

**DETERMINANTS OF TAX COMPLIANCE IN THE INFORMAL SECTOR IN KENYA:
A CASE STUDY OF SMALL AND MEDIUM ENTERPRISES IN MACHAKOS
COUNTY**

JANET CHEROP

**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 the Postgraduate Diploma in Tax Administration at Jomo Kenyatta University of
Agriculture and Technology**

2020

DECLARATION

This research Project is my original work and has not been presented for a degree in any other university.

Signature.....

Date.....

JANET CHEROP

REG NO. HDB336-C016-4080/2016

I confirm that this work was carried out under my supervision and has been submitted for defense with my approval as the University Supervisor.

Signature.....

Date.....

Madam Emma Kithinji

DEDICATION

I take this opportunity to thank God for bringing me this far. I want to appreciate my lovely family members, for being there during this difficult time. May the Lord bless them for their patience and support

ACKNOWLEDGEMENT

I wish to acknowledge my heartfelt thanks to my supervisor Madam Emma Kithinji for her support and undivided attention to ensure the quality of my work was unquestionable. Her comments feedback and criticisms have greatly improved the quality of this work. I am grateful to my supervisor and my colleagues for sharing and inspiring through shared knowledge and life experience.

TABLE OF CONTENTS

DECLARATION.....	ii
DEDICATION.....	iii
ACKNOWLEDGEMENT.....	iv
LIST OF TABLES.....	viii
LIST OF FIGURES.....	ix
ABBREVIATIONS/ACRONYMS.....	x
DEFINITIONS OF TERMS.....	xi
CHAPTER ONE.....	1
INTRODUCTION.....	1
1.1 Background of the Study.....	1
1.1.1 Tax Compliance.....	2
1.1.2 Machakos County.....	4
1.2 Problem statement.....	5
1.3 Objectives of the Study.....	6
1.3.1 General objective.....	6
1.3.2 Specific objectives.....	6
1.4 Research questions.....	6
1.5 Significance of the study.....	7
1.5.1 Kenya Revenue Authority.....	7
1.5.2 Policy makers.....	7
1.5.3 The County Government.....	7
1.5.4 Academicians.....	7
1.6 Scope of the study.....	7
CHAPTER TWO.....	9
LITERATURE REVIEW.....	9
2.1 Introduction.....	9
2.2 Theoretical review.....	9
2.2.1 Allingham and Sandom Model.....	9
2.2.2 Pecking Order Theory.....	10
2.2.3 Institutional Anomie Theory.....	10

2.3 Empirical Reviews.....	11
2.3.1 Tax Awareness.....	11
2.3.2 Tax Rate.....	12
2.3.3 Compliance Costs.....	14
2.4 Conceptual Framework.....	15
2.5 Critique of Existing Literature.....	16
2.6 Summary of literature review.....	17
2.7 Research Gaps.....	17
CHAPTER THREE.....	19
RESEARCH METHODOLOGY.....	19
3.1 Introduction.....	19
3.2 Research design.....	19
3.3 Target population.....	19
3.4 Sampling frame.....	20
3.5 Sample and sampling technique.....	20
3.6 Research instruments.....	21
3.7 Data collecting procedure.....	21
3.8 Pilot testing.....	21
3.8.1 Validity of the Instruments.....	22
3.8.2 Reliability of the Instruments.....	22
3.9 Data Processing & Analysis.....	22
3.9.1 Model.....	23
3.10 Ethical Considerations.....	23
CHAPTER FOUR.....	24
RESEARCH FINDING AND DISCUSSION.....	24
4.1 Introduction.....	24
4.2. Response Rate.....	24
4.3 Gender of respondents.....	24
4.4 Age of respondents.....	25
4.5 Education Level of respondents.....	25
4.6 Descriptive statistics.....	26

4.6.1 Tax Awareness	26
4.6.2 Tax Rate	27
4.6.3 Compliance Cost	28
4.6.4 Tax Compliance	29
4.7 Correlation Results	30
4.8 Regression Analysis.....	31
4.8.1 Model summary	32
4.8.2 Analysis of variance	32
CHAPTER FIVE.....	35
SUMMARY, CONCLUSION AND RECOMMENDATIONS.....	35
5.1 Introduction.....	35
5.2 Summary of the findings.....	35
5.2.1 Tax Awareness	35
5.2.2 Tax Rate	35
5.2.3 Compliance Cost	36
5.3 Conclusion	36
5.3.1 Tax Awareness	36
5.3.2 Tax Rate	36
5.3.3 Compliance Cost	36
5.4 Recommendations	36
5.4.1 Tax Awareness	36
5.4.2 Tax Rate	37
5.4.3 Compliance Cost	37
5.5 Suggestions for Further Research.....	37
REFERENCECS.....	38
APPENDICES.....	44
APPENDIX A: QUESTIONNAIRES	44
SECTION 1	44
SECTION 2	44

LIST OF TABLES

Table 3.1: Target population.....	26
Table 3.2: Sampling frame	27
Table 4.1: Response rate	32
Table 4.2: Gender	33
Table 4.3: Ages	34
Table 4.4: Level of education.....	34
Table 4.5: Tax Awareness.....	35
Table 4.6: Tax Rates	36
Table 4.7: Compliance cost.....	37
Table 4.8: Tax Compliance.....	38
Table 4.9: Correlation Analysis	39
Table 4.10: Regression Model Parameters	40
Table 4.11: Analysis of Variance of the Regression	40
Table 4.12: Significance of Independent Variables	41

LIST OF FIGURES

Figure 2.1: Conceptual Framework.....16

ABBREVIATIONS/ACRONYMS

ANOVA	Analysis of Variance
CBD	Central Business District
GDP	Gross domestic Product
KRA	Kenya Revenue Authority
SMEs	Small and Medium-Sized Enterprises
SPSS	Statistical Package for Social Sciences
USD	United States Dollars Business
VAT	Value-added tax

DEFINITIONS OF TERMS

Informal Sector: The informal sector refers to those workers who are self-employed. It is the diversified set of economic activities, enterprises, jobs, and workers that are not regulated by the state (Thiga & Muturi, 2015)

Small and Medium Enterprises :Those entities with full-time employees not exceeding 100 or annual sales turnover not exceeding Ksh 150 million (Ndemo, 2015).

Tax Compliance: The Degree to which a taxpayer complies (or fails to comply) with the tax rules of his country, for example by declaring income, filing a return, and paying the tax due in a timely manner (Kirchler, 2007).

Tax Evasion: It refers to the conscious or unconscious action and behavior of a person who is liable to pay tax but who fails to fulfill this duty by either under reporting his tax liability or failing to account for his income generating activities altogether (Kirchler, 2007).

Tax Rate: The tax rate is the tax imposed by the federal government based on an individual's taxable income or a corporation's earnings. Kenya uses a progressive tax rate system, where the percentage of tax increases as taxable income. It can also be defined as the percent of income paid as tax (KRA, 2011).

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 (Kirchler, 2007).

ABSTRACT

The aim of this study was to assess determinants of tax compliance in the informal sector in Kenya. This research will investigate the level of tax compliance in the informal sector with a focus on SMEs in Machakos County. The study was guided by the following objectives: to determine how tax Awareness on the tax compliance in the informal sector in Kenya; to assess the effect of Tax Rate on the tax compliance in the informal sector in Kenya and finally to establish the effect of Compliance Cost on the tax compliance in the informal sector in Kenya. This study was based on the following theories; Allingham and Sandom Model, Pecking Order Theory and finally Institutional Anomie Theory. The study adopted a descriptive research design. The study had a target population of 1,680 SMEs. The study adopted a stratified random sampling technique to select 10% of the target population as the sample size. Questionnaires were used as the research instrument to gather the relevant information. Primary data was used for the purpose of this study. The data was collected using semi structured questionnaires containing closed ended questions. The study was carried out a pilot test to test the validity and reliability of the questionnaires in gathering the data required for purposes of the study. The researcher edited the completed questionnaires for completeness and consistency. Regarding Tax Awareness, the study concluded that Awareness had a positive but significant effect on the tax compliance in the informal sector in Kenya. The study also concluded that Tax Rates had a negative but significant effect on the tax compliance in the informal sector in Kenya. The study further concluded that Compliance Cost had a positive but significant effect on the tax compliance in the informal sector in Kenya. The study recommends that Kenyan tax authorities needs to take an active role in enabling the capacity of traders in the informal sector in areas of training so that they can be equipped with basic Tax Knowledge. The study also recommends that tax rates should be reviewed for those in the informal sector to ensure that they commensurate with economic conditions. The study finally recommends that the Kenyan tax authorities should come up with policies to reduce tax compliance cost to ensure that they do not affect the growth of traders in the informal sector and encourages traders in the informal sector to comply with taxes.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Taxation is the main source of government's financing in both developed and developing countries. Marina et al. (2002) notes that taxation is the main source of generating revenue to finance public expenditure for any government. However, this is not entirely true as developing countries have several other non-tax revenues including user fees charged by different government departments and agencies, privatization of government assets, domestic and foreign borrowings as well as foreign aid. According to Mutua (2012), Kenya finances a considerable percentage of its annual budget from locally generated sources relative to most East African countries whereby a sizeable chunk of annual expenditure is sourced from foreign aid. This has placed tremendous pressure on taxes to shore up the revenue gaps that have been occasioned by the dwindling resources from foreign aid.

Kenya's tax system has been considerably reformed over the last two decades, policy wise, rate have been harmonized especially within the VAT regime where multiple rates have been removed and the external tariffs have also been standardized across the East African Community in line with the common market protocol. Administrative and institutional reforms have also been undertaken with the formation of a single collecting agency for the government mandated with the administration and collection of different taxes, levies and user charges administered by the government. All these reforms have been geared towards enhancing Tax compliance and addressing the problem of equity in taxation. Andreoni et al (1998) describes compliance as spanning the notions of equity, efficiency and incidence in taxation. Tax compliance is the ability

of a state to ensure that tax laws and regulation are adequately adhered to by the public. Compliance is very likely never an act of selflessness or being public spirited but is on more occasion a byproduct of a state's ability to ensure that tax frauds and offenders are detected, audited and penalized promptly before the cancer spreads to the rest of the society.

1.1.1 Tax Compliance

Tax compliance refers to the fulfilling of all tax procedures and obligations as required by law. Thiga and Muturi (2015) observed that there is a general positive correlation between Tax understanding, lower tax rates, compliance costs and high penalties to the general level of compliance. According to (CIAT, 2006), Kenya is ranked among countries with high levels of tax non-compliance with the revenue authority hard pressed to ensure efficient and effective tax administration. In order to ensure tax compliance, hence raising more revenue the administration of tax in Kenya is governed by Kenya Revenue Authority established through an Act of Parliament on July 1st 1995 (Cap 469).

According to William and Round (2009) tax penalties, inadequate understanding, high tax rates and high cost of compliances are some of the factors that lead to tax fraud and tax evasion. SMEs will fail to comply with tax laws either unwilling or willingly. Emerging economies should ensure that tax system is efficient and effective for SMEs and don't affect them negatively. The challenge that most authorities face are poor tax system and policies. The main objective of tax policy is to abide with tax laws (James & Alley, 2004). SMEs in Kenya operates in operate in an informal sector economic survey report 2016 indicates that the sector has semi organized and unregulated activities that are smaller.

According to Cascio, (2014), Tax Compliance in UK can be characterized as how much a taxpayer goes along (or neglects to go along) with nation tax rules, for instance, income declaration, return filing, and paying assessment due in time. While Tax evasion can be characterized as the failure by a man or business to follow the tax commitments. It is a genuine test to tax authorities in both the developing and developed nations. It decreases assets mobilization that administrations need to put resources into basic regions of social and self-

improvement including wellbeing, training and infrastructure advancement (Cummings, 2007). In 2011, it cost governments worldwide around 5.1 % of their GDP. In Europe tax avoidance constitutes around 8% of the GDP of economies in the area. In South and North America, tax evasion costs economies 2% and 10 percent of GDP separately. Indeed, even in most developed economies on planet, tax evasion erodes income accumulation (Rile, 2011).

Over 183 billion euros that is estimated to 242 million dollars has been lost in Italy with relation to tax evasion within one year and debt of almost two trillion representing just over 10 years of tax evasion. Nations such as Italy and Greece have pledged seriousness about evasion of tax and money exchanges for merchandise and enterprises falling underneath the radar of authorities. Germany and Britain consented to arrangement with Switzerland about recouping tax income from bank accounts retained in Swiss banks by their subjects. South America has worldwide big black-market economy compared to its G.D.P. taken after by Europe and Africa, where salary avoided assessment experts totaling 20.5percentof G.D.P, contrasts and 10.8 percent in North America (Association, 1998). Tanzania, Kenya, and Uganda, tax evasion is high being the component of GDP. Uganda loses minimal sum in evaded taxes: In 2011, it lost 856 million

United States dollars, trailed by Tanzania at 1.9 billion United States dollars; Kenya loses somewhat more than 2 billion USD. In 2011, in Kenya the informal economy makes over 33% of the country's GDP and spoke to 7% of aggregate government consumption. The taxation rate in Kenya would accordingly be high, remaining at around 20.9%. On the off chance that the Kenya government is to expand its social consumption, and there need to eliminate tax evasion in the informal economy (Griffiths, 2005). In Kenya the informal sector is fairly large accounting for an estimate of 25 percent of the national GDP.it has been noted that a sustained growth in the sector over time with the initial estimates 910,000 people are employed up to two million

employs. The informal economy in Kenya employed an estimate of 8.3 million people with an approximate seventh five percent of the nation's labor force being in the non- agricultural private sector Economic Survey for the year 2010

1.1.2 Machakos County

There are various difficulties hindering proficient setup of a viable tax framework in Machakos County. Economy structure, for example, proportion of formal versus informal sectors; extent of agricultural sector post challenges in tax outline and organization. Different obstructions include: nullification of tax occasions, high viable insurance, high scattering of levy rates, point by point and inflexible custom principles, poor reaction of VAT to changes, feeble ability to process substantial volumes of profits and discounts for zero-evaluated exchanges. Also, Kenya's tax framework is difficult as far as time taken to plan and submit government forms (Karingi, *et al*, 2005).

The business environment in Machakos County is majorly dominated by informal enterprises which fall into the three sectors manufacturing, trade and services industry. The informal sector in the County plays a greater role in generating employment for a large promotion of the population. There are however challenges between the county government and informal workers since their activities are not licensed and they do not pay taxes. This presents a challenge not only for the county government but also to Kenya revenue authority. The Machakos county fiscal strategic paper (2018) reveals that the county government of in Machakos targets to achieve revenue growth from 300 Million in 2019/2020 financial year to 338 Million in 2020/2021 financial year from single business permits. This is based on assumptions of growth of SMEs on the existing ones as well as thriving on new enterprises besides, the inclusion of

more informal sector enterprises into the tax net would be necessary to achieving the expected outcome.

1.2 Problem statement

Taxation is an important source of income for both the national and county government for it's a vital stream of income for government's improvement ventures. Tax evasion hampers government revenue collection thus inefficiency in Government spending because it diminishes the capacity of the state to mobilize domestic revenues, resources that are needed for investments (Slemrod, 2007). The informal sector accounts for about 34 per cent of the Kenyan gross domestic product and 77 per cent of the total employment in the country (IEA-Kenya 2012). This makes the sector very important and difficult to ignore.

Be that as it may, tax compliance among SMEs is poor. Tax evasion hampers government income accumulation in this manner wastefulness in Government spending since it decreases the limit of the state to assemble household incomes, assets that are required for speculations. Little and medium undertakings (SMEs) are noteworthy for financial development and generate taxable income for a country. SMEs are less tax compliant in contrast with expansive organizations and are viewed as the 'difficult to assess aggregate from the informal part (Akinboade, 2015). Tax evasion is on the challenges that a nation faces that hampers country development. KRA Annual report (2018) shows that authority lost Kshs 232 billion that was directly attributed to the informal sector. In Kenya generally the informal sector remains untaxed and the SMEs in the sector are continuously expanding and they have the potential to bridge the deficit that is always evasive to KRA.

A number of studies have been accomplished in developing nations in regard to tax compliance, more so in Kenya. The list of these studies includes studies by Lumumba, Wanjohi and Magutu (2010) analyzed how taxpayers' attitude and influences impacts compliance conduct among SMEs in Kerugoya town and reasoned that majority taxpayers see Kenyan tax framework as out of line. This on grounds that majority respondents varied payment of decent amount of tax; which neighbors and companions were filing. Magiya (2016) directed an examination on tax compliance determinants amongst little and medium estimated undertakings in Nairobi east tax

district and found that an expansion in the taxpayers' comprehension of the assessment laws and the tax framework as well as an increase in government accountability with regards to provision of public good and services results into higher compliance levels, thus more of funds through revenue collection. Thiga and Muturi (2015) conducted a study on Factors That impacts Tax Laws compliance amongst Kenyan SMEs and found tax rates and tax compliance expenses are highest tax compliance contributing factor.

However, despite several research on tax compliance, no research has ever been conducted in Machakos County to come up with the answers to the problems above. The business environment of Machakos County is unique and hence SMEs in that county may have a variety of reasons for not complying with tax.

1.3 Objectives of the Study

1.3.1 General objective

The general objective of this study was to assess determinants of tax compliance in the informal sector in Kenya.

1.3.2 Specific objectives

- i. To determine the effect of tax Awareness on the tax compliance in the informal sector in Kenya
- ii. To determine the effect of Tax Rate on the tax compliance in the informal sector in Kenya
- iii. To determine the effect of Compliance Cost on the tax compliance in the informal sector in Kenya

1.4 Research questions

- i. What is the effect of tax Awareness on the tax compliance in the informal sector in Kenya?
- ii. What is the effect of Tax Rate on the tax compliance in the informal sector in Kenya?

- iii. What is the effect of Compliance Cost on the tax compliance in the informal sector in Kenya?

1.5 Significance of the study

1.5.1 Kenya Revenue Authority

Revenue authorities such as Kenya Revenue Authority can gain superior comprehension of the issues or factors to look out for on revenue collection especially on instituting better reforms regarding the SMES for better revenue performance.

1.5.2 Policy makers

This study can also help tax practitioners and policy makers. Firms and individuals adopting the ever-changing tax systems and laws will gain an insight on the factors and relationship in the context of tax compliance thus helping forge a good relationship between the government and tax payers in the case of Small micro enterprises.

1.5.3 The County Government

Through the study the county government is able to realize the reason as to why many of the SMEs may be lagging behind in their growth.

1.5.4 Academicians

The research may assist academicians to understand the determinants of tax compliance in the informal sector in Kenya. Scholars interested in studies on these institutions may also use the findings of this study.

1.6 Scope of the study

The study main focus was on dynamics affecting tax compliance among informal sector in Machakos County. The specific objectives were tax Awareness, Tax Rate and Compliance Cost. The study was focus on the SMEs within the factors affecting tax compliance among SMEs in Machakos County because the operating environment of SMEs in Machakos differ from other areas of study and the distinctiveness in environment may influence the results. The target population of this study comprised of Small and medium Enterprises in Machakos County. Data from the Machakos County Government (2018) shows that there are 1,680 SMEs operating

within the township, concentrating within the manufacturing, trade and services sectors. The geographical area under the study provided adequate population and sample for the study and therefore gave reliable results and findings. The questionnaires for this study were administered to entrepreneurs who are currently operating SMEs in Machakos County. The study will be conducted between May 2019 and August 2019.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter examines the literature to develop a framework for this study. The chapter gives a theoretical framework, summary and highlights gaps on issues raised and issues reviewed as well as the conceptual framework of the study.

2.2 Theoretical review

The theoretical review of this study will be based on the following theories that support the concept of tax compliance in the informal sector in Kenya.

2.2.1 Allingham and Sandom Model

This model was theorized by Backer in 1968 and was later developed in 1972 by Allingham and Sandom and the model of tax compliance come into lame light. This model indicates that tax payer is always assumed to have an income and must decide on the part of the income to submit to the tax agency (Alm, Jackson & McKee, 1992). Declared income or revenue is taxed at a given rate by government agencies while undeclared tax is not subjected to any tax but the taxpayer will be exposed to a probability that being detected at given point which will be impose the taxpayer to a given penalty. There are two strategies that the taxpayer can choose that is true declaration of his revenue or income or he can decide to declare less that the actual income he earns. But regardless of the choice will all depend on whether the tax authorities will one day investigate the tax payer. If the investigation is conducted and the taxpayer is found to be culpable, he will be heavily penalized by the tax authorities (Allingahm & Sandom, 1972). 14 According to this model the declared income depends upon income or revenue, audit rate and tax rate. According to Alm, Jackson and McKee (1992) other factors that affect and determine tax compliance decision or evasion is what the government takes from the tax payer, the individual perception of benefits of taxes.

According to this model the declared income depends upon tax rate. According to Alm, Jackson and McKee (1992) other factors that affect and determine tax compliance decision or evasion is what the government takes from the tax payer, the individual perception of benefits of taxes.

2.2.2 Pecking Order Theory

This theory was originally developed by Donaldson and in 1984 the theory was modified by Myers and Majluf modified the theory which made it popular. Pecking order theory indicates that managers have more information on organization or business performance. Some businesses have higher level of asymmetric information such are organization with complex production and have less accounting transparency. The theory states that business prefer to be financed with internal funds while small firms that lack resources will have to rely on debt financing. In simple terms is that the theory suggest that organization will decrease or increase their debt ratio if they have a positive cash flow (Vanacke & Manigart, 2010). Business enterprises are concerned not only by current but also future financial cost. When the business climbs up the pecking order, they are faced with two increasing cost. When the business has higher probability of incurring financial distress cost and has a higher chance of surpassing future financial obligations (Quan, 2002).

According to pecking order theory business enterprise aim should be driven entirely towards debt financing as a result of tax deduction that is affiliated to interest payments that has accrued due to non-remittance of taxes. SMEs are affected by the use of debt that has increased due the fact that more debts increase after tax earnings and according to Mackie- Masion (2006) the choice between equity and debt have marginal changes on taxes that has an effect on overall business financial decision. According to Booth (2005) the use of tax rate that is average shows that the impact of tax loss determines what is carried forward and use of corporation as an avenue for income cash flows that affects the growth of SMEs that is determined by tax rate.

2.2.3 Institutional Anomie Theory

This theory emerged in the mid-1990s and it was first used in the book authored by Messner and Rosenfed in 1994. According to Messner and Rosenfed (1994) institutional arrangement where the economy is allowed to dominate without proper guidelines the society will be particularly criminology. The theory also stipulates that humans make decision based on social values which separately may contradict. When an individual hold believes in imbalanced set of social values

the decision made squarely produces deviant Behavior (Itashiki, 2011). Institutional Anomie Theory highlights four theoretically derived sets of national cultural dimensions likely to promote or suppress tax evasion. They include individualism, achievement orientation, assertiveness and humane orientation.

Individualistic cultural values set the stage for behaviors that emphasize the pursuit of firm self-interest, largely neglecting concern for ethical consequences. According to IAT, individualistic cultural values encourage firm's decision makers to choose goal achievement beyond concerns for the ethical or legal means to achieve goals (Bame-Aldred, Cullen, Martin & Parboteeah, 2011). Thus, in such societies, firms more willingly deviate from accepted norms and evade taxes. On the contrary, collectivist cultures favor allegiance to the greater collective rooted in the notion that societal members are interdependent (Triandis, 1995) and, as such, should deter individual gains at the expense of the collective. This suggests that individualistic cultural values should inflate temptations for firms to evade taxes. Deceiving the tax system and the dangers of being punished once detected of the cheating, and for this reason the individual will honor the tax compliance requirements for fear of being penalized. Needless to say, compliance amongst individual payment of tax has sustainably remained high over the years. Analytically, there is no support that enforcement by the relevant authorities could be responsible for making individuals comply. The ultimate idea with tax compliance is why less tax is paid than expected, not why tax payers evade paying taxes due.

2.3 Empirical Reviews

2.3.1 Tax Awareness

Awareness of the local tax payers is very low. Local tax payers lack sufficient knowledge on what type of products/businesses are subject to local taxes and the overall administration of the taxes concerned. In some cases, local tax payers do not aware about the payment procedures, timing of payment, and even the amount to be paid. Related to this is the case where some tax payers do not precisely distinguish between the local taxes charged by the Councils and the national taxes imposed by the Tanzania Revenue Authority (TRA). However, the Government is taking steps towards this anomaly. For instance, in some Council, the TRA is commissioned to collect certain types of local taxes, such as property taxes, on behalf of the Councils.

According to the study done by Ernest, (2014) on the Effective Revenue Mobilization by Districts Assemblies in Ghana context, lack of awareness was seen to be the main problem causing tax compliance among SMEs. The main challenges they encounter during revenue collection is that SMEs do not see the usefulness of paying these levies. This is because SMEs were not willing to pay any money to the district assembly due to lack of information regarding the use of the money within the assembly. In addition, some pay and do not see any activity or project being embarked on by the assembly using these funds hence their refusal to pay any longer.

Okoye, Akenbor and Obara (2012) led an examination on Tax Information, Administration and Tax Payers' Compliance knowledge of Ekiti State Manufacturing Firms. This examination analyzed the effect of tax data, organization and learning on taxpayer's compliance of Ekiti State manufacturing Ekiti State Firms in Nigeria utilizing survey research design. The outcomes demonstrated that tax data and learning had positive critical effects on tax compliance while tax organization insignificantly affected tax compliance with beta coefficients which are unstandardized of 0.251 ($t = 2.038$, $p < 0.05$) appropriately. Investigation showed tax data, tax learning tends to advance tax compliance than tax organization. The investigation prescribed that legislature ought to through its organizations instruct the potential taxpayers on taxation laws and controls by coordinate free symposia and courses.

2.3.2 Tax Rate

It is for most part trusted that a high tax rate is the primary driver of tax evasion. Motivating forces to sidestep tax rely upon the minimal rates of tax collection on the grounds that these oversee the increases from evasion as a total of the total sidestepped. One noteworthy evasion of tax is high individual income rate of taxation which tend to direct taxpayers to dodge tax. Excessively numerous and confounded standards and directions forced by the administration tend to prompt tax evasion. Organizations discover it by and large troublesome frequently not beneficial to work together lawfully (KRA, 2011)

Kenya Revenue Authority has moved to widen its VAT tax base in an ambitious plan seeking to raise the number of active Kenyan tax payers to 4 million by the year 2017 against the present 1.6 million. Under this new plan, the KRA seeks to rope in additional players in the small and medium sized enterprises (SMEs) category who have often eluded the taxman's scrutiny. It is known

that SMEs do not register voluntarily, while those which do often fail to keep adequate records, file tax returns and settle their tax liabilities promptly hampering the taxman's efforts to mobilize revenue in the bracket. A number of strategies leveraging on technology have been put in place to enhance new taxpayer registration, filing of returns and tax compliance. These include online tax registration and filing of returns, use of electronic tax registers at the point of sales as well as leveraging on information technology to share taxpayer information with other public institutions. However, the taxman is yet to achieve its targets on taxing of SMEs (IEA, 2012).

The profitable assets i.e. land, capital, work and business are designated to different enterprises or go unused. For example, when the administration increment taxes things, for example, beer and cigarettes to realize income and discouraging their utilization individuals tend to purchase neighborhood brews. At whatever point costs increment because of increment in rates of tax; merchandise costs and service increment and drop-in utilization rate and abatement in sales volumes prompting hindered development of small micro enterprises. Tax installment is amongst surges of money from business lessening buying influence of an undertaking. This is because of the way that lot of money gathered is utilized in tax payment instead of to extend business. The investigation demonstrated that the power of purchasing of a venture drops instantly an organization pays taxes (Mungaya, 2012).

As indicated by Osambo (2009) the elevated measure of tax collection of Small micro enterprises in Africa specifically Kenya, warrants thought on animated research domains went for watching out for the general effects of duty accumulation on SMEs by pondering tax appraisal direct in five particular countries (USA, Gambia, Nigeria, South Africa and Kenya), Osambo (2009) contemplated that extended tax assessment rate is a vital threat. The results show that expansion in tax rates prompts higher development, appropriation and offering costs which prompt higher costs and accordingly customers change their purchasing conduct. Individuals respond to the higher costs by purchasing less of the item. At the point when deals fall, manufacturers cut back on generation and a few specialists may lose their employments.

This capsules the individual characteristics of the tax itself; it involves such areas as the Tax base, frequency of filing returns, methods of collection and the impact and incidence of tax. Andreoni et.al (1998) ascertained that certain sources of income with no reporting requirements that is farming income and sole proprietors have a higher prevalence of underreporting their incomes. Cre

dence to this can be observed even locally where PAYE which has very high reporting requirements is usually the best performing tax accounting for over 60% of all income tax.

Certain collection methods also have a very high impact on the level of compliance; the withholding tax mechanism which has been re-introduced lately has already shown that it has a very high potential in terms of collection. The tax base onto which a specific tax is levied also has a considerable impact on the level of compliance, taxes mostly levied on the informal sector i.e. TOT has generally not performed well. Friedman et.al (2000) observed that the size of the unofficial economy is negatively correlated with the tax rate so that a country with a big informal economy should have low rates so as to encourage compliance.

Kiow, Salleh and Kassim (2017) conducted a study on the Determinants of Individual Taxpayers' Tax Compliance Behavior in Peninsular Malaysia. The findings from this review suggested that tax compliance behavior of individual taxpayers is influenced by ethical perception of individual taxpayers and their ethical perception is affected by public governance and transparency in government operations. Taxpayers will be more compliance if government use tax monies wisely or when taxpayers get benefits for the taxes paid in terms of public goods and social amenities that they prefer. Transparent surroundings will enhance taxpayers' confidence in public bodies. Taxpayers are concerned on transparency in public procurement as lack of transparency may cause corruption and reduces public sector efficiency. In contrast, scholars argued that greater degree of transparency could lead to less trust as it will be easier for taxpayers to audit government and they might blame government for small mistakes

2.3.3 Compliance Costs

Compliance cost involves a myriad of expenses or difficulties encountered by the taxpayer in complying with the tax law both in terms of administrative compliance; that is registration, filing and subsequent payment of the taxes and also technical compliance which involves maintenance of appropriate records, machines and organization of the supply chain so as to observe the requirements of the law. Administrative compliance is mostly direct and therefore it has been the area of concern in most of previous research. Thiga and Muturi, (2015) when studying Tax compliance among SME's in Kiambu County observed that low compliance cost is associated with high compliance level, these findings have been vindicated by several researchers including Lumumba et al , (2010) and Slemrod (1992).

Adesina and Obazee (2016) completed an investigation on Taxation information, Penalties and assessment compliance in Nigerian small and medium scale endeavors. Examination was led utilizing survey design and information were gathered through survey and broke down utilizing least square technique. Outcomes uncovered that tax learning had positively huge effect on tax compliance while taxation penalties had inconsequential positively effect on assess compliance. Prescription that legislature ought to energize taxpayer's information about assessment laws and standards in this way making mindfulness for the common advantages of the administration and the taxpayers.

Adeyeye and Otusanya (2015) examined the impact of taxpayers' perception of government's accountability, transparency and reduction in fiscal corruption on voluntary tax compliance. The study obtained data through questionnaire from a sample size of 1,700 selected randomly out of the population of 11,900 tradesmen and artisans belonging to 17 trade associations in Lagos State, Nigeria. Findings of the study indicate that each of the individual independent variables has significant positive relationship with the dependent variable. The study also suggests that the combined effect of government's accountability, transparency and reduction in fiscal corruption appears to have greater impact on voluntary tax compliance. The paper argues that for most taxable adults to be tax compliant in Nigeria, government must be perceived and seen to be accountable to the citizens, be transparent in its style of governance and be perceived and seen to take necessary steps in reducing the level of corruption in Nigeria.

Technical compliance is visible mostly among indirect taxes such as VAT and excise duty that require maintenance of substantive records, machines (ETR, flow meters), and at times might even call for a resident officer to monitor the production process. Although all these help in ensuring compliance it raises cost and increases the premium on non-compliance.

2.4 Conceptual Framework

A conceptual framework is a set of broad ideas and principles taken from relevant fields of inquiry and used to structure a subsequent presentation. It is a tool intended to assist a researcher to develop awareness and understanding of the situation under scrutiny. It helps the research to explain the relationship among interlinked concepts such as the dependent and independent variables (Rategan, 2012). It will be conceptualized within the dependent-independent variable

components and their indicators. The figure below shows a diagrammatic representation of the relationship between the dependent and independent variables.

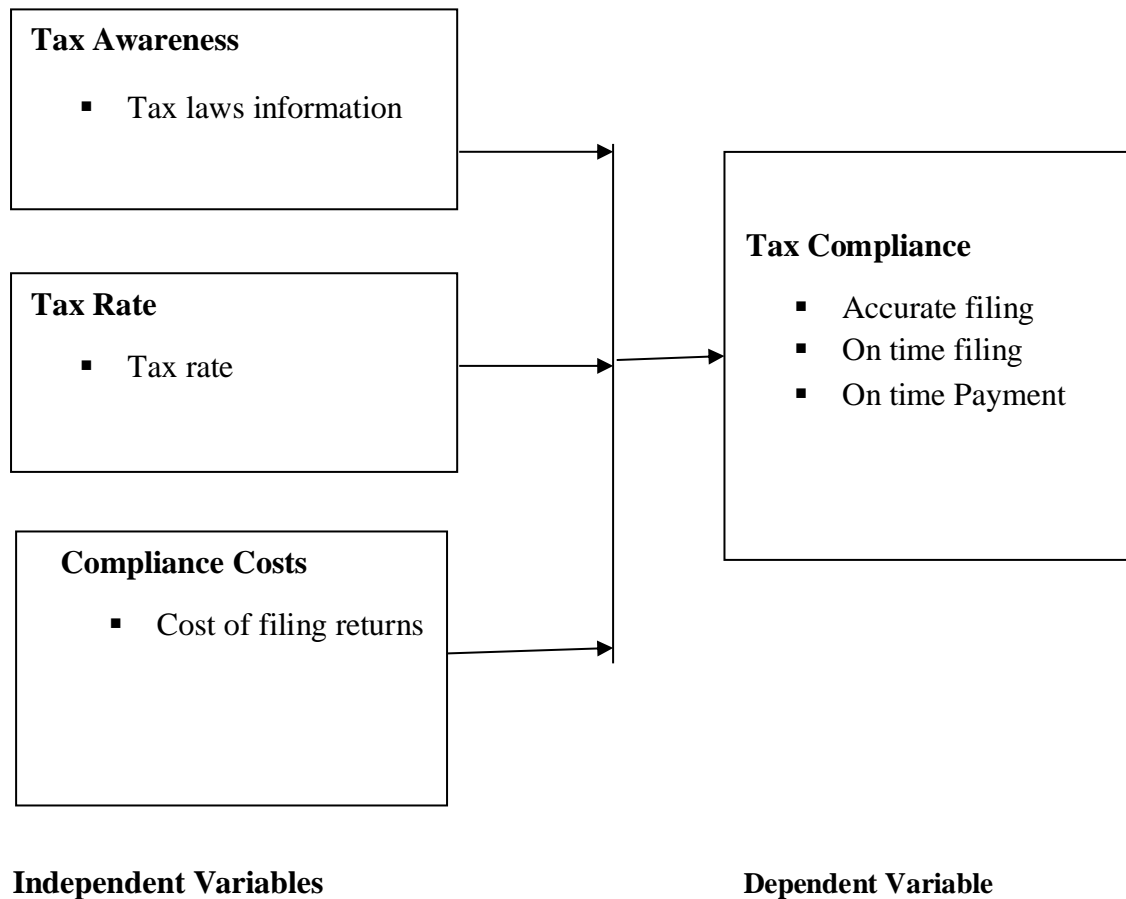


Figure 2.1: Conceptual Framework

2.5 Critique of Existing Literature

Mwangi, (2014) conducted a research study on factors influencing tax compliance among small and medium enterprises in Nairobi’s industrial area, Kenya. In his research, Mwangi used stratified sampling to select a sample of 150 SMEs as respondents which he used to obtain information and make conclusions. The reviewed study was only confined to larger SMEs in Nairobi’s industrial area while the current study is limited to the SMEs in the informal sectors

Okoye, Akenbor and Obara (2012) led an examination on Tax Information, Administration and Tax Payers' Compliance knowledge of Ekiti State Manufacturing Firms. This examination

analyzed the effect of tax data, organization and learning on taxpayer's compliance of Ekiti State manufacturing Ekiti State Firms in Nigeria utilizing survey research design. On other hand, Adesina and Obazee (2016) completed an investigation on Taxation information, Penalties and assessment compliance in Nigerian small and medium scale endeavors. Examination was led utilizing survey design and information were gathered through survey and broke down utilizing least square technique. The reviewed studies were confined to Nigeria culture while the current study was carried out in Kenya.

Machogu and Amayi (2013) directed examination on impact of taxpayer instruction on intentional tax compliance, amongst SMEs in Mwanza city, Tanzania. Examination looked to build up impact of taxpayer instruction on intentional tax compliance, amongst SMEs in City of Mwanza –Tanzania. The reviewed study was done on Tanzania and hence difficult to generalize to other settings while current study was carried in Kenya

2.6 Summary of literature review

This chapter reviewed the various theories that explain the independent and dependent variables. The chapter also presents the conceptualization of the independent and the dependent variables by analyzing the relationships between the two set of variables. The chapter also discusses various determinants of tax compliance in the informal sector in Kenya including tax Awareness, Tax Rate and Compliance Cost. In addition, empirical review, critique of existing studies and research gaps are discussed.

2.7 Research Gaps

A review of research that has been carried on this subject depicts that tax compliance has been studied more in the other Counties unlike Machakos County. It is also crystal clear that studies on tax compliance have been evident in the developed countries (including UK, USA, German, Spain etc.) and practice is hardly heard of in the developing world. These incorporate Lumumba, Wanjohi and Magutu (2010) examined how taxpayers' attitude influences compliance conduct amongst SMEs in Kerugoya town; Magiya (2016) conducted a study on tax compliance determinants amongst 23 Nairobi east tax district small and medium size firms; Thiga and Muturi (2016) conducted a study on variables Influencing Compliance with Taxation Laws

amongst Kenyan Small and Medium Size firms. Adesina and Obazee (2016) completed an investigation on Taxation information, Penalties and assessment compliance in Nigerian small and medium scale endeavors and noted that Outcomes uncovered that tax learning had positively huge effect on tax compliance while taxation penalties had inconsequential positively effect on assess compliance. Adeyeye and Otusanya (2018) examined the impact of taxpayers' perception of government's accountability, transparency and reduction in fiscal corruption on voluntary tax compliance and found out that the combined effect of government's accountability, transparency and reduction in fiscal corruption appears to have greater impact on voluntary tax compliance. Okoye, Akenbor and Obara (2012) led an examination on Tax Information, Administration and Tax Payers' Compliance knowledge of Ekiti State Manufacturing Firms and concluded that tax data and learning had positive critical effects on tax compliance. However, of all these studies, there has not been one that focused on establishing the four factors highlighted in this study that affecting tax compliance among SMEs in Naivasha Sub-County.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

In research, methodology means the analysis of the methods, principles and rules that the researcher applies while carrying out a research. In this chapter detail of research design, target population, data collection methods and tools, data analysis and ethical considerations are clearly explained.

3.2 Research design

The research design that was used in this study was descriptive research design. Descriptive study design is the method of collecting information by administering questioners to a sample of individuals (Mibei, 2007). Descriptive studies are not only restricted to fact but may often be used in the formulation of important principles of knowledge and solution to significant problems. Descriptive study design preferred because it present data in a meaningful form thus help to understand the characteristics of a group in a meaningful form thus help to understand the characteristics of a group in a given situation, think systematically about aspects in a given situation and help make certain simple decision (Orodho & Kombo 2002).

3.3 Target population

Population is defined as a complete set of individuals, case or objects with some common observable characteristics. Target population is defined as that population to which a researcher wants to generalize the results of a study. According to Mugenda and Mugenda (2009) there must be a rationale for defining and identifying the accessible population from target population. While from Hopkins et al. cited, selecting a target population is important because to a large extent it sets the parameter for the entire study during selection of target population some steps start with a broadly defined target population and then begin to narrow it to make it manageable. The target population of this study comprised of Small and medium Enterprises in Machakos County. Data from the Machakos County Government (2018) shows that there are 1,580 SMEs operating within the township, concentrating within the manufacturing, trade and services sectors. These formed the

e target population for this study.

Table 2.1 Target Population

	Population	Percentage (10%)
Manufacturing	180	11.4
Trade	950	60.1
Services	450	28.5
Total	1,580	100

Source: Machakos County, 2018

3.4 Sampling frame

A sampling frame according to Cooper and Schindler (2008) is a list of elements in the population from which the sample is actually drawn. Kombo and Tromp (2009) suggest that ‘the population size should be as big as you can manage within the practical constraints available to you. The sampling frame was drawn from the different category of population that included manufacturing, trade and services.

3.5 Sample and sampling technique

Cooper and Schilder, 2016) indicated, a sample is simply a subject of the population and arises from the inability of the researcher to test all the individuals in a given population. The main function of the sample is to allow the researcher to conduct the study on individuals from the population so that the results of the study can be used to derive conclusions that can apply to the entire population. The study adopted a stratified random sampling technique to select 10% of the target population as the sample size. According to Kothari (2004), a sample size of between 10% and 30% is a good representation of the target population, for populations below 10000. In stratified random sampling, the population is categorized into various strata. Random sampling is then applied in the selection of the respondents from each of the strata. In random sampling all the respondents have equal chances of being selected. The advantage of this method is that it gives a sample size that is representative of the whole population. The study adopted a stratified

random sampling technique to select 10% of the target population as the sample size. Therefore, the sample size for this study was the selection of 158 respondents

Table 2.2: Sampling frame

	Population	Sample	Percentage (10%)
Manufacturing	180	18	11.4
Trade	950	95	60.1
Services	450	45	28.5
Total	1,580	158	100

3.6 Research instruments

Questionnaires were used as the research instrument to gather the relevant information. According to (Toke et al., 2012), there are three basic types of questionnaires; closed ended, open-ended or a combination of both. Closed-ended questionnaires are used to generate statistics in quantitative research. Open-ended questionnaires are used in qualitative research. The study used closed ended questionnaires to respondents thus it was limited to give their opinion regarding the study at hand.

3.7 Data collecting procedure

Primary data was used for the purpose of this study. The data was collected using semi structured questionnaires containing closed ended questions. The questionnaire was divided into two parts. The first part was mainly on the demographics which enabled the researcher to get demographic information of the respondents, while the other was to evaluate the study variables. According to Mugenda and Mugenda (2009), questionnaires are commonly used to obtain important information about a population under study. The questionnaire was administered by the help of well-trained research assistants using a drop and pick later method.

3.8 Pilot testing

The study was carried out a pilot test to test the validity and reliability of the questionnaires in gathering the data required for purposes of the study. Kombo and Tromp (2009) and Kothari

(2004) describe a pilot test as a replica and rehearsal of the main survey. Gall and Borg, (2007) states that the purpose of a pilot test is not so much to test research hypotheses, but rather to test protocols, data collection instruments, sample recruitment strategies and other aspects of a study in preparation for a larger study (Cooper and Schilder, 2011). The study was piloted 10 SMEs from the Machakos town. The respondents there have characteristics similar as those other SMEs SACCO's from Machakos County. Before piloting, the study supervisor was consulted extensively to help clarify the concepts. Adjustments were made regarding readability, relevance, language and comprehension. Pilot data was analyzed using the Cronbach's Alpha test to examine the internal consistency of the data.

3.8.1 Validity of the Instruments

Validity determines whether the research items truly measure what they are intended to measure or how factual the research results are (Kombo and Tromp (2009). To test content validity (extent to which the sample is a representative of the population), experts' opinion was sought. The research questions in the questionnaire were developed to represent each variable in the research. The data collected from the pilot study was subjected to factor analysis to test construct validity.

3.8.2 Reliability of the Instruments

Reliability is the extent to which results of a study are consistent over time and there is an accurate representation of the total population under study. Reliability analysis aims at finding out the extent to which a measurement procedure will produce the same result if the process is repeated over and over again under the same conditions (Toke et al., 2012). Cronbach alpha coefficient was computed using SPSS. The Cronbach alpha coefficient value above 0.6 shows that the measurement procedure is reliable (Toke et al., 2012).

3.9 Data Processing & Analysis

According to Gall and Borg, (2007), data processing and analysis refers to analysis of data is a process of inspecting, cleaning, transforming, and modeling data with the goal of discovering useful information, suggesting conclusions, and supporting decision-making. The researcher edited the completed questionnaires for completeness and consistency. Data clean-up followed. The data was then analyzed using descriptive statistics. The descriptive statistical tool (SPSS)

will be used to help the researcher to describe the data. The finding was presented using tables and graphs for further analysis and to facilitate comparison. This generated quantitative reports through tabulations, percentages, and measure of central tendency.

3.9.1 Model

The study employed Regression analysis to estimate the causal relationships between factors under study. The study settled on the multiple regressions because it is the right the model that can be used when the study wants to predict the value of a dependable variable based on the value of two or more other variables of the independent variable. With the aid of SPSS version 18 software, the researcher performed multiple regressions analysis on primary data to estimate the beta values of factors and F – test statistics to determine their significance at confidence level of 95%. The regression equation of the study was as shown below;

$$y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \varepsilon$$

Where Y is the dependent variable Employee's performance

X₁ – Tax Awareness

X₂ – Tax Rate

X₃ – Compliance Cost

α = Constant

β_0 is the constant or intercept while β_1 , β_2 , β_3 , and β_4 , are the corresponding coefficients for the respective independent variables. ε is the error term which represents residual or disturbance factors or values that are not captured within the regression model. The interpretation of X, β and ε is the same for the subsequent equations for testing the other study objectives.

3.10 Ethical Considerations

The collected data was handled with confidentiality and it was not altered to meet any hidden or personal interest. Also, the researcher facilitated informed consent so as to let the respondents be aware of what the research was all about by informing them that the research was not to do anything with their tax compliance, but was only a requirement for the award of post graduate diploma in Tax Administration at Jomo Kenyatta University of Agriculture and Technology.

CHAPTER FOUR

RESEARCH FINDING AND DISCUSSION

4.1 Introduction

This chapter gives the findings of the primary and secondary facts accrued from the respondents. The questionnaire turned into designed and dispensed to help in collection of qualitative and quantitative information. The statistics has been presented in form of tables and charts in which feasible. This has been achieved in time period of introduction, response price, quantitative, qualitative records analysis and discussion of the observe outcomes and end.

4.2. Response Rate

The researcher administered a total of 158 questionnaires and 115 questionnaires were completed and returned. This represents a response rate of 72.8% as shown in Table 4.1. This response rate was adequate to allow the researcher to continue with the analysis. The questionnaires were composed of questions that addressed the objectives of the study.

Table 4.1: Response rate

Category	Frequency	Percentage
Completed and returned	115	72.8
Not returned	43	27.2
Total	158	100

4.3 Gender of respondents

The data was taken on a monthly basis and the male gender represented 63.4% and the female representing 36.6% of the monthly applicants, this is explained by the fact that the male gender is dominating in the business sector and also the common truth that the men are the bread winners of their families.

Table 4.2: Gender of respondents

Category	Frequent	percentage
Male	73	63.4
Female	42	36.6
Total	115	100

4.4 Age of respondents

Table 4.2 shows that most of the respondents are over 40 years, those over 40 years were 51 representing 44.4% and those between 31 years to 40 years were 38 representing 33% of the total applicants, while those below 30 years taking the lesser percentage. This has implication that most respondents are mature and therefore clear and valid information will be gathered from them.

Table 4.3: Age of respondents

Category	Frequency	Percentage
Below 30yrs	26	22.6
31-40yrs	38	33
Above 40yrs	51	44.4
Total	115	100

4.5 Education Level of respondents

The researcher wanted to establish the level of education of the respondents. Table 4.2.3 shows that 54.8% are KCSE holders and 33% of the respondents are KCPE holders while 12.2% were diploma holders. The researcher therefore concluded that respondents were all intellectuals and that they would effectively assist in achieving the objective of the study. The table 4.5 shows the responses concerning their level of education.

Table 4.4: Level of education

Education level	Frequency	Percentage %
Diploma	14	12.2
KCSE	63	54.8
KCPE	38	33.0
Total	115	100

4.6 Descriptive statistics

The findings are derived from a Linkert scale in the questionnaires where the respondents were supposed to indicate their level of agreement or otherwise with a given statement.

4.6.1 Tax Awareness

The respondents were asked to indicate their level of agreement with various aspects of the Tax Awareness. The table 4.5 below shows the descriptive statics from the responses based on 115 respondents. The results show the means and standard deviations about questions on Tax awareness

Table 4.5: Tax Awareness

Statements	Mean	Std. Dev.
I am aware of tax laws related to the SMEs in the County	4.56	.539
I am aware of how the tax system is structured and administered in the County	2.65	1.981
Rules on taxation are too sophisticated for a nonprofessional to understand	4.01	.801
Tax rules information is not promptly available to the SMEs in the County	3.94	1.097
Tax laws complexity add to incorrect tax returns of the SMEs in the County	3.92	.831

From table 4.5 above, the statement I am aware of tax laws related to the SMEs in the County had the highest mean of 4.46 and the least standard deviation of 0.539 while the statement I am aware of how the tax system is structured and administered in the County has the least mean of 2.65 and a high standard deviation of 1.981. High mean and low standard deviation means that the respondents agreed that there are tax laws governing taxation of SMEs in Machakos town, however, the low mean and high standard deviation in statement I am aware of how the tax system is structured and administered in the County shows that they disagreed on their knowledge of high the structure of tax system with majority indicating that they are not aware of the structure.

There is therefore need for the tax authorities to do more complain on educating the taxpayers, specifically SMEs in Machakos town on the structure of tax system so as to increase tax compliance.

4.6.2 Tax Rate

The respondents were asked to indicate their level of agreement with various aspects of the Tax rate. The table 4.6 below shows the descriptive statics from the responses based on 115 respondents. The results show the means and standard deviations about questions on tax rate.

Table 4.6: Tax Rate

Statements	Mean	Std. Dev.
Tax rates related to SMEs in the County are too high	4.72	.091
The tax rates affect the growth and development of our SME	4.44	.106
Review of the tax rates would be beneficial to SMEs in the county	4.69	.118
Our SME is affected adversely and disproportionately by Tax rates	3.25	.561
The tax rates contribute to the failure of businesses in the county	3.21	.701

From table 4.6 above, the statement Tax rates related to SMEs in the County are too high had the highest mean of 4.72 and lowest standard deviation of .091. However, the statement “The tax rates contribute to the failure of businesses in the county” had the least mean of 3.21 and a standard deviation of 0.701. high mean and low standard deviation shows that the respondents agreed that the tax rate are too high for the SMEs in Machakos town while the relatively low mean and standard deviation in the other statement shows that the respondents had divided opinions on whether the tax rates have influence on continuity of SMEs in Machakos county.

Generally, all the statements and relatively high mean and low standard deviation and this shows that the respondents had similar opinions concerning them. This shows that tax rate is a concern to many SMEs in Machakos town and thus there is need to look in to the tax rate to encourage growth of such SMEs in Kenya.

4.6.3 Compliance Cost

The respondents were asked to indicate their level of agreement with various aspects of the compliance cost. The table 4.7 below shows the descriptive statics from the responses based on 115 respondents. The results show the means and standard deviations about questions on compliance Cost.

Table 4.7: Compliance Cost

Statements	Mean	Std. Dev.
High tax compliance costs affect the growth and development of our SME	4.39	.650
Tax Compliance Cost restructuring can lead to achievement of a reduced average cost structure thus minimizing tax compliance	4.41	.491
Our SME is affected adversely and disproportionately by compliance costs	3.18	.609
Our SME consider the cost associated with filing tax returns as high	2.96	1.151
Our SME incur different tax compliance cost with most incurred costs being the cost of collecting and submitting taxes and the cost of filing taxes	4.32	.594

The statement “Tax Compliance Cost restructuring can lead to achievement of a reduced average cost structure thus minimizing tax compliance” had the highest mean of 4.41 and small standard deviation of 0.491. This indicates that majority of the respondents agreed that there is need to restructure tax compliance procedures so as to reduce the compliance cost which is born by the tax payer. On the other hand, the statement “Our SME consider the cost associated with filing tax returns as high” scored the least mean of 2.96 and high standard deviation of 1.151 meaning that the respondents were of different of varying opinions when it comes to tax filing.

There is therefore need for the tax authorities, both in county government and national government to consider restructuring of tax compliance requirements, which has greatly increased the compliance cost by SMEs in Machakos town.

4.6.4 Tax Compliance

The respondents were asked to indicate their level of agreement with various aspects of the tax compliance. The table 4.8 below shows the descriptive statistics from the responses based on 115 respondents. The results show the means and standard deviations about questions on Tax compliance

Table 4.8: Tax Compliance

Statements	Mean	Std. Dev.
Our SMEs file returns accurately	3.51	.509
Our SMEs file returns on time	4.41	.381
Our SMEs file the correct returns	3.48	.514
All our SMEs records like TB; Journals and Ledgers are updated	3.43	.672
Our SME is Registered as a taxpayer in the KRA system	4.82	.095

The statement “Our SME is Registered as a taxpayer in the KRA system” had the highest mean of 4.82 and smallest standard deviation of .095. This indicates that majority of the SMEs in Machakos town are registered with the tax authority for tax purposes. On the other hand, the statement “All our SMEs records like TB; Journals and Ledgers are updated” scored the least

mean of 3.43 and highest standard deviation of .672 meaning that the respondents were of different of varying opinions when it comes to record and book keeping.

These findings indicate that there is need for the taxman to do more work on enforcing bookkeeping and recording to ensure that compliance is increased. The findings also show that the requirement to have all SMEs registered for tax obligations is almost successful since majority of the SMEs have complied. On the side of filing returns, there is need to put more effort to ensure that the SMEs file the correct returns since majority indicated that their returns are not filed correctly.

4.7 Correlation Results

Correlation analysis was done to determine the association between independent and dependent variables. The correlation coefficients range from -1 for a perfect negative relationship to +1 for perfect positive relationship and zero for no relationship as shown in table 4.9 below.

Table 4.9: Correlations Analysis

		Tax awareness	Tax Rate	Compliance Cost	Tax compliance
Tax awareness	Pearson Correlation	1	.503**	.881**	.613**
	Sig. (2-tailed)		.000	.000	.000
	N	115	115	115	115
Tax Rate	Pearson Correlation	.503**	1	.497**	-.460**
	Sig. (2-tailed)	.000		.000	.000
	N	115	115	115	115
Compliance Cost	Pearson Correlation	.881**	.497**	1	-.425**
	Sig. (2-tailed)	.000	.000		.000
	N	115	115	115	115
Tax compliance	Pearson Correlation	.613**	-.460**	-.425**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	115	115	115	115

** . Correlation is significant at the 0.01 level (2-tailed).

As indicated in the table 4.9 above, there was a moderate positive correlation between tax awareness and tax compliance in the informal sector in Kenya, Tax Rate and tax compliance in the informal sector in Kenya and finally Compliance Cost and tax compliance in the informal sector in Kenya. This indicates that an increase in the study variables will lead to the increase in tax compliance in the informal sector in Kenya. The above results show little evidence on multi co-linearity among the independent variable since the correlations among them are not very strong henceforth all can be used into consequent regression analysis.

4.8 Regression Analysis

Regression analysis was done to generate model summary, analysis of variance (ANOVA) and regression coefficients.

4.8.1 Model summary

The model summary consists of R. value, R square value, Adjusted R Squared Value, and a standard error of the estimate. The values obtained were recorded in table 4.10 as shown below.

Table 4.10: The Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.940 ^a	.884	.880	.11396

Further, the regression output in Table 4.10 presents the source of variance, mean of variances and the f value. The results indicate that the overall model was significant and could provide important results. This indicates that the model could provide some predictive significance and was a good fit.

4.8.2 Analysis of variance

The analysis of variance was done to generate the f- statistic, which is used to test significance of R. The results were as shown in table 4.11 below

Table 4.11: Analysis of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	10.867	4	2.717	209.191	.000 ^b
	Residual	1.429	110	.013		
	Total	12.296	114			

Further, the regression output on significance of the independent variables is presented in table 4.12.

Table 4.12: Regression coefficients

Model	Unstandardized		Standardized	T	Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta		
1 (Constant)	692	.033		.000	.000
Tax Awareness	.981	.040	.917	24.402	.002
Tax Rate	-.737	.045	.837	-16.252	.004
Compliance Cost	-.583	.052	.725	-11.189	.000

$$Y = 0.692 + 0.981x_1 - 0.737x_2 - 0.583x_3 + \varepsilon$$

From the equations results, it can be interpreted that all three variables that is: tax awareness, tax rate and compliance costs all Impact tax compliance in the informal sector in Kenya. It should be noted that Y stands for the tax compliance while x_1 , x_2 and x_3 stand for tax awareness, tax rate and compliance cost respectively. The regression equation above has established that taking all factors into account (Tax Awareness, Tax Rate and Compliance Cost) constant at zero; tax compliance in the informal sector in Kenya will be 0.692. The findings presented also show that taking all other independent variables at zero; a unit increase in the Tax Awareness, would lead to a 0.981 increase in the scores of tax compliance in the informal sector in Kenya. A unit increase in the Tax Rate would lead to a 0.737 decrease in tax compliance in the informal sector in Kenya. Finally, the findings show that a unit increases in the Compliance Cost would lead to a 0.583 decrease in tax compliance in the informal sector in Kenya.

Therefore, results in Table 4.12 indicate that Tax Awareness significantly and positively influenced on the tax compliance in the informal sector in Kenya. The tax awareness received by taxpayers is an important factor that contributes to the understanding of tax requirements, especially regarding registration and filing requirements. A study by Palil (2010) has revealed that tax awareness has a very close relationship with taxpayers' ability to understand the laws and regulations of taxation, and their ability to comply. In this study, SMEs did not consider local authority levies to be different from government taxes because they lacked tax knowledge.

This misconception has an impact on their compliance decisions because when they pay council levies, they may consider that they have paid tax and complied. A research by Lumumba et al (2010) found that SMEs did not pay their tax obligations because of their inability to understand tax law requirements.

Further, Tax Rate has a significant and negatively influence on the tax compliance in the informal sector in Kenya. This implies that it is for most part trusted that a high tax rate is the primary driver of tax evasion. Motivating forces to sidestep tax rely upon the minimal rates of tax collection because these oversee the increases from evasion as a total of the total sidestepped. Compliance Cost had significant and a negative influence on the tax compliance in the informal sector in Kenya.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter provides a summary, discusses findings, and offers conclusions, gives recommendations and suggestions for further findings based on the objectives of the study. It comes after identifying the background, problem at hand and the objectives in chapter one, followed by an in-depth literature review done in chapter two. Chapter 3 set out the methodology that the study used to collect data as well as laying out the analysis methods that were used. Chapter 4 then analyzed the data obtained from the research instruments.

5.2 Summary of the findings

5.2.1 Tax Awareness

The study established that respondents were aware of tax laws related to the SMEs in the County. The study also established that respondents were aware of how the tax system is structured and administered in the County. Furthermore, the study established that tax rules information is not promptly available to the SMEs in the County. In addition, the study established that

Tax laws complexity adds to incorrect tax returns of the SMEs in the County. However, the study established that the respondents disagreed that rules on taxation are too sophisticated for a nonprofessional to understand.

5.2.2 Tax Rate

The study established that the respondents considered the tax rates related to SMEs in the County to be too high. The study also concluded that penalties charged for late filing are stiff. Furthermore, the study established that auditing cost required for filing the tax returns is high for the SMEs. The study also established that hiring a profession to do the filing is expensive for the SMEs.

5.2.3 Compliance Cost

The study established that high tax compliance costs affect the growth and development of the businesses. The study also established that tax Compliance Cost restructuring could lead to achievement of a reduced average cost structure thus minimizing the cost of tax compliance. The study further established that SMEs of the respondents are affected adversely and disproportionately by compliance costs. Furthermore, the study concluded that SMEs consider the cost associated with filing tax returns as high. Finally, the study established that SME incur different tax compliance cost with most incurred costs being the cost of submitting returns.

5.3 Conclusion

5.3.1 Tax Awareness

Regarding Tax Awareness, the study concluded that Awareness had a positive and significant effect on the tax compliance in the informal sector in Kenya. The tax awareness received by taxpayers is an important factor that contributes to the understanding of tax requirements, especially regarding registration and filing requirements.

5.3.2 Tax Rate

The study concluded that Tax Rates had a negative but significant effect on the tax compliance in the informal sector in Kenya. According to the correlation results, tax rate is negatively related to the tax compliance in the informal sector in Kenya. However, the effects of Tax Rates on the tax compliance in the informal sector were significant at 5% level.

5.3.3 Compliance Cost

The study concluded that Compliance Cost had a negative but significant effect on the tax compliance in the informal sector in Kenya. In other words, Kenyans are not ready to incur extra cost just to pay tax.

5.4 Recommendations

5.4.1 Tax Awareness

Increased tax awareness potentially increases tax compliance, as knowledgeable taxpayers are more aware of their responsibility as well as the sanctions to be imposed if they were not

compliant with tax laws. Therefore, the study recommends that Kenyan tax authorities needs to take an active role in enabling the capacity of traders in the informal sector in areas of training so that they can be equipped with basic tax knowledge.

5.4.2 Tax Rate

The study recommends that tax rates should be reviewed for those in the informal sector to ensure that they commensurate with economic conditions. Furthermore, Kenya Revenue Authority needs to educate business owners in the informal sector on the various tax rates and penalties they charge. This has potential of increasing the voluntary compliance and lowering the overall tax administration costs.

5.4.3 Compliance Cost

The study concluded that there is a significant relationship between compliance costs and tax compliance in the informal sector in Kenya. The study thus recommends that the Kenyan tax authorities should make it easy to comply so that the businesses do not have to incur costs to ensure that they do not affect the growth of traders in the informal sector and encourages traders in the informal sector to comply with taxes.

5.5 Suggestions for Further Research

The study has identified the determinants of tax compliance in the informal sector in Kenya. However, this study calls for a further investigation of each single factor to ensure that the issue of tax compliance is fully addressed not only in the informal sector but also in the formal sector. Since this study concentrated on determinants of tax compliance in the informal sector in Kenya with special reference to Machakos County, further studies should be done in other Counties for comparison purposes and allow for generalization of the findings. This study further recommends that since the study was limited to only three variables, a similar study could be conducted with additional variables. Different models besides regression could also be used on similar studies to get an in-depth understanding of the relationships between the variables being studied

REFERENCECS

- Adebayo, A. (2017). The Effect of Accountability and Transparency on Tax Returns in Nigeria
International Journal of Innovative Research & Development Vol 6 Issue 6
- Adesina, O. O., & Obazee, U. (2016). Tax knowledge, penalties and tax compliance in small and medium scale enterprises in Nigeria. *I Business*, 8, 1-9. <http://www.scirp.org/journal/ib>.
- Adeyeye, B., & Otusanya, A. (2015). The Impact of Taxpayers' Perception of Government's Accountability, Transparency and Reduction in Fiscal Corruption on Voluntary Tax Compliance in Nigeria. *Int. J. Economics and Accounting, Vol. 6, No. 3, 2015: 276-299*
- Ajzen, I. (1985). From intentions to actions: A theory of planned behavior. (J. Kuhl, & J. Beckmann, Eds.) Berlin: Heidelberg, New York: Springer-Verlag.
- Akinboade, O.A. (2015). Correlates of Tax Compliance of Small and Medium Size Businesses in Cameroon, *Managing Global Transitions*, 13(4), 389-413.
- Allingham, Michael & Agnar S. (1972). Income tax evasion: A theoretical analysis', *Journal of Public Economics* 1(3-4): 323-338
- Bame-Aldred, C., Cullen, J., Martin, K., & Parboteeah, K. (2011). National Culture and firm level tax evasion. *Journal of Business Research*, 1-7.
- Braithwaite V, Reinhart M, Graham R (2001). Preliminary findings from the Community Hopes, Fears and Actions Survey.
- Brautigam, et al, (eds.) (2008), Taxation and state-building in developing countries. Capacity and consent, *Cambridge University Press*.
- Cascio, P. (2014). Cultural change: opportunity, silent killer or metamorphosis. San Francisco: Jossey Bass.
- Chipta, C. (2002). The 2nd economy and Tax yield in Malawi. Nairobi: ARC. 78
- CIAT (2006). Organization Structures and Functions of the Tax Administration of Member Countries. *CIAT Technical Publication*.

- Cobham, A. (2005). Tax evasion, tax avoidance and the development finance.
- Geneva: QEB. Cooper, D., & Schindler, P. S. (2011). *Business research methods*. New Delhi: McGraw Hill.
- Cronbach, L. J. (1951). Coefficient alpha and the internal structure of tests. *Psychometrika*, 16, 297–334.
- Cummings, R. G. (2007). Effects of Tax Morale on Tax Compliance. Experimental and Survey Evidence. *Working Paper Series, Center for Research in Economics, Management and the Arts (CREMA)*
- Fahy, J. (2009). The resource-based view of the firm: some stumbling blocks on the road sustainable competitive advantage. *Journal of industrial trading vol. 24, 94-104.*
- Fishbein, M., & Ajzen, I. (1975). Belief, attitude, intention, and behavior: *An introduction to theory and research*. Reading, MA: Addison-Wesley.
- Fishlow, A., & Friedman, J. (1994). Tax Evasion, inflation and stabilization. *Journal of Development Economics*, 43(1), 105-123.
- Griffiths, N. C. (2005). Increasing Tax Revenue in Sub Saharan Africa; *A case study of Kenya*. Oxford: Oxford Council
- Hunt, S. D., & Derozier, C. (2004). The Normative imperatives of business and marketing strategy: Grounding Strategy in Resource Advantage Theory. *Journal of Business industrial marketing vol.19, 5 - 22.*
- Isa, K. M. (2012). Corporate taxpayers' compliance variables under the self-assessment system in Malaysia. (Doctor of Philosophy), Curtin University.
- Itashiki, M. (2011). Explaining" everyday crime": a test of anomie and relative deprivation theory. *Unpublished doctor of philosophy dissertation. University of North Texas. 79*
- Karingi, S., Wanjala, B., Nyamunga, J., Okello, A., Pambah, E., and Nyakang'o, E. (2005). Tax Reform Experience in Kenya. *Kenya Institute for Public Policy Research and Analysis, KIPPRA Working Paper No. 13*

- Kinyua, A. (2014). Factors affecting the performance of SMEs in Juakali sector in Machakos town town. *Journal of business and management volume 16(1)*, 53-62.
- Kiow, S., Salleh, M., & Kassim, B. (2017). The Determinants of Individual Taxpayers' Tax Compliance Behaviour in Peninsular Malaysia. *International Business and Accounting Research Journal*
- Kirchler, E. (2007). The economic psychology of tax Behaviour. *Cambridge: Cambridge University Press.*
- Kombo, D., & Tromp, D. (2009). Proposal and Thesis Writing: *An introduction. Nairobi: Pauline Publishers.*
- Kothari, C. R. (2014). Research-Methodology Methods-and-Techniques: *New Age Publications (Academic), India.*
- Kraaijenbrink, J., Spende, J. C., & Groen, A. J. (2010). The resource-based view: a review and assessment of its critiques. *Journal of Management vol. 36(1)*, 349 - 372.
- Lans, T., Hulsnik, W., & Mulder, M. (2008). Entrepreneurship education and training in a small business context. *Journal of enterprising culture volume 16(4)*, 89-95.
- Loo, E. C., McKerchar, M., & Hansford, A. (2010). Findings on the impact of self-assessment on the compliance behavior of individual taxpayer in Malaysia: A case study approach. *Journal of Australian Taxation, 13(1/2)*, 1-22.
- Lumumba, O. M., Wanjoli, M. S., Maguta, P. O., & Mokoro, J. M. (2010). Taxpayers' attitudes and tax compliance behavior in Kenya: How the taxpayers' attitudes influence compliance behavior among SMEs Business income earners in Kerugoya Town, Kirinyaga District. *African Journal of Business and Management.*
- Machogu, G.C., & Amayi, B.J. (2013). The effect of taxpayer education on voluntary tax compliance, among SMEs in Mwanza city – Tanzania *International Journal of Marketing, Financial Services & Management Research ISSN 2277-3622 Vol.2, No. 8*

- Magiya, S.O. (2016). Determinants of tax compliance among small and medium sized enterprises in Nairobi east tax district. *Unpublished Nairobi University Thesis*.
- Mbugua, J., Wangoi, M., Kariuki, N. J., & Oganda, J. (2014). Factors affecting the growth of small and medium enterprises in Kenya. *International journal of business and Social sciences vol. 4 issue 5, 21-30*.
- Messner, S., & Rosenfeld, R. (2001). Crime and the American dream.
- Belmont, CA: Wadsworth. Minniti, Y., & Naude, L. (2010). Entrepreneurship and Economic Activity. *European Journal of Performance vol. 22, 294 - 312*.
- Mohd, R. P. (2011). Determinants of Tax compliance in Asia. *Journal of social science vol.24 issue 1*.
- Mugenda, M., & Mugenda, G. (2013). *Research Methods: Qualitative and Quantitative approaches*. Nairobi: Acts Press
- Mugenda, O. & Mugenda, A. (2003). *Research Methods. Quantitative and Qualitative Approaches*. Acts Press, Nairobi.
- Mugo, W. L. (2012). Factors affecting entrepreneurs' performance in Kenya: A case study of Nairobi women groups in CBD. Nairobi.
- Mungaya, M. (2012). Study of Tax System Impact on the Growth of SME. With Reference to Shinyanga. *IJMBS Vol. 2, Issue 3*,
- Machakos County Government Records. (2018). Business Permit Register- 2015. Machakos County Government. 81
- Ndemo, A. M. (2015). Determinants of Tax Efficiency Perceptions by Domestic Taxpayers in Kenya: The Case of Nairobi. *International Journal of Economics, Finance and Management Sciences, 3 (5), 541-545*.
- Ngechu, M. (2004). Understanding the research process and methods. An introduction to research methods. Okello, A., Karingi, S., Wanjala, B., Nyamunga, J., Pambah, E., and

- Nyakang'o, E. (2005) Tax Reform Experience in Kenya, Macroeconomics Division Kenya Institute for Public Policy Research and Analysis KIPPRA Working Paper No. 13
- Okoye, P. V. C., Akenbor, C. O., & Obara, L. C. (2012). Promoting sustainable tax compliance in the informal sector in Nigeria. *International Journal of Arts and Humanities*, 1(1), 40-54.
- Okoye, P. V. C., Akenbor, C. O., & Obara, L. C. (2012). Promoting sustainable tax compliance in the informal sector in Nigeria. *An International Journal of Arts and Humanities*, 1(1), 40-54.
- Orodho J. A. (2005). Elements of Education and Social Science Research Methods, Kanezja Publishers Osambo, A. (2009). Effects of Taxation on SMEs.
- Ouma, S. J. Njeru, A. Kamau, D. Khainga, & B. Kiriga. (2009). estimating the size of the underground economy in Kenya, KIPPRA Discussion Paper, No. 82, Nairobi: Kenya Institute for Public Policy Research and Analysis.
- Ouma, S., Njeru J., Kamau, A., Khainga, D., & Kiriga, B. (2007). Estimating the Size of the Underground Economy in Kenya, KIPPRA. Discussion Paper, No. 82. Nairobi: Kenya Institute for Public Policy Research and Analysis.
- Riahi-Belkaoui, A. (2004). Relationship between tax compliance internationally and selected determinants of tax morale. *Journal of International Accounting, Auditing and Taxation*, 13, 135-143. 82 Rile, R. M. (2011). The cost of tax abuse; a paper on the cost of Tax evasion. Tax Justice Network:
- Sekaran, U. (2008). Research Methods for Business: A Skill Building Approach. New Delhi India: John Willey and Sons, Ltd.
- Thiga, M.N., & Muturi, W. (2015). Factors That Influence Compliance with Tax Laws among Small and Medium Sized Enterprises in Kenya. *International Journal of Scientific and Research Publications*, Volume 5, Issue 6, June 20151 ISSN 2250-3153

- Triandis, H. C. (1995). Individualism and collectivism. Boulder, CO: Westview Press. Vihanto, M. 2000. Tax evasion in a transition from socialism to capitalism: the psychology of the social contract
- Wanjohi, M. S. (2010). Taxpayer's Attitude and Tax Compliance Behaviour in SMEs: Taxpayer's Attitude and Tax Compliance Behaviour in SMEs.
- World Bank, (2013). Designing a Tax System for Micro and Small Businesses: Guide for Practitioners, International Finance Corporation
- Young A, Danny C, Daniel H (2013). A Study of the Impact of Culture on Tax Compliance in China. *International Tax Journal*; CCH Incorporated.
- Griffin, M. (2011). Business Research Methods. (9thEd.). *South-Western, Cengage Learning*

nonprofessional to understand					
Tax information is not promptly available to the SMEs in the County					
Tax laws complexity add to incorrect tax returns of the SMEs in the County					

Tax Rate

5. The following statements relate to Tax Rate. Tick appropriately according to the extent which you agree or disagree with the statements.

1-Strongly Agree 2-Agree 3-Neutral 4-Disagree 5-Strongly Disagree

Tax Rate	Rating				
	5	4	3	2	1
Tax rates related to SMEs in the County are high					
The tax rates affect the growth and development of our SME					
Review of the tax rates would be beneficial to SMEs in the county					
Our SME is affected adversely and disproportionately by Tax rates					
The tax rates contribute to the failure of businesses in the county					

Compliance Cost

7. Please indicate the extent to which you agree with the following statements with various aspects of the Compliance Cost

1-Strongly Agree 2-Agree 3-Neutral 4-Disagree 5-Strongly Disagree

Compliance Cost	Rating				
	5	4	3	2	1
High tax compliance costs affect the growth and development of our SME					
Tax Compliance Cost restructuring can reduce average cost structure thus minimizing tax compliance					
Our SME is affected adversely and disproportionately by compliance costs					
Our SME consider the cost associated with filing tax returns as high					
Our SME incur different tax compliance cost of collecting taxes					

Tax Compliance

8. The following statements relate to Tax compliance. Tick appropriately according to the extent which you agree or disagree with the statements.

Tax Compliance	Rating				
	5	4	3	2	1
Our SMEs file returns accurately					
Our SMEs file returns on time					
Our SMEs have the correct obligations					
All our SMEs keep records like TB; Journals and Ledgers are updated					
Our SME is Registered as a taxpayer in the KRA system					