

**Factors Affecting Tax Compliance among Small and Medium  
Enterprises in Nairobi City County, Kenya**

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**DECLARATION**

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

Signature..... Date.....

**Mathanjuki Gibson Kuria**

This project has been submitted for examination with my approval as the University Supervisor

Signature..... Date.....

**Dr. David Muraga**

## **DEDICATION**

This project is dedicated to my family for their support and encouragement throughout the study period.

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## **LIST OF ABBREVIATIONS /ACRONYMS**

|             |  |
|-------------|--|
| <b>OECD</b> | Organization for Economic Co-operation and Development |
| <b>KRA</b>  | Kenya Revenue Authority                                |
| <b>SMEs</b> | Small and Medium Enterprises                           |
| <b>GDP</b>  | Gross Domestic Product                                 |
| <b>KES</b>  | Kenyan Shillings                                       |
| <b>ILO</b>  | International Labor Organization                       |
| <b>MSME</b> | Micro and Small Enterprise                             |
| <b>GoK</b>  | Government of Kenya                                    |

## OPERATIONAL DEFINITION OF TERMS

|                           |   |
|---------------------------|---|
| <b>Tax</b>                | refers to a compulsory levy, imposed by government or other tax raising body on income expenditure or capital assets for which the taxpayer receives nothing specific in return'(Langham, Paulsen, & dan Härtel, 2012). |
| <b>Tax equity</b>         | refers to a tax system where tax payers are asked to pay taxes in proportion to their income (Maseko, 2014).  |
| <b>Tax convenience</b>    | refers to the system whereby tax should be levied at the time and the manner which is most convenient for the contributor to pay it when it is available (Langham, Paulsen, & dan Härtel, 2012).                        |
| <b>Tax Transparency</b>   | refers to the way an organization clarifies the taxation of its profits and the amount of tax it actually pays (Saad, 2011).  |
| <b>Tax accountability</b> | refers to a situation when a tax generates a degree of accountability between the government and civil society with respect to the resources being used on the budget (Kemboi & Tarus, 2012)                            |
| <b>Tax compliance</b>     | refers to the ability of citizens to fulfill the tax obligation as required of them by law and regulations of a country (Akinboade, 2015)   |
| <b>SME</b>                | refers to a business enterprise with revenue not exceeding KShs 5,000,000 per annum and more than KShs 500,000 in sales (Katua, 2014)   |

## ABSTRACT

Tax plays an important role in the growth of any economy so tax evasion is harmful to the economy. Tax evasion hampers government revenue collection thus inefficiency in Government spending because it diminishes the capacity of the state to mobilize domestic revenues, resources that are needed for investments. The study therefore sought to assess factors that affect tax compliance among SMEs in Nairobi County. It was guided by the following objectives: To determine the effect of Tax Transparency on tax compliance among SMEs in Nairobi County, Kenya, To evaluate the effects of tax accountability on tax compliance among SMEs in Nairobi County, Kenya and to establish the effects of tax convenience on tax compliance among SMEs in Nairobi County, Kenya. The study adopted descriptive survey research design. The target population for this study was all the licensed SMEs within Moi Avenue Street Nairobi which stands at 649 SMEs, The sample size of this study was based on Yamane's 1967 formulae, the desired sample size thus comprised of 249 respondents. It used random sampling in order to select the cases which were the SMEs studied. Questionnaires were used to collect data. To determine the reliability of research instruments a pilot study was conducted before the actual data collection and further split half method was carried out to calculate Cronbach alpha. A value of above 0.7 confirmed the reliability of the research instruments. The data was analyzed using both inferential (multiple regression) and descriptive statistics (frequencies, percentages, mean and standard deviation) and was presented by use of tables and charts. The study findings indicated that all the study variables tax transparency ( $B=0.241$ ,  $p$  value= $0.000$ ), tax accountability SMEs ( $B=0.299$ ,  $p$  value= $0.000$ ) and tax convenience was positively and significantly related to tax compliance among SMEs ( $B=0.407$ ,  $p$  value= $0.000$ ). It was therefore recommended that there is need to intensify taxpayer education, the returns ought to be simplified and accompanying notes reconstructed into plain language and Kenya revenue Authority should strive to give taxpayers high quality services as stipulated in the corporate plan.

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the study**

In the recent years, tax systems in most governments in the world have undergone significant changes as many countries across ideological spectrum and varying levels of development have undertaken reforms. In many developing countries, pressing fiscal imbalance was the driving force in the sector. In this regard, tax policy was employed as a principal instrument to correct severe budgetary pressures (Wasao, 2014). In others, transition from plan market necessitated wide ranging tax reforms.

Taxation is one of the important elements in managing national income, especially developing countries and has played an important role in civilized societies since their birth thousand years ago (Langham, Paulsen, & dan Härtel, 2012). Tax is defined as ‘a compulsory levy, imposed by government or other tax raising body on income expenditure or capital assets for which the taxpayer receives nothing specific in return’ (Langham, Paulsen, & dan Härtel, 2012). However, this does not mean all payments to the government are tax payment: charges sells or other levies on services to the citizens. Tax compliance by a citizen implies compliance with all statutory obligations specified in tax law, including registration as taxpayer maintaining required records, filing timely, accurate tax returns and paying taxes correctly and on time.

Tax administration and compliance issues determine the broad evolution of tax system. Therefore, when processes and changes in the economy cannot be explained on a level necessary using standard economic theory of the different processes, one has to turn to other branches of science including social psychology. Such a tendency is gaining momentum also upon identification of the reasons for payment of taxes, failure of payment, avoidance of tax liabilities and tax evasion (Makokha, Nambuswa, and Namusonge, 2017).

Maseko, (2014) states that, the issues of tax compliance cost and compliance level are as old as the collection of taxes and will be a target for research as long as taxes exist. Mohd, (2010) noted that however, that avoidance of paying taxes is a growing problem in most countries like Kenya. Kenya like other developing countries seeks to apply the tax weapon so as to meet the objective of raising enough revenue and ensuring that revenue is raised in ways that are equitable. In order to achieve all the necessary targets, the government must continue engaging all taxpayers (employers, employees and self-employed groups.) on the fight against tax evasion.

### **1.1.1 Global Perspective of Factors that Influence Tax Compliance**

Procedural justice and trust in the authority can explain the relationship between the authority and the citizen (Akinboade, 2015). If the individual perceives that the authority has exercised fair procedures, then that person will have more trust in the authority (Yong & Hooper, 2011). In taxation, a relationship between taxpayers and the authority relies on the existence of trust and cooperation for tax compliance. Fair treatment received by taxpayers will boost their confidence and trust in the tax authority and assist in achieving high tax compliance. In Australia, trust in the tax authority is low due to the unfair treatment received by taxpayers (Yong & Hooper, 2011). It is clear that there is a correlation between the fair treatment received by taxpayers and trust in the tax authority.

Globally It is widely held that the wealthy should pay more taxes, not only a greater absolute amount, but also a greater percentage, based on the benefits principle, the ability-to-pay principle, and the marginal utility principle. The benefits principle applies because the wealthy profit more from police and fire protection, the court system, and national defense, since they have more to protect. Indeed, the Republicans, who are the major party for the wealthy in the United States, fully supports the military and opposes any cuts in their apportionment of tax revenue, even though many seriously question the need for such a large military. On the other hand, the Republicans want to reduce or eliminate payments to poor people or the middle class so that the wealthy can pay even less tax (Maseko, 2014).

Based on the ability-to-pay principle, the wealthy should obviously pay a greater percentage of their income, since they reap the greatest benefits from our society. However, the strongest argument for why the wealthy should pay more is that the marginal utility of their money has much less value for them than it does for the working class. When millions of people in the United States are unemployed and can't afford healthcare, it is outrageous to see so many wealthy people pay record prices for paintings and other artifacts that have little real value (Emanuele, 2012).

### **1.1.2 Kenya Perspective of Factors that Influence Tax Compliance**

Taxpayers' behavior towards tax system has evoked great attention among many revenue authorities in the world especially in developed countries. However, it is debatable on what has been done towards the study of taxpayers' behavior towards tax system in developing countries (Lumumba et al., 2010). According to Wamathu, (2014, tax compliance is multi-faceted measure and theoretically, it can be defined by considering three distinct types of compliance such as payment compliance, filing compliance, and reporting compliance. OECD (2012) advocates dividing compliance into categories in considering definitions of tax compliance. These categories are administrative compliance and technical compliance. Administrative compliance otherwise referred to as reporting compliance or procedural compliance or regulatory compliance refers to complying with administrative rules of lodging and paying. Technical compliance refers to complying with technical requirements of the tax laws in calculating taxes or provisions of the tax laws in paying the share of the tax (Atawodi, & Ojeka, 2012).

Tax compliance in Kenya, especially among the small and medium enterprises is generally very low. Kenya is actually ranked among low-income countries or low compliance countries with hard task of ensuring efficient and effective tax administration. There is need to examine why this is so. As such, this study will examine what factors are important as regards tax compliance or lack of it from the perspective of small scale traders in Nairobi. Administration of tax in Kenya is by the Kenya Revenue Authority (KRA) established through an Act of Parliament on July 1st 1995 (Cap 469).

“Kenya Revenue Authority is supposed to promote compliance with Kenya’s tax ensure responsible enforcement by highly motivated and professional staff thereby maximizing revenue collection at least possible cost for the social-economic well-being of Kenyans” (Wamathu, 2014).

SMEs have been selected for this study given that they are central to the fiscal policy of the Government of Kenya as they offer employment opportunities to millions of Kenyans and also contribute to the national income through payment of taxes. According to the Ministry Industrialization and Enterprises Development (formerly Ministry of Trade), Kenya has about 1.6 million registered SMEs constituting about 96 per cent of all business enterprises in the country. KRA’s records indicate that there are only 1,500 recognized medium taxpayers out of the registered SMEs. Currently, it is estimated that the contribution to the GDP by this sector stands at over 45% in addition to contributing 80% of the jobs (CNBC Africa, 2015). Reliable data shows that by extending the tax net to the informal sector, for example in the year 2008, the government could have increased the tax base by approximately 7.66 percentage points, translating to revenue worth KES 45.9 billion (SMEs in Kenya that pay the turnover tax which was introduced by the KRA in 2008 contributed about KES 1 billion into the Treasury coffers (Onyango, 2010).

In this regard, the rate of SMEs compliance is relatively low and Kenya has an opportunity to address the increasing budget deficits by ensuring that there is improved compliance by the entities in the SME space. One of the most transformative aspects of the current constitution that was adapted to in the year 2010 is devolution of political power, responsibilities and resources. Under the Constitution, Kenya moved power from a centralized system and structure of government to a devolved system combining the concepts of self-governance at the local or county level and shared governance at the national level (Bosire and Ghai, 2013).

### **1.1.3 SMEs in Kenya**

SMEs in Kenya has long history, and basically with the same purpose of economy growth and employments creation. The Sessional Paper No 10 of 1965 advocated for Africans to start and own private enterprises. In 1972 ILO report highlighted the importance of small enterprises in terms of economy growth and employments creation. In the Session Paper No.1 of 1986, the Kenya Government underscored the importance of the sector in terms of its potential to bring about balanced rural-urban development and create non-farm employment based on its unique characteristics. Session Paper No.2 of 2005 defined an SME as an enterprise with 1-9 employees and annual turnover of less than ksh.500, 000 (Halim, Ahmad, & Ramayah, 2014).

The Micro and Small Enterprise (MSME) Act No. 55 2012 define SME as micro if with employees less than nine, and annual turnover of less than Ksh.500,000; and small if with employees between ten and fifty with annual turnover of between Ksh.500,000 and Ksh.5 million. According to Katua (2014) SMEs play a significant role in the development and growth of various economies. Success in SMEs sector will help the country to achieve vision 2030 and face a competitive, dynamic and challenging global environment. Collectively SMEs are the largest employers and greatest wealth creators.

The long term economic effect of SMEs is increased income, increased GDP and increased employment opportunities. Savlovschi and Robu (2011) indicated for the economy in whole, the SMEs are launchers of new ideas and assemblers of new products accelerating the effective use of resources. SMEs contribution in economy is extended as impact to other sectors, and hence SMEs serve as engine of economic growth. SMEs counter-balance the monopoly, and hence reduce the capacity of big companies controlling the market. SMEs generate to a greater extent the technical innovation applicable in the economy. The significance of SMEs in Kenya is reflected in the 2014 Economy Survey, which indicated that 83% of 800,000 jobs created in 2014 were in the informal sector that is dominated by SMEs.

According to Nairobi City Council (2012) there are over 50,000 registered SMEs located in Nairobi. Although SMEs are spread widely across the country, with two thirds of them located in rural areas (GoK, 2006; ILO, 2008), this study believes that the SMEs located in Nairobi County have significant potential to contribute to the country's GDP due to their enhanced governance structures amongst other factors. In addition, the cost of enhancing tax compliance in Nairobi County by the revenue authority would be minimal compared to any other county. This is premised on the ease of access to information as well as development in technology within the county. The increased tax collection at minimal cost is generally in line with the cannons of taxation

## **1.2 Statement of the Problem**

Tax plays an important role in the growth of any economy so tax evasion is harmful to the economy (Mwangi, 2014). Tax evasion hampers government revenue collection thus inefficiency in Government spending because it diminishes the capacity of the state to mobilize domestic revenues, resources that are needed for investments (Parliamentary Budget Office, 2016). In 2010, for example the amount lost to tax evasion represented about twice the amount the country spent on health care. Tax evasion also damages the country's growth capacity by discouraging both local and foreign investors. The high tax rate and burden in Kenya, which is related to the high levels of tax evasion, is the leading disincentive to business activity (Parliamentary Budget Office, 2016).

The increasing trend of disparity between the levels of submitted annual income tax returns, reported tax assessments and voluntarily paid tax liabilities, among SMEs, on the one hand, and the trend of business birth and growth, on the other hand, has been a cause of worry to the government of Kenya. This resulted in the government offer of an olive branch to taxpayers through the tax amnesty announced by the Minister for Finance in Kenya in 2004 (GOK, 2017)

According to the KRA annual report for year ended 2012, the amount lost inform of taxes was Ksh 108 billion which can be directly attributed to the informal sectors and SMEs (K.R.A, Annual Tax Report, 2013). The SMEs are continuously expanding and

has the potential to increase the revenue flows but which have been otherwise left out of the tax bracket. Generally, if the informal sector remains untaxed, and as more people transition in to the sector, the government is likely to continue losing billions of shillings. Such a scenario will impact on government's ability to achieve its revenue targets and consequently its development agenda. The question as to why some people pay tax while others do not has raised a lot of concern among economists, governments and tax administrators alike. Tax revenues have, for quite some time, remained low relative to the number of both registered and non-registered firms and individuals who are legally qualify to pay tax. Continued low revenue collection levels for government is detrimental to economic development of this nation (Mohd, 2010). It is therefore against this background that the study sought to assess the factors that influence tax compliance among SMEs in Nairobi County.

### **1.3 Research Objective**

#### **1.3.1 General Objective**

The purpose of the study assessed the factors that influence tax compliance among SMEs in Nairobi County

#### **1.3.2 Specific Objectives**

- i. To determine the effect of tax transparency on tax compliance among SMEs in Nairobi County, Kenya
- ii. To evaluate the effects of tax accountability on tax compliance among SMEs in Nairobi County, Kenya
- iii. To establish the effects of tax convenience on tax compliance among SMEs in Nairobi County, Kenya

#### **1.4. Research questions**

The study was guided by the following research questions

- i. What are the effects of tax transparency on tax compliance among SMEs in Nairobi County, Kenya?
- ii. What are the effects of tax accountability on tax compliance among SMEs in Nairobi County, Kenya?
- iii. What are the effects of tax convenience on tax compliance among SMEs in Nairobi County, Kenya?

#### **1.4 Significance of the study**

The research will be of significance to the public domain as it extends the knowledge base of the problem currently existence in the sector. The concept of tax equity especially in small business is relatively new to them and sometimes not perceived to be within their capability. Therefore, research which explores the causes of phenomenon will certainly help to raise awareness among the potential applications and benefits of preventing the act.

Upon completion, this study will benefit the following groups of people, organizations: family setting, small and corporate businesses. It will assist in understanding the canon of taxation equity in Kenya especially to SMEs. In addition, the research will be a reference point for future studies. Further, the study will provide information to the government and the society at large to use in the information of tax policies aimed mitigating tax evasion. Tax evasion does not affect the government alone but also it has a bearing on the other sector and this researcher will help in reconciling various taxpayers who had been evading tax. All taxpayers will benefit as it will help them abide by law to be consistent in paying their taxes to avoid unnecessary penalties.

### **1.5 Scope of the study**

The study sought to assess the factors that influence tax compliance among SMEs in Nairobi County; it was carried out between the months of July and November 2018. The specific factors to be covered include; tax convenience, Tax Transparency and tax accountability. The study unit of study was the SMEs in Moi Avenue Nairobi County.

### **1.6 Limitations of the study**

As a result of the time and resource limitations, the study was limited to SMEs in Moi Avenue Nairobi. However this research provides an opportunity for further research within other SMEs using a similar methodology or a different one with the aim of adding to the knowledge regarding factors that affect tax compliance among SMEs so that the findings are comparative to either confirm or dispute existing literature. The study experienced an initial slow response from the respondents who complained of the lengthy questionnaires. This was alleviated by physical follow up to the respondents' by using research assistants who offered help in understanding of the questionnaire and how to respond to questions which were not well understood by the respondents

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter introduces and discusses key areas that the researcher seeks to examine in the process especially for post studies. It includes review of literature, theoretical framework, conceptual framework, empirical review and the assessment of the gaps to be filled by the study

#### **2.2 Theoretical Review**

The study is grounded on benefit theory, the tax morale theory, ability to pay theory of taxation and fiscal psychology models as discussed as follows.

##### **2.2.1 Benefit theory**

The theory was put forward by Krauss (1896). This theory explains that every citizen should be called upon to pay taxes in proportion to the benefits derived by him from services provided by the Government. It is implied that the state provides certain facilities to its civilians who should, therefore, contribute to the cost or value of these facilities in proportion to benefits received by them.

This theory assumes that, the more the benefit a citizen derives, the more taxes he should bear, is the main assumption of the theory. It also justifies the paying of taxes. It also measures benefits received by the individuals in the case of certain special taxes such as petrol tax, betterment tax etc. (Mohd and Ahmad, 2011). According to Lumumba, Wanjohi, Magutu, & Mokoro, (2010) this theory maintains that justice in taxation is secured by taxing each citizen in the proportion to the benefits he derives from the activity of state. It is also known as insurance theory or quid pro quo theory of taxation. It implies that taxes should be paid by those people who receive the direct benefit of government programs and projects out of the taxes paid. However, it has some objections; the weak and poorer people receive great benefits from the government in

the form of free education etc. Though they receive the greatest benefit, they are however least able to bear the burden of taxation.

The assumption that the tax should be paid by an individual in proportion to benefits conferred by the State on that individual is quite unrealistic because the benefits derived cannot be correctly measured in terms of money. Benefit is purely a subjective matter and there is no scientific way to measure the magnitude of benefit and its money value. If benefits accrued to an individual is the basis of taxation, the poor must pay higher taxes because in a welfare State the poor get more benefits than the rich from the expenditure of the Government. This is clearly unjust and as such an unacceptable proposition. It is also very difficult to determine under this theory what proportion of the general benefits accrues to particular individuals. Government is for civilized existence and there is, therefore, no basis for valuing the services which the State renders. Most of the services provided by the State are indivisible and beneficiaries are unidentified. For example, it is not possible to divide the benefits of national defense. Lastly the equitable distribution of wealth, the main objective of most of the modern Governments, will be defeated if this principle is followed (Wanjohi, et al., (2010)

### **2.2.2 The Tax Morale Theory**

The tax morale theory was first advanced by German scholars centered on Gunter Schmolders known as Cologne school of tax psychology. Tax morale can be termed as the individual factor that motivates a person to comply with his or her tax obligations. As a determinant of tax behavior, tax morals aim to explain how and why a tax payer morality influences his or her tax behavior. Many studies have found out that tax evasion can be attributed to the tax morale (Mocetti, 2014). Tax payers would be inclined to evade tax when the communities in which they live or operate disapprove of tax evasion. Tax payers are more likely to comply with tax obligation if their friends, relatives and acquaintances comply with these obligations. Also tax payers will evade taxes if they feel that other people are getting away with tax evasion. In other words, if a society tolerates tax evasion, such a society would encourage tax evasion (Waweru, 2004). Religious beliefs are a variable in tax evasion as studies have shown that taxpayers who

have strong religious commitments or beliefs would likely be tax compliant even if they feel that the tax rate is high (Gee, 2016).

In some instances tax payers can feel morally feel justified in evading taxes if they feel that the tax system is unfair and unsatisfactory. The opposite is also true. In economies where they perceive the tax system as fair the evasion rates are low. Tax payers will tend to comply with their tax obligation if they feel that their government is honest, democratic and participatory and also if the tax payers feel they play a meaningful role in governance (Mwangi, 2014)). Thus the canon of equity are important predictors of tax evasion thus the study aims test for a canon of taxation equity and its effects on tax compliance among SMEs in Nairobi County

### **2.2.3 Ability to Pay Theory of Taxation**

Ability-to-pay theory is a progressive taxation principle that maintains that taxes should be levied according to a taxpayer's ability to pay. This theory places an increased tax burden on individuals, partnerships, companies, corporations, trusts, and certain estates with higher incomes. Ability-to-pay theory requires higher-earning individuals to pay a greater percentage of their income towards taxes, compared to individuals with lower incomes. The tax rate increases as a percentage along with income (Fjeldstad, Schulz-Herzenberg and Sjursen, 2012).

This is one of the major theories of modern taxation; it is primarily based on the Law of diminishing marginal utility. Mwangi, (2014), observed that in all instances in order to secure equal sacrifice, the tax formula must be in some measure progressive, in the sense that the rate of taxation grows as incomes increase. The ability to pay theory of taxation has been used to justify the progressive tax system of taxation that is widely practiced across the globe. It is based on the following assumptions; the falling rate of marginal utility of money given an increase in supply, sacrifice in payment of taxes and the ability to quantify the sacrifice (Merima, Fjeldstad, and Sjursen, 2013).

The theory was relevant to the study because it justifies equity as a principle of taxation and can also be applicable to SMEs to improve compliance, the SMEs sacrifices part of their income and it is turned over to the government to be spent on public services. The sacrifice is measured both in terms of the burden that SMES bears on sacrificing their income to the public but also the ease with which they got that income. Critics of ability-to-pay taxation state that progressive tax systems reduce the incentive to climb the earnings ladder. It penalizes those who through hard work and ingenuity have risen into higher incomes. These critics claim ability-to-pay taxation is not fair for wealthy individuals (Lumumba, Migwi, and Obara, 2011).

#### **2.2.4 Fiscal Psychology Models**

The theory of Planned Behavior which was developed by Ajzen (1991) and states that Psychology theories of tax compliance expect that mental elements – like good and moral concerns are additionally huge to taxpayers and in this manner taxpayers may agree even where the danger of review is low. These hypotheses of tax compliance expect that mental variables including moral and moral concerns are likewise vital to taxpayers. Brain research speculations de-underline reviews and punishments; rather center on changing individual dispositions towards tax framework (Trivedi and Shehata, 2005).

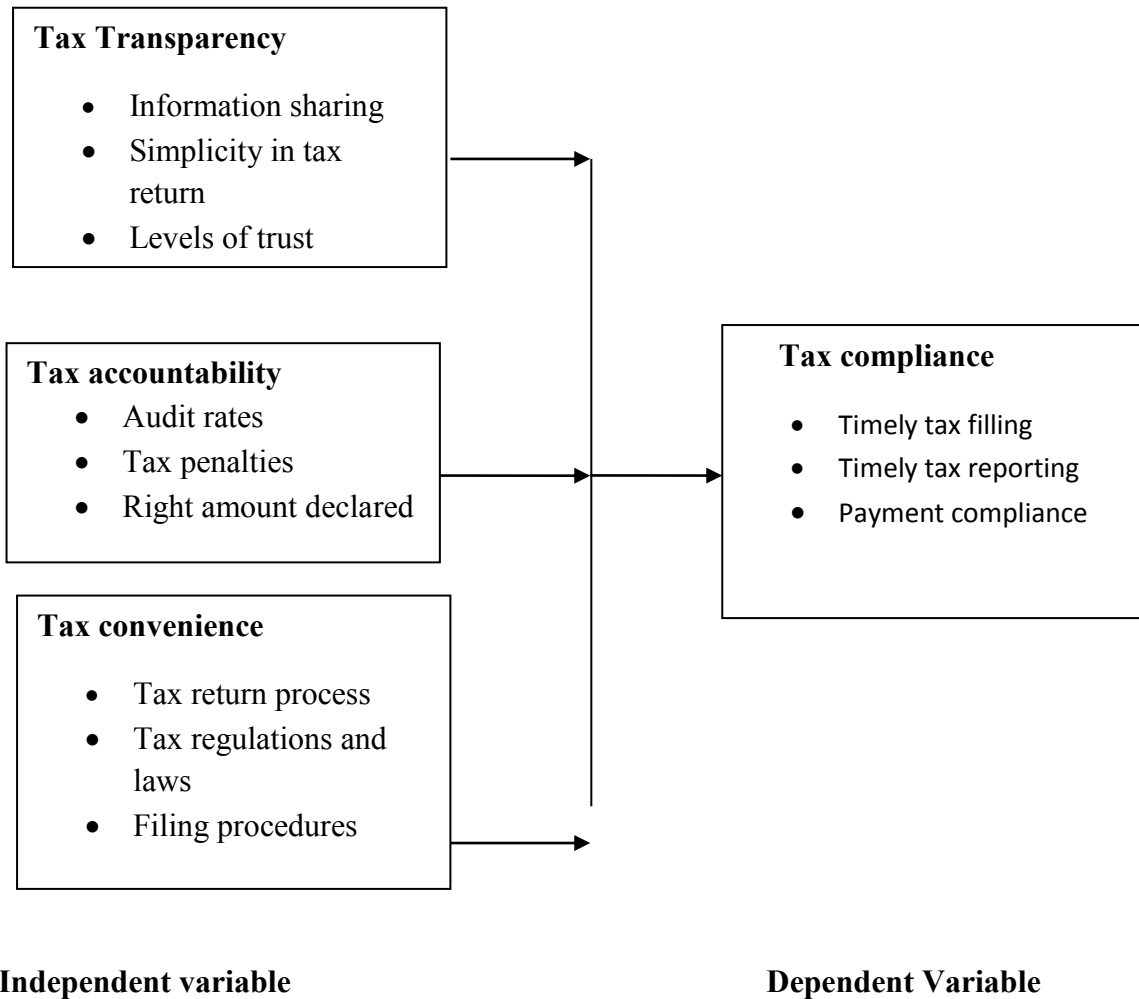
As indicated by this hypothesis, practices of the people inside the general public are affected by particular components, begin from specific reasons and get the job done planned. The capacity to play out a specific conduct relies upon the way that the individual has a reason towards that conduct (social goal). Social aim thusly relies upon three factors that is Attitude towards the conduct, Subjective standards and Perceived social control (Mohd, 2010). These three variables are likewise affected by conduct convictions, standardizing convictions and control convictions. The focal point of this hypothesis accordingly is on the taxpayer's ethics and morals. Rather than the financial speculations that underline on expanded reviews and punishments as answers for compliance issues, mental hypotheses lay accentuation on changing individual dispositions towards tax frameworks.

Mohd and Mustapha (2011) demonstrated that a few taxpayers' conduct may take after financial hypotheses while others may take after the mental speculations and a blend of the two is conceivable. Past investigations have recognized nine factors to be important determinants of tax compliance, to be specific tax rates, tax reviews, recognition on government budget and spending, tax experts and specialist, effortlessness of filling tax return, ability of detection, awareness about offenses and penalty for defaulters; and personal constraint financially (Yong & Hooper, 2011).

This theory was relevant to the study because it emphasizes the importance of positive policies developed by the government to improve the cooperation between the taxpayer and the government. Kogler et al., (2013) Mohd and Mustapha (2011) successfully demonstrated that the level of tax compliance is more influenced by the taxpayer trust in the government, especially against the tax system. Moreover, in the model proposed by Slippery Slope. Muehlbacher and Kirchler (2010) explains that compliance depends on the taxpayer's perception of the government. Therefore, this research examines the role of perception of tax fairness as a predictor of tax compliance.

### **2.3 Conceptual framework**

This study assumes that the taxation canon of equity has a direct influence on tax compliance among SMEs in Kenya. The relationship between the dependent and the independent variables is illustrated in the conceptual framework presented in figure 2.1.



**Figure 2.1: Conceptual Framework**

### **2.3.1 Effect of Tax Transparency as Predictors of Tax Compliance**

Tax transparency is at the heart of the global effort aimed at tackling tax evasion and avoidance. The Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum) supports governments around the world in enhancing the efficiency of tax enforcement and increasing the level of tax compliance. Year after year Global Forum members are making progress in the effective implementation of the internationally agreed standards on transparency and exchange of information for tax purposes, i.e. exchange of information on request (EOIR) and automatic exchange of

financial account information (AEOI). The effective use of these modern information sharing tools helps our member jurisdictions to narrow the tax gap created by evasion and avoidance, restore the balance in the allocation of tax burden and boost state revenues.

According to Transparency International, transparency is a ‘characteristic of governments, companies, organizations and individuals of being open in the clear disclosure of information rules, plans, processes and actions’ (Transparency International 2009). “Transparency is the degree to which an organization shares information its stakeholders need to make informed decisions” (Holtz, 2009). Transparency is the state in which social policies, processes, and actions are visible to external observers (Steiner and Steiner, 2009). Piotrowski (2007) states that governmental transparency allows the public to develop a more accurate picture of what is happening inside a government. According to Rawlins (2009), there are three aspects of transparency: Informational Transparency means openness, making publicly available all legally releasable information whether positive or negative in nature in a manner which is accurate, timely, balanced, and unequivocal. Information must be substantial to meet stakeholders’ needs. Disclosure by itself does not equal transparency; in fact some forms of disclosure can defeat the purposes of transparency. Participatory Transparency is what separates transparency from disclosure. Transparency cannot be successful unless you know what stakeholders want and need to know. So, to ensure that the information shared is relevant and useful, stakeholders must be allowed to identify what they need to know.. Transparency holds people accountable for their actions, words and decisions (Saad, 2011).

### **2.3.2 Effects of Tax Accountability as Predictors of Tax Compliance**

Slemrod and Yitzhaki (2000) observed that enforcement instruments, including the audit rates and the punishment function, are also determinants of tax compliance, although these variables are rarely available for empirical studies. For example, Dubin et al. (1990) and Pommerehne and Weck-Hannemann (1996) found that the probability of audit significantly affects tax compliance, whereas they found no evidence of a

significant deterrent effect of the penalty. Andreoni et.al (1998) based on studies of data generated from the Internal Revenue Service's Taxpayers Compliance Management Programme (TCMP) observed that due to the low probability of detection even high penalties has no observable impact on the level of compliance. Merima et al, (2013) when studying factors affecting tax compliance in a sample of African countries observed that an increase in perception of individuals about the difficulty of evading taxes enhances taxpayer's attitude towards compliance.

Trivedi and Shehata (2005) concluded that some taxpayers' behavior is a mixture of both economic and psychological considerations. This observation was the cornerstone in Lumumba et.al (2010) in their paper on taxpayer's attitude and compliance behavior in Kenya; in their findings they observed that majority of Kenyans view the tax regime to be unfair, complex and punitive in nature. Accountability in government expenditure also had a big role in influencing compliance behavior with most respondents intimating that they didn't comply as they weren't confident their taxpayer's money was used correctly

### **2.3.3 Effects of Tax Convenience as Predictors of Tax Compliance**

Convenience of the tax system is a major determinant of tax compliance. One would expect in Mauritius, where the tax returns are completed by the individuals themselves, that these returns would be as simple as possible. Taxpayers come from different backgrounds and tax knowledge. "Denmark, Canada and New Zealand (Mohani, 2001: Mohani and Sheehan, 2003, 2004). As per Silvani and Baer (1997), he argues that, there are very many errors experienced by the tax payers when filling returns and this is because of a complex tax system which are developed by the tax authority and administrator it is therefore important for tax experts to help the tax authority to put in place a simplified tax system which taxpayers can access and file their tax return easily without complications which will force them to involve third party or experts who may need additional cash which may be expensive to tax payers hence discouraging compliance.

## 2.4 Empirical Review

Makokha, Nambuswa and Namusonge, (2017) did a study to investigate the determinants of tax compliance among SMEs in Bungoma county. The study was guided by the following objective; to determine the effect of cost on tax compliance among SMEs in Bungoma County. The study applied a descriptive survey design of all the SMEs in Bungoma County. The population of the study consisted of all the SMEs in Bungoma County. A total of 170 SMEs in Bungoma County were targeted for the study, with a sample of size of 227 respondents. Closed-ended questionnaires covered all the issues relating to the causes of low tax compliance among SMEs in Bungoma County were personally administered the questionnaires to the respondents 227 managers, 1 from each of the sampled organizations in sectors. Pilot test was done to verify the reliability and validity of the research instrument. The data collected was analyzed using descriptive statistics, correlations, and linear regression analysis.

Results showed that there was a significant influence of cost on tax compliance in Bungoma County. From study findings and earlier discussion, it was noted that cost influence tax compliance negatively and significantly contributing 9.6% variability to tax compliance by SMEs when other factors are held constant. The Kenya Revenue Authority should consider revising the cost of tax product downwards. Additionally, Kenya Revenue Authority should make the tax filing process convenient, easy and costless. Similarly, Kenya revenue authority should not impose penalties on late filing of taxes. The tax computation should be as easy as possible to enhance eligible tax payers' compliance

Musau, (2015) examined factors affecting compliance with tax laws and regulations among income earners majoring on SME's in Nairobi County, Kenya. The exploration utilized a quantitative research plan. Given the extensive populace of enrolled SMEs as taxpayers in Nairobi County, an example size of 398 was picked as delegate, to be the focal point of this investigation out of which 120 of them were returned and dissected. To guarantee that different various classifications of taxpayers and business substances

were incorporated into the overview, stratified examining system was embraced. Information was gathered utilizing self-regulated polls.

The gathered information was thus investigated utilizing Statistical Package for Social Scientist programming and afterward exchanged to STATA for encourage examination. The examination discoveries uncovered that an expansion in the impression of people about the trouble of dodging taxes is found to improve the probability of being tax compliant among SMEs in Nairobi County. The discoveries likewise uncovered that people who are happier with open administration arrangement; have enough tax data; trust government authorities in taking care of their taxes; and have the observation that tax documenting strategies are less intricate will probably be tax compliant.

Mwangi, (2014) examined the factors influencing tax compliance among small and medium enterprises in Nairobi's Industrial Area, Kenya. The research was a descriptive survey. Given the large population of registered taxpayers in Nairobi, a sample size of 150 was picked as representative, to be the focus of this study. The findings of the study revealed that with regard to tax rate as a factor influencing SMEs compliance, the majority view that Kenya has high tax rates with several different tax heads and this consequently hinders their level of compliance. The SMEs view that if more information would be availed to them in form of tax seminars and literature, this would demystify the complex concept of tax and greatly motivate them to be compliant. Lastly the study recommended that, by gaining an understanding of these underlying factors, KRA and the government will be able to make changes that will greatly improve taxpayers' tax compliance level, with the end result being increased government revenues, allowing the tax authority to give quality service to taxpayers and the government as a whole providing more and improved utilities to the public.

Wasao, (2014) did a study on the effect of online tax system on tax compliance among small taxpayers In East of Nairobi Tax District. The study adopted quantitative and descriptive methods as a research designs. Data was collected using structured questionnaire, which covered all the variables of the study from 160 sampled taxpayers based in East of Nairobi tax District. Data obtained was subjected to quantitative

methods of data analysis using SPSS (version 20). Results obtained were presented using tables and graphs for ease of understanding and interpretation. In addition, both correlation and regression analyses were done and summaries presented. The findings of the study were that online system do affect tax compliance level among small taxpayers in East of Nairobi as far as registration, filing and payments were concerned. The study recommends that a further study should be done to establish how online system not only affect compliance in mines and minerals sector but also other tax districts of small taxpayers which are considered more/less advanced than East of Nairobi tax District.

An examination by Lumumba et al. (2010) analyzed how the taxpayers' state of mind impacts compliance conduct among SMEs in Kerugoya town. This exploration was an overview including business salary workers among little and medium size endeavors in Kerugoya town, in Kirinyaga area. Information was gathered from two hundred and sixty (260) little and medium size undertakings taxpayers, investigated utilizing clear insights, and outlined and exhibited as extents, tables and rates. The investigation discovered that non-compliance was impacted by taxpayers' absence of comprehension of tax laws and the inclination that the tax framework was out of line. One of the shortcomings of this investigation is the absence of operationalizing compliance as it isn't clear how compliance was estimated.

#### **2.4.1 Effect of Tax Transparency as Predictors of Tax Compliance**

Nowadays, taxpayers need greater information towards tax transparency, they want the government inform more openly about the taxes they pay. Transparency is generally defined as the open flow of information (Holzner & Holzner, 2006; Piotrowski, 2007). Tax transparency is the extent to which taxpayers have ready access to any required information about tax. To increase taxpayers' voluntary compliance, governments must be more open and transparent with their tax. Information transparency can be exploited by governments as an opportunity to improve voluntary compliance of existing taxpayers and to attract new ones. Increased tax transparency can encourage greater voluntary compliance by ensuring taxpayers that their tax payments are reaching the desired objectives. Based on the arguments developed above, tax transparency is

expected to have positive and direct effect on voluntary compliance behavior (Saad, 2011).

Transparency arises as one of the most important factors contributing to the increase of levels of trust (Golin, 2004; Savage, 2005). One important impact and consequence of perceived transparency that has been made theoretically is to trust in government, which is a necessary part of healthy democracy (Nye, 1997). Heald (2006: 62) stresses that “transparency is expected to contribute positively to trust by building credibility”. Furthermore, increasing transparency, a government can reduce its taxpayers’ uncertainty and allow taxpayers to make a rational decision. In a study of employees, Rawlins (2008) found that as the perception of organizational transparency increased, so did trust in the organization. If transparency plays a major role in an organization’s ability to obtain and maintain public trust, a profession that wants to be trusted by its publics needs to be transparent (Bunting, 2004). Thus, it is argued that trustworthiness of tax authorities will enhance voluntary compliance. Although a certain amount of skepticism is also necessary, trust in government authorities has been shown to have a strong influence on citizens’ reactions to authorities and their willingness to voluntarily comply with the authorities’ directives (Tyler, 1998). Murphy (2004) shows in a study of accused tax avoiders that there is a correlation between fair and correct treatment of the taxpayer and trust in the revenue body. Trust is in turn correlated to the willingness to comply. If regulators are seen to be acting transparently, people will trust the motives of that authority, and will defer to their decisions voluntarily.

According to Murphy and Tyler (2008), if taxpayers are treated nicely and fairly by the tax authority, they will cooperate and be more inclined to comply with the decisions made by the tax authority. Wenzel (2002b) found procedural justice could predict the compliance level of taxpayers in Australia. From his study, taxpayers are more compliant when they believe that tax officers serve them fairly and with respect. Procedural justice refers to the perception of the service or treatment received by individuals from the authorities (Murphy, 2009) and it also relates to the process of resource division by the authorities (Kirchler, 2007).

Taxation research on procedural justice showed a positive impact on tax compliance. Empirical studies indicated that if an individual perceives that the authority is exercising a fair, existing procedure, they are more likely to trust the authority (Murphy, 2004) and more compliant with any decision made by the tax authority (Murphy & Tyler, 2008). However, previous studies on procedural justice have not reported consistent findings. Some researchers reported that procedural justice has a positive impact (van Dijke & Verboon, 2010), while others have reported different findings (Worsham, 1996).

Previous studies have acknowledged the effects of distributive justice on tax compliance behavior. Distributive justice refers to the perception of how far the input provided can garner the expected result in achieving equity (Adams, 1965, Walster et al., 1973). Most studies found distributive justice to have an impact upon tax compliance. Taxpayers evade tax payment when they believe there is injustice in the exchange relationship between taxpayers and the government (Kim, 2002, Porcano, 1984, Verboon and van Dijke, 2007). Taxpayers not receiving public exchange from the government believe injustice happens. The same situation applies when taxpayers disagree with the government spending policy or they consider they did not receive fair exchange from the government, thus making them feel suppressed and influencing their non-compliance behavior (Kim, 2002).

Moser, Evans, and Kim (1995) in their study proved tax non-compliance happened when the respondent was taxed at a level higher than other taxpayers and did not receive public goods equivalent to the tax paid. The higher the return from tax received, the higher the level of tax compliance (Alm et al., 1992b, Alm et al., 1992a). Even though there has been less research done analyzing the relationship between retributive justices with tax compliance, the findings show the two variables are related. Retributive justice refers to the perception of suitable punitive action when an act is against the norm. It comprises the requirement of inflicting suitable punishment for the wrong done (Kirchler, 2007). Various punishments are imposed for tax non-compliance; thus, the punishment must be suited to the severity of the wrong doing (Saad, 2011).

Tax compliance will increase when taxpayers perceive there is justice in the tax system that is capable of detecting and punishing those who fail to pay tax (Saad, 2011). Besides punishment, rewards for compliant taxpayers also influence compliance behavior (Falkinger & Walther, 1991).

#### **2.4.2 Effects of Tax Accountability as Predictors of Tax Compliance**

Spicer and Lundstedt (1976) pointed out that also self-employed taxpayers have more possibilities to avoid taxes than employed taxpayers. However, self-employed taxpayers have also more opportunities for tax evasion and opportunities might further increase with the number of different income sources. Hence, in compliance decisions the level of income might interact with its source. A different aspect of the income source if income was earned by hard work or an effortless job - has been studied in experiments by Kirchler, Muehlbacher, Holzl, and Webley. Participants were less compliant when they reported income earned by low effort than when they reported hard-earned income. It seems that taxpayers are reluctant to lose their hard-earned money by “gambling” with tax authorities.

Kemboi and Tarus (2012) examined determinants of the compliance in Kenya for the period 2007 to 2009, using quarterly secondary data. The hypothesis on the existence of co-integrated relationship between determinants and compliance was tested using Johansen-Julius co-integration technique. The result indicated factors like tax compliance cost, fines and penalties, perceived opportunity for tax evasion and tax knowledge and education are important determinants of tax compliance. The results did show that macro-economic stability depended on tax compliance of these firms and other tax payer.

#### **2.4.3 Effects of Tax Convenience as Predictors of Tax Compliance**

Tax regulations and laws are amended every year as part of annual budget process, thereby making some of the current regulations not applicable in the future (Mohani, 2001; Bird, 1998; Silvani and Baer, 1997). Merima, Odd-Helge & Ingrid (2013) found

that tax compliance behavior among citizens in Kenya, Tanzania, Uganda and South Africa was influenced by perception about difficulty of evading taxes, satisfaction with public service provision, payments to non-state actors, perception of an ethnic group being treated unfairly, and tax knowledge. The study did not assess a number of possible determinants of tax compliance and therefore there is need to expand the variables.

Atawodi and Ojeka (2012) were also interested in finding out some of the factors which affect both positively and negatively compliance among SMEs in North Nigeria and they concluded their research and they had this to say, that high tax rates and complex filing procedures are the most crucial factors affecting -compliance negatively among the SMEs. Other factors were, multiple taxation and lack of proper education on tax systems among SMEs were also found to affect tax compliance negatively among the SMEs surveyed only to an extent which is lesser and insignificant. It is an important study that shows the factors that explain non-compliance but not compliance. Therefore, it may be important in the present study to perform an analysis that differentiates between the two sets of taxpayers.

Langham, Paulsen & dan Hartel (2012) assessed whether the theory of planned behavior can predict business compliance. The results showed that intention to comply did not predict compliance behavior. The results showed that as complexity and difficulty in performance increases, additional factors are required to predict compliance, such as awareness of the rules. The authors concluded that behavior prediction can be enhanced by quantifying environmental complexity, providing performance support, and eliminating potential obstacles. Intention can only be leveraged for compliance strategies when the tax system creates the optimal environment for taxpayers to successfully comply.

## **2.5 Critique of Existing Literature**

The above review has elucidated on some of the factors that have been examined in a number studies in Kenya and in other countries. In summary, there are several studies on tax compliance behavior, for example; Rosid, Evans and Tran-Nam (2016), conducted a

study to examine how perceptions of corruption may influence personal income taxpayer compliance behavior in Indonesia adopting a sequential mixed-methods approach. The findings suggest that high levels of perceived corruption were evident in Indonesia. Second, the quantitative findings clearly demonstrate that perceptions of corruption undermine taxpayers' intention to report actual income. The present empirical results support the notions that perceptions of corruption are important determinants and have a negative impact upon tax compliance behavior. The results also imply that combating corruption, especially grand corruption, would have a beneficial effect on voluntary tax compliance in Indonesia. This study left gaps since it dealt with perceptions of corruption while the current study deals with perception of tax principles.

Dang et al. (2016), to examine the factors that influence tax evasion in Vietnam. The study utilized a qualitative research method. Primary data were collected using a questionnaire-based survey. A random and proportional sampling was applied resulting in an effective sample of 525 household businesses in eight regions of Vietnam (out of 4.09 million households businesses in 2013). The empirical result revealed that: while the respondents complained that tax officials use their prerogative and authority with a view to demanding more tax payments, bribes often result from a process of negotiation and collusion rather than extortion. This study left gaps since it dealt with factors that influence tax evasion.

Alm, Martinez-Vazquez and McClellan (2016), conducted a study to examine relationship between perception tax corruption and firm tax evasion, using firm-level data obtained from the World Enterprise Survey and BEEPS covering 8,000 observations and 32 countries, applied the instrumental variable method to control for the potential endogeneity of corruption and tax evasion. As a robustness check, the method of propensity score matching was also employed. Their results indicated that it is corruption that largely drives tax evasion. The study further revealed that requests for bribes reduce reported taxable sales, and larger bribes result in higher levels of tax evasion. This study left gaps since dealt with perception of corruption and tax compliance.

Ebimobowei and Gbalam (2013) examined the impact of tax audit on tax compliance in Nigeria. To achieve this objective, data was collected from primary and secondary sources. The secondary sources was from scholarly published and unpublished studies and the primary source from a well-structured questionnaire of three sections administered to two hundred and four (204) respondents with an average reliability of 0.77 using diagnostic tests, augmented dickey-fuller, ordinary least square and granger causality. The empirical analysis provided a significant relationship between random tax audit, cut-off tax audit and conditional tax audit on tax compliance in Nigeria. On the basis of the empirical result, the author conclude that tax audit is one of the compliance strategies that can be used to achieve tax compliance because the average Nigerian is known for tax evasion and avoidance using all the available means of not paying the relevant tax to the government. This study left gaps since it was done in Nigeria adopting both secondary and primary data however the current study will be specifically on primary data.

A study by Lumumba et al. (2010) examined how the taxpayers' attitude influences compliance behavior among SMEs in Kerugoya town. This research was a survey involving business income earners among small and medium size enterprises in Kerugoya town, in Kirinyaga district. Data was collected from two hundred and sixty (260) small and medium size enterprises taxpayers, analyzed using descriptive statistics, and summarized and presented in the form of proportions, tables and percentages. The study found out that non-compliance was influenced by taxpayers' lack of understanding of tax laws and the feeling that the tax system was unfair. One of the weaknesses of this study is the lack of operationalizing compliance as it is not clear how compliance was measured. This study left gaps since it dealt with taxpayer's attitude and tax compliance while the current dealt with tax principles and tax compliance.

Mukabi (2014) explored factors influencing turnover tax compliance in the Kenya revenue authority domestic taxes department in Nairobi County. The study used a sample of 56 respondents selected via stratified sampling and data collected using questionnaires. The study findings revealed that the perceptions of taxpayers towards the

tax system greatly determine the level of compliance for turnover tax. The findings also found that other factors like cost of compliance and complicated systems result into the low levels of compliance. The study also established that increased tax knowledge had a significant effect on perception of tax system. This study left gaps since it was done in Kenya revenue authority domestic taxes however the current study will be done in SMEs within Nairobi.

## **2.6 Summary of Reviewed Literature**

From the above literature there is a wealth of knowledge in the area of tax equity and its impact on tax compliance. It can be observed that the general trend is that rates of taxes, nature and complexity of the tax, method of collection, enforcement mechanism, government transparency and the structure of the economy all have a positive impact on the level of compliance. This lends credence to the observation by Brown and Mazur (2003) that tax compliance is a multifaceted aspect which involves economic, psychological and socio-cultural factors. However other than Lumumba et.al (2010) and the Simiyu (2003) with the former being mostly localized to SME's in Nairobi and the latter being a book on taxation policy in Kenya, there has been no study to test for a canon of taxation equity and its effects on tax compliance among SMEs in Kenya or indeed in the developing world.

In addition, with the available literature there are some questions in the literature that which needs to be filled to help address the problems of tax equity. The literature review identifies not only what has been studied, but does not give us the reasons why all these studies and investigations on tax compliance were conducted in developed like Western Europe and North America countries but failed to address the factors that influence tax compliance in developing countries such as Kenya.

## **2.7 Research Gap**

According to Laffer (2014), tax compliance is characterized by considering three kinds of compliance, for example, payment, filing as well as reporting compliance. Etzion

(1986) argued that if a public feels increasingly overtime those taxes are unfairly imposed, and then there will be increase in likely hood to evade paying taxes. However it is important to note that the burden of taxation is felt by about 20% of the total productive labor force in the country raising fairness concerns despite tax being the most progressive tax. Unlike personal income tax, SMEs income tax is charged on profits from registered business entities at a flat rate of 5% (Kenya's Revenue Analysis 2010-2015). Tax turnover in Kenya which is at a rate of 5% is enforced in little companies with revenue not exceeding KShs 5,000,000 per annum and more than KShs 500,000 in sales. Turnover tax being a proportional tax is unfair because all taxable persons pay the same rate which is against the principle of equity which connotes that tax payers should pay taxes according to their ability to pay. On the other hand a number of businesses especially in the informal sector are not taxed again raising equity and tax fairness questions. Further perceptions of tax compliance issues have for a long time been viewed as a complex subject that should be left largely to tax experts. This perception has contributed to the huge information gaps on issues of tax compliance. This study therefore sought to assess factors that influence tax compliance among SMEs in Nairobi County with specifics to tax Transparency, tax accountability and tax convenience as a factor that influence tax compliance among SMEs in Nairobi County

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1. Introduction**

This chapter specifies the methodology that was used in the study, it also provides an overview of the methods that were used to collect, analyze and interpret the data so as to generate findings necessary to answer the research questions.

#### **3.2 Research Design**

This study adopted a descriptive survey design. Orodho (2003) and Kothari (2006) describe a descriptive survey design as that study which seeks to accurately depict the features of a particular area of study. According to Polit and Beck (2003), in a descriptive study, researchers observe, count, delineate, and classify. Cooper and Schindler (2011) concurred that a study concerned with finding out who, what, when, where and how of a phenomenon is a descriptive study. The descriptive design is expected to derive proper and concise recommendations to the management of Kenya Revenue Authority on the factors that influence tax compliance and the relationship that exists therein to tax compliance among SMEs.

#### **3.3 Target Population**

A population is a group of individual persons, objects or items which enjoy similar characteristics and from which samples are drawn for the purpose of drawing inference. The target population for this study was all the licensed SMEs within Moi Avenue Street Nairobi. A study by Musau (2015) showed that there were 649 SMEs in Moi Avenue Street licensed by Nairobi County.

### 3.4 Sampling Technique and Sample Size

The sample size of this study was based on Yamane's 1967 formulae which is shown below:

$$n = \frac{N}{1 + N(e)^2}$$

Where;

n is the sample size,

N is the population size, (98,608)

e is the level of precision (0.05).

$$\begin{aligned} n &= \frac{649}{1 + 649 (0.05)^2} \\ &= 249 \end{aligned}$$

The desired sample size thus comprised of 249 SMEs owners/Mangers.

The study therefore used random sampling in order to select the cases which were the SMEs studied (Lisa, 2008). According to Creswell and Plano Clark (2011), the choice of cases depends entirely on the researcher and the kind of information he or she is seeking such that the cases are often rich in certain desired information in this case tax compliance. Therefore, this study used a maximum of 249 respondents.

### 3.5 Data Collection Instruments

This study collected data using structured questionnaires; the questionnaires were well-situated for the assignment because they could be simply and expediently administered with the study sample. The use of questionnaire was done because it is less costly and less time consuming as compared to other methods. Data collected through the use of

well-structured questionnaire is straight forward to analyze. The questionnaire was designed in Likert scale because it required respondents to respond to a series of statements by indicating whether he or she agrees or disagrees to the statements. The study used the self-administered method of drop and pick, where the questionnaires were hand delivered to ensure safe delivery and collection.

### **3.6 Data Collection Procedures**

After successful defense and approval of the proposal, the researcher sought the consent of Jomo Kenyatta University of Agriculture and Technology and the Nairobi county government. The researcher informed the management of SMES in advance before the questionnaires reaches the respondents. The questionnaires were administered through a drop and pick method; this technique was an effective means to reduce potential non-response bias through increased response rate.

### **3.7 Pilot Study**

A pilot study is a minor study that is conducted before the main study with the objective of assessing both the study feasibility and the suitability of the data collection tool. A pilot test is further stated to be a small scale trial run of all procedures planned for use in the main study (Monette et al., 2012). The latter is examined through determination of both validity and reliability of the research instrument. The pilot study was conducted among randomly selected SMEs in Nakuru Town. The respondents in this minor study were 24 which is approximately 10% of the unit of analysis (Creswell, 2017).

#### **3.7.1 Validity of Research Instrument**

Validity is the degree to which an instrument measures what it purports to measure. It is the accuracy, truthfulness and meaningfulness of inferences that are based on the data obtained from a tool or a scale for each construct in the study (Mugenda, 2008). Content validity of research questionnaire was ensured by consulting the supervisor. This assisted in evaluation of the concept the questionnaire is trying to measure and to determine whether the set of items accurately represents the concepts.

### 3.7.2 Reliability of Research Instrument

Reliability is the consistency of measurement, or the extent to which an instrument measures the same method every time it is used under the same circumstance with the similar subject (Kombo and Tromph, 2006). A pilot study was conducted to test the validity and reliability of the research questionnaire. It involved about 10% of the size of the sample population (Kothari, 2004). This equals to 24 respondents randomly drawn from SMEs in Nakuru Town. Participants in the pilot testing were not involved in the final study.

### 3.8 Data Analysis and Presentation

Once the questionnaires were received, data was coded and edited for completeness and consistency. Data was analyzed by use of descriptive and inferential techniques, under descriptive statistics, frequency, percentages, standard deviation and mean was used to analyze data. Under inferential statistics, the study used simple multiple regression to test the hypotheses of the study. This study adopted the use of a 95% confidence level. A 95% confidence interval implies a significance level of 0.05. This connotes that for a null hypothesis to be rejected, the p-value ought to be below the significance level (0.05). Analysis of variance was used to ascertain the difference in means between various categories. Correlation analysis was also carried out to determine the relationship between dependent variable and the four independent variables. According to Orodho (2007), a multiple regression analysis is used to show the relationship between variables. Data was tested for the assumptions of simple multiple regression to ensure data is distributed normally.

The regression model was as follows:

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

Where:

Y=Tax compliance, dependent variable

$\alpha$ = constant

$\varepsilon$  = standard error

$X_1$ = Tax transparency

$X_2$ = tax accountability

$X_3$ = Tax convenience

### **3.9 Testing Assumptions of Multiple Regression Model**

Multiple linear regressions have several key assumptions. First is the linearity which requires the relationship between the independent and dependent variables to be linear. Testing for linearity is deemed necessary since linearity is an assumption of regression which must be satisfied. The Pearson moment correlation was used to assess the degree of linear relationship. Pearson correlation may also be used to test linearity though it is limited in determining the degree of linearity given that it only captures the linear component of the relationship. For linearity assumption to be met, variables were expected to produce plots in the normal P-P along the diagonal line, the distribution should not be skewed to either side. If the relationship between independent variables (IV) and the dependent variable (DV) is not linear, the results of the regression analysis will under-estimate the true relationship (Garson, 2012).

Normality test was used to determine if the data set is normally distributed. Graphical or mathematical test can be performed to test for normality. Kurtosis and Skewness were used in order to test the assumption of the normality of the population distribution, whereby a Skewness and kurtosis should be between  $\pm 3$ . Normality can be defined as, the shape of the data distribution for an individual variable and its association to the normal distribution, the benchmark for statistical methods. From the results if the significance value was between  $\pm 1.96$ , the data is normal, else if significance value is greater than 0.05, the data is not normally distributed (Garson, 2012).

Multicollinearity or excessive correlation among explanatory variables can complicate or prevent the identification of an optimal set of explanatory variables for a statistical model. Cohen et al., (2013)'s definition of variance inflation factor (VIF) is that it provides an index of the amount that the variance of each regression coefficient is increased relative to a situation in which all of the predictor variables are uncontrolled" and suggest VIF to be too large hence not suitable. The commonly used cut-off points for determining the presence of multicollinearity are (tolerance value of less than 0.10, or a VIF value of above 10) (Lind, Marchal & Wathen, 2012).

Homoscedasticity was tested using the Durbin Watson test. This tested whether there is a (linear) correlation between the error term for one observation and the next which is 2.00 when there is no correlation among residuals hence getting close to 0 when there is positive autocorrelation and beyond 2 when there is negative autocorrelation (Lind, Marchal & Wathen, 2012). A scatter plot of residuals versus anticipated qualities is great approach to check for homoscedasticity. There ought to be no reasonable example in the dissemination; if there is a cone-molded example (as appeared as follows), the information is heteroscedastic.

## CHAPTER FOUR

### DATA ANALYSIS PRESENTATION AND DISCUSSION OF THE RESULTS

#### 4.1 Introduction

This chapter presents the research findings and results of the application of the variables using techniques described in chapter three. The aim of the study was to assess the factors that influence tax compliance among SMEs in Nairobi County. Data analysis was based on specific objectives where patterns were investigated, interpreted and implications drawn on them.

#### 4.2 Response Rate

Response rate is defined as the extent to which the final data set includes all sample members, a ratio of actual respondents to expected number or the percentage of people who respond to the survey (Emore, 2007). High response rate ensures that the survey results are representative of the survey population. The data analyzed was obtained from 168 respondents out of a target of 249 which translated to 67.5%. The unreturned questionnaires were 81 representing 32.5% of the administered questionnaires. The main reason for the unreturned questionnaires were the respondents misplaced the questionnaires, questionnaires were wrongly filled and in some cases the respondents ticked two answers. However, this response rate was good and representative of the entire population. Zikmund *et al* (2010) observed that in descriptive research, a response rate of above fifty percent (50%) is adequate for analysis, sixty percent (60%) good and seventy percent (70%) and above to be very good while according to Mugenda (2008), a response rate of 50% or more is adequate. High response rate increases validity and usefulness of the results. This is shown in the Table 4.1

**Table 4.1 Response Rate**

| <b>Questionnaires</b>  | <b>No.</b> | <b>%</b> |
|------------------------|------------|----------|
| Issued                 | 249        | 100%     |
| Filled in and returned | 168        | 67.5%    |

### **4.3 Reliability Test Results**

Data reliability was assessed by computing a Cronbach's alpha reliability coefficient for each of the constructs. The Cronbach Alpha results are as shown in Table 4.2.

**Table 4.2 Reliability Analysis**

| <b>Constructs</b>  | <b>Cronbach's Alpha</b> |
|--------------------|-------------------------|
| Tax transparency   | 0.725                   |
| Tax accountability | 0.883                   |
| Tax convenience    | 0.802                   |
| Tax compliance     | 0.770                   |

From Table 4.2 Results of reliability analyses showed that the reliability coefficients of each variable were as follows: - tax transparency (0.725), tax accountability (0.883), tax convenience (0.802) and tax compliance (0,770). These results showed that all the variables were internally consistent and reliable.

### **4.4 Demographic Data of the Respondents**

Demographic data of the respondents was sought to provide information about the gender of respondents, highest level of education, length of time your business has been in Operation and sales level of your business per month.

#### 4.4.1 Distribution of Respondents by Gender

Gender was an important variable in this study to investigate the representation of male and female respondents in the study. The respondents were asked to indicate their gender on the questionnaire and the results are as presented in Table 4.3

**Table 4.3 Gender Composition of the Respondents**

| <b>Gender of Respondent</b> | <b>Frequency</b> | <b>Percentage (%)</b> |
|-----------------------------|------------------|-----------------------|
| Male                        | 100              | 59.5                  |
| Female                      | 68               | 40.5                  |
| <b>Total</b>                | <b>168</b>       | <b>100.0</b>          |

Table 4.3 indicates that out of a total of 168 respondents 59.5% of the respondents who participated in the study were male while 40.5% were female. This indicates that there are more male than female owners or managers of SMEs. However, the gap between male and female isn't so wide and thus information from both genders was obtained for the study.

#### 4.4.2 Distribution of Respondents by Highest Education Level

Respondents were asked to indicate their highest education level. This item was to assess their level of skills and to establish whether they were in a position to answer the questionnaire accurately and the results of are as indicated in Table 4.4.

**Table 4.4 Level of Education of Respondents**

| <b>Level of Education</b> | <b>Frequency</b> | <b>Percentage %</b> |
|---------------------------|------------------|---------------------|
| Diploma holder            | 37               | 22.0                |
| Bachelors' degree         | 105              | 62.5                |
| Master's degree           | 20               | 11.9                |
| PhD                       | 4                | 2.4                 |
| Others                    | 2                | 1.2                 |
| <b>Total</b>              | <b>168</b>       | <b>100.0</b>        |

As Indicated in Table 4.4, out of the 168 respondents, 22.0%) of the respondents were diploma holders, majority 62.5% had bachelor's degree, 11.9% had a master's degree, 2.4% were PHD holders and lastly 1.2 represented others of which most were accountants. These findings indicate that the respondents were in a position to accurately answer the questionnaire. In addition, the findings also indicate that the SME owners and managers are equipped with the necessary knowledge and skills to ensure efficiency of SMEs.

#### **4.4.3 Length of SME Operation**

Respondents were asked to indicate the number of years their business has been in operation to assess their familiarity in the field and hence assure validity of their responses the results are as indicated in Table 4.5.

**Table 4.5 Length of SME Operation**

| <b>No. of Years</b> | <b>Frequency</b> | <b>Percentage %</b> |
|---------------------|------------------|---------------------|
| 0-5 years           | 27               | 16.1                |
| Above 5 –10 years   | 55               | 32.7                |
| Above 10 –15 years  | 43               | 25.6                |
| Over 15 years       | 43               | 25.6                |
| <b>Total</b>        | <b>168</b>       | <b>100</b>          |

Table 4.5 shows the number of years the SMES had been in operation. Out of the 168 owners/managers, 16.1% indicated that their business has been in operation for 0 to 5 years, while the majority 32.7% had been in operation for 5-10 years, 25.6% had operated for 10-15 years and 25.6% had operated for over 15 years. The findings of this study indicate that the respondents had adequate experience to respond to the questions and are informed of the SMEs Tax compliance. This concurs with the study by Lussier (2008) who summarized that the individuals with higher experiences have greater chances of responding to the questionnaire statements compared to people with less experience.

#### **4.5 Tax Transparency as Predictors of Tax Compliance**

This study sought to determine the effect of tax transparency on tax compliance among SMEs in Nairobi County, Kenya. To achieve this objective mean, frequencies and percentages were used to interpret the data. Whereby for Strongly Disagree the mean ranged from 1 to 1.4, while for Disagree the mean ranged from 1.5 to 2.4, and for undecided the mean ranged from 2.5 to 3.4, for Agree the mean ranged from 3.5 to 4.4 and lastly, for Strongly Agree the mean ranged from 4.5 to 5.0.

**Table 4.6 Tax Transparency as Predictors of Tax Compliance**

| <b>Tax Transparency</b>  |   | <b>SA</b> | <b>A</b> | <b>U</b> | <b>D</b> | <b>SD</b> | <b>Min</b> | <b>Max</b> | <b>M</b> | <b>Std</b> |
|--|---|-----------|----------|----------|----------|-----------|------------|------------|----------|------------|
| Level of access to information promotes tax compliance                   | F | 62        | 61       | 9        | 12       | 24        | 1          | 5          | 3.74     | 1.203      |
|  | % | 36.9      | 36.3     | 14.3     | 7.1      | 5.4       |            |            |          |            |
| Simplicity in tax return enhances tax compliance                         | F | 57        | 68       | 13       | 30       | 0         | 1          | 5          | 3.90     | 1.111      |
|  | % | 33.9      | 40.5     | 7.7      | 17.9     | 0.0       |            |            |          |            |
| Level of trust promotes tax compliance morale                            | F | 78        | 49       | 32       | 5        | 4         | 1          | 5          | 4.14     | 0.996      |
|  | % | 46.4      | 29.2     | 19.0     | 3.0      | 2.4       |            |            |          |            |
| Attitude towards tax compliance procedures enhance compliance among SMEs | F | 80        | 56       | 8        | 20       | 4         | 1          | 5          | 4.12     | 0.987      |
|  | % | 47.6      | 33.3     | 4.8      | 11.9     | 2.4       |            |            |          |            |

From the descriptive statistics Table 4.6 above, most of the respondents 73.2% agreed that the level of access to information promotes tax compliance while 12.5% disagreed and was supported by a mean of 3.74. The respondents also agreed at 74.4% that the simplicity in tax return enhances tax compliance, while 17.9% disagreed, this had a mean of 3.90 on their responses. Further 75.6% of the respondents were in agreement with a mean of 4.14 that the level of trust promotes tax compliance morale, out of this 5.4% disagreed. Lastly 80.9% of the respondents were in agreement with a mean of 4.12 that the attitude towards tax compliance procedures enhance compliance among SMEs, out of this 14.3% disagreed.

This implied that the respondents are in agreement that tax transparency is a factor for tax compliance among SMEs since their responses were between mean scores of 3.90 and 4.8 on the continuous Likert scale.

These findings concurs to that of Piotrowski (2007) states that governmental transparency allows the public to develop a more accurate picture of what is happening inside a government. According to Rawlins (2009), there are three aspects of transparency: Informational Transparency means openness, making publicly available all legally releasable information whether positive or negative in nature in a manner which is accurate, timely, balanced, and unequivocal. Information must be substantial to meet stakeholder's needs. Disclosure by itself does not equal transparency; in fact some forms of disclosure can defeat the purposes of transparency. Participatory Transparency is what separates transparency from disclosure. Transparency cannot be successful unless you know what stakeholders want and need to know. So, to ensure that the information shared is relevant and useful, stakeholders must be allowed to identify what they need to know. 3. Accountability Transparency. Transparency holds people accountable for their actions, words and decisions (Saad, 2011).

#### **4.6 Tax Accountability as Predictors of Tax Compliance**

This study sought to assess the effects of tax accountability as predictors of tax compliance among SMEs in Nairobi County. To achieve this objective mean frequencies and percentages were used to interpret the data. In the analysis mean range of 1 to 1.4 represents Strongly Disagree, while for Disagree the mean ranged from 1.5 to 2.4, and for Neutral the mean ranged from 2.5 to 3.4, for Agree the mean ranged from 3.5 to 4.4 and lastly, for Strongly Agree the mean ranged from 4.5 to 5.0.

**Table 4.7 Tax Accountability as Predictors of Tax Compliance**

| <b>Tax Accountability</b>   |   | <b>SA</b> | <b>A</b> | <b>U</b> | <b>D</b> | <b>SD</b> | <b>Min</b> | <b>Max</b> | <b>M</b> | <b>Std</b> |
|---|---|-----------|----------|----------|----------|-----------|------------|------------|----------|------------|
| Tax audit rates enhance tax compliance                                    | F | 61        | 61       | 9        | 12       | 25        | 1          | 5          | 3.72     | 1.213      |
|   | % | 36.3      | 36.3     | 5.4      | 7.1      | 14.9      |            |            |          |            |
| Tax penalties discourage non-compliance among SMEs                        | F | 73        | 57       | 14       | 20       | 4         | 1          | 5          | 4.04     | 1.001      |
|   | % | 43.5      | 33.9     | 8.3      | 5.4      | 2.4       |            |            |          |            |
| Tax governance could encourage tax compliance                             | F | 80        | 49       | 3        | 32       | 4         | 1          | 5          | 4.18     | 0.999      |
|   | % | 47.6      | 29.2     | 1.8      | 19.0     | 2.4       |            |            |          |            |
| Integrity of tax officials and government officers enhance tax compliance | F | 57        | 88       | 4        | 3        | 16        | 1          | 5          | 4.07     | 1.021      |
|   | % | 33.9      | 52.4     | 2.4      | 1.8      | 9.5       |            |            |          |            |

From the descriptive statistics table 4.7, most of the respondents 72.6% strongly agreed that tax audit rates enhance tax compliance while 22% disagreed, this had a mean of 3.72. Further 77.4% of the respondents also agreed that tax penalties discourage non-compliance among SMEs, 7.8% disagreed. This also had a mean of 4.04. In addition 76.8% of the respondents were in agreement with a mean of 4.18 that Tax governance could encourage tax compliance while 5.2% disagreed. Lastly 86.6% of the respondents were in agreement with a mean of 4.07 that integrity of tax officials and government officers enhance tax compliance while 11.3% disagreed This implied that most of the respondents agreed that tax accountability is a predictors of tax compliance among

SMEs in Nairobi County since their responses were between mean scores of 3.5 and 4.8 on the continuous Likert scale.

These findings are also in line with Dubin et al. (1990) and Pommerehne and Weck-Hannemann (1996) found that the probability of audit significantly affects tax compliance, whereas they found no evidence of a significant deterrent effect of the penalty. Andreoni et al. (1998) based on studies of data generated from the Internal Revenue Service's Taxpayers Compliance Management Programme (TCMP) observed that due to the low probability of detection even high penalties has no observable impact on the level of compliance. Merima et al, (2013) when studying factors affecting tax compliance in a sample of African countries observed that an increase in perception of individuals about the difficulty of evading taxes enhances taxpayer's attitude towards compliance.

#### **4.7 Tax Convenience as Predictors of Tax Compliance**

This study sought to assess the effects of tax convenience on tax compliance among SMEs in Nairobi County. To achieve this objective mean frequencies and percentages were used to interpret the data. In the analysis mean range of 1 to 1.4 represents Strongly Disagree, while for Disagree the mean ranged from 1.5 to 2.4, and for Neutral the mean ranged from 2.5 to 3.4, for Agree the mean ranged from 3.5 to 4.4 and lastly, for Strongly Agree the mean ranged from 4.5 to 5.0.

**Table 4.8 Tax Convenience as Predictors of Tax Compliance**

| <b>Tax Convenience</b>   |   | <b>SA</b> | <b>A</b> | <b>U</b> | <b>D</b> | <b>SD</b> | <b>Min</b> | <b>Max</b> | <b>M</b> | <b>Std</b> |
|--|---|-----------|----------|----------|----------|-----------|------------|------------|----------|------------|
| Tax return process enhances revenue collection from SMEs               | F | 67        | 56       | 9        | 11       | 25        | 1          | 5          | 3.77     | 1.311      |
|  | % | 39.9      | 33.3     | 5.4      | 6.5      | 14.9      |            |            |          |            |
| Tax regulations and laws enhances tax compliance among SMEs            | F | 81        | 55       | 6        | 20       | 6         | 1          | 5          | 4.10     | 1.012      |
|  | % | 48.2      | 32.7     | 3.6      | 11.9     | 3.6       |            |            |          |            |
| Simplicity of tax filing procedures changes my tax compliance behavior | F | 97        | 43       | 18       | 4        | 6         | 1          | 5          | 4.32     | 0.987      |
|  | % | 57.7      | 25.6     | 10.7     | 2.4      | 3.6       |            |            |          |            |
| Good governance promotes my tax payment morale                         | F | 69        | 75       | 4        | 3        | 17        | 1          | 5          | 4.13     | 0.911      |
|  | % | 41.1      | 44.6     | 2.4      | 10.1     | 1.8       |            |            |          |            |

From the descriptive statistics table 4.8, most of the respondents 73.2% strongly agreed that tax return process enhances revenue collection from SMEs while 21.4% disagreed; this had a mean of 3.77. Further, 80.9% of the respondents also agreed that tax regulations and laws enhances tax compliance among SMEs, 15.5% disagreed and was supported by a mean of 4.10.

Further on their responses 83.3% of the respondents were in agreement with a mean of 4.32 that Simplicity of tax filing procedures changes my tax compliance behavior 6% disagreed. Lastly, 85.5% of the respondents were in agreement with a mean of 4.13 that good governance promotes my tax payment morale 11.9% disagreed This implied that most of the respondents agreed that Tax Convenience is a predictor for tax compliance among SMEs in Nairobi County since their responses were between mean scores of 3.5 and 4.8 on the continuous Likert scale.

This concurs to the findings by Merima, Odd-Helge& Ingrid (2013) found that tax compliance behavior among citizens in Kenya, Tanzania, Uganda and South Africa was influenced by perception about difficulty of evading taxes, satisfaction with public service provision, payments to non-state actors, perception of an ethnic group being treated unfairly, and tax knowledge. The study did not assess a number of possible determinants of tax compliance and therefore there is need to expand the variables.

Atawodi and Ojeka (2012) were also interested in finding out some of the factors which affect both positively and negatively compliance among SMEs in North Nigeria and they concluded their research and they had this to say, that high tax rates and complex filing procedures are the most crucial factors affecting -compliance negatively among the SMEs.

#### **4.8 Tax Compliance**

This study sought to assess the factors that influence tax compliance among SMEs in Nairobi County. To achieve this objective mean frequencies and percentages were used to interpret the data. In the analysis mean range of 1 to 1.4 represents Strongly Disagree, while for Disagree the mean ranged from 1.5 to 2.4, and for Neutral the mean ranged from 2.5 to 3.4, for Agree the mean ranged from 3.5 to 4.4 and lastly, for Strongly Agree the mean ranged from 4.5 to 5.0. Standard deviation showed deviation from the mean

**Table 4.9 Tax Compliance**

| <b>Tax Compliance</b>   |   | <b>SA</b> | <b>A</b> | <b>U</b> | <b>D</b> | <b>SD</b> | <b>Min</b> | <b>Max</b> | <b>M</b> | <b>Std</b> |
|---|---|-----------|----------|----------|----------|-----------|------------|------------|----------|------------|
| The process of calculating tax is easy thus enhancing SMEs behavior                         | F | 61        | 61       | 9        | 25       | 12        | 1          | 5          | 3.72     | 1.131      |
|   | % | 36.3      | 36.3     | 5.4      | 7.1      | 14.9      |            |            |          |            |
| It is easy to file complaints for any tax irregularities                                    | F | 73        | 57       | 14       | 20       | 4         | 1          | 5          | 4.04     | 1.107      |
|   | % | 43.8      | 35.5     | 9.1      | 9.1      | 2.5       |            |            |          |            |
| It easy to understand all the processes of the current tax system                           | F | 96        | 45       | 21       | 4        | 2         | 1          | 5          | 4.36     | 0.991      |
|   | % | 57.1      | 26.8     | 12.5     | 2.4      | 1.2       |            |            |          |            |
| KRA have been training taxpayers on formal taxation enhancing morale of SMEs on tax payment | F | 69        | 75       | 4        | 3        | 17        | 1          | 5          | 4.13     | 0.981      |
|   | % | 41.1      | 44.6     | 2.4      | 10.1     | 1.8       |            |            |          |            |

As indicated in table 4.9, the study findings indicated that majority of the respondents 72.6% agreed that the process of calculating tax is easy thus enhancing SMEs behavior while 20.7%, this had a mean of 3.72. Further 79.3% agreed that it is easy to file complaints for any tax irregularities while 11.5% disagreed. This was supported by a mean of 4.04. Further, 83.9% of the respondent agreed that it easy to understand all the processes of the current tax systemwhile 3.6% disagreed; this had a mean of 4.36. Lastly, 85.7% of the respondent agreed that KRA have been training taxpayers on formal taxation enhancing morale of SMEs on tax paymentwhile 11.9% disagreed, this

had a mean of 4.13. This implies that majority of the respondents were in agreement with factors that influence tax compliance among SMEs in Nairobi County .

This finding is consistent to other findings such as by Makokha, Nambuswa, and Namusonge, (2017) who stated that, tax administration and compliance issues determine the broad evolution of tax system. Therefore, when processes and changes in the economy cannot be explained on a level necessary using standard economic theory of the different processes, one has to turn to other branches of science including social psychology. Maseko, (2014) states that, the issues of tax compliance cost and compliance levels are as old as the collection of taxes and will be a target for research as long as taxes exist. Mohd, (2010) noted that however, that avoidance of paying taxes is a growing problem in most countries like Kenya.

#### **4.9 Inferential Statistics**

The study employed inferential statistics which include; Pearson's correlations and multiple regressions. To ascertain whether there is existing relationship between the variables correlation analysis was done. On the other hand multiple regression was used to test the hypothesis to estimate the coefficients of linear equations, with one or more independent variables and thus predicting the value of the dependent variable.

##### **4.9.1 Correlation Analysis**

From the study Karl Pearson's coefficient of correlation was used to check the linear relationship between the variables, The Pearson correlation coefficient is a very useful way to measure the existence of relationships between independent and dependent variables.

**Table 4.10 Correlation Analysis**

|                       |                        | Tax<br>transparency | Tax<br>accountability | Tax<br>convenience | Tax<br>compliance |
|-----------------------|------------------------|---------------------|-----------------------|--------------------|-------------------|
| Tax<br>transparency   | Pearson<br>Correlation | 1                   | .                     |                    |                   |
|                       | Sig. (2-tailed)        |                     |                       |                    |                   |
| Tax<br>accountability | Pearson<br>Correlation | .700**              | 1                     |                    |                   |
|                       | Sig. (2-tailed)        | .000                |                       |                    |                   |
| Tax<br>convenience    | Pearson<br>Correlation | .587**              | .837**                | 1                  |                   |
|                       | Sig. (2-tailed)        | .000                | .000                  |                    |                   |
| Tax<br>compliance     | Pearson<br>Correlation | .703**              | .883**                | .832**             | 1                 |
|                       | Sig. (2-tailed)        | .000                | .000                  | .000               |                   |

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

The evaluation of the correlation was in accordance to Saunders (2003) who indicated that  $r=1$  shows a Perfect linear correlation,  $0.9 < r < 1$  indicates Positive strong correlation,  $0.7 < r < 0.9$  Positive high correlation  $0.5 < r < 0.7$  Positive moderate correlation,  $0 < r < 0.5$  Weak correlation  $r=0$  No, relationship and  $-1 < r = < 0$  Negative relationship. From the study the results indicate that all the study variables had positive high correlation to tax compliance, this was indicated by tax transparency  $r=0.703$  and the p-value is .000, tax accountability  $r=0.883$  and the p-value is .000 and tax convenience  $r=0.832$  and the p-value is .000. This indicates that that there is a significant association between tax transparency, tax accountability and tax convenience among SMEs in Nairobi city.

## 4.9.2 Diagnostic Tests

To provide unbiased estimates of the study parameters, various assumptions of regression were tested, these include normality assumption linearity assumption and homoscedasticity means that the variance of errors is the same across all levels of the independent variables.

### 4.9.2.1 Normality Assumption

The study assumed that all the variables have a normal distribution. Kurtosis and Skewness were used in order to test the assumption of the normality of the population distribution, whereby a Skewness and kurtosis should be between  $\pm 3$ . Normality can be defined as, the shape of the data distribution for an individual variable and its association to the normal distribution, the benchmark for statistical methods. Skewness and kurtosis measures of the distributions should be calculated. Where Skewness describes how symmetrical the distribution is around the center, kurtosis describes how flat or peaked the distribution is (Cohen *et al.*, 2003). Table 4.11 shows all variables with corresponding Skewness and kurtosis values.

**Table 4.11 Descriptive Statistics**

|                    | N   | Skewness  |            | Kurtosis  |            |
|--------------------|-----|-----------|------------|-----------|------------|
|                    |     | Statistic | Std. Error | Statistic | Std. Error |
| Tax transparency   | 168 | -.871     | .238       | -.007     | .472       |
| Tax accountability | 168 | -1.236    | .238       | 1.476     | .472       |
| Tax convenience    | 168 | -1.196    | .238       | 1.108     | .472       |
| Tax compliance     | 168 | -.937     | .238       | .021      | .472       |

From the table 4.10 above, it is indicated that the data used in this study is normally distributed and hence can be subjected to other statistical tests of significance used to test the relationship between independent and dependent variables that require normally distributed data.

#### **4.9.2.2 Linearity Assumptions**

Linearity assumption accurately estimates the relationship between dependent and independent variables; it tests if the relationships are linear in nature. Non linearity of the regression analysis under-estimate the true relationship between the study variables, this was done by use of the Pearson product moment Correlation. Saunders (2009) indicated that a correlation of 1 shows a Perfect linear correlation, correlation of between 0.9 and 1 indicates Positive strong correlation, correlation between 0.7 and 0.9 Positive high correlation, correlation of between 0.5 and 0.7 indicates a Positive moderate correlation, correlation of 0 and 0.5 Weak correlation while a correlation of 0 indicates No relationship and a correlation of -1 and 0 indicates a negative relationship. Linearity assumption was therefore satisfied. This implies that all the dimensions of performance contracting under study jointly have a positive and significant impact on service delivery of state corporations. The results are shown in table 4.10 above

#### **4.9.2.3 Homoscedasticity**

Homoscedasticity assumes that the dependent variable show an equivalent level of variance across the range of predictor variable. Homoscedasticity is one of the assumptions required for multivariate analysis. Although the violation of homoscedasticity might reduce the accuracy of the analysis, the effect on ungrouped data is not fatal (Tabachnick and Fidell, 2007). The study used Durbin-Watson statistic to test the assumption of Homoscedasticity, the Durbin-Watson statistic should be between 1.5 and 2.5. the results in table 4.14 indicated that The Durbin-Watson statistic is 1.821 which is between 1.5 and 2.5 and therefore the data is not auto correlated.

**Table 4.12 Model Summary**

| Model | R                 | R Square | Adjusted Square | R Std. Error of the Estimate | Durbin-Watson |
|-------|-------------------|----------|-----------------|------------------------------|---------------|
| 1     | .786 <sup>a</sup> | .618     | .614            | .47536                       | 1.821         |

a. Predictors: (Constant), tax transparency, tax convenience, tax accountability

b. Dependent Variable: Tax Compliance

#### 4.9.2.4 Assumption of Multicollinearity

This study examined the data in order to verify if the assumption of no correlation between the independent variables was met. Multicollinearity under this study was tested under the study by the use of tolerance and Variance Inflation Factor (VIF). Multicollinearity is reflected by lower tolerance values and higher VIF values (Hair et al., 2006). The pertinent results of analysis are presented in Table 4.13

**Table 4.13 Multicollinearity Test Assumption**

| Model | Collinearity Statistics |      |       |
|-------|-------------------------|------|-------|
|       | Tolerance               | VIF  |       |
|       | (Constant)              |      |       |
| 1     | Tax transparency        | .210 | 4.771 |
|       | Tax accountability      | .115 | 8.732 |
|       | Tax convenience         | .125 | 8.021 |

The study found that tax accountability was the highest related to the other independent variables with (tolerance = 0.115; VIF = 8.732). It also was noted that tax convenience had the second high rated correlation with other independent variables at (tolerance = 0.125; VIF = 8.021), lastly, the study showed that tax accountability had the least high correlation with the other independent variables with (tolerance = 0.210; VIF = 4.771).

These results thus indicated a very little evidence of multicollinearity among the independent variables to warrant removal of any of the independent variables from the study analysis.

#### 4.9.3 Multiple Regression Analysis

In this study, a multiple regression analysis was conducted to test the influence among predictor variables and tax compliance among SMEs in Nairobi. The decision rule was that when the p-value is less than the conventional 0.05 the null hypothesis is rejected and when it is above the conventional value 0.05 the null hypothesis is accepted,

**Table 4.14 Overall Model Summary**

| Model | R                 | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------------------|----------|-------------------|----------------------------|
| 1     | .786 <sup>a</sup> | .618     | .614              | .47536                     |

a. Predictors: (Constant), tax transparency, tax convenience, tax accountability

From the results on model summary R= 0.786, R- square = 0.618, adjusted R- square= 0.614, and the SE= 0.475. The coefficient of determination also called the R square is 0.618. This implies that the effect of the predictor variables (tax transparency, tax convenience, tax accountability) explains 61.8% of the variations in tax compliance of SMEs in Nairobi. This implies that a change in the tax transparency, tax convenience, tax accountability has a strong and a positive effect on tax compliance of SMEs in Nairobi.

**Table 4.15 Overall ANOVA<sup>a</sup>**

| Model | Sum of Squares | df     | Mean Square | F      | Sig.    |                   |
|-------|----------------|--------|-------------|--------|---------|-------------------|
| 1     | Regression     | 44.007 | 3           | 14.669 | 167.167 | .000 <sup>b</sup> |
|       | Residual       | 8.687  | 99          | .088   |         |                   |
|       | Total          | 52.694 | 168         |        |         |                   |

a. Dependent Variable: Tax compliance

b. Predictors: (Constant), tax transparency, tax convenience, tax accountability

The significance of the regression model was tested using Analysis of Variance (ANOVA). Table 4.24 above presents the results of this test. The regression model also indicated that it was significant ( $p = .000$ ) to mean that it had not been computed by chance, this was because the significance value is 0.000 which is less than 0.05. This made the results of the regression model credible and reliable.

**Table 4.16 Overall Coefficients'**

| Model | Unstandardized Coefficients | Standardized Coefficients | t    | Sig. |       |      |
|-------|-----------------------------|---------------------------|------|------|-------|------|
|       | B                           | Std. Error                | Beta |      |       |      |
| 1     | (Constant)                  | .262                      | .180 |      | 1.456 | .148 |
|       | Tax transparency            | .241                      | .066 | .237 | 3.629 | .000 |
|       | Tax accountability          | .299                      | .077 | .330 | 3.879 | .000 |
|       | Tax convenience             | .407                      | .079 | .415 | 5.118 | .000 |

a. Dependent Variable: Tax compliance

Table 4.25 above shows the regression coefficients of the independent variables (tax transparency, tax convenience, tax accountability) are statistically significant in explaining tax compliance among SMEs.

Thus the regression equation becomes;

$$Y = 0.262 + 0.241X_1 + 0.299X_2 + 0.407X_3 \dots \dots \dots \text{Equation 4.1}$$

In addition the results shows that tax transparency was positive and significantly related to tax compliance (B=0.241, p value=0.000). This implies that an increase in Tax transparency by one unit leads to an increase in tax compliance among SMEs by 0.241 units. Tax accountability was also positively and significantly related to tax compliance among SMEs (B=0.299, p value=0.000). This implies that an increase in tax accountability by one unit leads to an increase in tax compliance among SMEs by 0.299 units. Lastly the study indicated that tax convenience was positively and significantly related to tax compliance among SMEs (B=0.407, p value=0.000). This implies that an increase in tax convenience by one unit leads to an increase in tax compliance among SMEs by 0.407 units

This concurs to the findings by Merima, Odd-Helge& Ingrid (2013) found that tax compliance behavior among citizens in Kenya, Tanzania, Uganda and South Africa was influenced by perception about difficulty of evading taxes, satisfaction with public service provision, payments to non-state actors, perception of an ethnic group being treated unfairly, and tax knowledge. The study did not assess a number of possible determinants of tax compliance and therefore there is need to expand the variables.

Atawodi and Ojeka (2012) were also interested in finding out some of the factors which affect both positively and negatively compliance among SMEs in North Nigeria and they concluded their research and they had this to say, that high tax rates and complex filing procedures are the most crucial factors affecting -compliance negatively among the SMEs.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

The chapter covers the summary of major findings; conclusion based on the findings and the recommendations. This study aimed at examining the effects of performance contracting on service delivery. In this study, a questionnaire was used to collect the needed quantitative data from the employees of the state corporations in Uasin Gishu County. This chapter therefore presents the conclusions reached as well as the recommendations of the study and areas warranting further research are also highlighted.

#### **5.2 Summary of Findings**

The first objective of the study sought to establish determine the effect of tax transparency on tax compliance among SMEs in Nairobi County, Kenya. The study indicated that the respondents are in agreement that tax transparency is a factor for tax compliance among SMEs. In addition the results shows that tax transparency was positive and significantly related to tax compliance ( $B=0.241$ ,  $p$  value= $0.000$ ). These findings concurs to that of Piotrowski (2007) states that governmental transparency allows the public to develop a more accurate picture of what is happening inside a government. According to Rawlins (2009), there are three aspects of transparency: Informational

The second objective sought to assess the effects of tax accountability as predictors of tax compliance among SMEs in Nairobi County, the study indicated that most of the respondents agreed that tax accountability is a predictors of tax compliance among SMEs in Nairobi County. In addition, it was indicated that tax accountability was also positively and significantly related to tax compliance among SMEs ( $B=0.299$ ,  $p$  value= $0.000$ ). These findings are also in line with Dubin et al. (1990) and Pommerehne and Weck-Hannemann (1996) found that the probability of audit significantly affects tax compliance, whereas they found no evidence of a significant deterrent effect of the.

Merima et al, (2013) when studying factors affecting tax compliance in a sample of African countries observed that an increase in perception of individuals about the difficulty of evading taxes enhances taxpayer's attitude towards compliance.

The third objective sought to assess the effects of tax convenience on tax compliance among SMEs in Nairobi County, the findings indicated that most of the respondents agreed that Tax Convenience is a predictor for tax compliance among SMEs in Nairobi County. It was also indicated that tax convenience was positively and significantly related to tax compliance among SMEs ( $B=0.407$ ,  $p \text{ value}=0.000$ ). This concurs to the findings by Merima, Odd-Helge & Ingrid (2013) found that tax compliance behavior among citizens in Kenya, Tanzania, Uganda and South Africa was influenced by perception about difficulty of evading taxes, satisfaction with public service provision, payments to non-state actors, perception of an ethnic group being treated unfairly, and tax knowledge. The study did not assess a number of possible determinants of tax compliance and therefore there is need to expand the variables.

### **5.3 Conclusions**

From the study in relation to the effects of tax transparency on tax compliance, it was concluded that level of access to information, Simplicity in tax return, level of trust, attitude towards tax compliance and Knowledge of tax filling procedures promotes tax compliance. Regarding the effects of tax accountability as predictors of tax compliance among SMEs in Nairobi County, it was concluded that tax audit rates, tax penalties, tax governance and integrity of tax officials and government officers enhance tax compliance. Lastly on the effects of tax convenience on tax compliance among SMEs in Nairobi County, it was concluded that tax return process, tax regulations and laws, simplicity of tax filing procedures and good governance promotes my tax payment morale.

#### **5.4 Recommendation of the Study**

Based on the results, findings and conclusions the following recommendations have been made

In relation to the effects of tax transparency on tax compliance, it is recommended that, there is need to intensify taxpayer education in terms of increasing the number of sessions and broadening coverage to include tax consultants. This will enlighten the taxpayers on existing law and any other tax liability. This will also provide a forum for taxpayers to air their complaints and or compliments.

Regarding the effects of tax accountability as predictors of tax compliance among SMEs in Nairobi County, it is recommended that, the returns ought to be simplified and accompanying notes reconstructed into plain language that can be understood by all taxpayers. They should also be clear and brief but complete in detail to enable the taxpayers fill the return.

Lastly on the effects of tax convenience on tax compliance among SMEs in Nairobi County, it is recommended that, Kenya revenue Authority should strive to give taxpayers high quality services as stipulated in the corporate plan. Where possible, officers should endeavor to adhere to the taxpayers' charter in terms of service provision to taxpayers. Help counters manned by technical and knowledgeable staff should be introduced and enhanced throughout the authority's offices to bring services closer to the taxpayers.

#### **5.5 Areas for Further Research**

Future research should attempt to collect data from SME's from other tax divisions in Kenya and find out whether the effect of tax compliance by small and medium enterprises is the same as in Nairobi region. In addition, further study should concentrate on the relationship between voluntary tax compliance strategy and the deterrence strategy and the factors that motivate SMEs to be tax compliant.

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**APPENDICES**

**Appendix I: Introductory Letter**

Dear Respondent,

**REF: CONSENT FOR PROVISION OF ACADEMIC DATA**

My name is Mathanjuki Gibson Kuria undertaking a study on factors that influence tax compliance among SMEs in Nairobi County. I would like to request for your consent to provide data meant for purely academic purposes.

Information provided will be treated as confidential and for purely academic purposes. Your consent will therefore be highly appreciated.

I consent to provide required data: -

Sign ..... Date .....

Witness

Sign.....Date.....

## Appendix II: Questionnaire

Please give answers in the spaces provided and tick (√) in the box that matches your responses to the questions where applicable.

### PART A: Demographic information.

Please tick the appropriate box that best describes your answer

1. Gender (Tick as applicable)

a) Male { }

b) Female { }

2. What is your highest level of education qualification? (Tick as applicable)

a) Post graduate { }

b) Undergraduate { }

c) Tertiary college { }

d) Secondary { }

3. What is the Length of time your business has been in Operation? (Tick as applicable)

a) Less than 5 year { }

b) 6-10 years { }

c) 11-15 years { }

d) More than 16 years { }

4 What is the sales level of your business per month?

a. Less than 50,000/- { }

b. 50,000/- to 100,000/- { }

c. 100,001/- to 200,000/- { }

d. 200,001/- to 300,000/- { }

e. 300,001/- to 400,000/- { }

f. 400,001/- to 500,000/- { }

g. Over 500,000/ { }

**SECTION B: Effect of Tax Transparency as predictors of tax compliance**

What is your level of agreement with the following statements regarding the effect of tax transparency as predictors of tax compliance among SMEs in Nairobi County? Use a scale of 1 to 5 where 1 = to strongly disagree and 5 = strongly agree.

| SN | Statements   | 5 | 4 | 3 | 2 | 1 |
|----|--|---|---|---|---|---|
| 1  | Level of access to information promotes tax compliance                   |   |   |   |   |   |
| 2  | Simplicity in tax return enhances tax compliance                         |   |   |   |   |   |
| 3  | Level of trust promotes tax compliance morale                            |   |   |   |   |   |
| 4  | Attitude towards tax compliance procedures enhance compliance among SMEs |   |   |   |   |   |
| 5  | Knowledge of tax filling procedures promotes tax compliance              |   |   |   |   |   |

**SECTION C: Effects of tax accountability as predictors of tax compliance**

What is your level of agreement with the following statements regarding the effects of tax accountability as predictors of tax compliance among SMEs in Nairobi County? Use a scale of 1 to 5 where 1 = to strongly disagree and 5 = strongly agree.

| SN | Statements  | 5 | 4 | 3 | 2 | 1 |
|----|---|---|---|---|---|---|
| 1  | Tax audit rates enhance tax compliance                                    |   |   |   |   |   |
| 2  | Tax penalties discourage non-compliance among SMEs                        |   |   |   |   |   |
| 3  | Tax governance could encourage tax compliance                             |   |   |   |   |   |
| 4  | Integrity of tax officials and government officers enhance tax compliance |   |   |   |   |   |

**SECTION D: Effects of tax convenience as predictors of tax compliance**

This section deals with information pertaining to the effects of tax convenience on tax compliance among SMEs in Nairobi County. Where: Strongly agree (5) Agree (4) Undecided (3) Disagree (2) Strongly Disagree (1)

| <b>SN</b> | <b>Variable constructs</b>   | <b>1</b> | <b>2</b> | <b>3</b> | <b>4</b> | <b>5</b> |
|-----------|--|----------|----------|----------|----------|----------|
| 1         | Tax return process enhances revenue collection from SMEs               |          |          |          |          |          |
| 2         | Tax regulations and laws enhances tax compliance among SMEs            |          |          |          |          |          |
| 3         | Simplicity of tax filing procedures changes my tax compliance behavior |          |          |          |          |          |
| 4         | Good governance promotes my tax payment morale                         |          |          |          |          |          |

## SECTION E: TAX COMPLIANCE

This section deals with the information pertaining to tax compliance. Use the rating provided. Where; strongly agree (5) Agree (4) Undecided (3) Disagree (2) Strongly Disagree (1)

| SN | Variable constructs   | 1 | 2 | 3 | 4 | 5 |
|----|---|---|---|---|---|---|
| 1  | The process of calculating tax is easy thus enhancing SMEs behavior                         |   |   |   |   |   |
| 2  | It is easy to file complaints for any tax irregularities                                    |   |   |   |   |   |
| 3  | It easy to understand all the processes of the current tax system                           |   |   |   |   |   |
| 4  | KRA have been training taxpayers on formal taxation enhancing morale of SMEs on tax payment |   |   |   |   |   |

*Thank you for Participating*