young with only less than 5 years of operation. Mnewa and Maliti (2008), stated that SMEs are less likely to attain or maintain their growing profitability due to several factors including tax policies making half of them collapse by end of 1st year, a quarter of remaining by end of 5 years and a third of reaming by end of 10th year. This explains why the number of SMEs keep decreasing as time goes on.

4.4 Diagnostic Tests

In order to achieve unbiased estimates of the study parameters, various assumptions of regression were tested. These included normality test and multicollinearity test of the three independent variables.

4.4.1 Normality test

To test whether the data was normally distributed, Shapiro Wilk test. This is because Shapiro–Wilk has the best power for a given significance, followed closely by Anderson–Darling when comparing the Shapiro–Wilk, Kolmogorov–Smirnov, Lilliefors, and Anderson–Darling tests (Razali and Wah 2011). Results of the normality test are presented in table 4.2.

Table 4.2: Normality test

Variable	Shapiro-Wilk		
	Statistic	df	Sig.
Tax Literacy	.607	197	.19
Cost of compliance	.521	197	.23
Tax audit	.511	197	.37
VAT performance	.651	197	.25

a. Lilliefors Significance Correction

The normality of data was tested using the Shapiro Wilk test. The p values for tax literacy, cost of compliance, tax audit and VAT compliance were found to be 0.19, 0.23, 0.37 and 0.25 respectively. Since the p value is greater than the chosen alpha level, then the null hypothesis that the data came from a normally distributed population cannot be rejected (Razali and Wah 2011).

4.4.2 Multicollinearity

Multicollinearity test was carried out to determine if one or more independent variable in regression model are highly correlated. Tolerance value and Variance Inflation Factor (VIF) are used to test multicollinearity. Tolerance value of less than 1 and VIF value of more than 10 suggest presence of multicollinearity.

Table 4.3 Multicollinearity

Model	Collinearity statistics	
	Tolerance	**VIF**
Tax Literacy	.56	1.786
Cost of compliance	.78	1.282
Tax audit	.64	1.562

The results Table 4.3 established that tax literacy had VIF of 1.786, Cost of compliance had VIF of 1.282 while tax audit had a VIF of 1.562. All the three independent variables had their VIF less than 10, thus there is no multicollinearity and thus regression analysis was conducted to determine the effect of the tax literacy, cost of compliance and tax audit on VAT performance.

4.5 Descriptive Statistics

The findings are derived from a Likert scale in the questionnaires where the respondents were supposed to indicate their level of agreement or otherwise with a given statement. The descriptive statistics was done based on each independent variable/objective.

4.6.1 Tax Literacy and VAT performance

The first objective of the study was to determine the effect of tax literacy on VAT performance among SMEs in Nakuru CBD. The results from a 5 point Linkert scale questionnaire are shown in table 4.5.

Table 4.4: Tax Literacy

Statement	N	Min	Max	Mean	S.D
Several tax trainings conducted by KRA through workshops and seminars in Nakuru CBD has equipped SMEs with basic understanding of tax laws.	197	1	5	4.58	.395
I have basic understanding of tax laws from the basic education in schools and colleges	197	1	5	3.74	.971
I access information on the aggregate taxes collected and how they are spent	197	1	5	2.74	1.318
I have access to tax education through media advertisements, magazines and from the KRA website	197	1	5	3.93	.973
Valid N (listwise)	**197**				

To great extent, several tax trainings conducted by KRA through workshops and seminars in Nakuru CBD has equipped SMEs with basic understanding of tax laws (Mean=4.58, Standard Deviation =0.395). The low standard deviation is an indication that the respondents agreed in their responses. Also, the respondents stated to an extent that they have basic understanding of tax laws from the basic education in schools and colleges as indicated by a mean of 3.74 accompanied by

41

a standard deviation of 0.971. the high standard deviation mean that the respondents differed on the statement. This could be result of few respondents who indicated that they have never been to institutions of higher learning. Also, SMEs have an access to tax education through media advertisements, magazines and from the KRA website (Mean=2.74, Standard Deviation=1.318).

However, concerning access to information on the aggregate taxes collected and how they are spent, the results show that KRA rarely share the information concerning collections and how they are spent (Mean=3.93, Standard Deviation=0.973). These results shows that there is some level of tax literacy among the SMEs in Nakuru CBD.

4.6.2 Cost of compliance and VAT performance

The second objective of the study was to determine the effect of Cost of compliance on VAT performance among SMEs in Nakuru CBD. The results from a 5 point Linkert scale questionnaire are shown in table 4.6.

Table 4.5: Cost of compliance

Statement	N	Min	Max	Mean	S.D
I regularly hire services of an experienced tax agents which is expensive for SME	197	1	5	2.90	1.243
The cost of keeping records is too high to the SME	197	1	5	3.61	1.098
Staff training on matters related to tax is expensive for the SMEs to afford	197	1	5	3.53	1.123
The cost of preparing, filing and submitting returns make significant part of indirect costs	197	1	5	3.62	1.171
Valid N (listwise)	**197**				

From the results most SMEs don't hire the services of an experienced tax agents (Mean=2.90, Standard Deviation=1.243). The high standard deviation is an indication that the respondents disagreed among themselves concerning the statement. Also, to some extent, the results shows that staff training on matters related to tax is expensive for the SMEs to afford (Mean=3.53, Standard Deviation=1.123). Concerning record keeping, the descriptive statistics shows that the cost of keeping records is too high to the SME (Mean=3.61, Standard Deviation=1.098). Lastly, the results indicated that the cost of preparing, filing and submitting returns make significant part of indirect business costs (Mean=3.62, Standard Deviation=1.171).

In all cases, the standard deviation was more than 1 and the range of responses lied between 1 and 5. This range also explain why the standard deviation is high. The respondents were of varying opinion on the variable cost of compliance.

4.6.3 Tax audit and VAT performance

The third objective of the study was to determine the effect of Tax audit on VAT performance among SMEs in Nakuru CBD. The results from a 5 point Linkert scale questionnaire are shown in table 4.6.

Table 4.6: Tax audit

Statement	N	Min	Max	Mean	S. D
KRA frequently do desktop audit to compel the SMEs in Nakuru CBD to pay their VAT on time.	197	1	5	3.93	.940
There is possibility of been exposed during desktop audit and this compels accurate reporting	197	1	5	3.53	1.162
Field audits are effective tool by KRA on ensuring compliance with VAT laws in Nakuru CBD	197	1	5	3.04	1.041
In case of inconsistency in the invoices, KRA send their officers to contact field audit	197	1	5	3.66	.979
Valid N (listwise)	**197**				

The results show that, in case of inconsistency in the invoices, KRA send their officers to contact field audit (Mean=3.66, standard deviation=0.979). Due to these inconsistencies, KRA frequently do desktop audit to compel the SMEs in Nakuru CBD to pay their VAT on time (Mean=3.93, Standard deviation=.940) that increases the possibility of been exposed during desktop audit and this compels the SMEs to accurately report their tax obligation (Mean=3.53, Standard

Deviation=1.162). These field audits are effective tool by KRA on ensuring compliance with Vat laws in Nakuru CBD (Mean=3.04, Standard Deviation=1.041). In all, cases, the means are either moderate on average while the standard deviation are high. Also, the range of responses lie between 1 and 5 meaning a range of 4. Both range and standard deviation shows the variability of responses given by the respondents. The respondents were generally of different opinion on matters related to tax audit.

4.6.4 Value Added Tax performance

The dependent variable of the study was Value Added Tax performance. The results from a 5 point Linkert scale questionnaire are shown in table 4.7.

Table 4.7: Value Added Tax performance

Statements	N	Min	Max	Mean	S. D
I file returns accurately	197	1	5	3.72	.959
I file returns on time	197	1	5	2.22	1.100
I have the correct obligations	197	1	5	3.34	1.229
I am Registered as a taxpayer in the KRA system	197	2	5	3.93	.640
Valid N (listwise)	**197**				

To some extent, SMEs file their returns accurately (Mean=3.72, Standard Deviation=0.959). The huge standards deviation is an indication of variability of the responses given by the 197 respondents. They disagreed among themselves. However, concerning filing returns on time, they were moderate in their responses as shown by a mean of 2.22 and a standard deviation of 1.100.

again here, they differed in terms of timely return filing. This shows that there are some SMEs who don't file their returns on time.

On whether the SMEs have the correct VAT obligations, they indicated that to a moderate extent, they have right VAT obligation (Mean=3.34). However, there was huge standard deviation (standard deviation=1.229) an indication of variability of results from the respondents. Lastly, the results show that to some extent, majority of SMEs are registered as a taxpayer in the KRA iTax system (Mean=3.93, Standard Deviation=0.640). These results clearly show that there is some level of VAT performance indicated by the mean responses, however, the standard deviations suggest that there are some SMEs which are not VAT compliant.

4.7 Correlation Analysis

After descriptive statistics, correlation analysis was done to determine the relationship between independent and dependent variables. The correlation coefficients values range from -1 for a perfect negative relationship to +1 for perfect positive relationship through zero for no relationship. These results are shown in table 4.8.

Table 4.8: Correlation Matrix

		Tax literacy	Cost of compliance	Tax audit	VAT performance
Tax literacy	Pearson Correlation	1	.201	.211	.652[*]
	Sig. (2-tailed)		.052	.093	.002
	N	197	197	197	197
Cost of compliance	Pearson Correlation	.201	1	.317	-.541
	Sig. (2-tailed)	.052		.002	.009
	N	197	197	197	197
Tax audit	Pearson Correlation	.211	.317	1	.512
	Sig. (2-tailed)	.093	.002		.005
	N	197	197	197	197
VAT performance	Pearson Correlation	.652[*]	-.541	.512	1
	Sig. (2-tailed)	.002	.009	.005	
	N	197	197	197	197

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

The correlation analysis established a strong positive and significant correlation between tax literacy and VAT performance (R=0.652, p=0.002<0.05). Increasing tax literacy for the taxpayer will lead to increased VAT performance. Cost of compliance had a strong and significant negative association with VAT performance (R=-0.541, p=0.009<0.05). When cost of compliance increases, level of VAT performance goes down. Lastly, tax audit had strong positive had a strong positive and significant correlation coefficient with VAT performance (R=0.512, p=0.005<0.05). The indication of these results is that increase in tax audit is likely to increase level of VAT of performance.

4.8 Model Summary

The model summary consists of R. value, R square value, Adjusted R Squared Value, and a standard error of the estimate. The values obtained were recorded in table 4.9 as shown below.

Table 4.9: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.712a	.507	.481	.762

a**. Predictors**: (Constant), tax literacy, cost of compliance, tax audit

Regression model summary shows that the correlation coefficient of R was 0.712 and R square of 0.507. The adjusted R square value was 0.478. these results shows that tax literacy, cost of compliance and tax audit explain 50.7% of the total variations of the VAT performance. The remaining 49.3% can be explained by other factors not in the current model.

4.9 Analysis of Variance

The analysis of variance was done to generate the f- statistic which is used to test significance of R in the model. That is, ANOVA was conducted to test goodness of fit in the model. The results are shown in table 4.10.

Table 4.10: ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	15.594	3	5.198	10.565	.000[b]
1	Residual	94.956	193	0.492		
	Total	110.55	196			

a. **Dependent Variable:** VAT performance

b. Predictors: (Constant), tax literacy, cost of compliance, tax audit

Table 4.10 showed the F value of 10.565. the f-statistics was statistically significant at p=0.00 <0.05 which implied that the model was statistically significant at 0.05 significant level. Thus tax literacy, cost of compliance, tax audit can significantly affect VAT performance. The model summary was fit to predict the variations between the independent and the dependent variables.

4.10 Regression Coefficients

A regression analysis was done to test combined effect of the independent variables to the dependent variable. The results were then presented in table 4.11 below.

Table 4.11: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	.098	.041		2.391	.000
Tax Literacy	.107	.052	.101	2.058	.006
Cost of compliance	-.121	.096	-.109	-1.260	.026
Tax audit	.156	.077	.112	2.026	.015

a. **Dependent Variable:** VAT Performance

From table 4.11, specific regression equation becomes $Y = 0.098 + 0.107X_1 - 0.121X_2 + 0.156X_3$

Where:

Y = VAT Performance

X₁ $= $Tax literacy

X₂ = Cost of compliance

X₃ = Tax audits

Constant term was found to be 0.098 and it was significant at 5% significant level ($\beta_0=0.098$, $p=0.000<0.050$). The meaning of these results is that in absence of all the other variables, the level of VAT performance by SMEs in Nakuru CBD will be 9.8%. Tax literacy had a positive beta coefficient (β_2) of 0.107 which was statistically significant at $p=0.006<0.050$). increasing tax literacy is likely to lead to improved VAT performance. Lastly, Tax audit has a significant beta coefficient (β_3) of 0.156 and a p value of 0.015 which is less than the 5% significant level chosen.

4.11 Discussion of The Findings

The discussions based on the findings from each of the three objectives is done and comparison with other empirical research done in this area of VAT performance. The discussions are done for both descriptive and regression findings.

4.11.1 Tax Literacy and VAT Performance

To great extent, KRA has conducted several tax trainings through workshops and seminars in Nakuru CBD making SMEs to have basic understanding of tax laws from the basic education in schools and colleges. Also, the results show that SMEs have an access to tax education through media advertisements, magazines and from the KRA website. However, concerning access to information on the aggregate taxes collected and how they are spent, the results show that KRA rarely share the information concerning collections and how they are spent.

Also, regression analysis and correlation analysis established a positive and significant relationship between tax literacy and VAT performance. These results are similar to Oxley and Yeung (2010) who explored on tax education and whether it improves tax compliance using 600 respondents from Hong Kong. He found that taxpayer training level does influence their decision making in effecting the adoption of VAT in the social commerce. Also, these results agree with previous research by Otieno (2011) who studied the effect of taxpayers' education on VAT performance among Small and Medium Sized Enterprises in Kenya.

4.11.2 Cost of Compliance and VAT Performance

From the results most SMEs don't hire the services of an experienced tax agents and staff training on matters related to tax is expensive for the SMEs to afford. Concerning record keeping, the descriptive statistics shows that the cost of keeping records is too high to the SME Lastly, the

descriptive results indicated that the cost of preparing, filing and submitting returns make significant part of indirect business costs.

A negative and significant beta coefficient and Pearson correlation coefficients were established between cost of compliance and VAT performance. The results agree with Abdul and Wang'ombe (2018) who indicated that tax compliance in Kenya significantly declines with increase in tax compliance costs.

4.11.3 Tax Audit and VAT Performance

The results show that, in case of inconsistency in the invoices, KRA send their officers to contact field audit. Also, KRA frequently do desktop audit to compel the SMEs in Nakuru CBD to pay their VAT on time and these audits increases the possibility of been exposed during desktop audit and this compels the SMEs to accurately report their tax obligation. These field audits are effective tool by KRA on ensuring compliance with Vat laws in Nakuru CBD.

The regression and correlation results confirmed the result obtained from the descriptive statistics as positive beta coefficients and Pearson Correlation coefficient were obtained. These findings are similar to findings by Adediran, Alade and, Oshode, (2013), Olatunji and Temitope (2018), Amah, & Nwaiwu (2018) and Nyakamba (2014) all of which establish significant relationship between tax audit and VAT performance in Nigeria.

CHAPTER FIVE

SUMMARY OF FINDINGS CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter covers summary, conclusions and recommendations based on the objectives. The recommendations were done to policy makers, practitioners and also to the scholars. The summary shows how the dependent variable and independent variable relates.

5.2 Summary of Findings

This sub section gives the summary of the findings based on the objectives. The summary shows how the dependent variable was affected by change in each of the independent variable. The depended variable was VAT performance while the independent variables were: tax literacy, cost of compliance and tax audit.

5.2.1Tax Literacy and VAT performance

Several tax trainings conducted by KRA through workshops and seminars in Nakuru CBD has equipped SMEs with basic understanding of tax laws. Also, the results show that SMEs have an access to tax education through media advertisements, magazines and from the KRA website. However, concerning access to information on the aggregate taxes collected and how they are spent, the results show that KRA rarely share the information concerning collections and how they are spent. Also, regression analysis and correlation analysis established a positive and significant relationship between tax literacy and VAT performance.

5.2.2 Cost of compliance and VAT performance

From the results most SMEs don't hire the services of an experienced tax agents and staff training on matters related to tax is expensive for the SMEs to afford. Concerning record keeping, the descriptive statistics shows that the cost of keeping records is too high to the SME Lastly, the descriptive results indicated that the cost of preparing, filing and submitting returns make significant part of indirect business costs. A negative and significant beta coefficient and Pearson correlation coefficients were established between cost of compliance and VAT performance.

5.2.3 Tax audit and VAT performance

The results show that, in case of inconsistency in the invoices, KRA send their officers to contact field audit. Also, KRA frequently do desktop audit to compel the SMEs in Nakuru CBD to pay their VAT on time and these audits increases the possibility of been exposed during desktop audit and this compels the SMEs to accurately report their tax obligation. These field audits are effective tool by KRA on ensuring compliance with Vat laws in Nakuru CBD. The regression and correlation results confirmed the result obtained from the descriptive statistics as positive beta coefficients and Pearson Correlation coefficient were obtained

5.3 Conclusions

The study made the conclusion that tax literacy, cost of compliance and tax audit were very instrumental in ensuring VAT performance. In the absence of any of these variables, VAT performance. is likely to experience a serious gap in terms of the amount of tax collected against its set targets.

5.3.1 Tax literacy and VAT performance

Both descriptive and inferential results have shown that tax literacy and VAT performance. have positive correlation with each other. The study concludes that tax literacy can help improve VAT performance.

5.3.2 Cost of compliance and VAT performance

Through both descriptive and inferential statistics, the respondents suggested that the cost of compliance is too high, and it has negative correlation with VAT performance. The study concludes that increasing cost of compliance can detrimental to VAT performance.

5.3.3 Tax audit and VAT performance

The analyzed results suggested that tax audit is an important tool used by KRA to enforce VAT performance. Thus the current study concludes that doing constant tax audit to the SMEs could lead to improved VAT performance.

5.4 Recommendations

The study provided the following recommendations based on the study variables: the study variables used were Tax literacy, cost of compliance and tax audit. The recommendations are based on the findings of the current study.

5.4.1 Tax literacy and VAT performance

The respondents showed that KRA rarely share the information concerning VAT collections and how they are spent either through the media and publications. The current study recommends that KRA need to establish ways of sharing information on VAT collection and usage to the taxpayers.

5.4.2 Cost of compliance and VAT performance

The study also established that cost of compliance negatively affect the compliance in VAT performance. The SMEs further said that cost of staff training on matters related to tax is expensive. The study recommends that KRA regularly organize for staff training to all stakeholders so as to reduce cost associated with acquiring information on VAT.

5.4.3 Tax audit and VAT performance

The study established that field audits are effective tool by KRA on ensuring compliance with Vat laws in Nakuru CBD. It therefore recommends that KRA regularly do both desktop and field audits to net the SMEs which are not VAT compliant.

5.5 Suggestion for Further Studies

The current study suggests that more research be done using more variables so as to establish which other variables for example, technology and levels of income affect VAT performance. Similar studies can also be done in other towns in Kenya to establish whether similar findings will be obtained. Also, similar study can be done in Nakuru CBD but in a different sector like real estates.

5.6 Limitations of The Study

Time was a major limitation as it had to be done within the stipulated period of four months. This problem was solved by committing much time on this project so as to ensure that it is done within the stipulated time, and ensuring all relevant information was collected. Another challenge was costs incurred during the study. The use of research assistants required payments of fare and other allowances making the whole process costly. The researcher had to use some of her savings to

ensure that these research assistants are well remunerated so as to have morale of helping her

collect the questionnaires.

REFERENCES

Abdul-Wahab, N. S. (2010). Tax planning and corporate governance: Effect on shareholders' valuation. Unpublished PhD thesis, University of Southampton, UK. Retrieved from http://eprints.soton.ac.uk

Adeyemi, K.S. (2012). Sustainable Development strategies for poverty Alleviation the Tax perspective. Paper delivered at the annual tax conference of the chartered institute of taxation of Nigeria, Nicon Luxury Hotel, Abuja, 10th May.

Aguolu, O. (2014). Taxation and Tax Management in Nigeria, 3rd Edition, Enugu; Meridan Associates.

Alabede J. O., Ariffin Z. Z., Idris K. (2011). *Individual taxpayers' attitude and compliance behaviour in Nigeria:* The moderating role of financial condition and risk preference.

Atawodi, O. W. & Ojeka, S. A., 2012. Factors that affect tax compliance among small and medium enterprises (SMEs) in north central Nigeria. *International journal of business and management,* 7(12).

Barreix A. and González D. (2019). Taxation for SMEs: A regime for the 80% of taxpayers who pay 2%. Retrieved from Taxation for SMEs: a regime for the 80% of taxpayers who pay 2% | (ciat.org)

Bornman m. and Wassermann m. (2018) Tax literacy in the digital economy. *eJournal of Tax Research* (2018) vol xx, no. xx, pp. xx

Bryman, A. (2008). Social Research Methods. Oxford: Oxford University Press.

Chukwumerije and Akinyomi (2011). Impact of the tax incentives on the overall performance of registered small scale industries in Rivers State, Nigeria**.**

Cooper, R.D. and Schindler, P.S. (2011). Business Research Methods. New Delhi: Tata McGraw-Hill Publishing, Co. Ltd.

Creswell, J. W. (2014). Research design: Qualitative, quantitative, and mixed methods approach.

Decker, Haltiwanger, Jarmin, and Miranda. 2014. "The Role of Entrepreneurship in US Job Creation and Economic Dynamism." *Journal of Economic Perspectives*, 28 (3): 3-24.

Dennis, Afuberoh and Okoye Emmanuel, (2014) The Impact of Taxation on Revenue Generation in Nigeria: A Study of Federal Capital Territory and Selected States, International *Journal of Public Administration and Management Research* (IJPAMR), Vol. 2, No 2 March., 2014, 2(2):22-47.

Desai, M. A., & Dharmapala, D. (2007). Corporate tax avoidance and firm value. University of Connecticut and University of Michigan, 1–27.

Desai, M. A., & Hines, J. R. Jr. (2002). Expectations and expatriations: Tracing the causes and consequences of corporate inversions. *National Tax Journal*, 55, 409–441.

Feyitimi, O., Temitope O., Akeem L. & Oladele O. (2016). Tax Incentives and The Growth of Small and Medium Scale Enterprises in Developing Economy –The Nigerian Experience. *European Journal of Research and Reflection in Management Sciences* Vol. 4 No. 2, 2016 Issn 2056-5992

Frank, M. M., Lynch, L. J., Rego, S. O. (2009). Tax reporting aggressiveness and its relation to aggressive financial reporting. *The Accounting Review*, 84(2), 467-496.

Gatsi J., Gadzo S. and Kportorgbi H. (2013). The Effect of Corporate Income Tax on Financial Performance of Listed Manufacturing Firms in Ghana. *Research Journal of Finance and Accounting* www.iiste.org ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online) Vol.4, No.15, 2013

Henderson Global Investors. (2005). Tax, Risk and Corporate Governance. Sustainable and Responsible Investment Reports, available on the internet at http://www.henderson.com/content/sri/publications/reports/taxriskcorporategovernance.pdf

Holban, 0.L. (2007). "The Taxation of Small and Medium Sized Enterprise — a hindering factor influencing the European economic growth". Doctoral Dissertation, Alexandry Loan Cuza university of Lasi and Academy of Economics Studies from Bucharest Romania.

International Tax Dialogue (2007). "Taxation of SMEs". Background Paper for the *International Tax Dialogue Conference*, Bueons Aires.

Jens, A. & Schwellnus, C. (2008). Do corporate income taxes reduce productivity and investment at the firm level? *cross-country evidence from the amadeus dataset.*

Kamleitner B., Korunka C., Kirchler E., (2012) "Tax compliance of small business owners: A review", *International Journal of Entrepreneurial Behaviour & Research*, Vol. 18, Issue 3, pp. 330 - 351, 2012.

Kawo S. & Kportorgbi H. (2014). Effect of Tax Planning on Firms Market Performance: Evidence from Listed Firms in Ghana. *International Journal of Economics and Finance*; Vol. 6, No. 3; 2014

Kenya National Bureau of Statistics (2019). *Kenya Economic Survey 2019.* Retrieved from file:///C:/Users/USER/Downloads/final-economic-survey-2019%20(1).pdf on 13th august 2020

Kenya National Bureau of Statistics (2019). 2019 Kenya Population and Housing Census Volume II: Distribution of Population by Administrative Units (Report). Kenya National Bureau of Statistics. p. 241. Retrieved 3 March 2020.

Kombo, D. K. & Tromp, L. A. (2009). Proposal and thesis writing: An introduction. Nairobi: Paulines Publications Africa

Kothari, C. (2004). *Research methodology:* Methods & techniques. (2nded). New Delhi, India: New age International Publishers

Kuria J. (2018) Effect of Vat Incentives On the Performance of EPZ Firms in Kenya. *American Journal of Finance.* Vol.3, Issue 1 No.1, pp 31 - 45, 2018.

Mirrlees, J. A. (1990) 'Taxing Uncertain Incomes.' Oxford Economic Papers, 42: 34- 45.

Mnewa, R. & Maliti, E., 2008. The role of small business in poverty alleviation: The case of Dar es Salaam, Tanzania, Research Report.

Mugenda & Mugenda (2003). Research methods: Quantitative and qualitative Approaches. Nairobi: African Centre for Technology Studies.

Nie, H., Fang, M., & Li, T. (2010). China's value-added tax reform, firm behavior and performance. Front. Econ. China, 5(3): 445–463

Nnadi,A., M., & Akpomi, K. (2008). "The Effect of Taxes on Dividend Policy of Banks in Nigeria", *International Research Journal of Finance and Economics*,19(2),1450-2887.

Ojo S.T.(2011). National Tax policy, issues, challenges and prospects. Paper Presented at the MPTP workshop, Abuja, 19th October 2011.

Oludele, A. A. & Emilie, C. K., 2012. Regulation, Awareness, Compliance and SME Performance in Cameroon's Manufacturing and Retail Sectors. *International Journal of Social Economics*, 39(12).

Pessali, F. (2006). "The rhetoric of Oliver Williamson's transaction cost economics". *Journal of Institutional Economics.* **2** (1): 45–65. doi:10.1017/s1744137405000238. ISSN 1744-1382.

Piper, M. (2014). Taxes Made Simple: Income Taxes Explained in 100 Pages or Less. Simple Subjects, LLC. ISBN 978-0-9814542-1-4.

Ritter, N. (2010). "Understanding a widely misunderstood statistic: Cronbach's alpha". *Paper presented at South-western Educational Research Association (SERA) Conference* 2010: New Orleans, LA (ED526237).

Rohaya, M. N., NurSyazwani M. F. & Nor'Azam, M. (2010). "Corporate Tax Planning: A Study on Corporate Effective Ta*x Rates of Malaysian Listed Companies",* International Journal of Trade, Economics and Finance, 1(2), 1-5.

Twesige D. and Gasheja F. (2019). Effect of tax incentives on the growth of small and medium-sized enterprises (SMEs) in Rwanda: A case study of SMEs in Nyarugenge district. *Journal of Accounting and Taxation.* Vol. 11(5), pp. 89-98, May 2019

UNIDO, (2009). Tanzarnia small and medium scale enterprises policy proposal, Tanzarnia: s.n.

VVA and ZEW (2015). SME taxation in Europe – An empirical study of applied corporate income taxation for SMEs compared to large enterprises

Wentworth, D. K., & Rickel, A. U. (2005). Determinants of tax evasion and compliance. *Behavioral Sciences & the Law*, 3(4), 455-466.

APPENDIX

Appendix I: Introductory letter

Jane Shaga Sora,

P.O box 20100-12976

Dear respondent,

<u>RE: REQUEST TO COMPLETE THE ATTACHED QUESTIONNAIRE</u>

I am a student at **JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY** pursuing a post graduate diploma in tax administration. The following questionnaire is meant to assist the researcher to determine the **DETERMINANTS OF VALUE ADDED TAX PERFORMANCE AMONG SMALL AND MEDIUM ENTERPRISES IN NAKURU CENTRAL BUSINESS DISTRICT.** The questionnaire consists of various questions regarding the research topic. Kindly, respond to the questions by marking appropriate answers or filling the blank spaces where necessary. The information obtained will be confidentially treated and only used for academic research purposes**.**

Yours faithfully

Jane Shaga Sora

Cell phone: 0713110694

Appendix II: Questionnaire for the study

SECTION A: GENERAL INFORMATION

Kindly answer all the questions either by ticking in the boxes or writing in the spaces provided

1. What is your gender

    Male   ( )

    Female   ( )

2. What is your highest level of education?

    None   ( )

    Primary   ( )

    Secondary   ( )

    Graduate   ( )

SECTION B: TAX LITERACY

3. To what extent do you agree with the following statements on tax literacy.

    Scale 5= Strongly Agree; 4=Agree; 3=Neutral; 2= Disagree; 1= Strongly Disagree

Statements	1	2	3	4	5
Several tax trainings conducted by KRA through workshops and seminars in Nakuru CBD has equipped SMEs with basic understanding of tax laws.					
I have basic understanding of tax laws from the basic education in schools and colleges					
I have access to tax education through media advertisements, magazines and from the KRA website.					
I access information on the aggregate taxes collected and how they are spent					
I know where to source for clarification on tax matters					

SECTION C: COST OF TAX COMPLIANCE

4. To what extent do you agree with the following statements on compliance cost?

Statements	1	2	3	4	5
I regularly hire services of an experienced tax agents which is expensive for SME					
I keep clear records though the cost of keeping records id too high to the SME					
Staff training on matters related to tax is expensive for the SMEs to afford					
The cost of preparing, filing and submitting returns make significant part of indirect costs					

SECTION D: TAX AUDIT

5. To what extent do you agree with the following statements on tax audit.

Scale 5= Strongly Agree; 4=Agree; 3=Neutral; 2= Disagree; 1= Strongly Disagree

Statements	1	2	3	4	5
There is possibility of been exposed during desktop audit and this compels accurate reporting					
KRA frequently do desktop audit to compel the SMEs in Nakuru CBD to pay their VAT on time.					
Field audits are effective tool by KRA on ensuring compliance with Vat laws in Nakuru CBD					
In case of inconsistency in the invoices, kra send their officers to contact field audit					

SECTION E: VAT PERFORMANCE

6. To what extent do you agree with the following statements on VAT performance.

Scale 5= Strongly Agree; 4=Agree; 3=Neutral; 2= Disagree; 1= Strongly Disagree

Statements	1	2	3	4	5
I file returns accurately					
I file returns on time					
I have the correct obligations					
I am Registered as a taxpayer in the KRA system					

Appendix III: Budget

Research item	Cost (Kshs)
Type setting, photocopying, printing, scanning and binding	25000
Travelling expenses	10000
Internet/Wi-Fi expenses	6000
Telephone expenses	6000
Research assistants	20000
Data Analysis	15000
Total	**82000**

Appendix IV: Work Plan

Task Description	Jan-Feb 2021	Mar-2021	April-2021	May-2021
Proposal writing	■			
Questionnaire design	■			
Proposal defense	■	■		
Data collection			■	
Data analysis			■	
Findings and report writing			■	
Submission of report				■

APPENDIX V: LIST OF SMES IN NAKURU CBD

1. The Continental Radiant Company Limited
2. Eunoia Women Group Limited
3. Vineyard Victory Tradings Limited
4. Reality Line Limited
5. Classic Developers Nairobi Limited
6. Young Gents Vision Limited
7. Al Mumin Property Limited
8. Jacksma Enterprises
9. Nawama Sunrise Trading Company Ltd
10. Davmauric Company Ltd
11. Maunak Investment Limited
12. Elmoc Investments Ltd
13. Deban Company Limited
14. Poroko Estates Limited
15. Fecund Investments Limited
16. Elijah Kagonye Kibuthah
17. Margaret Wangui Odupoy
18. Ruth Wanjiru
19. Lazarus Muna Kanyago
20. Mary Wanjiru Munene
21. Agnes Omosa
22. Isaiah Githongo Wanjau
23. Lucy Nyambura Ng'ang'a
24. Ben Wafula Sikuku
25. Peninah Wanjeri Kifothu
26. Julius K L Muthuri Thuranira
27. Reuben Manga Kariuki
28. James Mwangi Kimita
29. James Wanyoike Muiruri
30. Antony Simiyu Wekesa
31. Booker T W Obonyo Oyaya
32. Universal Shamba Supplies,Turi Limited
33. Golden Mirage Enterprise Limited
34. The Savori Ventures Ltd
35. Arnkel Co Limited
36. Saphe Suppliers Limited
37. Janann Suppliers and Contractors
38. Achifa Investments Limited
39. Discount Malimali Traders Limited
40. Super Vision Youth Group
41. Xnoil International Limited
42. Imooj Foods Limited
43. Khongus Company Limited
44. Sedaorigins Limited
45. Sparklean Aces Limited
46. Chandler Front Limited
47. Josve Company Limited
48. Centplain Limited
49. Farmin Tech Enterprises Limited
50. Kidichebo Investment Limited
51. Koskire Hardware Limited
52. Fresta Hardware Limited
53. Divsam General Contractors Limited
54. Lilliput Aglow Limited
55. Charlesko Holdings Limited
56. Nifa Enterprise
57. Glowray Supplies Ltd
58. Glamoh and Sons Limited
59. Plan Cube Limited
60. Crystalair Enterprise Limited
61. Tims Automart Distributors Limited
62. Lanecprime Limited
63. Victoria Nile Investment (K) Limited
64. Saprijo Investments Limited
65. Cider Collectons Limited
66. Pemca Westhope Logistics Limited
67. Meryjowles Enterprises Limited
68. Scope Capital Logistics Limited
69. Peywan Trading Company
70. Alemarto Investment Limited
71. Bold Compass Limited
72. Jonduwa Ventures Limited
73. Njoro Beer Stockist Limited
74. Vibrant Eagle Holdings Limited
75. Elltrad Enterprises Limited
76. Bolary International Limited
77. Skerp Limited
78. Cessy Company Ltd
79. Interlink Mechatronics Contractors
80. Tebah Services Nakuru
81. Mckgwaly Investment Limited
82. Corey Armani Investment Limited
83. Majeka Enterprises
84. Automated Investment Company Ltd
85. Sureneat Angven Supplies Limited
86. Panley Enterprises Limited
87. Siovi Limited

88. Leafdew General Merchant Limited
89. Jj Supermarkets and Distributors Limited
90. Cox Innovation Limited
91. Offcollar Ventures Limited
92. Sanka Ole Kimiriny
93. Paul Njoroge Mwangi
94. Jane Gathoni Njoroge
95. Joseph Kipkirui Kosgei
96. Beth Wangu Kinyanjui
97. Philip Njane Njoroge
98. Patrick Mutahi Chege
99. Davine Moraa
100. Jacqueline Monicah Momanyi
101. Mutua Musee
102. John Thuo Gathungu
103. Dickson Kamau Mbugua
104. Julius Chesir Lokwanga
105. Hellen Wanjiru Mwangi
106. Susan Nyokabi Mbugua
107. Felix Ouma Ajuok
108. Milkah Maureen
109. Patel Manhar Bhai Punam Bhai
110. Ann Wanjiku Githinji
111. Jane Nyambura Njoroge
112. Francis Njoroge Kiinama
113. Rose Chebindio Ngoria
114. Faith Chepkirui
115. Lucy Wanjiru Njoroge
116. Richard Kibiwott Too
117. Charles Wanjala Masika
118. Ngeno Justus Kipkirui
119. Zipporah Mugure Chege
120. Eunice Wanjeri Mukabi
121. Racheal Wangari Mwangi
122. Paul Thiongo Kamau
123. Rahab Wanjiru Gatungu
124. Jonah Mungunu Munene
125. Dorcas Yator
126. Parisonka Ole Sureny
127. Sammy Kipngeno Kurgat
128. Mary Watiri Mwangi
129. Tumaina Ole Oloitukuaki
130. Stanley Nyang'au Ongori
131. Regina Mugure Wanja
132. Margaret Nduta Njuguna
133. Stephen Njenga Habu
134. Beatrice Njoki Muhia
135. Everlyne Yenko
136. Solomon Matu Nono
137. John Nyamoko Mayieka
138. Hellen Chepkirui Ruto
139. Harun Ndirangu Munge
140. Haggai Okoth Okea
141. Stanley Kipingot Sadera
142. Kiprono Bii Kelvin
143. Daniel Mwangi Kamau
144. Joseph Gatu Maina
145. Lucia Lekupuny
146. Benard Kamau Mbuthia
147. Stephen Ndugire Kamau
148. Pauline Wanjiru Ngaruiya
149. David Muthui Githaiga
150. Dankan Kungu Kununu
151. Anthony Munga Kariru
152. Judith Naisiae Rutto
153. Cliff Gesimba Nyangau
154. Keziah Wanjiku Gichungu
155. Koitamet Ole Koisikirr
156. Joshua Partaruae Kikayaya
157. Miriam Huini Gacheru
158. Julius Kiplangat Chelule
159. Jackline Naserian Ng'isia
160. Naatasim Ole Saoli
161. John Ndung'u Ngugi
162. Samwel Gichuki Mwangi
163. Ester Wanjiru Kamau
164. James Irungu Kimani
165. Jackline Wangari Kamau
166. Margaret Buyaki Onyango
167. Agnes Sopia
168. Susan Nyambura Chongo
169. Miriam Huini Gacheru
170. Michael Mburu Njoroge
171. Mary Nyambura Kabera
172. George Kandet Kutinkala
173. Samuel Mwangi Ngechu
174. Hellen Jebet Kipkoech
175. Richard Kiplangat Bett
176. Joan Wanjiku Mwago

177. Richard Kipkirui Bwogo
178. Paul Kipkemoi Ngeno
179. Enock Kipkoech Sigei
180. James Ndirangu Mwangi
181. Jane Suyiasui Tipapa
182. Geoffrey Kipkemoi Chumo
183. Kikwai Chumo
184. Eunice Chepngetich Chumo
185. Wesley Kirui
186. Wesley Kipngeno Tanui
187. David Ndegwa Nderitu
188. Stephen Kipkoech Kemboi
189. Larasha Ole Mutenkere
190. Peter Nchaga Chuma
191. Erick Soinkei Kesoi
192. John Ndirangu Nguri
193. Jackson Tioko Ekiru
194. Daniel Kaibere Muchunu
195. Jane Wambui Mbugua
196. Joseph Cliff King'ori Warugongo
197. John Kiburi
198. Jedidah Nakae Parnyombe
199. Grace Muthoni Njoroge
200. Jackson Waweru Kamau
201. Samarik Ole Nkaiwuatei
202. Teresia Wamaitha Gatuma
203. Leonard Mithenya Waweru
204. Natorrinyo Kerenke
205. Stanley Kipkoech Tallam
206. Tarayia Ole Naiposhiposh
207. Jennifer Nyambura Kariuki
208. Eric Kuseyo Kerema
209. Narikukmuran Enole Koini
210. Alice Silole
211. Grace Wairimu Waweru
212. Paul Thiongo Kamau
213. Rahab Wanjiru Gatungu
214. Jonah Mungunu Munene
215. Dorcas Yator
216. Parisonka Ole Sureny
217. Sammy Kipngeno Kurgat
218. Mary Watiri Mwangi
219. Tumaina Ole Oloitukuaki
220. Stanley Nyang'au Ongori
221. Regina Mugure Wanja

222. Margaret Nduta Njuguna
223. Stephen Njenga Habu
224. Beatrice Njoki Muhia
225. Everlyne Yenko
226. Solomon Matu Nono
227. John Nyamoko Mayieka
228. Hellen Chepkirui Ruto
229. Harun Ndirangu Munge
230. Haggai Okoth Okea
231. Stanley Kipingot Sadera
232. Kiprono Bii Kelvin
233. Daniel Mwangi Kamau
234. Joseph Gatu Maina
235. Lucia Lekupuny
236. Benard Kamau Mbuthia

Source: (KRA 2021)