

**Factors Affecting Value Added Tax Compliance in Kenya. A Case Study of  
North of Nairobi.**

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**A Research Project Submitted in Partial Fulfillment of the Requirements  
for the Post Graduate Diploma in Tax Administration of the Jomo  
Kenyatta University of Agriculture and Technology**

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## DECLARATION

I declare that this research project is my original work and has not been presented for a degree in any other university.

Signed .....

Date.....

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**HDB336-CO-0328/2019**

### **Declaration by the Supervisor**

This project has been submitted for examination with my approval as university supervisor

Signed .....

Date.....

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## **DEDICATION**

This project 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. Special thanks to my supervisor, Dr. Marion Nekesa whose professional guidance and advice enabled me to successfully undertake and complete my study. I appreciate the support and encouragement received from all other individuals that I interacted with, in the course of my study that has led to the successful completion of this PGD programme.

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## **LIST OF ACRONYMS AND ABRAVIATIONS**

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

## DEFINITION OF TERMS

<b>SMEs:</b>	These are enterprises with a turnover of between 5M and 8M.
<b>Tax:</b>	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.
<b>Tax Compliance:</b>	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.
<b>Tax Evasion:</b>	It refers to using illegal means to avoid paying taxes.
<b>Tax Rate:</b>	Tax imposed by the federal government based on an individual's taxable income or a corporation's earnings
<b>Tax Information:</b>	The knowledge or facts provided about taxes.
<b>Tax Obligation:</b>	Responsibilities pertaining to tax payment and declaring of tax returns which a person duly registered
<b>Tax Compliance cost:</b>	It refers to the expenditure of time or money in conforming to government requirements such as legislation or regulation.
<b>Tax Administration:</b>	It refers to the procedures attached to tax compliance including registration and filling of returns.

## ABSTRACT

The study aims to establish the factors affecting Value added tax compliance in small and medium enterprises in North of Nairobi. The study will be guided by the following specific objectives:- to investigate the effect of costs of compliance on Value added tax compliance in among Small and medium enterprises in North of Nairobi, to find out the effect of penalties and interest on Value added tax compliance in among Small and medium enterprises in North of Nairobi, to determine the effect of level of tax knowledge on Value added tax compliance in among Small and medium enterprises in North of Nairobi, to assess the effect of rates of tax on Value added tax compliance in among Small and medium enterprises in North of Nairobi. The study employed descriptive research design. The study target population was 1600 Small and Medium taxpayers in North of Nairobi. The study sample size was 160. 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 was carried out by use of descriptive statistics and inferential statistics using Standard statistical techniques including Pearson correlation coefficient and regression analysis employed in the analysis. All the analysis was carried out using the statistical package for social sciences (SPSS Version.24). Analysis of variance (ANOVA) 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, tax compliance cost, level of tax knowledge, taxpayer perception and penalties and interest the findings reveals that assuming other variables are at zero a unit change in tax compliance cost will lead to a 0.422 increases value added tax compliance; a unit increase in level of tax knowledge will lead to a 0.432 increases value added tax compliance; a unit increase in taxpayer perception will lead to a 0.411 increases value added tax compliance and a unit increase in penalties and interest will lead to a 0.403 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 taxpayer perception while level of tax knowledge influence to a little extent value added tax.

# CHAPTER ONE

## INTRODUCTION OF THE STUDY

### 1.1 Background of the Study

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.

#### 1.1.1 Global perspective

There are 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 to 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 fulfilment 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).

### **1.1.2 Kenya Perspective**

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. VAT was introduced in Kenya in 1990 as a means of increasing the government tax collections by widening the tax base. VAT is imposed by Kenya revenue Authority (KRA) as per the laws of the Value Added Tax Act 2013. The Value Added Tax is an indirect tax on consumption applicable on the sale of supplies at all levels of production and distribution.

VAT registered taxpayer's acts as agents in collecting and remitting collected VAT to the government. The VAT paid on inputs in turn is claimed as credit when registered taxpayers declare output VAT on their sales (VAT Act 2013 Sec 17). Suppliers of exempt goods & services (VAT Act 2013, first schedule) do not charge VAT on their supplies and cannot claim credit for VAT paid on their purchases. The VAT system also contains zero rated goods and services (VAT Act 2013, 2nd schedule). Businesses charge VAT at a rate of 0% on their supplies and are allowed to deduct the input tax paid on the purchase of those zero rated goods and services (VAT Act 2013 Sec 17).

Value Added Tax is a multi-stage consumption tax charged on the sale of goods and services at all stage of production and distribution chain. The tax is charged on the supply of taxable goods or services in Kenya and the importation of taxable goods or services in Kenya. The tax

is collected by registered traders and remitted to Kenya Revenue Authority, but the burden is shifted to consumers through higher prices. Value Added Tax is charged under the VAT Act Cap 476 under the laws of Kenya. Tax compliance is a process in which taxpayers adhere to the rules set by the relevant tax authorities such as payment of taxes due and filing of returns so that revenue can be collected effectively.

The government formulates policy and VAT laws, KRA oversees implementation of the laws, professionals offer services to ensure tax compliance, businesses act as agents in collecting VAT & remitting it to the government and the general public is concerned about the VAT rate which influences their spending and how the government is utilizing the VAT revenue collected. VAT contributes about 23% of the total tax revenue collection by the government (KNBS 2014).

In Kenya, the controlling and formal context has based the definition of Kenya's SMEs on the employees' numbers and the overall turnover of a corporation (MSME's Act 2012). SME's have been defined by the act as those employing between ten and fifty employees with yearly turnover of between 500,000 and 5 million Kenya shillings. Generally, this sector comprises of manufacturing and trade activities which affect the general economy of the country. For the fundamental purpose of providing for compliance on a voluntary basis and growth of the economy, a tax policy that is ideal has to be adopted. Tax revenue is one of the major sources of revenue used to fund development projects and provision of public goods and services. Small and Medium Enterprises being part of the economy need to pay their taxes in consideration of their volatile nature. It is for this reason that most SMEs continue in the sector of the economy that does not have formalities and the compliance cost also happens to be too high

## **1.2 Statement of the Problem**

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. It's therefore against this background that this study aim to establish the factors influencing VAT compliance among the Small and medium sized enterprises in North of Nairobi.

### **1.3 Research Objectives**

#### **1.3.1 General Objective**

To establish the factors affecting Value Added Tax collection on small and medium enterprises in North of Nairobi, Kenya.

#### **1.3.2 Specific Objective**

- i. To determine the effect of level of tax knowledge on Value added tax compliance in among Small and medium enterprises in North of Nairobi, Kenya
- ii. To assess the effect of taxpayers perception on Value Added Tax collection of SMEs in North of Nairobi, Kenya.
- iii. To find out the effect of penalties and interest on Value added tax compliance in among Small and medium enterprises in North of Nairobi, Kenya.
- iv. To investigate the effect of tax compliance costs on Value added tax compliance in among Small and medium enterprises in North of Nairobi, Kenya.

### **1.4 Research Questions**

- i. What is the effect of level of tax knowledge on Value added tax compliance in among Small and medium enterprises in North of Nairobi, Kenya
- ii. What is the effect of taxpayers perception on Value Added Tax collection of SMEs in North of Nairobi, Kenya.
- iii. What is the effect of penalties and interest on Value added tax compliance in among Small and medium enterprises in North of Nairobi, Kenya.
- iv. What is the effect of tax compliance costs on Value added tax compliance in among Small and medium enterprises in North of Nairobi, Kenya.

## **1.5 Significance of the Study**

### **1.5.2 The Kenya Revenue Authority**

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

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

### **1.5.3 The 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 VAT registered traders in the country as well as ensuring adequate financial resources for the government.

### **1.5.2 The VAT Registered Traders**

Business people will also use the findings to understand the financial benefits associated with electronic processing of transactions. This will help them in addressing record keeping challenges that influence their growth in Kenya.

### **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 study was limited to Small, Medium enterprises in North of Nairobi. The study will target VAT registered SMEs tax compliance status of individual taxpayers between the periods of 2016 to 2018. The study will target a population of 1600 traders with a sample size of 160 will be drawn using questionnaires.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter presents 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**

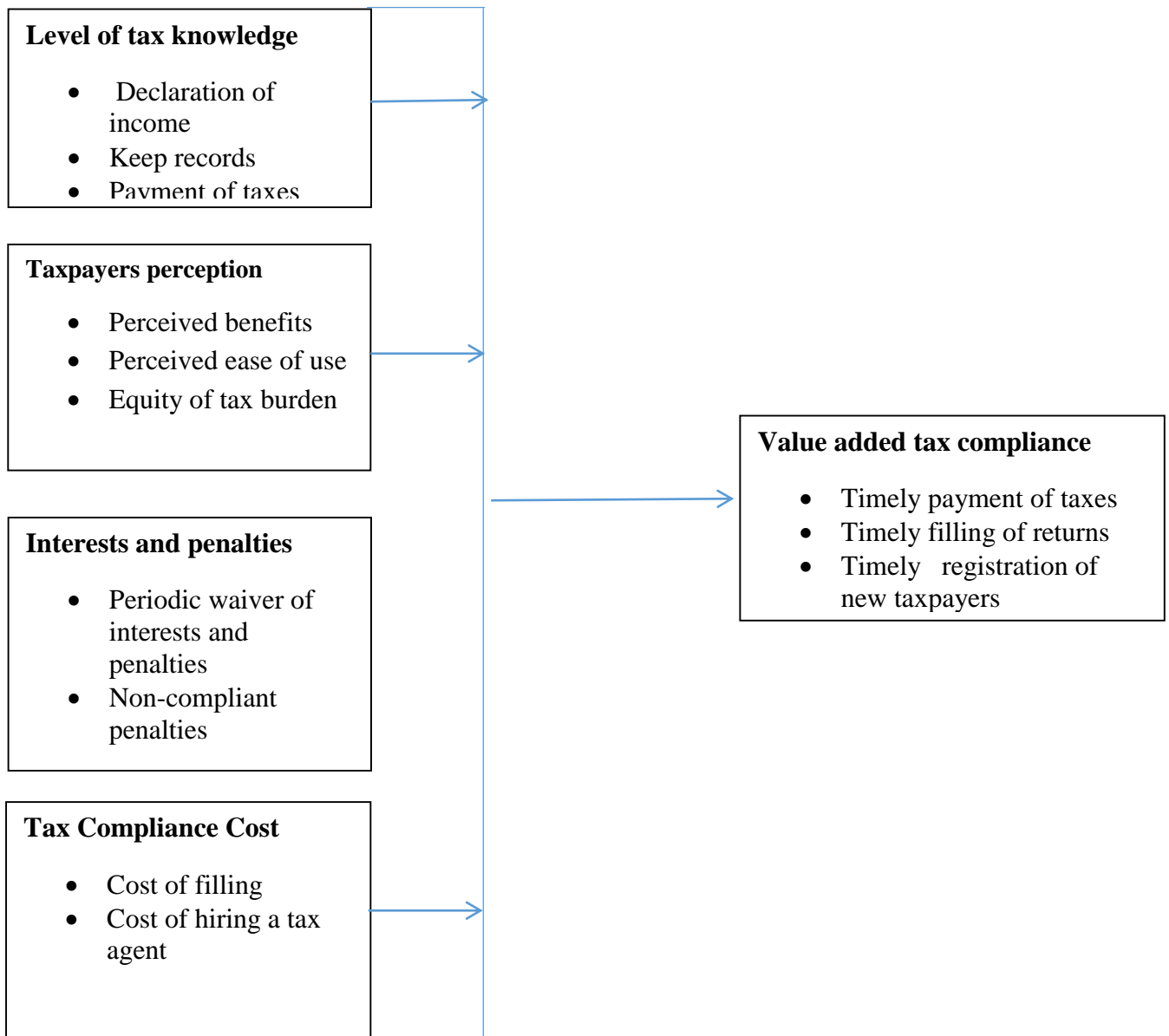
According to this theory, tax liability in its true form is a compulsory and an unconditional payment to the state. The theory posits that there is no commercial or semi-commercial relationship between the state and the citizens. A citizen is to pay taxes just because he or she can and his or her relative 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

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.

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 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 researchers and policy makers to put emphasis on tax noncompliance. 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 have 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 Level of tax Knowledge and value added tax compliance**

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).

Kimingu 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).

#### **2.4.2 Taxpayers perception and value added tax compliance**

Perception towards tax and its general compliance levels has been identified as one of the major factors that influence compliance, even in the theories as explained in Section 2 of this study. Fischer says tax evasion is a universal phenomenon that takes place in all societies and economic systems including both developed and developing countries and it's influenced by many factors among them attitudes and perceptions.

This is in contrasting between the benefits received for the tax given and the equity of the taxpayer's burden in reference to that of other individuals. It's thus seen that taxpayers who believe that the tax system is unfair are more likely to commit tax noncompliance behaviour. Social psychologists have offered several explanations why knowing a tax evader might cause an honest taxpayer to consider evasion. Lerner, 1998 suggests that people need to believe the world is just. Consequently, when people observe an unjust event, they may cope by punishing the harm-doer, compensating or blaming the victim, or denying the injustice by reasoning that justice will prevail in the next life. In some cases, such as tax evasion, one might seek justice by engaging in the activity oneself. When someone violates a standard, they incur a psychological cost-guilt whether or not others discover the behavioural violation. However, if others of perceived high moral character violate a law, then one's behavioural standard may change. For example, Kaplan and Reckers, 1985 provide experimental evidence that subjects were more likely to evade taxes when they observed a taxpayer of perceived high moral character evading.

In contrast, as noted above, the effect of others' behaviour does not require consensus about the esteem-worthiness of an action, and one's response to the action is independent of detection.

Tax fairness consists of at least two different dimensions. "One dimension appears to involve the equity of the trade - the benefits received for the tax given. The other dimension appears to involve the equity of the taxpayer's burden in reference to that of other individuals" Jackson

and Milliron, 1986. Thus, unfairness of the tax system may reflect taxpayers' perceptions that they are overpaying taxes in relation to the value of the services provided by government or in relation to what other taxpayers pay. Porcano, 1984 finds that taxpayers' need and ability to pay are the most significant variables related to perceptions of fairness of the tax system. Other surveys conducted by Scott and Grasmick, 1982 and Spicer and Lundstedt, 1976 indicate that respondents who believe that the tax system is unfair are more likely to commit tax noncompliance behaviour.

As the consensus about a norm increases, its effect on others increases, initially at an increasing rate and later at a decreasing rate. The effect of a social norm on behaviour eventually levels off as the proportion of the population adopting the norm approaches 100 per cent. Consequently; the effect of others' behaviour, triggering a flow from honesty to susceptibility; the effect of a social norm, causing some evaders to become honest each period; an enforcement effect triggering a shift from evasion to honesty and an enforcement effect on the flow from susceptibility to evasion.

#### **2.4.3 Interest and penalties and Value Added Tax compliance.**

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 noncompliance aspects.

#### **2.4.4 Tax compliance cost and value added tax compliance.**

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 interms 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 to salaries paid to internal employees and fees paid to external tax professionals. The psychological costs concerns the effects upon a taxpayer in dealing with the tax matters e.g. mental stress. Psychological 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).

## **2.5 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.

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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.

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specifically portray the exact effect of leadership on the stability of the labor force, specifically in public sector organizations.

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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 aforementioned literature review it is evident that VAT 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 VAT as necessary (Robert, 1997), others view it as an obstacle that hampers the growth of some VAT registered traders (Mboma, 2012; Mohammed & Gela, 2014).

## **2.7 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 employed descriptive research design, it was 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 assess the factors affecting Value Added Tax of SMEs in North of Nairobi Kenya.

#### **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. Generally, sampling frames can be divided into two types, list and non-list. Examples of list frames include a list of registered voters in a town, residents listed in a local telephone directory, or a roster of students enrolled in a course.

The study used sampling frame which comprised of segmented taxpayers from the Small and Medium Enterprises in North of Nairobi, Kenya.

### 3.5 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 was 1600 VAT registered SMEs operating business in North of Nairobi. The study was 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
<b>TOTAL</b>	<b>1600</b>

### 3.6 Sample and Sampling technique

#### 3.6.1 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 used a stratified random 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 study used the following formula;

$n = \frac{Nk}{k+1}$

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 1600 firms divided by 10 = 160 respondents. The respondent selected the first sample unit at random and then the remaining units were automatically selected in a definite sequence of the 10th. Hence the respondents were 160.

**Table 3.2 Sampling Frame and Sample Size**

<b>Type of Enterprises</b>	<b>Target population</b>	<b>Sample size 10%</b>
Small Scale Enterprises	1000	100
Medium Scale Enterprises	600	60
<b>TOTAL</b>	<b>1600</b>	<b>160</b>

### **3.7 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 was 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 used 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 were assured of strict confidentiality of the information they used share with the researcher and that the information is strictly for research purposes.

### **3.8 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 use primary data. Primary data used collected by use of questionnaires which was administered to the sampled respondents.

### **3.8.1 Primary Data**

This study used primary data collection through questionnaires. The questionnaire was closed structured ended questions in the form of likert scale.

### **3.9 Data Collection Procedures**

The relevant data was 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.

### **3.10 Pilot Study**

The study was 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 was selected to test the reliability of the research instruments the major purpose for pilot testing was to test whether the questionnaires could obtain the required results. The pilot study used to find out the clarity and objectivity of the selected questions.

#### **3.10.1 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 was 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.

#### **3.10.2 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. Validity is the degree to which an instrument measures what it is supposed to measure. (Kothari, 2004), the term refers to the

extent to which an instrument asks the right questions in terms of accuracy. The validity of this research instrument was determined through piloting, where the responses of the subjects was checked against the research objectives.

For a research instrument to be valid the content must be relevant to the variable being investigated. Validity therefore refers to the extent to which an instrument asks the right questions in terms of accuracy. .Mugenda *et al* (1999) looked at validity as the accuracy and meaningfulness of inferences, based on research results.

### **3.11 Data Analysis and Presentation**

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

#### **3.11.1 The Qualitative Analysis**

Qualitative data was collected through questionnaires and response rate calculated. The data was 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 was computed.

#### **3.11.2 The Quantitative Analysis**

Quantitative data from the questionnaire was coded and entered into the computer for statistical analysis. The Statistical Package for Social Sciences (SPSS version 20) was used for analysis. Frequencies, mean and standard deviation was used to summarize the data. Regression model was 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 was 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 employed a multi regression model

Findings

### **3.12 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 multicollinearity, autocorrelation and normality test.

#### **a) Multicollinearity**

To determine whether multicollinearity existed, collinearity test was conducted using, tolerance, and variance inflation factor (VIF).

#### **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.

#### **d) Normality test)**

Normality was tested by use of The Shapiro-Wilk Test to test whether the score of the samples is 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).

### 3.13 Measurements of the variables

**Table 3.2: Measurement of Variables**

<b>Variable</b>	<b>Indicators</b>	<b>Likert scale</b>
<b>Level of tax knowledge</b>	Declaration of income Keep records	<b>5 points</b>
<b>Taxpayers perception</b>	Payment of taxes Perceived benefits  Perceived ease of use	<b>5 points</b>
<b>Penalties and interest</b>	Punitive interests and penalties Periodic waiver of interests and penalties	<b>5 points</b>
<b>Tax Compliance Cost</b>	Cost of filling Cost of hiring a tax agent  Cost of travelling	<b>5 points</b>
<b>Value Added Tax compliance</b>	Non-compliant penalties Timely payment of taxes Correct returns filled Timely filling	<b>5 points</b> <b>5 points</b>

## 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 North of Nairobi, 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**

<b>Response Rate</b>	<b>Frequency</b>	<b>Percent</b>
Returned	155	97%
Unreturned	5	3%
Total	160	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**

<b>Constructs</b>	<b>Reliability Cronbach's alpha</b>	<b>Comment</b>
Tax compliance cost	0.773	Accepted
Level of tax knowledge	0.831	Accepted
Taxpayers perceptions	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, Taxpayers perceptions 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**

<b>Model</b>	<b>Collinearity Tolerance</b>	<b>Statistics VIF</b>
Tax compliance cost	.806	1.136
Level of tax knowledge	.830	1.161
Taxpayers perceptions	.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**

<b>Model</b>	<b>Durbin-Watson</b>
1	2.021

**a. Predictors: (Constant), Tax compliance cost, Level of tax knowledge, Taxpayers perceptions, 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
Taxpayers perceptions	.942	155	.022
Penalties and interest	.934	155	.633
Value Added Tax compliance			

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**

<b>Statement</b>	<b>SA</b>	<b>A</b>	<b>U</b>	<b>D</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
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 respondent's 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 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**

<b>Statement</b>	<b>SA</b>	<b>A</b>	<b>U</b>	<b>D</b>	<b>M</b>	<b>Sd</b>
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,56.6percent 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 (Hite and Hasseldine, 2001).

#### 4.4.3 Taxpayer perception and 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 Taxpayer perception**

<b>Statement</b>	<b>SA</b>	<b>A</b>	<b>U</b>	<b>D</b>	<b>M</b>	<b>Sd</b>
Tax rate charged by KRA is too high for SMEs taxpayers	39.3	52.2	9.5	0	1.8	0.9
Delay in receiving feedback on queries raised	30.1	57.6	13.6	1.7	1.6	0.9
Complex procedure in filing the return	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 . Tax rate charged by KRA is too high for SMEs taxpayers, 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 Complex procedure in filing the return. 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. The study findings are supported by a number of studies which includes Scott and Grasmick, 1982 and Spicer and Lundstedt, 1976

#### 4.4.4 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**

<b>Statement</b>	<b>SA</b>	<b>A</b>	<b>U</b>	<b>D</b>	<b>M</b>	<b>Sd</b>
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	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 , 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	Taxpayer perception	Penalties and interest
<b>Value Added Tax Compliance</b>	Pearson Correlation	1				
	Sig. (2-tailed)					
<b>Tax compliance cost</b>	Pearson Correlation	0.456	1			
	Sig. (2-tailed)	0.002				
<b>Level of tax knowledge</b>	Pearson Correlation	0.431	.3421	1		
	Sig. (2-tailed)	0.001	.0014			
<b>Taxpayer perception</b>	Pearson Correlation	0.458	.1240	.0621	1	
	Sig. (2-tailed)	0.003	.0120	.0043		
<b>Penalties and interest</b>	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 Taxpayer perception 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, taxpayer perception and penalties and interest and Value added tax compliance. The findings of this study agreed with the study conducted (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	.742 <sup>a</sup>	.550	.545	.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 0.550 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 45 % 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 <sup>b</sup>
	Residual	42.767	154	.277		
	Total	53.659	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 Coefficients		Standardized Coefficients		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	.195	.115	-	2.257	.028
	Tax compliance costs	.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 <sup>a</sup>	.228	.217	.75515	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 0.228 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 22.8% 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 <sup>b</sup>
	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 Taxpayer perception on value added tax compliance in Kenya.

**Table 4.16: Model Summary of Taxpayer perception**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.421 <sup>a</sup>	.174	.170	.87898	1.995

- a. Predictors: (Constant), Taxpayer perception**
- 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 taxpayer perception and Value added tax compliance as indicated in table above. This indicates that taxpayer perception share a variation of 17.4% of Value added tax compliance.

**Table 4.17: ANOVA of Taxpayer perception**

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

- a. Dependent Variable: Value added tax compliance**
- b. Predictors: (Constant), taxpayer perception**

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 taxpayer perception**

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 taxpayer perception was positive and significant ( $\beta = 0.408$ ,  $t = 3.708$ ,  $p < .05$ ). The regression estimate for Tax rate was 0.408 this

indicates that a unit increase in taxpayer perception 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 <sup>a</sup>	.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 <sup>b</sup>
	Residual	40.767	154	.867		
	Total	52.659	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
	Penalties and interest	.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 penalties and interest was 0.403; this indicates that a unit increase in penalties and interests 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 <sup>a</sup>	.499	.490	.71722	2.001

**a. Predictors: (Constant), Tax compliance cost, level of tax knowledge, taxpayers perception 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, taxpayer perception, 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 <sup>b</sup>
	Residual	28.262	155	.513		
	Total	56.638	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. In this case the F ratio (F=11.338, P=.000<sup>b</sup>) was found to be significant hence the model used for analysis was fit

**Table 4.20: Coefficients of Overall Regression Model**

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	.195	.096	-	2.054	.044
	Tax compliance cost	.422	.096	.234	2.266	.016
	Level of tax knowledge	.432	.098	.355	3.560	.043
	Taxpayers perception	.411	.096	.314	3.061	.022
	Penalties and interest	.412	.096	.244	2.366	.014

**a. Dependent Variable: Value added tax compliance**

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

$Y = 0.195 + 0.422X_1 + 0.432X_2 + 0.411X_3 + 0.403$  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, taxpayer perception 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 0.422 increases value added tax compliance; a unit increase in level of tax knowledge will lead to a 0.432 increases value added tax compliance; a unit increase in taxpayer perception will lead to a 0.411 increases value added tax compliance and a unit increase in penalties and interest will lead to a 0.403 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 taxpayer perception 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, taxpayer perception, 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 Taxpayer perception 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 taxpayer perception 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**

#### **5.0 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 Taxpayer perception**

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

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

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

The study found out that had a significant positive influence of taxpayer perception on value added tax compliance. The overall mean score of response regarding taxpayer perception and turnover tax compliance indicated that majority of the respondents agreed that tax affects the turnover tax compliance in Kenya. .

#### **5.3.2 Recommendations**

The study found out that taxpayer awareness had a significant positive influence on turnover tax compliance in Kenya. The overall mean score of responses regarding taxpayer awareness

indicated that majority of the respondents disagreed that taxpayer awareness affects the value added tax compliance in Kenya. The reliability analysis results showed that all the coefficients of the constructs were positive and significant. The study recommends that KRA should put more emphasis on the taxpayers' workshops and seminar to educate taxpayers on taxes.

The study found out that had a significant positive influence of taxpayer perception on value added tax compliance. The overall mean score of response regarding taxpayer perception and value added tax compliance indicated that majority of the respondents agreed that tax affects the value added tax compliance in Kenya. Correlation results indicated that there was a positive and significant relationship between taxpayer perception and turnover tax compliance. It was therefore concluded that taxpayer perception has significant positive effect on turnover tax compliance in Kenya. The study recommends that KRA should lower the tax rate of the value added tax to encourage the taxpayers to pay taxes accordingly.

The study found out that fines and penalties had a significant positive influence on turnover tax compliance in Kenya. The overall mean score of response regarding fines and penalties and turnover tax compliance indicated that majority of the respondents agreed that fines and penalties affects the value added tax compliance in Kenya.

Correlation results indicated that there was a positive and significant relationship between engagement efforts and value added tax compliance. It was therefore concluded that fines and penalties has significant positive effect on value added tax compliance in Kenya. The study recommends that KRA should remove punitive fines and penalties by giving waivers to taxpayers.

The study found out that cost of compliance had a significant positive influence on value added tax compliance in Kenya. The overall mean score of responses regarding cost of compliance indicated that majority of the respondents disagreed that cost of compliance affects

the value added tax compliance in Kenya. The reliability analysis results showed that all the coefficients of the constructs were positive and significant. The study recommends that the cost of compliance should be lowered thus KRA employees should assist taxpayers in filing, payment and registration of taxes.

#### **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.

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## **APPENDICES**

### **APPENDIX I: Letter to Respondents (Introduction Letter)**

**Naomi Muiruri**

P.O Box 85873-00200,

Nairobi.

To the respondent

#### **RE: QUESTIONNAIRE**

The above named is a second year student at JKUAT, Nairobi campus. In order to fulfil the requirements of the School, I am undertaking a research on factors affecting Value Added Tax (VAT) collection, a case study of Small and Medium Enterprises in North of Nairobi, Kenya.

You are among the chosen respondents of my study.

I hereby, kindly ask you to respond to the questionnaire to the best of your knowledge.

Confidentiality of the information given will be guaranteed.

Your cooperation will be highly appreciated.

Yours Sincerely,

**Naomi Muiruri**

## APPENDIX 2: QUESTIONNAIRE

### Introduction

This questionnaire is designed for the sole purpose of gathering information on Factors Affecting Value Added Tax Compliance in SMEs in North of Nairobi. The information obtained will only be used for academic purposes and shall be treated in utmost confidence.

You are requested to complete this questionnaire as honestly and objectively as possible.

Please tick in the appropriate box and also fill in the blank spaces provided for those questions.

Use the space at the back of this questionnaire if you need more space for your responses.

### SECTION B

#### 1. TAX KNOWLEDGE ON VALUE ADDED TAX COMPLIANCE.

II) Evaluate the following statements and tick where appropriate under the choices below

Where: 1 – Strongly Disagree, 2 – Disagree, 3 – Neutral, 4 - Agree or 5 - Strongly Agree

Statement	1	2	3	4	5
Small and Medium sized entrepreneurs have adequate knowledge on tax rate, basis of taxation and compliance requirements.					
Knowledge about declaration of income					
KRA has created a lot of public awareness payment of taxes					

**2. TAXPAYERS PERCEPTION ON VALUE ADDED TAX COMPLIANCE**

iv) Evaluate the following statements and tick where appropriate under the choices below

**Where: 1 – Strongly Disagree, 2 – Disagree, 3 – Neutral, 4 - Agree or 5 - Strongly Agree**

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Tax rate charged by KRA is too high for SMEs taxpayers					
Delay in receiving feedback on queries raised					
Complex procedure in filing the return					
Lack of internet to download forms for filling returns					

**3. INTERESTS AND PENALTIES ON VALUE ADDED TAX COMPLIANCE**

ii) evaluate the following statements and tick where appropriate under the choices below

**Where: 1 – Strongly Disagree, 2 – Disagree, 3 – Neutral, 4 - Agree or 5 - Strongly Agree**

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Interests and penalties are very punitive to business owners					
Periodic waiver of fines and penalties could encourage tax compliance					
Small and Medium sized entrepreneurs file returns on time to avoid penalties of non-compliance on the iTax system					

#### 4. TAX COMPLIANCE COST ON VALUE ADDED TAX COMPLIANCE

1) Evaluate the following statements and tick where appropriate under the choices below

Where: 1 – Strongly Disagree, 2 – Disagree, 3 – Neutral, 4 - Agree or 5 - Strongly Agree

Statement	1	2	3	4	5
The cost of filing a tax return is fair					
The cost of hiring a tax agent is high					
The cost of travelling in order to file a return is low					

#### 5. VALUE ADDED TAX COMPLIANCE

V) Evaluate the following statements and tick where appropriate under the choices below

Where: 1 – Strongly Disagree, 2 – Disagree, 3 – Neutral, 4 - Agree or 5 - Strongly Agree

Statement	1	2	3	4	5
The company submits VAT tax returns to KRA every month.					
The company's VAT tax returns submitted to KRA are correctly stated.					
The company pays the monthly self- assessed VAT tax to KRA by the due date					
The company declare taxes on monthly basis					

***THANK YOU FOR YOUR ASSISTANCE AND COOPERATION***

**APPENDIX 111: BUDGET**

<b>DESCRIPTION</b>	<b>TOTAL AMOUNT (Kshs)</b>
<b>Stationery</b> Photocopying papers Pens, pencils, rubbers Ink cartridge (Printer) Files (12 rim binders)	<b>20,000.00</b>
<b>Personnel</b> Questionnaires administrators Stastician	<b>20,000.00</b>
<b>Transport and subsistence</b> Vehicles Subsistence allowance	<b>10,000.00</b>
<b>Communication</b> Telephone Internet	<b>20,000.00</b>
<b>Other Services</b> Library services Purchase of periodicals and books	<b>30,000.00</b>
<b><u>Total expected cost</u></b>	<b><u>110,000.00</u></b>

**APPENDIX 1V: WORK PLAN**

<b>ACTIVITY (2018)</b>	<b>DECEMBER (2020)</b>	<b>APRIL (2021)</b>	<b>MAY (2021)</b>
Draft proposal			
Proposal presentation			
Designing the research instrument			
Field work & data Collection			
Data Entry / Analysis			
Report Writing			
Presentation of 1 <sup>st</sup> draft			
Presentation of 2 <sup>nd</sup> draft			
Submission of final report			