

**FACTORS AFFECTING VALUE ADDED TAX AMONG SMALL AND
MEDIUM ENTERPRISES IN CENTRAL BUSINESS DEVELOPMENT,
NAIROBI.**

JANE NGACHAH

**A RESEARCH PROJECT SUBMITTED TO THE DEPARTMENT OF ECONOMICS,
ACCOUNTING AND FINANCE, SCHOOL OF BUSINESS IN PARTIAL
FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF POST GRADUATE
DIPLOMA IN TAX ADMINISTRATION AT JOMO KENYATTA UNIVERSITY OF
AGRICULTURE AND TECHNOLOGY.**

2019

DECLARATION

Declaration by the student

This research project is my original work and has not been presented to any other examination body.

Name Jane Ngacha

Sign _____ Date _____

HDB336-C016-4352/2016

Declaration by the supervisor

This research project has been submitted with my consent as supervisor.

Name Marion Nekesa

Sign _____ Date _____

DEDICATION

This proposal is dedicated to my family for their support.

ACKNOWLEDGEMENT

I would like to thank the Kenya School of Revenue Administration in collaboration with JKUAT for giving me an opportunity to undertake this course.

TABLE OF CONTENTS

DECLARATION	ii
DEDICATION	iii
ACKNOWLEDGEMENT	iv
LIST OF TABLES	viii
LIST OF FIGURES	ix
LIST OF ACRONYMS AND ABRVIATIONS	x
DEFINITION OF TERMS	xi
ABSTRACT	xii
CHAPTER ONE	1
INTRODUCTION OF THE STUDY	1
1.1 Background of the Study	1
1.3 Research Objectives	13
1.3.1 General Objective	13
1.3.2 Specific Objective	13
1.4 Research Questions	14
1.5 Significance of the Study.....	14
1.5.1 The Government of Kenya.....	14
1.5.3 Other Researchers	14
1.6 Scope of the Study	14
CHAPTER TWO	15
LITERATURE REVIEW	15
2.1 Introduction	15
2.2 Theoretical Literature Review	15
2.2.1 The Prospect Theory	15
2.2.2 Deterrence Theory	16
2.2.3 Ability to Pay Theory.....	17
2.3 Conceptual Framework.....	17
2.4 Empirical Literature.....	19
2.5 Critiques of the study.....	25
2.6 Research Gap.....	28
2.6 Summary.....	28
CHAPTER THREE	30
RESEARCH DESIGN AND METHODOLOGY	30

3.1 Introduction	30
3.2 Research Design	30
3.4 Sampling Frame.....	30
3.4 Sample and Sampling technique	31
3.4.1 Sample Size.....	31
3.6 Data Collection Methods	33
3.5.1 Primary Data	33
3.6 Data Collection Procedures	33
3.7 Pilot Study	33
3.7.1 Reliability of Research Instruments.....	33
3.7.2 Validity of Research Instruments.....	34
3.8 Data Analysis and Presentation	34
3.8.1 The Qualitative Analysis.....	34
3.8.2 The Quantitative Analysis.....	34
CHAPTER FOUR.....	36
RESEARCH FINDINGS AND DISCUSSION.....	36
4.0 Introduction	36
4.1 Response Rates.....	36
4.2 Reliability test results	37
4.3 Test of Assumptions of the Study Variables	38
4.4.2 Effect of Level of tax knowledge on Value Added Tax compliance.....	42
4.4.3 Effect of rate of tax on Value Added tax compliance.....	43
4.4.4 Effect of Penalties and interest on Value Added tax compliance.....	45
4.5.1 Correlation results on independent variables	47
4.6 Regression Analysis	49
4.7 Discussion of key Findings	58
4.7.2 Level of tax knowledge and Value added tax compliance	58
4.7.3 Tax rate and Value added tax compliance.....	58
4.7.4 Penalties and interest and Value added tax compliance	59
CHAPTER FIVE.....	60
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS.....	60
Introduction	60
5.1 Summary of the findings	60
5.1.1 Tax compliance cost	60

5.1.3 Tax rate	61
5.2 Conclusions	61
5.2.2 Level of tax knowledge.....	62
5.2.3 Tax rate	62
5.3 Recommendations.	63
5.3.1 Managerial recommendations.....	63
5.4 Suggestions for Further Research.....	64
REFERENCES	65

LIST OF TABLES

Table 3.1	Target population
Table 3.2	Sample Size.....

LIST OF FIGURES

Figure 2.1: Conceptual Framework.....	17
---------------------------------------	----

LIST OF ACRONYMS AND ABRVIATIONS

CBD	Central Business District
ETR	Electronic Tax Register
ICT	Information and Communication Technology
IMF	International Monetary Fund
KRA	Kenya Revenue Authority
PC	Personal Computer
SMEs	Small and Medium Enterprises
VAT	Value Added Tax
GDP	Gross Domestic Product
KRA	Kenya Revenue Authority
MST	Medium and Small Taxpayers
PIN	Personal Identification Number
SPSS	Statistical Package of Social Sciences
VAT	Value Added Tax

DEFINITION OF TERMS

SMEs -	These are enterprises with a turnover of between 5M and 8M
Tax:	A compulsory financial contribution imposed by a government to raise revenue, levied on the income or property of persons or organizations, on the production costs or sales prices of goods and services, etc.
Tax Compliance:	The Degree to which a taxpayer complies with the tax rules of his country, for example by declaring income, filing a return, and paying the tax due in a timely manner.
Tax Evasion:	It refers to the conscious or unconscious action and behaviour
Tax Rate:	Tax imposed by the federal government based on an individual's taxable income or a corporation's earnings
Tax Information:	The knowledge or facts provided about taxes.
Tax Obligation:	Responsibilities pertaining to tax payment and declaring of tax returns which a person duly registered
Tax Compliance cost:	It refers to the expenditure of time or money in conforming to government requirements such as legislation or regulation.
Tax Administration:	It refers to the procedures attached to tax compliance including registration and filling of returns.

ABSTRACT

The study aim to investigate factors affecting value added tax among small and medium enterprises in Central Business Development, Nairobi, Kenya. The study was guided by the following specific objectives to establish the effect of tax compliance costs on revenue performance at KRA, Kenya, to determine the effect of level of tax knowledge on revenue performance at KRA, Kenya, to assess the effect of tax rates on revenue performance at KRA, Kenya. The study adopted descriptive research design. The study target population was 1200 Small and Medium taxpayers in CBD Nairobi. The study sample size was 120. This study used primary data collected through questionnaires. A pre-test on a different sample was carried out to give a Cronbach's alpha greater than 0.7 for all the variables as a rule of thumb. Data analysis used descriptive statistics and inferential statistics using Standard statistical techniques including Pearson correlation coefficient and regression analysis employed in the analysis. All the analysis used statistical package for social sciences (SPSS Version.24). Analysis of variance (ANOVA) was used to establish if there is a statistical significance between the observed and expected values with the Pearson Chi square giving the degree significance of the relations, hence establishing the hypotheses. Kenya revenue Authority should offer on a regular basis technical support to traders which will help them familiarise with tax systems in order to facilitate collection of VAT. Technical support will help traders reduce the transaction time in serving their clientele and transparency in service delivery. There is also need for training of traders from system developers on a regular basis in order to help the taxpayer in filing and paying of VAT. The management of Kenya Revenue Authority should be frequently organising workshops and seminars whereby they will be training the traders on proper use of tax systems in order to facilitate collection of VAT. The traders must have sufficient training in order to fully deploy use of tax systems to facilitate VAT collection

CHAPTER ONE

INTRODUCTION OF THE STUDY

1.1 Background of the Study

In order to compete effectively in today's complex, dynamic, and unpredictable global marketplace, having a strategy in place has become a necessity (Onditi, 2013). DeWit & Meyer (2004) state that the value of any strategy and its potential contributions include: increasing productivity, reducing costs, growing profits, and improving service or product quality. Therefore, implementing strategy would thus be perceived as being about allocating resources and changing organizational structure (Muraguri and Wagoki, 2016). The implementation process involves the collective wisdom, knowledge, and even subconscious minds of the collaborators (Grattan, 2011). Implementing strategies successfully is vital for any organization, be it public or private (Freeman, 2004).

Government of Kenya raises most of its revenue through enhancing elasticity of the existing tax system that is, rationalizing and regulating expenditure through strict fiscal controls (Muriithi and Moyi, 2003). The tax structure generally consists of the direct and indirect taxes. Regarding direct taxes, the factors that produce the incomes are assumed to pay the taxes, while for the indirect taxes, households, families and firms that consume the taxed items pay the associated taxes (Chan, 2000). Direct taxes often include corporate tax, personal income tax, withholding tax, rental income tax, tax on interest in banks and presumptive income tax. An example of indirect tax is Value Added Tax.

Karingi et al (2005) argues that in revenue collection, tax administration is crucial in the implementation of a properly designed tax. Tax administration consists of three interrelated activities: the identification of tax liabilities based on existing tax laws; the assessment of taxes to determine if the taxes actually paid are smaller (or large) than liabilities; and the collection, prosecution and penalty activities that impose sanctions on tax evaders and ensure that taxes and penalties due from tax payers are actually collected.

According to Seelmann et al., (2011), taxation is often the most important source of state revenue. However, many developing countries lack effective tax administration structures and processes. Technological innovations have not filtered through to the daily working reality of tax officials. Paperwork and loose leaf systems still dominate tax administration and prevent more effective tax processes. As a consequence, some developing countries capture as little as 40% of their tax potential. Efficient internal revenue collection is a major step towards self-sufficiency and independence. Computerization of tax revenue authorities can contribute to the goal of good financial governance (Seelmann et al., 2011).

Value Added Tax, (VAT) on consumer expenditure was introduced in Kenya in 1990 in order to replace sales tax, which had been in operation since 1973. It was introduced as a measure to increase government revenue through expansion of tax base. VAT is levied on consumption of taxable goods and services supplied in Kenya or imported into Kenya. Registered persons acting as agents of government of Kenya collect VAT at designated points and then submit to the Kenya Revenue Authority (KRA) (Simiyu 2003). Previous empirical study conducted by Moyi and Ronge (2006), indicates that VAT contribution is estimated to an average of 5.4% of GDP in the year 2005. The average of total tax contribution to GDP for the same period was 19.8%. This clearly indicates that in Kenya, VAT contributes substantially to the growth of the economy. Another study conducted by Waris et al(2009) reveals that despite the importance of

VAT in the national budget, the period between the year 2000-2003 showed that VAT had the highest share of total tax (above 30%). However VAT contribution trend declined to total taxes collected from the year 2003 onwards. This trend called for intervention reforms.

The compliance to tax needs that two forms of compliance that are distinct and reporting for organizations. These categories are divided into either administrative or technical compliance. The first category refers the compliance with all administrative roles of not only lodging but also of paying taxes. The administrative form of compliance is also known as reporting compliance. Technical compliance refers to the requirements of the tax laws on a technical perspective, such as in the calculations of taxes or understanding the provisions of tax laws in paying their share of the tax (Brown & Mazor, 2013).

From the theoretical point both the tax payers and the tax collectors, compliance to tax regulations implies conformity to laws that differ from one nation to another. The revenue authorities have the fundamental mandate of fostering compliance by the tax payers on a voluntary basis, consequently minimizing the tax gap. As measured by the GDP (gross domestic product) of many nations, tax compliance is quite a big challenge in different nations across the world especially in many developing countries, even though the GDP has been improving over the years. (Khalfan, 2010)

Small businesses uniquely generate a substantial amount of revenue for the tax system besides salary earning tax payers who are only subjected to the income tax withheld from the majority of the tax payers in the net tax. Moreover, the small enterprises (SMEs) contribute significantly to the informal economy that runs outside the tax net. Many nations whose economies are on the development stages have witnessed the growth of SMEs as being the most rapid in the economy. Compliance to tax payment by these enterprises vary from one country to another, in some cases the proprietors voluntarily choosing to comply while in other cases compliance coming as a

result of authorities enforcing the compliance. Nevertheless, for reasons such as difficult process of making the procedures of compliance being difficult and also the expectation of obtaining a comparative advantage for non-compliers, many small businesses choose to join the informal economy sector. (Torgler, 2011).

The rate of risk of compliance in the SMEs among the population of tax payers varies markedly from the rate of compliance of LTO. The tax system has resources that enable it to deal effectively with non-compliers in large businesses category. The large enterprises find it important to access complexities in regard to advice on tax and also have the capabilities to come up with strategic plans geared toward reduction of tax liability for the enterprise. Such strategies could for example take the form of using price transfer methods. (Helhel, & Ahmed, 2014).

The history of taxation can be found in ancient Egypt where the Pharaohs appointed tax collectors called scribes and paid them well to curtail their possible corrupt tendencies in collecting revenue (Webber and Wildavsky, 1986). Supervision was also done by appointed scribes in head office to closely monitor revenue collection and administration.

Historically, taxpayers choose how much income to declare for tax purposes by working out a trade-off between saving on tax and penalties resulting from noncompliance (Allingham and Sandmo, 1972).

According to James, Murphy and Reinhart (2005), tax law has to be supplemented with a reasonable degree of willingness to comply on the part of the taxpayers. Thus, compliance could be seen as the degree of willingness by the taxpayer to comply with the tax law and administration without coercion by the tax authority. Tax avoidance is a legal measure to reduce tax liability through tax planning, while tax evasion is an illegal measure aimed at cheating on

compliance. Hence compliance can be appropriately defined in terms of the spirit of the taxpayer as well as the letter of the tax law (James, Murphy and Reinhart, 2005).

Noncompliance with tax policies results from individuals deliberately failing to comply with the set tax law. This results in revenue loss which may adversely affect the functioning of the public sector, (Luigi Alberto Franzoni [1999]). Analytical investigation of noncompliance can be traced back to one of the pioneers of law and economics, Cesare Beccaria (1764). The problem was segregated from the main body of economics and left essentially to the attention of tax authorities and jurisprudence. The modern use of economic tools for the analysis of tax compliance can be credited to Allingham and Sandmo (1972; 1991), who extended the influential work of Becker (1968) on law enforcement to taxation using modern risk theory.

The attitude of taxpayers is influenced by factors such as their characters towards public institutions, the perceived fairness of the taxes, prevailing social norms, and the chances of noncompliance being detected and punished (Luigi Alberto Franzoni, 1999). He further found out that the economic analysis of tax compliance has focused mainly on how evasion can be deterred through detection and sanctions.

According to Ariyo (1997), fiscal deficit has become a cyclical feature of public sector financing worldwide due to the desire of various governments to respond positively to the ever-increasing demands of the populace while at the same time enhancing accelerated economic growth. Chipeta (1998) observed that often, tax as a source of revenue for many governments have gone short of generating adequate revenue to match growing expenditure thus making them look for alternative ways of financing. Poverty incidences in developing countries have resulted to over-dependence on government provision of public goods like education, health and others leading

to huge deficit financing. As noted by Chipeta (1998) this has created a situation of unsustainable external financing.

There are a number of tax compliance theories that have been developed by various scholars. The economic deterrence theory is a theory under criminology that views a taxpayer as a perfectly moral, risk-neutral or risk-averse individual who seek to derive maximum satisfaction whenever the expected gain exceed the cost (Becker, 1968). The fiscal and social psychology theory proposes that taxpayers are more willing to pay taxes if they have a positive attitude towards the payment of taxes (Schmolders, 1960). The theory has been built on by various scholars overtime. The taxpayers' willingness to comply with tax authorities relates to the individuals' attitudes and perception of the tax system (Strumpel, 1966). Psychology theories examines taxpayers' attitudes and beliefs so as to understand and predict their behavior and factors affecting their tax compliance. Social psychology theories inductively examine the attitudes and beliefs of taxpayers in order to understand & predict human behavior and factors that affect taxpayers' compliance attitudes.

The ability to pay theory proposes that citizens to contribute to the support of the government as nearly as possible, in proportion to their respective abilities in terms of revenue (Mill, 1848).

Tax compliance is the extent to which the taxpaying community fulfils their duties and obligations as per the tax legal provisions (Maxwell, 2013). Tax compliance involves proper computation of taxes and payment as per the tax laws. Tax compliance is the fulfillment of tax laws, declaration of the correct income & expenses and the payment of taxes on time. From the above definitions, it can be concluded that tax compliance means complying with the tax laws, accurate declaration of income & expenses and timely settlement of tax liabilities. (Mohd & Ahmad, 2011).

Tax compliance is measured in four ways that is registration, filing, computation and payment compliance. Registration compliance relates to the portion registered taxpayers with the appropriate tax obligation. Filing compliance relates to the proportion of tax returns filed on time. Computation compliance measures the percent of the correct tax liability that is correctly computed and reported. Tax payment compliance measures the portion of the computed tax liability that is paid within the timelines of tax laws. Taxpayer facilitation involves the provision of taxpayer services giving proper guidelines, instructions, and simplified ways of filing tax returns, educating taxpayers on their rights, duties and obligations. Another definition of tax compliance is the voluntary & timely registration with the relevant tax obligation(s), submission of accurate tax returns, voluntary & timely settlement of tax and keeping accurate records as required by law. (Leung, 2016).

Tax revenue plays a significant role in the economic growth of the country. Tax evasion and tax avoidance hampers revenue collection which leads to inefficiency in government operations. Tax evasion refers to the illegitimate intentional actions by taxpayers taken in order to reduce their tax liability. (Alm, 2012). Tax evasion is achieved through criminal acts of omission e.g. failure to register for VAT and acts of commission e.g. under declaration of sales, overstating expenses, claiming of personal expenses as if they are business expenses and misclassifying supplies to lower rates of tax. Also a taxpayer can reduce his VAT liability by abusing the credit and refund mechanism.

1.1.2 Kenya Perspective

KRA established a Taxpayer Services Division under the Support Services Department in 2005. It then moved to the Marketing & Communication Division in 2008 as a section mandated with internal and external education.

The function was centralized to enhance the effectiveness of taxpayer education and improve coordination (Gitaru, 2017). Customer Care Desks were established in all KRA Regions and major centers. KRA successfully hosted a television program ‘VI Working Nation Wins" aimed at propagating the need for citizens to pay their share of taxes in order to support service delivery by the Government. The level of awareness was also introduced through print and media campaigns and this increased the number of outreach services to taxpayers and other arms of Government. This targeted several groups including the Provincial Administration and Internal Security, Judiciary and Members of National Assembly. The annual taxpayers' week was designed to coincide with national freedom heroes' day. The slogan "Kulipa Ushuru ni Kujitegemea" was developed to celebrate the 10 years in Kenya anniversary celebrations in 2005. The concept of Tax Clinics was adopted, with service oriented approach where taxpayers were educated on various tax matters. During the clinics, taxpayers were given a chance to air their grievances and make suggestions on service improvement. Services such as issuance of PIN Card, VAT registration, Income Tax returns, driving license, TLB, PSV licenses for drivers and conductors, and transfer of logbooks were provided on site at the tax clinics (KRA, 2018).

KRA has also introduced i-tax registration in 2013 which enables taxpayers to be registered and file tax returns online, as well as produce e-slips to remit payments in the commercial banks (Muturi and Kiarie, 2015). Online tax filing system is an important application that automates tax related processes and enhances efficiency in assessing and collecting tax information.

As Kenya's budget continues to grow in trillions of shillings, there is need to put up a healthy fiscal management system that ensures stable revenues over time, improves equity and efficiency of taxes as well as promoting investment towards economic growth and increased national income. To improve the economy of country, the need to mobilize more tax revenues is

the priority agenda in development policy, as country's revenue performance is satisfactory on a given measuring scale when the available revenue sources provide sufficient revenue. Between the years 2010/11 to 2014/15, Kenya Revenue Authority experienced a positive response in revenue growth and economic growth.

The Authority surpassed its 2013/2014 target collection by Sh100 million as it bagged Sh963.8 billion in taxes against a target of Sh963.7 billion while in 2015/16 KRA missed its revenue collection targets with Treasury revealing a shortage of Sh205 billion.. The growth of tax revenue fell short further and KRA missed its target again by Sh50 billion collecting Sh1.365 trillion in 2016/2017 financial year, against the target of Sh1.415 trillion. Due to revenue deficit, there is a tax gap between what taxpayers are to pay (what they owe) and what they actually paid; a clear indication of how much additional revenue to be raised, for a higher level of consent of taxpayers to be achieved.

The growing variance between revenue targets and actual exchequer collections occasioned by among others, substantial increases in public expenditure, exerting commensurate pressure on the revenue targets. Kenya Revenue Authority as the main government tax agency has upraised methods to improve revenue collection despite variances in performance, which has weakened economic objectives creating a gap between actual and potential government tax revenue. The fact that the Authority endeavours to exercise its sovereign right to collect taxes, most people do not embrace paying taxes, driving some people into tax evasion and making the government constantly fail to raise targeted revenue for development.

There is also concern about the Authority's tax system design that does not accommodate most of informal sectors making it difficult to collect taxes from such self-employed citizens and small business entrepreneurs. Charles, K., Agnes, M and Dorothy, N. (2012). As result, the tax burden is borne by just a few people especially those employed or registered entities while

others joy ride by using public services provided through tax paid. Tax is viewed as a burden which should be avoided and when requested to pay some people feel they are being treated harshly and the punitive provisions in the tax laws are applied ruthlessly against them."(Coetzee, 1996). As a result, taxpayers become defiant, demotivated and disillusioned due to misunderstanding of their tax obligations and lack of a proper tax culture where taxpayer and tax collector discharge their obligations equally well through tax education awareness.

Most business enterprises fail to file their returns with reasons of not operating wherever there is crisis, urging lack of security resulting to stealing or destruction of their merchandise. The performance of revenue collection has been a source of concern, hence the need to investigate and to adopt different strategies to strengthen revenue collection.

Taxpayer education can be described as a method of educating the people about the whole process of taxation and why they should pay tax. It assists taxpayers in meeting their tax obligations to the government. This means that the primary existence of taxpayer education is to encourage voluntary compliance amongst taxpayers.

Tax Education to the SMEs becomes necessary when the objective of raising tax revenue, at the changing environment; particularly from the official tax assessment is considered (Munyu, 2014). At the same time, achieving tax compliance and improving revenue generation is not an easy task.

Taxpayer education program serves to: create taxpayer awareness of laws and procedures, educate taxpayers on their tax responsibilities and rights, assist and motivate taxpayer to comply voluntarily, assist taxpayers on reporting the correct income and amount of tax, maintaining close relationship between the tax authority and the taxpayer continuously, and, instill public

confidence in taxation system. It is expected that, tax education will assist taxpayers to understand tax laws and procedures as well as creating positive tax compliance attitude.

It was envisaged, that with an electronic filing system implemented, KRA will increase revenue collection, reduce the time taken in verification of manual data, reduce operational costs, and thereby channel and dedicate more time to taxpayer education to increase the rate of compliance. There is a paucity of published work on the effectiveness of tax payer education as a revenue collection strategy in KRA, particularly in the context of developing countries in the dynamic African region and specifically in Kenya. This study intended to bridge this gap in knowledge that exists. The objective of this study was to establish the effectiveness of tax payer education as a revenue collection strategy in KRA focusing on Nairobi region.

Non-compliance denies the government the required revenue. Even though there have been many administrative reforms, VAT compliance level has remained low contributing only 23% of the total revenue. KRA expects to achieve VAT compliance rate of 65% and raise the ratio of VAT to total revenue to 35% by 2019, (KRA 7th Corporate Plan, 2018).

Joint studies carried out by KIPPRA, KRA and the ministry of finance, revealed that VAT payment compliance was as low as 55% while return filing was 65% (Masinde and Makau,2010).Repercussions relating to non-compliance of raising enough tax revenue by the government to finance planned activities, has motivated researches and policy makers to put emphasis on tax non compliance.

Available information indicates that a significant percentage of registered SME's are Nil or Non-filers, (KRA, 2018 reports). In the month of April 2018 report, a total of 52,198 VAT registered taxpayers either returned a nil return or did not file a VAT return where, 23,948 of these nil and non-filers were SMEs. This contradicted KRA iTax reports which indicated that some of SMEs had conducted business with withholding tax agents during the same period.

The issue of non-compliance has led KRA to establish a unit in every KRA station to deal with Nil and Non-filers majority of them being contractors and SMEs.

With the advent of devolution, the SMEs sector has witnessed massive growth evidenced by the increased budgetary allocations towards infrastructure development with no corresponding growth in VAT collections from the registered construction firms. VAT in general continues to perform below expectations despite the increased taxable business transactions especially among firms in the SMEs. Its therefore against this background that this study aim to establish the factors influencing VAT compliance among the Small and medium sized enterprises in Nairobi, CBD.

1.2 Statement of the problem

In the 2015/16 KRA missed its revenue collection targets with Treasury revealing a shortage of Sh205 billion. <https://www.standardmedia.co.ke>. The growth of tax revenue fell short further and KRA missed its target again by Sh50 billion collecting Sh1.365 trillion in 2016/2017 financial year, against the target of Sh1.415 trillion. Due to revenue deficit, there is a tax gap between what taxpayers are to pay (what they owe) and what they actually paid; a clear indication of how much additional revenue to be raised, for a higher level of consent of taxpayers to be achieved.

The growing variance between revenue targets and actual exchequer collections occasioned by among others, substantial increases in public expenditure, exerting commensurate pressure on the revenue targets. Kenya Revenue Authority as the main government tax agency has upraised methods to improve revenue collection despite variances in performance, which has weakened economic objectives creating a gap between actual and potential government tax revenue. The fact that the Authority endeavours to exercise its sovereign right to collect taxes, most people do not embrace paying taxes, driving some people into tax evasion and making the government constantly fail to raise targeted revenue for development.

There is also concern about the Authority's tax system design that does not accommodate most of informal sectors making it difficult to collect taxes from such self-employed citizens and small business entrepreneurs. Charles, K., Agnes, M and Dorothy, N. (2012). As result, the tax burden is borne by just a few people especially those employed or registered entities while others joy ride by using public services provided through tax paid. Tax is viewed as a burden which should be avoided and when requested to pay some people feel they are being treated harshly and the punitive provisions in the tax laws are applied ruthlessly against them."(Coetzee, 1996). As a result, taxpayers become defiant, demotivated and disillusioned due to misunderstanding of their tax obligations and lack of a proper tax culture where taxpayer and tax collector discharge their obligations equally well through tax education awareness.

Most business enterprises fail to file their returns with reasons of not operating wherever there is crisis, urging lack of security resulting to stealing or destruction of their merchandise. The performance of revenue collection has been a source of concern, hence the need to investigate and to adopt different strategies to strengthen revenue collection

1.3 Research Objectives

1.3.1 General Objective

To investigate factors affecting revenue performance at Kenya Revenue Authority, Kenya.

1.3.2 Specific Objective

- i. To establish the effect of tax compliance costs on revenue performance at KRA, Kenya
- ii. To determine the effect of level of tax knowledge on revenue performance at KRA, Kenya

- iii. To assess the effect of tax rates on revenue performance at KRA, Kenya
- iv. To find out the effect of penalties and interest on revenue performance at KRA, Kenya

1.4 Research Questions

- i. Does tax compliance cost affect revenue performance at KRA, Kenya
- ii. Does level of tax knowledge affect revenue performance at KRA, Kenya
- iii. Does tax rate affect revenue performance at KRA, Kenya
- iv. Does penalties and interests affect revenue performance at KRA, Kenya

1.5 Significance of the Study

1.5.1 The Government of Kenya

Kenya Revenue Authority will be able to use the findings from this study to critically assess the influence of the systems and take any corrective measures to counter any weaknesses identified. This will help in promotion of tax registered traders in the country as well as ensuring adequate financial resources for the government.

1.5.3 Other Researchers

Other researchers will benefit from the findings in that the study will provide information to all future researchers interested in doing research on VAT.

1.6 Scope of the Study

The researcher will conduct a study in Nairobi region where different types of taxpayers are accessible within a reasonable population and it will cover the parameters in which the researcher will be operating. A sample of 120 SMEs will be selected randomly from the target population of 1200 SMEs in CBD, Nairobi.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presented review of literature on VAT collection. It first discussed three theories that provide the theoretical background of the study. These theories are prospect theory, deterrence theory and the ability to pay theory of taxation. The chapter also discussed other studies conducted that are relevant to this study. Furthermore, it developed a conceptual framework for the research variables and showed the gaps that the study sought to fill.

2.2 Theoretical Literature Review

2.2.1 The Prospect Theory

A rapidly growing body of literature has developed that challenges the descriptive validity of the most basic assumptions of expected utility and other models of choice (Casey and Scholz, 1991). Kahneman and Tversky (1999) have formulated a more descriptive model of choice under conditions of uncertainty, called “prospect theory.” This theory diverges from the expected utility model by considering the contextual presentation or frame of a decision as a factor influencing the choice of decision makers. The frame of a decision includes its presentation, reference points, alternatives, outcomes, and their probabilities of occurrence. Prospect theory recognizes that individuals have limited cognitive abilities and the theory envisions an editing step, the decision maker may simplify the decision by attending to only some factors, ignoring others, and encoding aspects into meaningful forms such as gains or losses, most applications of prospect theory in the tax compliance research area have examined the violation of the expected utility tenet of description invariance called the reflection effect

(gain/loss framing effect). That is the same outcome can be edited as either a gain or a loss depending on the reference point presented in the decision frame, and a different decision is likely depending on the frame adopted.

Prospect theory proposes that individuals will display a value (utility) function that is concave for gains and convex for losses, with the latter being steeper than the former. The shape of this value function suggests that individuals will be risk averse for gain frames and risk choice of equal or greater value (Kahneman and Tversky, 1999). The framing effect described by prospect theory is by no means, considered to be universal (Tversky and Kahneman, 1992). It is merely descriptive of how some individuals will behave some of the time. Other factors, such as social norms, ethics, and personal characteristics, may affect how a decision is edited and thus affect the ultimate decision made.

2.2.2 Deterrence Theory

The primary theoretical framework in economics for the study of noncompliance has been deterrence theory. This framework assumes that taxpayers rationally perform a cost- benefit analysis of noncompliance taking into consideration the value of the marginal tax dollar and the risks of sanctions (Carroll, 1992). Since deterrence theory emphasizes cost-benefits that are based on expected outcomes of choices, it can be considered an outcome- processing theory (Carroll, 1992). Consequently, taxpayers make compliance maximize their utility.

Within this classical view of decision making, choices are considered to be motivated by Self-interest (Hodgson, 1998). That is, individuals are thought to promote their own interests instead of the interests of others. Ethical values are seen as interfering with rational behaviour and utility maximization (Etzioni, 1998). Sociological research, however, has broadened the notion of utility to include concern for social duty as well as self -interested goals. Thus, in classical

deterrence theory, taxpayers choose a compliance level that maximizes utility (What is best for the taxpayer), and in sociological models, this choice also considers the social obligations and self-image of the taxpayers as well (Scholz, 1995).

2.2.3 Ability to Pay Theory

According to this theory, tax liability in its true form is a compulsory and an unconditional payment to the state. The theory posits that there is no commercial or semi-commercial relationship between the state and the citizens. A citizen is to pay taxes just because he or she can and his or her relative share in the total tax burden is to be determined by the relative paying capacity. This doctrine has been in vogue for at least as long as the benefits theory. The basic tenet of this theory is that the burden of taxation should be shared by the members of society on the principles of justice and equity and that these principles necessitate that the tax burden is apportioned according to their relative ability to pay. This theory suggests that the payers of VAT should pay unconditionally and according to paying capacity (Chigbu, Eze and Ebimobowei, 2012).

2.3 Conceptual Framework

This conceptual framework shows the relationship between the dependent variables and the independent variables. The independent variables are cost of compliance, penalties and interest, level of tax knowledge and rates of tax and the dependent variable is Value Added Tax as illustrated in the conceptual framework presented in figure 2.1

Independent Variables

Dependent Variable

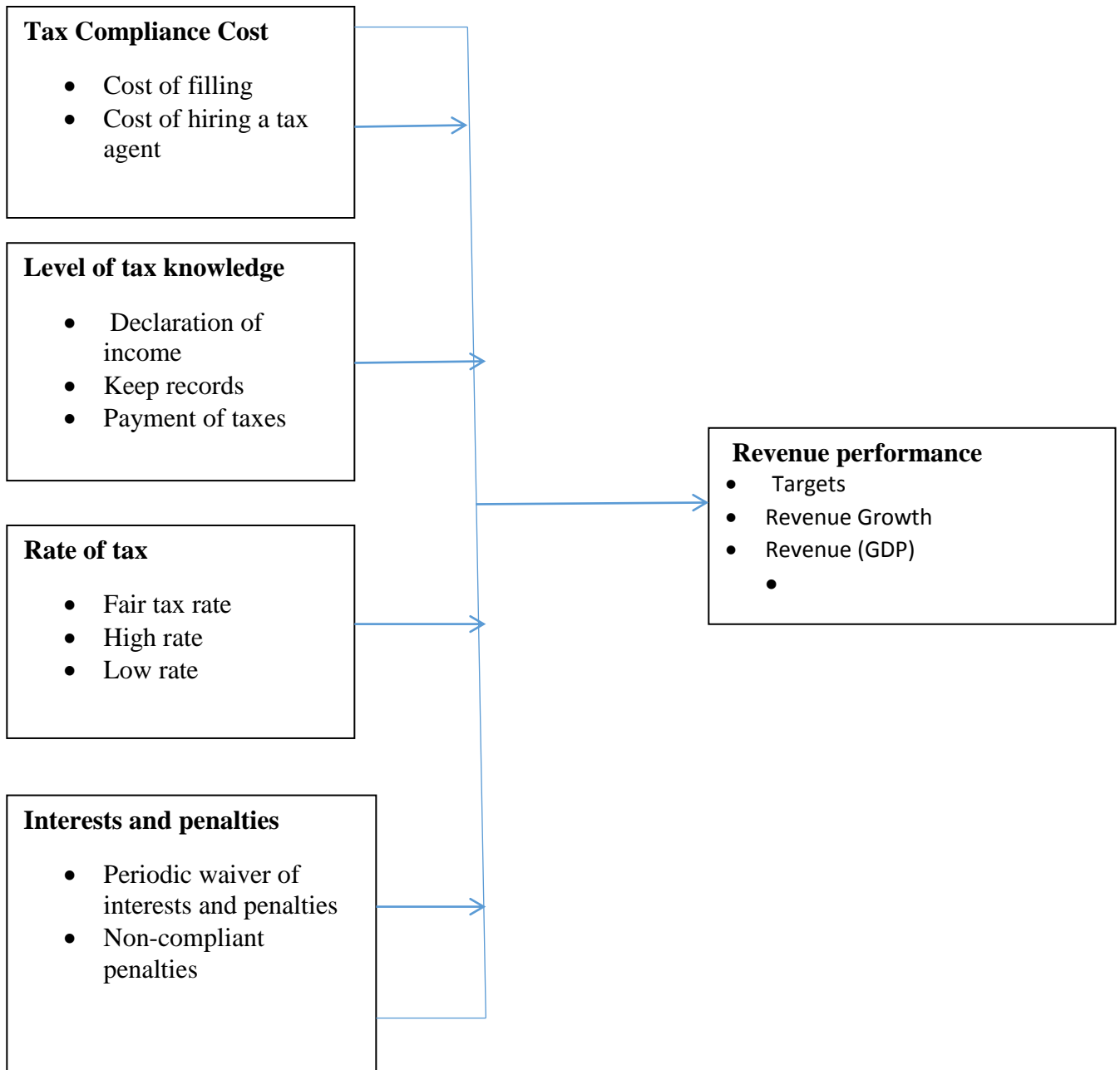


Figure 2.1 Conceptual Framework

2.4 Empirical Literature

Mukabi (2014) carried out a study on “factors influencing Turn over Tax compliance and concluded that, taxpayers’ perception of the tax system, level of awareness, enforcement efforts and compliance costs have an effect on compliance level. Osebe (2013) carried out a study on the analysis of factors affecting tax compliance in the real estate sector. He concluded that the established factors (compliance costs, available opportunity for tax evasion, taxpayer knowledge, fines and penalties) greatly affect the tax compliance level in the industry. The study of Mwangi(2013) on the establishment of factors affecting tax compliance among the small and medium enterprises reached a conclusion that rates of tax, availability of information, compliance costs and taxpayer attitude towards tax payments have a direct effect on tax compliance.

The essence of leadership in modern organizations nowadays is that leadership must be for the benefit of the followers and not necessarily for the enrichment of the leaders, (Kuppers, 2007). An individual will support an organization if he believes that through it his personal objectives and goals could be met; if not, the person’s interest will decline. Managerial style in an organization is one of the factors that play significant role in enhancing or retarding the interest and commitment of the individuals in the organization. However, the authors do not specifically portray the exact effect of leadership on the stability of the labor force, specifically in public sector organizations.

According to Madura, (2007), firms that invest in employee training are more profitable due to more output, effective use of resources. Furthermore the author demonstrates that effective training assists supply chain management in creating an effective workforce and business operations thus creating a competitive advantage for a firm over its competitors who do not train their employees on new processes, technologies and trends. This assertion may not always apply

to all firms of all sectors as training programs force investments which increase operational costs making it unattractive to decision makers. In addition the several authors has not shown how training affects the stability of the labor force in public sector organizations, therefore the study was conducted to fill the gaps. Studies have found that organizational policy was consistently associated with employee turnover. There are many organizational policies that can influence performance, stability and morale among employees in an organization. Noteworthy though, is the underwhelming gap on the explicit effect of organizational policies on the human resource stability in public sector organizations thus a need for a study to fill those gaps revealed.

According to Munaita, (2008), policies of the state affect the supply and demand of labor in a certain area as well as commercial properties and industrial projects. A company may decide for (or against) a certain location because of regulations and policies rolled out. In addition, the view and the support of the government which is reflected by its policy, affects the activities of public sectors organizations since they work on behalf of the state. However the several authors reviewed have not expressly stated the effect of government policy on the stability of the work force in public sector organizations, hence necessitating a study to establish as much.

Makau,2010).Repercussions relating to non-compliance of raising enough tax revenue by the government to finance planned activities, has motivated researches and policy makers to put emphasis on tax non-compliance.

Available information indicates that a significant percentage of registered SME's are Nil or Non-filers, (KRA, 2018 reports). In the month of April 2018 report, a total of 52,198 VAT registered taxpayers either returned a nil return or did not file a VAT return where, 23,948 of these nil and non-filers were SME's. This contradicted KRA iTax reports which indicated that some of these traders had conducted business with withholding tax agents during the same

period. These facts of non-compliance has led KRA to establish a unit in every KRA station to deal with Nil and Non-filers majority of them being contractors and SME. With the advent of devolution the SME sector has witnessed massive growth evidenced by the increased budgetary allocations towards infrastructure development with no corresponding growth in VAT collections from the registered construction firms. VAT in general continues to perform below expectations despite the increased taxable business transactions especially among firms in the SME.

2.4.1 Tax compliance cost

Tax compliance expenses are incurred by taxpayers in the process of fulfilling tax requirements laid on them by tax law (Sandford, 1995). Tax compliance costs include the tax collection costs expenses relating to paying and accounting for tax, wages & salaries of employees and professionals and the cost of acquiring knowledge, updating the system to enable it work. Taxpayers usually depend on tax professionals who through avoidance schemes minimize tax payments (Franzoni, 2000).

High tax compliance costs disadvantages a country's competitiveness interns of attractiveness, KRA has devised ways of simplifying the tax systems e.g. the iTax system in order to reduce reliance on tax professionals. This encourages voluntary compliance Compliance expenses can be interpreted in different ways. One, the costs are divided in three in respect to time, monetary and psychological costs. Time expenses relate to hours consumed to in ensuring all aspects of tax compliance. Cash expenses relate salaries paid to internal employees and fees paid external tax professionals. The psychological costs concerns the effects upon a taxpayer in dealing with the tax matters e.g. mental stress. Psyschological costs are difficult to quantify.

Other compliance expenses include all expenses incurred by the taxpayer but are outside the control of the taxpayer (Hijattulah and Pope, 2008). Vaillancourt (1987) held that Value Added

Tax (indirect tax) has a higher compliance cost than Income Tax (direct tax). In the study survey of the OECD countries, 8 out of 11 countries cited VAT compliance cost as forming the largest part of the total tax compliance cost (Pope, 2001). Compliance expenses entail record keeping, preparation and submission of VAT returns (Cleruox, 1992).

2.4.2 Level of tax Knowledge

Taxpayer knowledge is concerned with the taxpayers' ability in understanding tax laws, the willingness to comply and the role of taxes in national development (how tax collected by the government is utilized (Mohd, 2010). Taxpayer education activities are meant to enhance the level of taxpayer understanding of the tax systems and empower taxpayers in fulfilling their tax obligations. On compliance opportunities may be readily available to educated taxpayers but because of their better understanding of the tax system contributes towards positive attitudes hence promoting tax compliance. Education programs creates awareness of laws, procedures, motivates taxpayers to voluntarily comply, report correct income, maintain a close relationship between the revenue authority & the taxpayer and instill confidence in the tax system (Oyedele 2009). Teaching tax courses should be emphasized because of their impact on compliance (Hite and Hasseldine, 2001).

Taxpayer knowledge has influence on compliance and various researches support this argument. Knowledge is categorized on the basis ordinary or official education received and knowledge towards the opportunity to evade tax (Groenland & Veldhoven 1983). Tax knowledge as one of the key factor in tax compliance has a very close relationship with the taxpayers' ability to understand the tax law & regulations, and their ability to comply (Singh, 2003). Taxpayer education exists to encourage voluntary compliance through service delivery to taxpayers. Low levels of voluntary tax compliance will compel revenue authority to use costly and coercive methods to enforce compliance (Fjeldstad and Ranker 2003). Kimumu and Kileva (2007) says

that the education component will deal with compliance matters in the informal sector. This is premised on the possibility that non-compliance being unintentional due to the ignorance of the law or may be intentional due to the negative compliance attitudes. (Christina, Deboral and Gray, 2003).

2.4.3 Rate of tax

It is generally believed that a high tax rate is the main cause of tax evasion. Incentives to evade tax depend on the marginal rates of taxation because these govern the gains from evasion as a sum of the sum evaded (Kaldor, 1956).

One major tax evasion is the high personal income tax rates which tend to lead tax payers to evade tax. Too many and complicated rules and regulations imposed by the government tend to lead to tax evasion. Businesses find it generally difficult often not profitable to do business legally. The heavy taxation is also a subject of worry not only in developed countries like USA but also in Kenya and other less industrialized countries in Africa and Latin America. For instance, taxes in Kenya confront the large manufacturing sector in different shapes and shades example: import duties, export & excise duties, sales and VAT, withholdings and income taxes, and PAYE etc. (KRA, 2011)

The high levels of taxation of SMEs in Africa and in Kenya in particular, warrants attention on accelerated research areas aimed at addressing the overall effects of taxation on SMEs (Osambo, 2009) By studying taxation behavior in five different countries (USA, Gambia, Nigeria, South Africa and Kenya), Derwent (2000) concluded that increased tax burden is a major threat. The results show that the increase in tax rates leads to higher production, distribution and selling costs which lead to higher prices and as a result consumers change their buying behavior. People react to the higher prices by buying less of the product. When sales fall, some manufacturers cut back on production and some workers may lose their jobs. The productive resources i.e. land,

capital, labour and entrepreneurship are allocated to other industries or go unused. For instance when the government increase taxes on items such as beer and cigarettes for the purpose of realizing revenue and discouraging their consumption people tend to buy local brews. Whenever prices increase due to increase in tax rates; prices of goods and service increase and there is a drop in the consumption rate and a decrease in sales volumes which leads to retarded growth of SMEs.

Tax payment is among the outflows of cash from the business which reduce the purchasing power of an enterprise. This is due to the fact that a large amount of cash collected is used to pay taxes rather than to expand the business.

The study showed that the purchasing power of an enterprise drops immediately an organization pays taxes (Mika Mungaya, IJMBS Vol. 2, Issue 3, and July - Sept 2012).

Some studies suggest that high tax rates foster evasion. The intuition is that high tax rates increase the tax burden and, hence, lower the disposable income of the taxpayer (Chipeta, 2002) However, the level of the tax rate may not be the only factor influencing people's decision about paying taxes. In fact, the structure of the overall tax system has an impact as well. If, for example, the tax rate on corporate profits is relatively low, but individuals are facing a high tax rate on their personal income, they may perceive their personal tax burden as unfair and choose to declare only a part of their income. Similarly, large companies can often more easily take advantage of tax loopholes, thereby contributing to the perceived unfairness of the system. Tax rates and the overall structure of the tax system, therefore, have a significant effect on the disposition to evade and avoid taxes.

2.4.4 Interest and penalties

Empirical studies on the impact of fines on tax compliance do not provide a clear picture on the relation between fines and tax compliance (Fischer et al, 1992). Keeping constant the expected

value of a tax but changing audit probabilities and fines for non-compliance, it showed that compliance increased significantly with higher fines, but not with higher audit probabilities (Friedland, Maital and Rutenberg, 1978). Punitive penalties makes tax evasion more costly for the taxpayer hence leading to the reduction of tax evasion. Research studies show that more punitive fines and penalties can result in more tax avoidance (Kirchler, 2007).

Deterrence is effective when there is a combination of effective imposition of fines and frequent audits to detect cases of non-compliance.

Penalties and audit probabilities have a strong impact on tax compliance (Allingham and Sandmo, 1972). The Higher the fine, penalty and higher the potential of audit probability, the greater the deterrent effect on tax evasion. Extremely punitive tax penalties have no effect if it is common knowledge that tax audits will not occur. Fines should be set at a higher level to minimize the expected the value of tax evasion and assure its deterrent effect on taxpayers. The tax system would be viewed as unjust if fines are too high individuals would exploit any available opportunity to avoid tax payment (Kirchler et al, 2007). In Kenya, the penalty for non-submission or late filing of a VAT return is 5% of VAT payable or kshs.10, 000 per tax period whichever is higher. Fines and penalties commonly relate to failure to; register, submit a return on or before the due date or submitting a payment return without paying the tax due, filing incorrect tax returns, keeping inaccurate records, issue of improper tax invoice, failure to display a certificate of registration, and charging VAT when not registered among the many non compliance aspects.

2.5 Critiques of the study

According to Munaita, (2008), policies of the state affect the supply and demand of labor in a certain area as well as commercial properties and industrial projects. A company may decide for (or against) a certain location because of regulations and policies rolled out. In addition, the

view and the support of the government which is reflected by its policy, affects the activities of public sectors organizations since they work on behalf of the state. However the several authors reviewed have not expressly stated the effect of government policy on the stability of the work force in public sector organizations, hence necessitating a study to establish as much.

Makau,2010).Repercussions relating to non-compliance of raising enough tax revenue by the government to finance planned activities, has motivated researches and policy makers to put emphasis on tax non compliance.

Available information indicates that a significant percentage of registered SME's are Nil or Non-filers, (KRA, 2018 reports). In the month of April 2018 report, a total of 52,198 registered taxpayers either returned a nil return or did not file a return where, 23,948 of these nil and non-filers were SME's. This contradicted KRA iTax reports which indicated that some of these traders had conducted business with withholding tax agents during the same period. These facts of non-compliance has led KRA to establish a unit in every KRA station to deal with Nil and Non-filers majority of them being contractors and SME. With the advent of devolution the SME sector has witnessed massive growth evidenced by the increased budgetary allocations towards infrastructure development with no corresponding growth in VAT collections from the registered construction firms. In general continues to perform below expectations despite the increased taxable business transactions especially among firms in the SME.

Mukabi (2014) carried out a study on “factors influencing Turn over Tax compliance and concluded that, taxpayers’ perception of the tax system, level of awareness, enforcement efforts and compliance costs have an effect on compliance level. Osebe (2013) carried out a study on the analysis of factors affecting tax compliance in the real estate sector. He concluded that the established factors (compliance costs, available opportunity for tax evasion, taxpayer knowledge,

finances and penalties) greatly affect the tax compliance level in the industry. The study of Mwangi(2013) on the establishment of factors affecting tax compliance among the small and medium enterprises reached a conclusion that rates of tax, availability of information, compliance costs and taxpayer attitude towards tax payments have a direct effect on tax compliance.

The essence of leadership in modern organizations nowadays is that leadership must be for the benefit of the followers and not necessarily for the enrichment of the leaders, (Kuppers, 2007). An individual will support an organization if he believes that through it his personal objectives and goals could be met; if not, the person's interest will decline. Managerial style in an organization is one of the factors that play significant role in enhancing or retarding the interest and commitment of the individuals in the organization. However, the authors do not specifically portray the exact effect of leadership on the stability of the labor force, specifically in public sector organizations.

According to Madura, (2007), firms that invest in employee training are more profitable due to more output, effective use of resources. Furthermore the author demonstrates that effective training assists supply chain management in creating an effective workforce and business operations thus creating a competitive advantage for a firm over its competitors who do not train their employees on new processes, technologies and trends. This assertion may not always apply to all firms of all sectors as training programs force investments which increase operational costs making it unattractive to decision makers. In addition the several authors has not shown how training affects the stability of the labor force in public sector organizations, therefore the study was conducted to fill the gaps. Studies have found that organizational policy was consistently associated with employee turnover. There are many organizational policies that can influence performance, stability and morale among employees in an organization. Noteworthy

though, is the underwhelming gap on the explicit effect of organizational policies on the human resource stability in public sector organizations thus a need for a study to fill those gaps revealed.

2.6 Research Gap

From the literature review it is evident that revenue collection is an unsettled matter as it is being affected by several factors. The manner to achieve success in the collection of tax from this sector is a challenge to both the developed and the developing countries. In addition to this, while some studies see collection of revenue performance as necessary (Robert, 1997), others view it as an obstacle that hampers the growth of some registered traders (Mboma, 2012; Mohammed & Gela, 2014).

2.6 Summary

Chapter one gave an introduction and background to the study and outlined the problem statement and the purpose of the study, it also clearly stated the research questions that the study aims to achieve. The significance alongside beneficiaries of the study has been outlined. The scope both geographical and conceptual is covered. The chapter concludes by defining the key terminologies used. Chapter two elucidates the findings from the literature with the emphasis on the tax compliance and non-compliance. It will therefore serve to clarify how relationship between tax compliance and tax evasion and tax avoidance. Chapter three comprise of the research methodology used in the study. The chapter defines the research design, population targeted, sample design, procedures of data collection and analysis of data techniques. Also discussed are characteristics of the study design and why the research deemed it appropriate for this study. The chapter also provides information on the population, sample frame and size, sample selection. Data collection method and data collection tool used in the study is also

provided. Presentation the findings and results of the study is covered in chapter four. Presentations of the findings and results were presented in table forms. Percentages were used for easy interpretation and understanding.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This section provided a systematic description of the research methodology that was used to answer the research questions in chapter one of the research proposal . The methodology in this research study entail research design, target population, sampling design, data collection and analysis methods.

3.2 Research Design

The study will adopt descriptive research design, it will be structured in a formal study with clear and well stated investigative questions which sought to find out who, what, where, when and how much (Cooper and Schindler, 2010). Also descriptive design according to Kothari (2011) is concerned with describing, recording, analysing and interpreting of variables under the study a, the study sought to investigate the factors affecting revenue performance at KRA.

3.4 Sampling Frame

According to Thompson (2012), a sampling frame comprises of a list of people from which the researcher uses to obtain information about the study. The sampling frame defines a set of elements from which a researcher can select a sample of the target population. Because a researcher rarely has direct access to the entire population of interest in social science research, a researcher must rely upon a sampling frame to represent all of the elements of the population of interest. This consisted of segmented taxpayers from the Small and Medium Enterprises in Nairobi CBD, Kenya.

3.3 Target Population

Cooper & Schindler (2003) define target population as the entire group of people events or objects that a study focused on as the subject of analysis. The target population of this study will be 1200 VAT registered SMEs operating business in Nairobi, CBD and registered for VAT within Nairobi, CBD. The study will be interested in examining the tax behavior of these SMEs as shown in table 3.1.

Table 3.1 Target Population

Type of Enterprises	Target population
Small Scale Enterprises	1000
Medium Scale Enterprises	600
TOTAL	1200

3.4 Sample and Sampling technique

3.4.1 Sample Size

Cooper and Schindler (2003) describe sample or sample size as a subject of a population that is studied through a research study and generalized into the entire populations. The study will adopt a systematic sampling technique.

Sample size is important primarily 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 researcher will use the following formula;

$n = \frac{N}{k}$

Where; N= Total number of companies in any given sector

Kith item = Every tenth organisation selected in succession from N to form the sample. E.g. If the target population is 1200 firms divided by 10 = 120 respondents.

The respondent selected the first sample unit at random and then the remaining units will be automatically selected in a definite sequence of the 10th. Hence the respondents will be 120

Table 3.2 Sampling Frame and Sample Size

Type of Enterprises	Target population	Sample size 10%
Small Scale Enterprises	1000	100
Medium Scale Enterprises	600	60
TOTAL	1200	120

3.5 Data Collection Instruments

In data collection, the researcher should describe the major method(s) for collecting data from the subjects, Maxwell (2012). In this study the main data collection instruments will be the questionnaires. Questionnaire preferred because they are effective data collection instruments that allow respondents to give much of their opinions pertaining to the researched problem. The questionnaire to be used will be the five Likert scale (from strongly agree to strongly disagree). The questionnaires was self-administered to the personnel who handle taxes in the sampled taxpayers. The questionnaires had an introductory letter introducing the researcher to the respondents and explaining the purpose of the research.

Respondents will be strict confidentiality of the information they will use to share with the researcher and that the information is strictly for research purposes.

3.6 Data Collection Methods

Data collection instruments are tools or methods use to collect data from participants in a study (Cooper & Schindler, 2003). This study will rely on primary data. Primary data will use of questionnaires which was administered to the sampled respondents.

3.5.1 Primary Data

This study will use primary data collection through questionnaires. The questionnaires will be used because of its economy, its ability to ensure anonymity and use of standardized questions. It also provides time for subjects to think about responses. The questionnaire will be closed structured ended questions in the form of likert scale.

3.6 Data Collection Procedures

The relevant data will be collected from the field with the aid of a research assistant, as the questionnaires was distributed on a drop and pick later method to allow the respondents time to sufficiently go through them and give feedback.

3.7 Pilot Study

The study will be carried out a pilot test to pretest the validity and reliability of data collected using the questionnaire. A pilot group of 8 individuals from the target population will selected to test the reliability of the research instruments. The major purpose for pilot testing will be to test whether the questionnaires could obtain the required results. The pilot study will be used to find out the clarity and objectivity of the selected questions.

3.7.1 Reliability of Research Instruments

Reliability is increased by including many similar items on a measure, by testing a diverse sample of individuals and by using uniform testing procedures. In order to test the reliability of the instruments, internal consistency techniques will be carried using Cronbach's Alpha.

The alpha value ranges between 0 and 1 with reliability increasing with the increase in value. According to (Mugenda, 2008), a coefficient of 0.6-0.7 is a commonly accepted rule of thumb that indicates acceptable reliability and 0.8 or higher indicated good reliability.

3.7.2 Validity of Research Instruments

According to Berg and Gall (1989), validity is the degree by which the sample of test items represents the content of test is designed to measure.

3.8 Data Analysis and Presentation

Qualitative and quantitative approaches will be applied in this study as advocated for by Neuman (2000); and Babbie and Mouton (2001). These two main research approaches will be examined with respect to their suitability to the current research.

3.8.1 The Qualitative Analysis

Qualitative data will be collected through questionnaires and response rate calculated. The data will be then then categorized into different themes according to research variable and descriptive statistics such as mean, standard deviation and frequency distribution which according to Kothari (2012) measures the point about which items have a tendency to cluster and describe the characteristics of the data collected will be computed.

3.8.2 The Quantitative Analysis

Quantitative data from the questionnaire will be coded and entered into the computer for statistical analysis. The Statistical Package for Social Sciences (SPSS version 20) will be used for analysis. Frequencies, mean and standard deviation will be used to summarize the data.

Regression model will be used to assess variables that are considered in assessing the factors that influence taxation of the informal sector.

Regression Analysis is a statistical modeling technique will be used to identify meaningful, stable relationships among sets of data. The application of analytical procedures is based on the premise that, in the absence of known conditions to the contrary, relationships among information may reasonably be expected to exist.

Regression measures the causal relationship between one dependent and one independent variable. Multiple regression analysis measures the effects of multiple independent variables on one dependent variable.

The study will adopt a multi regression model

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$$

Where:

Y = Value Added Tax collection

β_0 = Constant Term

β_1 = Beta coefficients

X1 = Cost of compliance

X2 = Level of Tax knowledge

X3= Rate of tax

X4 = Penalties and Interest

ε = Error term

Table 3.2: Measurement of Variables

Variable	Indicators	Likert scale
Tax Compliance Cost	Cost of filling Cost of hiring a tax agent Cost of travelling	5 points
Level of tax knowledge	Declaration of income Keep records Payment of taxes	5 points
Rate of tax	Fair tax rate High rate low	5 points
Penalties and interest	Punitive interests and penalties Periodic waiver of interests and penalties Non-compliant penalties	5 points
VAT compliance		

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.0 Introduction

This chapter represents the analysis, presentation and interpretation of the findings. In addition the findings are also discussed in relation to literature reviewed. It gives the empirical findings and results following the application of the variables using the techniques mentioned in chapter three in methodology. The general objectives of this study were to establish the factors affecting Value Added Tax collection on small and medium enterprises in Nairobi CBD, Kenya. In an attempt to address the specific objectives of the study, this chapter provides details description of descriptive and inferential statistics and research findings and discussions.

4.1 Response Rates

Research's data collection instruments (questionnaires) were administered within a period of three weeks. Out of 160 questionnaires administered the researcher ensured a 97% response rate by personally administering the questionnaires with the help of research assistant. A total of 155 questionnaires were successfully completed and returned. Bailery, (2000) asserts that a response rate of 50 is considered good, and response greater than 70% is considered very good, therefore the response was very good. The findings are presented in Table 4.1.

Table 4.1: Response Rate

Response Rate	Frequency	Percent
Returned	155	97%
Unreturned	5	3%
Total	139	100

4.2 Reliability test results

Reliability is measure of the degree to which a research instrument yields consistent result after repeated trials (Mugenda & Mugenda, 2003). The results are depicted in tale 4.2 below.

Table 4.2: Reliability tests results

Constructs	Reliability Cronbach's alpha	Comment
Tax compliance cost	0.773	Accepted
Level of tax knowledge	0.831	Accepted
Rate of tax	0.781	Accepted
Penalties and interest	0.833	Accepted
Value Added Tax compliance	0.790	Accepted

The results of the reliability test produced an overall Cronbach Alpha correlation coefficient of 0.801 while specific findings indicated that, Tax compliance cost had a coefficient of 0.773, Level of tax knowledge had a coefficient of 0.831, Rate of tax had a coefficient of 0.781, Penalties and interest had a coefficient of 0.833 and Value Added Tax compliance had a coefficient of 0.790. Table 4.2 shows that all the study variables yielded Cronbach alpha coefficients values of more than 0.7, which is the recommended value. This indicates that the instrument was reliable to obtain data on determinants of residential rental income tax compliance by property owners.

4.3 Test of Assumptions of the Study Variables

When the assumptions of the linear regression model are correct, ordinary least squares (OLS) provides efficient and unbiased estimates of the parameters (Long & Ervin, 1998). To ensure that there was no violation of the assumptions, this study tested for multicollinearity, autocorrelation and normality test.

a) Multicollinearity

To determine whether multicollinearity existed, collinearity test was conducted using, tolerance, and variance inflation factor (VIF). The collinearity results are presented in Table 4.3.

Table 4.3: Multicollinearity Test Results for the study of independent variables

Model	Collinearity	Statistics
	Tolerance	VIF
Tax compliance cost	.806	1.136
Level of tax knowledge	.830	1.161
Rate of tax	.815	1.142
Penalties and interest	.749	1.231
Value Added Tax compliance	.870	1.133

a. Dependent Variable: Value Added Tax compliance

Table 4.3 shows that the variables have a VIF that is less than 10 and tolerance value more than 0.1 ruling out the possibility of multicollinearity. Therefore, the results imply that there was no multicollinearity problem among the variables.

b) Autocorrelation test

Autocorrelation was tested using Durbin Watson test. This tested whether there is a (linear) correlation between the error term for one observation and the next. A Durbin Watson test value (d) takes on values between 0 and 4. A value of $d = 2$ means there is no autocorrelation.

Table 4.4: Autocorrelation test

Model	Durbin-Watson
1	2.021

a. Predictors: (Constant), Tax compliance cost, Level of tax knowledge, Rate of tax, Penalties and interest

b. Dependent Variable: Value Added Tax compliance

Autocorrelation was tested using Durbin Watson test in Table 4.4. This tested whether there is a (linear) correlation between the error term for one observation and the next. A Durbin Watson test value (d) takes on values between 0 and 4. A value of $d = 2$ means there is no autocorrelation.

d) Normality test)

Normality was tested by use of The Shapiro-Wilk Test to test whether the score of the samples were normally distributed with the same mean and standard deviation. If the test is significant ($P < 0.05$) then the distribution is not significantly different from a normal distribution, but if the test is non – significant ($P > 0.05$) then the distribution of the sample is significantly different from a normal distribution (Kilungu et al., 2015). The results was significant.

Table 4.5: Tests of Normality

	Shapiro-Wilk		
	Statistic	df	Sig.
Tax compliance cost	.921	155	.193
Level of tax knowledge	.933	155	.233
Rate of tax	.942	155	.022
Penalties and interest	.934	155	.633

Normality was tested by use of Shapiro-Wilk test as shown in Table 4.5. The tests results showed that the p-values for the variables > 0.05 as shown in table above illustrating that the standardized residuals were significantly normally distributed.

4.4 Descriptive Statistics

4.4.1 Effect of Tax compliance cost on value added tax compliance

The study sought to establish the effect of tax compliance cost on value added tax compliance in Kenya. Specifically, the study focused on the cost of filling tax return, cost of hiring a tax agent and The cost of travelling in order to file a return. Descriptive statistics results for tax compliance cost were conducted and presented on table 4.6 below; -

Table 4.6 Tax compliance cost

Statement	SA	A	U	D	SD	Mean	SD
Cost of filing a tax return	47.1	46.3	3.2	1.1	0	1.8	0.5
The Cost of hiring a tax agent	25.3	58.2	12.8	1.8	0	1.6	0.6
The cost of travelling in order to file a return	14.5	25.2	44.7	12.1	3.3	2.9	1.3

The findings on the statement tax compliance tax of the cost of filing a tax return contributes to Value Added Tax compliance, 47.1 percent of the respondents strongly agreed, 46.3 percent of the respondents agreed, 3.2 percent of the respondents undecided and 1.1 percent of the respondents disagreed that the cost of filing a return contributes to Value added tax compliance. This show that majority of the respondents agreed that the cost of filing a return contributes to Value added tax compliance. Regarding the statement on the cost of hiring a tax agent contributes to Value added tax , 25.3 percent of the respondents strongly agreed, 58.2 percent of

the respondents agreed, 12.8 percent of the respondents undecided and 1.8 percent of the respondents disagreed respectively that the cost of hiring a tax agent contributes to Value added tax compliance. These shows that majority of the respondents agreed to the statement that the cost of hiring a tax agent contributes to Value added tax compliance.

Regarding the statement of the cost of travelling in order to file a return , 14.5 percent of the respondents strongly agreed, 25.2 percent of the respondents agreed, 44.7 percent of the respondents undecided and 12.1 percent of the respondents disagreed and 3.3 percent of the respondents strongly disagreed respectively that the cost of travelling in order to file a return . This shows that the majority of the respondents were undecided to the statement that the the cost of travelling in order to file a return .

Table 4.6 the highest mean value was 2.9 which corresponds to the scale value of 3 in the questionnaire an indication that the respondents were indifferent on whether that the cost of travelling in order to file a return . On average, the results indicate that the tax compliance cost influences Value added tax compliance respectively.

Tax compliance cost was assessed using five measures and the overall mean score or responses regarding capital allowance were 2.2 on a 5-point scale which indicates that majority of the respondents agreed that tax compliance cost affects the Value added tax compliance in Kenya.

The average overall standard deviation of 0.72 infers that 68% of the response was spread within one standard deviation of the overall mean. The standard deviation statistical rule of 68%, 95% and 99.7% applies in all the interpretations in the rest of the documents. This means that one standard deviations has 68% of the data spread around the mean and 95% for two standard deviations and 99.7% for three standard deviation. The study findings are supported by a number of studies which includes (Franzoni, 2000)

4.4.2 Effect of Level of tax knowledge on Value Added Tax compliance

The study sought to establish the effect of tax amnesty on rental revenue collection in Kenya. Specifically, the study focused on the self-assessment and amended returns. Descriptive statistics results for tax amnesty were conducted and presented on table 4.7 below

Table 4.7 Level of tax knowledge

Statement	SA	A	U	D	M	Sd
Small and Medium sized entrepreneurs have adequate knowledge on tax rate, basis of taxation and compliance requirements.	36.3	53.2	7.5	0	1.7	0.6
Knowledge about tax declaration of income role in determining Small and Medium sized entrepreneurs tax compliance	29.1	56.6	13.6	1.7	1.9	0.7
KRA has created a lot of public awareness on payment of taxes Value Added tax compliance.	30.5	76.1	3.4	0	1.2	0.5

The findings on the statement Small and Medium sized entrepreneurs have adequate knowledge on tax rate, basis of taxation and compliance requirements on Value added tax compliance, 36.2 percent of the respondents strongly agreed, 53.2 percent of the respondents agreed, 7.5 percent of the respondents undecided and none of the respondents disagreed respectively that Small and Medium sized entrepreneurs have adequate knowledge on tax rate, basis of taxation and compliance requirements. This show that majority of the respondents agreed Small and Medium sized entrepreneurs have adequate knowledge on tax rate, basis of taxation. Regarding the statement on the Knowledge about tax laws plays a major role in determining Small and Medium sized entrepreneurs tax compliance , 29.1 percent of the respondents strongly

agreed, 56.6 percent of the respondents agreed, 13.6 percent of the respondents undecided and 1.7 percent of the respondents disagreed respectively that the . These shows that majority of the respondents agreed to the statement that the Knowledge about tax laws plays a major role in determining Small and Medium sized entrepreneurs tax compliance. Regarding the KRA has created a lot of public awareness on Value Added tax compliance, 39 percent of the respondents strongly agreed, 54.2 percent of the respondents agreed, 5.1 percent of the respondents undecided and 1.7 percent of the respondents disagreed KRA has created a lot of public awareness on Value Added tax compliance.

This shows that the majority of the respondents agreed to the statement that the KRA has created a lot of public awareness on Value Added tax compliance. On average, the results indicate that the Level of tax knowledge influences Value Added tax compliance. Level of tax knowledge was assessed using five measures and the overall mean score or responses regarding tax amnesty were 1.66 on a 5-point scale which indicates that majority of the respondents agreed that level of tax knowledge affects the Value added tax compliance.

The average overall standard deviation of 0.6 infers that 68% of the response was spread within one standard deviation of the overall mean. The standard deviation statistical rule of 68%, 95% and 99.7% applies in all the interpretations in the rest of the documents. This means that one standard deviations has 68% of the data spread around the mean and 95% for two standard deviations and 99.7% for three standard deviation. The study findings are supported by a number of studies which includes (Fjeldstad and Ranker 2003). Kimingu and Kileva (2007)

4.4.3 Effect of rate of tax on Value Added tax compliance

The study sought to establish the effect of tax rate on Value Added tax compliance in Kenya. Descriptive statistics results for Rate of tax on value added tax compliance was conducted and presented on table 4.8 below

Table 4.8 Tax rate

Statement	SA	A	U	D	M	Sd
Value added tax rate is fair to Small and Medium sized entrepreneurs	39.3	52.2	9.5	0	1.8	0.9
Small and Medium sized entrepreneurs are now willingly paying tax due high tax rate	30.1	57.6	13.6	1.7	1.6	0.9
The computation of tax on proceeds is simple for Small and Medium sized entrepreneurs to apply due to low rate	35.5	29	3.4	0	1.4	0.6

The findings on the statement Value added tax rate is fair to Small and Medium sized entrepreneurs, 39.3 percent of the respondents strongly agreed, 52.2 percent of the respondents agreed, 9.5 percent of the respondents undecided and 1.8 percent of the respondents disagreed respectively that Value added tax rate is fair to Small and Medium sized entrepreneurs. This show that majority of the respondents agreed that Value added tax rate is fair to Small and Medium sized entrepreneurs. Regarding the statement on the Small and Medium sized entrepreneurs are now willingly paying tax due to the well-structured tax rate, 30.1 percent of the respondents strongly agreed, 57.6 percent of the respondents agreed, 13.6 percent of the respondents undecided and 1.7 percent of the respondents disagreed respectively that the Small and Medium sized entrepreneurs are now willingly paying tax due to the well-structured tax rate . These shows that majority of the respondents agreed to the statement that the Small and Medium sized entrepreneurs are now willingly paying tax due to the well-structured tax rate. Regarding the statement of the computation of tax on proceeds is simple for Small and Medium sized entrepreneurs to apply, 35.5 percent of the respondents strongly agreed, 29 percent of the respondents agreed, 3.4 percent of the respondents undecided computation of tax on proceeds is simple for Small and Medium sized entrepreneurs to apply .

Table 4.8 the highest mean value was 1.8 which corresponds to the scale value of 2 in the questionnaire an indication that the respondents were indifferent on whether the computation of tax on gross rental proceeds is simple for property owners to apply. On average, the results indicate that the tax rate influences Value added tax compliance in Kenya.

Tax rate was assessed using five measures and the overall mean score or responses regarding tax rates were 2.5 on a 5-point scale which indicates that majority of the respondents agreed that tax rate affects the residential rental income tax compliance by property owners in Kenya.

The average overall standard deviation of 0.8 infers that 68% of the response was spread within one standard deviation of the overall mean. The standard deviation statistical rule of 68%, 95% and 99.7% applies in all the interpretations in the rest of the documents.

This means that one standard deviations has 68% of the data spread around the mean and 95% for two standard deviations and 99.7% for three standard deviation. The study findings are supported by a number of studies which includes (Kaldor, 1956).

4.4.4 Effect of Penalties and interest on Value Added tax compliance

The study sought to establish the effect of penalties and interest on Value Added tax compliance in Kenya. Descriptive statistics results for Penalties and interest on value added tax compliance was conducted and presented on table 4.8 below;

Table 4.8 Penalties and interest

Statement	SA	A	U	D	M	Sd
Interests and penalties are very punitive to business owners	37.3	52.2	9.5	0	1.9	0.9
Periodic waiver of fines and penalties could encourage tax compliance	30.1	57.6	13.6	1.7	1.6	0.9

Small and Medium sized entrepreneurs file returns on time to avoid penalties of non-compliance on the iTax system	35.5	29	3.4	0	1.4	0.6
---	------	----	-----	---	-----	-----

The findings on the statement Interests and penalties are very punitive to business owners , 37.3 percent of the respondents strongly agreed, 52.2 percent of the respondents agreed, 9.5 percent of the respondents undecided respectively that Interests and penalties are very punitive to business owners . This show that majority of the respondents agreed that Interests and penalties are very punitive to business owners. Regarding the statement on the Periodic waiver of fines and penalties could encourage tax compliance, 30.1 percent of the respondents strongly agreed, 57.6 percent of the respondents agreed, 13.6 percent of the respondents undecided and 1.7 percent of the respondents disagreed respectively that the Periodic waiver of fines and penalties could encourage tax compliance. These shows that majority of the respondents agreed to the statement that the Periodic waiver of fines and penalties could encourage tax compliance.

Regarding the statement of the Small and Medium sized entrepreneurs file returns on time to avoid penalties of non-compliance on the iTax system , 35.5 percent of the respondents strongly agreed, 29 percent of the respondents agreed, 3.4 percent of the respondents undecided that Small and Medium sized entrepreneurs file returns on time to avoid penalties of non-compliance on the iTax system.

Table 4.8 the highest mean value was 1.9 which corresponds to the scale value of 2 in the questionnaire an indication that the respondents were indifferent on whether Interests and penalties are very punitive to business owners . On average, the results indicate that the penalties and interest influences Value added tax compliance in Kenya.

Tax rate was assessed using five measures and the overall mean score or responses regarding tax rates were 2.5 on a 5-point scale which indicates that majority of the respondents agreed that tax rate affects the residential rental income tax compliance by property owners in Kenya.

The average overall standard deviation of 0.8 infers that 68% of the response was spread within one standard deviation of the overall mean. The standard deviation statistical rule of 68%, 95% and 99.7% applies in all the interpretations in the rest of the documents.

This means that one standard deviations has 68% of the data spread around the mean and 95% for two standard deviations and 99.7% for three standard deviation. The study findings are supported by a number of studies which includes (Kaldor, 1956).

4.5 Correlation Analysis

4.5.1 Correlation results on independent variables

Correlation shows the relationship existing between variables in the study. The study's dependent variable is Value Added tax compliance and the independent variables consist of tax compliance cost, level of tax knowledge, tax rate and penalties and interest,.

The results depicted in table 4.9 below

Table 4.9: Correlation between independent variable and dependent variable

Variables		Value added tax compliance	Tax compliance cost	Level of tax knowledge	Tax rate	Penalties and interest
Value Added Tax Compliance	Pearson Correlation	1				
	Sig. (2-tailed)					
Tax compliance cost	Pearson Correlation	0.456	1			
	Sig. (2-tailed)	0.002				
Level of tax knowledge	Pearson Correlation	0.431	.3421	1		
	Sig. (2-tailed)	0.001	.0014			
Tax rate	Pearson Correlation	0.458	.1240	.0621	1	
	Sig. (2-tailed)	0.003	.0120	.0043		
Penalties and interest	Pearson Correlation	0.431,	.3120	.0000	.1310	1
	Sig. (2-tailed)	0.000	.0031	1.000	.0031	

In an attempt to show the relationship between the study variables and their findings the study used the Karl Pearson's coefficient of correlation (r). According to the findings as indicated in table 4.9, it was clear that there was a positive correlation between Value added tax compliance and tax compliance cost as depicted by a correlation value of 0.456. This implies that tax compliance cost was linearly related to value added tax compliance. The study also depicted that there is a positive correlation between level of tax knowledge and Value added tax compliance with a correlation value of 0.431. Another positive correlation was between Tax rate and Value added tax compliance with a correlation value of 0.458 and a positive correlation between penalties and interest and Value added tax compliance with a correlation value of 0.431. This shows that there was a positive correlation between tax compliance cost, level of tax knowledge, tax rates and penalties and interest and Value added tax compliance. The findings of this study agreed with the study conducted by (Kaldor, 1956).

4.6 Regression Analysis

A multiple regression analysis was conducted to investigate the joint causal relationship between the independent variables and dependent variable rental revenue collection. This is represented by the overall model $Y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \epsilon$...

The coefficient of multiple determinants denoted by R Squares is a measure of proportion of the variation of the regress and explained and by the corresponding explanatory variables. The values of R squared lies between zero and unity, $0 < R^2 < 1$. A value of unity implies that 100% of the variation of Y has been explained by the explanatory variables.

a) Tax compliance cost

To evaluate the effect Tax compliance cost and Value added tax compliance in Kenya.

Table 4.10: Model Summary of Tax compliance cost

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.437 ^a	.197	.186	.87526	1.987

a. Predictors: (Constant), Tax compliance cost

b. Dependent Variable: Value added tax compliance

The R square value in table 4.10 in this case is 0.197 which clearly suggests that there is a strong relationship between Tax compliance cost and Value added tax compliance as indicated in table above. This indicates that Tax compliance cost share a variation of 19.7% of Value added tax compliance.

Table 4.11: ANOVA of Tax compliance cost

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.892	1	10.892	14.162	.000 ^b
	Residual	42.767	154	.767		
	Total	54.648	155			

a. Dependent Variable: Value added tax compliance

b. Predictors: (Constant), Tax compliance cost

The ANOVA result in Table 4.11 showed that the overall model was a good fit since (F-value =14.162 and p-value=0.000<0.05).

Table 4.12: Coefficients of Tax compliance cost

Model		Unstandardized		Standardized		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	.258	.115	-	2.257	.028
	Capital tax allowance	.403	.107	.446	3.765	.000

a. Dependent Variable: Value added tax compliance

Table 4.12 indicates that the regression weight for tax compliance cost was positive and significant ($\beta = 0.403$, $t = 3.765$, $p < .05$). Therefore, the null hypothesis was rejected at $P < 0.05$ level of significance implying that tax compliance cost has a significant relationship with value added tax compliance. The regression estimate for tax compliance cost was 0.403; this indicates that a unit increase in tax compliance cost would result in 40.3% increase in value added tax compliance

b) Level of tax knowledge

To find out the effect of Level of tax knowledge on value added tax compliance in Kenya.

Table 4.13: Model Summary of Level of tax knowledge

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.478 ^a	.217	.207	.85515	2.006

a. Predictors: (Constant), Level of tax knowledge**b. Dependent Variable: Value added tax compliance**

The R square value in Table 4.13 was 0.217 which clearly suggested that there is a strong relationship between Level of tax knowledge and Value added tax compliance. This indicates that level of tax knowledge share a variation of 21.7% of value added tax compliance.

Table 4.14: ANOVA of level of tax knowledge

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.886	1	11.987	16.033	.000 ^b
	Residual	42.643	154	.749		
	Total	54.648	155			

a. Dependent Variable: Value added tax compliance

b. Predictors: (Constant), Level of tax knowledge

The ANOVA Table in 4.14 indicates that the overall model was a good fit since (F-value=16.033 and p-value=0.000<0.05).

Table 4.15: Coefficients of Level of tax knowledge

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.221	.104	-	2.041	.047
	Level of tax knowledge	.451	.114	.468	4.001	.000

a. Dependent Variable: Value added tax compliance

Table 4.15 indicates that the regression weight for level of tax knowledge was positive and significant ($\beta = 0.451$, $t = 4.001$, $p < .05$). Therefore, the null hypothesis was rejected at $P < 0.05$ level of significance implying that level of tax knowledge has a significant relationship with value added tax compliance. The regression estimate for level of tax knowledge was 0.451; this indicates that a unit increase in level of tax knowledge would result in 45.2% increase in value added tax compliance in Kenya.

c) Tax rate

To investigate the effect of tax rate on value added tax compliance in Kenya.

Table 4.16: Model Summary of Tax rate

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
-------	---	----------	-------------------	----------------------------	---------------

1	.421 ^a	.174	.170	.87898	1.995
---	-------------------	------	------	--------	-------

a. Predictors: (Constant), Tax rate

b. Dependent Variable: Value added tax compliance

The R square value in Table 4.16 is 0.174 which clearly suggests that there is a strong relationship between Tax rate and Value added tax compliance as indicated in table above. This indicates that Tax rate share a variation of 17.4% of Value added tax compliance.

Table 4.17: ANOVA of Tax rate

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.617	1	10.608	11.732	.00 ^b
	Residual	44.035	154	.754		
	Total	54.647	155			

a. Dependent Variable: Value added tax compliance

b. Predictors: (Constant), tax rate

The ANOVA able in 4.17 indicates that the overall model was a good fit since (F-value=11.732 and p-value=0.000<0.05).

Table 4.18: Coefficients of tax rate

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	.258	.115	-	2.235	.028
	Tax rate	.408	.108	.442	3.708	.000

a. Dependent Variable: Value added tax compliance

Table 4.18 indicates that the regression weight for Tax rate was positive and significant ($\beta=0.408$, $t=3.708$, $p < .05$). Therefore, the null hypothesis was rejected at $P < 0.05$ level of significance implying that Tax rate has a significant relationship with Value added tax compliance in Kenya. The regression estimate for Tax rate was 0.408 this indicates that a unit increase in Tax rate would result in 40.5% increase in Value added tax compliance in Kenya. .

d) Penalties and interest

To evaluate the effect Penalties and interest and Value added tax compliance in Kenya.

Table 4.10: Model Summary of penalties and interest

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.447 ^a	.199	.187	.89526	1.977

a. Predictors: (Constant), Penalties and interest

b. Dependent Variable: Value added tax compliance

The R square value in table 4.10 in this case is 0.199 which clearly suggests that there is a strong relationship between penalties and interest and Value added tax compliance as indicated in table above. This indicates that penalties and interest share a variation of 19.9% of Value added tax compliance.

Table 4.11: ANOVA of Penalties and interest

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.892	1	11.892	12.162	.000 ^b
	Residual	40.767	154	.867		
	Total	52.648	155			

a. Dependent Variable: Value added tax compliance

b. Predictors: (Constant), Penalties and interest

The ANOVA result in Table 4.11 showed that the overall model was a good fit since (F-value =12.162 and p-value=0.000<0.05).

Table 4.12: Coefficients of Penalties and interest

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	.268	.114	-	2.259	.027
	Capital tax allowance	.404	.108	.444	3.865	.000

a. Dependent Variable: Value added tax compliance

Table 4.12 indicates that the regression weight for penalties and interest was positive and significant ($\beta = 0.404$, $t = 3.865$, $p < .05$). Therefore, the null hypothesis was rejected at $P < 0.05$ level of significance implying that penalties and interest has a significant relationship with value added tax compliance. The regression estimate for capital allowance was 0.403; this indicates that a unit increase in capital tax allowance would result in 40.4% increase in Value added tax compliance.

Table 4.19: Model Summary for independent and dependent variables

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.707 ^a	.505	.453	.71722	2.001

a. Predictors: (Constant), Tax compliance cost, level of tax knowledge, tax rate and penalties and interest

b. Dependent Variable: Value added tax compliance

From the model summary The R square value in Table 4.19 is 0.502 which clearly suggests that there is a strong relationship between tax compliance cost, level of tax knowledge, tax rate, penalties and interest and value added compliance as indicated in table above. This indicates that tax compliance cost, level of tax knowledge, tax rate, penalties and interest share a variation of 50.5% of value added tax compliance in Kenya .

The overall goodness of fit was obtained through regressing the goodness of fit for all the independent variables. The results of the multiple regression indicate $R^2 = .505$ and adjusted $R = .453$ as shown in Table 4.19. This is an indication that there is a strong relationship between independent variables and value added tax compliance.

Table 4.19: ANOVA for independent and dependent variables

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	28.376	1	5.466	11.338	.000 ^b
	Residual	28.262	155	.513		
	Total	45.629	155			

a. Dependent Variable: Value added tax compliance

b. Predictors: (Constant), Tax compliance cost, level of tax knowledge, tax rate, penalties and interest

The overall model significance was presented using the ANOVA test table. The results in Table 4.19 shows that the overall model was a good fit since (F-value=11.338 and p-value=0.000<0.05) for all independent variables meaning that null hypothesis is rejected and concludes that there is a relationship between different independent and dependent variables. The findings there imply that all independent variables were statistically significant in explaining Value added tax compliance in Kenya. ANOVA was used to test whether the regression analysis model used is fit or the relationship of the variable just occurred by chance. Significance of F ratio is used to determine whether model used was fit or not. If the F ratio is significant the model used is considered fit and vice versa. A P - value of less than 0.05 indicates that the F statistics is high and that the null hypothesis of independent needs to be rejected since it's not true. In this case the F ratio (F=11.338, P=.000^b) was found to be significant hence the model used for analysis was fit

Table 4.20: Coefficients of Overall Regression Model

Model		Unstandardized		Standardized		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	.195	.096	-	2.054	.044
	Tax compliance cost	.312	.096	.234	2.266	.016
	Level of tax knowledge	.241	.098	.355	3.560	.043
	Tax rate	.296	.096	.314	3.061	.022
	Penalties and interest	.315	.096	.244	2.366	.014

a. Dependent Variable: Value added tax compliance

$$Y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \varepsilon \dots \dots \dots$$

$Y = 0.195 + 0.312X_1 + 0.241X_2 + 0.296X_3 + 0.315$ were significant with p- values of 0.044, 0.016, 0.043 + 0.014, respectively.

The regression equation above has established that taking all factors into account (tax compliance cost, level of tax knowledge, tax rate and penalties and interest) the findings reveals that assuming other variables are at zero a unit change (increase) in tax compliance cost will lead to a 0.312 increases value added tax compliance; a unit increase in level of tax knowledge will lead to a 0.241 increases value added tax compliance; a unit increase in tax rate will lead to a 0.296 increases value added tax compliance and a unit increase in penalties and interest will lead to a 0.315 increases value added tax compliance as shown in table 4.20. This infers that penalties and interest influences value added tax compliance to a great extent followed by tax compliance cost then tax rate while level of tax knowledge influence to a little extent value added tax compliance

The regression coefficient results indicate a positive significant effect between tax compliance cost, level of tax knowledge, tax rate, penalties and interest and value added tax compliance.

4.7 Discussion of key Findings

The key findings of the study are discussed in this section as per study objectives.

4.7.1 Tax compliance cost and Value added tax compliance

Tax compliance cost was assessed using five measures and the overall mean score or responses regarding tax compliance cost were 2.2 on a 5-point scale which indicates that majority of the respondents agreed that tax compliance cost on value added tax compliance in Kenya. The average overall standard deviation of 0.7 infers that 68% of the response was spread within one standard deviation of the overall mean. Further collinearity analysis was done and the results showed that tax compliance cost had positive and significantly related to value added tax compliance ($r = 0.456$, $p\text{-value}=0.00<0.05$).

4.7.2 Level of tax knowledge and Value added tax compliance

Level of tax knowledge was assessed using five measures and the overall mean score or responses regarding level of level of tax knowledge were 1.6 on a 5-point scale which indicates that majority of the respondents agreed that level of tax knowledge affects the Value added tax compliance in Kenya. The average overall standard deviation of 0.0.66 infers that 68% of the response was spread within one standard deviation of the overall mean. Further collinearity analysis was done and the results revealed that Level of tax knowledge had a positive and significantly related to value added tax compliance ($r = 0.431$, $p\text{-value}=0.00<0.05$).

4.7.3 Tax rate and Value added tax compliance

Tax rate was assessed using four measures and the overall mean score or responses regarding tax rate were 2.5 on a 5-point scale which indicates that majority of the respondents agreed that

tax rate affects the value added tax compliance in Kenya. The average overall standard deviation of 0.74 infers that 68% of the response was spread within one standard deviation of the overall mean. Further collinearity analysis was done and the results showed that tax rate had a positive and significantly related to value added tax compliance ($r = 0.458$, $p\text{-value}=0.00<0.05$).

4.7.4 Penalties and interest and Value added tax compliance

Penalties and interest was assessed using five measures and the overall mean score or responses regarding penalties and interest were 1.6 on a 5-point scale which indicates that majority of the respondents agreed that level of tax knowledge affects the Value added tax compliance in Kenya. The average overall standard deviation of 0.0.66 infers that 68% of the response was spread within one standard deviation of the overall mean. Further collinearity analysis was done and the results revealed that penalties and interest had a positive and significantly related to value added tax compliance ($r = 0.431$, $p\text{-value}=0.00<0.05$).

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

Chapter five outlines the summary of this research, conclusions and recommendations based on research findings and suggestion of areas which may require further consideration as far as future research is concerned.

5.1 Summary of the findings

The findings of the study have been summarized below as per the study objectives. The findings were supported by the frequencies of the responses

5.1.1 Tax compliance cost

The first objective of the study was to evaluate the effect of tax compliance cost on value added tax in Kenya. Methods used to arrive at the findings included descriptive statistics, analysis of variance and regression analysis. The study found out that tax compliance cost had a significant positive influence on value added tax. The overall mean score of responses regarding tax compliance cost indicated that majority of the respondents agreed that tax compliance cost affects the value added tax compliance in Kenya.

The reliability analysis results showed that all the coefficients of the constructs were positive and significant.

5.1.2 Level of tax knowledge

The second objective of the study sought to find out` the effect of level of tax knowledge on value added tax compliance in Kenya. Descriptive statistics, regression analysis and analysis of

variance were conducted. The study found out that level of tax knowledge had a significant positive influence on value added tax compliance.

The overall mean score of response regarding level of tax knowledge and value added tax compliance collection indicated that majority of the respondents agreed that level of tax knowledge affects the value added tax in Kenya. Correlation results indicated that there was a positive and significant relationship between level of tax knowledge and value added tax collection. It was therefore concluded that level of tax knowledge has significant positive effect on value added tax compliance.

5.1.3 Tax rate

The third objective of the study sought to investigate the effect of tax rate on value added tax compliance in Kenya. Descriptive statistics, regression analysis and analysis of variance were conducted. The study found out that tax rate had a significant positive influence on value added tax compliance.

The overall mean score of response regarding tax rate and value added tax compliance indicated that majority of the respondents agreed that tax rate affects the value added tax compliance in Kenya. Correlation results indicated that there was a positive and significant relationship between tax rate and value added tax compliance. It was therefore concluded that tax rate has significant positive effect on value added tax compliance.

5.2 Conclusions

The aim of the study was to determine effect of factors affect value added tax compliance in Kenya. Data collected and analysed through both descriptive and inferential statistics established that all independent variables had significant effects on value added tax compliance.

5.2.1 Tax compliance cost

The study found out that tax compliance cost had a significant positive influence on value added tax compliance. The overall mean score of responses regarding tax compliance cost indicated that majority of the respondents agreed that tax compliance cost affects the value added tax compliance in Kenya. The reliability analysis results showed that all the coefficients of the constructs were positive and significant.

5.2.2 Level of tax knowledge

The study found out that level of tax knowledge had a significant positive influence on value added tax compliance. The overall mean score of response regarding level of knowledge and value added tax compliance indicated that majority of the respondents agreed that level of tax knowledge affects the value added tax compliance in Kenya. Correlation results indicated that there was a positive and significant relationship between level of tax knowledge and value added tax compliance. It was therefore concluded that level of tax knowledge has significant positive effect on value added tax compliance.

5.2.3 Tax rate

The study found out that tax rate had a significant positive influence on value added tax compliance. The overall mean score of response regarding tax rate and penalties and interest indicated that majority of the respondents agreed that tax rate affects the value added tax compliance in Kenya. Correlation results indicated that there was a positive and significant relationship between tax rate and value added tax compliance. It was therefore concluded that tax rate has significant positive effect on value added tax compliance. 5.2.4 Penalties and interest

The study found out that penalties and interest had a significant positive influence on value added tax compliance. The overall mean score of response regarding penalties and interest and

penalties and interest indicated that majority of the respondents agreed that penalties and interest affects the value added tax compliance in Kenya. Correlation results indicated that there was a positive and significant relationship between penalties and interest and value added tax compliance. It was therefore concluded that penalties and interest has significant positive effect on value added tax compliance.

5.3 Recommendations.

5.3.1 Managerial recommendations

The study found that Tax compliance cost, penalties and interest and tax rate significantly influences value added tax compliance. Based on study finding, this study recommends there is need for effective cost management when administering tax. Reduction in cost of compliance will increase the number of registered traders which will increase VAT Collection.

Kenya revenue Authority should offer on a regular basis technical support to traders which will help them familiarise with tax systems in order to facilitate collection of VAT. Technical support will help traders reduce the transaction time in serving their clientele and transparency in service delivery. There is also need for training of traders from system developers on a regular basis in order to help the taxpayer in filing and paying of VAT.

The management of Kenya Revenue Authority should be frequently organising workshops and seminars whereby they will be training the traders on proper use of tax systems in order to facilitate collection of VAT. The traders must have sufficient training in order to fully deploy use of tax systems to facilitate VAT collection.

5.3.2 Policy recommendations

The study further established that Tax rate encourage compliance with Value added tax compliance. The study therefore recommends that the tax authority in Kenya (KRA) should reduce tax rates to encourage tax compliance Value added tax

5.4 Suggestions for Further Research

This study recommends a similar study, which incorporates the views of the tax authority in Kenya to establish the factors behind value added tax collection.

The study recommends an additional study on the other factors that influence value added tax compliance of SMEs.

REFERENCES

- Brondolo, J. (2009). *Collecting taxes during an economic crisis: challenges and policy options* International Monetary Fund, Fiscal Affairs Department.
- Chattopay, S. & Arindam D. G. (2002). *The compliance cost of the personal income tax determinant*, National institute of Public Finance and Policy, New Delhi.
- DAC (2008). *Governance, taxation and accountability: issues and practices*, OECD Government of Kenya. *Income Tax Act, Cap 470, Government of Kenya.*
- De Mello, L., (2008). *Avoiding the Value Added Tax: theory and Cross Country Evidence*. OECD Working papers 10(406).
- Harold, C. (2011). *How to get plugged into electronic tax filing*. RETRsieved on March 15, 2011, from <http://www.questia.com/googlescholar.qst?docId=5000127924> 36.
- Kathuri, B. (2006). *Traders Oppose ETRS Dateline*, Financial Standard, June 20th, 2006, Standard Group Kenya.
- Laporta, R. & Schleiffer, J. (2008). *Participation in tax amnesties: The individual income tax*. National Tax Journal, 42(2), 15-27.
- Lavoie, R. (2008). *Cultivating a compliance culture: An alternative approach for addressing the tax gap*. University of Akron research paper no. 08-05.
- Levi, M. (1998). *Of Rule and Revenue*, Berkeley: University of California Press.
- Lumumba, O., Wanjohi, M. S., Magutu, O., Mokoro, J. (2010). *Taxpayers' attitudes and tax compliance behaviour in Kenya: How the Taxpayers' Attitudes Influence Compliance, Behavior among SME's Business Income Earners in Kerugoya Town, Kirinyaga District*.
- Manly, T.S., Thomas, D.W and Ristema, C.M. (2005). *Attracting non-filers through amnesty programmes*. Journal of American Taxation Association, 27, 75-95.
- Mohammed, H. K., & Gela, Z. D. (2014). *Challenges of Electronics Tax Register Machine (ETRSS) to Businesses and its Impact in Improving Tax Revenue*. International Journal of Scientific Knowledge, 5 (3). 17-22.
- Morse G, Williams D. D, (2000). *Principles of tax law, (4th edition)*. Sweet and Maxwell Publishers, New York, USA.

