

**INFLUENCE OF TAX ADMINISTRATION ON THE GROWTH OF SMALL AND
MEDIUM ENTERPRISES IN THE MANUFACTURING SECTOR IN NAIROBI
CITY.**

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**A project submitted in partial fulfillment of the requirement for the award of the
postgraduate diploma degree in Tax Administration, School of Business Jomo Kenyatta
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DECLARATION

This is my original work and it has not been submitted for an award of any degree in any other academic institution of higher learning.

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DEDICATION

This research project is dedicated to my family for the immeasurable support they gave me. Additionally, I want to thank the staff at National Library Service for their immense support and motivation. It is because of this that this research work is a success.

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| <p>This chapter presents the major findings summary, conclusions and essential recommendations, the study sought to examine influence of tax administration on the growth of small and medium enterprises in the manufacturing sector in Nairobi city. The following are the specific breakdown of the summaries of the major findings based on the output of the descriptive inferential statistical analysis guided to answer research questions of the study.</p> | |
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LIST OF ACRONYMS

| | |
|---------------|---|
| SMES | Small and Medium Enterprises |
| GDP | Gross Domestic Product |
| KIPPRA | Kenya Institute for Public Policy Research and Analysis |
| KAM | Kenya Association of Manufacturers |
| KRA | Kenya Revenue Authority |
| VAT | Value Added Tax |

DEFINITION OF TERMS

Form of business: The legal form an enterprise chooses to operate under which has Structural implications on resources (MSME Basic Report, 2016).

Multiple taxation: Where more than one government authority charges tax on same income or product. (Baurer, 2005).

SMEs: A firm ,trade or service ,industry or a business activity whose annual turnover does not exceed SH 500,000 and employees and whose total assets and financial statements shall be determined by the cabinet secretary from time to time.(Micro Small and enterprises act 2012)

Tax administration: The administration, management, conduct, direction, and supervision of the execution and application of a government, country or a state tax law, tax legislation and their related statute.(TPA 2016)

Turnover: These are net sales generated by an enterprise for a given period of time (KAM 2018)

ABSTRACT

The consistently rising financial and economic needs of Kenya and the budget constraints that continually exist compromise the sustainability and development of the Kenyan economy. The motivation behind this study is to collect data on the influence of tax administration on the growth of SMEs in Nairobi City. More specifically it is limited to the influence of efficiency of tax administration, tax equity and fairness and taxpayer education with regards to the growth of SMEs. This was further discussed in this study and further review empirical literature conducted by various authors on how these factors have catalyzed improvement in collection of revenue by the Kenya Revenue Authority to spur growth of SMEs. The taxpayers who participated in this study comprised SMEs in Nairobi City. There are over 10, 0000 SME taxpayers located in Nairobi. However, a sample size of 50 was considered for investigation where stratified random sampling method was used to arrive at the figure. The study employed the use of structured and open-ended questionnaires to collect primary data which was edited for consistency. It was entered in Statistical package for social science (SPSS) to enable a comprehensive descriptive statistical data analysis for ease of presentation. The findings indicated that tax equity and fairness on the growth of SME as supported by 89.79% on the statement that some SME sectors are taxed more while some receive bonuses and incentives which is unfair. The research concluded that the tax system was efficient and that it is designed in order to accelerate voluntary tax compliance. Tax inefficiencies gives rise to additional costs to the SMEs which include social costs, travelling costs, audit costs, administrative costs. These costs will divert funds meant to expand and facilitate growth of SMEs to comply with tax authorities. Further conclusions are made that taxpayer education has a significant effect on the growth of SMEs on the manufacturing industry in Nairobi City. The study recommends that Kenya Revenue Authority (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. KRA should create more awareness on the tax compliance among SMEs through policy documentation which classify different betting firms' entities.

CHAPTER ONE

INTRODUCTION

This chapter covers background of the study, statement of the problem, objectives of the study, significance of the study and the scope of this study.

1.1 Background of the Study

SMEs are economic drivers that must never be overlooked in their role of triggering economic development and growth. In North America, SMEs represented significantly larger percentages of the business enterprises with their contributions totaling close to half the Gross Domestic Product (GDP) in both the USA and Canada (Al-mahrouq, 2010). Al-mahrouq (2010) further notes that SMEs account for 60% of the total labor force of the working populace across the globe, making it the backbone of the private sector. In Asia, SME's are key economic drivers, for instance, SMEs represents slightly over 90% of all the total enterprises absorbing two thirds labor force in Thailand while in Korea, SMEs constituted 99 of all the enterprises in Korean economy, absorbing 88 percent of the working population (Veskisri et al., 2010).

Researchers are in agreement that the key to alleviating poverty and unemployment rates in Africa and other developing nations lie in their effort to create, administer and manage policies aimed at supporting African Economic growth (UNIDO, 2009). In South Africa for instance, SMEs accounted for over 55 percent of employment opportunities to the working populations while SMEs in Ghana provided 85% of employment opportunities in the manufacturing sector thus contributing over 90% of the country's GDP (Aryeetey, 2001).

Most SMEs hardly survive three years after they are formed. This is due to the stiff competition from established organizations and little or no support framework accorded to them by the government. Mnewa & Maliti (2008) asserts that the majority of SMEs are unlikely to attain and maintain a growing profitability due to constraints related to tax policies and their administration thereof. Implication of this assertion made by Mnewa & Maliti (2008) suggests to the Government to formulate policies and regulate the SME sector in order to keep in check the possible factors that could impact on the competitiveness and growth of SMEs.

Past studies have been central in identifying a multiplicity of factors behind the success or failure of Small and Medium Enterprises that can be categorized into internal determinants and external determinants. The internal determinants relate to enterprise-specific issues which

include managerial skills, human resources, organizational demographics, management of finance and innovation. External determinants refer to market opportunities, Institutional forces macroeconomic, social-cultural and political factors (Thandeka, 2008; Olawale & Garwe, 2010).

In Kenya, SMEs are enterprises that have an annual turnover ranging from 0 to KES 1M, employing between 10-99 employees. Although considered an informal sector, SMES plays crucial roles in economic growth thus are critical for Kenya's economic health (MSME Basic Report, 2016). In the year 2015, it is estimated that this informal sector accounted for 713,600 new employment opportunities which translated to 84.8% of all the new jobs created in 2015 across all the economic sectors which is testament to the magnitude of this sector (KNBS Economic Survey Report, 2016)

Studies on African Small and Medium Enterprises have largely focused on the causes of business failures. A study by Bowen et al (2009) focused on the challenges faced by SMEs in Kenya where an explanatory approach was used. The study established that micro and small enterprises were faced with numerous challenges among them including; stiff competition across different sectors, security uncertainties, management of debt-related issues, lack of adequate capital, and lack of innovative operations. In Uganda, a study on SME's was spearheaded by Tushabomwe-Kazooba (2006). The study found that political, social and economic issues coupled with poor management comprised the main factors that resulted to the collapse of most SMEs.

KAM (2018) alludes that challenges faced by SMEs were lack of innovation, below optimal product development, inaccessibility of affordable loans, difficulty in accessing domestic and international markets, lengthy and tiring process of certification and standardization. Additionally, rapid technological changes, unsupportive infrastructure and the chronic corruption bedeviling the country have served to hinder the growth of SMEs in Kenya. These myriads of factors hindering growth of SMEs saw Kenyan Government commission the creation of Micro and Small Enterprises Authority (MSEA) in 2012 to promote, regulate and develop SMEs in Kenya. Additionally, President Kenyatta issued a directive to respective ministries in 2018 to devise strategies that focused on SMEs (KAM, 2018).

There is an assumption by policy makers about the homogeneity of challenges that SMEs face which informs the opinion that a one-size-fits-all strategy can be used as a solution to these challenges. However, SMEs in retail trade or service industry are very different from those in

the manufacturing sectors. They might be facing same challenges, but each will require slightly or completely different strategies, policies and interventions in solving challenges akin to these SMEs (KAM, 2018).

Therefore, these challenges which are as a result of increasing liberalization, new entries into the market, increased levels of standards requirements as well as advancements in technology dictates SMEs to increase their levels of efficiency, strengthening the inter-firm linkages and timely response to market changes. Additionally, greater integration into the global economy will provide great opportunities for SMEs to be involved in the global business landscape. This move will help SMEs to scale up the value chain and adopt newer technologies, particularly ICT. SMEs can be able to compete globally if only they exhibit the capability to harness technology and knowledge in order to develop products with superior quality and high value (GoK, 2007).

1.2 Statement of the Problem

Past research work by different scholars are in agreement that unfavorable taxation increases costs of operation and production. This will be transferred to consumers in the form of high product prices hence the business might lose on their competitive edge. This arises due to poorly conceived and implemented tax policies and ambiguous laws (Baurer, 2005).

Corruption within KRA and other public sectors has served to taint the image of the tax collection authority (EN Gichuki 2015). Many enterprise owners are actively evading tax due to lost trust in the tax collection authority. This is despite conducting extensive awareness campaigns on the benefits of being a tax compliant citizen and taxation process. The lack of transparencies and confidence in the tax system and tax authorities is hindering their effective tax law implementation agenda (Baurer, 2005). Additionally, unrealistic penalties such as whichever is greater 5% of the amount of the tax due or KES 10,000(KRA Offences and Penalties 2019) charged for failing to file VAT monthly returns has resulted to some enterprises being closed and reopened with a different registered name to avoid the payment of accumulated tax penalties. Instances of enterprise owners unwilling to disclose all of their income sources arise from the increasing dissatisfaction caused by poor clientele service by KRA such as the refund policy.

Complex and inefficient taxation systems have been identified as one of the factors that give rise to non-compliance of some SMEs and economic sectors. This will put pressure on the existing tax base as they will bear the tax burden and double taxation. For instance, in Food and Beverage manufacturing industry, a farmer who has not registered for VAT supplies Oranges to a manufacturing SME and so the VAT on this raw material is not factored in. The Manufacturing SME will bear the whole tax burden. Furthermore, costs of hiring accountants and professional tax experts is expensive for most SMEs may not afford to meet the costs of tax compliance in terms of accounting for taxes due to complexities involved with tax filing (Marti, 2010)

Kenya aims to shift from an agricultural economy to an industrial economy by 2030. Over the years, the industrial sector has gained traction due to the numerous technological revolutions that are initiated. One key attribute to these is the constant goodwill to oversee the growth of SMEs in the industrial sector, specifically in the manufacturing. However, there is a gap as the scholarly work on the growth of SMEs has not evolved at the same pace, oftentimes due to lack

of adequate information and interest. Consequently, the number of literature studies in this sector has not matched the sector's economic development.

This study will aim to fill the gaps by conducting a comprehensive research work to include, more factors that affect SMEs growth. This study seeks to focus more on the manufacturing sector due to Kenya's drive to become an industrialized nation by year 2030. In filling the research gap, this research study will answer the following research question; what are the basic tax administration activities that influence the growth of SMEs in the manufacturing sector?

1.3 Objectives of the Study

1.3.1 General Objectives

To determine the influence of tax administration in the growth of SMEs in the manufacturing industry in Nairobi city

1.3.2 Specific Objectives

- i. To determine the influence of efficiency of tax system on the growth of SME in the manufacturing industry in Nairobi City.
- ii. To determine the influence of taxpayer education on the growth of SMEs on the manufacturing industry in Nairobi City.
- iii. To determine the influence of tax equity and fairness on the growth of SME on the manufacturing industry in Nairobi City.

1.4 Research Questions

- i. What is the influence of efficiency of tax system on the growth of SMEs on the manufacturing sector in Nairobi City?
- ii. What is the influence of taxpayer education on the growth of SMEs on the manufacturing industry in Nairobi City?
- iii. What is the influence of tax equity and fairness on the growth of SMEs on the manufacturing industry in Nairobi City?

1.5 Significance of the Study

1.5.1 The Government of Kenya and Policy Makers

The study will aim to provide useful insights that will be beneficial to Government of Kenya through her Revenue Collection Agency (KRA) and relevant policy makers such as Ministry

of Finance and planning, Parliament and Central Bank of Kenya to improve their tax administration policies, legislations, activities and management efforts towards propelling the growth of SMEs in the already fiercely competitive economic market. The study also offers suggestion on how the Government can curb incidents of tax evasion by SME managers and owners hence increasing revenue collection amounts.

1.5.2 Owners and Management of SMEs

The study will highlight the various challenges the SMES in the manufacturing industry face while trying to suggest alternative measures and mechanisms that can be adopted by new and existing SME owners to reduce the impact of these challenges. It will also further educate owners of SMEs on tax compliance to avoid unnecessary tax penalties and punishments related to tax default and evasion.

1.5.3 Researches and Scholars

Lastly, this study shall be of significant interest to researchers and scholars as it shall contribute to the already available scholarly materials related to role of tax administration activities on SMEs in Kenya and by extension other African countries.

1.6 Scope of the Study

The study is confined to SMES in the manufacturing industry located within Nairobi City, Nairobi County. The City is one of the fastest growing metropolitan economies in East and Central Africa. The city sits on 696 square kilometers (270 sq. mi) land and boasts a top ten largest metropolitan economies in Africa.

Although there are many Small and Medium Enterprises in Nairobi city, this study will focus on manufacturing SMEs that are compliant with Kenyan Tax laws. All other factors impacting on the growth of SMES in manufacturing other than tax Administration will be held constant.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter will discuss relevant studies that have been done by other researchers in relation to the topic of the researcher. It aims at identifying and outlining the tax theories advanced by different scholars with respect to tax administration. For each question outlined in 1.4 in chapter one, the researcher highlighted and presented the result of previous findings and scholarly work of different authors with respect to the role of tax administration on the growth of SMEs in manufacturing. Additionally, conceptual framework was drawn to outline the relationship between the dependent variable and the independent variables.

2.2 Theoretical Framework

2.2.1 Fischer Model

Fischer et al (1992) established this model. This offers an insight into how complex cultural, economic and psychological factors affect the taxpayer's enforcement choices. These tax compliance variables are categorized into four categories (Fischer et al 1992): the demographic (age, sex, education), non-compliance (employment, earnings and occupation level), and tax systems and structure (intricacy of the process, fines and tax rates, probability) and tax perceptions and perceptions.

It further provides a context for comprehension of the effect on the enforcement choices of a taxpayer of diverse sociological, economic and emotional factors. These factors that affect the compliance of taxpayers are grouped in four groups: Demographic (age, sex, and education), Potential for non-compliance (level of income, source of income and occupation), Attitudes and attitudes (fair and unjust of the tax system and control by peers) and the Tax System and function (Intricacy of the system, fines and tax rates, possibility).

Thus he argues that demographic factors implicitly influence taxpayer enforcement through their impacts on behaviors, expectations and incentives for non-compliance. Age, sex and education (Jackson & Milliron, 1986) have still been three main personal attributes that defines compliance with taxes.

The positive relationship between taxpayer and taxpayer enforcement is stated by Jackson & Milliron (1986). Young taxpayers are reckless and less vulnerable to sanctions. Young

taxpayers are more probable than taxpayers in more than 65 years (Jackson & Milliron) to evade taxes.

Tittle (1980) stated that women were more likely to comply with tax law when checking their level of consistency amongst men and women. Women have historically been identified with positions that comply, habits of conservatism, and ethical limitations (Jackson and Milliron 1986). It is stated that these characteristics encourage more female compliance than male compliance.

Education is characterized as the taxpayers' ability to understand and comply with tax laws with regard to tax compliance (Jackson and Milliron, 1986). The knowledge of tax avoidance and evasion is high (Tittle, 1980). Fiscal taxpayers would potentially have good results in terms of tax ethics.

The main cause of tax breaches is the increasing frustration of taxpayers and tax managers with justice and equality in the tax structure, it is widely believed.

"One factor appears to include trade equity -the tax dollars benefits received. In contrast to that of another person, the other element appears to include the equity of the taxpayer burden" (Jackson and Milliron, 1986 p. 137).

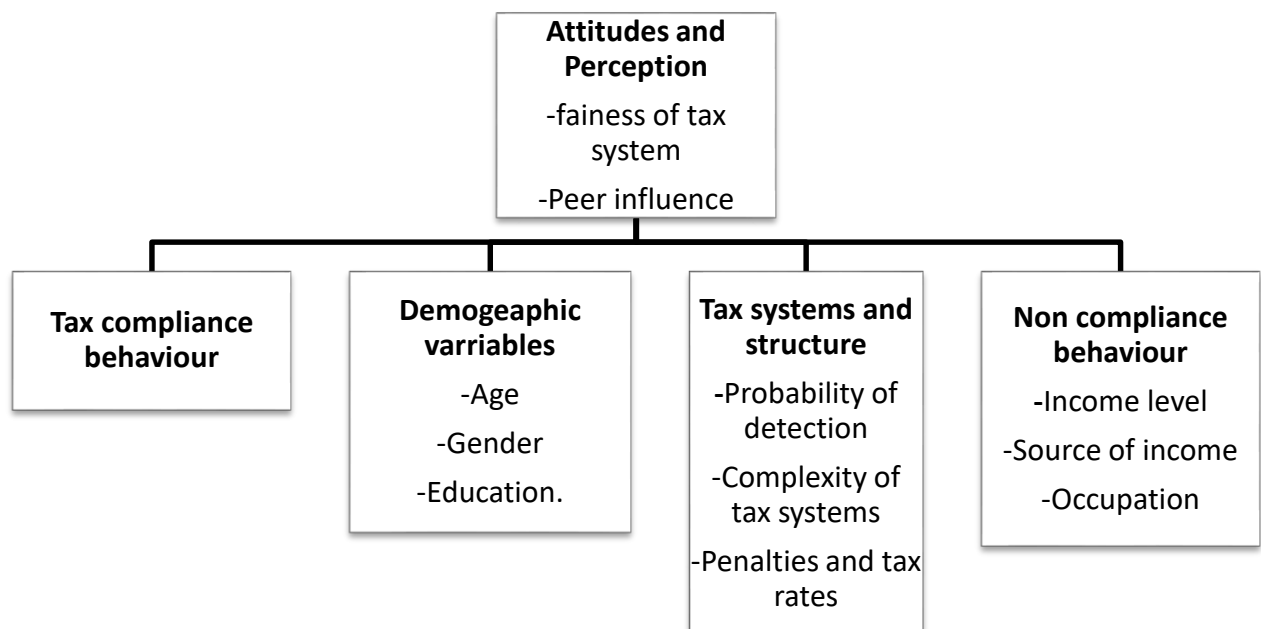
The model affirms that the tax structure's inequity may cause taxpayers to believe that the cost of public services rendered is being paid unfairly by their duty to pay tax. Peer pressure (taxpayer's associate), which involves family, friends and colleagues, also influences taxpayer enforcement decisions (Jackson and Milliron, 1986). Taxpayers who have peers who conform with tax rules are more inclined to comply with tax rules, while taxpayers whose peers more non-compliant are likely to comply with the expectations and standards of the community.

Low tax enforcement was largely attributed to underdeveloped tax systems and structure in the design of systems. The Fischer model discusses the impact of tax system complexity, tax rates, and the probability of identification and penalty being levied in order to achieve effective tax enforcement. Tax laws are becoming increasingly complex and this may be the reason for failure to comply (Jackson and Milliron, 1986). Excessive tax data and many tax estimates should be included in the tax system. Taxpayers should understand mathematical tax rules that should be transparent, descriptive and understandable. Substantial tax regulations result in tax evasion. A complicated tax system may result in the tax being unreported. By increasing the likelihood of tax audits and severe penalties, tax enforcement will be greatly encouraged.

Increasing tax fines associated with tax non-compliance, as per Allingham & Sandmo (1972), would raise the tax compliance. However, in his report, Title (1980) suggested that participants who accepted such forms of non-compliance would be less inclined to commit such actions if punishments were harshly applied.

Empirical evidence suggests that high tax rates levied on taxpayers' income are linked with less tax compliance. Instances of income underreporting are positively linked to marginal tax rate.

Figure 1. Summary of Fischer Model of Taxation.



2.2.2 The Ability to Pay Theory of Taxation

This theory was developed by Kaldor (1958). It holds that a taxpayers' ability to pay should be put into consideration before levying taxes. This places an increasing tax burden on individual taxpayers, corporations, trusts, SMEs, companies and other forms of enterprises with higher income.

The theory further posits that a commercial relationship does not exist between the government and the taxpayers. Every eligible individual taxpayer is to meet their tax obligations because

they are able to. Additionally, their relative contribution to the total tax burden is determined by their relative paying capacity.

This theory was hinged on the basic principles of fairness and equity which necessitates tax to be apportioned to every individual taxpayer in the society according to their ability to meet their tax obligations. Therefore, tax remitted by SMEs to the tax authorities should reflect the enterprises ability to pay those obligations (Chigbu, Eze & Ebimobowei, 2012).

2.2.3 Economic Deterrence Theory

Becker (1968) established this theory and Allingham & Sandom (1972) further developed this theory. The principle is based on the principle that: if the consequence of committing a crime is greater than the benefits of committing a crime, the crime will not be committed by a person. This is because people are of what is right and wrong, and the resulting consequences of the crime. Proponents of this theory claim that after evaluating the advantages and consequences of their actions, individuals choose to adhere to or violate the law (Becker, 1972).

Allingham&Sandom (1972) applied Becker's (1968) development of the utility model of criminality theory to the tax domain. The tax model proposed by Allingham & Sandom (1972) is based on the principle that tax evasion would require an economically rational taxpayer as long as the tax evasion benefit exceeds the estimated cost of being captured.

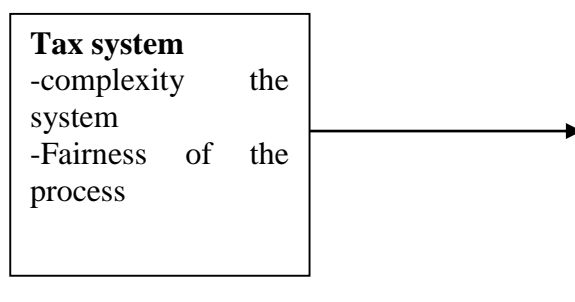
This theory attempts seeks an enforcement mechanism that is substitutable or complimented by taxpayers 'appeal to tax morality. According to Alm (2013), there is evidence tax evasion which is aimed at reducing tax responsibility exists in almost all countries. Taxpayers willfully and intentionally use illegal means to evade their tax obligations. This is opposed to tax avoidance where a taxpayer uses legal ways to minimize their tax responsibility. The practices involved in tax evasion include underreporting or failing to report income, fabricating deductions and using unscrupulous means of reducing tax obligations (Oliver &Honiball, 2008: 381).

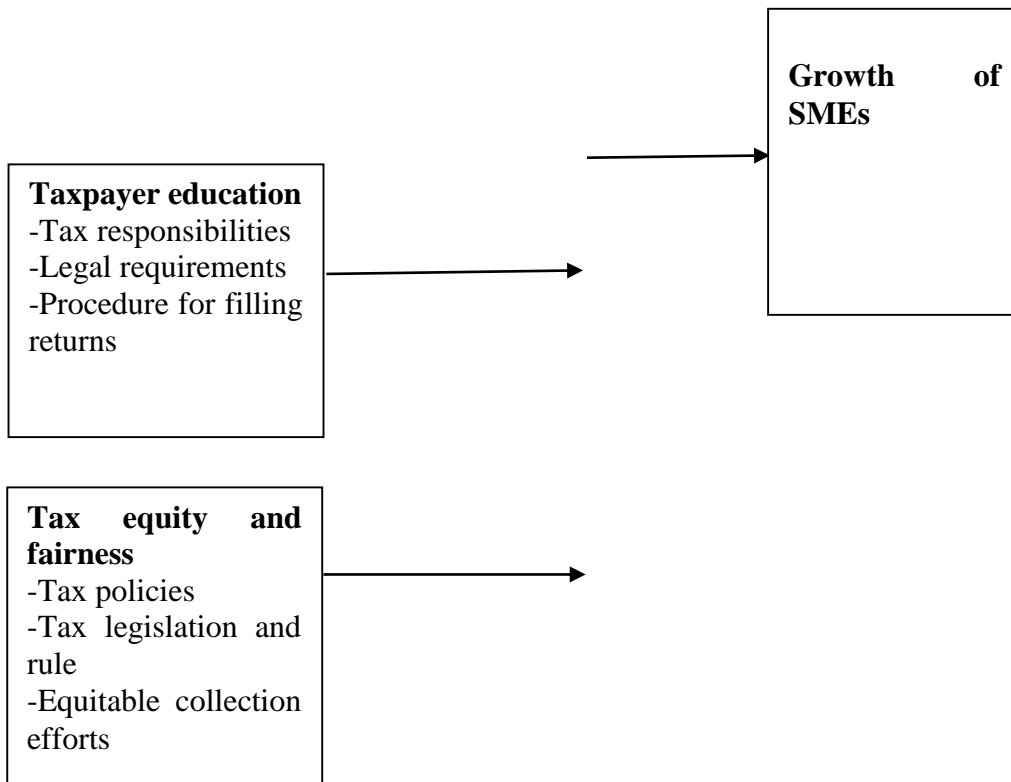
However, it is important to determine the tax-paying capacity of taxpayers before applying the deterrence mechanisms. Taxes paid are seen as sacrifices made taxpayers in order to comply with the tax regime. This therefore begs the question; what is the sacrifice each taxpayer can comfortably bear and how should the authority measure such sacrifice (Rai, 2004). Rai (2004) further states that the most just method a government can use to levy taxes on its taxpayer is to comply with tax laws in accordance with their capacity to pay.

It is in this point of view that this paper attempts to argue the impact an efficient, just, effective and administratively feasible sound tax system has towards rapidly promoting the economic growth of SMEs.

2.3 Conceptual framework

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Independent Variables

Dependent Variable

Figure 2.1: Conceptual Framework

(Adopted from Daisy research)

2.4 Empirical Review

2.4.1 Efficiency of tax system and growth of SMEs

As KRA looks to consolidate finances, they have placed stricter limits on the funds available to it as a result there is growing attention on the increasing efficiency of tax compliance. Tax inefficiency arises when organizations do not design their internal organizational structures, tax policies are unfavorable, irrational and directly targets one particular economic sector (Ng'ang'a & Muturi, 2015). Even though legislations and policies are mandatory in regulating and protecting the business environment and economic agents, it may also act as a barrier to the growth of enterprises through additional expenditures (Williams and Round, 2009).

Franzoni (1998) concluded that enterprises will resent against tax authorities who levy high rates and complicated tax systems. These will accelerate instances of tax evasion. Additionally, due to complexity and inefficiency of the tax system, SMEs oftentimes rely on services of external tax experts which will prove to be expensive. Other times, services of external tax experts are required to engineer tax avoidance to minimize tax obligations (Franzoni, 1998)

Costs incurred gives rise to additional costs to the SMEs which include social costs, travelling costs, audit costs, administrative costs. These costs will divert funds meant to expand and facilitate growth of SMEs to comply with tax authorities.

2.4.2 Taxpayer education and the growth of SMEs

A taxpayer who has attended a taxation course as opposed to the one, who has not attended a taxation course, is expected to have a superior understanding of tax laws and regulations and have higher tax compliance levels (Mohd, 2010). Enhancing tax understanding is likely to improve taxpayer attitude towards tax system.

It relates to the awareness and ability of taxpayers to recognize tax laws and their desire to comply with tax laws. Kasipillai (2003) describes the field of tax knowledge as the general understanding of tax rules and regulations and information pertaining to the possibilities of tax evasion. Tax education is essential for creating and improving public understanding in tax law-related areas, the role it plays in social development and the complex process of collecting it.

2.4.3 Tax equity and fairness

Tax equity and fairness is often seen as drawing legislative measures and policies with regards to taxpayer's ability to pay. This takes into account income, wealth, health status, social status,

family situation and other variables associated with the taxpayer to reduce the tax rates or increase them depending on their impact on taxpayer's ability to meet their tax obligations.

Granting tax benefits and incentives can be viewed as a form of tax equity and fairness. It is a positive discrimination as it seeks to empower the vulnerable among the tax base. This in itself has a long-term benefit to the tax authority as enterprises which are positively discriminated will grow rapidly to stability hence higher taxes.

The tax systems are based on the principle of equality and equality, viewed from three relational viewpoints—horizontal equity (meaning that taxpayers with different income brackets / earnings must pay the varied according to their ability to pay), horizontal equity (meaning that taxes paid should rise with the size of the tax base) and, furthermore, exchange equality (Richardson, 2006; Wallschultzky, 1984). The tax system's interpretation as equal and fair affects the propensity to evade tax (Richardson, 2008, Jackson & Milliron, 1986).

2.5 Critique of the Literature

Various studies have been conducted in relation to influence of tax administration in the growth of small and medium enterprises. These include: Ng'ang'a & Muturi, 2015; Williams and Round, 2009; Mohd, 2010; Kasipillai, 2003; Richardson, 2006; Wallschultzky, 1984; Richardson, 2008 and Jackson and Milliron, 1986. However these studies did not focus on the influence of tax administration in the growth of small and medium enterprises. Hence this study seeks to bridge this gap by establishing the influence of tax administration in the growth of SMEs in the manufacturing industry in Nairobi city.

2.6 Research Gap

There is no a “one size fit all” theory to exclusively and exhaustively explore and explain the role of tax administration on SMEs growth. Additionally, there is little local literature on this field. In light of these challenges, research need to focus more on study work that will consists of full house theories explaining behaviors of different compliant and non-compliant SMEs in different times. Tax administrations must recognize these varying behaviors among taxpayers to devise effective policies to ensure higher compliance levels. Governments must draft multifaceted strategies and approaches that encompass broad range of actual motivation to boost growth of these SMEs in the manufacturing industry.

This paper therefore aims to address this research gap and gain useful insights into the role the tax administrations play in facilitating the growth of SMEs. The findings are expected to help policy makers gain a better comprehension of this group of tax payers hence enabling them to devise newer ways of handling them.

2.7 Summary of Literature Review

Several conclusions can be drawn from the literature herein. First, the primary goal of setting up a business enterprise is to make profits and a business should thrive on these profits and thus a business without profits isn't worth running. Several factors both internal and external have been attributed to either the success or failure of a business enterprise. From the literature, several studies had been carried out by several various researchers to shed light on growth of enterprises. However, it was of concern that little has been done to ascertain the impact of tax administration on the growth of small and medium enterprises in the manufacturing sector - a knowledge gap that the study objectively attempted to fill.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 Introduction

This chapter highlights the research methods that were employed in this study to establish answers to research questions outlined in section 1.5 in chapter 2.

This chapter therefore encompasses in-depth discussion of methodological aspects of this study including research design, population, sampling framework, data collection Instruments, data collection procedure and data analysis.

3.2 Research Design

Coopers & Schindler (2003) defines research design as a set of methods and procedures a researcher uses to collect and analyze measurement of variables outlined in the research objectives. This study employed descriptive research design in to describe characteristics of the target population. The aim of descriptive statistics is to discover and measure the possible causes and their effect towards the relationships between the various variables (Coopers & Schindler, 2003). Further, Mugenda & Mugenda (1999) asserts that objective of descriptive research design is to determine, report and attempt to precisely describe the characteristics, attitudes, behaviors and values associated with the variables.

The study, therefore, adopted the design because it enabled the researcher to easily collect large quantities of in-depth qualitative and quantitative data related with the target population. This helped the researcher to gather statistical data on the role of tax administration in the growth of SME in the manufacturing sector in Nairobi City.

3.3 Population

Donald Cooper (2010) defines population as the unit of the study on which measurement is being taken. The target population that was captured in this study constituted 50 SMEs which were created from the data from KRA records of Manufacturing SMEs operating in Nairobi City. The focus on Nairobi City is informed by the fact that it has the highest concentration of SMEs in the manufacturing industry and the diversity of the enterprises thereof made it financially easier for the researcher to come up with a representative sampling framework. It also enabled the researcher to generalize the findings in this study on the role of tax

administration on the growth of SMEs in manufacturing in Nairobi City and to further extend it to cover SMEs growth in Kenya and East African Region.

3.4 Sampling Frame

Sampling is defined as a way of selecting a section of a group from the target population to represent the characteristics of the population of interest. Sampling makes it easier to complete the study in a smaller time frame and with lower costs associated with conducting the study. Additionally, a researcher can collect in-depth information when working with a fewer cases (Saunders, Lewis and Thornhill, 2000) With respect to this approach, the researcher opted to work with a sample size of 50 taxpayers involved in partnerships.

3.5 Sample Size and Sample Technique

Stratified random sampling technique was adopted in this study. Coopers & Schindler (2003) implied that stratified sampling method increases statistical efficiency of a sample and adequately provides data for exhaustive analysis of the various sub-sets. Stratified sampling technique provides a more detailed representation of the sample than strict random sampling method. The study population therefore be stratified into 10 homogenous sub-sets after which random stratification method used to sample SMEs within each stratum. This ensures elimination of biasness since each element of the population of interest is presented with equal probability of being selected. Based on 10-30% sampling rule derived from each stratum, a total sample size of fifty (50) was selected from target population consisting of 500 SMEs (Mugenda, 1999). Owing to time, resource availability and the large population, this was an ideal number. The following is the ideal sampling frame basing on the 10% rule from the target population.

Table 3. 1: Stratified Sampling Frame

| | Manufacturing Industry | Population | Sample Size |
|----|------------------------------------|-------------------|--------------------|
| 1 | Building Mining & construction | 40 | 4 |
| 2 | Food, beverage and confectionaries | 50 | 5 |
| 3 | Leather and Footwear | 30 | 3 |
| 4 | Energy, Electrical and Electronics | 60 | 6 |
| 5 | Paper and Board | 50 | 5 |
| 6 | Plastics and Rubber | 40 | 4 |
| 7 | Textiles and apparel | 40 | 4 |
| 8 | Timber, wood and Furniture | 60 | 6 |
| 9 | Agriculture and fresh produce | 60 | 6 |
| 10 | Artistry, craft and Jua Kali | 70 | 7 |
| | Total | 500 | 50 |

3.6 Data Collection Instruments

In this study, Primary data was collected. Self-made questionnaire that was used adopted structured questions and open-ended questions. The choice of using questionnaires over other data collection instruments such as interviews was influenced by the reduced costs, less administrative costs as well as their usefulness in obtaining objective data (Marshall & Rossman, 2006).

3.7 Data Collection Procedure

This is the systematic process of accurately collecting and measuring data on variables of interest that enable the researcher to answer research questions and evaluate outcomes (Marshall & Rossman, 2006).

The researcher issued printed structured open-ended and structured questionnaires to respective accountants and directors of SMEs identified in the sample. The questionnaires was collected 24 hours later after they had been duly and filled.

3.8 Data Analysis and Presentation

The data filled in the questionnaires was edited for consistency to enable a comprehensive descriptive statistical data analysis. The data coded, thematically presented and classified based on common attributes and characteristics. Thereafter, data was assembled, sorted and tabulated in frequency tables which allowed for further analysis and detect any errors. Using SPSS software, quantitative data was coded for descriptive data analysis, presented in the most appropriate statistical tables, graphs and pie charts for easier presentation of data.

The study conducted diagnostic tests such as tested for normality, heteroscedasticity, autocorrelation, test for multicollinearity and sampling adequacy. The study was undertaken a regression analysis of the various variables to determine how the various variables relate to each other. The multiple regression models were chosen because it is useful in establishing the relative importance of independent variables to the dependent variable (Bryman & Cramer, 2012). The multiple regression model which was used in this study is stated as;

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$$

Where,

Y = Growth of SMEs

α = Constants

X1 = Tax Equity and Fairness

X2 = Tax System

X3 = Taxpayer Education

CHAPTER 4

RESEARCH FINDINGS AND ANALYSIS

4.1 Introduction

This chapter outlines data analysis, presentation and interprets findings on the collected data from respondents on the effects of tax administration in the growth of small and medium enterprises in manufacturing in Nairobi city. The main objectives of the study were to determine the influence of tax system, taxpayer education and tax fairness and equity on the growth of SMEs in Nairobi city. This study sampled fifty (50) respondents within the CBD of Nairobi city and data was interpreted with respect to research questions.

4.2 Response rate

A total of 50 respondents were issued with questionnaires, 49 responses were received with a response rate of 98 percent as shown in table 4.1 below. Mugenda and Mugenda (2003) say a response rate of 50 percent is acceptable; a response rate of 60 percent is good, while a response rate above 70 percent is very great. Therefore, on the basis of this suggestion, a response rate of 98 percent is very good.

Table 4. 1: Response Rate

| Response | Questionnaires administered | Questionnaires filled and administered | Percentage |
|----------|-----------------------------|--|------------|
| Total | 50 | 49 | 98 |

4.3 Demographic Information

This study sought to establish demographic details for purposes of evaluating the influence of tax administration in the growth of small and medium enterprises in manufacturing in Nairobi city. Demographic details of the respondents include age, level of education, form of SME, period of SME operation, workers employed and KRA PIN registration.

4.3.1 Gender Distribution

Majority of respondents that participated in this study were males who accounted for 65.31% while females accounted for 34. 69% as depicted in figure 4.1 below

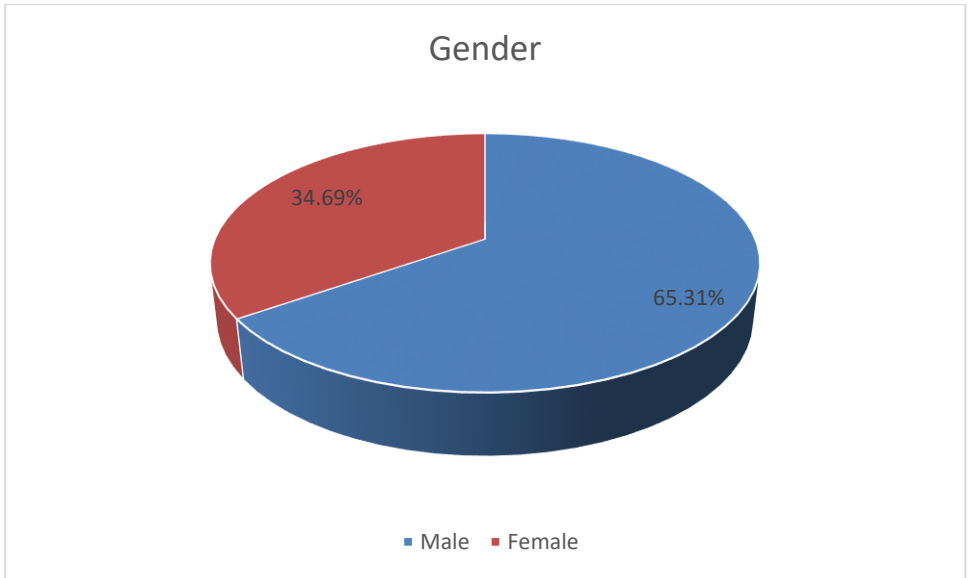


Figure 4. 1:Gender

This implies that majority of SMEs respondents are male.

4.3.2 Age

Findings for the age categories that respondent's fall are shown in figure 4.2 below

Figure 4. 2:Age

The study shows that majority of the respondents were aged between 29 and 38 years.

4.3.3 Level of Education

The study also found it paramount to establish the level of education of participants to eliminate the biasness associated with uneducated respondents.

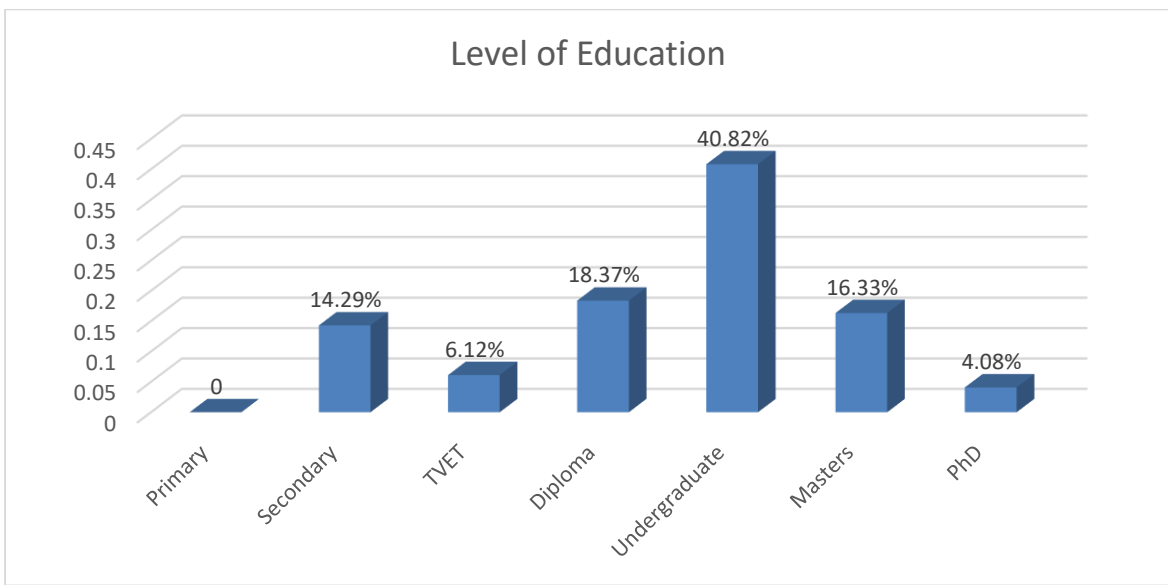


Figure 4. 3: Level of Education

The results show that 14.29% of the respondents had secondary education, 6.12% had TVET, 18.37% had Diploma education, 40.82% were undergraduates, and 16.33% had mastersdegrees while only 4.08% had Doctorate degree.

The results show that majority of the respondents were undergraduates as supported by a response 40.82%.

4.3.4 Form of SME

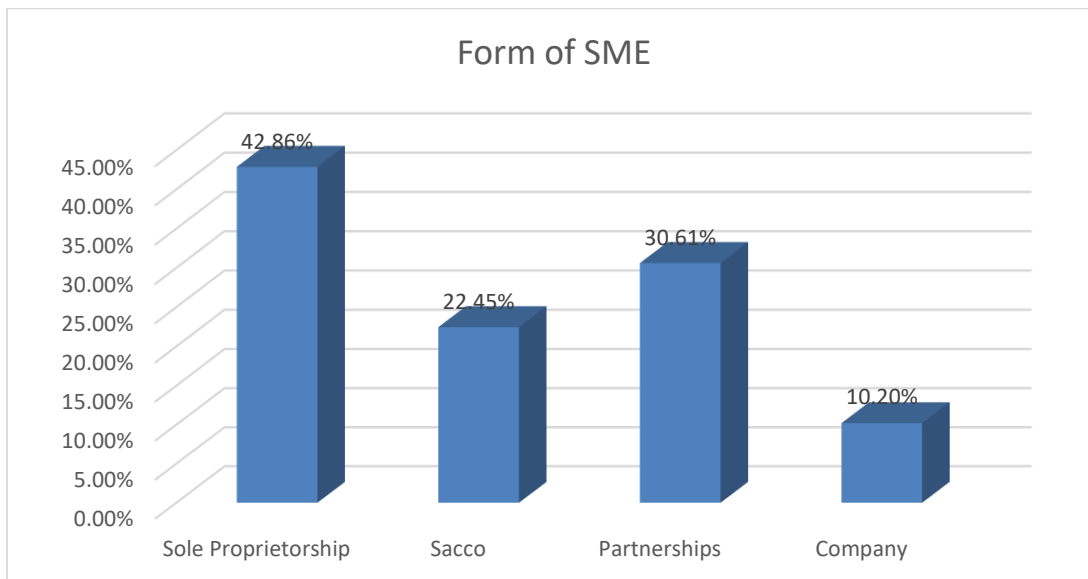


Figure 4. 4:Form of SME

Most SMEs under this study were sole proprietors at 42.86%, Savings and credit cooperative societies(Sacco's) constituted 22.45% while partnerships accounted for 30.61%. Respondents who were incorporated companies 10.20%.

4.3.5 Years of SME operation

The study also established the number of years of operation of the SMEs.

The results were as follows.

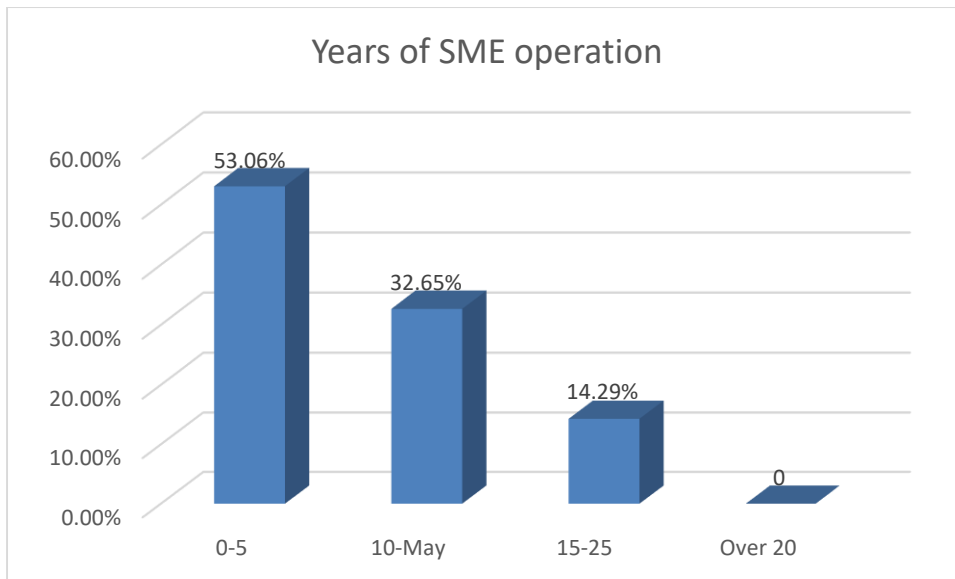


Figure 4. 5: Years of SME operation

53.06% of the SMEs who were involved in this study had been in operation for 0-5 years while 5-10 years constituting 32.65%. It further reveals that 14.29% of the SMEs had been in operation for 15-25 years. There were no SMEs that have been in operation for over 25 years. Majority of SMEs are in operation for a period of between 0-10 years accounting for over 85% of the total population.

4.3.6 Workers employed

This was important at identifying whether the SMEs fall in the legal requirements of SMEs not exceeding 99 employees. The findings are as shown in the table below

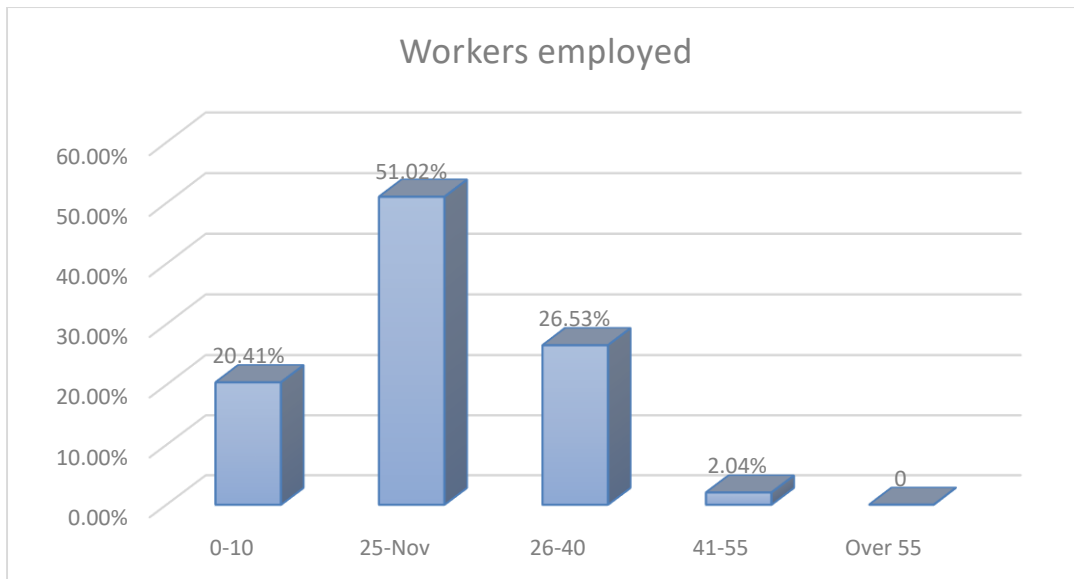


Figure 4. 6: Workers employed

The study found out that 51.02% of SMEs employed 11-25 employees, SMEs that employed between 26-40 workers constituted 26.53%, 0-10 workers were employed in 20.41% SMEs while 41-55 workers were represented by 2.04% SMEs.

4.3.7 KRA pin registration

The study found it important to establish whether the respondents had KRA PINs or not and the results are shown in table 4.8 below.

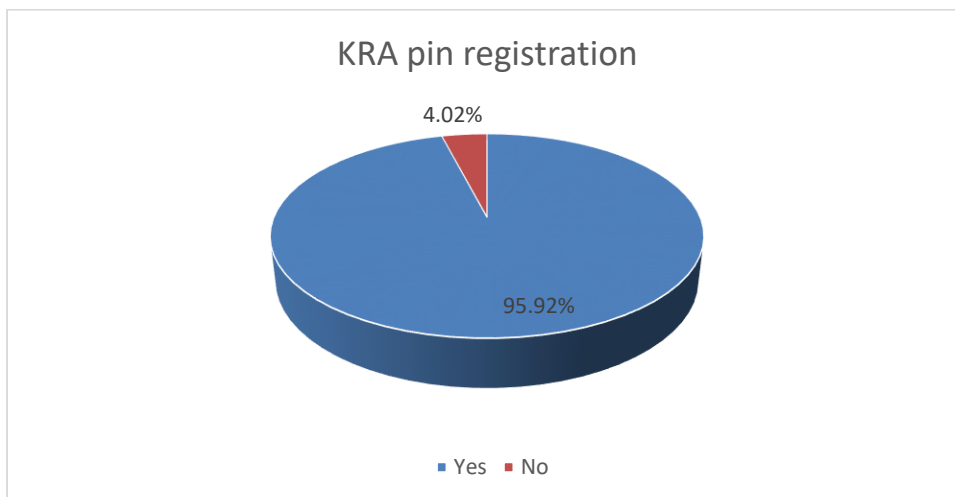


Figure 4. 7: KRA pin registration

Respondents registered for tax purposes were 95.92% while those not registered constituted 4.02%. This implies that majority of SMEs are registered with KRA PINs to enable for easier tax compliance.

4.4 Tax System

With regards to tax system, the respondents were measured by their belief on sufficiency of information, simplified forms of payments, accessibility of KRA customer centers, complexity of filing and payment procedures and the complexity of KRA website with respect to their effects towards the growth of SMEs. The findings were as below.

Table 4. 2:TaxSystem

| Statement | Rankings | | | | |
|--|------------|------------|------------|------------|------------|
| | SD f(%) | Df(%) | Nf(%) | Af(%) | S Af(%) |
| There is sufficient information on tax and tax procedures | 3(6.12%) | 2(4.08%) | 3(6.12%) | 29(59.18%) | 12(24.50%) |
| There exist simplified forms of tax payment | 4(8.17%) | 16(32.65%) | 9(18.37%) | 14(28.57%) | 6(24.24%) |
| There is increased accessibility of KRA customer centers | 33(67.35%) | 12(24.48%) | 0(0%) | 1(2.04%) | 3(6.12%) |
| KRA should be a be a tax partner and not merely tax | 9(18.37%) | 22(44.90%) | 10(20.41%) | 6(12.24%) | 2(4.08%) |
| Tax filing and payment procedures are complex | 1(2.04%) | 10(20.41%) | 2(4.08%) | 17(34.69%) | 19(38.78%) |
| KRA website is quite complex regarding services being offered on the website | 0(0%) | 3(6.12%) | 2(4.08%) | 16(32.65%) | 28(57.14%) |

4.4.1 Sufficient information on tax and tax procedures.

The result show that 6.12% strongly disagree that sufficient information on tax policies and tax procedures influences the growth of their SMEs,4.08 a population of disagree,6.12% of the population were neutral while 59.18% Agree and 24.50% strongly agree that information on tax and tax policies increase tax efficiency hence growth of SMEs.

4.4.1 Simplified forms of tax payment.

The result indicate that 24.24% strongly agree that simplified forms of payment helps them to easily comply with paying of taxes hence increase growth of SMEs,28.57% of the population

agree,18.37% of the population were neutral,32.65% of the population disagree while 8.1% strongly disagree that the simplified forms of tax payment increases their compliance.

4.4.3 Increased accessibility of KRA customer centers.

There was a response rate of 67.35% who strongly disagree that KRA needs to increase its centers for the tax administration to increase the growth of SMEs, 24.48%disagree, 0% were neutral, 2.04% agreed while a percentage of 6.12%strongly agree.

4.4.4 KRA should be a tax partner.

The result indicate that 18.37% strongly disagree that KRA should be a tax partner and not a merely tax, 44.90%disagree, 20.41% were neutral, 12.24% agreed and 4.08%strongly agreed.

4.4.5 Tax filing and payment procedures are complex.

38.78% of the population strongly agree that the tax procedures and filing are complex for one to pay taxes, 34.69%agree, 4.08% were neutral, 20.41%disagree finally 2.04%strongly disagree.

4.4.6 Complexity of KRA website.

The results show that 57.14% strongly agree that the website for KRA is complex for them to use, 32.65% agree, 4.08%were neutral on the question, 6.12% disagree and 0% strongly disagreed.

That result indicates that the tax system was efficient as supported by 83.68% on the statement that there was sufficient information on tax and tax procedures. These findings were in line with Ng'ang'aandMuturi, (2015) that an efficient tax system must be designed in order to accelerate voluntary tax compliance. Tax inefficiency arises when tax policies are unfavorable, irrational and directly targets one particular economic sector. Even though legislations and policies are mandatory in regulating and protecting the business environment and economic agents, it may also act as a barrier to the growth of enterprises through additional expenditures (Williams and Round, 2009). Tax inefficiencies gives rise to additional costs to the SMEs

which include social costs, travelling costs, audit costs, administrative costs. These costs will divert funds meant to expand and facilitate growth of SMEs to comply with tax laws.

4.5 Taxpayer Education

Table 4. 3: Taxpayer Education

| Statement | Rankings | | | | |
|---|----------|------------|------------|------------|------------|
| | S Df(%) | Df(%) | Nf(%) | Af(%) | S Af(%) |
| The perception of taxpayers has made the public aware of a need to pay income tax | 2(4.08%) | 1(2.04%) | 10(20.41%) | 20(42.86%) | 15(30.61%) |
| Understanding of taxes has made it easy for taxpayers to file their returns | 2(4.08%) | 11(22.45%) | 19(38.78%) | 14(28.57%) | 3(6.12%) |
| KRA's consumer education initiatives culminated in a lower tax base and income collection | 2(4.08%) | 10(20.41%) | 19(38.78%) | 15(30.61%) | 3(6.12%) |
| Sensitization of taxpayers has played an important role in improving taxpayers' behaviors | 3(6.12%) | 7(14.29%) | 6(12.24%) | 28(57.14%) | 5(10.20%) |
| Workshops are more informative and give the public sufficient time to properly understand the ideas | 1(2.04%) | 14(28.57%) | 2(4.08%) | 11(22.45%) | 21(42.86%) |
| Great record keeping in a company is very necessary to promote proper tax filling | 1(2.04%) | 2(4.08%) | 1(2.04%) | 23(46.94%) | 22(44.90%) |

4.5.1 Perception taxpayers have made aware of the need to pay income tax.

The results show that 2.08% disagree that they have made any public aware on the need to pay income tax, 2.04% disagree, 20.41% are neutral, 42.86% agree, 30.61% strongly agree.

4.5.2 Understanding of taxes has made it easy for taxpayers to file their returns.

The study shows that 4.08% strongly disagree that their understanding taxes has made it easier for them to file returns, 22.45% disagree, 38.78% are neutral, 28.57% agree and 6.12% strongly agree.

4.5.3 KRA consumer education culmination.

The study shows that 6.12% strongly agree that KRA's education initiatives has culminated in a lower tax base and income collection, 30.61% agree, 38.78% are neutral, 20.41% disagree while 4.08% strongly disagree.

4.5.4 Sensitization of taxpayers.

The results show that 10.20% strongly disagree that sensitization of taxpayers has played an important role in improving taxpayer's behavior 54.14% agree, 12.24% are neutral, 14.29% disagree and 6.12% strongly agree.

4.5.5 Workshops are more informative.

The findings show that 2.04% strongly disagree that workshops are more informative and give the public sufficient time to comply and understand ideas, 28.57% disagree, 4.08% are neutral, 22.45% agree while 42.86% strongly agree.

4.5.6 Record keeping.

The results show that 2.04% strongly disagree that great record keeping is very necessary to promote proper tax filing, 4.08% disagree, 2.04% are neutral, 46.94% agree whereas 44.90% strongly agree.

The results indicate that taxpayer education has a significant effect on the growth of SMEs on the manufacturing industry in Nairobi City as supported by 73% on the statement that taxpayer awareness has enlightened the public on the need to pay taxes. These findings were in line with Normala (2007) conducted a study to examine the influence of tax education, as a proactive approach to enhance the voluntary tax compliance, among the taxpayers, in Malaysia.

4.6 Tax Fairness and Equity

Table 4. 4: Tax fairness and equity

| Statement | Rankings | | | | |
|---|------------|------------|------------|------------|------------|
| | S D f(%) | D f(%) | N f(%) | A f(%) | S Af(%) |
| Lack of transparency and accountability and instances of bureaucracy and corruption leads to low compliance culture | 3(7.12%) | 2(3.08%) | 3(6.12%) | 28(57.18%) | 12(24.50%) |
| Narrow tax base leads to higher tax burden on compliant SMEs | 4(8.17%) | 16(32.65%) | 9(18.37%) | 14(28.57%) | 6(24.24%) |
| Ambiguous tax legislation provides loopholes for tax evasion | 33(67.35%) | 12(24.48%) | 0(0%) | 1(2.04%) | 3(6.12%) |
| Unfriendly system of filing and submitting tax to taxpayer's utilization | 9(18.37%) | 22(44.90%) | 10(20.41%) | 6(12.24%) | 2(4.08%) |
| Using technology in filing taxes such as ETR machines will increase perceived fairness and equity of the tax system | 1(2.04%) | 10(20.41%) | 2(4.08%) | 17(34.69%) | 19(38.78%) |
| Some SME sectors are taxed more while some receive bonuses and incentives which is unfair | 0(0%) | 3(6.12%) | 2(4.08%) | 16(32.65%) | 28(57.14%) |
| Tax authority is ineffective and unfair in their collection efforts | 3(6.12%) | 2(4.08%) | 3(6.12%) | 29(59.18%) | 12(24.50%) |

4.6.1 Lack of transparency and corruption.

The results show that 7.12% that lack of conspiracy and accountability and instances of bureaucracy and corruption leads to low compliance culture, 3.08% disagree, 6.12% are neutral, 57.18% agree and 24.50% strongly agree.

4.6.2 Narrow tax base.

The result show that 24.50% strongly agree that the narrow tax base leads to higher tax burden on compliant of SMEs to tax laws,28.57% agree,18.37% are neutral,32.65% disagree while 8.17% strongly disagree.

4.6.3 Ambiguous tax legislation.

The results show that 6.12% agree that ambiguous tax legislation provides loopholes for tax evasion, 2.04 agree, 0% are neutral, 24.48%diagree and 67.35% strongly disagree.

4.6.4 Unfriendly system of filing and submitting of tax.

The results show that 18.37% strongly disagree that unfriendly system of filing and submitting tax to taxpayers utilization hinders them from filling and complying,44.90% disagree,20.41% are neutral,12.24% agree and 4.08% strongly agree.

4.6.5 Use of technology.

The results show that 38.78% strongly agree that the use of technology increases perceived fairness and equity of tax systems, 34.69% agree, 4.08% are neutral, 20.41% disagree and 2.04% strongly disagree.

4.6.5 Some SMEs are taxed more and some receive incentives.

The result show that 57.14% strongly agree, 32.65% agree, 4.08% are neutral, 6.12% disagree and 0% strongly disagree.

4.6.6 Tax authority is ineffective and unfair in their collection efforts.

The result show that 24.50% strongly agree that the tax authority is ineffective and unfair in its collection efforts, 59.18% agree,6.12% disagree while 6.12% strongly disagree.

The results indicate that tax equity and fairness on the growth of SME as supported by 89.79% on the statement that some SME sectors are taxed more while some receive bonuses and incentives which is unfair. These findings were in line with Richardson, (2006) that taxation system is designed on the principle of equity and fairness, perceived via three dimensional perspectives – horizontal equity (which means that taxpayers with similar wealth brackets/

income should remit the same tax amounts), vertical equity (which implies that taxes paid will increase with the size of the tax base) and lastly the Exchange Equity. The perception of the tax system as fair and equitable has an influence on the inclination towards evading tax. Tax equity and fairness is often seen as drawing legislative measures and policies with regards to taxpayer's ability to pay. This takes into account income, wealth, health status, social status, family situation and other variables associated with the taxpayer to reduce the tax rates or increase them depending on their impact on taxpayer's ability to meet their tax obligations.

4.7 Growth of SME

The study seeks to establish SMEs growth with respect to tax administration activities. Table 4.5 shows the results.

Table 4. 5: Growth of SME

| Statement | SD f(%) | D f(%) | N f(%) | A f(%) | S A f(%) |
|--|----------------|---------------|---------------|---------------|-----------------|
| Efficient tax administration leads to increased SME growth | 5(9.3%) | 14(29.4%) | 9(19.2%) | 15(27.9%) | 7(14.2%) |
| Fair and equitable taxation leads to increased growth of SMEs | 7(13.9%) | 3(6.1%) | 4(8.9%) | 27(55.1%) | 8(16.0%) |
| Increased profits and capital gains to SMES that are tax compliant | 1(1.4%) | 7(13.4%) | 5(9.3%) | 14(27.8%) | 24(48.1%) |
| There are few/ no SME exits as a result of taxation | 1(1.4%) | 2(3.4%) | 5(10.1%) | 23(46.3%) | 19(38.8%) |
| High tax rates and frequent tax penalties leads to stunted SME growth | 1(2.8%) | 2(3.3%) | 6(13.1%) | 22(43.9%) | 18(36.9%) |
| Increased tax awareness to SMES leads to increased efficiency in SMEs hence growth | 1(2.3%) | 9(18.7%) | 5(9.3%) | 10(21.0%) | 24(48.6%) |

In relation to efficient tax administration leads to increased SME growth, 9.3% of the respondents strongly disagreed, 29.4% disagreed, 19.2% were neutral, 27.9% agreed while

14.2% strongly agreed. On fair and equitable taxation leading to increased growth of SMEs 13.9% of the respondents strongly disagreed, 6.1% disagreed, 8.9% were neutral, 55.1% agreed while 16.0% strongly agreed. As per increased profits and capital gains to SMES that are tax compliant, 1.4% of the respondents strongly disagreed, 13.4% disagreed, 9.3% were neutral, 27.8% agreed while 48.1% strongly agreed. Further, the respondents also gave their opinion on if there are few/ no SME exits as a result of taxation. 1.4% strongly disagreed, 3.4% disagreed, 10.1% were neutral, 46.3% agreed while 38.8% strongly agreed. Also, on high tax rates and frequent tax penalties leads to stunted SME growth, 2.8% strongly disagreed, 3.3% disagreed, 13.1% were neutral, 43.9% agreed while 36.9% strongly agreed. On increased tax awareness to SMES leads to increased efficiency in SMEs hence growth, 2.3% strongly disagreed, 18.7% disagreed, 9.3% were neutral, 21.0% agreed while 48.6% strongly agreed. These findings are in line with Mnewa and Maliti (2008) who assert that the majority of SMEs are unlikely to attain and maintain a growing profitability due to constraints related to tax policies and their administration thereof.

4.8 Regression Analysis

Using multiple regression analysis was used to test the relationship between the variables where it shows how the dependent variable is influenced by the independent variables.

Table 4. 6: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------|----------|-------------------|----------------------------|
| 1 | 0.848 | 0.719 | 0.701 | 1.011 |

The ANOVA tests whether the model is fit for data. From the ANOVA table, the independent variables were statistically significant predicting the dependent variable since adjusted R square was 0.701 implying that tax equity and fairness, tax system and taxpayer education explains 70.1% variation in Growth of SMEs in Nairobi city.

Table 4. 7: ANOVA Test

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|--------------|------------|----------------|-----------|-------------|--------|------|
| 1 | Regression | 123.121 | 3 | 41.040 | 38.460 | .000 |
| | Residual | 48.019 | 45 | 1.067 | | |
| Total | | 171.14 | 48 | | | |

The probability value of 0.000 indicates that the regression relationship was significant in determining how tax equity and fairness, tax system and taxpayer education influence Growth of SMEs in Kenya. The F calculated at 5 percent level of significance was 38.460. Since F calculated is greater than the F critical (Value = 2.2899), the overall model was significant.

Table 4. 8: Coefficients of Determination

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|-------------------------|-----------------------------|------------|---------------------------|-------|------|
| | B | Std. Error | Beta | | |
| (Constant) | 0.988 | 0.182 | | 5.429 | .000 |
| Tax equity and fairness | 0.716 | 0.296 | 0.623 | 2.419 | .020 |
| Tax system | 0.606 | 0.208 | 0.527 | 2.913 | .005 |
| Taxpayer education | 0.803 | 0.117 | 0.699 | 6.863 | .000 |

The established model for the study was:

$$Y = 2.345 + 0.716X_1 + 0.606X_2 + 0.803X_3$$

Where: -

Y= Growth of SMEs in Kenya

β_0 =constant

X_1 = Tax Equity and Fairness

X_2 = Tax System

X_3 = Taxpayer Education

The regression equation above has established that taking (tax equity and fairness, tax system and taxpayer education), growth of SMEs in Nairobi will be 2.345. The findings presented also show that taking all other independent variables at zero, a unit increase in the tax equity and fairness would lead to a 0.716 increase in the score of growth of SMEs in Nairobi and the variable was significant since $0.020 < 0.05$.

Further it was found that a unit increase in the scores of tax system would lead to a 0.606 increase in the scores of Growth of SMEs in Nairobi. Thus, variable was significant since $0.005 < 0.05$. Further, the findings show that a unit increases in the scores of taxpayer education would lead to a 0.803 increase in the scores of growth of SMEs in Nairobi city and the variable was significant since $0.000 < 0.05$. Overall, Taxpayer Education had the greatest effect on Growth of SMEs in Nairobi followed by Tax Equity while Tax System had the least effect on the Growth of SMEs in Kenya.

4.9 Diagnostic Tests

Before a complete regression analysis can be performed, the assumptions concerning the original data must be made (Sevier, 1957). Ignoring the regression assumptions may contribute to wrong validity estimates (Antonakis & Deitz, 2011). When the assumptions are not met, the results may result in Type I or Type II errors, or over- or under-estimation of significance of the effect size (Osborne & Waters, 2002). Under this section diagnostic tests for testing the regression assumptions will be presented. These tests include normality, heteroscedasticity, autocorrelation, multicollinearity and sampling adequacy.

4.9.1 Normality Test

This test is used to determine whether sample data has been drawn from a normally distributed population. The testing for normality in this study was conducted using Kolmogorov Smirnov test and Shapiro Wilk test. Testing for normality findings were illustrated in Table 4.9.

Table 4. 9: Checking for Normality of Performance of Aquaculture Projects

| | Kolmogorov-Smirnova | | | Shapiro-Wilk | | |
|-------------------------|---------------------|----|-------|--------------|----|-------|
| | Statistic | df | Sig. | Statistic | df | Sig. |
| Growth of SMEs in Kenya | 0.183 | 48 | 0.001 | 0.907 | 48 | 0.001 |
| Tax equity and fairness | 0.171 | 48 | 0.000 | 0.902 | 48 | 0.000 |
| Tax system | 0.172 | 48 | 0.010 | 0.932 | 48 | 0.030 |
| Taxpayer education | 0.238 | 48 | 0.000 | 0.917 | 48 | 0.006 |

Thus, Table 4.9 indicates that using both tests of normality, which is Kolmogorov Smirnov test and Shapiro-Wilk tests, the p-value for both tests, is less than 0.05, thus the study rejected H0 and a conclusion was made that data on both the dependent and the independent factors were not normally distributed and as a result it helps to predict dependent variables.

The normality of the dependent and the independent variables was determined by use of a Quantile - Quantile (Q-Q) plot. The plot is useful in the early stages of analysis when exploring data before actually calculating a correlation coefficient or fitting regression curve. It helped to determine whether a linear regression model is appropriate (Paul & Zhang, 2009). The results of the Q - Q Plot indicated that the dependent variable was normally distributed (Figure 4.1) so are the independent variables

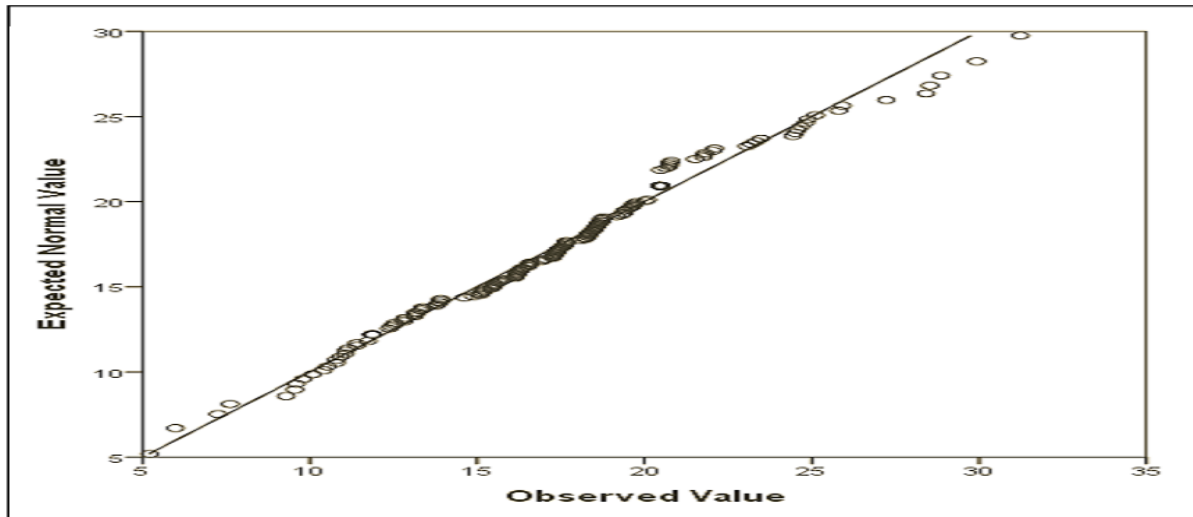


Figure 4. 8: Normal Q-Q Plot for Growth of SMEs in Nairobi City.

From the findings, the normal Q-Q plot of Growth of SMEs in Nairobi city had most of its cases lying on the 45° lines, thus the observed values of Growth of SMEs in Nairobi city with the hypothetical distribution and hence normally distributed. Further, the Q-Q plots affirmed the normality of the data.

4.9.2 Heteroscedasticity

This test checks whether the variance of the errors from a regression is dependent on the values of the independent variables (test the assumption of equal variance). To test for heteroscedasticity the Levene test was used where if P-value < 0.05 is an indication of presence of non-uniform variance. The test results were as shown in Table 4.10.

Table 4. 10: Levene Test Results

| | Levene Statistic | Df1 | Df2 | Sig. |
|-------------------------|-------------------------|------------|------------|-------------|
| Tax equity and fairness | 0.183 | 1 | 212 | 0.021 |
| Tax system | 2.171 | 1 | 212 | 0.014 |
| Taxpayer education | 3.172 | 1 | 212 | 0.031 |
| Growth of SMEs in Kenya | 2.331 | 1 | 212 | 0.034 |

From the findings, the p-value for all the variables (Tax equity and fairness, Tax system, Taxpayer education and Growth of SMEs in Nairobi city) were less than 0.05 hence the null hypotheses for equal variances in rejected and concluded that this further shows that the data set had no heteroscedasticity which is desirable for modelling of regression equation

4.9.3 Autocorrelation Test

If the errors are correlated with one another, it would be stated that they are 'serially correlated'. A test of this assumption is therefore conducted. The first test was Durbin-Watson which is

shown in the regression output of the model. The Autocorrelation Test results were presented in Table 4.11.

Table 4. 11: Autocorrelation Test

| Model | Durbin-Watson |
|--------------|----------------------|
| 1 | 2.000 ^a |

According to Bhattacharjee (2012), the Durbin Watson statistic is a number that tests for autocorrelation in the residuals from a statistical regression analysis that is always between 0 and 4. A value of 2 means that there is no autocorrelation in the sample. Values approaching 0 indicate positive autocorrelation and values toward 4 indicate negative autocorrelation. The value of Durbin-Watson for the model as per the findings was 2.000. Thus, the null hypotheses were rejected for the model so there is no problem of autocorrelation.

4.9.4 Test for Multicollinearity

Multi-collinearity occurs when the independent variables are not independent from each other. Collinearity (also called multi-Collinearity) refers to the assumption that the independent variables are uncorrelated (Darlington, 1968; Keith, 2006). Multi-collinearity occurs when several independent variables correlate at high levels with one another, or when one independent variable is a near linear combination of other independent variables. The study utilized Collinearity Statistics to find out whether the independent variables are adequately correlated to show a substantial causal correlation. The results for multicollinearity test were presented in Table 4.12.

Table 4. 12: Collinearity Statistics

| | Collinearity Statistics | |
|-------------------------|--------------------------------|------------|
| | Tolerance | VIF |
| Tax equity and fairness | .127 | 7.855 |
| Tax system | .166 | 6.134 |
| Taxpayer education | .103 | 8.998 |
| Growth of SMEs in Kenya | .101 | 8.834 |

Based on the coefficients output, Tax equity and fairness had a VIF value of 7.855, Tax system had a VIF value of 6.134, Taxpayer education had a VIF value of 8.998, and Growth of SMEs in Nairobi City had a VIF value of 8.823. The VIF values for all the variables were less than 10 implying that there were no Multicollinearity symptoms as indicated by Keith (2006).

CHAPTER 5

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the major findings summary, conclusions and essential recommendations, the study sought to examine influence of tax administration on the growth of small and medium enterprises in the manufacturing sector in Nairobi city. The following are the specific breakdown of the summaries of the major findings based on the output of the descriptive inferential statistical analysis guided to answer research questions of the study.

5.2 Summary

The findings of this study show that most respondents are within the age bracket of 29-38 representing 40.82 % followed by 28.57% who fall into 18-28 years while 18.37% of the respondents who participated in this study were aged between 39-48. It further reveals that 8.16% were aged between 49-58 while those aged between 59-68 were 4.08%. There were no respondents aged over 69 years. It can therefore be deduced that majority of respondents in this study were youths aged between 18 years and 38 years. This implies that majority of SME owners are youths, who according to law are aged between 18-35 years.

5.2.1 Tax System

That result indicates that the tax system was efficient as supported by 83.68% on the statement that there was sufficient information on tax and tax procedures. The study found that there is sufficient information on tax and tax procedures, there exist simplified forms of tax payment, there is increased accessibility of KRA customer centers, KRA should be a tax partner and not merely tax and tax filing and payment procedures are complex and KRA website is quite complex regarding services being offered on the website.

5.2.2 Taxpayer Education

The results indicate that taxpayer education has a significant effect on the growth of SMEs on the manufacturing industry in Nairobi City as supported by 73% on the statement that taxpayer awareness has enlightened the public on the need to pay taxes. The study found that perception of taxpayers has made the public aware of a need to pay income tax, understanding of taxes has made it easy for taxpayers to file their returns, KRA's consumer education initiatives culminated in a lower tax base and income collection, sensitization of taxpayers has played an important role in improving taxpayers ' behaviors, workshops are more informative and give the public sufficient time to properly understand the ideas and great record keeping in a company is very necessary to promote proper tax filling.

5.2.3 Tax Fairness and Equity

The results indicate that tax equity and fairness on the growth of SME as supported by 89.79% on the statement that some SME sectors are taxed more while some receive bonuses and incentives which is unfair. The study found that lack of transparency and accountability and instances of bureaucracy and corruption leads to low compliance culture, narrow tax base leads to higher tax burden on compliant SMEs, ambiguous tax legislation provides loopholes for tax evasion, unfriendly system of filing and submitting tax to taxpayer's utilization, using technology in filing taxes such as ETR machines will increase perceived fairness and equity of the tax system and some SME sectors are taxed more while some receive bonuses and incentives which is unfair.

5.3 Conclusion

The study deduces that taxpayer system has a significant effect on the growth of SMEs on the manufacturing industry in Nairobi City. The tax system was concluded to have be efficient and to have been designed in order to accelerate voluntary tax compliance. The study concluded that tax inefficiencies gives rise to additional costs to the SMEs which include social costs,

travelling costs, audit costs, administrative costs. These costs will divert funds meant to expand and facilitate growth of SMEs to comply with tax authorities.

Further, taxpayer education has a significant effect on the growth of SMEs on the manufacturing industry in Nairobi City. The study concluded those taxpayers who attend taxation courses as opposed to those who don't are expected to have a superior understanding of tax laws and regulations and have higher tax compliance. Further, tax education is essential for creating and improving public understanding in tax law-related areas, the role it plays in social development and the complex process of collecting it.

The study concluded that tax equity and fairness has a significant effect on the growth of SMEs on the manufacturing industry in Nairobi City. The study also concluded that the perception of the tax system as fair and equitable has an influence on the inclination towards evading tax. Tax equity and fairness is often seen as drawing legislative measures and policies with regards to taxpayer's ability to pay. This takes into account income, wealth, health status, social status, family situation and other variables associated with the taxpayer to reduce the tax rates or increase them depending on their impact on taxpayer's ability to meet their tax obligations

5.4 Recommendations

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. KRA should create more awareness on the tax compliance among SMEs through policy documentation which classify different betting firms' entities.

The ministry of education has to introduce taxpayers' education and try to include the public finance and taxation course in the curriculum of all departments. This is because, tax is one of the major sources of revenue for a government which is used in general to finance public expenditures and if tax education influences tax compliance attitude of tax payers, the tax course (similar to civics and ethics) must be provided as a common course for all.

Greater education potentially increases compliance; as educated taxpayers are more aware of their responsibility as well as the sanctions to be imposed if they were not compliant with tax laws. Education levels become more important in increasing tax compliance across countries. One of the measures to increase voluntary compliance is by assuring that taxpayers have a certain level of qualifications, ability and confidence to exercise their tax responsibility

It is recommended that tax administration should reduce criminal aspects of tax evasion with well know tax measures. Further, tax administration should use current tax reform to reduce tax complexity with Tax authorities should focus and help taxpayer during filing taxes returns information. However, tax authority provides greater assistance to tax payers; it should create favorable conditions for tax compliance not only tax awareness.

From the findings of this study, we recommend that the government should set tax rates that are considerable so that SMEs and other investors can be motivated to expand their unlimited potential in the business world. This would in turn impact the economy of Kenya positively and the benefits would be passed on to all the citizens.

5.5 Suggestions for Further Studies

Further study should be carried out in East African countries to validate these findings and also have a comparison with what the current research has established. Moreover, the study was done in Kenya; other studies should be conducted in additional countries to see if the variables used have any effect on tax compliance in other countries. Another study may be done using other variables such as legal framework, government regulation and government policy and their effect on tax compliance

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APPENDICES

APPENDIX I: LETTER OF TRANSMITTAL

Daisy KwambokaMarieta

P.O Box 4550-40200

Kisii, Kenya.

Daisykwamboka10@gmail.com

Dear Respondent,

RE: LETTER OF TRANSMITTAL

I am a post graduate student of Jomo Kenyatta University of Agriculture and Technology pursuing a post graduate diploma in Tax management. I am conducting academic research on the roles of tax administration on the growth of SMEs in manufacturing in Nairobi City. I'm writing this letter to request for your participation in the study by accurately filling the questionnaire with relevant information.

My research project will focus on efficiency of the tax system, Tax rates, penalties and incentives, Taxpayer Education and Tax equity and fairness. Your participation in this study is entirely voluntary and the identity in the questionnaire will completely be anonymous.

I wish to assure you that the information that you will provide for the purpose of this research study will be treated with respect and confidentiality it deserves. Your ability to answer all the questions herein honestly, and to the best of your knowledge will be highly appreciated.

I look forward to your support.

Yours Sincerely,

Daisy KwambokaMarieta

Tel: 0798050466

APPENDIX II: QUESTIONNAIRE

Section 1: General Information

This section seeks to obtain the general information about the managers of the SMEs and their involvement in the SMEs operations.

1. What is your gender?

Male () Female ()

2. What is your age?

18-28 () 29-38 () 39-48 ()

49-58 () 59-68 () Over 69 ()

3. What is your highest level of education?

Primary () Undergraduate ()

Secondary () Masters ()

TVET () PhD ()

Diploma ()

4. What is the form of your SME?

Sole Proprietorship () Sacco ()

Partnerships () Company ()

5. For how long has your SME been operational?

0-5 yrs () 15-20 yrs ()

5-10 yrs () Over 20 yrs ()

6. How many workers do you employ?

10-25 () 25-40 ()

40-55 () Over 55 ()

7. Does your SME have a KRA Personal Identification Number (PIN)?

Yes () No ()

Section 2: Tax Efficiency

This section will attempt to collect information on the efficiency of taxation system.

1. On a scale of 1-5 where 1=strongly disagree, 2= disagree, 3= Neutral, 4= agree and 5=strongly agree, kindly indicate your level of agreement with the following statements

| Statement | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Do you have sufficient information on tax and tax procedures? | | | | | |
| Do you require simplified forms of tax payment? | | | | | |
| Do you require easier reach to KRA customer centers? | | | | | |
| Do you want KRA to be a tax partner and not merely tax enforcer? | | | | | |
| Do you find tax filing and payment procedures complex? | | | | | |
| Do you find KRA website to be quite complex regarding services being offered on the website | | | | | |

2. Using a scale of 1-5 (1 = Strongly Disagree 2 = Disagree 3 = Neutral 4 = Agree 5 = Strongly Agree), what is your level of agreement with the following tax administration strategies aimed at increasing taxation efficiency? (Tick appropriately)

| Statement | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Command regulation (non-discretionary; use full force of the law) | | | | | |
| Command regulation (discretionary; deter by detection) | | | | | |
| Enforced self-regulation (help to comply) | | | | | |

| | | | | | |
|--|--|--|--|--|--|
| Self-regulation (make compliance easy) | | | | | |
|--|--|--|--|--|--|

Section 3: Tax Equity and Fairness

This section seeks to determine indicators of equitable and fair tax system and how they influence compliance and growth to SMEs

1. Kindly indicate your level of agreement or disagreement with the following statements on a scale of 1 to 5 where 1= strongly disagree, 2=disagree, 3=neutral, 4=agree and 5=agree strongly.

| Statement | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Lack of transparency and accountability and instances of bureaucracy and corruption leads to low compliance culture | | | | | |
| Narrow tax base leads to higher tax burden on compliant SMEs | | | | | |
| Ambiguous tax legislation provides loopholes for tax evasion | | | | | |
| Unfriendly system of filing and submitting tax to taxpayer's utilization | | | | | |
| Using technology in filing taxes such as ETR machines will increase perceived fairness and equity of the tax system | | | | | |
| Some SME sectors are taxed more while some receive bonuses and incentives which is unfair | | | | | |
| Tax authority are ineffective and unfair in their collection efforts | | | | | |

Section 4: Taxpayer Education

1. Are you aware of any tax payer education programs conducted by KRA?

Yes () No ()

2. Which of these areas of tax payer education trainings have you been trained on?

KRA PIN registration ()

Filing tax returns through itax system ()

Records keeping ()

Payment of taxes ()

3. Please rate the following statements in regards to Taxpayer awareness programs.

Rate on a scale of 1-5 where; 1 = Strongly disagree, 2 = Disagree, 3 = Neutral, 4 = Agree and 5 = Disagree

| Statement | 1 | 2 | 3 | 4 | 5 |
|--|---|---|---|---|---|
| Taxpayer awareness has enlightened the public on the need to pay taxes | | | | | |
| Taxpayer awareness has enabled tax payers file their returns easily | | | | | |
| Taxpayer awareness programs by KRA have resulted into increased tax base and revenue collection | | | | | |
| Taxpayer sensitization has played a vital role in changing the attitudes of taxpayers | | | | | |
| Workshops are more detailed and provide ample time for the public to conceptualize the ideas | | | | | |
| Good record keeping is very important in a business so as to facilitate correct filling of taxes | | | | | |

Section 6: Growth of SMEs

This section seeks to establish SMEs growth with respect to tax administration activities.

1. Using a scale of 1 to 5, where 1=Strongly disagree, 2= disagree, 3= neutral, 4= agree and 5=strongly agree, how does the following indicators affect the growth of SMEs

| Statement | 1 | 2 | 3 | 4 | 5 |
|--|---|---|---|---|---|
| Efficient tax administration leads to increased SME growth | | | | | |

| | | | | | |
|--|--|--|--|--|--|
| Fair and equitable taxation leads to increased growth of SMEs | | | | | |
| Increased profits and capital gains to SMES that are tax compliant | | | | | |
| There are few/ no SME exits as a result of taxation | | | | | |
| High tax rates and frequent tax penalties leads to stunted SME growth | | | | | |
| Increased tax awareness to SMES leads to increased efficiency in SMEs hence growth | | | | | |

APPENDIX III: MANUFACTURING SMES IN NAIROBI CITY

1. TRI CLOVER INDUSTRIES (K)Ltd
2. DREEN GARDEN DELI
3. JOELIZ BONE MEAL LTD
4. MIBISCO LTD
5. B.D ENGINEERS LTD
6. KENAFRIC INDUSTRIES LTD
7. PATCO INDUSTRIES LTD
8. INGREDION HOLDING LLC
9. PREMIER FLOUR MILLS LTD
10. RAFIKI MILLERS LTD
11. CAPWELL INDUSTRIES LTD
12. GREED FOREST FOODS LTD
13. DULEX FRUITS LTD
14. CAPE EQUATORIAL GROUP OF CO
15. GOOD MORNING WHOLESALERS
16. LEADING EDGE FOOD AND ENTERPRISES LTD
17. INNER RESOURCES LTD
18. HASSNALI GLASS AND HARDWARE
19. METAL CANS AND CLOSURES KENYA LIMITED

20. OCEAN ENGINEERING WORKS LIMITED
21. GOODAMERICAN LTD
22. ROCK PLANT KENYA LTD
23. BIO FOOD PRODUCTS LTD
24. ELITE TOOL LTD
25. AQUVA AGENCIES LTD
26. NG AND MH NAIROBI GLASS MOTOR
27. ADVANCE LITHO LTD
28. ASSOCIATED STEEL LTD
29. ESQUIRE WHOLESALERS LTD
30. MECOL LTD
31. STAINLESS STEEL PRODUCTS
32. ASL LIMITED
33. PAPERLESS BAG LTD
34. R HENKEL LTD
35. WIRE PRODUCTS LTD
36. THERMOPAK LTD
37. BRENTAG KENYA LTD
38. METRO PLASTICS LTD
39. FURNITURE ELEGANCE LTD
40. WOOD PRODUCTS (K)LTD
41. TIMBER CORNER LTD
42. DAWN COSMETICS
43. ENGOKO KUKU FARMER
44. PG BISON
45. TWIGA STATIONERS AND PRINTERS LTD
46. STEEL STRUCTURED LTD
47. ECOCHICKD LTD
48. MARVEL LIFESTYLE LTD
49. SLUMBERLAND KENYA LTD
50. HIGHCHEM GROUP OF COMPANIES.