

**FACTORS INFLUENCING TAX COMPLIANCE AMONG SMALL AND MEDIUM
ENTERPRISES IN MERU TOWN**

WACHIRA JOHN

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DECLARATION

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

WACHIRA JOHN

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Signature

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Date

Declaration by the Supervisor

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

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Signature

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Date

DEDICATION

I dedicate this work to the Almighty God because without him I could not have done much. To my wife Carol; your practical help and emotional encouragement as I pursued this course is highly appreciated.

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I would like to thank my supervisor, Madam Peninah Munga, who has guided me throughout the completion of this research project.

ABSTRACT

Taxes are an involuntary charge levied by the government on individual income, business profits and on transactions of goods and services. The purpose of the study was to analyze determinants of income tax compliance on SMEs. The main issue faced by tax authorities is that it has never been easy to persuade all taxpayers to comply with the regulations of the tax systems. Small and medium enterprises are the majority of businesses in Kenya yet taxes collected from this sector are considerably low. In Kenya, the biggest block of taxpayers on the business sector are the Small and Medium enterprises(SMEs) who according to IMF are 80 percent of taxpayers but remit only 5-10 percent of revenue. Their compliance rate is poor as most of the businesses are not registered and hence not paying taxes. This study aimed at assessing the tax compliance by SMEs in Meru town. The study used a descriptive research design and owing to the large population a sample size of 166 traders was drawn from the target population of around 1657 traders. To ensure that various diverse categories of taxpayers and business entities were included in the survey, stratified sampling technique was adopted. Data was collected using structured questionnaires with both closed and open ended questions and analyzed using both descriptive and inferential statistics. The research found that the SMEs know how to keep records/documents; the SMEs have obtained a taxpayer identification pin number as well as registered the business as a tax agent; the SMEs are fully aware of the tax filing procedures; and the SMEs understand that they should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period. The study also found that tax authority audits and investigations are few among SMEs; the SMEs were legally not obligated to audit their books therefore successful prosecution is not possible; and the SMEs believe that the penalty is lower than their tax saving due to not complying with tax laws. The study found that automated tax systems has ensured full compliance and reduced the associated costs quantity. The study concluded that taxpayer knowledge had the greatest effect on tax compliance among SMEs in Meru Township, followed by technology strategy, and then penalties and interests had the least effect on tax compliance among SMEs in Meru Township. On taxpayer's knowledge and tax compliance, the study recommends that tax payers learning ought to be emphasized since tax data, tax learning tends to advance tax compliance than tax organization. There is also need to enhance compliance to intensify taxpayer education in terms of increasing the number of sessions and broadening coverage to include tax consultants. The study recommends that KRA should have an office in every county that will address tax issues at county level and the services to be offered should include tax penalties, filing of tax returns, tax computation and tax differentiation.

TABLE OF CONTENTS

DECLARATION	i
DEDICATION	ii
ACKNOWLEDGEMENT	iii
ABSTRACT	iv
TABLE OF CONTENTS	v
LIST OF TABLES	viii
LIST OF FIGURES	ix
ABBREVIATIONS AND ACRONYMS	x
DEFINITION OF TERMS	xi
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background of the Study	1
1.2 Statement of the Problem	2
1.3 Research Objectives	3
1.3.1 General Objective	3
1.3.2 Specific Objectives	3
1.4 Research Questions	4
1.5 Significance of the Study	4
1.6 Scope of the Study.....	5
CHAPTER TWO	6
LITERATURE REVIEW	6
2.1 Introduction	6
2.2 Theoretical Framework	6
2.2.1 Economic Deterrence Theory.....	6
2.2.2 Optimal Taxation Theory	7
2.2.3 Technology acceptance model.....	7
2.3 Empirical Review	8
2.3.1 Tax Compliance.....	8
2.3.2 Taxpayer Knowledge.....	9
2.3.3 Penalties and Interests	10

2.3.4 Technology and Tax compliance.....	12
2.4 Conceptual Framework	13
2.5 Critique of the Study	16
2.6 Summary of Literature Review	17
2.7 Research Gaps	17
CHAPTER THREE	18
RESEARCH METHODOLOGY	18
3.1 Research Design	18
3.2 Target Population	18
3.3 Sample and Sampling Technique	18
3.4 Data Collection Instruments.....	19
3.5 Pilot Study	19
3.5.1 Reliability of the Research Instrument	20
3.5.2 Validity of Research Instrument.....	20
3.6 Data Collection Procedure	20
3.7 Data Analysis and Presentation.....	20
CHAPTER FOUR.....	22
DATA ANALYSIS, PRESENTATION AND INTERPRETATION OF FINDINGS	22
4.1 Introduction	22
4.1.1 Response Rate.....	22
4.1.2 Reliability Analysis	22
4.1.3 Validity Analysis	23
4.2 Demographic Information	26
4.2.1 Respondents' Highest Level of Education	26
4.2.2 Monthly Turnover.....	26
4.2.3 Business Personal Identification Number (PIN)	27
4.2.4 Business Tax Compliance Certificate.....	27
4.3 Tax Knowledge	28
4.4 Penalties and Interests	29
4.5 Technology.....	30
4.6 Tax Compliance	31

4.7 Correlation analysis.....	32
4.8 Multiple Regression Analysis	33
CHAPTER FIVE	36
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS	36
5.1 Introduction	36
5.2 Summary of the Findings	36
5.3 Conclusions	37
5.4 Recommendations	38
5.5 Recommendations for Further Research	39
REFERENCES.....	40
APPENDICES	45
Appendix I: Introduction Letter	45
Appendix II: Questionnaire.....	46

LIST OF TABLES

Table 3. 1: Sampling Frame and Sample Size	19
Table 4. 1: Response Rate.....	22
Table 4. 2: Reliability Statistics	22
Table 4. 3: Component Matrix.....	24
Table 4. 4: Respondents' Highest Level of Education	26
Table 4. 5: Monthly turnover	26
Table 4. 6: Business Personal Identification Number (PIN).....	27
Table 4. 7: Business Tax Compliance Certificate.....	27
Table 4.8: Level of Agreement with Statements Related to Tax Knowledge on Tax Compliance among SMEs in Meru Township.....	28
Table 4.9: Level of Agreement with Statements Related to Penalties and Interests on Tax Compliance among SMEs in Meru Township	29
Table 4.10: Level of Agreement with Statements Related to Technology on Tax Compliance among SMEs in Meru Township.....	30
Table 4. 11: Trend of Tax Compliance among SMEs in Meru Township	31
Table 4. 12: Correlation coefficients matrix	32
Table 4.13: Model Summary	33
Table 4. 14: Analysis of Variance (ANOVA) results	33
Table 4. 15: Regression Coefficients	34

LIST OF FIGURES

Figure 2.1: Conceptual Framework 15

ABBREVIATIONS AND ACRONYMS

COMESA	Common Market for Eastern & Southern Africa
EAC	East Africa Communities
KESRA	Kenya School of Revenue Administration
KRA	Kenya Revenue Authority
PAYE	Pay as you earn
SMEs	Small and Medium Enterprises
TOT	Turnover Tax
VAT	Value added Tax

DEFINITION OF TERMS

Fines and penalties – A fine or penalty is money paid to the Government authority, as a punishment for a crime or offense (Michele et al., 2012).

Tax Administration: It refers to the procedures attached to tax compliance including registration and filling of returns (Rile, 2011).

Tax Avoidance – Refers to the legal reduction in tax liabilities by practices that take full advantage of the tax code, such as income splitting and postponement of taxes for example through contribution to a home ownership Savings Plan (George et al., 2017).

Tax compliance – Refers to adherence to the administrative rules of lodging and paying taxes on time. This includes compliance with the reporting requirements, procedural rules and regulations. This entails filing tax returns on time, reporting all the income and claiming the right deductions and where taxes are due making taxes payments on time (Marti, 2010).

Tax Evasion – Refers to the illegal and intentional actions taken by individuals to reduce their legally due tax obligations. Individuals and firms can evade taxes by underreporting income, sales, or wealth, by overstating deductions or by failing to file appropriate tax returns (Palil & Fariq, 2011).

Tax Obligation- Responsibilities pertaining to tax payment and declaring of tax returns which a person duly registered and having a PIN is required to observe (Muturi & Kiaire, 2015).

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The extent of adherence by taxpayer to countries laws that sets out procedures for tax declaration, filling and submission of taxable pay defines tax compliance, while tax evasion is non-adherence of a person or business to comply with related tax obligations (Cummings, 2007). Non-adherence to tax laws and regulations is a challenge facing governments in both developed as the level of evasion sophistication and developing economies due to enforcement and auditing challenges leading to lower resources available for infrastructure, agriculture, health care and energy development among others (Rile, 2011).

According to Parliamentary Service Commission [PSC] (2010), changes in the business environment with globalization and rise of informal business while revenue agency administrative TAMacity has not been adequately improved to match these challenges are some of the factors affecting performance of revenue agencies. Changes in policies and administrative procedures by tax agencies are geared towards creating a private sector friendly business environment, broaden the tax base and distribute taxation more equally which results in improved revenue collection. Implementation of tax policy reforms have brought in new techniques in staff motivation, organizational design and tailored customer services such as utilization on information technology under iTAX which not only improve efficiency but also combat corruption.

Tax compliance management has changed over the years to a balance between deterrence, enforcement and improved taxpayer services all geared to reducing the cost of revenue collection while increasing revenue collection. It has been reported that complexity of taxation law and restraint against tax avoidance mitigate the tendency to avoid tax. The result regarding characteristics of SMEs show larger firm size, higher TAMital intensity, lower profitability, and less experience in tax audit are all associated with a stronger propensity toward tax avoidance (Aryeetey, 2005).

The informal business sector characterized by SMEs contributes 50% of employment worldwide, 60-70% of employment in countries under Organization for Economic Co-operation and Development (OECD) and accounting for 90% of the businesses in Africa (Engelschalk, 2007). In Kenya SMEs contribute 18% of national GDP, while in Morocco the SME sector accounts for 93% of the industrial firms and 46% employment. Some of the less

developed SMEs can mainly be found in Zimbabwe, Tanzania, Kenya, South Africa and Nigeria (Saravanan et al., 2008).

OECD (2010) observes that economic status of SMEs influences the economy of the country. When the economic health of SMEs is less favorable, opportunities for profitable employment expansion in SMEs are limited to SMEs being a source of indigenous entrepreneurship. While balancing the needs of equitable taxation and tax compliance, developing economies like Kenya need to address factors that can hinder advancements of SMEs by creating favorable business conditions (Aryeetey & Ahene, 2004).

SMEs have a substantial influence in availing savings used to generate employment opportunities, diversifying goods and services available for export through continuous research and development which also increases consumption of local materials. They significantly contribute to poverty alleviation by providing basic health, shelter and food security through earning from these businesses sustained by Kenya's small-scale economy. Their ability and scale which allows them to reach areas lacking infrastructure for the big businesses creates the need for tax policies that enhance voluntary tax compliance. This can only be achieved after a clear understanding of factors that affect/influence tax compliance (Aryeetey & Ahene, 2005).

1.2 Statement of the Problem

Various studies have been carried out, seeking to determine the impact of different variables on tax compliance targeting different tax regions among others but no study has focused on Meru (Zachary et al., 2015; George et al., 2017). With its rapidly growing economic potential, Meru Town and to a greater extent Meru County is of interest in understanding and tailoring products that enhance revenue collection. In Kenya, taxation contributes the largest amount of resources for government projects hence accurate and efficient collection is paramount which can be achieved through the inclusion of more Kenyans into the tax base, tailored service delivery form KRA and equitable resource distribution. With the increased tax base, compliance especially, on the fast-growing SME sector, has been key to maximizing collection and achieving revenue targets (KPMG, 2017a; KPMG, 2017b).

Tax evasion reduces available resources for government funding diminishing the quality and scale of investment the government can undertake. This reduces countries growth ability and discourages investment into the country as a result of uneven taxation, high taxation rates and

evasion loopholes in the system. In Kenya, high tax rates can be said to contribute to tax evasion leading to a disincentive to business (Karingi, 2005).

Presently, KRA's taxpayer base stands at 2.9 million active taxpayers out of the 8.1 million (KRA, 2017) taxpayers registered in the Personal Identification Number (PIN) database. A significant proportion of taxpayers are non-filers, nil-filers, or credit filers despite business income. The small and medium scale business is continuously growing but are left out of the tax base though they have the potential to increase revenue. The government stands to lose billions in revenue if this sector remains untaxed negatively impacting government TAMacity to deliver. The majority of the citizens in Meru County fall under the small tax payer bracket. As indicated by Kamleitner et al (2010), this group of taxpayers are described by low business turnover (annual turnover \leq sh 5 million), small TAMital, unspecialized merchandize, sole worker structure (in most cases the proprietor runs the business with assistance of one or two assistants), poor records keeping and generally non-compliance with tax matters.

SMEs are continuing to expand yet most of them remain outside the tax net. Continued low revenue collection levels for any government are detrimental to the economic development of this nation (Cobham, 2005). A large segment of businesses in Meru town is in the informal sector hence the need to determine their tax compliance levels and the factors that contribute to tax compliance among Small and Medium enterprises in Meru Township.

1.3 Research Objectives

1.3.1 General Objective

The main objective of the study was to determine the factors that influence tax compliance among Small and Medium Enterprises in Kenya regarding to Meru Township.

1.3.2 Specific Objectives

- i. To establish the effects of taxpayer knowledge on tax compliance among SMEs in Meru Township.
- ii. To examine the effect of penalties and interests on tax compliance among SMEs in Meru Township.
- iii. To determine the effects of technology on tax compliance by SMEs in Meru township.

1.4 Research Questions

- i. To what extent does taxpayer knowledge affect tax compliance amongst SMEs in Meru Town?
- ii. How does penalties and interests affect tax compliance among SMEs in Meru Town?
- iii. How does technology affect tax compliance among SMEs in Meru Town?

1.5 Significance of the Study

1.5.1 The Government

The government raises tax revenue to finance public security, health, education and infrastructure. In this regard, the government has to ensure that its source of revenue is effective and efficient. The government was not able to collect the required taxes from the targeted taxpayers. From the SMEs point of view, tax evasion is driven generally by a perception that the tax burden is too high.

1.5.2 The Kenya Revenue Authority

The findings of this study helped the Authority and the Government at large to institute the necessary legislative and administrative measures to enhance tax compliance in case of voluntary compliance and enforce compliance in cases of noncompliance.

Kenya Revenue Authority was interested in maximizing revenue collections and thus the study was useful in instituting measures, policies, and initiatives to address or minimize noncompliance hence enhancing revenue collection. Tax practitioners assist taxpayers to interpret the complicated tax law and help them understand various challenges faced by taxpayers towards voluntary compliance and help them understand taxation.

1.5.3 The Taxpayers

The study was also very important to the general public since it highlighted various challenges faced by the taxpayers towards compliance and the possible solutions to these challenges.

1.5.4 Future researchers

The survey was also of importance to other researchers as it acted as a basis for further research so when seeking research to enhancing revenue collection through other systems that either supplement or substitute self-assessment system.

1.6 Scope of the Study

The research was to identify the variables affecting the tax compliance of Meru Township among small and medium-sized enterprises in Kenya. The study was limited to the determination of the impact on tax compliance among SMEs of the details, penalties and interests of taxpayers and technology in Meru Township. The study sought to survey the tax compliance status of individual taxpayers between the periods of 2015 to 2019. The study targeted a population of 1657 registered SME's in Meru County in Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter focuses on various theories of tax compliance and how other researchers have written concerning tax compliance. It begins with a theoretical literature review, empirical literature review and conceptual framework.

2.2 Theoretical Framework

This chapter examines some related literature on previous work done on related studies and looks at the thematic areas stated in the objective. Theories try to help one understand the problem and make it known what other researchers view on the subject matter. The following are the theories used to understand on tax compliance by small and medium enterprises.

2.2.1 Economic Deterrence Theory

In economic deterrence theory, if the benefits derived from engaging in crime are outweighed by the consequences, then a person would be deterred from engaging in the crime (Becker, 1968). To increase tax compliance, it is therefore suggested that penalties and tax audits for non-compliance should be increased. Through punitive approaches, deterrence can be achieved. This can be achieved either by imposition of tougher penalties, reducing the tax rate or increasing the probability of detection (Fischer, Wartrick & Mark, 1992).

Allingham and Sandmo (1972) further developed the economic deterrence model by incorporating tax compliance concept. The new model postulates that a rational taxpayer would consider evading tax if the payoff arising from the evasion outweighs the cost of committing the crime.

This theory purports that economic motives and trade on the probability that their actions will not be detected, influence taxpayers. They assess the situation to determine whether they have an option to pay or evade tax. Taxpayers are constantly looking for opportunities to evade tax. Some overstate their expenses while others reduce their profit before tax all in the name of paying lesser tax (Hanefar, Ariff & Kasipillahi, 2012).

In the informal sector, for instance, some unscrupulous traders close their shops to elude tax collectors. To deter such traders from desisting to pay taxes, punitive penalties should be

instituted. Increased tax penalty deters them from not paying taxes as and when they are due (Braithwaite, 2007).

2.2.2 Optimal Taxation Theory

Optimal tax theory is the study of how to design a tax to minimize distortion and inefficiency caused by raising set revenues through distortionary taxation (Saez 2016). It highlights how best to design and implement a tax that maximizes a social welfare function subject to economic constraints. The basic premise of the theory is that if the government wishes to raise a given sum through taxation that taxes distort economic behavior, how the taxes should be set to minimize the distortion which occurs (Kira, 2017).

Other factors being constant, if a taxpayer must choose between two mutually exclusive investments with the same risk and returns, the one with the lower tax will be chosen. That shows that taxes distort economic choices (Moore, 2017).

Taxpayer education is important in designing an optimal tax system (Palil, 2010). Taxpayer education is important in informing the taxpayers on their rights and obligations, which will, in turn, enhance tax compliance because taxpayers are aware of any tax reliefs and other incentives that authorities put in place to have an optimal tax system (Christina, 2010). A tax system where taxpayers don't feel overburdened will result in higher compliance levels.

2.2.3 Technology acceptance model

TAM was initially proposed by Davis in 1986. TAMt, a hypothetical model, was created to help clarify and anticipate user conduct on IT (Lai et al., 2004). TAM is viewed as an influential expansion of the TRA (Ajzen and Fishbein, 1980). Davis et al. (1989) proposed TAM to clarify why a client acknowledges to utilize or rejects to utilize IT by adjusting TRA.

Carter and Belanger (2004) as cited to in Shajari and Ismail (2010) featured that TAM is utilized by many researchers particularly in information frameworks to accomplish a better comprehension of IT adoption and its achievement in associations. Nonetheless, TAM has demonstrated to be a strong and robust structure to explain adoption pattern of clients (Shajari and Ismail, 2010). Chuttur (2009) admitted that several studies discovered significant measurable outcomes for the high influence of attitude on conduct aim to utilize a specific framework, and these studies gave a solid proof to help TAM as a model for anticipating systems usage conduct. Moreover, TAM provides a basis with which belief or attitude to

utilize an electronic tax system improves reception of an electronic tax system which influences tax consistence practices among SBEs.

2.3 Empirical Review

This relates to the work done by other researchers especially those studies relevant to one's topic. According to Auriola and Waktors (2005), tax revenues as a proportion to Gross Domestic Product is typically much lower in developing countries than in developed countries. Howard (1997) undertook a study to find out why taxes were introduced. Their search found out that taxes were imposed mostly on the rich to redistribute the resources. However, since the rich have the powers and influence, they become more tax non – compliance. This led to the scenario of taxing the whole population to attain taxation canon of equality. Baldly (1987) manipulated participants SMEs income and found lower compliance at higher income levels.

Onjochogwu and Stephen (2012) assessed factors affecting tax compliance among small and medium-sized enterprises in northwestern Nigeria. They concluded that the major causes of non-compliance with SMEs were high tax rates and complex filing procedures. They proposed that to allow growth and continuity in a competitive market, small and medium-sized enterprises (SMEs) should be charged at a lower rate. Tax incentives will go a long way in encouraging voluntary tax compliance and also attracting investors.

Marita (2019) conducted a study on the effectiveness of taxpayer education on tax compliance for SMEs in Kitengela, Kenya. The study sought to understand how taxpayer education can change the non – compliant behavior of SMEs and narrow the tax gap. The study concluded that tax compliance levels were heavily dependent on taxpayer education as taxpayers would be aware of the tax rates, fines, and penalties.

2.3.1 Tax Compliance

Tax compliance is often given in terms of the degree to which taxpayers comply with the tax law (James & Alley, 2004). Large taxpayers are less likely and have more possibilities to evade taxes as compared to SMEs (Spicer & Lundstedt, 1976). To be able to comply with the tax law, a degree of integrity, adequate knowledge and TAMacity to use the knowledge is required. Adequate documents, timeliness and precision are often pursued to complete the tax returns and related tax documentation (Singh & Bhupalan, 2001). In developing countries, SMEs often face difficulties when dealing with tax matters. In evaluating the total tax burden on the business community, we also hear complaints about the complexity and or ambiguity

of tax law, high tax rates and a lack of fiscal policy that takes account of social taxes and fees (Baurer, 2005).

Due to most SMEs in Kenya being found in the informal sector, it becomes difficult to Kenya Revenue authority to tax them and therefore most of them succeed in evading tax. Terkper (2007) notes that one of the key problems facing the nation is how to widen the tax net since if taxes are only levied to few citizens, the situation calls for concerns.

According to Marti (2010), tax compliance is a complex term to define, simply put, tax compliance refers to fulfilling all tax obligations as specified by the law freely and completely. The size and nature of Small and Medium enterprises makes the issue of tax compliance one of particular importance especially since most SMEs have access to limited resources and inadequate expertise to comply with diverse and complicated regulation. High costs of compliance can result in tax avoidance, tax fraud, and inhibit investment by way of diminishing the competitiveness of the country in terms of taxation.

2.3.2 Taxpayer Knowledge

The degree of tax compliance with tax regulations and rules to a great extent depends on the level of taxpayer knowledge. As a result, low literacy levels create taxpayer uncertainty about tax regulation requirements, thus resulting in high levels of unintentional non – compliance (Latiff et al., 2005). Thus, the literacy levels of taxpayers on rules of tax have an impact on the level of taxpayer compliance. Individual ability to fill tax return forms, incident of errors while filing tax returns forms and individual interest in learning about tax are critical determiners of taxpayer literacy levels on taxation procedures and regulations.

Self-assessment system (SAS) places a great importance on education as a factor in improving tax compliance since the taxpayer needs to be knowledgeable on laws governing taxation and their implementation. This enables taxpayers falling within the target bracket to correctly calculate and make payments (Kasipillai et al., 2003).

Taxpayer understanding of tax laws and requirements influences their ability to comply. Knowledge passed on to the taxpayers expounds there understanding on why the taxes are required, how they are utilized and consequences for noncompliance which increases their willingness to be tax compliant. Taxpayer education helps to tailor attitude towards taxation with positive altitude reduces the desire to evade taxes. This is motivated by knowledge on why, when and how the taxes are due or utilized (Kasipillai et al., 2003; Palil & Fariq, 2011).

Mwangi (2014) focused in on the factors affecting duty consistence among little and medium endeavors in Nairobi's modern territory, Kenya. The scientist sketched out a definite writing survey and perceived the components for this research to be duty rate, availability of cost information, charge consistence cost and mindset of SME's. The research was an unmistakable overview. Given the enormous populace of selected residents in Nairobi, a model size of 150 was picked as agent, to be the point of convergence of this research. To ensure that distinctive different assorted classes of residents and business components were associated with the overview, defined testing procedure was received. Data was accumulated using self-controlled surveys and a meeting guide. The gathered information was therefore analyzed using Statistical Package for Social Scientist software and the outcomes of the research introduced using tables. The absence of promptly accessible data identifying with tax matters accounted to an incredible percent as a reason for non-compliance. The absence of data added to the inability of the taxpayers to effectively compute the assessments payable; another type of non-compliance. The SMEs see that if more data would be profited to them in type of tax seminars and literature, this would demystify the complex concept of tax and significantly spur them to be consistent.

The impact of taxpayer awareness and compliance costs on tax compliance among small-scale traders in Nakuru city, Kenya, was studied by Omondi and Theuri (2019). The research was motivated by tax compliance's economic deterrent and psychological theories. Descriptive research design was employed in the analysis. A sample size of 302 was drawn from the target population of 1416 small scale traders approved by the Nakuru County Government. Using standardized questionnaires, data was obtained. The data was also coded; both inferential and descriptive statistics were used to quantitatively interpret it. Then the knowledge was summarized in the form of tables and charts. The findings revealed that tax awareness and education has a positive and significant effect on the tax compliance ($\beta_2=0.315$), and the cost of compliance has a significant effect on the level of tax compliance ($\beta_1=0.416$).

2.3.3 Penalties and Interests

Both fines and penalties can be used by tax administrators interchangeably as long as neither of the two is set at zero allowing for variable consequences depending on non-compliance level and type of non-compliance to eliminate the risk of future profit advantage in tax evasion. High penalties or fines are geared towards creating a negative benefit mindset among taxpayers since it might cost more in fines and/or penalties when detected that the

actual tax payable. However, some studies show a weaker relationship where higher tax fines and penalties might result in increased tax evasion with an optimal balance obtained when they are coupled with frequent audits (Michele et al., 2012).

Punishments under tax administration either as fines or penalties are geared towards reducing the profit available by non-compliance. Studies have however indicated that at some level, higher levels of punishment results in increased levels of tax evasion bringing forward the question on how to effectively assess effectiveness of tax fines and penalties. High levels of punishment are viewed as unfair with low fines and penalties not providing the level of deterrence required for effective control of tax evasion. These results in revenue collection agencies having to create a balance whereby the taxpayers have a risk associated with non-compliance in form of tax fines and penalties set at a level to reduce the incentive and a higher risk of detection (Michele et al., 2012).

Ngigi and Collins (2015) decided the impact of coordinated tax management framework on assessment consistence by small and medium enterprises in the focal business region, Nairobi County. For this an unmistakable descriptive research design was adopted. An example of 173 SMEs was chosen through stratified random sampling. The multiple linear regressions were utilized to set up the connection between the autonomous and ward factors. The investigation found that a positive and significant relationship with tax enforcement is framed between the measure of fines and penalties charged and tax counseling/filing costs related with the coordinated tax management framework. The investigation presumed that in the Central Business District, Nairobi County, the coordinated tax management framework impacts charge implementation by small and medium enterprises.

Mwaura (2019) surveyed the determinants of assessment consistence among small scale organizations in Thika Town. The study was guided by three explicit targets being: to decide the impact of duty punishments on assessment consistence among little scope organizations in Thika Town; to assess how citizens insights on expense laws influences tax consistence among little scope organizations in Thika Town and to decide how automation of assessment documenting influences charge consistence among little scope organizations in Thika Town. The study methodology was based on explanatory research design with causal links between the determinants and tax compliance as to when, where, how why and what analysis in presenting qualitative and quantitative features. The area of the study was Thika Town with the main interest skewed to small scale businesses in the region that were estimated to be 1,200 from the records of the Thika Town Government in cadres of retailers, general merchants, kiosks, fruit vendors, informal traders, transporters, agri-processors,

hoteliers among others. The analysis adopted Yamane formula to derive the sample size of 300 respondents from a target population of 1,200 taxpayers who own small scale businesses in Thika Town. The inquiry used primary data consisting of open and closed ended questionnaire to collect data with a five point Likert scale ratings. The data was analyzed in Statistical Package for Social Sciences (SPSS) version 24 for final analysis and generation of the outputs, descriptive statistics such as mean, variance and standard deviation and inferential statistics such as multiple regression analysis from the Likert scale. The findings of the research indicated that tax penalties, taxpayers' perception on tax laws and automation of tax filing had a strong positive correlation to tax compliance. The results noted that the coefficient of determination indicated three variables had a joint significant impact on tax compliance. The study concluded that tax penalties registered a strong positive association to tax compliance hence the need to ensure consistent compliance to tax filing, SMEs owner to have proper records of transactions and fair judgement to all taxpayers.

2.3.4 Technology and Tax compliance

Holniker (2005) argues that the use of the system has brought about a significant improvement in the revenue collection time for taxpayers. iTax is the system that has been developed to replace the old KRA system. It is an online web enabled and secure application system that provides a fully integrated and automated solution for administration of domestic taxes.

Enables Taxpayer internet based PIN registration, returns filing, payment registration to allow for tax payments and status inquiries with real-time monitoring of accounts. According to Hawley (2006), modern trading practices make it essential for Kenya Revenue Authority administrations to offer simple, predictable as well as efficient procedures for the clearance of goods and movement of people while simultaneously tackling increasingly complicated national and international requirements to ensure compliance with national laws, international agreements and meeting security challenges.

Tax Compliance has become the key administrative approach for both personal and corporate taxation in developed countries making it important to investigate the impact of iTax on SMEs compliance. There has been witnessed a tremendous increase in the efficiency of tax collection for the tax authority but there is still need for development public awareness of tax laws, and improvement in voluntary compliance. Between January 1 and June 8 in 2016, the iTax platform processed transactions worth 280 billion.

iTax is based on the self-assessment system, and it accepts the reality that no tax administration has, or ever will have sufficient resources to determine the correct liability of every taxpayer. It recognizes that taxpayers themselves with appropriate assistance from the tax department are in the best position to determine their tax liabilities, given that they have first-hand knowledge of their business affairs and financial transactions, and have ready access to underlying accounting records. The emphasis under this system shifts the verification process from pre to a post filing basis. Self-assessment allows for the democratic exercise of taxpayers' rights resulting in an increased involvement by the taxpayers in their tax affairs (Loo et al., 2005). The tax administration relies more on post filing controls such as risk based audits, collection enforcement measures and prosecution of tax evaders. Tax administrations operating self-assessment systems adopt targeted verification approaches, to verify the information contained in tax returns. In this way the administrations limited resources are directed toward addressing the most significant threats to the tax system, while in principle leaving compliant taxpayers free to conduct their business without unnecessary intervention. Mararia, 2014 examined the effect of integrated tax management system on tax compliance by SMEs. The challenge of lack of knowledge on the impact of online tax filing on tax compliance is serious because it may have played part in the Kshs 60 Billion in half year tax collection short fall in 2012/2013 financial year and 11.47 billion tax collection short fall in 2011/2012 financial year (Standard Newspaper, January 15, 2013) and (Standard newspaper, July 21, 2012).

Lunani, Ayuma and Tanui (2019) studied the effect of online taxpayer registration on tax compliance of small and medium enterprises in Eldoret town, Kenya. The development of literature was guided by the technology acceptance model (TAM) theory. An explanatory research design was adopted and 2670 Small and Medium Enterprise taxpayers in Eldoret City, North Rift Region were the target population. 347 Small and Medium Business tax payers were the sample size. In order to classify the respondents, a stratified and simple random sampling technique was used. Using the alpha technique of cronbachs, construct validity was checked using factor analysis and reliability. The data was analyzed using SPSS version 20 software using descriptive statistics and inferential statistics. The results were, online tax registration ($\beta = .333$, $p = .041$, $< .05$). The study concluded that online tax registration has a significant effect on tax compliance.

Muturi and Kiaire (2015) took a gander at the impacts of online tax framework on assessment consistence among little citizens in Meru County, Kenya. This goal was addressed utilizing

three exploration theories which rotated around online tax enlistment, online tax filing and online tax settlements. The survey of the past research considers were completed. The investigation received a spellbinding research plan. Information was gathered utilizing organized poll, which covered all the factors of the investigation from 60 sample citizens from Meru region charge District. Information gotten were subjected to quantitative methods of data research utilizing SPSS (rendition 20). In addition to descriptive statistics, both correlation and regression were done and synopses introduced. The discoveries of the research were that online expense framework influences charge consistence level among little citizens in Meru County.

2.4 Conceptual Framework

The study conceptualizes that the tax compliance of SME's could be affected by the opportunity of the tax rates, tax knowledge, penalties and interests and technology. The study assumes that the factors under discussion have a direct influence on tax compliance among SMEs in Kenya. The relationship between the dependent and the independent variables is illustrated in Figure 2.1.

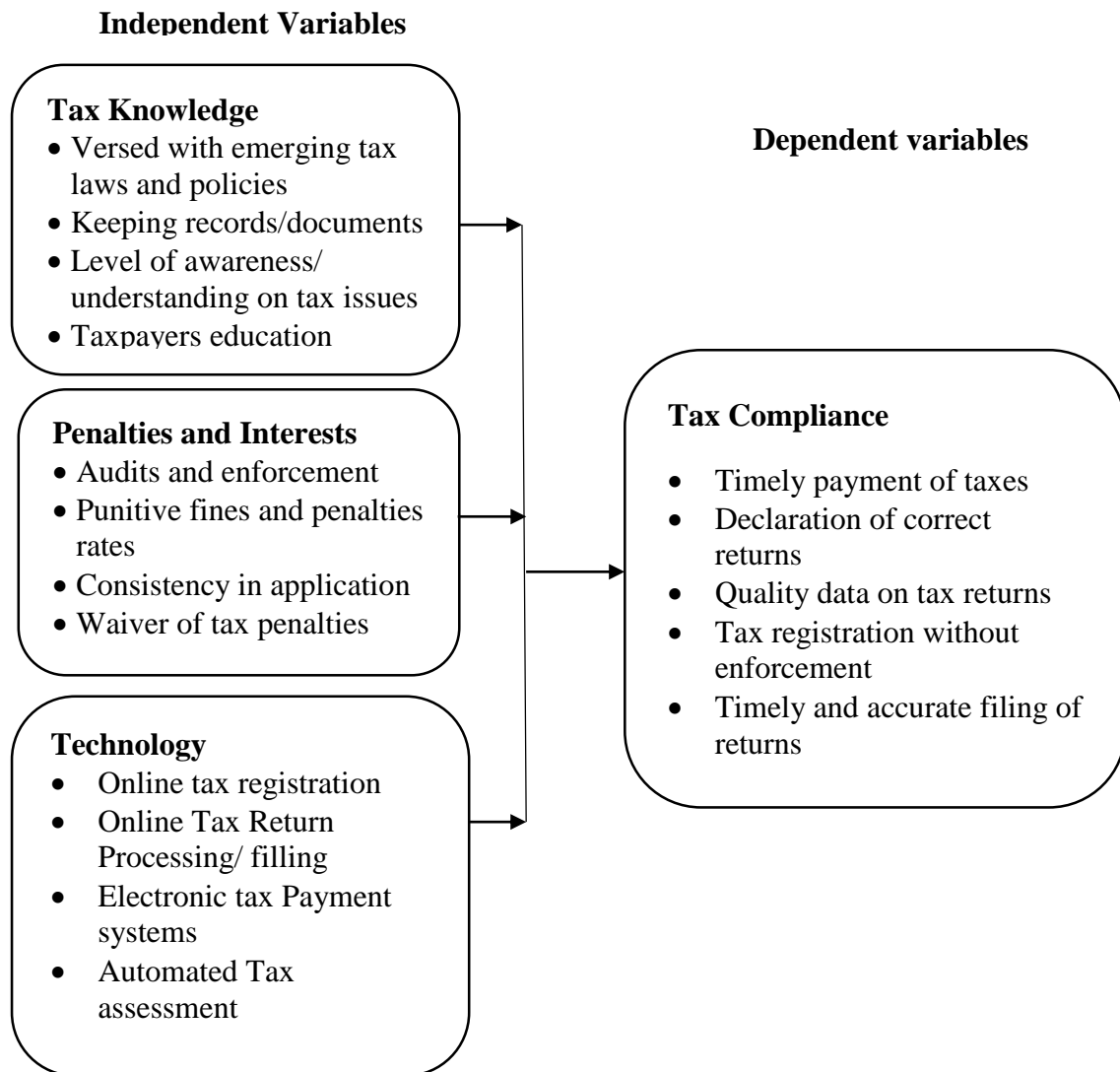


Figure 2.1: Conceptual Framework

2.4.1 Measurement of Variables

The study looked into three factors consisting of taxpayer knowledge, penalties and interests and technology on tax compliance among SMEs in Meru Township. Tax knowledge were measured through the individuals being versed with emerging tax laws and policies, keeping records/documents, level of awareness/ understanding on tax issues and taxpayers education in relation to tax compliance.

To measure tax penalties and interests, the effect of audits and enforcement, punitive fines and penalties rates, consistency in application and waiver of tax penalties on tax compliance among SMEs were studied.

Further, on the effect of technology on tax compliance among SMEs in Meru Township: online tax registration, online tax return processing/ filling, electronic tax payment systems and automated tax assessment were investigated. In order to measure tax compliance, timely payment of taxes, declaration of correct returns, quality data on tax returns, tax registration without enforcement and timely and accurate filing of returns were used.

2.5 Critique of the Study

Mararia (2014) examined the effect of integrated tax management system on tax compliance by SMEs. The challenge of lack of knowledge on the impact of online tax filing on tax compliance is serious on the grounds that it may have played part in the Kshs 60 Billion in half year tax collection short fall in 2012/2013 financial year and 11.47 billion tax collection short fall in 2011/2012 financial year (Standard Newspaper, January 15, 2013) and (Standard newspaper, July 21, 2012).

Holniker (2005) argues that the use of the system has brought about a significant improvement in the revenue collection time for taxpayers. iTax is the system that has been developed to replace the old KRA system of ITMS. It is an online web enabled and secure application system that provides a fully integrated and automated solution for administration of domestic taxes.

According to Marti (2010), tax compliance is a complex term to define, simply put, tax compliance refers to fulfilling all tax obligations as specified by the law freely and completely. The size and nature of Micro and Small enterprises makes the issue of tax compliance one of particular importance especially since most SMEs have access to limited resources and inadequate expertise to comply with diverse and complicated regulation. High costs of compliance can result in tax avoidance, tax fraud, and inhibit investment by way of diminishing competitiveness of the country in terms of taxation.

Alm et al (1992) supports the evidence that fines do affect tax compliance though the impact is virtually zero. Friedland et al. (1978) compliance was strongly affected by the amount of fines than by audit probabilities. Several studies however found no support for the deterring effects of fines since it is weak (Andreoni, 1998). The most extreme penalties will have no

effect; it is common knowledge that audits virtually do not occur. The increasing tax avoidance and tax resistance due to an increase of fines puts into question how fines should be assessed to be effective. On the one hand fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on tax payers.

2.6 Summary of Literature Review

This started with the acceptance of the proposal; the sampled respondents were given an introduction letter to agree to the collection of data from them. The questionnaires were administered directly by the researcher to the respondents and were emailed to them for those respondents who were not eligible for a sit-in filling of the questionnaire. The research sought to gain insight into determinants of tax compliance among SMEs in Meru town. It is expected that the findings helped the decision makers and KRA to deeper understand SMEs, which enabled them plan and deliver services more efficiently and effectively.

In a study carried out among SMEs in Kerugoya, Kenya, on the attitudes of taxpayers and their tax compliance established that the attitudes of taxpayers do not encourage tax compliance (Lumumba et al., 2010). Most of them felt that they were paying a fair share of tax, yet they were not getting the right services. As a result, they concluded that the tax system in Kenya is unfair.

Therefore, the factors which influence taxpayers' compliance behavior among SMEs need to be well evaluated to help correct this economic vice.

From all the studies reviewed above, it is clear that past research has tried to study the area but from a shallow perspective and no one has actually done the research in depth, the research tried to seek solutions to the problem statement which are mentioned later in Chapter four and five.

2.7 Research Gaps

The issues of tax compliance need to be addressed soberly; an effective and efficient tax administration system is integral to any Country's well-being. The Revenue Authority has not been able to balance its educational and assistance role with its enforcement role; the overriding goal is to foster voluntary compliance with the tax laws which represents a significant challenge in a developing economy.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter detailed steps and variable measurements that were undertaken to achieve the objectives. It gives the steps under research design, determination of sample size from the population, collection of the data and how data was analyzed and presented.

3.1 Research Design

According to Kothari (2014), a research design can be regarded as a composition of rules for data collection and analysis of the same in a way that combines relevance with the aim of the research. The study employed descriptive survey research design. The design is the most appropriate since it ensured that the data that was obtained gave appropriate answers to the research questions. Descriptive study was used to describe characteristics of a population or phenomenon under study.

3.2 Target Population

According to Mugenda and Mugenda (2013), target population entails an entire group of persons or things which have similar features which are preferred by the investigator. Target population consist of a group of entities or elements which must be huge than or distinct from sampled group from which the researcher will draw conclusions about the interested population. The target population comprised of 1657 registered SME's in Meru County in Kenya (Meru County records, 2014).

3.3 Sample and Sampling Technique

A sample is a subset of a particular population that represents the whole. The sample size is an essential feature of any empirical analysis that attempts to draw inferences from a sample about a population. In practice, depending on the cost of data collection and the need to provide adequate statistical TAMacity, the sample size used in a study is calculated. Where the population is heterogeneous a big sample should be taken.

Mugenda (2013) defines a sample as a part of the total population. Orodho and Kombo (2002) view a sample as a finite and representative number of individuals or objects in a population to be studied. Further, Kothari (2004) describes a sample as a collection of units chosen from the universe to represent it.

According to Kothari (2004), a sample size of 10% to 30% is a good representation of the target population, for population below 10,000. The study sampled 10% from the target population and the sample size was 166 respondents.

Sample size is important because of its effect on statistical power. Statistical power is the probability that a statistical test indicated a significant difference when there truly is one (Morgan, 2001). The study employed convenience sampling technique in the selection of the sample. This was the most effective considering the nature of business at Meru town whereby you cannot get all the traders at once.

Table 3.1: Sampling Frame and Sample Size

Type of Enterprise	Target Population	Sample size 10%
General merchants & kiosks	540	54
Medium & small retails	320	32
Informal traders	367	37
Agricultural producers & processors	280	28
Lodging hotels & restaurants	150	15
Total	1,657	166

3.4 Data Collection Instruments

Data gathering includes a procedure that is exact and involves deliberate social event of data applicable to the exploration sub-issues. The researcher utilized questionnaire as the essential instrument for data gathering. The questionnaire was formatted to contain sections reflecting the study variables. Self-administered questionnaire was used. Cooper and Schindler (2008) suggest that a self-administered survey method is especially appropriate when it is important for the respondent to have adequate time to carefully consider their responses as was the case in this research.

3.5 Pilot Study

Study piloting was carried out before primary research to establish the reliability and validity of the research instrument (Mugenda & Mugenda, 2013).

3.5.1 Reliability of the Research Instrument

Consistency of a research tool over repeated trials is key to quality data and achieving the objectives with the study using a test-retest (after two weeks) approach where small set of respondents were selected outside of the study area with similar characteristics and repeated to check for questionnaire data reliability (Cooper & Schindler, 2003). This was used to check if similar responses were given in both cases. According to Mugenda (2003) a reliability test of research instruments is one that consistently produces the expected results. According to Kothari (2004), a questionnaire has the same expectation, that is, it reliably does what it is designed to do every time it is used. If the questionnaire is consistent over time and yields similar results each time it is used, it is reliable. A construct composite reliability co-efficient (Cronbach alpha) of 0.7 or above, for all the constructs, was considered to be adequate for this study (Rousson, Gasser & Seifer, 2012). Reliability coefficient of the research instrument was assessed using Cronbach's alpha (α) which was computed as follows:

$$A = k/k-1 \times [1 - \sum (S^2) / \sum S^2_{sum}]$$

Where: α = Cronbach's alpha

k = Number of responses

$\sum (S^2)$ = Variance of individual items summed up

$\sum S^2_{sum}$ = Variance of summed up scores

3.5.2 Validity of Research Instrument

Validity is how much an instrument estimates what it should measure. (Kothari, 2004), the term alludes to the degree to which an instrument poses the correct questions as far as exactness. Legitimacy accordingly alludes to the degree to which an instrument poses the correct inquiries as far as exactness. Mugenda et al. (1999) looked at validity as the exactness and importance of inductions, in light of research results. The legitimacy of this research instrument was resolved through guiding, where the reactions of the subjects were checked against the research destinations. For a research instrument to be substantial the substance should be pertinent to the variable being researched.

3.6 Data Collection Procedure

This started with the acceptance of the proposal; the sampled respondents were given an introduction letter to agree to the collection of data from them. The questionnaires were administered directly by the researcher to the respondents and were emailed to them for those respondents who were not eligible for a sit-in filling of the questionnaire. The respondents

filled the questionnaires at a time and place convenient to them to provide an environment which they were free to take part.

3.7 Data Analysis and Presentation

All the surveys were checked for completeness, then, categorized, coded, analyzed using Statistical Package for Social Sciences (SPSS Version 25.0). After data cleaning which entails checking for errors in entry, descriptive statistics such as frequencies, percentages, mean score and standard deviation were estimated for all the quantitative variables and information presented in form of tables. The qualitative data from the open-ended questions was analyzed using conceptual content analysis and presented in prose.

Inferential data analysis was done using multiple regression analysis. Multiple regression analysis was used to establish the relations between the independent and dependent variables. Multiple regression was used because it is the procedure that uses two or more independent variables to predict a dependent variable. Since there are three independent variables in this study the multiple regression model generally assumed the following equation;

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

Where: -Y- Tax compliance

β_0 - Constant

β_1, β_2 & β_3 - Regression coefficients

X_1 - Tax knowledge

X_2 - Penalties and interests

X_3 - Technology

ε - Error term

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION OF FINDINGS

4.1 Introduction

This chapter analyzed, discussed and presented the study results with the overall aim of establishing the factors affecting tax compliance among small and medium enterprises (SMEs) in Meru Town.

4.1.1 Response Rate

The study targeted 166 respondents, out of which only 128 respondents returned the questionnaires dully filled. This represented a response rate of 77.1% which is above 50% and is considered significant response rate for as statistical analysis as prescribed by Rousson, Gasser and Seifer (2012). The response rate is as shown in Table 4.1.

Table 4. 1: Response Rate

	Frequency	Percent
Response	128	77.1
Non-response	38	22.9
Total	166	100.0

4.1.2 Reliability Analysis

A pilot study was carried out to determine reliability of the questionnaires. Reliability analysis was subsequently done using Cronbach's Alpha which measures the internal consistency by establishing if certain items within a scale measure the same construct. Table 4.2 displays the results.

Table 4. 2: Reliability Statistics

Items	Cronbach's Alpha	Decision
Taxpayer knowledge	.772	Reliable
Penalties and interests	.809	Reliable
Technology	.849	Reliable
Tax compliance among SMEs	.782	Reliable

As shown in Table 4.2, technology had an alpha value of 0.849, penalties and interests had an alpha value of 0.809, tax compliance among SMEs had an alpha value of 0.782 while taxpayer knowledge had an alpha value of 0.772. All alphas were above 0.70 and therefore the factors were all reflective because their indicators were highly correlated and are largely interchangeable.

4.1.3 Validity Analysis

Exploratory factor analysis was used to establish the construct validity of the questionnaire. The factors that explain the highest proportion of variance the variables share was expected to represent the underlying constructs. Table 4.3 presents validity analysis.

Table 4. 3: Component Matrix

	Component									
	1	2	3	4	5	6	7	8	9	10
I know how to declare actual income received from all sources to the tax authority pertaining to income and expenditure	.064	.185	.045	.632	.118	.088	.019	.327	.236	.199
I understand that I should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period	.627	.147	.145	.001	.244	.164	.007	.074	.379	.144
I know how to keep records/documents	.257	.014	.334	.034	.605	.119	.143	.155	.002	.332
I am well versed with the existing tax laws/policies	.062	.317	.537	.014	.170	.157	.040	.218	.186	.523
I have been informed by tax awareness campaigns targeted at the SME sector	.196	.456	.181	.345	.173	.256	.205	.279	.238	.179
I have obtained a taxpayer identification pin number as well as registered my business as a tax agent	.555	.237	.332	.042	.070	.199	.074	.219	.088	.007
I am fully aware of the tax filing procedures	.367	.569	.257	.005	.289	.139	.164	.209	.171	.096
I am legally not obligated to audit my books therefore successful prosecution is not possible	.314	.262	.256	.042	.442	.104	.501	.059	.039	.072
There exists punitive fines and penalties imposed on SMEs	.670	.021	.019	.130	.028	.196	.067	.174	.192	.027
The tax enforcement is very weak	.171	.018	.058	.094	.211	.671	.124	.121	.012	.399
I believe that the penalty is lower than my tax saving due to not complying with tax laws.	.330	.050	.226	.428	.184	.147	.398	.198	.261	.032
Serious enforcement and penalty by the KRA may result if I do not comply	.608	.173	.200	.243	.006	.102	.341	.080	.106	.019
Tax authority audits and investigations are few among SMEs	.425	.371	.086	.502	.024	.195	.212	.058	.112	.170
There is frequent prosecution of tax offenders which make me comply	.533	.351	.288	.254	.168	.120	.106	.016	.111	.207
Presence of punitive tax penalties to non-disclosure has increased tax compliance	.013	.599	.037	.077	.234	.178	.062	.289	.438	.181
Relevant transactions records are used in waiver of tax penalties hence increases tax compliance	.073	.076	.667	.282	.043	.242	.025	.029	.075	.073
KRA cautions tax defaults in due time to avoid increase in penalties and thus enhances tax compliance	.714	.107	.077	.117	.073	.111	.182	.048	.097	.007

Online filing of tax returns is faster and more convenient in the submission of my returns as compared to the manual system	.010	.299	.459	.019	.040	.243	.078	.058	.587	.068
My basic information is accurately maintained	.385	.123	.066	.372	.421	.145	.310	.110	.099	.044
The time policies by KRA on the online payment procedures are clear	.736	.094	.068	.254	.048	.012	.106	.050	.242	.129
Using on line payment reduces has reduced the tax payment process which saves on time	.124	.133	.221	.109	.078	.631	.231	.067	.185	.014
It takes less time to be registered as a taxpayer online	.631	.039	.074	.027	.248	.062	.030	.303	.079	.087
Online submission of tax data has improved my tax records' management through iTax system database	.378	.264	.535	.118	.061	.025	.213	.239	.300	.084
iTax has made it easier to assess my taxes	.584	.161	.309	.062	.247	.266	.179	.141	.081	.095
Automated tax systems has ensured full compliance and reduced the associated costs	.086	.205	.087	.075	.096	.686	.199	.270	.233	.365
Our enterprise files and pays its taxes as a matter of course.	.095	.649	.000	.132	.164	.074	.299	.404	.177	.013
Our enterprise would still pay its taxes on time if there were no controls	.503	.055	.324	.073	.059	.200	.032	.525	.176	.218
Our enterprise has always declared actual income received from all sources to the tax authority honestly without being forced to.	.176	.583	.303	.331	.295	.176	.225	.050	.094	.156
Our enterprise does not follow the stipulated tax rules and regulations because of the fear of the risks of being checked.	.195	.121	.148	.135	.154	.031	.626	.054	.229	.060
Our enterprise has registered as taxpayer for all the taxes it qualifies for without being forced to.	.049	.004	.264	.001	.124	.367	.378	.295	.136	.493
Our enterprise is always keeping up to date records and books of accounts without being forced to	.681	.098	.081	.114	.156	.113	.145	.028	.068	.070

Extraction Method: Principal Component Analysis.

a. 10 components extracted.

From the findings above, each of 31 parameters were observed and placed to one of the 10 components depending on the percentage of variability it explained the total variability of each factor. From the factor analysis, all the variables indicators high construct validity since all exceeded the prescribed threshold of 0.40 (Saunders, Lewis & Thornhill, 2012).

4.2 Demographic Information

The study gathered data on various demographics of the SME's in Meru County. The demographics that were considered included the highest level of education, their monthly turnover, whether the business has a personal identification number and tax compliance certificate.

4.2.1 Respondents' Highest Level of Education

The study sought to find the respondents' highest level of education. The responses were summarized in Table 4.4.

Table 4. 4: Respondents' Highest Level of Education

	Frequency	Percent
Primary school	34	26.6
Secondary School	33	25.8
Tertiary education	32	25.0
University education	29	22.7
Total	128	100.0

The findings reveal that most of the respondents as represented by 26.6% had reached primary school level, 25.8% had reached secondary school level, 25.0% had reached the tertiary education level, while 22.7% had reached the university education level. This implies that the respondents had enough basic education to comprehend and give reliable information about the subject under study.

4.2.2 Monthly Turnover

The researcher also sought the businesses monthly turnover as displayed on Table 4.5.

Table 4. 5: Monthly turnover

	Frequency	Percent
Up to ksh 500,000	27	21.1
Ksh500,001-1000,000	21	16.4
1000,001-2000,000	17	13.3
2000,001 – 3000,000	37	28.9
Above 3000,000	26	20.3
Total	128	100.0

The findings show that 28.9% of the businesses had a monthly turnover of between 2,000,001– 3,000,000 , 21.1% had a monthly turnover of Up to ksh 500,000, 20.3% had a monthly turnover of above 3,000,000, 16.4% had a monthly turnover of between Ksh500, 001-1,000, 000 while 13.3% had a monthly turnover of between 1,000, 001-2,000, 000. This implies that most of the businesses had good turnover rate and hence could give reliable data regarding the subject matter.

4.2.3 Business Personal Identification Number (PIN)

The researcher also required the respondents to indicate whether their businesses have Personal Identification Number (PIN). The results were as shown on Table 4.6.

Table 4. 6: Business Personal Identification Number (PIN)

	Frequency	Percent
Yes	58	45.3
No	70	54.7
Total	128	100.0

From the findings, 54.7% of the respondents indicated that their businesses did not have Personal Identification Number (PIN) while 45.3% indicated that they had Personal Identification Number (PIN). This implies that the data collected had a variety of opinions on the subject matter.

4.2.4 Business Tax Compliance Certificate

The research further sought to know if the businesses had a tax compliance certificate. Table 4.7 shows the outcomes.

Table 4. 7: Business Tax Compliance Certificate

	Frequency	Percent
Yes	63	49.2
No	65	50.8
Total	128	100.0

The results revealed that 50.8% of the respondents indicated that the businesses had no tax compliance certificate while 49.2% had a tax compliance certificate. This implies that the data collected had a variety of opinions on the subject matter.

4.3 Tax Knowledge

The study sought to establish the effects of taxpayer knowledge on tax compliance among SMEs in Meru Township. The researcher required to know the level of agreement that the respondents had with statements related to tax knowledge on tax compliance among SMEs in Meru Township. The results were as displayed on Table 4.8.

Table 4.8: Level of Agreement with Statements Related to Tax Knowledge on Tax Compliance among SMEs in Meru Township

	Mean	Std. Dev.
I know how to declare actual income received from all sources to the tax authority pertaining to income and expenditure	3.211	0.627
I understand that I should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period	3.523	0.947
I know how to keep records/documents	4.383	0.598
I am well versed with the existing tax laws/policies	2.969	0.897
I have been informed by tax awareness campaigns targeted at the SME sector	3.141	0.957
I have obtained a taxpayer identification pin number as well as registered my business as a tax agent	3.828	0.870
I fully aware of the tax filing procedures	3.750	0.963

As per Table 4.8, the respondents agreed that SMEs know how to keep records/documents as illustrated by an average of 4.383; the SMEs have obtained a taxpayer identification pin number as well as registered the business as a tax agent as illustrated by an average of 3.828; the SMEs are fully aware of the tax filing procedures as illustrated by an average of 3.750; and the SMEs understand that they should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period as illustrated by an average of 3.523. The researcher also found that the respondents were not sure that the SMEs knew how to declare actual income received from all sources to the tax authority pertaining to income and expenditure as illustrated by an average of 3.211; the SMEs had been informed by tax awareness campaigns targeted at the SME sector as illustrated by an average of 3.141; and the SMEs were well versed with the existing tax laws/policies as illustrated by an average of 2.969. These findings conform to Latiff et al.

(2005) who state that the degree of tax compliance with tax regulations and rules to a great extent depends on the level of taxpayer knowledge. As a result, low literacy levels create taxpayer uncertainty about tax regulation requirements, thus resulting in high levels of unintentional non – compliance.

4.4 Penalties and Interests

The research aimed at examining the effect of penalties and interests on tax compliance among SMEs in Meru Township. The respondents were required to indicate their level of agreement with statements related to penalties and interests on tax compliance among SMEs in Meru Township. The responses were as presented on Table 4.9.

Table 4.9: Level of Agreement with Statements Related to Penalties and Interests on Tax Compliance among SMEs in Meru Township

	Mean	Std. Dev.
I am legally not obligated to audit my books therefore successful prosecution is not possible	3.258	0.781
There exists punitive fines and penalties imposed on SMEs	3.984	0.786
The tax enforcement is very weak	3.938	0.951
I believe that the penalty is lower than my tax saving due to not complying with tax laws.	3.227	0.763
Serious enforcement and penalty by the KRA may result if I do not comply	4.125	0.704
Tax authority audits and investigations are few among SMEs	3.430	0.861
There is frequent prosecution of tax offenders which make me comply	3.672	0.768
Presence of punitive tax penalties to non-disclosure has increased tax compliance	3.898	0.821
Relevant transactions records are used in waiver of tax penalties hence increases tax compliance	3.680	0.886
KRA cautions tax defaults in due time to avoid increase in penalties and thus enhances tax compliance	3.672	0.959

The findings show that the respondents agreed that serious enforcement and penalty by the KRA may result if they do not comply as shown by a mean of 4.125; there exists punitive fines and penalties imposed on SMEs as shown by a mean of 3.984; the tax enforcement is very weak as shown by a mean of 3.938; presence of punitive tax penalties to non-disclosure has increased tax compliance as shown by a mean of 3.898; relevant transactions records are used in waiver of tax penalties hence increases tax compliance as shown by a mean of 3.680; there is frequent prosecution of tax offenders which make them comply as shown by a mean

of 3.672; and KRA cautions tax defaults in due time to avoid increase in penalties and thus enhances tax compliance as shown by a mean of 3.672. The respondents were not sure that tax authority audits and investigations are few among SMEs as shown by a mean of 3.430; the SMEs were legally not obligated to audit their books therefore successful prosecution is not possible as shown by a mean of 3.258; and the SMEs believe that the penalty is lower than their tax saving due to not complying with tax laws as shown by a mean of 3.227. these relates to Michele et al. (2012) who noted that both fines and penalties can be used by tax administrators interchangeably as long as neither of the two is set at zero allowing for variable consequences depending on non-compliance level and type of non-compliance to eliminate the risk of future profit advantage in tax evasion.

4.5 Technology

The study sought to evaluate the impact of technology on tax enforcement by small and medium-sized enterprises in the township of Meru. In Meru Township, the respondents were asked to indicate their level of agreement with statements relating to technology relating to tax compliance among SMEs. Table 4.10 indicates their reactions.

Table 4.10: Level of Agreement with Statements Related to Technology on Tax Compliance among SMEs in Meru Township

	Mean	Std. Dev.
Online filing of tax returns is faster and more convenient in the submission of my returns as compared to the manual system	4.273	0.814
My basic information is accurately TAMtured	4.188	0.576
The time policies by KRA on the online payment procedures are clear	3.781	0.963
Using on-line payment reduces has reduced the tax payment process which saves on time	3.625	0.584
It takes less time to be registered as a taxpayer online	3.820	0.955
Online submission of tax data has improved my tax records' management through iTax system database	4.180	0.504
iTax has made it easier to assess my taxes	4.234	0.819
Automated tax systems has ensured full compliance and reduced the associated costs	3.211	0.749

The findings show that the respondents agreed that online filing of tax returns is faster and more convenient in the submission of returns as compared to the manual system quantity as

illustrated by a mean score of 4.273; iTax has made it easier to assess taxes quantity as illustrated by a mean score of 4.234; the basic information is accurately TAMtured quantity as illustrated by a mean score of 4.188; online submission of tax data has improved tax records' management through iTax system database quantity as illustrated by a mean score of 4.180; it takes less time to be registered as a taxpayer online quantity as illustrated by a mean score of 3.820; the time policies by KRA on the online payment procedures are clear quantity as illustrated by a mean score of 3.781; and using on-line payment reduces has reduced the tax payment process which saves on time quantity as illustrated by a mean score of 3.625. The respondents were not sure that automated tax systems has ensured full compliance and reduced the associated costs quantity as illustrated by a mean score of 3.211. The results correlate to Holniker (2005) who argues that the use of the system has brought about a significant improvement in the revenue collection time for taxpayers. ITax is the system that has been developed to replace the old KRA system. It is an online web enabled and secure application system that provides a fully integrated and automated solution for administration of domestic taxes.

4.6 Tax Compliance

The respondents were also required to indicate the trend of tax compliance among SMEs in Meru Township for the past five years. The results were as shown in Table 4.11.

Table 4. 11: Trend of Tax Compliance among SMEs in Meru Township

	Mean	Std. Dev.
Our enterprise files and pays its taxes as a matter of course.	3.172	0.588
Our enterprise would still pay its taxes on time if there were no controls	3.492	0.655
Our enterprise has always declared actual income received from all sources to the tax authority honestly without being forced to.	3.320	0.577
Our enterprise does not follow the stipulated tax rules and regulations because of the fear of the risks of being checked.	3.945	0.830
Our enterprise has registered as taxpayer for all the taxes it qualifies for without being forced to.	4.000	0.642
Our enterprise is always keeping up to date records and books of accounts without being forced to	3.906	0.987

The findings revealed that the respondents agreed that the enterprise has registered as taxpayer for all the taxes it qualifies for without being forced to as presented by an average score of 4.000; the enterprise does not follow the stipulated tax rules and regulations because of the fear of the risks of being checked as presented by an average score of 3.945; and the enterprise is always keeping up to date records and books of accounts without being forced to as presented by an average score of 3.906. The respondents were not sure on whether the enterprise would still pay its taxes on time if there were no controls as presented by an average score of 3.492; the enterprise has always declared actual income received from all sources to the tax authority honestly without being forced to as presented by an average score of 3.320; and the enterprise files and pays its taxes as a matter of course as presented by an average score of 3.172. This is in accordance to Marti (2010) who states that high costs of compliance can result in tax avoidance, tax fraud, and inhibit investment by way of diminishing the competitiveness of the country in terms of taxation.

4.7 Correlation analysis

A correlation is a number between -1 and +1 that measures the degree of association between two variables. A positive value for the correlation implies a positive association while a negative value for the correlation implies a negative or inverse association.

Table 4. 12: Correlation coefficients matrix

		Tax compliance among SMEs	Taxpayer knowledge	Penalties and interests	Technology
Tax compliance among SMEs	Pearson Correlation	1			
	Sig. (2-tailed)	.			
Taxpayer knowledge	Pearson Correlation	.889	1		
	Sig. (2-tailed)	.020	.		
Penalties and interests	Pearson Correlation	.864	.223	1	
	Sig. (2-tailed)	.027	.006	.	
Technology	Pearson Correlation	.732	.243	.497	1
	Sig. (2-tailed)	.025	.002	.000	.

The analysis of correlation results between the Tax compliance among Small and Medium Enterprises and Taxpayer knowledge show a positive coefficient 0.889, with p-value of 0.020. It indicates that the result is significant at $\alpha = 5\%$ and that if the Taxpayer knowledge

increases it will have a positive impact on the Tax compliance among Small and Medium Enterprises. The correlation results between Penalties and interests and Tax compliance among Small and Medium Enterprises also indicates the same type of result where the correlation coefficient is 0.864 and a p-value of 0.027 which significant at $\alpha = 5\%$. The results also show that there is a positive association between Technology and Tax compliance among Small and Medium Enterprises where the correlation coefficient is 0.732, with a p-value of 0.025.

4.8 Multiple Regression Analysis

This was conducted to determine the relationship between taxpayer knowledge, penalties and interests, technology, and as the independent variables against the dependent variable tax compliance among SMEs. The results were as presented in Table 4.13, Table 4.14 and Table 4.15.

Table 4.13: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.846	0.716	0.709	1.383

From the study results, Table 4.13 is a model fit which establish how fit the model equation fits the data. The adjusted R^2 was used to establish the predictive power of the study model and it was found to be 0.709 implying that 70.9% of the variations in tax compliance among SMEs in Meru Township are explained by changes in taxpayer knowledge, penalties and interests and technology. This is in line with Baurer (2005) noted that in developing countries, SMEs often face difficulties when dealing with tax matters. Often we hear complaints about complexity and or ambiguity of the tax laws, high tax rates and lack of fiscal strategy that takes social taxes and fees into account when determining the overall tax burden placed on the business community.

Table 4. 14: Analysis of Variance (ANOVA) results

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	608.032	3	202.677	104.258	.000
Residual	241.056	124	1.944		
Total	849.088	127			

The probability value of 0.000 indicates that the regression relationship was highly significant in predicting how the taxpayer knowledge, penalties and interests and technology influence tax compliance among SMEs in Meru Township. The F calculated at 5 per cent level of significance was 104.258. Since F calculated is greater than the F-critical (value = 2.6777) and p-value was less than 0.05, the overall model was significant. These results correspond to Singh and Bhupalan (2001) who stated that a degree of honesty, sufficient knowledge and ability to use the knowledge is required to be able to comply with the tax law. Also, adequate records, timeliness, and accuracy to complete the tax returns and associated tax documentation are adhered to.

Table 4. 15: Regression Coefficients

	Un standardized		Standardized	t	Sig
	Coefficients		Coefficients		
	B	Std. Error	Beta		
(Constant)	0.864	0.412		2.097	0.038
Taxpayer knowledge	0.805	0.393	0.721	2.048	0.043
Penalties and interests	0.717	0.244	0.664	2.939	0.004
Technology	0.775	0.339	0.718	2.286	0.024

The regression equation obtained from this outcome was: -

$$Y = 0.864 + 0.805X_1 + 0.717X_2 + 0.775X_3$$

As per the study results, it was revealed that if all independent variables were held constant at zero, then the tax compliance among SMEs in Meru Township will be 0.864. From the findings, the study revealed that a unit increase in taxpayer knowledge would lead to 0.805 increases in tax compliance among SMEs in Meru Township. This variable was significant since p=0.043 is less than 0.05. This is consonance with Kasipillai et al. (2003) asserts that taxpayer education helps to tailor attitude towards taxation with positive attitude reduces the desire to evade taxes. This is motivated by knowledge on why, when and how the taxes are due or utilized.

The study further revealed that a unit change in penalties and interests would lead to a 0.717 unit change in tax compliance among SMEs in Meru Township. The variable was significant since p-value=0.004<0.05. These results are in line with Michele et al. (2012) argue that high penalties or fines are geared towards creating a negative benefit mindset among taxpayers

since it might cost more in fines and/or penalties when detected that the actual tax payable. However, some studies show a weaker relationship where higher tax fines and penalties might result in increased tax evasion with an optimal balance obtained when they are coupled with frequent audits.

Moreover, the study showed that if all other variables are held constant, a unit change in the score of technology would lead to a 0.775 change in tax compliance among SMEs in Meru Township. This variable was significant since $p=0.024$ was less than 0.05. The results corresponds to Hawley (2006) stated that modern trading practices make it essential for Kenya Revenue Authority administrations to offer simple, predictable as well as efficient procedures for the clearance of goods and movement of people while simultaneously tackling increasingly complicated national and international requirements to ensure compliance with national laws, international agreements and meeting security challenges.

Overall, taxpayer knowledge had the greatest effect on tax compliance among SMEs in Meru Township, followed by technology strategy, then penalties and interests had the least effect on tax compliance among SMEs in Meru Township. All the variables were significant since p-values were less than 0.05.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of the data findings, discussion of the data findings, conclusion drawn from the findings highlighted and recommendation made. The conclusions and recommendations drawn are focused on addressing the objective of the study.

5.2 Summary of the Findings

The study sought to establish the effects of taxpayer knowledge on tax compliance among SMEs in Meru Township. The research found that the SMEs know how to keep records/documents; the SMEs have obtained a taxpayer identification pin number as well as registered the business as a tax agent; the SMEs are fully aware of the tax filing procedures; and the SMEs understand that they should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period. The research also found that the SMEs knew how to declare actual income received from all sources to the tax authority pertaining to income and expenditure; the SMEs had been informed by tax awareness campaigns targeted at the SME sector; and the SMEs were well versed with the existing tax laws/policies. These findings are consistent with those of Ochola (2012) who established that tax knowledge has a significant impact on tax compliance even though the level of tax knowledge varies significantly among respondents.

The research aimed at examining the effect of penalties and interests on tax compliance among SMEs in Meru Township. The study found that serious enforcement and penalty by the KRA may result if they do not comply; there exists punitive fines and penalties imposed on SMEs; the tax enforcement is very weak; presence of punitive tax penalties to non-disclosure has increased tax compliance; relevant transactions records are used in waiver of tax penalties hence increases tax compliance; there is frequent prosecution of tax offenders which make them comply; and KRA cautions tax defaults in due time to avoid increase in penalties and thus enhances tax compliance. The study also found that tax authority audits and investigations are few among SMEs; the SMEs were legally not obligated to audit their books therefore successful prosecution is not possible; and the SMEs believe that the penalty is lower than their tax saving due to not complying with tax laws. These findings are consistent with those James Ngunjiri (2016) who established that fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on tax payers.

The study sought to determine the effects of technology on tax compliance by SMEs in Meru Township. The study found that online filing of tax returns is faster and more convenient in the submission of returns as compared to the manual system quantity; iTax has made it easier to assess taxes quantity; the basic information is accurately TAMtured quantity; online submission of tax data has improved tax records' management through iTax system database quantity; it takes less time to be registered as a taxpayer online quantity; the time policies by KRA on the online payment procedures are clear; and using on-line payment reduces has reduced the tax payment process which saves on time quantity. The study found that automated tax systems has ensured full compliance and reduced the associated costs quantity. These findings are consistent with those of Gwaro, Maina&Kwasira (2016) who established that computer literacy had significant effect on the influence of tax compliance levels amongst small and medium enterprises in Nakuru County.

5.3 Conclusions

The research concluded that taxpayer knowledge has a positive and significant effect on tax compliance among SMEs in Meru Township. The research concluded that it is important to create awareness on tax laws, create awareness on how the tax system is structured and administered, have less sophisticated rules on taxation for a non-professional to understand, have readily available tax rules information so as encourage tax compliance. The study also concluded that tax rates are too high, fines and penalties charged for late fillings are stiff, the cost required for filling the tax returns is high, hiring a profession to do the fillings as expensive and that the number of government bodies involved in tax collection are many and this has led to poor tax compliance

The study deduced that penalties and interests affect tax compliance among SMEs in Meru Township significantly. The analysis concluded that some small scale business owners ensure that they're in consistent compliance to tax filing to avoid penalties and other expenses that accrues to their KRA pin status. Further, the business owners have sufficient and proper records in place as they are used as evidence in case of errors when filing returns.

The study concluded that technology has a significant effect on tax compliance by SMEs in Meru Township. The study concluded that KRA has not put in place enough measures to ensure that taxpayers have technical skills to file tax returns online. This could also be a reason as to why those who do not feel the online tax filing is efficient are yet to appreciate it and use it. The study concluded that technical skills of the filing tax returns can also be

identified as a challenge facing taxpayers as many of them fear the notion and consequences of errors from online filing such as keying-in incorrect information in tax returns that could lead to the wrong calculation of tax payable.

5.4 Recommendations

On taxpayer's knowledge and tax compliance, the study recommends that tax payers learning ought to be emphasized since tax data, tax learning tends to advance tax compliance than tax organization. Thus legislature ought to through its organizations instruct the potential taxpayers on taxation laws and controls by coordinate free symposia and courses.

The study suggests that they ought to consider bringing the expense rates down to upgrade collections. Bringing down tax rates make it less appealing to evade taxes rather than high rates. High penalty rates will build compliance but only marginally. This penalty rates should be kept at an ideal level not to debilitate citizens. Additionally consider uniform penalty rates for all tax heads. KRA ought to make more awareness on the tax consistence among SMEs through policy documentation which classify different SMEs entity.

In order to increase the number of sessions and expand the coverage to include tax consultants, there is also a need to boost enforcement to increase taxpayer education. This will explain the current legislation and any other tax responsibility for taxpayers. It will also provide taxpayers with a platform for airing their grievances and or compliments.

The study recommends that the revenue body in conjunction with other law enforcement agencies like Directorate of Criminal Investigation, Anti counterfeit Agency, Kenya Bureau of Standards (KEBS) to have a concerted effort in having and making sure business owners comply with the law and are involved in legal business transactions. There is also need to instill a culture of record keeping and observing time when it comes to making payment and rendering services.

The study recommends that KRA should have an office in every county that will address tax issues at county level and the services to be offered should include tax penalties, filing of tax returns, tax computation and tax differentiation. KRA should also establish different deduction levels and apply the standard rate plan on the revenue turnover less standard deduction. KRA should continuously implement reforms on publicizing prosecution of non-compliant by providing incentives for voluntary compliance and the tax laws should be constantly reviewed to strengthen to seal loopholes that are being exploited by non-compliant

SMEs.

The study further recommended that the Kenya revenue authority should ensure revenue streams are tracked by involving financial institutions since majority as well as enhance its manpower to ensure monitoring and tracking of all income reported by SME operators. The online tax filing process should also be simplified with clear instructions and guidelines provided on the website and the system server should be upgraded to reduce on the system downtimes experienced.

5.5 Recommendations for Further Research

The study recommends that further research be carried out on the same topic focusing on a different sector other than SMEs in order to get the perspective of other sectors. Further, the research suggests that other factors should be considered that influence tax compliance. The study was done based in Meru Town; however there is need to replicate it in other counties. Since taxpayer knowledge had the greatest effect on tax compliance, there is need for a study to be done on the influence of taxpayer knowledge on tax compliance.

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APPENDICES

Appendix I: Introduction Letter

John Wachira Waithaka

Meru Kenya,

7th February 2020.

Dear Respondent,

RE: DATA COLLECTION

I'm a student at Kenya School of Revenue Administration (KESRA) Nairobi Campus. I'm carrying out a research solely for academic purpose on "Factors affecting tax compliance among small and medium enterprises (SMEs) in Meru Town."

I'm requesting for your cooperation and sincerely answer the questions on the questionnaire and assure you that the information provided will not be used against you.

Thankyou in advance.

Yours faithfully,

John Wachira Waithaka,

Researcher.

0702309444

Appendix II: Questionnaire

Instructions

The questionnaire is designed to collect information on the determinants of tax compliance in SMEs in Meru town. The information obtained will only be used for academic purposes and shall be treated in utmost confidence. You are requested to complete this questionnaire as honestly and objectively as possible.

Please tick in the appropriate box and also fill in the blank spaces provided for those questions where elaborate answers are required. Use the space at the back of this questionnaire if you need more space for your responses.

SECTION A: GENERAL INFORMATION

1. Name of business or taxpayer (optional).....
2. What is your highest level of education?
 - a. Primary school ()
 - b. Secondary School ()
 - c. Tertiary education ()
 - d. University education ()
3. Main Business Activity.....
4. What is your monthly turnover?
 - a. Up to ksh 500,000 ()
 - b. Ksh500,001-1000,000 ()
 - c. 1000,001-2000,000 ()
 - d. 2000,001 – 3000,000 ()
 - e. Above 3000,000 ()
5. Does your business have a Personal Identification Number (PIN) Yes () No ()
6. Do you have a tax compliance certificate Yes () No ()

SECTION B: DETERMINANTS OF INCOME TAX COMPLIANCE AMONG SMES

Tax Knowledge

7. Please indicate your level of agreement with statements related to tax knowledge on tax compliance among SMEs in Meru Township. Use the scale, 1= Strongly disagree, 2=Disagree, 3= Not sure, 4=Agree and 5=Strongly agree

	1	2	3	4	5
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I know how to declare actual income received from all sources to the tax authority pertaining to income and expenditure					
I understand that I should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period					
I know how to keep records/documents					
I am well versed with the existing tax laws/policies					
I have been informed by tax awareness campaigns targeted at the SME sector					
I have obtained a taxpayer identification pin number as well as registered my business as a tax agent					
I fully aware of the tax filing procedures					

Penalties and Interests

8. Please indicate your level of agreement with statements related to penalties and interests on tax compliance among SMEs in Meru Township. Use the scale, 1= Strongly disagree, 2=Disagree, 3= Not sure, 4=Agree and 5=Strongly agree

	1	2	3	4	5
I am legally not obligated to audit my books therefore successful prosecution is not possible					
There exists punitive fines and penalties imposed on SMEs					
The tax enforcement is very weak					
I believe that the penalty is lower than my tax saving due to not complying with tax laws.					
Serious enforcement and penalty by the KRA may result if I do not comply					
Tax authority audits and investigations are few among SMEs					
There is frequent prosecution of tax offenders which make me comply					
Presence of punitive tax penalties to non-disclosure has increased tax compliance					
Relevant transactions records are used in waiver of tax penalties					

hence increases tax compliance					
KRA cautions tax defaults in due time to avoid increase in penalties and thus enhances tax compliance					

Technology

9. Please indicate your level of agreement with statements related to technology on tax compliance among SMEs in Meru Township. Use the scale, 1= Strongly disagree, 2=Disagree, 3= Not sure, 4=Agree and 5=Strongly agree

	1	2	3	4	5
Online filing of tax returns is faster and more convenient in the submission of my returns as compared to the manual system					
My basic information is accurately TAMtured					
The time policies by KRA on the online payment procedures are clear					
Using on-line payment reduces has reduced the tax payment process which saves on time					
It takes less time to be registered as a taxpayer online					
Online submission of tax data has improved my tax records' management through iTax system database					
iTax has made it easier to assess my taxes					
Automated tax systems has ensured full compliance and reduced the associated costs					

Tax Compliance

10. Please indicate the trend of tax compliance among SMEs in Meru Township for the past five years. Use the scale, 1= Strongly disagree, 2=Disagree, 3= Not sure, 4=Agree and 5=Strongly agree

	1	2	3	4	5
Our enterprise files and pays its taxes as a matter of course.					
Our enterprise would still pay its taxes on time if there were no controls					
Our enterprise has always declared actual income received from all sources to the tax authority honestly without being forced to.					
Our enterprise does not follow the stipulated tax rules and regulations because of the fear of the risks of being checked.					

Our enterprise has registered as taxpayer for all the taxes it qualifies for without being forced to.					
Our enterprise is always keeping up to date records and books of accounts without being forced to					

THANK YOU