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THE IMPACT OF CORPORATE GOVERNANCE ON TAX COMPLIANCE IN KENYA: A CASE STUDY OF THE TRANSPORT INDUSTRY

BY

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God richly bless you all.

DEDICATION

This thesis is dedicated to my family for their encouragement and support.

Special dedication to my parents, Rosebella and Joseph Lekake. In as much as they are not around to read this and to witness my graduation, I know they are proud of how far I have come in my studies. I thank them for their commitment in ensuring that I get an education.

I also dedicate this study to my dear husband Anthony Toroitich, my son Ezra Kipkech, daughters Nana Chesiro and Kristie Chemunge. You guys are my heart!

LIST OF ABBREVIATIONS

OECD Economic Co-operation and Development

SOX Sarbanes-Oxley Act

CMA Capital Market Authority

NSE Nairobi Stock Exchange

FTA Forum on Tax Administration

PAYE Pay As You Earn

VAT Value Added Tax

PIN Personal Identification Number

ICPAK Institute of Certified Public Accountants of Kenya

KRA Kenya Revenue Authority

KEY TERMS OF THE STUDY

(a) Corporate Governance

Corporate governance is the systems which dictate how a corporation is controlled and directed. Corporate governance is the manner in which power is exercised in the leadership of a portfolio of a corporation's resources and assets with the aim of maintaining and satisfying shareholders value within the ambit of the corporate mission.[1]

(b) Transport

Transport is the means or the system by which goods and people are conveyed from one place another by means of aircraft, ship or vehicle.

(c) Customs

The state department responsible for the administration of customs law and the collection of taxes and duties

(d) **Tax Compliance**

Tax compliance denotes the extent or the degree a taxpayer either complies or fails to comply with the taxation laws of the state.

(e) Tax Avoidance

This means a way in which a taxpayer arranges financial affairs in order to minimize on the tax burden but within the confines of the law.

[1] Cadbury, Adrian "The Committee on the Financial Aspects of Corporate Governance, Gee and Co.Ltd" London, UK Report 61 (1992)14

STATUTES

Companies Act, 2015

Companies Act Chapter 486 Laws of Kenya

Penal Code Chapter 63 Laws of Kenya

The Sarbanes-Oxley Act (SOX)

The Capital Markets Act, Cap 485A Laws of Kenya

The Constitution of Kenya, 2010,

The Kenya Revenue Authority Act, 1995 Chapter 469 Laws of Kenya.

Traffic Act, Chapter 405, Laws of Kenya

ABSTRACT

This study is on the impact of corporate governance on tax compliance with a focus on the transport sector in Kenya. To narrow down the broader issue of corporate governance, the study undertook to ascertain the experience of corporate governance as far as the transport companies under review are concerned and how the same has shaped their levels of tax compliance.

To achieve its objectives this study provides a background into history of corporate governance in Kenya and notes that there have been several cases of corporate failures both internationally and locally. The theoretical framework to be applied in this study are two, namely; the agency theory and stakeholder theory with emphasize being on the duties and responsibilities of the directors especially with regard to their stakeholders. Thereafter, the study will highlight the research methodology to be used with transport companies within the Medium Taxpayers' Office of the Kenya Revenue Authority being the case study.

The study looks at the legal framework as well as at different dynamics in governance structures in transport companies. This will include but is not limited to a look at the relationship between ownership (family owned versus non-family owned) and tax compliance in the transport industry.

The study finally concludes with a summary of the findings and offers appropriate recommendations.

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1.0 CHAPTER ONE: INTRODUCTION

Corporate governance is the process and structure that informs the management of business affairs of a company.[2] This management is aimed at enhancing the main objectives of realizing shareholders long-term interests, the interests of the other stakeholders and assuring sustainability in corporate accounting.[3] According to the Cadbury Committee Report, [4]corporate governance is the systems which dictate how a corporation is controlled and directed. In this view, corporate governance would be viewed as the manner in which power is exercised in the leadership of a portfolio of a corporation's resources and assets with the aim of maintaining and satisfying shareholders value within the ambit of the corporate mission.

This study seeks to elucidate the impact of corporate governance on tax compliance in Kenya with a focus on the transport industry in Kenya as a case study. To achieve this objective, the Transport industry is used as the case study to ensure that the dynamics of tax compliance are sufficiently interrogated within the realm of corporate governance.

1.1 Background to the problem

The establishment of good corporate governance principles is diverse depending from one jurisdiction to the other. Nonetheless, there exist conventional principles of good corporate governance as envisaged by various instruments including: Cadbury Report[5], Organization for

[2]. Cadbury, Adrian. "„The Committee on the Financial Aspects of Corporate Governance and Gee and Co. Ltd”." London, UK. Re port 61 (1992): 14
[3] *Ibid*
[4] *Ibid*
[5] *Ibid*

Economic Co-operation and Development (OECD)[6], The Business Roundtable[7], Sarbanes-Oxley Act [8] and the Australian Stock Exchange Corporate Governance Council.[9] In the preceding, the Cadbury Report has been termed ground breaking, it provides for the following key aspects that should constitute good corporate governance namely:

First, the Board of directors should have clear responsibilities whose role is divorced from that of the firm's managers. Second, need to establish checks and balance in the structures of governance without any individual having unfettered power. It is also important to have a Board comprising of both non-executive and executive directors. Finally, need to ensure Board's transparency in controlling and directing a corporation.[10]

In view of the developments, history of corporate governance is dented with notorious cases of collapse of corporation at the global level that informed the existing developments. As a result of the collapse of Enron and WorldCom, Congress passed a legislation known as the Sarbanes-Oxley Act (SOX) in 2002.[11] This Act's main principles regarding corporate governance include the requirement of an independent auditor[12], the need for the financial officers and the executive to

[6] OECD, principles of corporate governance, Paris,1999.
[7] Business Roundtable. Principles of corporate governance. Business Roundtable, Washington DC, 2002.
[8] Sarbanes-Oxley Act, *Washington DC* (2002). (SOX)
[9] Exchange, Australian Stock, and Corporate Governance Council. Principles of Good Corporate Governance and Best Practice Recommendations. Australian Stock Exchange, 2003.
10 Mulili, Benjamin Mwanzia, and Peter Wong. "Corporate governance practices in developing countries: The case for Kenya." International journal of business administration 2, no. 1 (2011): 14. Available at < http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.1023.6635&rep=rep1&type=pdf >
[11] Dembinski, Paul H., Lager, Carole, Cornford, Andrew, & Bonvin, Jean-Michel. (Eds.). *Enron and world finance*. London: Palgrave Macmillan (2005).
[12] The Sarbanes-Oxley Act, Washington DC(2002) (SOX) section 301

sign statements verifying that they are devoid of misstatements[13] and the independence of the external auditors and that independent directors to be the majority in companies that are listed.[14]

On the other hand, the OECD[15] provides for the principles of good corporate governance. These include: among others stakeholders rights recognition; disclosure of material matters concerning the firm in a timely manner and finally accountability based on the effective management and monitoring.

Like at the international platform, Kenya is also punctuated with corporate governance failures. In one way or the other, the same may be attributed to the current development in corporate governance in Kenya. There is the existence of Capital Market Authority (CMA)[16] which is the corporate agency that is mandated to oversee Kenya's stock exchange. Kenya adopted a sample code in 2002 developed by the centre for Corporate Governance. In enforcement of the corporate governance in Kenya, the CMA Guidelines acts as the roadmap.

In terms of the statutory regulatory framework, Kenya is governed by the Companies Act, 2015 which came into operation on the 15th of September, 2015.[17] This Act replaced the 1948 Companies Act, Chapter 486, and Laws of Kenya. The Companies Act, 2015 in this case was also an adoption of England's Companies Act of 2006 with some variations but the entire substantive provisions remaining as the parent Act. The Companies Act, 2015 deals with the duties of the Directors and protection of the shareholders and the general corporate governance matters within the purview of

[13] *Ibid*, section 302
[14] *Ibid*, sections 201-209
[15] OECD,The OECD principles of corporate governance, OECD publishers (2004) p.18-46
[16] Capital Markets Act, Cap 485 A Laws of Kenya, section. 5.
[17] Companies Act (No. 17 of 2015), Laws of Kenya

regulation and legislation. Besides, the existence of the Act, there is also the Nairobi Stock Exchange (NSE) Regulations and the Penal Code.[18]

The existence of the above laws and regulations has been responsible for the regulatory framework of corporate governance within the Kenya's commercial environment. The background on corporate governance in Kenya has not been impressive. This is informed by the failure of various corporations due to failures in corporate governance systems. Recent review of the Companies Act in Kenya would be attributed to the positive development in corporate governance in Kenya. Essentially, it would be worth noting that the Companies Act, 2015 is rich in the regulation of the duties of the directors and the Board. Nonetheless, negative evidence in the weak corporate governance in Kenya still exists within the systems. This development informs this study but with a focus on corporate governance and how the same affects tax compliance in Kenya.

There exist various modes of transport in Kenya. As a whole, there exist four main modes that constitute the transport industry in Kenya. These include: road, rail, air and water transport. In Kenya, since independence, the dominant mode of transport has been road transport. It is worth noting that the transport industry impacts the development and growth of a nation. On this basis, the level of development of a country can be measured also in terms of the development in the transport industry of a country.[19] As a whole, the transport industry facilitates the free movement of individuals from one region to another. This system also serves as the channel in which luggage

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[18] Chapter 63 Laws of Kenya

[19] Weisbrod, Glen, and Arlee Reno. Economic *impact* of *public transportation investment*. Washington, DC: American public transportation association, 2009. <http://www.apta.com/resources/reportsandpublications/Documents/economic_impact_of_public_transportation_investment.pdf> accessed 3rd December 2017

and cargoes are transferred from one region to the other for commercial purposes and other social purposes. It follows therefore, that a State cannot exist without a functioning transport system.

Kenya has had an extensive motor transport system which can be traced back to 1934. The first fleet of buses in Kenya was Kenya Bus Service.[20] Although the buses are still in existence, governance issues have rocked its management leading to a decline in its operations to date. The history of road transport has also recorded that there have been both successful and unsuccessful entrants in the industry. For instance the introduction of Nyayo bus service in 1986 collapsed seven years after its introduction.[21] The existence of the other modes of transport including rail, air and water transport will not from part of this discourse. The study will seek to lay emphasis on road transport generally.

1.2 Problem Statement

Corporations, being legal entities, have a duty not only to their shareholders or investors but also to the public at large. They have a general responsibility of good citizenship, which means they ought to pay their share amount of taxes due to them under the applicable tax laws. Empirical studies show that the transport industry is laden with cases of non-compliance with the various tax statutes. The study seeks to investigate why that is the case and attempts to offer solutions.

It will seek to interrogate the system and structure of corporate governance within the transport companies in Kenya, specifically those companies that fall within the Medium Taxpayer's Office (MTO) of the Kenya Revenue Authority. Once the structure has been examined, there will be an

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[20] Oira, Alex Sereti, and M. Makori. "Challenges affecting investment in public transport (Matatu) Industry in Nairobi-Kenya." *Strategic Journal of business & Change management* 2, no. 2 (2015). <http://pdf.usaid.gov/pdf_docs/Pnads064.pdf> Last accessed 3rd December 2016

[21] *Ibid*

attempt at understanding the link between the corporate governance structure and the level of tax compliance.

1.3 Research Questions

This study will seek to answer the following question:

1.0 What is the existing legal framework regulating corporate governance in Kenya and tax compliance?

2.0 What is the corporate governance practice within the transport industry framework in Kenya?

3.0 How has that practice shaped tax compliance in Kenya?

1.4 Hypothesis

The study will be premised on the hypothesis that most transport companies under the Medium Taxpayers Office are not compliant with the tax laws because they do not have proper corporate governance structures. The owners lack adequate knowledge on corporate governance matters. Some of the owners may not be educated and therefore lack the relevant knowledge concerning corporate governance matters and by extension taxation.

The second hypothesis is that the reason for non-compliance is because the management of transport companies lacks the human resource capacity to understand and comply with their tax obligations. In some cases, they don't wish to hire auditors or consultants who can assist them with the same because of the costs that come with hiring those personnel.

The final hypothesis is that most transport businesses are family owned hence may lack some elements of professionalism. This may bring about non- compliance. Therefore, good corporate governance practices are significant for tax compliance. On the other hand, the study will

hypothesize that bad corporate governance practices have a negative impact on tax compliance. As such, the study will perceive that therefore, it is necessary to take into consideration the principles of good corporate governance as an integral part of tax administration in Kenya.

1.5 Objectives of the Study

The main objective of the study is to determine the effect that corporate governance has on a company's tax compliance levels. Focus will be on companies that are in the transport sector, specifically those under the Medium Taxpayer's Office of KRA.

This will be achieved through examining the corporate governance structures in these companies and the various dynamics that impact on compliance to tax. At the end of the study, we should be able to link corporate governance to tax compliance and thereby give appropriate recommendations.

1.6 Theoretical Framework

There are two main theories that will inform this study. Agency theory will dominantly feature in this study as will be highlighted in this section. Secondly, there will be a discussion on the stakeholders' theory. This analysis is as contextualized below:

1.6.1 Agency Theory

The theory has been in existence since the early 1960's which commenced as a theoretical advancement in the sphere of risk sharing among various individuals, groups Vis a Vis their

attitudes to risks. Essentially, this depicts that individuals or parties in a relation of contracts have divergent visions and goals. The origin of the theory is as a result of works of Berle and Means.[22] The contribution of the Agency theory is also credited to Harold Demsetz, Michael Jensen, and Armen Alchian.[23] The contributors of the Agency theory particularly advanced that the theory is a product of the contract theory. According to Fama and Jensen, they posit that firms and corporations are a web of connections, contractual in nature between the holders of the resources (principals) and the individual (Agents).[24] In this regard, the Principal entrust the agents to carry out functions on their behalf. For this to happen, it is necessary that the principals have to hand over the power fully to make decisions on their behalf.

The foregoing being the case, the relationship between the principal and the agent is not harmonious at all times. There exist inherent limitations in the principal-agent model.[25] In a critical look at this model, Eisenhardt describes this challenge as where "the desire or goal of the principal and agent conflict. And it is difficult or expensive for the principal to verify what the agent is actually doing [or that] the agent has behaved appropriately."[26]

In view of the above, the theory in a way to remedy the shortcoming employs the most efficient contractual terms that minimizes the Agency problem (principal-agent problem) notwithstanding the presumption of self-centeredness of man, risk averseness and limited rationality. The theory also seeks to remedy the fact that organizations are always punctuated with conflicts of goals as

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[22] Dalton, Dan R., Catherine M. Daily, Alan E. Ellstrand, and Jonathan L. Johnson. "Meta-analytic reviews of board composition, leadership structure, and financial performance." *Strategic management journal* 19, no. 3 (1998): 269-290.

[23] Jensen, Michael C., and William H. Meckling. "Theory of the firm: Managerial behavior, agency costs and ownership structure." *Journal of financial economics* 3, no. 4 (1976): 305-360.

[24] Fama, Eugene F., and Michael C. Jensen. "Agency problems and residual claims." *The journal of law and Economics* 26, no. 2 (1983): 327-349.

[25] *Ibid*

[26] *Ibid*

among and between individual members, and, also bearing in mind that information is a commodity like any other that can be sold and equally purchased. This in itself shows the tensions in the theory.[27]

Agency theory seems to suggest that an agent is not just motivated by the pay they receive for services rendered to the company but by dividends or bonuses paid from the profits of the corporation.

This theory is particularly significant in corporate relationships in view of the exercise of powers in a corporation. It determines the flow of not only power, but, also the authority that comes along with it. In the case of the transport industry, it is a representative of the various conglomerates of industries that represents corporations liable to taxation. As corporations, they are liable to taxation as a matter of law. It follows that the theory represents the shareholders as the owner of the corporations whose functions are exercised by the board on their behalf. This means that the Board in its policy measures has to ensure that efficient tax compliance measures are implanted to resonate with the law.

1.6.2 Stakeholder theory

The Stakeholder theory advances on the premise that the import of a corporation pays particular attention to groups (stakeholders) over and above investors.[28] This theory is a culmination of the work of Edward Friedman.[29] In essence, the organizations look at the greater interests in society than the investors' interests in making profit on their behalf.[30] According to Griffiths *et al*, they

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[27] *Ibid*

[28] Gibson, Kevin. "The moral basis of stakeholder theory." *Journal of business ethics* (2000): 245-257.

[29] Freeman, R. Edward. *Strategic management: A stakeholder approach*. Cambridge university press, 2010.

[30] Mulili, Benjamin Mwanzia, and Peter Wong. "Corporate governance practices in developing countries: The case for Kenya." *International journal of business administration* 2, no. 1 (2011): 14.

suggest that corporation's decisions and actions impact on their stakeholders.[31] Therefore, it is important for corporations to factor in stakeholder concerns which will add value to their corporations.

These stakeholders include but are not limited to their employees and also government. In this regard, it is incumbent upon the corporation as a business entity, not on a moral pedestal only but also on a legal obligation to regard the interests of all the stakeholders. This should be particularly considered, bearing in mind that the success of either depends on the other.[32]

According to the Stakeholder theory, the success of the corporation is guaranteed the moment the stakeholders are satisfied and as such, they are motivated to go back to the corporation. In this regard, it is particularly significant if the corporations would consider the interest of the various stakeholders in their decision making.[33] It arguable on this basis, that there should be an increased representation of all the stakeholder groups representing the diverse constituents of stakeholders on corporations' Boards to bolster corporate governance.[34] This also helps in the reduction of the conflicts hence facilitate efficiency in the corporation.

Looked at it in terms of the impact of corporate governance and tax compliance, the transport industry would be pictured as one among many corporations that grapple in ensuring tax compliance as part of the mandate of good corporate governance policy measures.

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[31] Benn, Suzanne, Dexter Dunphy, and Andrew Griffiths. "Enabling change for corporate sustainability: An integrated perspective." *Australasian Journal of Environmental Management* 13, no. 3 (2006): 156-165.

[32] Ulrich, Peter. *Integrative economic ethics: Foundations of a civilized market economy*. Cambridge University Press, 2008.

[33] Manville, Brook, and Josiah Ober. "Beyond empowerment: Building a company of citizens." *Harvard business review* 81, no. 1 (2003): 48.

[34] Rothman, Jay, and Victor J. Friedman. "Identity, conflict, and organizational learning." *Handbook of organizational learning and knowledge* (2001): 582-97.

1.7 Justification of the Study

The need to ensure proper corporate governance mechanisms are put in place is without question of fundamental importance to any corporation. This is not just for the benefit of shareholders but also for the benefit of other stakeholders and the public at large. A good corporate governance structure will determine whether a company will effectively meet its tax obligations or not. Recent happenings in Kenya where companies like CMC Motors, Mumias Sugar Ltd, Uchumi Supermarkets, Imperial Bank, among others have been embroiled in corporate governance scandals and in some cases even collapsed, clearly show that the country at large stands to suffer if there are no proper corporate governance systems in place.

A Corporation that is not being managed well is most likely to experience financial problems which will automatically translate to low payment of taxes and in some instances complete non-compliance to the tax legislations.

1.8 Literature Review

This section seeks to review the available literature on corporate governance. The literature review shall also seek to appraise materials relating to tax compliance within the framework and the impact of corporate governance. Both national and global perspectives will be explicated. It is therefore, imperative to point out that this section seeks to capture critical authorities in this respect. In this regard, the study seeks to interrogate the impact of corporate governance on tax compliance in Kenya, with a focus on the transport industry. The literature review therefore revolves around the broad limb namely: the impact of corporate governance on tax compliance in Kenya a case study of the transport industry.

According to Kiarie Mwaura, [35]in his study premised on corporate governance with a perspective on human rights, he opines that companies may be prone to pursuit of profit at the expense of the rights of its human resource capital. He further opines that such like practices may be achieved through the veil of incorporation where the parent companies take advantage of their subsidiaries as a means to avoid responsibility.[36] This study emphasizes the need for corporations to put into consideration the needs of not only the shareholders but also those of their stakeholders.

Miring'u Alice N., and Muoria, Esther T,[37] conducted an analysis on the effect of corporate governance in view of performance of corporations. The study focused on Kenya. They reached a conclusion that effective Board of Directors and governance structures greatly affect the efficient responses by corporate bodies to external changes and factors.[38] This is an excellent study on the effect of corporate governance on corporations. Although the study was conducted in Kenya, the same did not look specifically on the effect of corporate governance on tax compliance as is the objective of this study.

Mbai C. Odhiambo attributes poor corporate governance systems historically in the country to lack of effective corporate governance structures and practices.[39] He further attributes the poor performance on the quality of directors of Boards charged with the responsibility managing the Corporations.[40] He goes further to state that there is a weak legal framework as far as management

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[35] Mwaura, Kiarie. "Internalization of costs to corporate groups: part-whole relationships, human rights norms and the futility of the corporate veil." *J. Int'l Bus. & L.* 11 (2012): 85.
[36] *Ibid*
[37] Miring'u Alice, N., and T. Muoria Esther. "An analysis of the effect of Corporate Governance on Performance of Commercial State Corporations in Kenya." *International Journal of Business and Public Management* 1, no. 1 (2011).
[38] *Ibid*
[39] Mbai Odhiambo. (2003). Public Service Accountability and Governance in Kenya since Independence. African Journal on Political Science, 8(1), 113-45.
[40] *Ibid*

of corporations is concerned.[41] This reinforces the discussions made in this chapter and later in subsequent chapters about the poor history of corporate governance in Kenya.

It is important to note in light of the foregoing finding that, since the publication of the study a lot has changed especially in terms of laws and the regulatory framework. While the same might be the case, it is still arguable though that the change in the regulatory landscape in Kenya has not reinvented corporate governance. This, however, does not exclude the possibility that they are still alive within the system and structures of corporate governance of corporations. In fact, empirical evidence shows that they are still vibrant, notwithstanding the principles of good corporate governance principles in the Constitution of Kenya, 2010.

On the same face, Atieno Yvonne Awuor [42] in her study about corporate governance in view of parastatals in Kenya, she further observes that a raft of corporate governance issues are related to weak legal framework regulating corporate governance.[43] This state of events informed the recommendations for her proposed review of the regulatory framework of corporate governance in Kenya.[44]

The need for elevated accountability is called for in the study conducted by Oloo Ochieng.[45] He opines that this should be the case solely for the reason that for the case of State corporations, they are held on behalf of the citizenry who are the source of the revenues that fund the corporations.[46]

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[41] *Ibid*

[42] Atieno, Yvonne Awuor. "Corporate Governance Problems facing Kenyan parastatals: A case study of the sugar industry. *Master's Thesis in Law and Business*, Bucerius Law School and Otto Beisheim School of Business. (2009)

[43] *Ibid*

[44] *Ibid*

[45] Oloo Ochieng (2013). Market regulator moves to bolster Corporate Governance in capital markets. Think Business Africa, April 25, 2013, Okundi Benson.(2011). Kenya should adopt good corporate governance tenets." *Business Daily Africa* (2013).

[46] *Ibid*

Other studies have also delved into the existence of corporate governance problems in Kenya regarding other sectors have reached twin conclusions.[47] As for the case of the transport industry, it is no exception as part of the transport system is owned by both the public and private entities. Our focus will be mainly on the private entities on the part of tax compliance to the government.

In a study conducted by Mulili B and Wong P,[48] on corporate governance in Kenya, they make observations for the need to train Board Members on the significance of corporate governance and its application. This entails taking into regard the need to ensure that the board is competent and understands the implications of good corporate governance and its impact on tax compliance.

Mahdi *et al,* in their study[49] on the impact of corporate governance on tax compliance, they opine that corporate governance is mechanism that enhances improvement of reporting quality and reduction of agency costs. They further posit that corporate governance also helps improve tax compliance and augment the right of the stockholders. They investigated the effects of corporate governance on tax divergence. They concluded that corporations which had a higher ownership concentration and high institutional ownership had higher compliance rates than the others. The same finding is made on the corporations with a high leverage. This study is relevant to this research because it addresses a similar problem. However, the focus of that study was in Tehran specifically the financial sector and not the transport sector.

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[47]Kegode Peter. (2005). Economic Governance Reform in the Sugar Sub-Sector. Center for Governance and Development Report, 1-14.

[48] Mulili Benjamin and Wong Peter, 'Corporate Governance Practices In Developing Countries: The Case For Kenya' (2011) 2 *International Journal of Business Administration* ,22

[49] Mahdi Mina & Rezvan, *The Effect Of Corporate Governance On Book-Tax Differences In Tehran Security Exchange* (1st edn, Proceedings of 8th Asia-Pacific Business Research Conference 2015) <http://www.wbiworldconpro.com/uploads/malaysia-conference-2015-february/accounting/1422938731.pdf> accessed 3 December 2016

Charles Kemboi [50] in his study on the correlation of corporate governance and revenue collection, he concludes that good corporate governance has a positive impact on the effect on the revenue collected during the period the study was conducted. In this regard, he recommends therefore, that there is need for proper policies on recruitment of board Members to be put in place to ensure that they come on the board with relevant knowledge and skills in the management of the corporation. He further asserts that if the recommendations are to be put in place, then it is a safety net against political appointments. Kemboi's study focused on the KRA board and on appointments to the board and its impact on revenue collection. It is important because it reinforces the hypothesis that good corporate governance has a positive impact on revenue collection.

According to Musikali, Lois M.,[51] in the study of corporate governance in Kenya and the need for review, she posits that there is increasing evidence that the legal system of a country has an impact on corporate governance of a country. She observes that this comes along with a strong system of governance. With regard to Kenya, she provides that the Kenya has adopted corporate governance code, which is a culmination of codes from the developed States. That notwithstanding, she provides, that the adoption of the Codes overlooked the need to develop a code based on the prevailing market conditions in the country. She also shades light on the various scandals that have punctuated the Commercial environment in Kenya and attributes the same to lack of proper governance structures in Kenya.[52]

[50] Kemboi Charles, 'The Effect Of Corporate Governance On Revenue Collection In Kenya Revenue Authority' (*Erepository.uonbi.ac.ke*, 2013) <http://erepository.uonbi.ac.ke/handle/11295/63366?show=full> accessed 28 November 2016

[51] Musikali Lois , 'The Law Affecting Corporate Governance in Kenya: A Need for Review,' (September 29, 2008). *International Company and Commercial Law Review*, Vol. 19, No. 7, pp. 213-227, 2008.

[52] *Ibid*

This study provides sober reflections on what needs to be done to strengthen corporate governance in the country and therefore is quite relevant to this research.

Boussaidi and Sidhom in their study[53], they opine that the increase of corporate scandals and the subject of tax aggressiveness have been debatable for many researchers. They define tax aggressiveness as a trigger to activities related to management that are employed for tax planning but have a collateral effect of tax avoidance. They provide that the role of corporate governance is to ensure that it monitors the various actors and to take into regard the need to control planning procedures. They posit that tax practices are not a preserve of the developed countries but also the developing countries too. And as such, they attribute the practices to result in the loss of money.

This study offers a great link between corporate governance and tax practices. However, the study does not specially address the problems in the transport sector in as much as it was not conducted in Kenya. There is a mention that tax practices are the same in both developing and developed countries and therefore it will be useful in determining the conclusion in this research.

1.9 Limitations

This paper limits its research to the transport industry only and specifically the transport companies under the Medium Taxpayers Office (MTO) of the Kenya Revenue Authority. Companies that fall under MTO have an annual sales turnover of between 350 Million to about 1 Billion Kenya Shillings. The study will also narrow down to cover only road transport; specifically, the

[53] Boussaidi Ahmed & Sidhom Mounira, *The Impact Of Governance Mechanisms on Tax Aggressiveness: Empirical Evidence From Tunisian Context* (5th edn, Asian Economic and Social Society 2015) <http://www.aessweb.com/pdf-files/1-161-5(1)2015-JABS-1-12.pdf> accessed 3 December 2015

commercial transport companies operating in Nairobi. These commercial transport companies however, does not include the public service vehicles popularly known as *matatus* in Kenya.

The road transport sector is huge, therefore, this grouping will not only narrow it down but also ensure that the research is conducted on companies operating in a similar economic environment.

1.10 Methodology of the study

This study will be based on: primary data collected by way of questionnaires, secondary data and relevant literature regarding the impact of corporate governance on tax compliance in Kenya with a focus on the Transport industry. This will inter alia include leading texts on corporate governance law, the Constitution of Kenya, 2010, the various tax legislations, related statutes and various scholarly legal articles in the subject area. A culmination of these materials will help a great deal in understanding the conceptual underpinnings of corporate governance in Kenya, the impact of corporate governance on tax compliance. A proper analysis of the materials as against the research hypothesis shall help achieve the research objectives.

1.11 Chapter breakdown

This study will contain Four Chapters as outlined below:

1. **Chapter One: Introduction**

   The first Chapter contains the background to the problem, the objective of the study, the hypothesis, the theoretical framework to be applied in this study, the methodology, the literature review as well as the chapter breakdown.

2. **Chapter Two: Assessing the Legal Framework Regulating Tax Compliance and Corporate Governance in the Transport Industry in Kenya**

This Chapter examines the legal framework currently governing taxation specifically those applying to the transport sector. It also analyses the legal framework applicable to corporate governance in Kenya and attempts to link the framework on tax compliance.

3. **Chapter Three: Dynamics in Corporate Governance structures and tax compliance in the transport industry in Kenya**

This Chapter gives a brief background of corporate governance and attempts to look at different dynamics in corporate governance structures and its effects on tax compliance. The various dynamics include the relationship between firm size and tax compliance, the relationship between ownership (family owned versus non-family owned) and tax compliance, the level of education and tax compliance in the transport industry and also the profitability and tax compliance in the transport industry.

This chapter also contains Data analysis, presentation, interpretation and discussion.

4. **Chapter Four: Summary of findings: Conclusions and Recommendations**

This final chapter will give a summary of findings based on the literature reviewed and data analysed. It will also contain the conclusion and appropriate recommendations based on the findings of the study.

2.0 CHAPTER TWO: ASSESSING THE LEGAL FRAMEWORK REGULATING TAX COMPLIANCE AND CORPORATE GOVERNANCE IN THE TRANSPORT INDUSTRY IN KENYA

2.1 Introduction

This chapter seeks to assess the legal framework that regulates tax compliance and corporate governance in the transport industry. In this regard, the chapter seeks to give a legal basis of the discussions in chapters one. This is achieved specifically by analysing the legal perspective that informs the current tax laws and corporate governance in the transport industry. The main legislation that impacts tax compliance in view of transport industry in Kenya is discussed in the first instance. Thereafter, a discussion on the legal framework regulating corporate governance is considered. The latter, is particularly significant, taking into consideration that the usefulness of the corporate governance frameworks are dependent on various facets of factors, including the regulatory framework of a jurisdiction and corporate ownership structures.[54]

As regards taxation framework in Kenya, it is notable that Kenya has a broad taxation system covering various taxes including income taxes, value-added tax (VAT), customs and excise. Similarly, it should be noted that the various taxes are governed by different statutes that provide for among others assessment, charging, collection of the taxes. The responsibility to collect the various taxes falls with the Kenya Revenue Authority as statutorily mandated. In view of the same, corporate governance structures are essential elements in ensuring tax compliance. And as such, the regulatory frameworks in this chapter are considered in light of the transport industry in Kenya.

[54] Gakeri Jacob, (2013). Enhancing Kenya's Securities Markets through Corporate Governance : Challenges and Opportunities. *International Journal of Humanities and Social Science*, *3*(6), 94–117: <http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf> at 3 (9th July 2016).

2.2 Corporate Establishment and Taxes

Tax is an obligation that exists both at an individual and corporate levels. Corporations in Kenya are established under the Companies Act. Regarding ownership in the transport industry in Kenya, it is notable that it owned both locally and foreign. The Income Tax Act[55] is the main legislation that will be considered for taxation purposes in the taxation of the transport industry.

In view of the foregoing, tax laws and regulations apply to both local and foreign owned companies in the transport industry like other sectors. To be able to operate a business in Kenya, a personal identification number (PIN) is required, which is given by KRA upon application.[56] Companies are also required to register for the required tax obligations including Income tax, Pay as you earn (PAYE) for those with employees, excise duty (for those dealing in excisable goods) and VAT.[57]

The establishment of the companies is regulated by the Companies Act, 2015.[58] The Act exists as the main legislative framework that enables the institution and operation of corporate entities in Kenya. Significantly, the Act also requires the companies to file their returns with the registrar.[59]

2.3 Overview of taxation of Transport Industry

Taxation in the transport industry in Kenya applies at different levels taking in regard the forms of business operations. The transport industry consists of companies existing as registered corporate entities, partnerships, individual businesses and unincorporated entities.[60] It follows therefore that

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[55] Chapter 470 of the Laws of Kenya
[56] *Ibid* s.132(6); See also Thirteenth Schedule
[57] VAT Act, 2013 Laws of Kenya <http://www.oxfordbusinessgroup.com/overview/duties-detail-look-tax-regulation-and-recent-changes >
[58] Companies Act (No.17 of 2015), Laws of Kenya
[59] See Companies Act, 2015 ss. 705:Registered foreign companies to lodge certain returns with the Registrar ss. 989: Enforcement of duty of company to make returns to registrar ss. 708 & 992, respectively.
[60] Under the Companies Act, 2015,sections. 3 . Meaning of firm;
"firm " means an entity, whether or not a legal person, that is not a natural person; and includes a body corporate, sole proprietorship, partnership or other unincorporated association;

taxes are payable in view of the form of business operated. The subject of ownership will be considered in Chapter three of this study. Nonetheless, for the sake of this chapter, we analyse entities in this the Medium Taxpayers Office for the sake of tax compliance and corporate governance.

Corporate entities in Kenya are subject to corporation tax or corporate income tax. The regulation of the corporate income tax is governed by the Income Tax Act.[61] Income to be taxed as to be derived from Kenya. [62] Otherwise double taxation provisions come in for companies incorporated outside the country[63] since they are supposed to report their income and claim tax relief from their home countries.[64] In the foregoing regard, it is notable that most of the transport companies in Kenya, they operate not only in Kenya but also within the East Africa. In some instances, there are others wholly foreign owned and incorporated in foreign States. Therefore, for purposes of taxation, they are to be taxed as branches or subsidiaries of the main branches in Kenya.

Corporation tax rate for resident companies in Kenya is thirty percent while for Non-resident companies in Kenya, with a permanent establishment are taxed on the income derived or earned from Kenya at the rate of 37.5 percent. The later (tax on Non-resident) is with restrictions on deductible expenses. As for Non-residents without a permanent establishment in Kenya are taxed under the withholding tax system, in instances where the payments made are qualified for withholding tax.[65]

[61]Chapter 470 of the Laws of Kenya
[62] Ibid, section 3.
[63] Companies Act, 2015 section. 366-375.
[64] Ibid. In Kenya, residency for a legal entity may arise through incorporation, management and control of said entity and the declaration by the Cabinet secretary in charge of the Treasury that the person is a resident.
[65] <http://www.oxfordbusinessgroup.com/overview/duties-detail-look-tax-regulation-and-recent-changes>

As for the case of Partnerships in the transport business in Kenya, they are taxed at a partner's level and not at entity level. Each partner is required to declare and pay tax on the partnership income regardless of whether it has been shared or not. For individual business owners, taxation of income is taxed at the individual level and only at corporate level if the transport business is a registered business under the Companies Act.

2.4 Other Taxes and Penalties

There is also the advance tax, withholding tax, capital gains tax and turnover tax as under the Income Tax Act.66 First, regarding advance tax, the Income Tax Act provides at section 12A for compliance by the resident corporations in respect for commercial vehicles. Commercial vehicle is defined as a road vehicle which is: 'Manufactured for the carriage of goods and so used in connection with a trade or business; or a motor omnibus as defined in the Traffic Act; or used for the carriage of members of the public for hire or reward'.[67] The list includes road vehicles as vans, trucks, Lorries, pick-ups, station wagons, buses, minibuses and coaches. As the case for the transport industry, it is obligatory for the transport company to pay advance tax for every commercial vehicle it uses in business.[68]

There is also the withholding tax under the Act.[69] This tax is levied on specific services rendered. The tax is deducted on payments made to the service providers. Both withholding tax and advance taxes are allowed as tax credits during the filing of tax returns at the end of the year.

[66] Chapter 470 of the Laws of Kenya
[67] < http://www.kra.go.ke/incometax/advanceTaxpaymentoverview131206.html>
[68] *Ibid*, Commercial vehicles are classified in two categories: those that carry loads, and those that carry passengers, and the rates of payment of the advance tax are different
[69] Income Tax Act, Chapter 470 of the Laws of Kenya S.4

As for capital gains tax, it has been reintroduced in Kenya.[70] Capital gains tax is charged at the rate of five percent on net of the transfer value over adjusted cost. The tax is payable not later than the twentieth day of the month following that in which the transfer was made. As of its nature, capital gains tax is a final tax that is not subject to offsetting against other income taxes.

There is also turnover tax. This type of tax regulates the small and the medium sized business. The tax is payable by individuals whose business income is over KSh500, 000 but less than KSh5, 000,000 in year of income. It is regulated under Section 12C of the Income Tax Act. Majority of the transport industry in Kenya falls within this bracket, although these entities will not be included in the scope of this study. Notwithstanding the provision of the Act, it is worth noting that compliance to this tax has proven a challenge especially in the transport industry which some have maintained an informal status.

In summary, failure to pay taxes as required, or to file returns in time as specified attracts sanctions under the law. It is therefore, as part of sound corporate governance systems for corporations in the transport industry to ensure that tax obligations are met in a timely manner to avoid tax penalties.

2.5 Taxation for unincorporated entities and Individuals in the Transport Industry

As highlighted above, the transport industry is composed of various entities including partnerships, unincorporated entities and individual businesses. As of unincorporated entities and individual

[70] Ibid; 8th Schedule Capital gains tax (CGT) has been suspended in Kenya since 1985. With effect from January 1, 2015, however, CGT was reintroduced on the transfer of property situated in Kenya, whether or not the property was acquired before January 1, 2015;See Global Tax Alert | 7 October 2014
Kenya reintroduces capital gains tax < http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--Kenya-reintroduces-capital-gains-tax>;< http://www.oxfordbusinessgroup.com/overview/duties-detail-look-tax-regulation-and-recent-changes>

taxpayers, they are governed by the Income Tax Act. Under the Act, it perceives the incorporated entities and individuals in terms of residents and non-residents. The Act requires that an employer to make tax deductions from the income of its employees on a monthly basis.[71] The deducted tax should thereafter be remitted to Kenya Revenue authority by the ninth day of the following month. It follows therefore that as an employer, whether a corporation or an individual operating in the transport industry, they have this responsibility too in ensuring compliance in terms of tax remittances.

The general penalty for an offence under the Act is a fine as provided under section 107 of the Income tax Act. Additional offences and penalties for various offences relating to tax are provided for under the Tax Procedures Act, 2015.[72]

2.6 The Code of Corporate Governance Practices[73]

In a bid to promote good corporate governance practice in Kenya, the Capital Markets Authority published the Code of Corporate Governance Practices for Issuers of Securities to the public, 2015, for application by both listed and unlisted public companies in Kenya.[74] Noteworthy is that the

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[71] Ibid; Section 2 An employer is defined under the Income Tax Act to include any resident person responsible for the payment of or on account of, emoluments to an employee, and an agent, manager or other representative so responsible in Kenya on behalf of a non-resident employer.

72 Tax Procedure Act, (No. 29 of 2015) under s. 2 (1) provides that;
'' The object and purpose of this Act is to provide uniform procedures for-
(a) consistency and efficiency in the administration of tax laws;
(b) facilitation of tax compliance by taxpayers; and
(c) effective and efficient collection of tax.''

[73] See Gazette Notice No. 1420 of 2015; In exercise of the powers conferred by sections 11 (3) (v) of the Capital Markets Act Chapter 485A Laws of Kenya,

[74] In exercise of the powers conferred by sections 11 (3) (v) of the Capital Markets Act Chapter 485A Laws of Kenya, See also < http://www.cma.or.ke/index.php?view=download&alias=486-code-of-corporate-governance-practices-for-issuers-of-securities-to-the-public-2015-2&category_slug=guidelines&option=com_docman&Itemid=524> :

Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 repealed the Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, 2002.[75] Significantly, the application of the Code transcends both the listed and unlisted public companies in Kenya. The analysis of this Code though meant for public listed companies, it also benchmark for private companies. The analysis of this regulation is shared in light of corporate governance in the transport industry in Kenya.

The Code provides certain recommendations on structures and processes, which companies should adopt in making good corporate governance an integral part of their business dealings and culture.'[76] It also calls for companies to apply standards that are above the minimum legislation prescribed requirements.

In view of the above, the intention of the Code therefore is to provide the minimum standards required from directors or managers and ownership of a listed company or an unlisted company that issues securities to the public, so as to promote high standards of good conduct. This will in turn ensure that duties and responsibilities are carried out in a clear and effective manner.[77]

Against the foregoing backdrop, it is imperative for the transport companies to adopt the Regulations as it forms part of sound corporate governance and promote compliance.

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[75] See < https://www.nse.co.ke/regulatory-framework/capital-markets-authority.html?download=475%3Acorporate-governance-guidelines-2002>

[76] < http://www.cma.or.ke/index.php?view=download&alias=486-code-of-corporate-governance-practices-for-issuers-of-securities-to-the-public-2015-2&category_slug=guidelines&option=com_docman&Itemid=524>

[77] *Ibid*

2.6.1 Board Operations and Control

The Code provides that one of the significant institutions in corporate governance is the Board of Directors. It is therefore necessary that the board is qualified and it is competent in terms of members' qualifications. This is necessary in ensuring the independence of the Board and that it is able to offer strategic leadership to the Company.[78] The Code also provides that there is need for proper understanding of roles and responsibilities of the Board not only by members of the Board, but similarly by external stakeholders and company executives. This is necessary to ensure that the Board can be held accountable by the various stakeholders.

Regarding the appointment of the Board, the Code provides that the corporation to ensure that there is a formal and a transparent system in place in the appointment of members of the Board and all other individuals with interest in the position should as a requirement disclose any areas of conflict of interest that may come in the way of directorship.[79] The Code also provides the Board shall be structured to ensure effectiveness and add value to the Company.[80]

For the purposes of ensuring compliance, the Code provides that there shall be an audit Committee. The Audit Committee shall be comprised of three independent and non-executive directors. There is also the governance audit which the Code provides that there should be an audit at least annually.[81]On this basis, there is no doubt that even for the transport companies that have boards

[78] *Ibid* , Code Chapter Two Overview
[79] *Ibid* , Code Chapter Two 2.1
[80]*Ibid* 2.2.1 Recommendation: *Skills and experience* The Board and its committees shall have the appropriate balance of skills, experience, independence and knowledge of the company and its business, to enable them discharges their respective duties and responsibilities effectively.
[81] *Ibid* , Code, Chapter Two 2.11.1

that are qualified in terms of competency, then, they are likely to be tax compliant, as they are in a position to understand the benefits of compliance.

2.6.2 Accountability, Risk Management and Internal Control

Under this limb, the Code provides that the Board has the responsibility of ensuring that systems which are in place are adequate and the processes of accountability, management of risk and internal control are set to achieve its objectives. In this light, the Code provides that Board shall ensure adequate structures to facilitate the creation of true and fair financial statements.

True and fair financial statements are important in ensuring tax compliance by companies. It is also recommended that entities put in place effective risk management systems. This will entail reviewing the internal control systems to determine the existing risks and thereby put proper safeguard measures in place.

It is therefore necessary for Boards of transport companies to appreciate the place of risk in complying with tax laws.

2.6.3 Financial and business reporting

The Code requires that there be a structure to independently safeguard and verify the integrity of the financial reporting process.[82] That it is the responsibility of the Board to ensure there are mechanisms of authorization and review put in place to guarantee the truthful and factual presentation of the corporation's financial position. This structure places emphasize on the role of the Audit Committee of the Board and also on the role of the Company's external auditors.'[83]

[82] *Ibid* , Code Chapter Six 6.1
[83] *Ibid* , Code Chapter Six 6.1.1

Over and above the reporting, it also places on the Audit committee the responsibility to ensure that the financial statements are reliable and also comply with the reporting standards.[84]

The Code also requires the adoption of an integrated reporting which results in effective disclosure, including that stakeholders concerns have been taken into account in the running of the company. And as such, regarding the interest of the various stakeholders leads to better control and management of the company.[85]

The Code also recommends that there shall be internal control systems.[86] The Board has the responsibility in ensuring that these systems are established and on a regular basis, review the integrity and the adequacy of the company's internal control systems and management including the management of information systems and compliance with laws applicable, rules, regulations and guidelines.[87]The import of internal controls, according to the guidelines is essential for risk management. It is therefore sound that the systems are tested to ensure that the systems are robust and viable. It is notable that tax compliance mechanisms for companies' forms part of the internal control mechanisms. This includes the transport companies.

2.6.3 Transparency and Disclosure

The Code provides that transparency and disclosure are a necessary function for market based monitoring of corporations and is significant to shareholders ability to exercise their rights. Disclosure according to the Code is a strong tool that places influence on companies and ensures

[84] *Ibid*
[85] *Ibid*
[86] *Ibid* , Code Chapter Six 6.3
[87] *Ibid*

confidence in the markets. It also allows stakeholders to understand the company, in terms of their values and environmental standards.

The Board should therefore ensure that there is a balanced disclosure of all material information of the company in a timely manner. Inter alia, the Code requires that the disclosure contains information showing that a legal and compliance audit was carried out, that there is compliance with the laws, standards and regulations and should also show any material departures from required compliance and measures put in place to address the same.

In a nutshell, the above forms the legal framework governing taxation as well as corporate governance in the transport industry in Kenya. This discussion is relevant to the study because it highlights the current laws, and regulations that entities are required to comply with. It also forms the basis for the discussions in subsequent chapters. Therefore, in conclusion , it is important to understand what compliance to the relevant tax laws entail before looking at whether or not they are compliant. It is also critical to understand why entities in Kenya do not have similar corporate governance structures. As we have noted above, the corporate governance code is not mandatory for companies that are not listed. It only acts as a benchmarking tool for unlisted companies.

3.0 CHAPTER THREE: DYNAMICS IN CORPORATE GOVERNANCE STRUCTURES AND TAX COMPLIANCE IN TRANSPORT INDUSTRY IN KENYA

3.1 An introduction

It is arguably true that the history of corporate governance is poorly recorded in the case for Kenya. What exists in form of material evidence shows lack of consistency on the various respective stakeholders' responsibility to provide cogent sources of information about historical background of corporate governance in Kenya.

The foregoing notwithstanding, historical perspectives favour that corporate governance as emerged in the developed jurisdictions, was meant to address disparity between the management and the investors.[88] As such, corporate governance was necessary to improve on the challenge of agency costs. The interest of the principals and their agents was thus thought over as aligned in view of corporate governance.

Emergence of corporate governance Codes was recorded in countries with dispersed share ownership in corporations.[89] The codes were therefore meant to ensure that the Board of Directors was effective, professional and accountable in carrying out of their duties. The usefulness of the Codes is nonetheless dependent on various facets of factors, including the regulatory framework of a jurisdiction and diverse cultures and corporate ownership structures.

As for the case of developing jurisdictions, evidence shows that there is concentration of share ownership and the challenge being the expropriation of minority shareholders and also deriving benefits.[90]

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[88]Gakeri Jacob , Enhancing Kenya's Securities Markets through Corporate Governance : Challenges and Opportunities. *International Journal of Humanities and Social Science*, *3*(6), (2013) 94–117: <http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf> at 3 (29 Jan 2016).

[89] *Ibid* at 3

[90] *Ibid* at 3

3.2 The Case for Kenya

Evidence from the 1990s shows that before liberalization of Kenya's economy, accountability particularly in the public sector was at its worst.[91] Some of the challenges that fractured the culture of accountability in Kenya included corruption and nepotism. The private sector was not different either. The absence of a corporate governance framework compounded the already dire situation. Government officials owned shares in the few public companies while the government itself had been silent on enforcing securities laws. Furthermore, most of the Boards consisted of the political cronies and family members at the expense of professional Board Members.

In view of above, the situation was worsened by the fact that there was no strong institutionalized securities exchange institution. What existed was the Nairobi Securities Exchange which was family owned business. And as such, the impetus of the Body was profit oriented at the expense of regulation. The stock brokers exploited this avenue to their advantage. Evidence shows that regulatory sanctions were rarely issued in view of the listing procedures and non-compliance as against the companies.[92]

The paradigms in governance were arguably changed with the privatization of the government owned enterprises. This introduced novel dynamics in the market place. At this point, companies' entrant in the market floated securities and a positive response was felt by a positive subscription from the public. [93] The new companies in the market were then listed on the Nairobi Securities Exchange. In 1990, there was the establishment of the Capital Markets Authority (CMA).

[91] *Ibid* at 4
[92] *Ibid* at 4
[93] *Ibid* at 4

The development of corporate governance in Kenya was gratefully influenced in 1998 and 1999. During this period, Consultative Corporate Sector seminars were held leading to a resolution for adoption and establishment for Private Sector Initiative for Corporate Governance in Kenya.[94] This was necessary specifically for the formulation and development of a Code of best practices for corporate governance in Kenya. Second, it was necessary for the exploration of means and ways necessary for the establishment of the top national body to promote good governance practices in Kenya. Third, the body was for purposes of coordination of developments regarding corporate governance in Kenya alongside related issues.[95]

In 2002, there was the adoption of Guidelines on Principles of Corporate Governance for Public Listed Companies.[96] The Guidelines as adopted was a replica of the UK Codes of Corporate Governance. It is notable also that Kenya also implemented the "explain or comply" approach through the adoption of the Non Statutory Guidelines in the enforcement system. Evidence also points to the fact that there was no effort to domesticate the Guidelines and as such were implanted in their original state as adopted. No effort was made to tailor the Code as to the local experience and institutions.[97]

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[94] Private Sector Initiative for Corporate Governance, Principles for Corporate Governance in Kenya and a Sample Code of Best Practice for Corporate Governance. In Private Sector Corporate Governance Trust (Ed.), 10) (1999). . Nairobi: <http://www.ecgi.org/codes/documents/principles_2.pdf> at 10; See also <http://www.ccg.or.ke/our-history> (for brief history of development of Centre for Corporate Governance) in Kenya (29 Jan 2016).

[95] *Ibid*

[96] *Ibid* at 4; Young, Angus. (2005). CORPORATE GOVERNANCE AND COMPLIANCE PREVENTIVE MEASURE OR JUSTANOTHER FAD ? *Faculty of Law & School of Management, University of Technology, Sydney*, (Conference paper presented at: Delivering crime prevention : making the evidence work), 1–23: <http://www.aic.gov.au/media_library/conferences/2005-cp/young.pdf> (29 Jan 2016).

[97] *Ibid* at 4; See also Lilian Miles , (2007) " The Cultural Aspects of Corporate Governance Reform in South Korea ",. (2007), (51), 1–14: <https://www.researchgate.net/profile/Lilian_Miles/publication/236881020_Lilian_Miles_2007_The_Cultural_Aspects_of_Corporate_Governance_Reform_in_South_Korea_Journal_of_Business_Law_2007_Issue_51_8_851-867/links/00b7d5256a26818f3e000000.pdf?inViewer=0&pdfJsDownload=0&origin=publication_detail>

A culture of corporate accountability and responsiveness to investors' interests is engendered through corporate governance Guidelines that encourage a positive engagement. As such, the Guidelines provide a framework for enhancing corporate governance mechanisms. [98] The Guidelines also provide a mechanism of distribution of power of the Board and demarcate distinctively the boundaries between the responsibilities of the chairman and those of the CEO.[99] By analogy, it is therefore deducible that the introduction of the Guidelines in Kenya was an affirmative step towards entrenching the good corporate governance structures.

While a full exposition of the Guidelines will be considered later in this chapter, a highlight of the critical areas of the Guidelines that helped shape the corporate landscape in Kenya will be provided at this point. First, the Guidelines introduced the office of independent non-executive directors. The position of the independent non-executive directors was created for the purposes of checking the excesses of the executive directors and also in safeguarding the minority shareholders' interests.[100]

Company directorships were a preserve of the affluent in society.[101]The development of the corporate governance in Kenya was perceived less of a professional cadre of responsibility as to that of an honourable one. One was therefore appointed to the Board not because of the professional experience but as a form of bestowing honour upon such individuals.[102] While the

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[98] Gakeri Jacob, (2013). Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities. *International Journal of Humanities and Social Science*, *3*(6), 94–117:< <http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf> at 5(29 Jan 2016).

[99] *Ibid* at 5

[100] *Ibid* at 5; See also Daniele Marchesani (2005). The Concept of Autonomy and the Independent Director of Public Corporations Director of Public Corporations. *Berkeley Business Law Journal*, *2*(2): <http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1031&context=bblj >; Clarke Donald, (2007). Three Concepts of the Independent Director. *Delaware Journal of Corporate Law*, *32*(1), 73–111: <http://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1045&context=faculty_publications> (29 Jan 2016).

[101] Gakeri Jacob, (2013). Enhancing Kenya' s Securities Markets through Corporate Governance : Challenges and Opportunities. *International Journal of Humanities and Social Science*, *3*(6), 94–117 at 6: <http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf> (29 Jan 2016).

[102] *Ibid* at 6

institutionalization of the office of the independent Director is apparent, its effectiveness in engendering good corporate governance culture in Kenya is still debatable. The level of independence by such office bearers is not particularly demarcated. As such, there has been the argument that the office of the independent Directors exist under various manifestations.[103]It is therefore apparent that maintaining a level of independence may be abstract rather concrete practical example in the functioning of the office of the Non independent Director.[104]

3.3 Dynamics in corporate governance structures and Tax compliance in Transport industry in Kenya

The subsequent sections seek to lay a background of the various corporate governance structures and dynamics in management in transport industry in Kenya. The various issues will be regarded including: *the relationship between firm size and tax compliance, the relationship between ownership (family owned versus non-family owned) and tax compliance, the level of education and tax compliance in the transport industry and finally the profitability and tax compliance in the transport industry.* It is notable from this onset that while some of the transport companies have formal governance structures in place, some remain to operate informally. Either way, this section seeks to bring to the fore the impact it has on tax compliance.

[103] Clarke Donald, (2007). Three Concepts of the Independent Director. *Delaware Journal of Corporate Law*, *32*(1), 73–111: < http://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1045&context=faculty_publications> at 2 (29 Jan 2016).

[104] Weinstein M. (2008). The Independent Director Requirement and Its Effects on the Foreign Investment Climate in China: Progress or regress? *B U S I N E S S L A W B R I E F | S P R I N G 2 0 0 8*, 36–37: < http://www.wcl.american.edu/blr/04/documents/Weinstein.pdf> ; Compare Introduction, I. (2000). CURRENT TRENDS IN CORPORATE GOVERNANCE : GOING FROM LONDON TO MILAN VIA TORONTO. *DUKE JOURNAL OF COMPARATIVE & INTERNATIONAL LAW*, *2*(1997), 17–19: < http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1225&context=djcil> (29 Jan 2016).

3.3.1 The relationship between firm size and tax compliance

There are various studies which have been conducted on tax compliance in Kenya.[105] According to Chepkurui, et *al*, there are various factors that affect tax compliance of many individuals and firms. In the same respect, the same factors also influence tax non –compliance. For instance in the transport business in Kenya, they exist both large and small companies. Depending on the size of the firm, studies have shown that small firms are largely non-compliant. This is attributed to factors such as such firms have small profits and fail to keep proper financial records.[106]

"The taxpayers' attitude on compliance may be influenced by many factors, which eventually influence taxpayer's behaviour. Those factors which influence tax compliance and/or non-compliance behaviour are differing from one country to another and also from one individual to another. They include: taxpayers perceptions of the tax system and Revenue Authority; peer attitude / subjective norms; taxpayers' understanding of the tax system / tax laws; motivation such as rewards and punishment such as penalties; cost of compliance; enforcement efforts such as audit; probability of detection; difference across - culture; perceived behavioural control; ethics / morality of the taxpayer and tax collector; equity of the tax systems; demographic factors such as sex, age, education and size of income and use of informants."[107]

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[105] Chepkurui Chebusit, *et al* , 'Factors Affecting Tax Compliance Among Small And Medium Enterprises In Kitale Town Trans-Nzoia County,'ISSN 2349-7807 *International Journal of Recent Research in Commerce Economics and Management* (IJRRCEM) Vol. 1, Issue 3, pp: (60-75), Month: October - December 2014, Available at: www.paperpublications.org Page | 60 Paper Publications KENYA

[106] *Ibid*

[107] Nicoleta Bărbuţă Mişu, *A Review of Factors For Tax Compliance* (1st edn, Annals of "Dunarea de Jo s" University of Galati Fascicle I Economics and Applied Informatics 2011);

Studies have shown that there exist great differences between larger companies and small firms in terms of tax compliance.[108] It has also been shown that larger firms incur higher costs generally for compliance than the small and the medium sized firms. For the small firms, the costs have been shown to be regressive, in the sense that, small firm and medium sized firms have greater costs of compliance if compared with their sales proportion.

It has also been shown that for the large firms, they spend greater proportions of the sum compliance expenditures mainly on planning of tax, than it is the case for small firms.[109] According to above study, the cost of compliance for corporate tax amounts to approximately four percent of the generated revenue.[110] It also noted that the costs of compliance of firms decrease with the increase of the size of the firm in relation to proportion of turnover. The study concluded that the costs of compliance are regressive with regards to measures of the size of the firm.

According to Aaron, H. and Slemrod J, they are of the opinion that on the measuring of tax evasion, the claim which is standard, is that smaller businesses are either non-compliant or less compliant on taxes and taxation laws. In the same regard, it has a systematic downward spiral effect bias in the payment of taxes as compared to the larger firms.[111] As well, this can be contrasted to the transport industry in Kenya. Empirical studies have shown that for big transport firms, they have more structured governance systems which positively impact on their tax compliance.

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[108] Venkatesh Varsha and Slemrod Joel, *The Income Tax Compliance Cost of Large And Mid-Size Businesses* (1st edn, Submitted by the Office of Tax Policy Research, University of Michigan Business School 2002) Available at <http://www.bus.umich.edu/otpr/WP2004-4.pdf>

[109] *Ibid*

[110] *Ibid*

[111] Aaron, Henry and Joel Slemrod, eds. *The Crisis in Tax Administration, Brookings Institution press, 2004*

Other studies have shown that by the fact that large corporations and large businesses are subjected to audits at a higher rate than the small ones, they are more compliant.[112] Research suggests that the finding is based on myriad of factors and not only limited to the level of tax evasion. In fact, the research propagates that the same is linked to output levels, as with many businesses and also when there is lack of a direct link between the owner's or firms income, audit probability, risk preference, and evasion decisions. As such, the study holds true particularly for businesses where tax evasion decisions are not made by the owners.[113]

It has been shown that the decisions about tax matters are made at an individual level for the small firms. It is notable that this is mainly characterized when the chain of decision making in a firm is determined by the firm owner for the small firms, closely-held businesses. The results are not applicable to other large firms as managers are to exercise these powers.[114] In the same regard, Crocker and Slemrod focusing on large corporations, they proposed a model of tax evasion in the context of the relationship contractual in nature between the shareholders of a firm and the financial officer who makes a determination on taxes and deductions at corporate level.[115]Through their model, they imply that tax evasion is greatly reduced at corporate level if the charges are directly imposed at the chief financial officer or particular managers holding such position in the firm.

According to Lindsay, the size of the firm and tax compliance is directly related.[116] It is further observed that tax-noncompliance exist in many states, but other geographical locations are rampant

[112] Lindsay Tedds, *Keeping It Off The Books: An Empirical Investigation Into The Characteristics Of Firms That Engage In Tax Non-Compliance* (1st edn, Department of Economics McMaster University 2016) at 9.
[113] *Ibid.*
[114] *Ibid*
[115] *Ibid*
[116] *Ibid*

than others. Through the said study, it is observed that corporations who engage in tax non-compliance appear to be geographically bundled. In this case, the case for Africa and South America would be a case study. Many Countries in these continents have been reported to house non-compliant corporations. That it is also true that non-compliant corporations are likely managed by executives who have evaded personal taxes.

Another factor that is attributed to the firm size and the level of tax non-compliance is the level of corruption. It is argued, that among other effects, if the level of corruption of a country is high, this in turn increases the cost of doing business, reduces the confidence of the firm in the government and reduces the morality which ends up having a negative relationship with tax compliance of the firm.[117] It is arguable thus, that if a firm is not convinced of the tax laws, the courts and the tax system of a State then it negatively impacts on their compliance levels.

3.3.2 Relationship between ownership (family owned versus non-family owned) and tax compliance in the transport Industry

Family owned businesses exist as the dominant forms of business around the world. This is no different in the transport industry in Kenya. Family owned businesses may come in the form of small family businesses or in other cases they are large businesses with wide interests. They take the form of sole traders, private companies and partnerships. There are also public companies in the transport, though the small families owned transport are numerous; there are also a few established large scale family owned transport companies. It is notable that for the family owned business, they stand to benefit when they have in place effective governance structures. In this

[117] *Ibid*

case, the governance structures of the family owned businesses gain if they are willing to take into account the views of the outsiders.

The management of small companies owned by family members is generally managed by the members of the family themselves. Family ownership of firms reduces the agency problems. In essence, the challenges of split up, control and ownership are merged and thus reduce the problem of opportunistic behaviour and information asymmetry. It also argued that family owned business have a higher level of trust and hence less monitoring of the management activities.

There is also another advantage for the family owned firms with regards to their ability to be driven with market short term demands. Indeed, they still have to make profits, nevertheless the advantage is that family owned business can do so with more flexibility as and when they want to. In the alternative, this form of flexibility also creates avenues for tax non-compliance. Empirical studies show that tax non-compliance is high for the transport firms owned at family level.

Corporate governance challenges, including tax compliance measures exist also under family owned transport firms. It is also notable that even for small family owned businesses; there may be tensions and divisions. These tensions may be based on either division within the family as members may be of different views of progressing that affect the day to day operations (including tax compliance and procedures) of the company and the long term strategy. The issue of who should hold power is also contentious especially where there in poor communication channels in the family. According to Cadbury (2000) 'establishing a board of directors in a family firm is a means of progressing from an organization based on family relationships to one that is based primarily on business relationships.' The import of establishing formal governance in family owned business include: clear channels of for making decisions and clear lines of responsibility,

the board can tackle many sensitive areas than a family would, for instance matters of succession and finally, that depending on the size of the firm, external shareholders would have interests for instance in the appointment of non-executive directors.[118]

3.3.3 Relationship Between profitability and tax compliance in transport industry in Kenya

Firm performance influences tax compliance of a company.[119] In the same regard, studies show that tax compliance is positively related with public disclosures of a firm and negatively associated with marginal rate tax rate. It is also observed that the rates of audit performance of a firm are positively associated with tax compliance of a firm. Studies front that greater audit coverage act as an effective deterrent to corporate non-compliance.[120]

According to a study conducted on relationship between corporate tax and profitability,[121] it was noted that revenue derived from corporate income tax is sometimes very low possibly because of the reluctance of tax payers to pay tax.[122] This includes managers and directors of firms, as and when taxes are due, probably because of the likely adverse impact that tax payment has on profitability.'[123] The study further noted that an increase in profitability inclines to have an increasing effect on corporate tax level of a firm.[124]

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[118] Mallin, Christine, *Corporate Governance*, Oxford University Press (4th ed)(2013) at 85-89

[119] Noor *et al*, *Determinants Of Tax Compliance Behaviour Of Corporate Taxpayers In Malaysia* (1st edn, eJournal of Tax Research (2014) Vol. 12, No. 2, pp 383 – 409 2014).
[120] *Ibid*
[121] Abdul Azeez & Adelabu Isiaka, *Relationship Between Corporate Tax And Profitability A Case Study Of Oando Plc* (1st edn, International Research Journal of Education and Innovation (IRJEI) Vol 1.2005).
[122] *Ibid*
[123] *Ibid*
[124] *Ibid*

In another study conducted on the impact of high corporate tax on profitability of a firm, the it showed that such taxes are likely to hamper 'invention and enterprise and it cuts down revenues thus hindering of modernization of a plant'[125] In the same regard, Hicks in Dewett, Navalur & Janmejoy was of the position that:

> '*The effect of an additional tax on profits on a curve of expected returns is to shift the curve bodily to the left, but without altering its shape or chance of loss. The chance of very high gains which formally balanced the big chance of loss in the risky investment curve is thus cut-off and the scales are consequently tipped against it; while the safe investment, being relatively unaffected, will become the more attractive. The discrimination of high profits tax against 'venture capital' is serious for any country that means to keep abreast of modern development; it is perhaps especially serious in established industrial equipment and where, consequently, new enterprise needs to be especially on the alert. This tax has also important cyclical relevance; in depression, curves of expected returns flatten out; many safe investments pass into the risky class.*'[126]

Worth noting is the way tax authorities treat the various segments of both the informal and the formal economy of the business tax. Either way, the treatment and the perception has an impact on the attitudes, and the cultures of the entrepreneurs, in the various segments of the economy. Empirical studies show that there is little effort in supervision of the small business as the case for the large tax payers in the economy. This has greatly influenced the way the business have been approaching tax compliance concerns in correlation with their profits. A lesser scrutiny by the tax authorities increases no-compliance manifold. This is true for the transport industry in Kenya.

[125] Ezugwu &. Akubo, *Analysis Of The Effect Of High Corporate Tax Rate On The Profitability Of Corporate Organisations In Nigeria – A Study Of Some Selected Corporate Organisations* (5th edn, Mediterranean Journal of Social Sciences MCSER Publishing, 2014).
[126] *Ibid*

It has also been noted that other factors that affect the tax compliance at the corporate level include the accountability of the state officials, corruption and the legitimacy of the state. Tax collection and effort not only depend on income base but also on the institutional and political bases and the extent to which the taxpayers trust their governments.[127]

The link between firm profit, tax compliance and governance is not proximately apparent. But it is arguable that, the latter two are dependent. Good corporate governance structures manifestly changes the way the management views the obligation for tax compliance. This also weighs on the risks and the benefits of being tax compliant at corporate level. In essence, a firm makes profits, but also realizes the obligation to pay taxes.

It is suggested, that the level of compliance with taxation requirements is affected by factors including: perceptions of the government's legitimacy and the fairness of the tax system, as well as taxpayers' expectation that their tax moneys will be spent on valued public services. Therefore, how the tax authority treats different segments of the formal and informal economy shapes the business tax culture.[128]

Contrasted with the transport industry, high levels of non-compliance may be informed on the basis of factors, for instance corruption in the transport industry. This makes the management of the various transport firms perceive it (corruption) as factors that 'eat' into their profits, hence justifying their non-compliance on taxes. The risk of being detected on audit, by Tax authorities notwithstanding their non-compliance on tax.

[127] *Ibid*
[128] *Ibid*

3.3.4 Level of Education and Tax compliance

The level of education has a direct influence on the level of tax compliance. Educated taxpayers and managers (especially with the knowledge on taxes and its laws) are well placed in understanding the tax responsibility and sanctions. Research shows that tax compliance is also improved with the improvement of tax knowledge.[129] Knowledge of taxation is one of the factors that influence compliance relating to the ability of the taxpayers and the managers to understand taxation laws and also the willingness to comply.[130]

There exist two primary factors that have a major effect on taxpayer compliance namely: moral commitment and financial self-interest. This is not different for the managers of the firms. Regarding Financial self-interest, it assumes that individuals exploit their expected utility and that of the firm by reporting on income that weighs the benefits of successful evasion alongside the consequences of detection. Thus, the import of detection and sanctions are the significant means to increase compliance both for managers and the firms.

Research has found that decisions to comply with tax laws were mainly driven by age and education of the managers and the individual taxpayers, which in turn, certainly influences moral development and attitude. This responsibility is also observable mainly for the firms mainly owned at family level.

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[129] *The influence of tax education on tax compliance attitude,*< https://www.lap-publishing.com/catalog/details//store/gb/book/978-3-659-20785-3/the-influence-of-tax-education-on-tax-compliance-attitude >

[130] *Ibid*

In study conducted for college students, the results confirmed the existence of a relationship between education and tax compliance.[131] In the study, it is recommended that 'If the employees had adequate tax knowledge, then there would be minimal unintentional non-compliance. When there is tax evasion among those who have adequate tax knowledge, then, it is as a result of deliberate non-compliance that would then attract higher tax penalties.'[132]

According to Misra[133] the:

> *Primary existence of taxpayer education is to encourage voluntary compliance amongst taxpayers, but the theory needs to be developed further to establish whether taxpayer education in isolation can impact on compliance. Before this phenomenon can be explored the components of voluntary compliance needs to be examined. A taxpayer will be considered to be voluntarily compliant if the individual registers for tax when he becomes liable to pay tax, files all returns timeously, discloses financial information accurately, pays taxes when they are due and reports tax evaders*.[134]

Empirical studies show that many individuals who are employed in the transport industry are semi-illiterate. It therefore follows that the workmanship has little knowledge in taxation or simply do not appreciate the system of taxation laws at all. The level of education especially in the family owned transport owned businesses in Kenya is low and negatively impacts on the level of tax compliance.

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[131] Kasipillai, Jeyapalan, Aripin, *et al,* "The Influence of Education on Tax Avoidance and Tax Evasion" [2003] eJlTaxR 7; (2003) 1(2) eJournal of Tax Research 134 <http://www.austlii.edu.au/au/journals/eJTR/2003/7.html >
[132] *Ibid*
[133] Roshelle Misra, *The Impact Of Taxpayer Education On Tax Compliance In South Africa* (1st edn, University of Kwazulu-Natal 2004).
[134] *Ibid*

3.4 DATA ANALYSIS, PRESENTATION, INTERPRETATION AND DISCUSSION

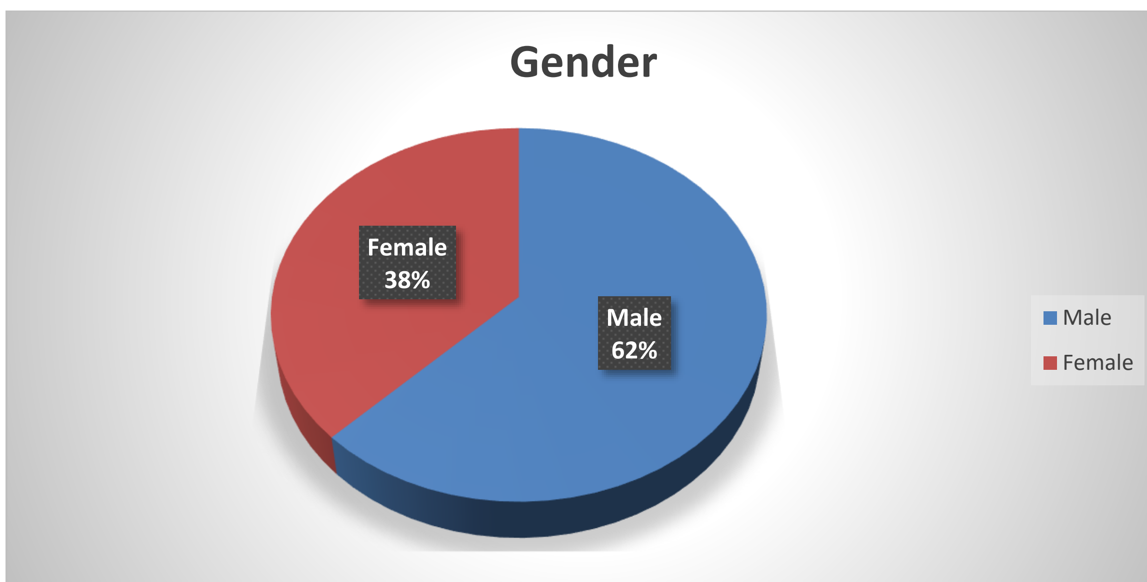
This section seeks to establish first-hand information from a number of respondents who were asked to fill the questionnaire on the study topic. The study topic sought to establish the impact of corporate governance on tax compliance in Kenya: a case study of the transport industry. It was therefore necessary to conduct this study by way of quantitative analysis of data to ensure that the research objectives are effectively met. The essence of the questionnaire was also to guarantee that first-hand information from a pool of respondents is represented for the findings which would not be the case if the same was conducted qualitatively. This is as presented below:

3.5 Demographic Analysis.

This part of the questionnaire intended to establish the respondent's personal information. Information sought included the Gender, Age, Education level, professional courses attended and the frequency in a year. The section was essential in establishing a linkage between the personnel and their competency in realization of the essence of basic matters of governance and how the same has an impact on tax as the study sought to establish.

3.5.1 Respondents Gender.

The respondents were asked to indicate their gender. The results are shown in figure 1 below.

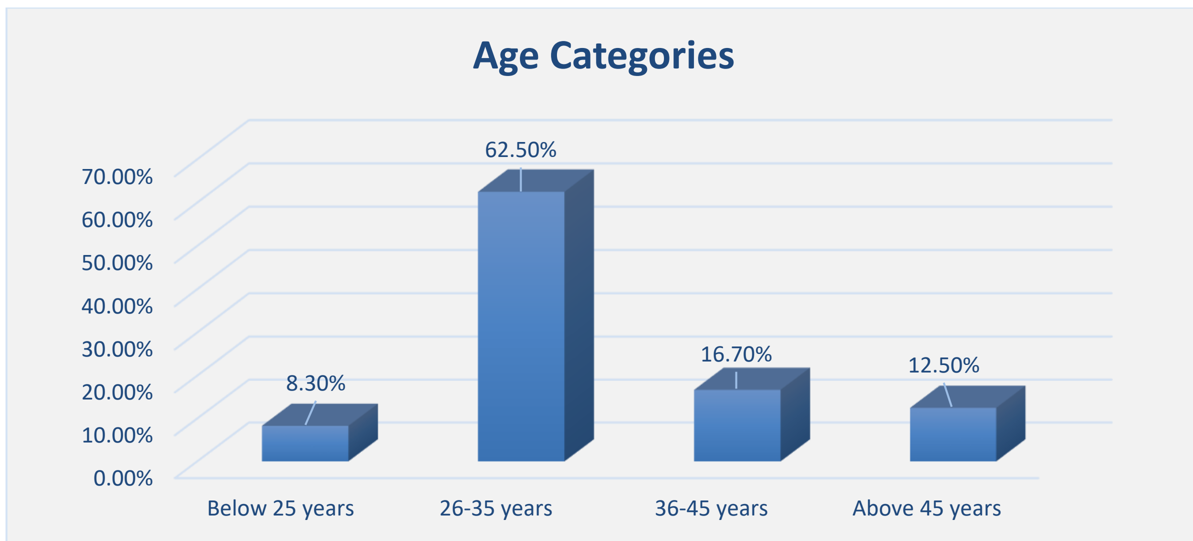


The results show that 62% of the respondents were male while 38% were female. This shows that the opinions of both genders were taken into consideration during this study and that there was no gender biasness.

3.5.2 Respondents Age category

The respondents were asked to indicate their ages. The results are indicated in the table below.

Figure 2: Age category of Respondents

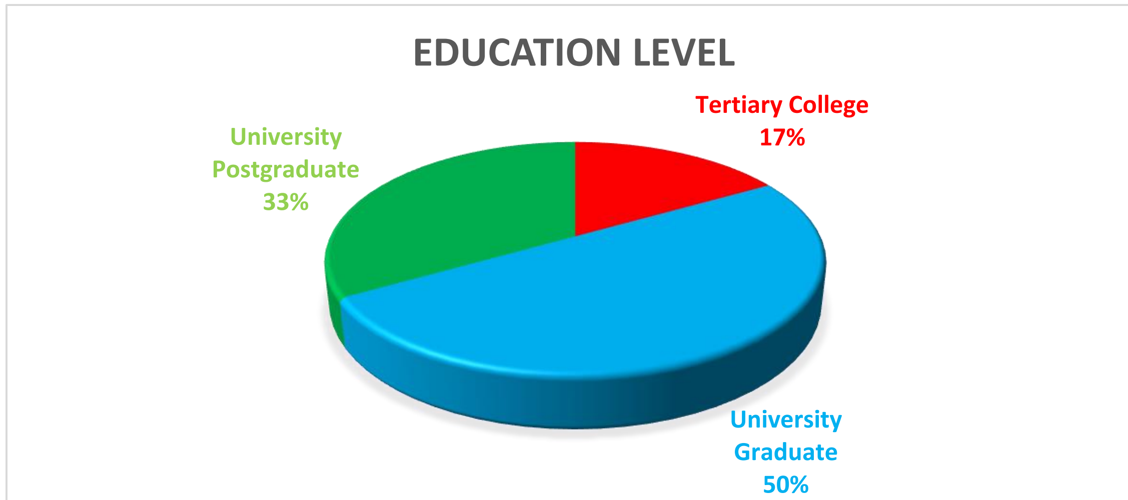


From Figure 2 above, majority of the respondents were between 26-35 years with 62.5%... It was important for the study to establish the age of the respondents so as to ascertain the age bracket that comprises the workforce in various transport industries. The age bracket of the respondents is also necessary and a likely indicator as the experience that an employee has.

3.5.3 Level of Education.

The respondents were asked to indicate their level of education and the findings were as shown in the table below.

Figure.3: Education Level of Respondents



From the figure above, about 50.0% of respondents were university graduate and 33.3% of respondents having university postgraduate level. This means that most of the respondents were competent and in a position to appreciate not only the basics of taxation and corporate governance, but also had the requisite knowledge on how to respond to the questions touching on the same.

3.5.4 Tax Training/seminars attended before

The study asked respondents to indicate if they had been trained or attended seminars on tax matters. The results were as shown in the table below.

Figure 4: Training/seminars attended before

Training	Frequency	Percent
Yes	21	87.5
No	3	12.5
Total	24	100.0

From figure.4, majority of respondents 87.5% indicated that they have been trained or attended seminars before. This therefore means that they are in a position to understand the study topic; the

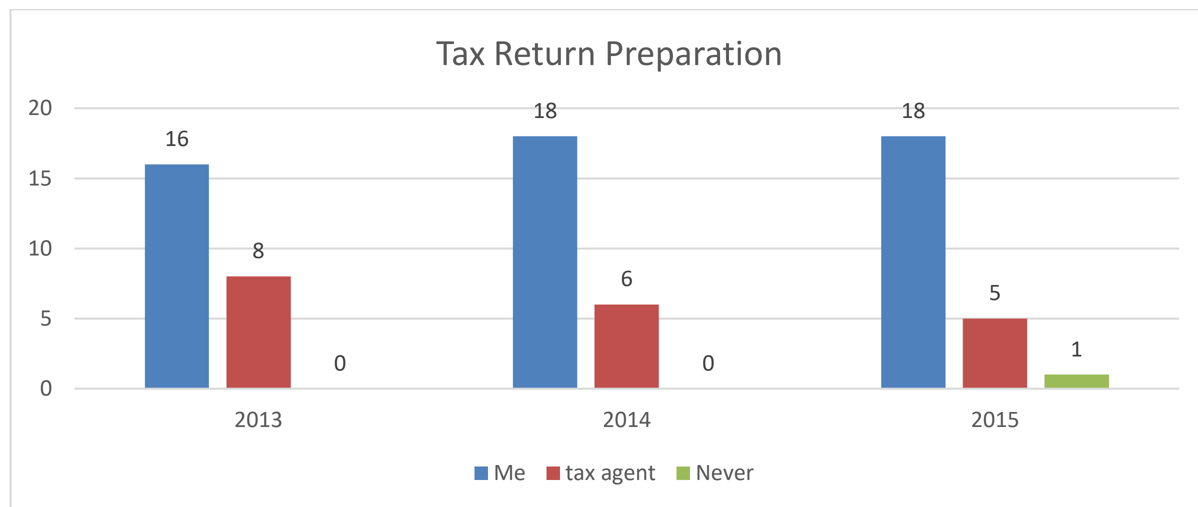
impact of corporate governance on tax compliance in Kenya. The same also indicates that the respondents were well aware of the current developments in matters of taxation in the country.

3.5.5: Designation

Designation	2	Percent
Director		8.3
Employee	22	91.7
Total	24	100.0

From the table 5 above, majority of respondents 91.7% were employees while 8.3 of respondents were directors of the transport sector. These implies that most of the respondents were employees who are most likely to be open about giving information about their industry unlike the directors who might be economical with the truth in terms of volunteering accurate information. In essence therefore, this aspect boosts the credibility of the results of the findings of the study.

3.5.6: Filing of tax returns



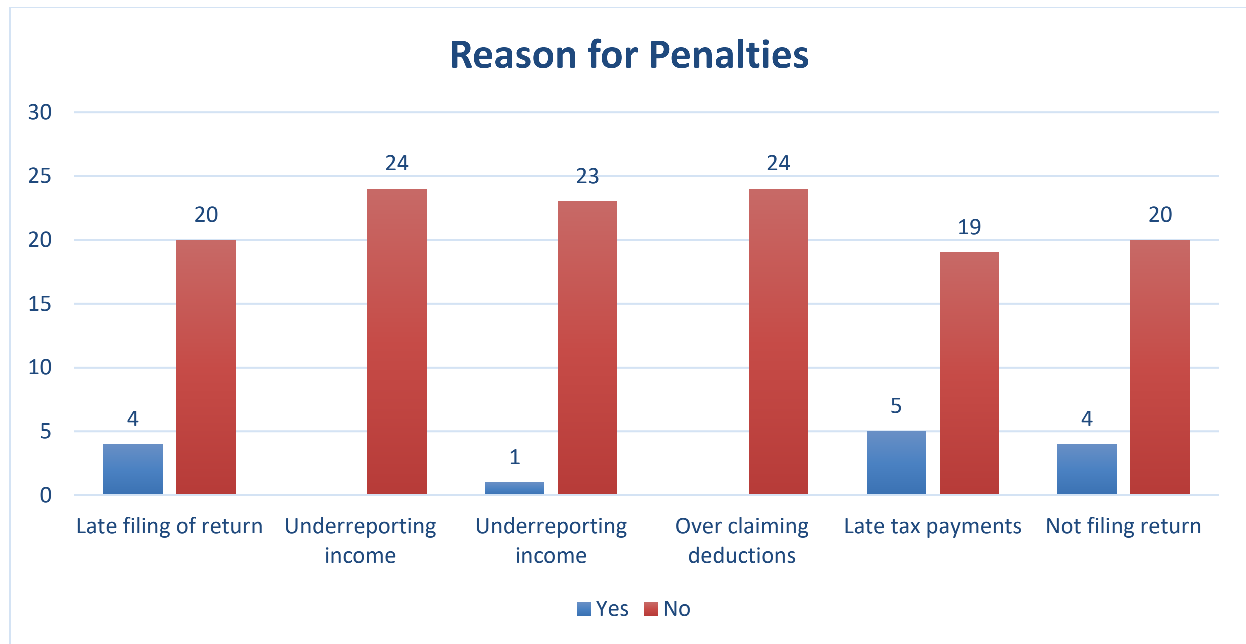
Study findings from figure 6 above indicates that majority of respondents prepared their tax returns as opposed to engaging a tax agent to prepare their tax returns for them. A small number of respondents did not file tax returns. This implies that majority of respondents are aware of their tax obligations and prefer filing their tax returns instead of using a tax agent.

3.5.7: Audited by KRA in the Last 2 years

	Frequency	Percent
Yes	1	4.2
No	23	95.8
Total	24	100.0

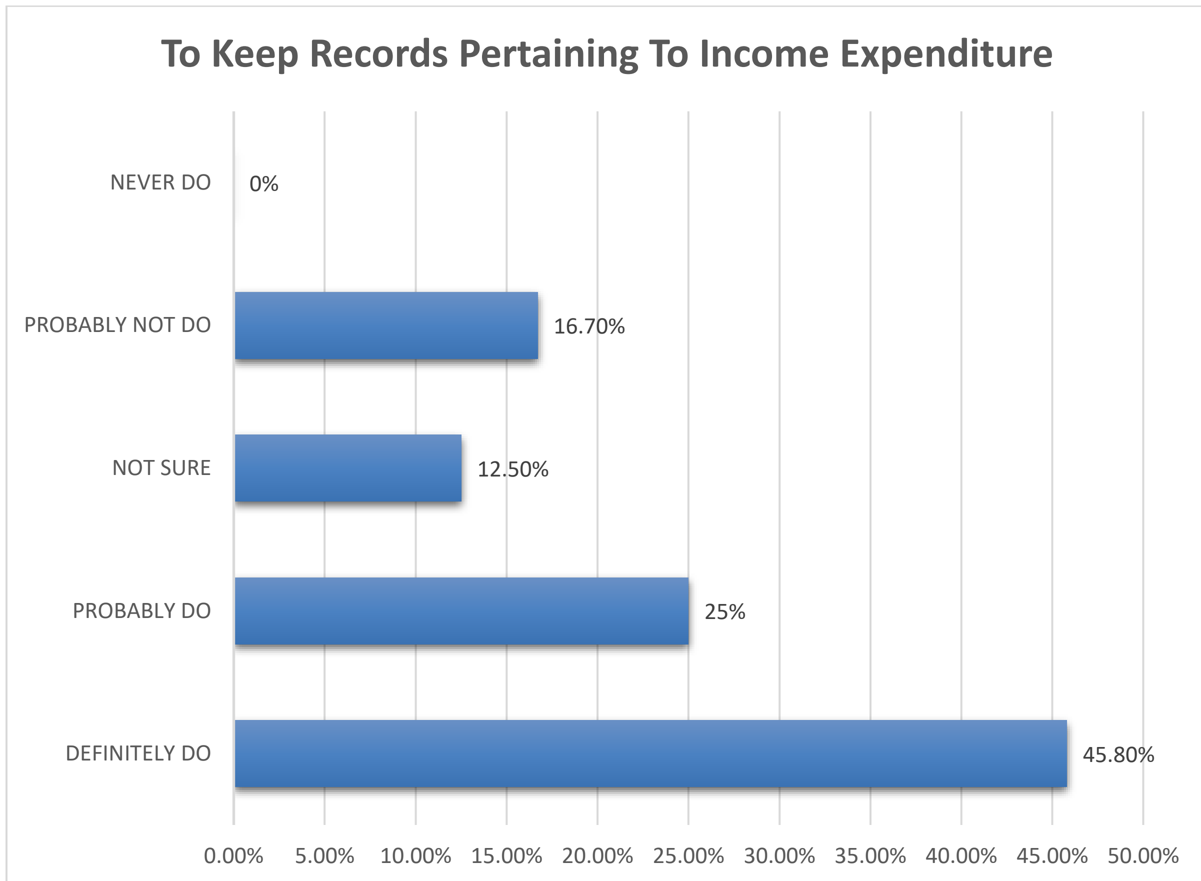
From table 7. Majority of respondents 95.8% indicated that they had not been audited by KRA in the last two years while only 4.2% of respondents have been audited by KRA in the last two years.

3.5.8: Penalized for tax related matters



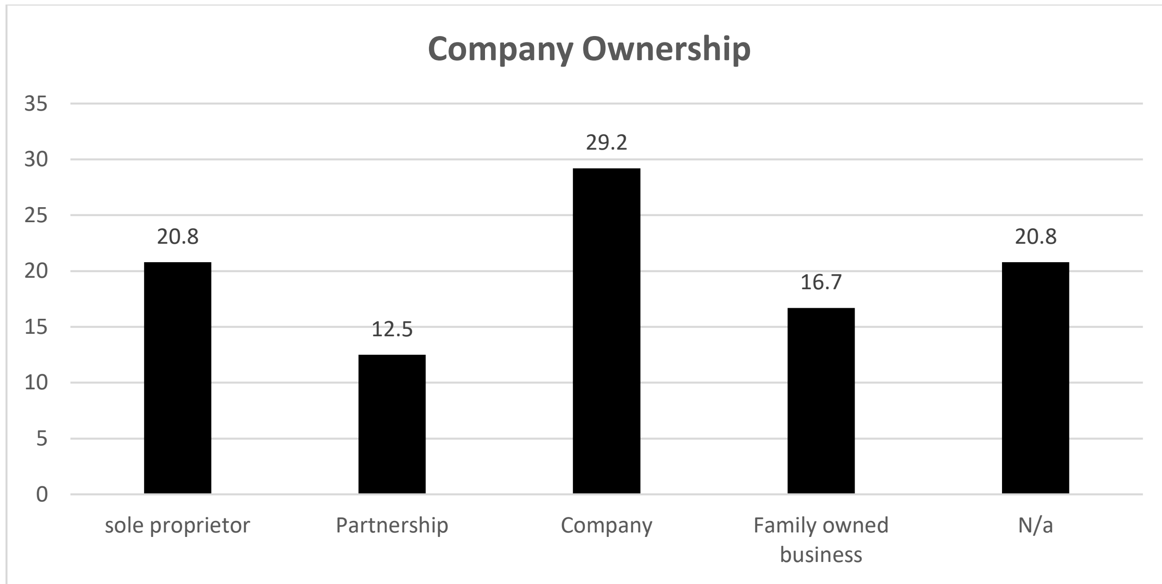
From figure 8 above, it illustrates that most penalties are on late payments of tax, late filing of returns and non-filing of tax returns. This illustrates that majority of the respondents interviewed are not very compliant. These penalties help to keep in check taxpayers, who have an obligation to ensure that taxes are paid in a timely manner.

3.5.9: Information on KRA



The study findings from figure 9 above are that the majority of the respondents keep records pertaining to income and expenditure. This information is critical in determining whether the respondents' tax compliance levels are linked to lack of proper record keeping.

3.5.10: Company Ownership



From study findings in figure 10 above, it revealed that most of respondents 29.2% are Companies, 20.8% of respondents are in sole proprietorship businesses, 16.7% of respondents are family owned business and 12.5% of respondents are partnerships. Companies are more likely to have corporate governance structures as opposed to the other legal entities. Therefore, it's easy to conclude that corporate governance structures are lacking in most of these transport companies.

3.5.11 Tax Compliance as Part of Corporate Governance

	Frequency	Percent
Yes	19	79.2
No	5	20.8
Total	24	100.0

From figure 11 above, the study findings indicated that the majority (79.2 %) of respondents perceived that tax compliance is part of good corporate governance while 20.8% of respondents disagree with the statement. The response denotes that a majority of the respondents have an understanding on the import being tax compliant and how the same supports good governance of a company.

3.5.12: Directors Have Ultimate Responsibility on Corporate Governance.

	Frequency	Percent
I strongly agree	15	62.5
I agree	8	33.3
I neither agree nor disagree	1	4.2
Total	24	100.0

From Table 12 above, 62.5% of the respondents strongly agree and 33.3% agreed that directors have ultimate responsibility on good corporate governance. However, only 4.2% of respondents neither agree nor disagree with that statement.

3.5.13: Clear and explicit defined roles between directors and executives

	Frequency	Percent
I strongly agree	5	20.8
I agree	15	62.5
I neither agree nor disagree	3	12.5
I do not know	1	4.2
Total	24	100.0

Table 13 above indicates that 20.8% strongly agreed and 62.5% agree that there are clearly and explicitly defined roles between directors and executive. However, 12.5% of respondents neither agree nor disagree with the statement and only 4.2% of respondents did not know.

3.5.14: Organization Has Codes on Corporate Governance

	Frequency	Percent
I strongly agree	5	20.8

I agree	14	58.3
I neither agree nor disagree	3	12.5
I disagree	1	4.2
I do not know	1	4.2
Total	24	100.0

From table 14 above, it indicates that 20.8% and 58.3% of respondents strongly agreed and agreed respectively that organization has codes of ethics on good corporate governance. 12.5% of respondents neither agreed nor disagreed, however; only 4.2% and 4.2% of respondents disagree and don't know about the statement.

3.5.15: Directors receive regular information on good corporate governance

	Frequency	Percent
I strongly agree	2	8.3
I agree	9	37.5
I neither agree nor disagree	8	33.3
I disagree	4	16.7
I do not know	1	4.2
Total	24	100.0

Table 15 above indicates that 8.3% and 37.5% of respondents strongly agreed and agreed respectively that Directors receive regular information on good governance. 33.3% of respondents neither agree nor disagree with the statement, 16.7% and 4.2% of respondents disagree and disagree strongly respectively that directors receive regular information on good governance.

3.5.16: Directors have arrangements for supervision or appraisal

	Frequency	Percent

I strongly agree	4	16.7
I agree	12	50.0
I neither agree nor disagree	7	29.2
I strongly disagree	1	4.2
Total	24	100.0

Table 16 above indicates that 16.7% and 50.0% of respondents strongly agreed and agreed respectively that directors have arrangements for supervision or appraisal on good corporate governance. 29.2% of respondents neither agreed nor disagreed, however; only 4.2% respondents strongly disagree about the statement. This indicates that majority of the respondents/employees work where there are check mechanisms for appraisal on good corporate governance.

3.5.17: Recruitment Is Open and Focused

	Frequency	Percent
I strongly agree	4	16.7
I agree	7	29.2
I neither agree nor disagree	5	20.8
I disagree	6	25.0
I disagree strongly	1	4.2
I do not know	1	4.2
Total	24	100.0

Table 17 above indicates that 16.7% and 29.2% of respondents strongly agreed and agreed respectively that Recruitment Is Open and Focused on Good Corporate Governance. 20.8% of respondents neither agrees nor disagrees with the statement, 25.0% and 4.2% of respondents disagree and disagree strongly respectively.

3.5.18: Values and Ethics Enshrined in Its Policies on Good Corporate Governance.

	Frequency	Percent
I strongly agree	5	20.8
I agree	8	33.3
I neither agree nor disagree	4	16.7
I disagree	6	25.0
I do not know	1	4.2
Total	24	100.0

Table 18 above indicates that 20.8% strongly agreed and 33.3% agreed that values and ethics are enshrined in its policies on good corporate governance. However, 16.7% of respondents neither agree nor disagree with the statement and only 25.0% of respondents did not know. Having a fairly distributed curve on the number of the respondents who believe that values and ethics are enshrined in its policies on good corporate governance; it shows that it is slowly being accepted in a number of corporations, as part and parcel of good corporate governance.

3.5.19: Directors Foster Good Environment

	Frequency	Percent
I strongly agree	4	16.7
I agree	7	29.2
I neither agree nor disagree	7	29.2
I disagree	4	16.7
I strongly disagree	1	4.2
I do not know	1	4.2
Total	24	100.0

Table 19 above indicates that 16.7% and 29.2% of respondents strongly agreed and agreed respectively that directors foster a good corporate governance environment. 29.2% of respondents neither agreed nor disagreed. .However, only 16.7%, 4.2% and 4.2% respondents disagree, strongly disagree and do not know about the statement. This shows that fairly a couple of respondent employees do not realize or do not understand the functional role of the directors in bolstering good environment for good corporate governance.

3.5.20: Directors act openly and honestly

	Frequency	Percent
I strongly agree	4	16.7
I agree	5	20.8
I neither agree nor disagree	4	16.7
I disagree	9	37.5
I strongly disagree	1	4.2
I do not know	1	4.2
Total	24	100.0

Table 20 above indicates that 16.7% and 20.8% of respondents strongly agreed and agreed respectively that directors act openly and honestly. 16.7% of respondents neither agreed nor disagreed, 37.5% of respondents disagreed, and 4.2% disagree strongly, however, only 4.2% respondents did not know about the statement.

3.5.21: Directors Have Clear Whistle blowing Policies

	Frequency	Percent
I strongly agree	4	16.7
I agree	8	33.3
I neither agree nor disagree	4	16.7

I disagree	4	16.7
I strongly disagree	2	8.3
I do not know	2	8.3
Total	24	100.0

Table 21 above indicates that 16.7% strongly agreed and 33.3% agreed that directors have a clear whistle blowing policies. However, 16.7% of respondents neither agree nor disagree with the statement and only 8.3% of respondents did not know.

3.5.22: Directors and Stakeholders Have Regular Communication

	Frequency	Percent
I strongly agree	7	29.2
I agree	9	37.5
I neither agree nor disagree	3	12.5
I disagree	4	16.7
I strongly disagree	1	4.2
Total	24	100.0

Table 22 above indicates that 29.2% and 37.5% of respondents strongly agreed and agreed respectively that directors and stakeholders have regular communication. 12.5% of respondents neither agreed nor disagreed, 16.7% of respondents disagreed, and 4.2% disagree strongly.

In conclusion, this chapter has provided an analysis of both the primary and secondary data used in this study. It has demonstrated the various structures in corporate entities that are relevant to tax compliance.

4.0 CHAPTER FOUR: SUMMARY OF FINDINGS: CONCLUSIONS AND RECOMMENDATIONS

4.1 Summary of findings

This chapter seeks to give a general conclusion of the study as a whole. The study topic sought to establish the impact of corporate governance on tax compliance in Kenya with a case study of the transport industry. The general outline of the whole study includes: chapter one, discussed a general introduction to the study; chapter two discussed the legal framework regulating tax compliance and corporate governance in the transport Industry in Kenya; chapter three premised on historical background of corporate governance in Kenya as well as the dynamics in corporate governance structures vis a vis tax compliance and data analysis, presentation, and interpretation.

The study concludes that the dynamics of tax compliance have sufficiently been interrogated within the realm of corporate governance in the transport industry. The study notes from the basics of corporate governance, inter alia, the sine qua non aspects that constitute good corporate governance: First, the Board of directors should have clear responsibilities whose role is divorced from that of the firm’s managers. Second, need to establish checks and balance in the structures of governance without any individual having unfettered power. Third, the need of having a balanced Board composed of a team of both non-executive and executive directors. Finally, need to ensure Board’s transparency in controlling and directing a corporation.

The study also notes the various historical cases of collapse of corporations at both global and local levels. This lays a foundation and on the very premise justifies the need for good corporate governance. The study also notes that even nationally, there has been failure in corporate governance systems that have perhaps informed the enactment of the Companies Act, 2015.

As regarding the general legal framework regulating Tax compliance and corporate governance in the transport Industry in Kenya, the study makes a number of observations. First, the study notes that Kenya has a broad taxation system covering various taxes including income taxes, value-added tax (VAT) and Customs and excise duty. It also notes that Income Tax Act is the main legislation that under consideration for taxation purposes of taxation in the transport industry. Alongside other statutes, the study underscores the import of regulation of the transport industry by the Companies Act, 2015 as repealed as a dominant statute. Notably, the Act also requires the companies to file their returns with the registrar of Companies.

The study observes that corporate entities in Kenya are subject to corporation tax or corporate income tax, and are subject to penalties for failure to file returns in time. The study underscores that it is therefore necessary, and as part of sound corporate governance systems for corporations in the transport industry to ensure that tax obligations are met in a timely manner to avoid tax penalties.

All companies, both listed and unlisted are required, in view of sound corporate governance practice to consider the Code of Corporate Governance Practices for Issuers of Securities to the public, 2015. Significantly that the Code has moved away from "Comply or Explain" approach to "Apply or Explain" approach in a bid to strengthen corporate governance. Essentially, the Code is "principle-based rather than rule-based, and recognizes that a satisfactory explanation for any non-compliance will be acceptable in certain circumstances."

Notably, this Act represents a rich regulation of the duties of the directors and the Board although fails to adequately address the issue sanctions in case of breach of corporate governance guidelines.

In terms of the historical perspective of corporate governance, the study observes that the history of corporate governance is poorly recorded in Kenya. And for that case, what exists in form of material evidence shows lack of consistency on the various respective stakeholders' responsibility to provide cogent sources of information about historical background of corporate governance in Kenya.

The study underscores that to introduce positive engagement in terms of corporate governance, it is necessary to ensure that a culture of corporate accountability and responsiveness to investors' interests is enforced in Kenya through Statutory means. As part and parcel of good corporate governance practices, the study notes that Kenya adopted corporate governance Codes.

In terms of dynamics in corporate governance structures and tax compliance in transport industry in Kenya, the study puts into perspective various aspects including: the relationship between firm size and tax compliance, the relationship between ownership (family owned versus non-family owned) and tax compliance, the level of education and tax compliance in the transport industry and finally the profitability and tax compliance in the transport industry.

In the foregoing regard, in view of the relationship between firm size and tax compliance, the study notes that small firms are more tax non-compliant. This is attributed to factors such as such firms have small profits and fail to keep proper financial records. This could also be because small firms may not be in a position to employ accountants, auditors or tax consultants. The study also observes that corruption is also leading factor that encourages non-compliance, which is not only limited to government revenue collection, but the transport industry as a whole.

On the relationship between ownership (family owned versus non-family owned) and tax compliance in the transport Industry, the study observes that family owned firms have challenges

in tax compliance. Similar observations are made in terms the relationship between profitability and tax compliance in transport industry in Kenya. The study noted that that revenue derived from corporate income tax is sometimes very low possibly because of the reluctance of tax payers to pay tax, a factor that is attributed also to likely ‘adverse’ impact that tax payment has on profitability of a corporate.

Regarding the level of education and tax compliance, the study observes that the level of education has a direct influence on the level of tax compliance. Educated taxpayers and managers (especially with the knowledge on taxes and its laws) are well placed in understanding the tax responsibility and sanctions. The study also notes that the transport industry has also a number of illiterate employees which follows therefore that the part workmanship has little knowledge in taxation or simply do not appreciate the system of taxation laws at all. As for those who understand about the import of tax returns, a majority still do not file their returns on time.

From the study, we observed that only about 30% of the respondents were companies. Companies are more likely to have corporate governance structures as opposed to the other types of legal entities. Therefore, based on this finding we can conclude that corporate governance structures are lacking in most of these transport companies.

The study also concludes that the level of compliance with taxation requirements is affected by factors including: perceptions of the government’s legitimacy and the fairness of the tax system, as well as taxpayers’ expectation that their tax moneys will be spent on valued public services. Therefore, how the tax authority treats different segments of the formal and informal economy shapes the business tax culture. On this aspect, 83 % of the respondents, when asked about the consequences of not filing returns stated that they do understand. 16.7% of respondents stated that

they have been penalized for late filing of returns. This denotes that failure to file essentially denotes tax evasion on part of the tax payers.

A majority of respondents confirmed that they believe that values and ethics is a necessity in ensuring good corporate governance. This underscores that it is slowly being accepted in a number of corporations, nay transport companies, as part and parcel of good corporate governance to encourage good values and ethics.

4.2 Conclusion and recommendations

The study has demonstrated the effect of corporate governance on tax compliance and why entities should have proper corporate governance structures in place.

In summary, it is important for Company directors, specifically in transport companies to embrace good corporate governance practices in their organizations. This is key in ensuring the long term profitability of the companies regardless of the size or the ownership. This, as we have observed, determines a great deal whether or not an organization will be tax compliant.

It is advisable for family owned business and as small firms to consider implementing formal governance structures in the management of its affairs. At a comparative level, family owned business and small firms have shown positive performance in terms of corporate governance, with engagement of professional ‘outsider’ members in their management. This applies in the case for the transport industry and has a positive effect in tax compliance.

These companies should adhere to the CMA guidelines on corporate governance and ensure that they have a balanced number of non-executive directors in their Boards. This will ensure accountability in the management process. Appointment to the Board should factor in the different skills and knowledge required to run the corporation.

Furthermore, there is need for the Kenya Revenue Authority to come up with measures to continuously sensitize these specific sector of the economy on their tax obligations. Even as they impose penalties on tax defaulters, KRA and relevant stakeholders in this sector should deliberate and determine exactly where the problem lies and come up with possible solutions and assist these transport companies to be more compliant. Where possible, the government should engage corporate governance experts to provide technical assistance to such sectors of the economy.

There is also need for government to consider proper entrenchment of corporate governance principles and practices in laws and regulations to ensure good corporate practices. As it is currently, there are no robust and clear laws that companies are mandated to comply with when it comes to corporate governance. Corporate failures have adverse effects on the economy especially when it comes to taxation matters, and also on the effects on other stakeholders generally. The government should consider legal reforms in the area of corporate governance to address this. However, a balance between statutory control and private rights has to be reached to ensure that these laws do not impede the development of businesses in Kenya.

In conclusion, therefore the importance of every legal person (both individuals and corporations) paying their share amount of taxes to the government cannot be overemphasized.

APPENDIX 1: QUESTIONNAIRE

Part I: Questionnaire Cover Letter

Dear Respondent,

I am a Master's student at the University Nairobi School of Law. In partial fulfillment of the course (LLM) requirements, I am conducting a study on **"THE IMPACT OF CORPORATE GOVERNANCE ON TAX COMPLIANCE IN KENYA: A CASE STUDY OF THE TRANSPORT INDUSTRY".** I would appreciate if you could spare a few minutes of your time to fill in the blanks in the attached list of questions to the best of your knowledge.

The information in this questionnaire will be strictly confidential. The information will not be used for any other purpose other than for this research. Your assistance in facilitating the same will be highly appreciated.

Thank you in advance.

____

Lekake N Monicah

Part II: Questionnaire for Employees

The questionnaire is meant to collect information on the impact of corporate governance on tax compliance in Kenya with a focus on the transport industry. Kindly answer the questions by writing a brief statement or ticking in the boxes provided as will be applicable.

Date ______/_______/ 2017

SECTION 1: BACKGROUND INFORMATION

1. What is your Gender?
   i. Male ☐
   ii. Female ☐
2. Age Category
   a. Below 25 years ☐
   b. 26 – 35 years ☐
   c. 36 – 45 years ☐
   d. Above 45 years ☐
3. What is your highest level of education
   a. Secondary ☐
   b. Tertiary College ☐
   c. University Graduate ☐
   d. University Postgraduate ☐
   e. Other (please specify) ________________________________
4. Have you attended any training or seminar on taxation organized by KRA, university, college or other professional bodies or any bodies previously?
   a. Yes ☐
   b. No ☐

5. What is your designation?

    a. Director ☐

    b. Employee ☐

If (b) above, kindly specify (Manager, accountant, human resource person, etc.)

____

SECTION 2: INFORMATION ON TAX COMPLIANCE.

1. Are you a registered tax payer?

    a. Yes ☐

    b. No ☐

2. Who prepares your tax return? (Please tick)

Year assessment	Me	Tax Agent	Never
2013			
2014			
2015			

3. Have you ever been audited by Kenya Revenue Authority (KRA) in the last 2 years?

    a. Yes ☐

    b. No ☐

4. Have you ever been penalized by the KRA due to the following conditions?

Year assessment	Yes	If Yes, how many times	No
Not filing a tax return			
Late filing of tax return			
Under reporting income			
Under claiming deductions			
Over claiming deductions			
Late tax payments			

5. For each question in this part, please tick your response:

   a. If you think you will **DEFINITELY DO**

   b. If you think you will **PROBABLY DO**

   c. If you are **NOT SURE** either do or not to do

   d. If you think you will **PROBABLY NOT DO**

   e. If you think you will **NEVER DO**

The following are my responsibilities and rights as taxpayers:	**a**	**b**	**c**	**d**	**e**
To inform and declare actual income received from all sources to the KRA					
To keep records/documents pertaining to income and expenditure after submission of the Tax Return					
To pay taxes due within 30 days from the date of issue of the Notice of Assessment or within the stipulated period					

6. Who are the owners of the transport company you work for/ manage?

   a. Sole Proprietor owned

   b. Partnership/ SACCO owned

   c. Shareholder owned

   d. Family Business/ Family owned

7. Do you think tax compliance is part and parcel of good corporate governance?

   a. Yes ☐

   b. No ☐

8. Complete the form (below) indicating your individual opinions regarding each statement with an **X** or √

   a. I agree strongly,

   b. I agree,

   c. I neither agree nor disagree,

   d. I disagree,

   e. I disagree strongly

   f. I do not know

Reasons Why People Do Not Pay Their Taxes	a	b	c	d	e	f
The risk of getting caught is low						
There is a culture of tax evasion within transport industry						
The taxes collected by KRA are used poorly and stolen						
The potential consequences of being caught are not serious						
Our organization think they pay too much taxes						
Tax evasion is not a problem in our organization						
Tax evasion is not acceptable in our organization						
We have not been paying taxes because we have loans and are at a loss.						

SECTION 3: INFORMATION ON CORPORATE GOVERNANCE.

1. What do you understand by the term corporate governance?

____

____

2. Complete the form indicating your individual opinions regarding each statement with an X or √

    g. I agree strongly,

    h. I agree,

    i. I neither agree nor disagree,

    j. I disagree,

    k. I disagree strongly

    l. I do not know

Good Governance	a	b	c	d	e	f
The directors have ultimate responsibility for directing the affairs of the organization.						
The roles and responsibilities between directors and executive staff is clearly and explicitly defined						
The organization has codes on ethics and strategies to reduce conflicts of interest						
The directors regularly review and monitor performance of staff						
The directors receive regular and timely information from the staff						
The directors has proper arrangements for the supervision, appraisal and remuneration of its staff						
The recruitment of new members is open and focused on creating						
The directors ensures the organization's values and ethics are enshrined in its policies and practices						
The directors foster an environment that supports constructive challenge and welcomes different points of view.						
The directors acts openly and honestly in all matters, and interests are declared even if the relevance or impact is unclear.						
The directors have clear policies and procedures for whistleblowing.						
The directors ensure there is a strategy for regular and effective communication with all stakeholders						

The directors supports the process of learning from mistakes and successes						

3. Does your organization have an external auditor?

   a. Yes ☐

   b. No ☐

4. In your view, a person in your organization who is regarded as a whistle blower will be;

   a. Promoted ☐

   b. Harassed ☐

   c. Sacked ☐

   d. No Idea ☐

5. In your view, are there challenges particularly in ensuring compliance regarding taxes in your industry

   a. YES

   b. NO

6. If Yes in 11(above) , Kindly list at least three challenges

   ____

   ____

   ____

7. As a director/ employee in the transport industry, what are the things that you think should be addressed differently to ensure tax compliance?

   ____

   ____

   ____

8. Any other information you would like to share with us.

   ____

THANK YOU FOR YOUR RESPONSE

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