

**FACTORS AFFECTING TAX COMPLIANCE IN THE INFORMAL SECTOR IN
NAIROBI.**

(CASE OF NAIROBI CENTRAL BUSINESS DISTRICT)

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and Technology**

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DECLARATION

This research Project is my original work and has not been presented for a postgraduate diploma in any other academic or non- academic institution

Sign Date.....

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This research Project has been submitted for examination with my approval as the Supervisor

Sign Date.....

Ms_AnneMaina

DEDICATION

This Project is dedicated to my family members, my parents Mr. and Mrs. Gogo for their parental love, inspirations, sacrifice and endless support financially

To my sister Vallary Kings and my brother Rodgers Otieno for their compassion and encouragement to great achievement.

To my colleagues, friends and classmates for their support and friendship that I truly cherish.

To my supervisor Ms. Anne Maina for her guidance and mentorship all through.

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LIST OF ACRONYMS

- DTD:** DOMESTICS TAX DEPARTMENT.
- KESRA:** KENYA SCHOOL OF REVENUE ADMINISTRATION.
- KIPPRA:** KENYA INSTITUTE OF PUBLIC POLICY RESEARCH AND ANALYSIS.
- KNBS:** KENYA NATIONAL BUREAU OF STATISTICS.
- KRA:** KENYA REVENUE AUTHORITY.
- SMEs:** SMALL AND MEDIUM ENTERPRISES.

OPERATIONAL DEFINITION OF TERMS

Tax- This is a charge imposed on a country's citizens and corporate entities to finance the government's expenditures (Oat, 2009).

Tax compliance- This is the willingness of taxpayer to pay their taxes (kirchler, Effort and aspirations of tax evasion, 2009). With regards to KRA, the word voluntary tax compliance is used to refer to taxpayer registration, keeping of business records, filing of self-assessment returns and payment of taxes when they are due.

ABSTRACT

This study sought to determine the factors affecting tax compliance in the informal sector in Nairobi. To achieve this, central business district of Nairobi was taken as a case study. In previous years' revenue targets set by treasury are never met. Therefore, the actual revenue collected has always been behind the targets. This is as a result of tax noncompliance. Tax non-compliance may be measured in terms of the tax gap. It is very clear that there has been tax gaps every fiscal year. Therefore, the researcher opted to carry out this study to determine factors affecting tax compliance in the informal sector and recommend measures to be put in place by the government and Kenya Revenue Authority to enhance tax compliance in this sector. The main objectives of this study was to establish tax information on tax rates, tax penalties and fines and tax compliance cost on tax compliance level. This has been considered by the researcher to be the most key factors that affect tax compliance level in Kenya. This study was controlled by two theories, that is, theory of partnership and theory of Allingham and sandmo. The study used questionnaires and oral interview method to collect data. The population of the study was a number of 265 informal sector in central business district of Nairobi and a sample of 53 enterprises. Once the data was collected, it was coded and analyzed with the help of the SPSS. Mean, frequencies, and percentages were calculated. It was presented in tables, charts using simple percentages. correlation analysis was done in order to make a thorough conclusion on factors affecting compliance with tax laws in Kenya. It was clear from the findings that tax information is the greatest contributing factor in tax compliance .According to the study findings there is enough proof to conclude that low tax knowledge and education are associated with high levels of tax compliance. Their (KRA) main objective should be to offer tax information advices for free. Some of the key services that they should be offering that are in great need are; tax computation, filing of tax returns, which tax to be paid where, tax penalties and the due dates. This will not only help tax payers but also tax practitioners. KRA should also formally communicate tax information changes. KRA should ensure that there is no tax payer who doesn't pay tax or file tax returns due to failure of tax understanding.

CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter presents the background of the research on the factors affecting tax compliance in the informal sector in Nairobi County. It further, presents statement of the problem, research objectives and questions and finally the importance of the research.

1.1 Background of the study

Taxation of the informal economy is just one of many concerns that affect tax policy. Taxes are necessary for raising tax revenue, to pay for what is considered by society to be public goods. Tax policy is concerned about the impact of taxes on economic efficiency, aggregate demand and income distribution. However, whenever there are taxes, there will be tax evasion. Though tax policy cannot be concerned solely or even primarily with minimizing evasion, the fact of evasion and its consequences, it alters the way in which taxes impact on economic efficiency and income distribution. Therefore, the informal economy needs to be taken into account in predicting the impacts of tax changes (Giles D.A.E, 2002)

In any country, there are going to be a significant number of people working who are not registered with the authorities at all. The greater the degree of personal liberty, the more of these people there are likely to be. Often, they are illegal immigrants. However, at any point in time there are also going to be some legal residents who choose to work entirely underground, filing no tax return at all. This may well be the most effective form of tax evasion. Somebody who files a tax return, and under-reports income, is at some risk of being audited. By contrast, somebody who never files a return is likely to be safer, and may completely escape the notice of the authorities (J.Shapiro, 2005).

The complexities of tax compliance in the informal sector are not unique to Kenya. In the US, for instance, forty per cent of Americans, in the informal sector, are not in compliance with income tax. The reasons for non-compliance are instructive. For instance, taxpayers lack the requisite knowledge of the tax law, taxpayers interpret the law differently from the Internal Revenue Service

of the USA, taxpayers lack record keeping ability sufficient to satisfy the Internal Revenue Service and the taxpayers do their math wrong, or they rely on professional return preparers who get it wrong (Spiro, 2005)

Some of the problems regarding the informal sector that exist under the income tax are likely to remain so, particularly those involving cash transactions made in the informal economy or with the explicit intent of evading taxation. However, as the costs of compliance reduce and the perceived fairness of the tax system increases, some of the hostilities in the informal sector may decline (Chattopadhyay, 2002). Businesses that are non-compliant because they perceive the present system as unfair or illegitimate may choose to comply. Research has confirmed the intuitive relationship between higher marginal tax rates and higher rates of evasion. Lower rates, all other things being equal, imply lower evasion because the benefits from evasion decline while the costs of evasion remain comparable (Shapiro, 2005).

Small businesses are viewed as more likely to evade taxes since the owner, and beneficiary of tax evasion, is more likely to also be responsible for keeping the books and filing the tax returns. Those small business persons that are inclined to cheat on their sales tax are probably already cheating on their income tax and would be inclined to do so under any tax system. Further, the economic importance of small firms in the retail sector is usually grossly overstated (Friedman, 2000).

The taxation of informal sector faces several major policy challenges (Chilipunde, 2010). The first one concerns compliance costs of taxation. Given that small start-ups and research oriented informal sector are generally considered as important factors for economic growth, tax compliance cost may slow down the economy. At least two policy responses to the problem of compliance costs are conceivable. Governments could try to generally simplify tax administration for businesses. At the same time, special responses targeted at informal sector are conceivable. For example, a widely observed measure to reduce the cost for small businesses are exemption thresholds under value added taxation (Weichenrieder, 2007).

1.1.1 Informal sector in Kenya

Informal sector targets traders who use turnover tax. Turnover tax is a simple tax on the gross income of any resident person whose turnover from business does not exceed Kshs.5 million during any year of Income. According to turnover tax targets traders, artisans and others working in market stalls, in residential houses or in open places (Ouma, 2007).

The small business taxpayers who do not qualify for VAT pay the turnover tax. This tax was aimed at bringing businesses in the informal sector into the tax bracket (DAC, 2008). These businesses include small scale manufacturing firms and Jua Kali businesses, agricultural enterprises and transport industries. The turnover tax rate was set at three per cent. Turnover tax does not apply to rental income, management or professional fees or training fees, income subject to withholding tax as a final tax and income of incorporated companies (INCOME TAX ACT).

The informal sector in Kenya is characterized by the ease of entry and exit, the small scale nature of activities, self-employment with a high proportion of family workers and apprentices, the little amount of capital and equipment, their labour intensive technology, the low level of skills, the low level of organization with little access to organized markets, the unregulated and competitive markets, the limited access to formal credit, the low levels of education and training and the limited access to services and amenities (Waweru, 2007).

Every sector of operations has smaller operations. These include textile industry, manufacturing, finance, security, food and hotels, transport, service sector to mention a few. From the economic survey of 2004 it shows Employment within the Sector accounted for 74.2 per cent of the total persons in employment. The sector contributes up to 18.4 per cent of the country's Gross Domestic Product (GDP) (Kenya national official assembly record). The sector is, therefore, not only a provider of goods and services but also a driver in promoting competition and innovation, and enhancing the enterprise culture which is necessary for private sector development and industrialization. It is expected that by the year 2030, Kenya would have been transformed into a newly industrialized nation. If the country has to make this leap, then informal sector are expected

to play a key role in this transformation. To play this role, the informal sector must succeed and the failure rate characterizing the sector be minimized if not abolished (wANJIKU, 2009).

Despite the increasing importance of the informal sector in every sector of the Kenyan economy, (Waweru, 2007) posits that the current taxation policy towards the informal sector that involves advance tax on Passenger Service and Commercial Vehicles; The Unified Tax System (UTS) which caters for licensing fees and tax liabilities that a business entity is required to pay periodically, usually one year; and the Turnover Tax (TOT) have not yielded much as the revenues are poor and decreasing with time.

1.2 Statement of the Problem

Taxation has important effects on many parts of the economy, including impacts on firm creation and on the development of informal sector thereby making tax evasion very harmful to the economy. Developing an environment conducive to informal sector growth whilst ensuring tax compliance is a challenge all countries face. (Weichenrieder, 2007) posits that the taxation of informal sector faces several major policy challenges that include compliance costs of taxation, revenue cost and tax evasion. In Kenya, (MembaS. F., 2012) posit that the informal sector is a driver in promoting competition, innovation and enhancing the enterprise culture which is necessary for private sector development and industrialization. (Kringi, 2005) acknowledge that like many other developing countries, Kenya faces challenges in taxing income derived from agriculture and the informal sector. However, an empirical study by (Muriithi, 2003) suggested that tax reforms in Kenya under the Tax Modernization Program have led to improved productivity of direct taxes. Tax evasion prevents government revenue collection hence inefficiency in Government spending because it diminishes the capacity of the state to mobilize domestic revenues, resources that are needed for investments (fishlow, 1994). 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 (freeman, 2003).

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 (Kringi, 2005). The increasing trend of disparity between the levels of submitted annual income tax returns, reported tax assessments and voluntarily paid tax liabilities, among informal sectors, 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 (kenya). A study by, Parliamentary Budget Office (2010) shows that in 2008 the government could have increased the tax base by approximately Kshs.79.3 billion if the tax evasion among informal sectors was addressed. According to the KRA annual report for year ended 2012,shows a deficit of Ksh 108 billion which can be directly attributed to the informal sectors and SMEs. (authority, 2013).

The informal sector is 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 (Cobham, 2005). A large segment of the informal sector exhibit low tax compliance levels. This is a great loss of revenues meant for public expenditure. It is for this reason that research need to be undertaken to identify the causes for low tax compliance in the informal sector in Nairobi central business district. It is also instructive to note that there is little research that has been done in this area. In this context informal sector in Nairobi central business district exhibit low tax compliance levels and this requires an understanding on the determinants of tax compliance to enable the government to improve on its tax.

1.3 Objectives

The study had both a general objective and specific objectives as outlined below:

1.3.1 General Objectives.

The study seeks to establish factors affecting tax compliance in the informal sector in Nairobi central business district

1.3.2 Specific Objectives.

The study will be guided by the following specific objectives;

- i. To explain the effects of tax rates on tax compliance in the informal sector in Nairobi central business district
- ii. To establish how availability of tax information and taxpayer education as a factor affects tax compliance in the informal sector in Nairobi central business district
- iii. To determine how costs incurred by informal sector in being tax compliant affect their level of tax compliance in Nairobi central business district.

1.4 Research Questions.

The study sought to answer the following research questions

- i. what is the effect of tax rates in Kenya to tax compliance in the informal sector in Nairobi central business district?
- ii. what is the effect of lack of taxpayer education and tax information on tax compliance in the informal sector in Nairobi central business district?
- iii. What is the effect of tax compliance cost on tax compliance in the informal sector Nairobi central business district?

1.5 Scope of the Study.

The study was limited to informal sectors in Nairobi CBD which is within the county of Nairobi. The population of Nairobi which is the capital city of Kenya is about 7 million Kenyans. The target population for this study was those taxpayers whose pin domicile is in north of Nairobi kra station. This helped in conducting the research on time, as opposed to large population which if adopted, could take more time and resources in drawing conclusion.

1.6 Significance of the study.

This study will provide useful information to the Kenyan Government on efficient and effective taxation strategy for the informal sector.

The taxpayers themselves will be captured by this study and this will enable them to provide the data that can be used to tailor a solution to the challenges of tax compliance. Other policy makers in different countries of the world may borrow from the findings of this research when seeking solutions to a similar problem in their countries.

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

This chapter covers the theoretical and empirical review revolving around the factors affecting tax compliance in the informal sector the informal sector and the conceptual framework.

2.2 Theoretical Literature Review

This section will discuss tax compliance theories in the informal sector. This theory includes; the partnership theory of taxation and the Allingham and sandmo theory

2.2.1 The partnership Theory of Taxation

The partnership theory of taxation posits that government should share in the profits of economic enterprise by way of an income tax. One might call the partnership theory the economic version of the Benefit theory, and the latter as the moral entitlement version of the former. The partnership theory is based on the notion that government should share in national income (or, more technically, gross national product, or GNP), because government, by supplying infrastructure in the broad sense (physical infrastructure, national and domestic security, a capitalism-enabling legal system and regulatory structure), earns a share of the GNP. This theory is especially appealing to this study, because it seems to normatively prescribe an income tax in preference to a consumption tax. The government should therefore collect tax revenue from the informal sector given that it contributes to the general environment enabling business to be conducted (Dodge, 2005) . This theory supports the dependent variable of tax compliance in payment of taxes and filling of returns where it urges that taxes should be collected in the informal sector.

2.2.2 The Allingham and Sandmo Theory (AS Theory)

This theory was advanced by Allingham and Sandmo. According to (Sandmo Agar, 1972).The AS theory holds that the government deters tax evasion through a sanction arrangement and audits. A tax payer will decide to violate and evade his or her tax obligations when he or she perceives that the cost of evading tax is too low, believing he or she does that he or she is unlikely to be detected or audited. Tax payers would also evade tax when he or she perceives the cost of compliance is high. Tax systems and procedures that are involving and cumbersome tend to encourage tax

evasion. Tax payers who feel that tax rate is high and punitive will evade tax. There is a negative correlation between tax evasion, the probability of detection, the degree of punishment and high transactional costs associated with tax laws. Income tax evasion was pioneered by (Sandmo Agar, 1972) where a rational and a moral taxpayer maximizes expected utility, which solely depends on income. When caught, the agent must pay penalties, imposed on the amount of evaded income. A key comparative static result is that when the tax rate goes up, competing income and substitution effects might lead to more or less tax compliance. The substitution effect encourages evasion since the marginal benefit of cheating goes up with the tax rate. On the contrary, the income effect tends to suppress evasion since a higher tax rate makes the taxpayer with decreasing absolute risk aversion feel worse-off, and thus decrease risk-taking.

Therefore, the net effect is ambiguous. However, (Yitzhaki, 2000) showed that when the penalty is imposed on the amount of evaded taxes, as it is under most current tax laws, the substitution effect vanishes. At the original optimum, the penalty paid on concealed income increases proportionally with the tax rate, and hence, there is no substitution effect. The remaining income effect is responsible for inducing the taxpayer to cheat less. Therefore, the net effect is better compliance. (yitzhaki, 20025) result is perhaps the single most important finding in the early tax evasion literature, having spurred a lot of remarkable extensions. The SMEs are prone to tax evasion as they face difficulties in complying with tax laws. They are expected to comply with strict deadlines, keep proper books of accounts. This kind of environment leads to tax evasion (Chiumya, 2006). This theory supports the independent variables of tax rates which is measured by tax penalties and tax heads supporting that informal sector will be less compliance due to stiff penalties and high tax rates.

2.3 Empirical Review

This section reviews the relationship between each factor and how it affects tax compliance in the informal sector.

2.3.1 Tax Rate

Fines and penalty rates may substitute each other due to their multiplicative linkages as long as neither of them is set to zero, (kirchler, The Economic Psychology of tax Behaviour, 2007). Higher

penalties simply make evading taxes more hazardous for tax payers and should deter them from evasion.

Empirically, the deterrent effect of fines could not always be supported. The observed effect was weaker than expected and some studies suggests that an increase of penalties can have a more tax avoidance (Kirchler Et Al,2007).

(al, 1999)supports the evidence that penalties do not effect tax compliance though the impact was virtually zero. (Fridland et al 1978) was strongly affected by the amount of fines than by audit probabilities. Several studies however found no support for the deterring effect of penalties since it was weak (Andreoni,1998). Some of the findings suggests that a policy based on deterrent is effective only in combination with frequent audit (Kirchler Et Al,2007).

From the tax administration view point, researchers have concluded that compliance could be influenced by educating tax payers of social responsibilities to pay and thus their intentions would be as a behavior problem. Tax compliance depends on the operation of the public. There are greater gains in assisting compliance tax payers meet their fiscal obligations rather than spending more resources in pursuing minority of no compliance. Assisting tax payers by improving the flow and quality of information and educating them example, the campaigns into becoming more responsible citizens has the potential to yield greater revenue than if it was spend on enforcement activities. A theoretical economic model introduced by (Sandmo Agar, 1972)has clearly indicated that penalty were as well as audit probality have an impact on tax compliance. The higher the penalty, and the potential audit probability the greater discouragement for potential tax evasion.

2.3.2 Tax Information

Information is the state or ability to perceive, to feel or to be conscious of events, objects or sensory patterns. In biological psychology, information is defined as human or animal's perception and precognitive reaction to a condition or event. It is knowledge or understanding of a subject. This knowledge can be gained through one's own perception or by means of awareness. Education as a democratic variable relates to the tax payer's ability to comprehend and comply or not to comply with the tax loss, (Jackson &Milliron,1986). The aspect of education has been

distinguished; with “general degree of physical knowledge and the degree of knowledge involving version opportunities” (Groenland&Veldhoven, 1983). This knowledge is considered to be important for attitude towards tax compliance. Persons both corporate and individuals a subject to taxation. The amount of taxes you owe is based on your income. You must pay taxes throughout the year. People who earn more income have higher tax rate than those who has less. This means tax rate gets progressive higher the more you earn. You can reduce your taxes by taking advantage of various tax benefits. Finally, it is up to you to take control of your tax situation (Pashev, 2005).

2.3.3 Tax Compliance Cost

Tax compliance cost are those cost incurred by tax payers or in third party such as businesses, in meeting the requirement laid upon them in complying with a given structure and level of tax (Sandford, 1995). This cost of compliance can be categorized into the following depending on where they are incurred; accounting cost, economic cost, lobbying cost, training cost, hiring cost of staff who do the return filing and calculation of the tax liability and loss of revenue. The real cost of taxation goes beyond the amount that is written on the cheque to the authority. The most important cost of taxation is compliance. Compliance are the real cost associated with calculating and making the payment. This cost can be substantial, especially for businesses. The costs of tax preparation can vary but unlike the taxes themselves preparation costs don't get any smaller for low income people. A time, they can even get larger. One way of measuring compliance costs associated with taxation for businesses is to measure the number of hours it takes a business to calculate and pay its taxes. Taking the time to just figure out what you owe, calculate it, then send it in, requires a business to give up a more productive activity. In response to this concern about tax compliance cost, government have often endeavored to implement tax policies inform of concessions that produce favorable outcomes for the small business sectors, (Pope,2008) such special tax concessions for small business fall mainly into two categories; positive concession that provide a lower rate of concession, an exemption or an accelerated deduction and relieving concessions that excuses the tax payers from the requirement otherwise imposed (Payne,2003).

2.4 Critique of the existing literature relevant to the study

Early research on the factors affecting tax compliance was done by (schmolder,1960) in his study on tax evasion. Since then, tax compliance and factors that affect it have been extensively studied yearly and still remains a topic of interest in research. However, the results of some of these studies are inconclusive. Despite their large number and considerable diversity, most of them consider only some selected issues and there are few works carried out, conducting a comprehensive and extensive evaluation of the factors affecting tax compliance (Bernadette kemleitner,2012).

Studies show mixed results and conclusion apropos the determinant of tax compliance. There is lack of consistency of the empirical findings as to which factors have a stronger effect than the other on tax compliance depending on countries where the studies have been done. In their study, (Nilgunserium and dilek murat,2012) determined factors affecting tax compliance between the years 1994 to 2011 using correlation analysis. They used taxpayer, tax officer and chief tax officer who are in direct with taxpayers to establish this factors affecting tax compliance. From their findings, they emphases' with tax payer, treat equally to each tax payer and motivate the taxpayers regarding conformity with the taxes hence will increase the leaven of tax compliance. In South Africa, studies conducted by economy watch dog on tax burdens on SMEs revealed that tax requirements procedures acted as stumbling blocks to tax compliance (Ojeka, 2011). This is because complying with taxes tended to swallow up the resources that the SMEs could devote to more 23 economical running of these businesses.

A majority of SMEs experience their tax liability as an increasing burden since they lack enough skilled staff to handle tax compliance issues and are therefore forced to incur „extra“ tax costs. Most SMEs do not even recognize the tax incentives and services available to them. The study also noted that changes in tax policies sometimes result in an even more complex tax system. A clear finding was that elaborate tax incentive schemes which require sophisticated systems and skilled staff would often result in increasing compliance costs rather than provide real tax relief. As a result, small businesses (and probably other taxpayers as well) would prefer simple cuts in tax rates and penalties. Related studies have been done in Kenya in this regard. (ndegwa mwangi,2014), determining the factors influencing tax compliance on small medium traders industrial area of

Nairobi. He used statistical analysis and linear regressions model to determine the relationship between the independent variables and the dependent variable i.e. tax compliance by fitting the equation to observed data. During the five-year research between 2007-2012, the study found out that the four variable i.e. tax payers' attitude, availability of information, tax compliance cost and tax rates affected tax compliance.

The regression results also indicated that the relationship between tax payers' attitude, tax rates, tax information and tax compliance cost against tax compliance was very significant statistically hence showing they are all highly correlated. Related arguments are presented by (Sydney, 2014) who states that both taxes rates, tax availability and tax who states that both tax rates, availability of information and tax compliance cost are major and vital factors when determining tax compliance.

Another study on attitude as a factor affecting tax compliance in Kenya revealed that most taxpayers view the Kenyan tax system as unfair. Most respondents said that the tax laws are complex and not easy to understand. They found it difficult to calculate the tax required from them. In order to make business out of their operations, they were forced to underreport profits and operate illegal businesses. The study also established that the taxpayers are given rewards, and that there is use of informants by KRA to report tax evaders. Generally, taxpayers are indifferent to the paying of tax fines and penalties. KRA tries to enforce tax compliance by carrying out tax enforcement efforts such as carrying out tax audits and ensuring prosecutions of tax evaders.

However, there is still a very high degree of undetected tax offenders, fear of tax audits and prosecution notwithstanding. For this reason, more people are beginning to believe in corruption and that tax is not an obligation. Over time, Taxpayers are generally indifferent with the KRA harassments (Lumumba et al, 2010).

However, other records that are requirements for tax compliance such as the trial balance, Journals and Ledgers were not up to date. (Furnharn, 1983) noted that the taxpayers' behavior may be influenced by many factors, which are brought about by their attitudes. These factors are many and differ from one individual to the other and from one county to the other. They include: cost of compliance, the general taxpayers perceptions of the tax system, motivation such as reward, perceived behavioral control and Protestant work ethics, taxpayers' understanding of a tax

system/tax laws, ethics/morality of the taxpayer and tax collector, enforcement efforts such as audit, demographic factors such as sex, age, education, use of informants, and equity of the tax systems.

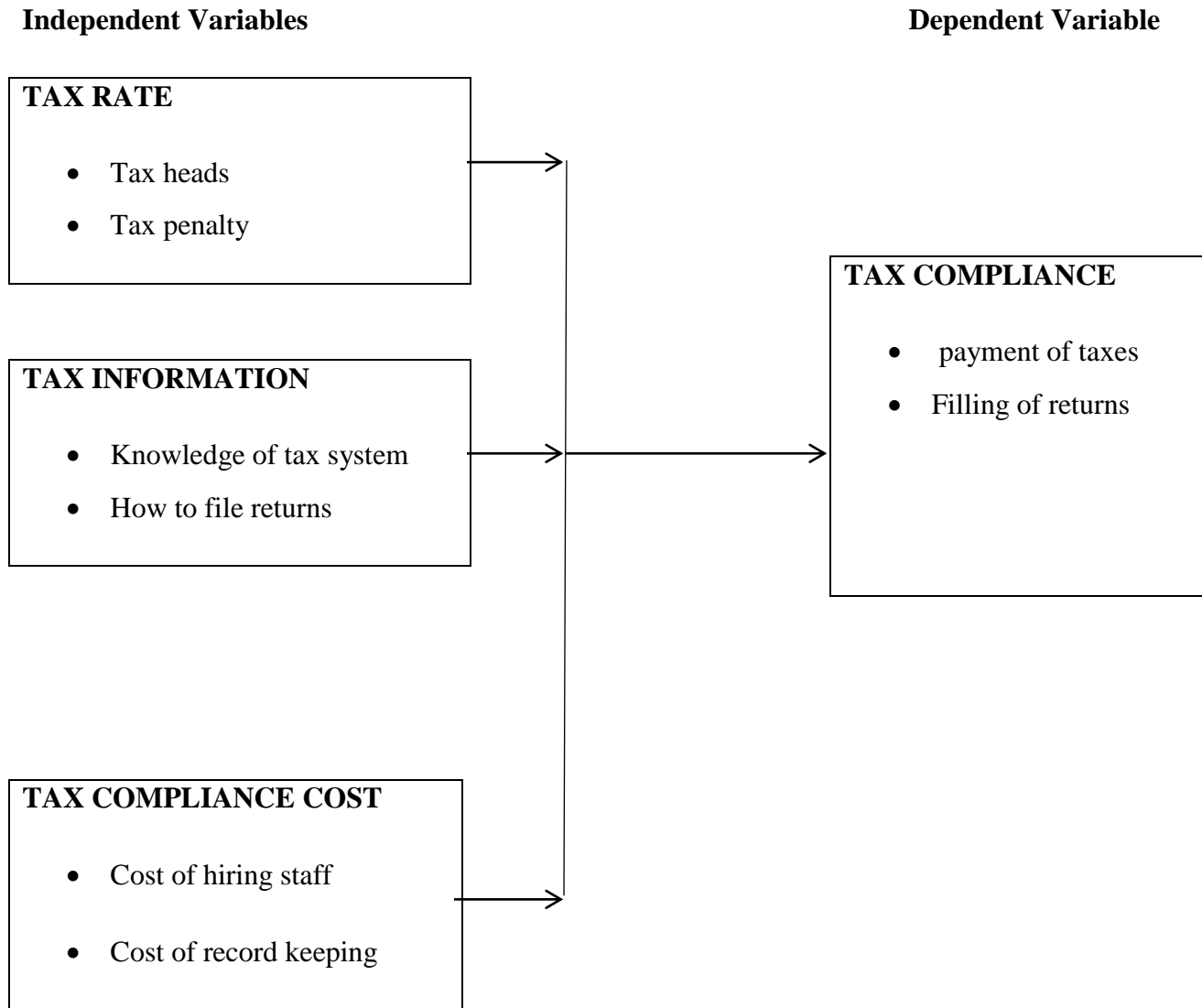
Empirical literature investigated by the studies above show that there are mixed views on the strength of factors affecting tax compliance. Further research along these lines is therefore necessary in order to determine more comprehensively the contribution of each factor on tax compliance, specifically in Kenya.

2.5 Conceptual framework.

The tax compliance from the informal sector is the dependent variable of this study. The set of factors that have to be overcome are the independent variables. As shown in the figure below, the factors affecting the taxation of informal sector directly affect compliance. When the factors are many and difficult to overcome, compliance reduces and when they are few and easy to overcome, compliance will be expected to be high. This happens within the context of the tax collection management policy of the tax collector. The tax collection management policy affects the nature and types of challenges, the revenue collections and the nature of the relationship between the challenges and the revenues (Rakner, 2002).

The independent variables therefore are tax rate and system, tax information and education and tax compliance cost. Tax rate and system as an independent variable affect tax compliance as indicated by the complex nature of the tax system and high tax rate. Tax information and education is the second independent variable, characterized by the lack of knowledge of taxation by the informal sector as well as misunderstanding of the taxation system. Tax compliance cost is characterized by the time it takes and the cost of compliance by the informal sector.

Figure2.1: conceptual framework



2.6 Summary

This chapter covered literature review relating to the theories of taxation. First, the study looked at the theoretical framework where it outlined the theories on which the study is grounded. The theories covered were the expediency theory, the partnership theory and the Allingham and Sandmo theories. In addition, the chapter establishes the conceptual framework for the research project based on the factors and empirical reviewed the variables that affect tax compliance in the informal sector. This chapter also critiqued the existing literature relevant to the study and finally

established the research gaps based on the review of literature. After a critical examination of literature and empirical studies conducted by different researchers on factors affecting tax compliance, we can deduce theoretically that the different factors vary on their impact on tax compliance. The extent of all these factors however varies substantially across different countries. Although there is a wide range of factors identified from the above researches as variables that affect tax compliance, most studies empirically have identified tax rates tax compliance cost and tax information as some of the factors which are more vital.

2.7 Research Gaps

From the literature review it is evident that the taxation of the informal sector is an unsettled matter. The manner to achieve success in the collection of tax from this sector is a challenge to both the developed and the developing countries. In addition to this, while some studies see this tax as necessary, others view it as an obstacle that hampers the growth of informal sector into the formal tax bracket.

Evidently, it is clear to date, there has been research exploring factors that influence compliance among informal sector. The main objective of this study was to identify the factors that affect tax compliance among informal sector. The research focused on tax rate, tax information, tax compliance cost and taxpayers attitude. The research outlined in this paper aims to address the tax gap of non-filing, under reporting and under payment. The specific aim of the research is to gain insight into the factors that influence the tax compliance among informal sector in Kenya by focusing on those operating within Nairobi's central business district. It is expected that the findings will help decision makers and particularly K.R.A gain a better understanding of informal sector enabling them to plan and design services more effectively.

CHAPTER THREE

APPROACH AND METHODOLOGY

3.0 Introduction

This chapter presents the methods and procedures that were used to carry out this research. Specifically, the chapter presents the research design, the target population, the sampling strategy, the data collection procedures, reliability, pilot test and data analysis.

3.1 Research Design

This study adopted a descriptive research technique. Descriptive design discovers and measures the cause and effect of relationships between variables (Cooper and Schindler, 2003). It allows collection of a large quantity of in-depth information about the population being studied and enables the researcher to test and measure the population needed for quantitative experimentation since it gives valuable pointers as to what variables are worth testing quantitatively.

3.2 Target Population

The population of the study consisted of all the informal sector in Nairobi central business district, Nairobi County. A total of 265 SMEs from the Kenya revenue authority website were targeted for this study.

3.3 Sample and Sampling Techniques

According to Chandran (2004), sampling as a method is used in drawing samples from a population usually in such a manner that the sample facilitated determination of some hypothesis concerning the population. Sampling techniques offer methods that facilitate reduction of the amount of data collected from a representative population rather than the entire set. Systematic sampling and stratified sampling technique were employed in this study. The business firm operating in the informal sector were grouped into sector stratum of Agriculture, manufacturing, Transport, Tourism, and Telecommunications. Every fifth firm in every cluster was selected and information gathered on the same firms. A total of 53 firms were selected as shown in the table 3.1 below:-

Table 3.1: Sample distribution

Sector	Population (N)	Kith Item (Every 5th item of N)
Agriculture	90	18
Manufacturing	50	10
Telecommunications	60	12
Transport	50	10
Tourism	15	3
Total	265	53

Source: Author (2017)

As shown in the table 3.1, the formula used to arrive at the sample will be: $N/kith$:

Where; N= total number of firms in any given sector

kith item = Every fifth firm selected in succession from N to form the sample e.g. in Agriculture the sample size was 90 firms divided by 5 = 18 firms

3.4 Data Collection

The researcher used both primary and secondary data. Primary data was gathered and generated directly from respondents by use of questionnaires. The researcher administered the questionnaires individually to all the respondents of the study. The questionnaires were distributed via a drop off and pick up method. The respondent were given 2 weeks to respond via the questionnaire. The variables in the questionnaire were measured differently in that the tax rate and tax information used the nominal tool of measure whereas the tax compliance cost used the ordinal measure. To save on time I had a research assistance (senior student from Kenyatta university) to help in data collection.

3.5 Reliability

(Mugenda and Mugenda 2003) define unwavering quality (reliability) as a measure of the extent to which an examination instrument yields consistent results or information after repeated trial. Crude information from the instruments was subjected to an unwavering quality investigation from which Cronbach's co-efficient alpha which was systematically and consistently computed using the following formula:

$$\frac{k}{k-1} \left(\frac{1 - \sum sdi^2}{sdi^2} \right)$$

K= the number of data items.

sdi= the summation, variance for individual items.

\sum sdi= the variance for all summoned items in the questionnaires.

A commonly accepted rule of thumb for describing internal consistency using Cronbach's Alpha is 70% shown in Table 3.2

Table 3.2: Cronbach's Alpha Measures.

Cronbach's Alpha Measures	Level of Internal consistency
$\alpha \geq 0.9$	Excellent
$0.8 \leq \alpha < 0.9$	Good
$0.7 \leq \alpha < 0.8$	Acceptable
$0.6 \leq \alpha < 0.7$	Questionable
$0.5 \leq \alpha < 0.6$	Poor

3.7 Pilot Test

The researcher conducted a pre-test in order to validate the questionnaire. Cronbach's alpha methodology, which is based on internal consistency, was used. Cronbach's alpha measures the average of measurable items and its correlation (Tavakol, 2011). This is in line with a quantitative research design methodology which was employed in this research.

3.8 Data Collection Procedures

A research permit was obtained from KESRA registrar office Nairobi to give permission to the research to carry out data collection exercise. An introductory letter was sent to department and section heads two weeks prior to commencement of the exercise to enable the relevant Authorities to prepare for the exercise in advance to a void inconvenience.

3.9 Data Analysis.

Data collected was simplified, organized and tabulated to make it easier to understand and analyze the data using the Statistical Package for Social Sciences (SPSS). Measures of central tendencies, standard deviations and percentages were used in analyzing the data. Correlation analysis was used to show the correlation between the variables while regression analysis was used to measure the nature of relationship between them. The quantitative reports obtained from the analysis were presented using tables. .

The empirical model in this study is based on the following equation:

$$TC = f(R, I, CC)$$

The Linear Regression Model is given by:-

$$TC = \alpha + \beta_1 R + \beta_2 I + \beta_3 CC + \varepsilon$$

Where, TC is tax compliance

R is the tax rate

I is the tax information

CC is the tax compliance cost

ε is the error term

The standardized beta coefficients from the linear regression analysis shows the effect of the regress or variables on the dependent variable. By standardizing the variables before running the regression, you have put all of the variables on the same scale, and you can compare the magnitude of the coefficients to see which one has more of an effect. Therefore, the strength of effect of each determinant factor will be measured using the standardized beta coefficients of the explanatory variables in the linear regression model because the beta coefficients show the independent contribution each explanatory variable has to the prediction of the response variable. It answers the

question as to the extent to which the determinant factors influence tax compliance by comparing the values of Beta 1, Beta 2 and Beta 3

3.10 Operationalization of variables

The measurement of variables in the study and relationship between the variables and the survey questions are illustrated in the table 3.3

objectives	variable	indicator	Measure scale	Tool of analysis	Type of analysis
To explain the effects of tax rates on tax compliance in the informal sector .	independent	Several tax heads Stiff tax penalties	nominal	Mean percentage	Descriptive statistics
To establish how availability of tax information and taxpayers education affect tax compliance in the informal sector.	independent	Knowledge of tax system How to file return	nominal	Mean percentage frequency	Descriptive statistics inferential statistics
To determine how cost incurred by informal sector by being tax compliant influence their level of tax compliance .	independent	Cost of hiring Cost of record keeping	ordinal	Mean percentage	descriptive

CHAPTER FOUR

FINDINGS AND DISCUSSIONS

4.0 Introduction

This chapter presents and discusses the main findings of the study as set out in the research methodology. The purpose of the study was to establish factors affecting tax compliance in the informal sector in Nairobi central business district and the study was guided by the following research questions: what effects do tax rates in Kenya have on tax compliance in the informal sector?, what effect does lack of taxpayer education and tax information have on tax compliance in the informal sector in Nairobi central business District?, and what effect does the cost of tax compliance have on tax compliance in the informal sector Nairobi central business District? Both primary and secondary data was collected using a questionnaire and through Kenya revenue authority website, permission to carry out data collection was obtained from KESRA registrar office Nairobi, data was tested for reliability and validity using Cronbach's Alpha measures and thereafter analyses using Statistical Package for Social Sciences (SPSS) and presented using tables.

4.1 Response Rate

Out of the 53 respondents which included business firms in the informal sector, 40 responded to the research tool against 13 who did not. This formed a response rate of 75.47%. The response rate was adequate to examine the factors affecting tax compliance in the informal sector since it is above 50% as recommended by (Mugenda).

4.2 Background of the Respondents

The background information provides findings on respondents' position in the organization, how long the organization has been in existence, main business activity and the monthly business turnover as discussed below.

4.2.1 Position in the Organization

The respondents' position in the organizations was represented by business owners and finance managers as shown in the table 4.1 below with a percentage of 12.5% and managing directors, accountants and others who were represented by a percentage of 25%. The position of the respondents in the organization indicate that, views concerning the factors affecting tax compliance in the informal sector were represented by different levels of people in the organizations, and no single opinion can be attributed to a position held.

Table 4.1: Position in the Organization

	Frequency	Percentage
Business owner	5	12.5
Managing Director	10	25
Accountant	10	25
Finance managers	5	12.5
Others	10	25
Total	40	100

4.2.2 Period of Working

From the findings in the table 4.2 below Majority of the respondents have worked in the institutions for 1-5 years as shown by 37.5%. A proportion of 25% have worked for a period of 6-10 years and more than 10 years while those who have worked for less than 1 year are represented by 12.5%. Period of working for the respondents depict the experience they have as far as the factors affecting tax compliance in the informal sector is concerned.

Table 4.2: Period of Working

Period of Working	Frequency	Percentage
Less than 1 year	5	12.5
1-5 years	15	37.5
6-10 years	10	25
More than 10 years	10	25
Total	40	100

4.2.3 Average Monthly Turnover

Most of the organizations which took part in the study had an average monthly turnover of less than Ksh. 500,000 represented by 37.5%. Organizations which had a turnover of 500,001-1,000,000 and 1,000,001 -2,000,000 were represented by 25% each. 12.5% of the organizations had a monthly turnover of between 2,000,001 and 3,000,000. No organization had an average monthly turnover of more than 3,000,000.

Table 4.3 Average Monthly Turnover

Monthly Turnover(Ksh)	Frequency	Percentage
Below 500,000	15	37.5
500,001 – 1,000,000	10	25
1,000,001 – 2,000,000	10	25
2,000,001 – 3,000,000	5	12.5
Above 3,000,000	0	0
Total	40	100

4.3 Factors Affecting Tax Compliance in the Informal Sector

4.3.1 Existence of Challenges Affecting Tax Compliance

The study findings revealed that all the respondents agreed that they face challenges which affect their tax compliance. These challenges present a varying degree.

The challenges affecting tax compliance by organization in the informal sector include high tax rates, various different forms of taxes and the amount of income tax payable. Among these challenges, high tax rates and different forms of taxes are the most common with a 37.5% each. Amount of income tax payable can be considered as the challenge with less effect as it is represented by 25% of the total respondents as evident in the table 4.5 below. These challenges show why some informal organizations have shown a very low rate of tax compliance while others have not shown any tax compliance at all.

As depicted that among the challenges facing organizations in the informal sector include; high tax rates, many different forms of taxes and the amount of income tax payable. The way forward for these organizations is, the income tax regulating body for this instance Kenya Revenue Authority, should appropriately set regulations that will make it friendly for this organizations to run effectively and submit their tax returns without any strain.

Table 4.4: Challenges Affecting Tax Compliance in the Informal Sector.

Challenges	Frequency	Percentage
Tax Rates	15	37.5
Different Forms of Taxes	15	37.5
Income Tax Payable	10	25
Total	40	100

4.3.2 Availability of Tax Information

In a question seeking to find out whether the availability of tax information has affected tax compliance by organizations in the informal sector, 75% said yes against 25% who gave a contrary opinion, no as shown in the table 4.6 below. The interpretation of the response is based on the experience meaning that, those with No opinion might have tried to access tax information and

found it while those with a yes opinion might have tried to access tax information but could not find any thus leading to their non-tax compliance.

Table 4.5: Whether Availability of Tax Information has Affected Tax Compliance

Response	Frequency	Percentage
Yes	30	75
No	10	25
Total	40	100

4.3.3 Effect of Lack of Information on Tax Compliance

The effect of availability of tax information on tax compliance by organizations in the informal sector was measured using two parameters. Majority of the respondents, equivalent to 37.5%, expressed a great extent opinion that knowledge of tax system has increased availability of tax information thus facilitating tax compliance. 25% had some extent and not at all opinion, 12.5% expressed a less extent opinion while no respondent had a very great extent opinion. Elsewhere, in the assertion seeking to find out if information on how to file tax returns has had any effect on tax compliance, 75% of the respondents expressed a very great extent opinion while an equal percentage of 12.5% expressed some extent and great extent opinions.

The above parameters indicate that availability of tax information is a great factor affecting tax compliance by organizations in the informal sector. This is evident as majority of the respondents, 75%, strongly agreed to the assertion that availability on information to file tax returns is a major factor influencing tax compliance by organizations in the informal sector. This can also be supported by the parameter on knowledge of the tax system as 25% and 37.5% expressed positive opinions of some extent and great extend respectively. This therefore concludes that availability of tax information is very important factor when it comes to tax compliance. This is shown in the table 4.7 below.

Table 4.6: Effect of Tax Information on Tax Compliance

Parameter	Level of Agreement	Frequency	Percentage
Knowledge of tax system has increased availability of Tax Information	Not at all	10	25
	Less extent	5	12.5
	Some extent	10	25
	Great extent	15	37.5
	Very great extent	0	0
	Total	40	100
Information on how to file tax returns has increased tax compliance	Not at all	0	0
	Less extent	0	0
	Some extent	5	12.5
	Great extent	5	12.5
	Very great extent	30	75
	Total	40	100

4.3.4 Ability to Calculate Tax Liability Based on the Available Information

The findings from the study as shown in the table 4.8 below indicates that 62.5% of the respondents gave a positive response that availability of tax information made it able to calculate their tax liability thus easily filing their returns. On the other hand, 25% of all the respondents expressed a negative opinion while 12.5% expressed a neutral opinion meaning that they were not sure if their ability to calculate their tax liability was based on the availability of tax information.

Table 4.7: Ability to Calculate Tax Liability Based on the Available Information

Response	Frequency	Parameter
Yes	25	62.5
No	10	25
Not sure	5	12.5
Total	40	100

4.3.5 Effect of Tax Compliance Cost on Tax Compliance

The cost of hiring staff can be noted to greatly affect tax compliance in the informal sector. This is evident from the findings in the *Table4.9* below where 37.5% of the respondents gave some extent and great extent opinions. 12.5% gave a very great extent opinion which was also given by the same margin by those who expressed a less extent opinion. This therefore illustrates that, cost of hiring staff has a very major influence on tax compliance as it can be noted that 87.5% of the respondents expressed a positive opinion that this leads to non-compliance while only 12.5% expressed a negative opinion that this does not lead to non-compliance.

The parameter cost of record keeping can be noted to have a very minimal influence on tax compliance as a total of 75% respondents gave a negative opinion (50% not at all and 25% less extent) whereas those who expressed some extent and great extent opinions were represented by 12.5% each. This therefore indicates that, the cost of record keeping has little or no influence at all on the tax compliance of organizations in the informal sector.

Table 4.8: Effect of Tax Compliance Cost on Tax Compliance

Parameter	Level of Agreement	Frequency	Percentage
Cost of hiring staff has affected tax compliance in the informal sector	Not at all	0	0
	Less extent	5	12.75
	Some extent	15	37.5
	Great extent	15	37.5
	Very great extent	5	12.5
	Total	40	100
Cost of record keeping has affected tax compliance in the informal sector	Not at all	20	50
	Less extent	10	25
	Some extent	5	12.5
	Great extent	5	12.5
	Very great extent	0	0
	Total	40	100

4.3.6 Expenses Constituting Highest Tax Compliance Costs

The researcher tried to find out which expenses had the highest effect on the tax compliance costs and three expenses were used which included cost of employing professional staff, book keeping and software and internet costs. Of this three expenses software and internet costs constituted the highest percentage of the tax compliance cost of 50% meaning half of the tax compliance costs are attributed to software and internet as shown in the table 4.10 below. These may include tax software installation, buying and maintenance costs and also internet costs mostly during filing of tax returns and calculating tax liability. Cost of employing professional staff came second as the highest cost of tax compliance while book keeping was the least contributing cost and this can be

attributed to the fact that most organization have gone technological and most costs incurred here are categorized under software and internet.

Table 4.9 Expenses Constituting Highest Tax Compliance Costs

Expenses	Frequency	Percentage
Cost of employing professional staff	15	37.5
Book keeping	5	12.5
Software and internet	20	50
Total	40	100

4.3.7 Need to Improve Tax System in Kenya

The question of whether there was need to improve the tax system in Kenya received different opinions with the majority of the respondents agreeing to this assertion represented by 37.5%. 12.5% of the respondents expressed a strongly agreeing, disagreeing and strongly disagreeing opinion. On the other hand, a quarter of the respondents, that is 25%, expressed a neutral opinion and this maybe as a result of not understanding what a tax system is. From the above findings it can be concluded that majority of the respondents feel there is need for improvements in the tax system in Kenya as 50% of all the respondents gave a positive response (12.5% strongly agreeing and 37.5% strongly disagreeing). The researcher also found out that most people need to be educated on what a tax system is, how it functions and its importance as majority of those who expressed a neutral opinion, 25% of the respondents, did not have any clue on tax systems. Those who expressed disagreeing and strongly disagreeing opinion who were represented by 12.5% each felt that they are very much comfortable with the tax system in place in Kenya currently and that the system does not require any improvements. The findings are shown clearly in the table 4.11 below.

Table 4.10: Need to Improve Tax System in Kenya

Level of Agreement	Frequency	Percentage
Strongly agree	5	12.5
Agree	15	37.5
Neutral	10	25
Disagree	5	12.5
Strongly Disagree	5	12.5
Total	40	100

4.4 Regression Analysis on the Factors Affecting Tax Compliance in the Informal Sector

A regression analysis was conducted to find, how different factors affected tax compliance by organizations in the informal sector, Nairobi central business District. For this, the respondent's overall average score on tax compliance was the dependent variable and factors affecting this tax compliance being the independent variables. Thus mean aggregate scores of different factors were regressed on the overall score for tax compliance by organizations in the informal sector. The beta coefficient provided the relative importance factors affecting tax compliance. The highest beta coefficient for factors affecting tax compliance was considered to have maximum influence on tax compliance while the second highest beta coefficient stands second in terms of relative significance and so on. The overall model was also statistically significant, where (Rsquare = .405, $p < .001$). We got the adjusted Rsquare value 0.397, which shows that this model has accounted for 39.7 % of the variance in the dependent variable. The Regression results are shown in tables below:

Table 4.11: Summary of the Regression Model

Model	R	R SQUARE	ADJUSTED R SQUARE	STD .ERROR OF THE ESTIMATES	OF THE CHANGE			DFI	DF2	SIG.F CHANGE
					R SQUARE CHANGE	F CHANGE				
1	.637	.405	.397	.47973	.405	.46245	5	339	0.000	

- a. Predictors (constant): Tax rates, Tax information, Tax compliance costs
- b. Dependent variable: Tax compliance

Table 4.12: Coefficients

Model	Unstandardized coefficient	standardized coefficient	T	Sig
1	B	Beta		
constant	.524	2.011	0.45	
Tax Rates	.184	0.78	3.372	0.001
Tax Information	.361	0.350	6.102	0.000
Tax Compliance cost	0.125	0.119	2.434	0.015

Dependent variable :Tax Compliance

$$Y = \alpha + \beta_1 (R.Avd) + \beta_2 (R.Rdn) + \beta_3 (R.Rtn) + \varepsilon$$

Thus Y (Tax Compliance) = 2.011 + 0.78(R. Avd) +0.350(R.Rdn) +0.119(R.Rtn)

B: Dependent variable

The equation revealed that holding Tax rates, Tax information and Tax Compliance cost at constant zero, tax compliance in SMEs in the informal sector, Nairobi central business district would stand at 2.011 Constant

$\beta_1=0.78$ means that one unit change in tax rates results in 0.78 increase in tax compliance.

$\beta_2=0.350$ means that a unit change in tax information results in 0.350 increase in tax compliance.

$\beta_3 = 0.119$ means that a unit change in tax compliance cost results in 0.119 increase in tax compliance.

For further testing of the relations, a correlation analysis was done and results presented in table below. Table 4.14 is showing the correlation analysis values with its level of significance.

Table 4.13: Correlation Analysis

Factors Affecting Tax Compliance	r(Correlation coefficient)	P
Tax Rates	.491	.000
Tax Information	.584	.000
Tax Compliance Costs	.404	.000

The results indicate that Tax rates, Tax information and Tax compliance costs play a positive correlation with Tax Compliance (significance level <0.001). With Tax information being the highest, followed by Tax rates and lastly Tax compliance costs.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the findings, as regards to the main objectives of the study. Based on these findings the conclusions were drawn and some recommendations on the way forward made. The key objective of this study was to determine the major factors affecting tax compliance in the informal sector, Nairobi central business district. Three factors were covered which included; tax rates; tax information; and tax compliance costs.

5.2 Summary

The objective of this study was to investigate factors affecting tax compliance in the informal sector in Nairobi central business district. The study analyzed various objectives which included; tax rates, tax information and tax compliance costs and how they affect tax compliance in the informal sector. To trace such objectives, the researcher used a convenience sampling procedure comprising 40 observations. The sample size used was 40 respondents including business owners, managing directors, finance managers and accountants in the organizations. Descriptive survey revealed that most respondents were managing directors and accountants. In tax compliance by organizations, the availability of tax information matters more. In this regard, the results showed that 75% percent of the respondents considered availability of tax information as a major factor influencing their tax compliance. This was followed by tax rates and lastly tax compliance costs seemed to be the least factor affecting tax compliance.

Tax rates were upheld by many respondents as one of the factors that have affected their tax compliance. The impacts of tax rates on the tax compliance in the informal sector measured by different assertions revealed that, most of the respondents agreed to the assertions. High tax rates had increased tax compliance challenges among in the informal sector as agreed upon by 37.5% of the respondents. Different forms of tax payable was also observed to be another major challenge affecting tax compliance as 37.5% of the respondents agreed to this assertion too. The beta coefficient value for tax rates indicated a value of 0.78 while the correlation value was 0.49,

indicating a moderate positive relationship with tax compliance. Thus any rise in tax rates would affect tax compliance by a coefficient of 0.78.

Availability of tax information is very crucial in computing income tax liability hence ensuring that organizations are tax compliant. This is shown by 75% who held that availability of tax information aided greatly in tax compliance. However, availability of tax information received a mixed reaction based on two different assertions. Based on the response from the majority, the knowledge of tax systems affected tax compliance at a great extent. This is revealed by the great extent opinion sought by many respondents. The beta coefficient value for tax information indicated a value of 0.350 while the correlation value was 0.584, indicating a moderately strong positive relationship with tax compliance. Thus any availability of tax information would affect tax compliance by a coefficient of 0.119.

On the costs affecting tax compliance, cost of software and internet is among them, which affects tax compliance. The study further revealed that, in relation to the rate of tax compliance based on different parameters, many respondents can attribute their compliance to costs of hiring staff. These costs scored 37.5% on some extent and great extent opinions each and 12.5% expressed a less extent and a very great extent opinion each. The beta coefficient value for tax compliance costs indicated a value of 0.350 while the correlation value was 0.404 indicating a moderate positive relationship with tax compliance. Thus any increase in tax compliance costs would affect tax compliance by a coefficient of 0.350.

5.3 Conclusion

Availability of tax information, favorable tax rates and reduced tax compliance costs are the factors that most affect tax compliance in the informal sector. According to the response indication, it can be noted that if tax information is readily available, then most organizations will readily file their tax returns thus making them tax compliant.

In all the statements determining the availability of tax information, lack of tax information is the main hindrance towards tax compliance. Most do not understand the tax system in place due to lack of information. From the great response of those who articulated some effect and great effects

opinion, it can be noted that the availability of tax information greatly affects tax compliance in the informal sector. In addition, with the minority expressing a not at all view coupled by less extent view, no concern exists on whether availability of tax information has any major impact on the tax compliance by organizations in the informal sector. Furthermore, those in business and the general public at large, need a lot of sensitization on the tax system in place concerning the importance of being tax compliant, how to calculate tax liability and to file returns and also the risks that are associated with failure to being tax compliant.

5.4 Recommendations

Since most of the respondents expressed an agreeing opinion on the improvement of the tax system in place, the Kenya Revenue Authority should put this in place. This will ensure that a great majority of individuals understand how the tax system operates and the benefits of being tax compliant, if any. An improved tax system will also ensure that the tax rates offered by the taxing authority are favorable hence ensuring very easy tax compliance by those in the informal sector.

Organizations in the informal sector should find ways of reducing their tax compliance costs. This can be easily achieved by cutting the number of tax professionals hired in the firm. In case the firm is a sole proprietorship, the owner can go for tax lessons to equip them with tax knowledge thus helping in cutting on the costs of hiring a tax consultant where necessary.

5.5 Limitation of the study

Time constraint was a limiting factor because the study is to be concluded within a short time. Availability of funds was also a limiting factor to the study since the researcher is self-sponsored. There was no assurance that the respondents will return all the questionnaires duly completed, neither was there a guarantee that those who will be interviewed would respond to all the questions put forward to them comprehensively for fear that it would expose their noncompliance to K.R.A. To counter these limitations, the researcher took leave from work to make time to interview the respondents and also sought for funding from relatives. The sectors fear of participation was overcome by explaining to them the intent of the study and issuing the transmittal letter as well as the supervisors contact for verification purposes.

5.6 Area of future research

Since this study focused majorly on the informal sector in the Nairobi central business district, a similar study can be carried out to assess the factors affecting tax compliance in the formal sector in the Kenya as a whole. Also a similar study can be carried out on the informal sectors in other region across the country. In addition, future researchers can focus on carrying out a study on tax information and its effect on tax compliance in Kenya. Tax evasion is one of the major problems facing Kenya revenue Authority. In many cases government has lost lots of revenue through this evil (tax evasion). Therefore, further research on tax evasion and turn over tax would be necessary

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Appendix I: Research Budget.

The following is a budget proposal of the total amount of money to be spent:

Item/Activity	Estimated Cost (Ksh)
Stationery	7,000
Printing/Photocopying	7,000
Transport	14,000
Binding	3,000
Data analysis	20,000
Miscellaneous	15,000
Total cost	66,000

Appendix II: Work Plan

This research is proposed to take approximately 7 weeks including the report writing.

Phase	Description	1	2	3	4	5	6	7
1	Proposal writing	■	■					
2	Data collection			■				
3	Data Analysis				■			
4	Result writing					■		
5	Report writing						■	
6	Compilation and Presentation							■

APPENDIX III: Letter of Transmittal

Pamela Gogo

P.O Box 20723-00100

Nairobi, Kenya.

pamella.gogo@yahoo.com

Dear Respondent,

I am a student of the Kenya school of revenue administration pursuing a post graduate diploma in Taxation. I am conducting academic research on the factors affecting tax compliance in the informal sector in Nairobi central business district. I'm writing to invite you to participate in the research by filling in the questionnaire. My research project focuses on tax rate, tax information, tax compliance costs and taxpayers' attitude. The questionnaire would take about 30 minutes to complete. Your participation is entirely voluntary and the questionnaire is completely anonymous. I wish to assure you that the information you will provide will be treated with utmost confidentiality. Your ability to answer all the questions comprehensively and to the best of your knowledge will be highly appreciated. I look forward to your support.

Thank you.

Yours Sincerely,

Pamela Gogo

Tel: 0716738123

APPENDIX IV: Questionnaire

Instructions

This questionnaire is designed to collect information on the factors affecting tax compliance in informal sector in Nairobi central business district, Kenya. The information obtained will only be used for academic purposes and shall be treated in utmost confidence. You are requested to complete this questionnaire as honestly and objectively as possible. Please tick in the appropriate box and also fill in the blank spaces provided for those questions where elaborate answers are required. Use the space at the back of this questionnaire if you need more space for your responses.

SECTION A: BACKGROUND] INFORMATION

1. Name of sector (Optional).....

2. Position of respondent in the organization.

- Business Owner
- Managing Directors
- Finance Managers
- Accountant
- Others (Specify).....

3. How long has the organization been in existence?

- Less than One year
- 1-5 Years
- 6-10 Years
- More than 10 Years

4. What is your main business activity?

.....
.....

5. On average, what is your business 'monthly turnover?

- Below Ksh 500, 000
- Between Ksh 500,001 and Ksh 1 Million
- Between Ksh 1,000,001 and Ksh 2 Million
- Between Ksh 2,000,001 and Ksh 3 Million
- Over Ksh 3 million

SECTION B: FACTORS INFLUENCING TAX COMPLIANCE AMONG SMEs

Tax Rates

1. Do you think the Kenyan tax rates are high?
Yes [] No []
2. Do you think there are too many different forms of taxes in Kenya?
Yes [] No []
3. . Is the amount payable in terms of taxes influence your tax compliance?
Yes [] No []

Availability of tax information

Tick or circle where appropriate) {Note: [1] = Not at all, [2] = Less extent, [3] = Some extent, [4] = Great extent, [5] =Very Great extent}

4. Is Information about taxes in Kenya readily available?
Yes [] No []
5. How does the lack of tax information affect your company's tax compliance?

[1] [2] [3] [4] [5]

6. As an organization we are able to correctly calculate the tax amount payable based on available information.

Yes [] No [] Not sure []

Tax Compliance Cost

Tick or circle where appropriate) {Note: [1] = Not at all, [2] = Less extent, [3] = some extent, [4] = Great extent, [5] =Very Great extent}

7. On average how much do you spend in a month in order to be tax compliant?

- Below Ksh 10, 000
- Between Ksh 10,001 and Ksh 50,000
- Between Ksh 50,001 and Ksh 100,000
- Over Ksh 100,000

8. How does the cost of compliance affect your company's tax compliance?

[1] [2] [3] [4] [5]

9. Which of the following expenses constitute the highest tax compliance cost?

- Cost of employing professional staff
- Book Keeping
- Software and Internet

SECTION C: STRATEGIES THAT CAN IMPROVE TAX COMPLIANCE AMONG INFORMAL SECTOR

10. Are there strategies that can improve the tax compliance by informal sector in Kenya? If so kindly list them down?

.....
.....
.....
.....
.....

11. Is there a need to improve the Kenya’s tax system?

Strongly Agree Not Sure Disagree Strongly Disagree

12. What other challenges do you view affect the tax compliance in the informal sector?

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13. Please give recommendations of how these challenges can be addressed.

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