

**DETERMINANTS OF RESIDENTIAL RENTAL INCOME TAX  
COMPLIANCE BY PROPERTY OWNERS IN THIKA TOWN**

**BY**

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## DECLARATION

This is my own original work that has never been presented in any other University for an award of any academic satisfaction.

Signature \_\_\_\_\_ Date \_\_\_\_\_

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### **Supervisor's Declaration**

This research project has been submitted for examination with my approval as the University supervisor.

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## **DEDICATION**

I dedicate this paper to the amazing people who believed in me and offered me support through this journey; my mother Lucy Waithira, brother Anthony, husband Zachary, lovely children Samara and Alvin, Nancy, Niece Lucy, Nephews Anselm, Ndung'u and Njoroge.

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## **LIST OF ABBREVIATIONS**

<b>ANOVA</b>	-	Analysis of Variance
<b>AS</b>	-	Allingham-Sandmo Theory
<b>KRA</b>	-	Kenya Revenue Authority
<b>OECD</b>	-	Organization for Economic Co-operation and Development
<b>SMEs</b>	-	Small and medium Enterprises
<b>SPSS 21</b>	-	Statistical Package for Social Sciences version 21

## **ABSTRACT**

Tax compliance has been a crucial subject to researchers in many countries around the globe. In most third world countries house rental taxation has been classified as economic. In Kenya, statistics indicate that less than half of property owners and developers comply with rental income tax requirements. Thus, this study sought to examine the determinants residential rental income tax compliance by property owners in Thika town. The study employed a descriptive research design and collected data from a sample of 58 property owners using questionnaires. The data collected was analyzed using descriptive and inferential statistics with the help of Statistical Package for Social Sciences version 21 for evaluation of relation between dependent and independent variables. Multiple regression model was adopted. The findings of the study found a significant positive relationship between tax rate, tax knowledge and residential rental income tax compliance and an insignificant positive relationship between attitude and perception and residential rental income tax compliance. The study also found an insignificant negative effect between income levels, fines and penalties and residential rental income tax compliance by property owners. The study concluded that tax rate, tax knowledge, attitude and perception positively influence residential rental income tax compliance while income levels, fines and penalties negatively influence residential rental income tax compliance by property owners. It was recommended that KRA develops training programs to create awareness on residential rental income tax compliance by property owners and that the tax authority in Kenya (KRA) should develop effective working policies to develop a positive relationship and trust with taxpayers. It was recommended that further study be carried on the other factors that affect compliance with residential rental income tax and study to cover other areas besides Thika Town.

# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the Study

A residential property refers to a land that is predominated by houses, though it is not for industrial and commercial use but rather for domestic use. Housing does vary significantly. These may include single-family, multi-family and so on (Vadde, 2014). Residential rental properties can be of various classes based on flats, stand-alone houses, apartments and so on. The demand for housing depends on one's ability and willingness to pay the required fee in form of rent. Rental housing has really expanded and most individuals or entities are investing in rental houses (Sani & Gbadegesin, 2015). Thus, understanding the compliance of rental income taxation is highly important for the government and for the reason that taxation of rental income influences the relationship between house owners and house rentees (Berhane & Yesuf, 2013).

Tax compliance refers to an accurate reporting of income and expenses claims in accordance with tax stipulated laws (Sapiei & Kasipillai, 2013). The main objective of taxation is actually to raise income to enable the government to finance development projects that are meant to improve the economy of a given country or the region. It's therefore important for the government to put in place a mechanism that will help in ensuring that all citizens are tax compliant (Ayuba, Saad & Ariffin, 2016). Tax is the main source of revenue for developing and developed countries (Vadde, 2014).

Tax compliance levels have steadily remained low, even after the use of sanctions like penalties, Armed monitoring, routine audits, fines and so on, but no much improvement in tax revenue collections (Karanja, 2015). An improvement in tax compliance results in

more tax revenue collection hence some improvements in economy since with more revenue, the government can invest more in development projects (Tilahun & Yidersal, 2014).

In Kenya, it is a law that any income generated from any investment in the country is subject to taxation (Karanja, 2014). However, the low tax revenue is more attributed to lack of good mechanisms to enforce tax collection. The Kenyan government needs to invest more on tax administration so as to ensure that no tax revenue is lost or uncollected. As such, Kenya is also ranked among countries with low compliance as far as tax revenue collection is concerned (Makori et al., 2013). Although there has been significant growth in tax collection by over 300% (2003-2011), the contribution by landlords has been very low despite all the efforts by government taxing all Kenyans to support the development of the economy by paying their fair share of taxes (Karanja, 2014).

### **1.1.1 Residential Rental Income Tax Compliance**

Residential rental income tax is the tax imposed on income from rent of residential buildings. Since any income that is received from renting out a property is legally chargeable to income tax, the owners of the property are required to declare this income on their tax return. This income could be from renting out land or buildings (Berhane & Yesuf, 2013).

The rental income tax rate of 10% tax on gross rent took effects on 1<sup>st</sup> January 2016 and applies to rental income received from calendar month January 2016. Eligible persons are required to file their tax return via iTax System (KRA, 2015). The 10% tax rate on gross

rental income is payable by a resident person whether individual or an entity and will apply to rental income that has accrued in or is derived from Kenya for the use of residential property where the rent income does not exceed KShs.10 million per annum (The Finance Act, 2015).

The change is part of the KRA efforts to encourage property owners to be tax compliant. The tax is simple to compute since it is based on a percentage of the gross rentals and is lower than the standard rate of 30% to reflect the fact that the landlords do not receive a deduction for the expenses incurred to generate the income (KPMG, 2015). Some of the benefits of the residential rental income tax include simplified tax computation at 10% flat rate on gross rent and not at 10% -30% rates. Landlords shall not be required to produce records to account for expenses. In addition to simplifying the taxation of rental income, the Finance Act also provides for an amnesty on taxes, penalties and interest on rental income for the period prior to 2014 (KPMG, 2015).

### **1.1.2 Determinants of Residential Rental Income Tax Compliance**

There is a growing body of research into taxpayer compliance behavior that is helping to develop a better understanding of what motivates taxpayers to comply, or not, with requirements of the tax system (Gayer & Mourre, 2012). According to Mwangi (2014) one of the main tax evasion reason is the high personal income tax rates, which tend to lead taxpayers to evade tax. It is generally believed that a high tax rate is the main cause of tax evasion. Incentives to evade tax depend on the marginal rates of taxation because these govern the gains from evasion as a sum of the tax evaded. High tax may be a disincentive to work which can lead to low tax revenue collection (Kołodziej, 2011).

Attitude and perception towards tax and its general compliance levels has also been identified as a major factor which influences compliance of tax (Mukabi, 2014). Attitude may be positive or negative evaluation of an individual about someone or an object and so forth. Attitude usually controls an individual's action. Thus, a taxpayer with positive attitude toward tax evasion is expected to be less compliant than a taxpayer with negative attitude (Kirchler et al., 2008; Nicoleta, 2011).

Income levels are also deemed to influence tax compliance by various individuals and entities. According to Kirchler et al. (2007), most taxpayers do want to lose their hard earned cash by gambling with tax authorities. Nicoleta (2011) also posits that the self-employed people are more likely to avoid paying taxes as compared to employed ones.

Fines and penalties are part of the coercive approach, which advocates hard actions against tax non-compliance. Penalties and fines usually encourage tax compliance. The only problem lies with detection of such individuals or entities that are likely to avoid paying taxes (Mukabi, 2014). Thus, it's crucial for the tax authority to have an effective system that can help in detection of non-compliance and penalize or fine tax evaders.

Tax knowledge and education are also considered to be a vital part of attitudes towards tax compliance. Kirchler et al. (2008) posits that knowledge of tax is crucial since when an individual knows what is supposed to be done at anytime he/she will always comply. Knowledge is power as they say. Poor knowledge on taxation can lead to a distrust and negative attitude towards tax; while good tax knowledge, correlates with a positive attitude towards tax (Hofmann, Hoelzl & Kirchler, 2008).

### **1.1.3 Property Owners in Thika Town**

Thika is a market town in Kiambu County in Central Kenya. Thika town is one of leading towns in Kenya as far as starting and registering a business is concerned with a population of over 200,000 (Mosoti & Murabu, 2014). Thika town is known for light industry like food and horticulture processing. The recent growth of the town has been heightened by growth of service sector especially education and finance (Muchira, 2007).

Residential housing in Thika town comprise of wide variety of forms, from publicly aided tenant purchase, mortgage houses and apartments to semi-urban houses. Some residents of Thika own a quiet number of some rental houses or units and manage them secretively (Mwangi, 1997). The level of rent charged on such units varies depending on some facts like closeness to a tarmac road, a business centre, security, the size of the house and so forth. Rents are usually collected by the owners or the agents appointed by the owners (UN-HABITAT, 2006). Thus, residential rental houses in Thika town collect rent income, which is subject to taxation.

### **1.2 Research Problem**

Tax compliance has been a crucial subject to researchers in many countries around the globe. In most third world countries house rental taxation has been classified as economic. (Tilahun & Yidersal, 2014; Palil, 2010). Like the other tax systems, the system of house rental taxation has been confronted with many challenges both on the side of the tax payers and the officials (Berhane & Yesuf, 2013). In most third world countries house rental taxation has been classified as economic transactions which a bit difficult to detect given the large number of citizens involved (OECD, 2012).



In Kenya, taxation has been the main source of revenue to the government. The taxes are used by the government to provide public goods and/or services to general public. Over the past years, though revenue collections by the Kenya Revenue Authority have increased, the revenues collected have not been sufficient to fund the budget proposals resulting into budget deficits (Alegana, 2014). In addition, the rise in government expenditure has forced the government to bring each and every sector into taxation bracket so as to be able to fund such crucial goods and services to the public. Thus, there is need to examine the factors influencing residential rental income tax compliance by property owners in Thika town.

In addition, several studies have also been carried on tax compliance around the globe. A study by Hargreaves (2008) explored the influence of tax system on New Zealand's housing market and revealed that owner-occupiers do not pay tax from a rental income. Dube (2014) explored tax administration of informal sector in Zimbabwe and revealed that a high rate of tax and sheer ignorance are the main tax compliance disincentive in informal sector which leads to a low tax revenue collection. Palil (2010) also investigated tax knowledge and tax compliance determinants in self-assessment system in Malaysia and established that compliance of tax is influenced by probability of being audited, penalties, personal financial constraints and referent groups. However, the above international studies did not concentrate on residential rental income taxes.

In Kenya, a study by Osebe (2013) analyzed factors which affect tax compliance in Kenyan real estate sector and established that compliance costs, knowledge of tax and education, penalties and the perceived tax evasion opportunities influenced tax compliance. Mwangi (2014) also investigated the factors which influence tax compliance

with a focus on SME's which operates in Industrial area, Nairobi and revealed high tax rates, lack of adequate information on tax matters and costs of tax compliance affected tax compliance. However, many local studies on tax compliance focus more on tax compliance by SMEs. In addition, few studies on rental income taxation in Kenya are based on the old method of taxation where landlords were taxed at a rate of 30% on their net rental income in comparison to the current 10% tax rate on gross income. Since the residential rental income tax regime was introduced as an incentive to attract more people into the tax net, the main drive or purpose of this study is to investigate various factors which affect attainment of this objective. This research therefore seeks to determine; how do various factors influence whether or not property owners in Thika town adopt and comply with residential rental income tax?

### **1.3 Objective of the Study**

To investigate determinants of residential rental income tax adoption by property owners in Thika Town

### **1.4 Value of the Study**

This study sought to establish factors that influence residential rental income tax compliance by property owners in Thika town. Thus, the findings of this study will be of help to property owners as it highlighted the various factors that influence their compliance to rental income taxes. In addition, the study gives recommendations on how tax compliance by property owners can be enhanced. The findings of this study will assist various policy makers including the Kenya Revenue authority, the government of Kenya and other line ministries in developing effective policies to enhance residential rental

income tax compliance by property owners and to reduce tax non-compliance to acceptable levels.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

Chapter two review available literature on tax compliance as investigated by various scholars around the world. The chapter presents the theoretical literature review, the empirical literature review and finally a summary of literature review.

### **2.2 Theoretical Literature Review**

The study explored the Allingham-Sandmo (AS) Theory, the fiscal exchange theory and the social influences theory to explain the concept of tax compliance and the various motives behind tax non-compliance.

#### **2.2.1 The Allingham-Sandmo (AS) Theory**

The Allingham-Sandmo (AS) theory is also known as the economic deterrence theory emanated from the seminal work of Allingham and Sandmo (1972). This theory affirms that the behavior of a taxpayer is usually influenced by the factors which determine the benefits and cost of tax evasion (Allingham & Sandmo, 1972).

The economic deterrence model in its basic form views the individual taxpayer as a rational economic agent, who assesses the costs (determined by probability of detection and penalties or a fine for the fraud) and benefits (determined by tax rate) of evading taxes, and thus chooses not to pay, if the benefit of non-compliance outweighs the costs (Walsh, 2012). The theory assumes taxpayer maximizes expected utilities of noncompliance tax gamble. That is, balancing between tax cheating benefits against

detection and sanctions (Sandmo, 2005). The basic premise is that individual usually takes part in activities which have the potential of maximizing their returns or rewards as well as minimizing their costs, tax amnesty being one of those activities. If sanctions are probable enough, and the costs severe enough to outweigh the rewards of an act, the act will not be performed (Mengere, 2014).

This theory concludes that tax compliance depends more on tax audit and the penalties or fines. This implies that, all taxpayers only pay their taxes because they fear being sanctioned. Thus, an increase in sanctions or fines and penalties will increase tax revenue (Awa & Ikpor, 2015). It is on the basis of this assumption that the model advocates stricter audit and heavy penalties for offenders as a basis for reducing non-compliance (Fjeldstad, Schulz-Herzenberg & Sjursen, 2012). The relevance of the AS model in residential rental income tax compliance is that when there are low probability of audit and penalties, tendency for evasion by property owners will be higher, while if there is a high tendency for detection and penalties are severe, fewer property owners will evade residential rental income tax.

### **2.2.2 Fiscal Exchange Theory**

This theory is acclaimed to have evolved from the economic deterrence and social psychology models. It is premised upon the existence of a social, relational or psychological contract between the government and the taxpayers (McKerchar & Evans, 2009). This theory suggests that government expenditures are the main motivate of tax compliance and the governments has the ability to ensure that its citizen comply by offering more improved public goods and services with the little they collects in form of

tax (Ali, Fjeldstad & Sjørusen, 2013). Another major proposition of this theory is that of tax bargaining between taxpayers and the government, which is considered as fundamental to building a relation of accountability and obligations between state and society (Fjeldstad, et al., 2012).

This theory affirms that government expenditures serves as a motivating factor for taxpayer compliance, especially when the taxpayers value the goods and services they perceive to be receiving from the government (Bello & Danjuma, 2014). Thus, the taxpayers will be more willing to comply when they are satisfied with provision of services from government, even in the absence of detection and punishment. Conversely, they are also likely to adjust their terms of trade, by reducing compliance when they are dissatisfied with services provision from the government, or even when they dislike the way their taxes are spent (Torgler, 2003). The relevance of this theory is that property owners may be willing to pay residential rental income tax since they value public goods and services being offered by their government and believe that the more they pay taxes, they will be offered more improved and better goods and services. Conversely, the property owners may not be willing to comply if they feel that they do not derive any benefit from the taxes collected by the government or that there is wasteful spending and looting in public coffers.

### **2.2.3 Social Influences Theory**

This theory affirms that, tax compliance by citizens is specifically influenced by their individual behavior and social norms. The theory assumes that individual behavior in taxation is basically influenced by social interactions like other forms of behavior (Ali et

al., 2013). The theory follows that an individual is most likely to comply with tax requirements if he believes members of his reference groups also comply, just as he is also likely not to comply if he believes that members of his referent group do not comply (Walsh, 2012).

The social influence theory presupposes that individual behavior in taxation is basically influenced by social interactions like other forms of behavior (Bello & Danjuma, 2014). The theory also presupposes that the fear of social stigmatization as one of the possible deterrent factor to tax compliance (Kirchler, 2007), and that existence of the social norms effect on compliance behavior. The relevance of this theory is that property owners are likely to be influenced by social groups, family members, friends and other property owners to comply on payment of residential rental income tax.

### **2.3 Empirical Literature Review**

Maseko (2014) investigated the impact of personal tax knowledge and tax compliance costs behavior of SMEs in Zimbabwe. The findings of the study revealed that unlike large companies, SMEs face different business conditions which make them to endure high tax compliance load.

Berhane and Yesuf (2013) assessed the challenges and opportunities of house rental income business tax in Regional state of Tigray in Ethiopia. The study collected data via a survey questionnaire. The study findings established that there exists inefficiency and insufficient number of business house rent tax assessment and collection officers in the regional state of Tigray. Moreover, the study found that most taxpayers lack sufficient knowledge of tax assessment and collection procedures. Thus, most of business house

rent taxpayers do not know the existing applicable rules and regulations. Further, the study found that due to negligence, delay in tax payment and evasion are taken by taxpayers as solution to escape from payment of proper business house rental income taxes.

Kasipillai & Jabbar (2006) assessed whether gender and ethnicity differences occur in relation to tax compliance attitude and behavior. The results of t-test established that both male and female had similar tax compliant attitude and for ethnicity, similar result were also observed. In addition, regression results established that gender, education, and individual tax return preparation were statistically significant as the main determinants of non-compliant attitude.

Musau (2015) assessed factors influencing tax compliance among SMEs in Nairobi County. The study picked a sample of 398 respondents and collected data using questionnaires which was analyzed using the binary probit regression model. The study findings revealed that when an individual perception about difficulties of evading taxes increases, the high likelihood of being tax compliant among SMEs in Nairobi County. The findings also revealed those individuals who are satisfied with what the government is offering as public goods and service from taxes; have enough tax information; trust government officials in handling their taxes; and have the perception that if tax filing procedures are less complex, tax payers are likely to comply with tax payment.

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.

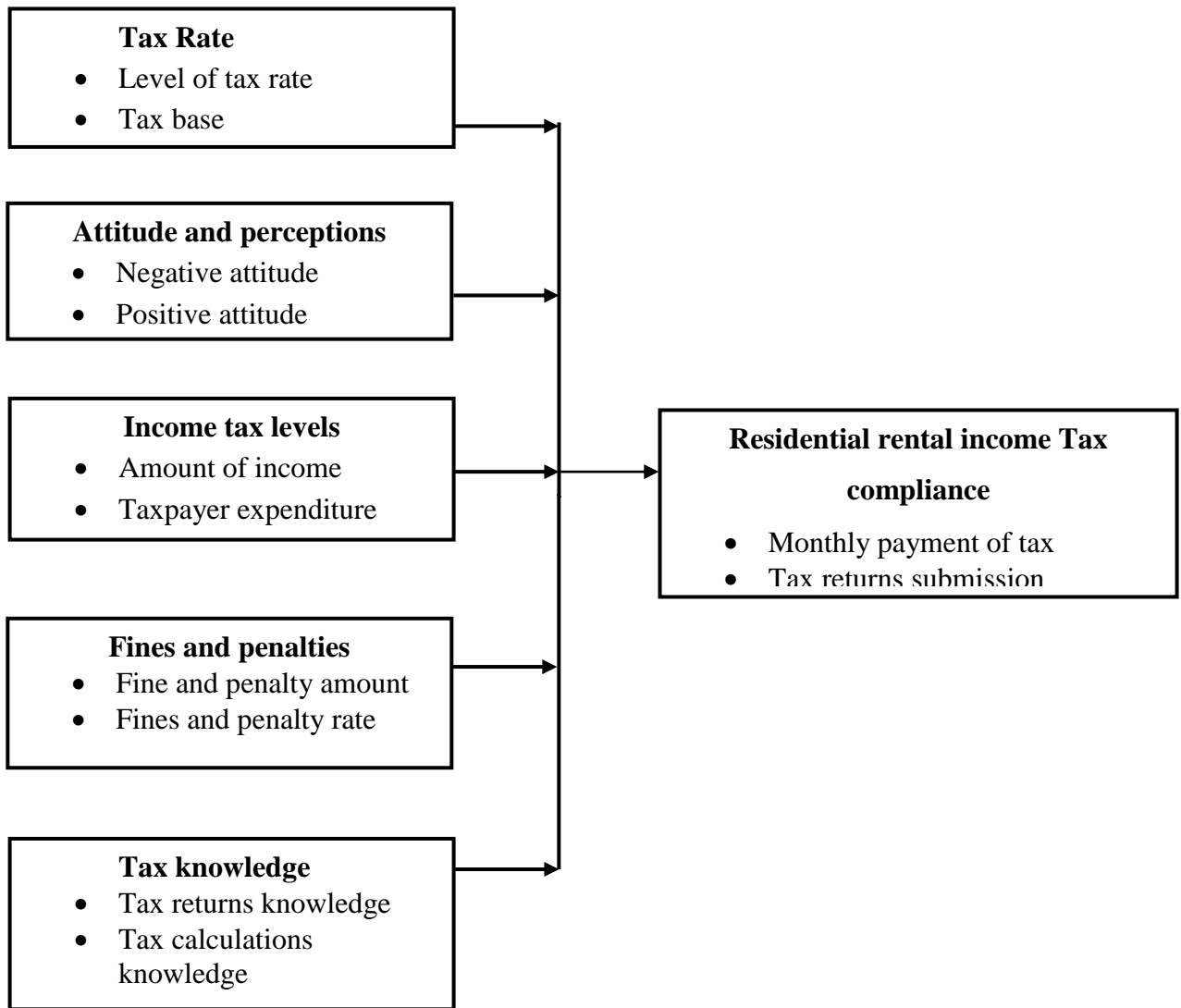
Thananga, Wanyoike and Wagoki (2013) carried out a study on how landlords in Nakuru Municipality responded to new taxation measures, and factors which influence compliance. The study used a sample of 94 respondents and questionnaires for data collection. The findings of the study revealed that compliance level to provisions of rental income tax policy by landlords was very low and non-compliance was due to expenses overstatement and deductions which would in turn reduce taxable pay.

Karanja (2014) examined factors affecting voluntarily tax compliance in Kenya by landlords in Nairobi County. The study adopted a descriptive research design and a sample of 45 respondents was selected and questionnaire used for data collection. The findings of the study established that attitude and perception that politicians misuse taxes, financial and family obligation had strong positive responses. The study findings also revealed that social norms and respondent's income levels strongly influenced tax non-compliance level among the Kenyan taxpayers on rental income. The study concluded that attitude factors, high tax rate, unfair tax system, social norms, gender and education level factors are significant and play a great role towards the compliance or non-compliance of Kenyan taxpayers.

## **2.4 Conceptual Framework**

The study sought to investigate determinants of residential rental income tax adoption by property owners in Thika Town. The independent variables will include the tax rate, attitude and perceptions, income tax levels, fines, penalties, knowledge of tax and education while dependent variable will be residential rental income tax compliance. The economic deterrence theory explains that detection and penalties for fraud reduce the likelihood to evade taxes while several scholars have indicated that income levels, tax knowledge and attitude as key variables that influence tax compliance in several business entities. Figure 2.1 shows the conceptual framework

**Figure 2.1 Conceptual Framework**



**Source: Researcher**

## **2.5 Summary of Literature Review**

This section has reviewed existing literature on tax compliance by various organizations. In addition, several studies have also been explored. For instance, Vadde (2014) and Berhane and Yesuf (2013) assessed the factors which influence attitudes of rental taxpayers and compliance behavior with tax system. Mas'ud, Aliyu and Gambo (2014), Nicoleta (2011) and Kasipillai and Jabbar (2006) also examined various factors that influence tax compliance in the respective countries while Thananga, Wanyoike and Wagoki (2013), Karanja (2014) and Kuria (2013) examined the factors affecting voluntarily tax compliance by landlords in Kenya. Additionally, Maseko (2014), Musau (2015), Mukabi (2014) and Makori et al (2013) assessed the various factors which influence tax compliance by SMEs in various parts of Kenya. However, most of the existing and reviewed studies have focused more on small and medium enterprises compared to residential rental property owners. Moreover, taxation of rental properties in Kenya is still a young concept since residential rental property owners did not have a specific tax regime in the past years.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

Chapter four focuses on research design, population of the study, data collection, validity and reliability and analysis of data.

### **3.2 Research Design**

A research design refers to plan that guide a researcher on how to organize the research activities (Bryman & Bell 2003). A research design presents a framework or arrangement of action for a study. A descriptive research design was adopted which provides a comprehensive picture of a circumstance or a situation. It is normally done in order to determine and be in a position where one can describe features of a given variable of interest for a certain situation was used in this study. Since this study sought to investigate determinants of residential rental income tax compliance by property owners in Thika Town, a descriptive design helped to present and to determine the status of the phenomenon under investigation.

### **3.3 Population of the Study**

Population is a set of people or items with similar features that a researcher intends to study and to draw statistical inferences or conclusions (Gall et al., 2006). Therefore, the study population involved the 193 property owners as indicated in the Kiambu County Records (2015).

### **3.4 Sample Design**

A sample design refers to a plan to be used in obtaining a sample from a population. It is a technique or procedure which a researcher adopts when selecting sample items (Kothari, 2004). A sample of 58 property owners was selected using simple random sampling method.

### **3.5 Data Collection**

This study integrated both the primary and the secondary sources of data. Primary data was obtained through a questionnaire. The first section of the questionnaire gathered data on the respondents' background information while the other sections gathered data on the study variables, which comprised of tax rate, attitude and perception, income levels, fines and penalties, tax knowledge and how they affect residential rental income tax compliance. In designing the questionnaires for the study, the questions were designed in such a manner as to attract vital answers, which helped the researcher in analyzing the situation at hand. The questionnaires were issued to the property owners through agents or managers (caretakers) requested to pass them to the property owners of the sampled residential rental houses and then picked after one week. Secondary data on the research was obtained from KRA publications. The KRA publications provided information on the number of property owners were on board the residential rental income tax regime.

### **3.6 Validity and Reliability**

Reliability is about consistency and ability of a measure to obtain similar results at any time a test is carried out while validity test is used in determination of a measurement if it really reflects the concept under the study. To ensure validity of data collection

instrument, expert opinion was sought from the project supervisor and other scholars who were familiar with the topic. To test reliability of research instrument the Cronbach Alpha Coefficient was employed. The Cronbach alpha provides a coefficient of inter-item correlations. The Cronbach alpha ranges between 0 and 1 and a value of 0.7 or more was considered as an indication of reliability

### **3.7 Data Analysis**

Collected data was analyzed using descriptive and inferential statistics with the help of Statistical Package for Social Sciences version 21(SPSS 21). Descriptive statistics involved the use of measures of central tendency, which included frequencies, percentages, the mean and standard deviation while inferential statistics was used to draw conclusions.

#### **3.7.1 Analytical Model**

In evaluation of relation between variables, that is dependent variables and independent variables, a multiple regression model was adopted. Regression analysis is a technique used to estimate relationships between two or more variables. The multiple linear regressions was as follows

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \varepsilon$$

Where

$Y$  = Residential rental income tax compliance

$X_1$  = Tax rate

$X_2$  = Attitude and perceptions

$X_3$  = Income levels

$X_4$  = Fines and penalties

$X_5$  = Tax knowledge

$\beta_0$  = Constant

$\beta_1 - \beta_4$  = Regression Coefficients

$\varepsilon$  = Error term

### **3.7.2 Test of Significance**

To test the statistical significance, the F and t test was used. The F-Statistic was used to determine significance of regression model, that is, to what extent the variation in independent variable explains the changes in dependent variable. Analysis of Variance (ANOVA) was also used to establish total variations within and between variables to determine relation between variables. T- test was employed to test statistical significance of regression coefficients at 95% confidence level.



## **CHAPTER FOUR: DATA ANALYSIS, RESULTS AND INTERPRETATION**

### **4.1 Introduction**

This chapter shows response rate, the results of data reliability, descriptive statistics of the study variables, regression analysis and an interpretation of the study findings.

### **4.2 Response Rate**

This study had selected a sample of 58 respondents and dropped 54 questionnaires to the sampled property owners. 46 questionnaires were completely responded to which made a response rate of 85.2%, which was considered sufficient.

### **4.3 Data Reliability**

The Cronbach alpha coefficient was used to establish the reliability of the questionnaire.

Table 4.1 shows obtained results

**Table 4.1 Data Reliability**

<b>Variable</b>	<b>Cronbach's alpha</b>	<b>N of items</b>
Tax rate	.792	5
Attitude and perceptions	.737	6
Income levels	.744	6
Fines and penalties	.747	4
Tax knowledge	.814	6

**Source: Research Findings**

Table 4.1 shows that all the study variables yielded Cronbach alpha coefficients values of more than 0.7, which is the recommended value. This indicates that the instrument was reliable to obtain data on determinants of residential rental income tax compliance by property owners.

#### 4.4 Descriptive Statistics

This comprised of the results on the respondents profile and summary descriptive statistics of the research variables.

##### 4.4.1 Respondents Profile

Table 4.2 shows obtained results

**Table 4.2 Respondents Profile**

		<b>Frequency</b>	<b>Percent</b>
Gender	Male	33	71.7
	Female	13	28.3
	Total	46	100.0
Years of property existence	Below 2 years	8	17.4
	3-5 years	21	45.7
	6-8 years	5	10.9
	9 years and above	12	26.1
	Total	46	100.0

**Source: Research Findings**

Table 4.2 shows that 71.7% of respondents were male whereas 28.3% were female. Results also show that on average most properties had been in existence for a period of more than 3 years.

#### 4.4.2 Tax Rate

This section evaluated several statements on tax rate to determine its effect on residential rental income tax compliance by property owners. Table 4.3 shows obtained results

**Table 4.3 Tax rate**

<b>Statement</b>	<b>Mean</b>	<b>Std. Deviation</b>
1. 10% residential rental income tax rate is fair to property owners	2.96	1.398
2. Residential rental property owners are now willingly paying tax due to the well-structured tax rate	2.78	1.348
3. The computation of tax on gross rental proceeds is simple for property owners to apply	3.04	1.282
4. A 10% tax rate on gross receipts results in overall lower tax burden than a 30% tax rate on net rental income	2.74	1.182
5. The lowered tax rate has influenced willingness of residential rental property owners to be tax compliant	2.67	1.248

**Source: Research Findings**

Table 4.3 the highest mean value was 3.04 which corresponds to the scale value of 3 in the questionnaire an indication that the respondents were indifferent on whether the computation of tax on gross rental proceeds is simple for property owners to apply. The other mean value correspond to the value 2 which indicates that the respondents agree

that 10% residential rental income tax rate is fair to property owners and residential rental property owners are now willingly paying tax due to the well-structured tax rate. The respondents also agreed that a 10% tax rate on gross receipts results in overall lower tax burden than a 30% tax rate on net rental income and the lowered tax rate has influenced willingness of residential rental property owners to be tax compliant. On average, the results indicate that the tax rate influences residential rental income tax compliance by property owners respectively.

#### 4.4.3 Attitude and Perceptions

This section evaluated several statements on attitude and perceptions to determine its effect on compliance by property owners. Table 4.4 shows obtained results

**Table 4.4 Attitude and Perceptions**

	<b>Mean</b>	<b>Std. Deviation</b>
1. The relationship between a tax payer and the revenue authority influences the willingness of tax payers to be compliant	2.83	1.217
2. Payment of taxes is perceived by property owners as contribution to economic growth	2.52	1.278
3. Visible improvements in government spending encourages property owners to be tax compliant	2.85	1.366
4. Property owners have a negative attitude towards tax evasion	2.43	1.259
5. Political goodwill and fair distribution of public resources influences your perception towards tax compliance	2.57	1.344
6. The Kenya Revenue Authority(KRA) is perceived to be efficient in tax administration thus likely to catch up with defaulters	2.85	1.316

**Source: Research Findings**

Table 4.3 shows that, highest mean value was 2.85, which corresponds to the scale value of 2 hence an indication that the respondents agreed that visible improvements in government spending encourages property owners to be tax compliant and KRA is perceived to be efficient in tax administration thus likely to catch up with defaulters respectively. The respondents also agreed that the relation between a taxpayer and revenue authority influences willingness of taxpayers to be compliant and that political goodwill and fair distribution of public resources influences the perception towards tax compliance. Further, the respondents agreed that property owners perceive payment of taxes as contribution to economic growth and that property owners have a negative attitude towards tax evasion respectively.

#### **4.4.4 Income levels**

This part sought to evaluate several statements on income levels to determine its effect on residential rental income tax compliance by property owners. Table 4.5 shows the results obtained

**Table 4.5 Income levels**

	Mean	Std. Deviation
1. Tax rate should vary with level of residential rental income	1.93	1.124
2. Low residential rental income earners should not be taxed	2.11	1.320
3. Tax on residential rental income is lower when based on gross income instead of net income	2.59	1.257
4. The monthly payment of tax has an evenly distributed impact on the cash flow of property owners	2.39	1.064

5. Property owners with low income levels are more likely to be non-compliant	2.57	1.500
6. Residential rental income tax poses high administrative cost to property owners as it is due monthly.	2.39	1.453

**Source: Research Findings**

Results on table 4.5 indicate that, highest mean values are 2.59 and 2.57 which corresponds to the scale value of 2 which indicates that the respondents agreed that tax on residential rental income is lower when based on gross income instead of net income and that property owners with low income levels are more likely to be non-compliant. The respondents also agreed that the monthly payment of tax has an evenly distributed impact on the cash flow of property owners, residential rental income tax poses high administrative cost to property owners as it is due monthly and low residential rental income earners should not be taxed respectively. Additionally, the respondents strongly agreed that the tax rate should vary with level of residential rental income.

**4.4.5 Fines and Penalties**

This section sought to evaluate several statements on fines and penalties to determine its effect on residential rental income tax compliance by property owners. Table 4.6 shows the results obtained.

**Table 4.6 Fines and Penalties**

	Mean	Std. Deviation
1. Fines and penalties are very punitive to property owners	1.83	1.102
2. Fines and penalties discourage non-compliance with of residential rental income tax obligations	2.22	1.172
3. Periodic waiver of fines and penalties could encourage tax compliance	2.35	1.251
4. Property owners file nil or incorrect returns to avoid penalties of non-compliance on the iTax system	2.24	1.214

**Source: Research Findings**

Results on table 4.6 shows that, highest mean values were 2.35, 2.24 and 2.22, which correspond to the likert scale value of 2. This indicates that the respondents agree that periodic waiver of fines and penalties could encourage tax compliance, property owners file nil or incorrect returns to avoid penalties of non-compliance on the iTax system and fines and penalties discourage non-compliance with of residential rental income tax obligations. The lowest mean value was 1.83, which indicates that the respondents strongly agreed that fines and penalties are very punitive to property owners.

#### **4.4.6 Tax Knowledge**

This section sought to evaluate several statements on tax knowledge to determine its effect on residential rental income tax compliance by property owners.

**Table 4.7 Tax Knowledge**

	Mean	Std. Deviation
1. Property owners have adequate knowledge on tax rate, basis of taxation and compliance requirements under residential rental income tax regime	3.20	1.344
2. Lack of proper records on expenses incurred greatly contributed to non-compliance by property owners in the previous regime	2.39	1.085
3. Knowledge about tax laws plays a major role in determining property owners' tax compliance	1.87	.909
4. Effective tax education can change the attitude and perception of property owner towards tax compliance	2.11	1.080
5. Majority of tax payers are familiar with the iTax system	3.28	1.259
6. KRA has created a lot of public awareness on residential rental income tax	2.61	1.468

**Source: Research Findings**

As per the results on table 4.7 the highest mean values were 3.28 and 3.20 which corresponds to the scale value of 3. The results indicate that the respondents were indifferent on whether majority of tax payers are familiar with the iTax system and that property owners have adequate knowledge on tax rate, basis of taxation and compliance requirements under residential rental income tax regime. The results also established that the respondents agreed that lack of proper records on expenses incurred greatly contributed to non-compliance by property owners in the previous regime, KRA has created a lot of public awareness on residential rental income tax and that effective tax



education can change the attitude and perception of property owner towards tax compliance. The results also established that respondents strongly agreed that tax knowledge on tax laws plays a crucial role in determination of property owners' tax compliance. Table 4.7 shows obtained results

## 4.5 Regression Analysis

### 4.5.1 Model Summary

Table 4.8 shows the model summary results

**Table 4.8 Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.539 <sup>a</sup>	.291	.202	.71664

a. Predictors: (Constant), Tax knowledge, Tax rate, Fines and penalties, Attitude and perceptions, Income levels

#### Source: Research Findings

Table 4.8 shows that R-Square value (coefficient of determination) is 0.291, which indicates that the independent variables (Tax rate, attitude and perceptions, income levels, fines and penalties and tax knowledge) explain 29.1% of the variation in the dependent variable (Residential rental income tax compliance). This means that 70.9% of residential rental income tax compliance is influenced by other factors apart from the considered research variables.

## 4.5.2 Analysis of Variance

The results of the Analysis of variance are shown by table 4.9 below

**Table 4.9 ANOVA**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	8.414	5	1.683	3.277	.014 <sup>b</sup>
	Residual	20.543	40	.514		
	Total	28.957	45			

a. Dependent Variable: Residential rental income tax compliance

b. Predictors: (Constant), Tax knowledge, Tax rate, Fines and penalties, Attitude and perceptions, Income levels

### Source: Research Findings

ANOVA results on table 4.9 shows regression model is significant since the F statistics value (3.277) is significant at 95% confidence level since the p-value ( $0.014 < 0.05$ ). This indicate a significant relation between independent research variables Tax rate, attitude and perceptions, income levels, fines and penalties and tax knowledge) and residential rental income tax compliance.

## 4.5.3 Regression Coefficients

Table 4.10 below shows the regression coefficients results

**Table 4.10 Regression Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.490	.745		1.999	.052
1 Tax rate	.347	.137	.345	2.537	.015
Attitude and perceptions	.170	.184	.132	.920	.363
Income levels	-.417	.254	-.260	-1.642	.109
Fines and penalties	-.148	.184	-.121	-.804	.426
Tax knowledge	.522	.211	.373	2.476	.018

a. Dependent Variable: Residential rental income tax compliance

**Source: Research Findings**

From results on table 4.10 the following regression equation was obtained

$$Y = 1.490 + 0.347X_1 + 0.170X_2 - 0.417X_3 - .148X_4 + 0.522X_5 + \varepsilon$$

The regression coefficient results indicate a positive significant effect between tax rate, tax knowledge and residential rental income tax compliance by property owners. Results also indicates an insignificant positive relation between attitude and perception and residential rental income tax compliance by property owners. The results further show that there is an insignificant negative effect between income levels, fines and penalties and residential rental income tax compliance by property owners.

## **4.6 Interpretation of the Findings**

The study result found a significant positive relation between tax rate, knowledge of tax and residential rental income tax compliance. This means that, tax rate has a direct effect on residential rental income tax compliance. The findings also means tax knowledge has a direct impact on residential rental income tax compliance hence an increase in knowledge of tax and awareness increases the levels of residential rental income tax compliance by property owners. Kołodziej (2011), support that a high tax rate could be seen as an unfair treatment of taxpayers.

The results also found that attitude and perceptions positively influence residential rental income tax compliance by property owners though the relationship is insignificant. This indicates that there attitude and perceptions also have a direct impact on residential rental income tax compliance by property owners. In similarity, Maseko (2014) established that perceptions of SME operators about tax fairness, quality of tax service and government expenditures greatly affect tax compliance decisions. Chepkurui et al (2014) also points out that attitude and perceptions of taxpayer plays a vital role in compliance decisions.

Finally, the results have found that income levels, fines and penalties negatively influence residential rental income tax compliance by property owners but the relationship is insignificant. This indicates an inverse relationship between income levels, fines and penalties and residential rental income tax compliance by property owners that indicates that a decrease in income and fines and penalties reduces compliance with residential rental income tax by property owners.

## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Introduction**

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

### **5.2 Summary**

The findings on tax rate revealed that property owners were indifferent on whether the computation of tax on gross rental proceeds was simple for property owners and that property owners agreed that the 10% tax rate on gross receipts was fair compared to the previous 30% rate. The findings on attitude and perceptions established that visible improvements in government spending, political goodwill and fair distribution of public resources encouraged tax compliance by property owners. The findings also established that the relation between a taxpayer and revenue authority influences willingness of taxpayers to be compliant and that property owners perceive payment of taxes as contribution to economic growth.

The findings on income level found that the monthly payment of residential rental income tax had an evenly distributed impact on the cash flow of property owners but the payment pose a high administrative cost to property owners. The results on fines and penalties established that periodic waiver of fines, penalties encouraged compliance and that punitive fine and penalties discourage non-compliance with of residential rental income

tax obligations. The findings on tax knowledge and education revealed that property owners were indifferent on whether majority of taxpayers are familiar with the iTax system and that property owners have adequate knowledge on tax rate, basis of taxation and compliance requirements under residential rental income tax regime. The results also revealed that tax knowledge on tax laws plays a vital role in determination of property owners' tax compliance.

The results of regression analysis established that tax rate, attitude and perceptions, income levels, fines and penalties and tax knowledge explained 29.1% of the variation residential rental income tax compliance by property owners. The ANOVA results established a significant relation between tax rate, attitude and perceptions, income levels, fines and penalties and tax knowledge and residential rental income tax compliance. The regression coefficient results established a positive significant relation between tax rate, tax knowledge and residential rental income tax compliance and an insignificant positive relationship between attitude and perception and residential rental income tax compliance. The findings also established an insignificant negative relationship between income levels, fines and penalties and residential rental income tax compliance by property owners.

### **5.3 Conclusion**

The study findings established that tax rate and tax knowledge significantly and positively influences residential rental income tax compliance by property owners. Based on this finding the study recommends that tax rate applicable on residential rental income influences tax compliance by property owners and an increase in tax knowledge and

education enhances compliance by property owners. The study also found that attitude and perceptions positively influences tax compliance thus the study concludes that attitude and perceptions have a direct impact on residential rental income tax compliance by property owners. The study found that income levels, fines and penalties negatively influence tax compliance by property owners. The study thus concludes that high levels of income encourage tax compliance but low-income levels encourage non-compliance of residential rental income tax by property owners and punitive fines and penalties encourage property owners to comply tax obligations.

#### **5.4 Recommendation for Policy**

The study found that tax knowledge significantly influences residential rental income tax compliance by property owners. Based on study finding, this study recommends that KRA should develop training programs to create awareness on residential rental income tax compliance by property owners.

The study also found that attitude and perception towards the tax authority influences compliance of residential rental income tax by property owners. The study therefore recommends that the tax authority in Kenya (KRA) need to develop effective policies to develop a positive relationship and trust with taxpayers since this would encourage tax compliance.

The study further established that punitive fines and penalties encourage compliance with residential rental income tax by property owners. The study therefore recommends that the tax authority in Kenya (KRA) should revise its fines and penalties to make them more severe to encourage tax compliance.

## **5.5 Limitations**

The focus of this study was residential rental income tax compliance by property owners hence the finding and conclusions are only applicable to residential rental income tax compliance and not compliance with other taxes.

In addition, the study sought the views of property owners and examined the various factors that influence tax compliance by the property owners thus the views of tax authority in Kenya on non-compliance by property owners has not been incorporated.

## **5.6 Suggestion for Further Research**

This study collected data from property owners to establish the various factors which influence compliance with residential rental income tax. Thus, this study recommends a similar study, which incorporates the views of the tax authority in Kenya to establish the factors behind residential rental income tax non-compliance by property owners. The study found that the considered research variables explain 29.1% of variation in residential rental income tax compliance by property owners thus the study recommends an additional study on the other factors that influence compliance of residential rental income tax by property owners.



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## APPENDICES

### APPENDIX I: Questionnaire

I am a student pursuing a Degree in Masters of Business Administration, University of Nairobi and carrying out a research on **the determinants of residential rental income tax adoption by property owners in Thika Town**. The research is purely academic in nature and any information obtained will be kept confidential.

Your cooperation and support will be highly appreciated.

#### Section I: Background information

Please **tick** and **fill** where appropriate

1. Gender:

Male [ ]          Female [ ]

2. Number of years property has existed

Below 2 years [ ]      3-5 years [ ]      6-8 years [ ]      9 years and above [ ]

#### Section II

##### Part I: Tax rate

3. Evaluate the following statements and tick where appropriate under the choices below

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

Statement	1	2	3	4	5
1) 10% residential rental income tax rate is fair to property owners					

2) Residential rental property owners are now willingly paying tax due to the well-structured tax rate					
3) The computation of tax on gross rental proceeds is simple for property owners to apply					
4) A 10% tax rate on gross receipts results in overall lower tax burden than a 30% tax rate on net rental income					
5) The lowered tax rate has influenced willingness of residential rental property owners to be tax compliant					

**Part II: Attitude and perceptions**

4. Evaluate the following statements and tick where appropriate under the choices below

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

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1) The relationship between a tax payer and the revenue authority influences the willingness of tax payers to be compliant					
2) Payment of taxes is perceived by property owners as contribution to economic growth					
3) Visible improvements in government spending encourages property owners to be tax compliant					
4) Property owners have a negative attitude towards tax evasion					
5) Political goodwill and fair distribution of public resources influences your perception towards tax compliance					
6) The Kenya Revenue Authority(KRA) is perceived to be efficient in tax administration thus likely to catch up with defaulters					

**Part III: Income levels**

5. Based on the property income levels evaluates the following statements and tick where appropriate under the choices below.

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

Statement	1	2	3	4	5
1) Tax rate should vary with level of residential rental income					
2) Low residential rental income earners should not be taxed					
3) Tax on residential rental income is lower when based on gross income instead of net income					
4) The monthly payment of tax has an evenly distributed impact on the cash flow of property owners					
5) Property owners with low income levels are more likely to be non-compliant					
6) Residential rental income tax poses high administrative cost to property owners as it is due monthly.					

**Part IV: Fines and Penalties**

6. Evaluate the following statements and tick where appropriate under the choices below

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

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1) Fines and penalties are very punitive to property owners					
2) Fines and penalties discourage non-compliance with of residential rental income tax obligations					
3) Periodic waiver of fines and penalties could encourage tax compliance					
4) Property owners file nil or incorrect returns to avoid penalties of non-compliance on the iTax system					

**Part V: Tax knowledge**

7. Have you attended any formal training organized by KRA or other institution on residential rental income tax?

Yes ( )

No ( )

8. Evaluate the following statements and tick where appropriate under the choices below

**Where: 1 – Strongly Agree, 2 – Agree, 3 – Disagree and 4 - Strongly Disagree**

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1) Property owners have adequate knowledge on tax rate, basis of taxation and compliance requirements under residential rental income tax regime					
2) Lack of proper records on expenses incurred greatly contributed to non-compliance by property owners in the previous regime					

3) Knowledge about tax laws plays a major role in determining property owners' tax compliance					
4) Effective tax education can change the attitude and perception of property owner towards tax compliance					
5) Majority of tax payers are familiar with the iTax system					
6) KRA has created a lot of public awareness on residential rental income tax					

**Part VI: Residential rental income tax compliance**

9. Is your business registered for Residential rental income tax?

Yes                                        No     

10. Evaluate the following statements and tick where appropriate under the choices below

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

Statement	1	2	3	4	5
1) Residential rental property owners file tax returns every month					
2) Residential rental property owners declare correct monthly rental income					
3) Residential rental property owners file tax returns only to avoid penalties					
4) KRA has offered an enabling environment for tax filing					
5) Residential rental property owners file returns on time and as required by law					
6) Residential rental property owners enjoy paying taxes and are always tax compliant					

**11. Can you recommend ways of creating more awareness on residential rental income tax?**

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**Thank you very much for your patience, cooperation and support in my research.**