

**THE EFFECT OF INTEGRATED TAX MANAGEMENT SYSTEM ON TAX
COMPLIANCE BY SMALL AND MEDIUM SIZED ENTERPRISES IN NAIROBI
CENTRAL BUSINESS DISTRICT**

BY

ANDREW KAMAU MARARIA

D63/61044/2013

**A RESEARCH PROJECT REPORT SUBMITTED IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER
OF SCIENCE FINANCE, UNIVERSITY OF NAIROBI.**

OCTOBER 2014

DECLARATION

This is my original work and has not been presented for examination in any other university.

Signed..... Date.....

ANDREW KAMAU MARARIA

D63/61044/2013

This research project report has been submitted for examination with my approval as a university supervisor.

Signed..... Date.....

DR. ADUDA JOSIAH,

DEAN,

SCHOOL OF BUSINESS,

UNIVERSITY OF NAIROBI.

DEDICATION

I dedicate this research project to my family for the support and patience during the entire period of my study. Thank you and God bless you abundantly.

ACKNOWLEDGEMENT

First and foremost, I thank the Almighty God for His guidance and care which enabled me to work on this project. I trust Him for a sober state of mind to the very end. I would like to express my sincere thanks to my supervisor DR. Josiah Aduda for his guidance to make this study a reality

I also acknowledge my respondents for providing me with information to enable me compile my work.

I also want to acknowledge my friends and colleagues for their support during my study.

TABLE OF CONTENTS

DECLARATION.....	ii
DEDICATION.....	iii
ACKNOWLEDGEMENT.....	iv
TABLE OF CONTENTS	v
LIST OF TABLES	vii
LIST OF ABBREVIATIONS	viii
ABSTRACT.....	ix
CHAPTER ONE	1
INTRODUCTION	1
1.0 Introduction	1
1.1 Background of the Study.....	1
1.1.1 Integrated Tax Management System	1
1.1.2 Tax compliance	2
1.1.3 Integrated Tax Management System and Tax Compliance	3
1.1.4 Small and Medium Sized Enterprises in Kenya	5
1.2 Research problem.....	5
1.3 Objective of the Study	7
1.3.1 Specific objectives	7
1.4 Value of the Study	7
1.4.1 Kenya Revenue Authority.....	8
1.4.2 Tax Payer	8
1.4.3 Students of Taxation and Accounting.....	8
CHAPTER TWO	9
LITERATURE REVIEW	9
2.1 Introduction.....	9
2.2 Theoretical Review	9
2.2.1 Diffusion of Innovation (DOI) Theory	9
2.2.2 Theory of Reasoned Action	10
2.2.3 Technology Acceptance Model	10
2.2.4 Economic Deterrence Model	11
2.3 Determinants of Tax Compliance by SMEs	12
2.3.1 Compliance Cost.....	12
2.3.2 Tax Knowledge and Education.....	13
2.3.3 Fines and Penalties.....	14
2.3.4 Perceived Opportunity for tax evasion	15
2.4 Review of empirical studies.....	17
2.5 Summary of Literature Review	20
CHAPTER THREE	21
RESEARCH METHODOLOGY.....	21
3.1 Introduction.....	21
3.2 Research Design.....	21
3.3 Target Population.....	21
3.4 Sample.....	22
3.5 Data Collection	22
3.6 Data Analysis and Presentation	22
3.7 Data validity and reliability	22

3.8 Operationalization of variables	23
3.9 Analytical model	23
CHAPTER FOUR.....	25
DATA ANALYSIS, PRESENTATION AND INTERPRETATION	25
4.1 Introduction.....	25
4.2 Demographic Information.....	25
4.3 Annual Turnover	26
4.4 Personal Identification Number	26
4.5 Tax compliance level	27
4.6 Adoption of ITMS.....	28
4.7 Tax Compliance Cost.....	28
4.8 Tax Knowledge and Education	29
4.9 Fines and Penalties.....	30
4.10 Perceived Opportunity for Tax Evasion	30
4.11 Regression.....	31
4.12 Coefficients Model.....	32
4.13 Summary and Interpretation of the findings	33
CHAPTER FIVE	36
SUMMARY CONCLUSION AND RECCOMENDATIONS.....	36
5.1 Summary	36
5.2 Conclusion	37
5.3 Recommendations to policy and practice	37
5.4 Limitations of the Study.....	38
5.5 Suggestions for further studies.....	39
REFERENCES	40

LIST OF TABLES

Table 3.1:	Operationalization of variables.....	23
Table 4.1	Demographic Information.....	26
Table 4.2	Annual Turnover.....	26
Table 4.3	Personal Identification Numbers.....	27
Table 4.4	Tax compliance Level.....	28
Table 4.5	Adoption of ITMS.....	28
Table 4.6	Tax compliance Cost	29
Table 4.7	Tax knowledge and Education.....	29
Table 4.8	Fines and Penalties.....	30
Table 4.9	Perceived opportunity for tax evasion.....	31
Table 4.10	Model summary.....	31
Table 4.11	ANOVA Model.....	32
Table 4.12	Coefficients model.....	33

LIST OF ABBREVIATIONS

ASYCUDA	Automated systems for customs data
E-tax	Electronic tax
ITMS	Integrated tax management system
ICT	Information and Communication Technology
IRB	Inland Revenue Board.
KRA	Kenya Revenue Authority
OECD	Organization of Economic Co-operation and Development
PAYE	Pay As You Earn
SAS	Self-Assessment System
TAM	Technology acceptance model
VAT	Value Added Tax

ABSTRACT

Tax is an important stream of revenue for government's development projects and therefore all efforts must be made by governments to ensure that it is accurately and efficiently collected so as to facilitate the government's operations. In an effort to maintain a modernized tax administration system, the Kenya Revenue Authority developed ITMS, an e-filing system that integrates the processes of registration for tax purposes, tax preparation, tax filing and consequently tax payment. With the introduction of ITMS, it has become mandatory for taxpayers to register for tax purposes online using the system, but online filing of returns is yet to become fully mandatory and several taxpayers still opt to file their tax returns manually and physically drop them at K.R.A offices countrywide.

This study sought to examine the effect ITMS on tax compliance by Medium and Small Taxpayers, focusing on those operating within Nairobi's Central Business District. The researcher outlined a detailed literature review and identified the variables for this research to be Tax compliance, Tax compliance cost, Tax knowledge and education and perceived fines and penalties. The target population of comprised of 200 taxpayers. A total sample size of 100 was selected as representative, to be the focus of this study. A descriptive survey design was used. Random sampling technique was used to create a sampling frame. Data was collected using self-administered questionnaires and an interview guide. The collected data was analyzed using Statistical Package for Social Scientist software and findings presented using tables.

The study findings provide direct evidence that Adoption of ITMS is a contributory factor in tax compliance. From the study findings there is enough proof to conclude that Adoption of ITMS is associated with high levels of tax compliance. The study also provides evidence that tax compliance cost, Tax knowledge and Education, and tax fines and penalties are contributory factors in tax compliance.

To enhance tax compliance governments should enhance Adoption of E filing systems such as ITMS, reduce tax compliance costs and enhance tax fines and penalties as well as tax knowledge and education.

CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter contains the background of the study where the subject at hand is introduced, statement of the problem stated, objectives of the study outlined and significance of the study explained.

1.1 Background of the Study

1.1.1 Integrated Tax Management System

An E-filing system is an automated system that enables taxpayers to file and submit their income tax returns online. The benefits of an E-filing over submitting manual returns to the tax authorities' office are that the returns are uploaded directly to the income tax authorities' systems with negligible possibilities of human errors. E-filed returns cost less to process when contrasted with a manual returns both regarding cost and time to the income tax authorities and also the citizen (Lemuria Carter, 2011).

Advancement in information and communication technology that the world continues to experience makes tax collection and administration a challenge for many authorities. Tax authorities have to maintain a modernized and responsive tax administration system so as to facilitate faster collection of taxes. An E-filing integrates the processes of registration, tax preparation, tax filing and tax payment. Taxpayers avoid the hassles of visiting the tax office and making long queues, because the returns are filed at their convenience. It is in this regard that several tax authorities have embraced the change and adopted an e-filing approach (Mandola, 2013).

An e-filing system enables taxpayers to submit their tax returns electronically to the tax authorities (government) thus helping to prevent many mistakes which might occur by taxpayers in manual filing (Ramayah , 2013)

In the financial year 2004/05, K.R.A launched a Revenue Administration Reform and Modernization Programme (RARMP), whose goal was to transform “K.R.A into a modern, fully integrated and client-focused organization”. Among the initiatives under the programme was automation and integration of ICT into the tax collection in a bid to modernize tax administration. It is in this regard that an electronic filing system was introduced and rolled out in December 2008 known as Integrated Tax Management System (ITMS). With introduction of ITMS, KRA automated the issue of unique personal identification numbers (PINs) through the electronic registration (e-Registration) module. ITMS initially enabled registered taxpayers to file their tax returns for VAT and PAYE online but over the years, the system has been upgraded to cover the filing of corporate as well as individual income tax returns, stamp duty, Turn over Tax and Land Rent.

1.1.2 Tax compliance

Taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago. Tax is defined as ‘a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing specific in return (Lymer and Oats, 2009). However, not all payments to government are considered tax payments: for example, charges, tolls and other levies are paid to obtain a specific service and are not strictly tax payments.

According to Smith, “The subject of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities that is in proportion to the revenue which they respectively enjoy under the protection of the state. Governments use different kinds of taxes and varying tax rates.” This is done to distribute the tax burden among individuals or classes of the population involved in taxable activities (Hunter, 2010).

Tax compliance refers to adherence to the administrative rules of lodging and paying taxes on time. This includes compliance with the reporting requirements, procedural rules and regulations. This entails filing tax returns on time, reporting all the income and claiming the right deductions and where taxes are due making tax payments on time.

Tax compliance can be defined as a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow up actions from the authority (Singh, 2003).

Kenya is ranked among low income countries or low compliance countries with hard task of ensuring efficient and effective tax administration in order to ensure tax compliance, hence raising more revenue. Administration of tax in Kenya is done by Kenya Revenue Authority (KRA) established through an Act of Parliament of July 1st 1995 (Cap 469). The purpose of Kenya Revenue Authority is assessment, collection, administration and enforcement of tax laws with professionalism governed by integrity and fairness. To achieve this purpose, KRA is divided into regions such as North Region, Rift Valley Region, Western Region, Southern Region and Central Region and departments such as Customs Services Department, Domestic Services Department, Road Transport Department and Support Services Department. KRA administers different types of taxes under different Laws (Acts) such as Income Tax, Value Added Tax, Custom duties and Excise Tax among many others (Kuria 2013)

1.1.3 Integrated Tax Management System and Tax Compliance

The manual system of filing returns had a lot of loopholes which unscrupulous tax payers used to under-declare taxes. Integrated tax Management system (ITMS) requires tax payers to register, file returns and pay their dues online. Data capturing is automated, which is good for enhancing the level of compliance and push up government revenue collection.

The main tax obligations under ITMS are income tax, corporation tax, VAT, withholding tax and other domestic levies that were prone to non-compliance due to the previous manual system of filling returns.

In the old system, an employee had to go to KRA offices to manually find out if his/her employer was remitting deductions from their pay. On its part, KRA could only determine who was remitting and who was not through random payroll audits. Integrated Tax Management System (ITMS) makes it possible for taxpayers to monitor their tax positions from the comfort of their living rooms and offices online. Employees are able to

check whether their employer have been remitting PAYE deductions and raise the alarm in case of discrepancies.

Professionals who under-declare their earnings from contracts are easily exposed by the system. This is because when firms declare the amount of their legal fees or cash paid to professional contractors during filing of returns, it will be easy for the taxman to determine what has gone into the pockets of the professionals and hence the tax they are supposed to pay. Under the manual system, tax auditors had to go through the various manual returns to determine what is due from such entities and the tedious process only meant they declared what they deemed fit.

Under the ITMS a lot of corroborating evidence in the declarations made in the tax returns is generated, automatically raising the standards of compliance. For instance, employers who pay some of their staff in cash but still declare that as an expense when filing their returns will have no option but to remit income tax on such payments.

Withholding tax system is another area that has been significantly changed by ITMS.KRA dealt with multiple cases where taxes are withheld but not remitted, although withholding tax certificates are manually issued to the payees. Such certificates would then be used to claim refunds from the taxman, who apparently found it hard to determine whether the money was ever remitted .ITMS generates withholding tax certificate electronically upon receiving payment from the person that has withheld the tax, and it is only with the certificate that someone can claim credit. This ensures easy reconciliation of the taxes withheld against those paid since the system guarantees a common reference for the same transaction.

KRA is also developing a new customs management system that will replace the current SIMBA system. It is expected that the new programme will have greater capacity to deal with the challenges of risk profiling, valuation and administrative issues like management of auctions. The customs management system will be integrated with the domestic taxes ITMS system to provide a unified view of taxpayer's international and domestic trade operations (Business Daily).

1.1.4 Small and Medium Sized Enterprises in Kenya

There is no clear definition for small and medium enterprises (SMEs); they are rather identified more by their characteristics than by explicit definition and may therefore vary in different jurisdictions. For example, in Britain, a small business is that with paid employees totaling less than 200, while in Kenya, a small business is that with 10-49 employees, and a medium business is that with 50-99 employees. It has been argued that the definition of SMEs is mainly derived from SMEs being entities engaged in an economic activity, irrespective of their legal form coupled with pre-determined thresholds in the total full time and part time staff headcount, the annual turnover and the annual balance sheet after all rebates have been paid out. (Kuria 2013)

Some studies estimate that informal businesses account for 35-50% of GDP in many developing countries. Similarly, in Kenya, the informal sector is quite large, estimated at 34.3% and accounting for 77% of employment statistics .Over 60% of those working in the informal sector are the youth, aged between 18-35 years, 50% being women (Ouma et al 2009).The First 1993 Small & Medium Enterprises (SME) baseline survey revealed that there were approximately 910,000 SMEs employing up to 2 million people. The second SME baseline survey (1995), estimated the size of the SME sector at 708,000 enterprises employing up to 1.2 million people. Compared to the other sectors of the economy, the contribution of the SME sector to the country's Gross Domestic Product (GDP) increased from 13.8% in 1993 to over 18% in 1999, (Sessional Paper No. 2 of 2005). Currently, it is estimated that the contribution to the GDP by this sector stands at over 25% (Economic Survey, 2012).

The focus of this study is to establish the effect of ITMS on tax compliance by Medium and Small Taxpayers since its inception to date and their experiences on using the system.

1.2 Research problem

In most countries, e-filing is not mandatory, rather it is offered as an option to taxpayers and their tax representatives. As a result, worldwide, several studies found tax users' resistance to use e-filing system remains a widespread problem. Although, the e-filing system may offer potential benefits to improve administrative compliance efficiency, the

benefits gained may be obstructed by tax users' unwillingness to accept and use the new tax technology. In essence, the move to adopt an e-filing system is neither hassle free nor well accepted by all tax parties, particularly the tax agents and professionals (Kamarulzaman, 2010).

To date, there have been little published empirical studies on the effect of e-filing system on tax compliance, particularly in East Africa. Therefore, in considering that e-filing is the direction global tax authorities is taking, this study has emerged to find out how taxpayers and tax practitioners in Kenya as a developing nation, respond to e-filing endeavors put in place by K.R.A to address a research void, in order to fill up a knowledge gap. This study's aim is to assess the effect of adoption of Integrated Tax Management System (ITMS) on tax compliance by Medium and Small Taxpayers as well as to examine the importance of various incentives that will motivate taxpayers to adopt the system.

K.R.A fulfils its tax administration and collection objective through its three revenue departments: Domestic Taxes, Customs and Road Transport Department. The Domestic Taxes Department is further divided into three sub departments, based on the annual turnover of the taxpayers (K.R.A, 2012). Large Taxpayers' Office covering the taxpayers whose annual turnover is above Kshs 750 million. Medium Taxpayers' office manages taxpayers whose annual turnover is between Kshs 300 million and Kshs. 750 million. Taxpayers whose annual turnover is below Kshs 300 Million fall under the Medium and Small Taxpayers office and they were the major focus of this research.

Compared to other EAC countries, Kenya has a large modern and diversified economy with a vibrant private sector with many formalized enterprises, where majority of Medium and Small Taxpayers fall under. The informal sector, also known as Jua Kali is also growing at a fast rate and businesses in this sector are also categorized as Medium and Small Taxpayers .It is in order to say that SME's must be nurtured and a favorable trading environment created, by strengthening the factors that lead to business success while mitigating the challenges and problems that threaten their advancement, so as to ensure their growth as they form a substantial portion of our growing economy. For this reason, an ideal tax policy needs to be adopted in order to ensure voluntary compliance, economic growth and proper utilization of resources. Their size and nature makes the

issue of tax compliance one of particular importance especially since most SMEs have access to limited resources and inadequate expertise to comply with diverse and complicated regulation. High compliance costs can result in tax avoidance, tax fraud, and inhibit investment by way of diminishing competitiveness of the country in terms of taxation attractiveness (Ojochogwu, 2012).

At the end of the first year of its inception, 479,592 Medium and Small taxpayers had used ITMS to register for tax purposes while only 24,626 had used it for e-filing. Four years later, the number of taxpayers who have registered using ITMS has increased to 790,048 whereas those using the system for e-filing have reduced to 7,832 (K.R.A, 2012). In this regard, this study will be conducted, focusing on Medium and Small Taxpayers based in Nairobi, with an aim to assess the effect of Integrated Tax Management System on Tax compliance by SMEs.

1.3 Objective of the Study

The purpose of this study was to evaluate the effect of Integrated Tax Management System on tax compliance by Medium and Small Taxpayers in Nairobi Central business District.

1.3.1 Specific objectives

- i. To determine the effect of compliance cost on tax compliance level
- ii. To examine the effect of tax knowledge and education on tax compliance level
- iii. To assess the effect of fines and penalties on tax compliance level
- iv. To evaluate the effect of perceived opportunity for tax evasion on tax compliance level

1.4 Value of the Study

The following interest groups will find usefulness of this study:

1.4.1 Kenya Revenue Authority

The growing concern of tax administration throughout the world is on how to simplify the tax assessment system to encourage voluntary compliance. Thus, the issue of tax compliance is a major concern of many developing countries (Sanker, 2003).

Kenya Revenue Authority is the arm of the government, which collects tax after parliament, passes laws regarding taxation. There are many ways of enhancing tax compliance as discussed in this paper. This research will highlight the application of fiscal policy as a measure of improving compliance as applied in Kenya. The selection between tax policy, which includes installation of fiscal policy and the deterrent measure of enhancing tax revenue collection, will be more certain.

1.4.2 Tax Payer

The taxpayer is the target of all tax measures. This research will evaluate the experience by taxpayers in implementing the electronic tax filing as directed by KRA. The taxpayer will appreciate and understand the purpose of the Electronic filing in their businesses.

1.4.3 Students of Taxation and Accounting

Taxation is an interesting area, which is of concern to every citizen. Both undergraduate and postgraduate student need to know the origin of taxation its dynamics and future direction concerning enforcement. This will foster a better understanding of the topic and the urge to do more research

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This area seeks to explain what is contained in this chapter. This includes a detailed review of theories guiding the study, a review of empirical studies and past researches, Tax Compliance by SMEs and a chapter summary and conclusion of literature review.

2.2 Theoretical Review

This study borrows heavily from existing research that is increasing. It was influenced by the following theories which have been put across by various scholars with regard to adoption of technology in society:

2.2.1 Diffusion of Innovation (DOI) Theory

This theory which seeks to describe the patterns of adoption of technology, explaining the mechanism of the adoption and further predicting whether and how a new invention or innovation will be successful, was advanced by Everett Rogers in 1962. The DoI theory proposes that technological innovation is communicated through particular channels, over time, among the members of a social system. Based on this definition, using e-filing technology is a fairly new practice in Kenya and can be seen as an innovation for each individual internet user.

According to (Rogers, 2003), the stages through which a technological innovation passes involves five steps which typically follow each other in a time-ordered manner. The stages are: Knowledge: An individual learns of the existence of the innovation, understands its functioning and seeks information on how to use it correctly.

Persuasion: This is the forming of a favorable attitude to the technology/innovation after the knowledge stage in the innovation-decision process.

Decision: At this stage, the individual chooses to adopt or reject the innovation. Rogers

defines adoption as ‘full use of the innovation as the best course of action available’ and rejection means not using the innovation.

Implementation: This is the stage at which the innovation is put into practice or use.

Confirmation: At this stage, reinforcement is based on positive outcomes from the innovation and the individual looks for support for his / her decision.

Innovation decisions may be optional (where the person or organization has a real opportunity to adopt or reject the idea), collective (where a decision is reached by consensus among the members of a system), or authority-based (where a decision is imposed by another person or organization which possesses requisite power, status or technical expertise) (Sahin, 2006).

2.2.2 Theory of Reasoned Action

This theory was advanced by Fishbone and Ajzen in 1975. The theory is based on the proposition that an individual's behavior is determined by his / her behavioral intention to perform that behavior, which provides the most accurate prediction of behavior (Fishbein and Ajzen, 1975). Behavioral intention is a function of two factors: one's Attitude toward the behavior and Subjective Norm. Attitude toward the behavior is defined as "a person's general feeling of favorableness or unfavorableness for that behavior" (Ajzen and Fishbein, 1980). Subjective Norm is defined as a person's "perception that most people who are important to him think he should or should not perform the behavior in question" (Ajzen and Fishbein, 1980).

2.2.3 Technology Acceptance Model

An adaptation of TRA, this theory was advanced by Venkatesh and Davis, and it purports that an individual's behavioral intention to use a system is determined by two beliefs: perceived usefulness, defined as the extent to which a person believes that using the system will enhance his or her job performance, and perceived ease of use, defined as the extent to which a person believes that using the system will be free of effort (Venkatesh, 2000). TAM theorizes that the effects of external variables (e.g., system characteristics, development process, training) on intention to use are mediated by perceived usefulness

and perceived ease of use. According to TAM, perceived usefulness is also influenced by perceived ease of use because, other things being equal, the easier the system is to use, and the more useful it can be. Over the years, TAM has become well-established as a robust, powerful, and parsimonious model for predicting user acceptance (Venkatesh, 2000).

The TAM model proposes the following relationship between the adoption of a new technology and this variable: The higher the perceived usefulness of the new technology, the more likely it is to be adopted by the consumer. This proposition points to the fact that the decision to adopt a new technology service, for example, ITMS, is based on a subjective perception on the part of the user (Dimitrova & Chen, 2006).

2.2.4 Economic Deterrence Model

Deterrence theory is a theory under criminology and was developed by Becker (1968). This theory is based on the concept that, if the consequence of committing a crime outweighs the benefit of the crime itself, the individual will be deterred from committing the crime. This is founded in the idea that all individuals are aware of the difference between right and wrong and the consequences associated with right or criminal behaviors. Proponents of deterrence theory believe that people choose to obey or violate the law after calculating the gains and consequences of their actions. Economic Deterrence model, one of the economic based models was developed by Allingham and Sandm (1972) who extended the expected utility model of criminal activity originated by Becker (1968) to the tax arena. This model incorporates the concept of an economically rational taxpayer who will evade taxation as long as the pay-off from evading is greater than the expected cost of being caught. Allingham and Sandmo (1972) proposed a seminal economic deterrence model based on the expected utility function of the taxpayer who evades. This model incorporates several aspects. Firstly, the taxpayer has some level of risk aversion, the more risk averse the taxpayer is, the less likely (s) he is to evade taxes. Secondly, the taxpayer needs to have knowledge regarding the taxation system in order to assess the probability of being detected, and the extent of the penalties that may be incurred upon detection. Under A-S model the taxpayer decides upon the amount of taxes to report to the taxing agency. When making this decision the taxpayer seeks to maximize expected utility which is defined to be the sum of the utility value of

each outcome weighted by the probability that the particular outcome occurs. The A-S model shows that the higher probabilities of audit deter underreporting and that a higher rate for the proportional tax leads to lower levels of reported income. The general conclusion of this theory is that compliance depends largely on tax audit and penalty. The implication of the theory is that taxpayers will pay taxes only because of the fear of sanctions.

2.3 Determinants of Tax Compliance by SMEs

2.3.1 Compliance Cost

The costs of complying with tax obligations have generated widespread interest among academics, government policy makers and business organizations. Contemporary research in the area was pioneered by Sandford who examined the cost of complying with Valued Added Tax (VAT) and other taxes for taxpayers in the United Kingdom (UK) in the 1970s and 1980s (C Sandford, M Godwin and P Hardwick, 1989).

Sandford (1989) defined Tax compliance costs as the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. Most published research adheres to the convention established by Sandford and distinguishes between gross compliance costs and net compliance costs. Net compliance costs are defined as the gross compliance costs less tax compliance benefits which include tax deductibility benefits, cash flow benefits, and managerial benefits. Tax deductibility benefits result from the fact that business taxpayers are entitled to tax deductions for some of the compliance costs they incur. Cash flow benefits arise because of the difference between the time when the tax is collected by the taxpayer and the time when it is actually handed over to the tax authorities (B Tran-Nam et al, 2000). Managerial benefits may be derived by the taxpayers, in particular business taxpayers, where the more stringent record keeping requirements imposed by tax compliance result in the production of managerial accounting information available for decision making and other business purposes (McKerchar and Walpole, 2006).

Slemrod and Yitzhaki (1996) identified compliance costs as one of the three components of the social costs of taxation. These social costs can be paraphrased as costs incurred by

society in the process of transferring purchasing power from the taxpayers to the government. The other elements are administrative costs and deadweight efficiency loss from taxation.

Administrative costs are the costs that exist besides the occurrence of compliance costs that are borne by the companies. These costs are cited as costs that the government must also take into account as a public cost to ensure that the tax legislation is obeyed. For example, it obtains the costs to collect taxes and to maintain the system to collect the taxes. These are to some extent substitutable, for example when a country transfers from a system where the tax office calculates the tax owed, to a self- assessment system. As a consequence an increased burden arises on the company. Together, the compliance costs and administrative costs are defined as the operating cost of taxation (Evans, 2001).

Deadweight efficiency loss from taxation can be defined as opportunity costs. If the compliance costs were no longer necessary, they could be used to recruit more staff, acquire additional assets or introduce higher wages for employees (Sandford, Godwin, Hardwick and Slemrod, 1989).

2.3.2 Tax Knowledge and Education

The influence of knowledge on compliance behaviors has been assessed in various researches. Knowledge as one of the factors in compliance is related to the taxpayers' ability to understand taxation laws, and their willingness to comply. The aspect of knowledge that relates to compliance is the general understanding about taxation regulations and information pertaining to the opportunity to evade tax (Kasipillai, Norhani, and Noor, 2003).

Taxation knowledge is necessary to increase public awareness especially in areas concerning taxation laws, the role of tax in national development, and especially to explain how and where the money collected is spent by the government (Mohd, 2010). Attitude towards tax compliance can be improved through the enhancement of taxation knowledge. When a taxpayer has a positive attitude towards tax, this will reduce his or her inclination to evade tax payment (Eriksen&Fallan, 1996). Self assessment system (SAS) requires taxpayers to understand all the laws and regulations that govern taxation.

This is necessary because taxpayers will have to calculate themselves the amount of tax they need to pay and make the payment (Kasipillai, 2003). Taxpayers will readily accept any new system introduced, like the SAS, if they have ample knowledge to understand the system. Thus, education programs organized by the tax authority or other public education institutions are needed to enhance taxpayers' ability to understand Self assessment system and to increase their confidence in fulfilling their responsibilities as taxpayers (Mohani, 2001).

Greater education is directly linked to a likelihood of compliance. Educated taxpayers may be aware of non compliance opportunities, but their potentially better understanding of the tax system and their higher level of moral development promotes a more favorable taxpayer attitude and therefore greater compliance (Chan et. al. 2000). Chan *et. al.* also suggested that those with a higher education level are more likely to have a higher level of moral development and higher level attitudes toward compliance and thus will tend to comply more. One of the measures to increase voluntary compliance is by assuring that taxpayers have a certain level of qualifications, ability and confidence to exercise their tax responsibility (Mohani, 2001). Taxpayers who have attended a tax course would be expected to have better tax knowledge and tax compliance attitude in comparison with taxpayers who have never attended a tax course (Mohd, 2010). Hite and Hasseldine (2001) highlighted that tax authority need to emphasize teaching tax courses because of impact of education on compliance.

2.3.3 Fines and Penalties

Fines and penalty rates may substitute each other due to their multiplicative linkages as long as neither of them is set to zero (Kirchler et al 2007). Higher fines simply make evading taxes more hazardous for taxpayers and should deter them from evasion.

Empirically, the deterrent effect of fines could not always be supported. The observed effects were weaker than expected and some studies even suggest that an increase of penalties can have undesirable effect and result in more tax avoidance (Kirchler et al, (2007).

Alm et al., (1992) supports the evidence that fines do affect tax compliance though the

impact was virtually zero. Friedland *et al.*, (1978) compliance was strongly affected by the amount of fines than by audit probabilities. Several studies however found no support for the deterring effects of fines since it was weak (Andreoni, 1998). Some of the findings suggest that a policy based on deterrence is effective only in combination with frequent Audits (Kirchler *et al.*, 2007).

From the tax administration viewpoint, researchers have concluded that compliance could be influenced by educating taxpayers of their social responsibilities to pay and thus their intention would be to comply. As a behavior problem, tax compliance depends on the cooperation of the public. There are greater gains in assisting compliant taxpayers meet their fiscal obligations rather than spending more resources pursuing the minority of non-compliers. Assisting tax payers by improving the flow and quality of information or education them (e.g., TV campaigns) in to becoming more responsible citizens has the potential to yield greater revenue than if it were spent on enforcement activities. A theoretical economic model introduced by Allingham and Sandmo (1972) has clearly indicated that penalties as well as audit probability have an impact on tax compliance. The higher the penalty and the potential audit probability the greater discouragement for potential tax evasion.

The most extreme penalties will have no effect, if it is common knowledge that audits virtually do not occur. The increasing tax avoidance and tax resistance due to an increase of fines puts into question how fines should be assessed to be effective. On the one hand fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on tax payers. On the other hand, if fines are too high, the tax system would be perceived as unjust and unfair and taxpayers would use any possibility to legally avoid taxes (Kirchler *et al.*, 2007). In Kenya for instance, the maximum penalty for tax evasion is 20% of the evaded amount (Sec 72 D IT Act, Cap 470). In summary evidence suggests fines have mixed impact on tax compliance.

2.3.4 Perceived Opportunity for tax evasion

Business owners are often mentioned as a high-risk group in terms of tax compliance because their opportunities to evade are high. Opportunity has often been documented as a major explanatory factor in non-compliance (Webley, 2004). In particular, if incomes

are not subject to automated third-party reporting, or if taxes are not withheld at source (e.g. in cases of receiving gross incomes or cash payments), opportunities to evade taxes exist (Williams and Round, 2009).

The link between opportunity and non-compliance seems to have at least two different facets. First, in cases where people do not deliberately capitalize on opportunities, the specific circumstances leading to evasion opportunities might still lead to non-compliance. Opportunities usually come about when tax filings are not entirely automated. Through the lack of automation tax filing procedures are more likely to become error prone even without intent to capitalize on the entailed opportunities. Consequently, opportunities may lead to an increase in intended as well as unintended non-compliance. For instance, Robben et al. (1990b) show that an experimentally induced opportunity to cheat (more possibilities to deduct non-deductible expenses) increased non-compliance regardless of whether the participants actually intended to be non-compliant or not.

Second, assuming that people are willing to capitalize on opportunities, they are able to do so only if the opportunities are recognized in the first place. However, opportunities to evade often tend to remain unnoticed. While many taxpayers perceive opportunities for evading small amounts, only a minority perceives opportunities for evading larger amounts (Antonides and Robben, 1995). Such failure to perceive opportunities even persists in laboratory experiments explicitly manipulating opportunity. Whereas controlling for intended evasion annihilated the effect of opportunity on evasion, simultaneously controlling for intended evasion and perceived opportunity re-established the main effect of opportunity on non-compliance (Robben et al., 1990b). Indeed, it has been shown that those actually evading perceive increased opportunities to do so (Ashby et al., 2009).

Overall, actual opportunities can increase both intentional and unintentional evasion. Although such a distinction is theoretically and practically meaningful, it is difficult to determine whether filing errors were intentional or not. For example, in a study by Slemrod et al. (2001), taxpayers were informed that their tax files would be closely examined. Those with considerable opportunities to evade, including small business owners, reacted to this message by increasing their tax payments significantly. Even

though this might indicate severe tax evasion – as assumed by Slemrod et al. (2001) increased tax payments in response to the prospect of being audited may also originate from increased willingness to avoid errors. Those taxpayers facing high opportunities for evasion might feel less certain about how to pay their taxes correctly (Ahmed and Braithwaite, 2005), and consequently, threats may also elicit partly unintentional over reporting, just to be on the safe side.

To conclude, opportunity is a key constituent of small business tax compliance and its role is moderated by its perceptual correlates. Given the opportunity to evade, those unwilling to evade may become involuntarily non-compliant and those willing to evade may fail to perceive the chance to do so. In order to determine the actual effect of opportunity, it is necessary to control for compliance intention as well as opportunity perception.

2.4 Review of empirical studies

Madola (2013) in his study on the factors affecting adoption of ITMS by Small and Medium sized entities in Nairobi between the years 2008 and 2012 revealed that perception of taxpayers towards e-filing technology as well as its perceived ease of use and perceived usefulness greatly determine the adoption and usage of the system. Over 88.9% of the 245 interviewed taxpayers in Nairobi consider e-filing technology a beneficial idea and its availability motivates them to comply with their tax obligations, particularly because they find the online system efficient as compared to the manual system. However, they feel K.R.A has not put in place enough measures to ensure that taxpayers know how to use the system. This could also be a reason as to why those who do not feel the e-filing technology is a necessary or efficient system are yet to appreciate it and use it.

Osebe (2013) in his study of the factors affecting tax compliance by Real Estate developers in Nakuru town revealed that tax compliance cost is a contributory factor to tax compliance, and an indication of its magnitude effect. From the study findings there is enough indication that tax compliance cost is associated with high levels of tax compliance. The study also provides some preliminary evidence that fines and penalties play a vital role in improving tax compliance. Specifically, for a tax system with fair tax

rates of fines and penalties, tax compliance is likely to improve. The study results also inferred that perceived opportunity for tax evasion has a significant effect on tax compliance. This is because through opportunity, induced opportunity to cheat increased non-compliance regardless of whether the participants actually intended to be non-compliant or not. Finally, the study concludes that tax knowledge and education has a significant effect on tax compliance. It is therefore prudent for the tax system to enhance education on how to file tax returns and the importance of paying tax. Of the 271 tax payers interviewed 149 had used e filing to file their income tax returns.

Simiyu (2013) in his study on the challenges affecting collection of turnover taxes in Nairobi county indicates that the effective remedies for tax collection include putting in place tough laws to check evaders, frequent taxpayer education and sensitization, putting in place mechanisms to address public misconceptions or inaccuracies and providing information in a customer-focused way to reduce error. The mode of payment of the taxes is time consuming and tedious for most SMEs and that they encounter problems when filing tax returns .Most SMEs do not understand their obligations hence greatly reducing tax collection. The manner in which tax is collected encourages extortion because the taxpayers are ignorant of their rights and are not involved in formulation of taxation policies. Tax officers accept bribes when offered to reduce tax liability and demand for bribes when they visit thus greatly affecting collection. 68 SME in Buruburu were targeted but only 40 completed the questionnaires successfully leading to a response rate of 58.82 %.

Mwonge, (2011) conducted a study that sought to find out the influence of electronic tax filing on tax collection and compliance in Uganda .He found out that with the commencement of an e-filing system (e Tax) in June 2009, at least US\$ 7 trillion worth of revenue resulting from 1.4 million payments has been receipted through electronic tax payments. This revenue is a result of over 360,000 tax returns that have been received online.He made the recommendations that the tax authority should upgrade the e tax servers, incorporate user friendly features to improve tax payer's interest in the use of the system and embark on a country wide sensitization programe to enhance the adoption of the system.

Seatini (2010) conducted a study that sought to find out the challenges facing tax revenue collection in Uganda (among other objectives) and came up with five pertinent challenges

that were found to have serious impact on tax revenues. The challenges were: the biggest population of the workforce is found in agriculture or in small and informal enterprises which makes it difficult to impose taxes on them; tax evasion and avoidance practices contribute greatly to shrinking the country's taxable base; the limited capacity of revenue collecting agencies both at the central and local levels; and poor quality of basic data that can be utilized in tax collection.

A study by Ojeka (2011) found that Small and Medium Enterprises play a very important role in development of the Nigerian economy, making up about 97% of the entire economy. The research work sought to establish if any relationship exists between the growth of SMEs and the tax policy in Nigeria. It was found that most SMEs surveyed were faced with the problem of high tax rates, multiple taxation, complex tax regulations and lack of proper enlightenment or education about tax related issues. Although there was a general perception that tax is an important source of fund for development of the economy and provision of social services, the study revealed a significant negative relationship between taxes and the business' ability to sustain itself and to expand. A suggested solution by this study was increasing tax incentives through reducing tax rates and increasing tax authorities' support services towards small and medium enterprises.

Brondolo (2009) conducted a study on the challenges facing tax collection and strategies and measures for responding to the challenges among EU countries during the global financial and economic crisis of 2008. The study posited that an economic downturn tends to worsen taxpayer compliance in important aspects. Consequently tax agencies were encouraged to develop tax compliance strategies that are structured around two objectives: containing the growth in noncompliance and helping taxpayers to cope with the crisis. To achieve these objectives, four sets of measures were identified: expanding assistance to taxpayers; refocusing enforcement on the highest revenue risks; introducing legislative reforms that facilitate administration; and improving communication and outreach programs.

Schneider and Torgler (2007), using various statistical procedures and data from 110 developing, transition, and OECD countries, estimated the size of the underground economy in developing, developed, and transition countries. Analysis on a indicated that the level of activities of the underground economy is substantially higher in developing

and transition countries compared to developed countries. In Africa, 41 % of GDP comes from the informal sector, in Central and South America 41 %, in Asia 29 %, in Economies in Transition 35%, in European OECD countries 18 %, and in North American and Pacific OECD countries 13%. As they found, while some developing countries showed a level of informal sector activities comparable to OECD countries, the informal economy in other countries exceeded 50% of GDP.

Mohd Rizalpalil in (2010) study titled ‘Tax Knowledge and Tax Compliance determinants in Self-Assessment System in Malaysia’ concluded that in the self-assessment system in Malaysia, tax knowledge has a significant impact on tax compliance and the level of tax knowledge varies among respondents. Males, Malaysian, residents of Eastern region, high income earners and taxpayers who have attended tax courses appear to be the most knowledgeable taxpayer groups. The results also indicate that tax compliance was influenced by probability of being audited, perception of government spending, penalties, personal financial constraints, and referent group. These results were validated through a multiple method of questionnaires (direct and hypothetical questions) and analysis (stepwise multiple regressions and multiple regressions)

2.5 Summary of Literature Review

To date, there has been little research exploring effect of Electronic filing systems on Tax compliance.

The existing studies reviewed in this research proposal provide a useful starting point for assessing the effect of Integrated Tax Management System (ITMS) on tax compliance by small and medium sized enterprises.

The research outlined in this paper aims to address this gap. The specific aim of the research is to gain insight into the e filing as a determinant of tax compliance in addition to tax compliance cost, tax knowledge and education, fines and penalties as well as perceived opportunities for tax evasion.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the research methodology as the mode of achieving the purpose of the study. It specifically highlights the methods used in carrying out the study in an attempt to answer the research questions. In addition, various methodological issues discussed include population, sampling technique(s), sampling frame, sampling size, data collection and analysis of the methods adopted in conducting the study. It also gives the data validity and reliability statement.

3.2 Research Design

A descriptive survey design was adopted for this study. A descriptive survey design is best for this study as it describes characteristics associated with the subject population, and in particular factors that make them behave the way they do. According to Cooper and Schindler (Cooper, 2003) descriptive design discovers and measures the cause and effect of relationships between variables. Mugenda and Mugenda (Mugenda, 2003) state that a descriptive research determines and reports the way things are and attempt to describe possible behavior, attitude, values and characteristics of such things. The study used a descriptive design because it enables the researcher to collect a large quantity of in-depth information about the population being studied. A survey design was appropriate as the data required for analysis needed to be collected from a large population, which is Medium and Small taxpayers operating within Nairobi Central Business District. The unit of analysis for the study is every individual taxpayer that has used the e-filing system.

3.3 Target Population

The focus of the study was on Medium and Small Taxpayers operating in Nairobi. The population of interest for this study comprised of 200 registered Medium and Small Taxpayers. Cooper and Schindler (Cooper, 2003) define a population element as the subject on which the measurement is being taken and is the unit of study. Nairobi Central Business district was of particular focus for this study due to its large concentration of

business entities and diversity of business entities who are users of ITMS.

3.4 Sample

The sample size of this study comprised of 100 SMEs. This sample size conforms to Mugenda & Mugenda (2003) who contend that a sample size should be at least 30% of the population. The researcher will randomly chose respondents.

3.5 Data Collection

The study employed primary data collection. Primary data was collected through a self-made questionnaire as well as in depth interview method. The questionnaire adopted structured open ended as well as closed questions.

3.6 Data Analysis and Presentation

Data was analyzed using Statistical Package for Social Sciences (SPSS Version 20.0) program. Both quantitative analysis and regression analysis was used as data analysis technique. The data collected was run through various models so as to clearly bring out the effect of integrated tax management system on tax compliance by SMEs in Nairobi Central Business District.

3.7 Data validity and reliability

According to Kothari (Kothari, 2004), validity is the degree to which an instrument measures what it is supposed to measure. Therefore, the term refers to the extent to which an instrument asks the right questions in terms of accuracy. The content validity of the research instrument for this study was determined through piloting, where the responses of the subjects were checked against the research objectives. For a research instrument to be considered valid, the content selected and included in the questionnaire must be relevant to the variable being investigated (Kothari, 2004).

Reliability of an instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trials (Cooper, 2003). To test the reliability of the questionnaire as a research instrument, a test-retest technique was employed.

3.8 Operationalization of variables

The measurement of variables in the study and relationship between the variables and the survey questions are illustrated in table 3.1.

Table 3.1: Operationalization of variables

Objective	Variable	Indicator	Tools of Analysis	Type of Analysis
To estimate tax compliances levels by Medium and Small enterprises in Nairobi Central Business District.	Dependent	Timely filing of tax returns and payment of taxes	Frequencies	Descriptive statistics
To Determine effect of Integrated Tax Management System on tax compliance Level	Independent	Adoption of ITMS for filing of tax returns and payment of taxes	Frequencies	Descriptive statistics
To determine the effect of compliance cost on tax compliance level	Independent	Cost of traveling, filing and hiring tax agents.	Frequencies	Descriptive statistics
To examine the effect of tax knowledge and education on tax compliance level		Awareness of tax obligations and compliance requirements.	Frequencies	Descriptive statistics
To assess the effect of fines and penalties on tax compliance level	Independent	Extent of penalties and enforcement efforts by KRA.	Frequencies	Descriptive statistics
To evaluate the effect of perceived opportunity for tax evasion on tax compliance level	Independent	Opportunities for tax evasion.	Frequencies	Descriptive statistics

3.9 Analytical model

A Multiple linear regression model was used to predict tax compliance using the five independent variables in the study: tax compliance cost, tax knowledge and education, fines and penalties and perceived opportunity for tax evasion. In addition, the β coefficients for each independent variable generated from the model and subjected to a z-test, in order to test each of the hypotheses under study. The regression model used to test is shown below:

$$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \epsilon$$

Where; Y - Tax compliance

α - Constant

$\beta_1, \beta_2, \beta_3, \beta_4$ and β_5 - Coefficient indicating rate of change of tax compliances as adoption of ITMS, tax compliance cost, tax knowledge and education, fines and penalties and perceived opportunity for tax evasion changes

X1 - Adoption of ITMS

X2 - tax compliance cost

X3 - tax knowledge and education

X4 - tax fines and penalties

X5 - perceived opportunity for tax evasion

ϵ - Error term

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This chapter presents results of the study based on the formulated objectives as presented in chapter one. The chapter analyzes the variables involved in the study. In the first two sections data description and analysis is presented. The model estimation and the analysis of the results are then discussed. Finally concluding remarks are made. Data description involves a discussion on the sources of data and definitions of the dependent and the independent variables. Data collected was quantitatively analyzed and presented in tables.

4.2 Demographic Information

Demographic information shows the characteristics of the elements in the sample size: As such the researcher sought to establish the general information of the respondents, which forms the basis under which the interpretations are made. Demographic factor one analyzed the gender of the respondents. This information was necessary to enable the researcher to obtain information on whether the respondents were either male or female. 73% of the respondents were male whereas 27% were female.

Demographic factor 2 shows the age brackets of respondents, 7.7% of the respondents are between 18-30 years of age, 42.3% are between 31-40 years, 38.5% are in the 41-50 age bracket and 11.5 % are over fifty years of age. This result illustrates that most of the medium and small enterprises investors are generally between thirty and fifty years of age.

Demographic factor 3 examines the academic qualifications of the respondents. The information is necessary to enable the researcher to know whether the respondents are educated or illiterate. Information on the academic qualifications of the respondents is statistically shown in table 4.1 below. It reflects the academic qualifications of the respondents. 26.9% have a high school certificate; 55.8% have an undergraduates Degree and 17.3% have a post graduate qualification. The study indicates that majority of respondents in the study area are fairly educated.

Table 4.1 Demographic Information

		Frequency	Percent
Gender	Male	38	73
	Female	14	27
	Total	52	100
Age bracket	18-30	4	7.7
	31-40	22	42.3
	41-50	20	38.5
	Above 50	6	11.5
	Total	52	100
Level of Education	None	-	-
	Primary	-	-
	Secondary	14	26.9
	Undergraduate	29	55.8
	Postgraduate	9	17.3
	Total	52	100

4.3 Annual Turnover

Findings on the annual turnover affirmed that the turnover between 1-10 million was 61.5% whereas turnover between 11-15 million was 25%. In addition, annual turnover between 16-20 million was 7.7%. Annual turnover above 21 million was 5.8%. The results reveal that most of the medium and small enterprises in Nairobi central business district have their annual turnover below 15 million.

Table 4.2: Annual turnover

Annual Turnover	Frequency	Percent
Below Million 1-10 Million	32	61.5
11-15 Million	13	25.0
16-20 Million	4	7.7
Over 21 Million	3	5.8
Total	52	100

4.4 Personal Identification Number

The researcher inquired as to whether the respondents' business had a PIN. This was to determine that the businesses are registered for tax purposes as the PIN is a mandatory requirement for all operating businesses. The findings are presented in table 4.3 all the

respondents have a PIN according to the results of the findings and are therefore duly registered for tax purposes.

The respondents were requested to indicate on how they registered for their business' personal identification number, either online or manually. The results of the findings are tabulated in the table 4.3. The results reveal 66.5% of the respondents registered online while 33.5% registered for their PINs manually at KRA office. According to the results of the findings, majority of the respondents registered for their respectful PINs online.

Table 4.3: Personal identification Number

		Frequency	Percent
Respondents with PIN	Yes	52	100
	No	-	-
	Total	52	100
Mode of PIN registration	Online	40	76.9
	Manual	12	23.1
	Total	52	100

4.5 Tax compliance level

The results in table 4.4 reveal that on average SMEs file their Income Tax ,VAT ,PAYE and Withholding Tax returns on time (Mean= 4.0962,4.1923,4.1538 and 4.3846 respectively). They also pay the right amount of taxes on time (mean = 4.2115).

Generally tax compliance levels was (mean=4.2077)

Table 4.4: Tax compliance Levels

	Mean	Std. Deviation	Skewness	Kurtosis
I file all my income tax returns on time.	4.0962	.84621	-.390	-.973
I file all my VAT returns on time.	4.1923	.92965	-.401	-1.759
I deduct PAYE and remit the amounts on time.	4.1538	.95762	-.877	.397
I deduct withholding tax on professional fees and remit to KRA on time.	4.3846	.77089	-.798	-.840
I pay all my taxes within the required time frame.	4.2115	.84799	-.427	-1.485
Tax compliance Levels	4.2077	.83451	-.512	-1.294

4.6 Adoption of ITMS

The results in table 4.5 reveal that most SMEs use ITMS for filing their PAYE, VAT and Income Tax (Mean= 4.6538, 4.7308 and 4.5962 respectively). They also use ITMS for payment of Taxes (mean = 4.2692).

Generally Most SMEs have adopted ITMS (mean=4.5625)

Table 4.5: Adoption of ITMS

	Mean	Std. Deviation	Skewness	Kurtosis
I use ITMS for filing PAYE returns	4.6538	.48038	-.666	-1.620
I use ITMS for filing VAT returns.	4.7308	.44789	-1.072	-.887
I use ITMS for filing income tax returns.	4.5962	.49545	-.404	-1.912
I use ITMS for paying my taxes	4.2692	.44789	1.072	-.887
Adoption of ITMS	4.5625	.39876	-.428	-1.463

4.7 Tax Compliance Cost

Findings on tax compliance cost shows that respondents were satisfactory on the cost of filling a tax return (mean=2.9615) which confirms that the respondents agreed that the cost of filling a tax return is fair, also respondents believe the cost of hiring a tax agent is fair (mean= 2.8269).

Similarly, the cost of travelling in order to fill a return is fair (mean=3.6923).

Generally tax compliance costs are fair (mean=3.1603)

Table 4.6 Tax compliance Cost

	Mean	Std. Deviation	Skewness	Kurtosis
The cost of filing a tax return is high	2.9615	1.62048	.007	-1.531
The cost of hiring a tax agent is high	2.8269	1.59314	.113	-1.448
The cost of travelling in order to file a return is high.	3.6923	1.43539	-.920	-.413
Tax compliance cost	3.1603	1.49871	-.170	-1.433

4.8 Tax Knowledge and Education

Tax knowledge and education was inquired from the respondents. From the study results, respondents are not certain on how to declare actual income received from all sources to the tax authority (mean=2.75). Also, respondents are not certain on how to keep records/documents pertaining to income and expenditure for a period of seven years after submission of the tax return (mean=2.6154) and they seem not to understand that they should pay tax due within the prescribed period from the date of issue of the notice of assessment or within the stipulated period (mean=2.9423). Further, respondents seem not to know which income should be included or excluded in determining the taxable income (mean=3.0385).

Generally findings on tax knowledge and education was (mean=2.8365)

Table 4.7 Tax Knowledge and Education

	Mean	Std. Deviation	Skewness	Kurtosis
I know how to declare actual income received from all sources to the tax authority	2.7500	1.39853	.333	-1.374
I know how to keep records/documents pertaining to income and expenditure for a period of seven years after submission of the Tax Return	2.6154	1.43012	.386	-1.374
I understand that I should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period	2.9423	1.69675	-.132	-1.767
I know which income should be included or excluded in determining the taxable income	3.0385	1.31300	.143	-1.487
Tax Knowledge and education	2.8365	1.39667	.213	-1.505

4.9 Fines and Penalties

Findings on Fines and Penalties reveal that the enforcement is not very strong (mean=3.3077), respondents were not certain on whether the penalty is lower than their tax saving due to not complying with tax laws (mean=3.2115). Finally, respondents seemed unsure on whether serious enforcement and penalty by the KRA may result if they do not comply (mean=3.1538).

Generally findings on tax fines and penalties was (mean=3.2244)

Table 4.8 Fines and Penalties

	Mean	Std. Deviation	Skewness	Kurtosis
The penalty rates are very low and I can afford to pay the penalty	3.2115	1.41887	.038	-1.352
The enforcement is very weak	3.3077	1.52802	-.237	-1.442
Serious enforcement and penalty by the KRA may result if I do not comply	3.1538	1.57660	-.264	-1.396
Fines and penalties	3.2244	1.48004	-.129	-1.439

4.10 Perceived Opportunity for Tax Evasion

Regarding findings on Perceived opportunity for tax evasion in table 4.9, respondents agreed that since supporting documents do not need to be sent to the KRA, they can manipulate the figure in the tax return(mean =4.2692), respondents were not certain if they are detected not reporting the exact income, that the tax authority is tolerant towards the offence and most probably it will escape without any punishment (mean=2.8077), respondents were uncertain that the tax authority has limited capability to investigate all income reported to them so they have an opportunity not to report their exact income(mean=2.7308) .In general, findings on perceived opportunity for tax evasion was found to be (mean=3.2692)

Table 4.9 Perceived Opportunity for Tax Evasion

	Mean	Std. Deviation	Skewness	Kurtosis
Since the supporting documents do not need to be sent to the KRA, I can manipulate the figure in the tax return	4.2692	.88817	-.917	-.202
If detected not reporting my exact income, I believe that the tax authority is tolerant to my offence and most likely I will escape without punishment.	2.8077	1.68078	.187	-1.683
I believe the tax authorities have limited capability of detecting tax evasion.	2.7308	1.66998	.183	-1.730
Tax evasion	3.2692	1.36409	.033	-1.720

4.11 Regression

A Multiple linear regression model was used to predict tax compliance in the study. The prediction was carried out basing on the effect of the five independent factors: Adoption of ITMS, tax compliance cost, tax knowledge and education, tax fines and penalties and perceived opportunity for tax evasion. In addition, the b coefficients for each independent variable generated from the model was subjected to a t-test, in order to test each of the hypotheses under study. The study thus came up with a model summary, the anova for the effect sizes and the regression model as presented in table 4.10, 4.11 and 4.12. From table 4.10, the findings indicated that the model correlation coefficient was 0.978 which indicated that the model predicted over 98% of the change in the independent variable. This relationship was significant considering the coefficient of determination value of 0.957. The model was adequate in this case as indicated by the Durbin-Watson statistic value of 1.124 which is in the range of 1 to 2.

Table 4.10: Model summary

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
.978	.957	.953	.18175	1.124

a. Predictors: (Constant), Adoption of ITMS, Tax compliance Cost, Tax knowledge and education, Tax fines and penalties, Perceived opportunity for tax evasion

b. Dependent Variable: Tax compliance level

Source: (Survey Data, 2014)

The ANOVA model in table 4.11 showed that the regression model was also adequate. The effect size of the regression model was shown to be over 205 that contributed by the residual mean sum of squares. The F-ratio was 205.831 at 4 degrees of freedom which are the four factors.

This represented the effect size of the regression model and was significant with a p-value of 0.000.

Table 4.11: ANOVA Model

	Sum of Squares	df	Mean Square	F	Sig.
Regression	33.997	5	6.799	205.831	.000
Residual	1.520	46	.033		
Total	35.517	51			

a. Dependent Variable: Tax compliance

b. Predictors: (Constant), Tax compliance cost, tax knowledge and education, tax fines and penalties and perceived opportunity for tax evasion.

Source: (Survey Data, 2014)

4.12 Coefficients Model

The regression results in table 4.12 show that each of the predicted parameters in relation to the independent factors were significant; $\beta_1 = 0.621$ (p-value = 0.000 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between Adoption of ITMS and tax compliance level. This indicates that for each unit increase in the effect of Adoption of ITMS, there is 0.621 units increase in tax compliance level.

The table shows $\beta_2 = -0.753$ (p-value = 0.001 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between tax compliance cost and tax compliance level. This indicates that for each unit increase in the negative effect of tax compliance cost, there is 0.753 units decrease in tax compliance level.

The table also shows that $\beta_3 = -0.254$ (p-value = 0.175 which is more than $\alpha = 0.05$)

which indicates that we accept the null hypothesis stating that there is no significant relationship between tax knowledge and education and tax compliance.

The value of $\beta_4 = 0.973$ (p-value = 0.000 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between tax fines and penalties and tax compliance. This indicates that for each unit increase in tax fines and penalties, there is up to 0.973 units increase in tax compliance.

The findings also showed that β_5 was 0.396 (p-value = 0.051 which is More than $\alpha = 0.05$) which implies that we accept the null hypothesis that states that there is no significant relationship between perceived opportunity for tax evasion and tax compliance levels.

Table 4.12 Coefficients model

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	-2.528	.971		-2.603	.012
Adoption of ITMS	1.300	.262	.621	4.960	.000
Tax Compliance costs	-.419	.124	-.753	-3.388	.001
Tax Knowledge and Education	-.152	.110	-.254	-1.377	.000
Tax fines and Penalties	.548	.132	.973	4.159	.000
Perceived opportunity for tax evasion	.243	.121	.396	2.008	.051

a. Dependent Variable: Tax compliance

Source: (Survey Data, 2014)

4.13 Summary and Interpretation of the findings

Findings on gender revealed that there are more male than females among the respondents indicating that more men than female are Medium and Small investors. It was also affirmed that majority of the respondents were between the age bracket of 30-50 years and they. It was also brought to light that majority of respondents were fairly educated, those with a undergraduate Degree contributing the highest percentage followed by those with an Secondary School certificate affirming that there were

moderate levels of literacy among the respondents.

Findings on information about Turnover affirmed that majority of Medium and Small Enterprises have a turnover below 10 million.

Findings on Personal identification numbers revealed that most Medium and Small Enterprises have got personal Identification numbers which were generated online.

The study found that compliance levels among Medium and Small Enterprises is Moderate. There is therefore a need for tax authorities and the government to come up with strategies to effectively monitor this category of taxpayers with a view of enhancing compliance levels.

An analysis of the effect of Adoption of ITMS on tax compliance level revealed a strong Positive correlation meaning that Adoption of ITMS has a significant effect on the level of tax compliance. This means that higher adoption of ITMS for filing PAYE VAT and Income tax Returns as well as for payment of Taxes will enhance tax compliance levels. This is in agreement with a study conducted by Mwonge, (2011) .He found out that with the commencement of an e-filing system (e Tax) by Uganda Revenue Authority in June 2009, there was an increase of US\$ 7 trillion worth of revenue resulting from 1.4 million payments that had been receipted through electronic tax payments. This revenue is a result of over 360,000 tax returns that have been received online.

A determination of the effect of compliance cost on tax compliance level revealed a strong negative correlation meaning that compliance cost has a significant effect on the level of tax compliance. This means that higher compliance costs will reduce tax compliance levels.

This study finding is in agreement with Slemrod and Yitzhaki (1996) that compliance cost is one of the three elements of social costs of taxation which are incurred when purchasing power is transferred from the taxpayers to the government. As Hijattulah and Pope (2008) argue compliance costs include costs that are incurred by a company, but are beyond the control of its management hence tax compliance cost is likely to affect tax compliance in the real estate sector.

The study also examined the effect of tax knowledge and education on tax compliance level. The findings show there is a significant a strong negative correlation relationship between the two. A study by (Mohd, 2010) asserts that tax knowledge is necessary to increase public awareness on taxation rules and the role of taxation in national development. Once individuals have the knowledge pertaining the importance of taxation, they will be influenced to comply without any enforcements or pressure on them. In addition attitude towards taxation can also be improved through taxation knowledge, thus when a taxpayer has a positive attitude toward tax, this may influence him or her to comply (Eriksen&Fallan, 1996).

An assessment of the effect of fines and penalties on tax compliance levels revealed that there is a significant positive relationship between them. This implies that an effective use and enforcement of fines and penalties on tax offenders will enhance levels of tax compliance. This in agreement with studies by Friedland et al. (1978) that compliance was strongly affected by the amount of fines than by audit probabilities. Studies by Allingham and Sandmo (1972) indicate that penalties as well as audit probability have an effect on tax compliance, thus the higher the penalty and the potential audit probability the greater discouragement for potential tax evasion.

The study having evaluated the effect of perceived opportunity for tax evasion on tax compliance level concluded that there is a no relationship between the two implying that a perceived opportunity for tax evasion will not affect levels of tax compliance.

CHAPTER FIVE

SUMMARY CONCLUSION AND RECCOMENDATIONS

5.1 Summary

The researcher sampled 100 Medium and Small taxpayers operating within Nairobi's Central Business District. 86 of the targeted respondents filled in and returned the questionnaires, giving an 86% response rate. A majority of respondents in the study area had at least an undergraduate degree which indicated that they are fairly educated. Relying on the responses given by the respondents; the researcher came up with findings which were used to make conclusions and give recommendations.

The results reveal that most of the medium and small enterprises in Nairobi central business district have their annual turnover at below 15 million; they are run by men of between 30 and 50 years and 100% of the respondents do have a PIN for their respective business. Most small enterprises are fairly tax compliant and have adopted ITMS.

Most medium and small enterprises in Nairobi central business district believe adoption of ITMS for filing PAYE VAT and Income tax Returns as well as for payment of Taxes will enhance tax compliance levels. The findings of this study reveal that majority of the respondents think that development of ITMS as an e-filing system in a bid to modernize and automate tax collection is a wise idea which motivates them to comply with their tax obligations. This positive attitude coupled with the perception that in comparison to the manual system of tax registration and submission of tax returns, the online system is efficient indeed influences them to use ITMS.

They also believe that higher compliance costs will reduce tax compliance levels while higher fines and penalties will increase compliance levels.

Most medium and small enterprises in Nairobi central business district believe that higher tax knowledge and education on tax compliance enhances tax compliance levels.

They also believe that perceived opportunity for tax evasion does not affect tax compliance levels.

5.2 Conclusion

These study findings provide direct evidence that Adoption of ITMS is a contributory factor in tax compliance, and an indication of its magnitude effect. From the study findings there is enough proof to conclude that Adoption of ITMS is associated with high levels of tax compliance.

The study provides evidence that tax compliance cost, Tax knowledge and Education, and tax fines and penalties are contributory factors in tax compliance. Specifically, for a tax system with fair tax rates of fines and penalties, tax compliance is likely to improve.

Finally, the study results also inferred that perceived opportunity for tax evasion have no effect on tax compliance.

To enhance tax compliance governments should enhance Adoption of E filing systems such as ITMS, reduce tax compliance costs and enhance tax fines and penalties as well as tax knowledge and education.

5.3 Recommendations to policy and practice

From the study findings it was deduced that Adoption of ITMS has a profound effect on tax compliance. The findings suggest tax systems that have adopted e-filing systems are most likely to be complied with. Therefore, tax systems should adopt e-filing systems.

To further increase the rate of adoption and ITMS usage, the option of manual filing should be faced out and completely abolished. However in so doing, the challenges experienced when using ITMS should be addressed and user friendliness of the system enhanced. The e-filing process should be simplified with clear instructions and guidelines provided on the website and the system server should be upgraded to reduce on the system downtimes experienced. There should be an interactive feedback portal on the website where taxpayers can provide their input on areas where the authority can improve and the challenges taxpayers experience can be addressed without them having to go to a K.R.A office.

The study findings it was deduced that tax compliance cost has a profound effect on tax compliance. The findings suggest tax systems with low tax compliance costs are most likely to be complied with. Therefore, the tax compliance cost should be in a way that does not encourage taxpayers to evade tax.

Also, tax knowledge and education has a significant effect on tax compliance. Thus K.R.A should undertake intensive and increased sensitization of taxpayers to make them aware of the e-filing system, how it works and advantages of using it so that taxpayers can understand and appreciate it. The authority should also frequently hold training seminars countrywide on the e-filing process and also visit taxpayers in their business premises to give them any assistance they may need

K.R.A should also undertake thorough taxpayer education from high school level so that taxpayers gain knowledge and understanding of the taxation system, appreciate it and are consequently able to comply with the tax obligations. Taxpayers should also equip themselves by gaining knowledge relating to tax by reading the Taxation Acts and guides provided on the K.R.A website so as to increase and improve their understanding and taxation knowledge which will enable them fully, correctly and easily comply with their tax obligations, particularly filing of tax returns.

The study also finds strong support for the argument that fines and penalties impacts highly on tax compliance, thus there should be moderate levels of fines and taxes to employ. This way, tax payers will be encouraged to comply since they will keep accurate records for taxation purposes in order to avoid fines and penalties.

5.4 Limitations of the Study

First, the Likert scale which was used to collect data is highly qualitative. This meant that the responses provided may be no more than mere opinions of the respondents and not necessarily the situation on the ground. The Likert scale is highly dependent upon the rationality status of the person providing the response. It is possible that if the questionnaires were given to other officers in the same companies, the results would be significantly different.

E filing is a new concept in Kenya. The results in this study may be imprecise due to the limitations of the data. More years of data and more micro-level, or individual taxpayer level data would help in estimating the effect of electronic filing on compliance more precisely, leading to more effective policy evaluation and thus improving compliance.

The findings only address a specific instance in time, that is, the time when the questionnaires were completed by the SMEs. The findings and the corresponding suggestions of remedies are highly dynamic and dictated by the ever changing factors in the SMEs and the tax collection agencies. This limits the universalization of the findings of this research across time and across countries.

5.5 Suggestions for further studies

In future, researchers should replicate this study to cover the whole country. A study on the self-assessment system can also be carried out to determine its effectiveness on enhancing tax compliance levels. Further the study should also put into consideration the influence of Economic conditions on tax compliance

The study can be repeated in other countries that have similarities with Kenya to establish if the situation is the same as in Kenya. The sample and the population of this study was mainly Kenyan.

The findings of this study can be improved if more empirical methods can be used. Since this study was mainly based on the Likert scale and on the opinions of the respondents, an improvement can be made with the use of historical data. Using Likert scales reduced the findings to opinions.

Further, the study can be repeated some other time later to assess the changes that might have occurred. Due to the dynamic nature of information and communication technology (ICT), the study can be repeated later to determine whether the findings of this research still hold.

REFERENCES

- Ajzen, F. M. (1975). *Belief, Attitude, Intention and Behaviour: An Introduction to Theory and Research*. Ontario: Addison - Wesley Publication company.
- Al-Dmour, H. P.-S. (2012). Factors Affecting SME's Adoption of Internet Based Information Systems in Business to Business and the Value-Added Aid in Organization's Performance. *Jordan Journal of Applied Science, Vol 14, Issue 1* .
- Awadhi, A. M. (2009). Factors Influencing Adoption of e-government Services. *Journal of Software, Vol4* .
- Bandura, A. (1986). *Social Foundations of Thought and action: A Social Cognitive Theory*. Englewood Cliffs, New Jersey: Prentice hall.
- Boone, M. (2012). *E-Government and Citizen Adoption of Innovation: Factors underlying Citizen use of the Internet for State Tax Filing*.
- Carter Lemuria, L. C. (2011). The U.S E-file Initiative: An Investigation of the Antecedents to Adoption from the Individual Taxpayers' Perspective. *E-Service Journal, Vol7* .
- Choong, M.-M.L.-F. (2010). Motivators, Barriers and Concerns in Adoption of Electronic Filing System: Survey Evidence from Malaysian Professional Accountants. *American Journal of Applied Sciences* , 562-567.
- Cooper, R. D. (2003). *Business Research Methods*. McGraw-Hill School Education Group.
- Davis, F. (1989). Perceived Usefulness, Perceived Ease of Use and User Acceptance of Information Technology. *MIS Quarterly* 13 , 319-339.
- Eloff, M. C. (2005). Autonomous Trust for Web Services. *Internet Research* , 498-508.
- ETAAC.(2002). *Annual Report to Congress*. USA: Electronic Tax Administration Advisory Committee.
- ETAAC.(2007). *Annual Report to Congress*. USA: Electronic Tax Administration Advisory Committee.
- ETAAC.(2009). *Annual Report to Congress*. USA: Electronic Tax Administration Advisory Committee

- Fishbein, T. A. (2004). *Belief, Attitude, Intention and Behaviour: An Introduction to Theory and Research*. Reading: Addison-Wesley.
- Fournier, M. D. (1998). Paradoxes of Technology; Consumer Cognizance, Emotions and Coping Strategies. *Journal of Consumer Research* .
- Group, A. D. (2010). *Domestic Resource Mobilization for Poverty Reduction in East Africa: Kenya Case Study*. OREA.
- Heijden, V. D. (2004). User Acceptance of Hedonic Information Systems. *MIS Quarterly*, Vol 28
- J Fu, W. C. (2004). Determinants of Taxpayers Adoption of electronic filing methods in Taiwan: An exploratory study. *Journal of Government Information* .
- K.R.A. (2012). *Fifth Corporate Plan*. Kenya Revenue Authority.
- Kamarulzaman, A. A. (2010). Adoption of Tax E-filing : A Conceptual Paper. *Africa Journal of Business Management- Vol5* .
- Kangave, J. (2005). Improving Tax Administration: A Case Study of the Uganda Revenue Authority. *Journal of African Law* , 145-176.
- Kothari, C. (2004). *Research Methodology; Methods and Techniques*. New Delhi, India: New Age International (P) Ltd.
- Krejcie, V. R. (1970). *Determining Sample Size for Research Activities*.
- Lai Ming, M. A. (2005). Tax Practitioners and the electronic filing system. *Academy of Accounting and Financial studies* .
- Mandola, V. (2013). Factors influencing the adoption and use of integrated tax management system by medium and small taxpayers in Nairobi Central Business District, Kenya (Doctoral dissertation, University of Nairobi).
- Mahadeo, J. D. (2009). Towards an Understanding of the Factors Influencing the Acceptance and Diffusion of E-government Services. *Electronic Journal of E-government Services* , 391-402.
- Ming-Ling Lai, S.-N. S.-K. (January 2005). Tax Practitioners and the Electronic Filing System: An empirical Analysis. *Academy of Accounting and Financial Studies Journal* .
- Mugenda, M. O. (2003). *Research Methods; Qualitative and Quantitative Approaches*. African Centre for Technology Studies.

- Mwonge, H. L. (2011). *The Influence of Electronic Tax Filing System on Tax Compliance and Tax Collection*. Academia.edu.
- Mohani, A. (2001). Personal income tax non-compliance in Malaysia. PhD thesis. Victoria University: Melbourne, Australia.
- Mohd Rizal Palil and Ahmad Fariq Mustapha (2011); Determinants of Tax Compliance in Asia: A case of Malaysia, *European Journal of Social Sciences* Vol 24 No 1.
- Mohd, R. (2010), Tax knowledge and tax compliance determinants in self assessment system, a thesis submitted to the University of Birmingham for the degree of Doctor of Philosophy, available at <http://www.acta.uob.edu.au/asfc.html>, accessed in March 2013.
- Robben, H.S.J., Webley, P., Elffers, H. and Hessing, D.J. (1990a), "Decision frames, opportunity Tax compliance and tax evasion: an experimental approach", *Journal of Economic Behavior and Organization*, Vol. 14 No. 3, pp. 353-61.
- Sandford, C. (1993). *Successful Tax Reform: Lesson From an Analysis of Tax Reform in Six Countries*. Birmingham: Fiscal Publications.
- Sandford, C., and Wallschutzky, I.G. (1994a). Self-assessment and all that-UK proposals in the light of Australian experience. *Management Accounting*, July/August, 34, 57.
- Sandford, C., and Wallschutzky, I.G. (1994b). Self assessment for income tax: Lessons from Australia. *British Tax Review*, 3, 213-220.
- Sandford, C., Godwin, M., and Hardwick, P. (1989). *Administrative and Compliance Cost of Taxation*. Birmingham: Fiscal Publications.
- Sandford, C., Godwin, M., Hardwick, P. and Slemrod, J., (1989), Administrative and compliance costs of taxation, fiscal publications, *Journal of Economic Literature*, issue 3
- Singh, P. (2003), 'Behavioral intention of tax non compliance among sole proprietors', *School of Business*,
- Slemrod, J., and Venkatesh, V., (2002), The tax compliance costs of large and mid-size businesses, a report to The IRS LMSB division, Submitted by the Office of Tax Policy Research, university of Michigan business school
- Slemrod, J., Blumenthal, M. and Christian, C. (2001), "Taxpayer response to an increased probability of audit: evidence from a controlled experiment in Minnesota", *Journal of*

Public Economics, Vol. 79, pp. 455-83.

Slemrod, J. and Yitzhaki, S., (1996), the costs of taxation and the marginal efficiency cost of funds, International Monetary Fund staff papers, 43(1) 42

Webley, P. (2004), "Tax compliance by businesses", in Sjogren, H. and Skogh, G. (Eds), New Perspectives on Economic Crime, Edward Elgar, Cheltenham.

Williams, C.C. and Round, J. (2009), "Evaluating informal entrepreneurs' motives: evidence from Moscow", International Journal of Entrepreneurial Behaviour & Research, Vol. 15 No. 1, pp. 94-107.

www.ijbssnet.com/journals/Vol._2_No._6;_April_2003/15.pdf, accessed April, 2013.

APPENDICES

APPENDIX I: LETTER OF TRANSMITTAL

Andrew Mararia

P.O Box 52518-0100

Nairobi, Kenya.

andrewmararia@gmail.com

Dear Respondent,

I am a student of the University of Nairobi pursuing a Master of Science Degree in Finance. I am conducting academic research on the Effect of ITMS on Tax compliance by Medium and Small Taxpayers in Nairobi. I'm writing to invite you to participate in the research by filling in the questionnaire.

The questionnaire should take about 30 minutes to complete. Your participation is entirely voluntary and the questionnaire is completely anonymous.

I wish to assure you that the information you will provide will be treated with utmost confidentiality. Your ability to answer all the questions comprehensively and to the best of your knowledge will be highly appreciated. I look forward to your support.

Thankyou. Yours Sincerely,

Andrew Mararia .

Tel: 0727138877

APPENDIX II: QUESTIONNAIRE

Instructions

This questionnaire is designed to collect information on the effect of ITMS on tax compliance by Medium and Small Taxpayers in Nairobi Central Business District. The information obtained will only be used for academic purposes and shall be treated in utmost confidence. You are requested to complete this questionnaire as honestly and objectively as possible. Note that you are not required to indicate your name anywhere on the questionnaire.

Please tick in the appropriate box and also fill in the blank spaces provided for those questions where elaborate answers are required. Use the space at the back of this questionnaire if you need more space for your responses.

SECTION A: GENERAL INFORMATION

1. Kindly indicate your gender: Male [] Female []

2. Kindly indicate your age bracket:

18 to 30 years []

31 to 40 years []

41 to 50 years []

Above 50 years []

3. Level of Education Attained:

None []

Primary []

Secondary []

Undergraduate []

Postgraduate []

4. What is your annual turnover?

Below Million 5-10 Million []

11-15 Million 16-20 Million []

Over 21 Million []

5. Do you have a Personal Identification Number (PIN)?

Yes []

No []

6. If yes, how did you register for the PIN?

Online []
 Manual []

7. Have you ever been penalized by the KRA ?

Yes []
 No []

8. If Yes what was the reason?

Not filing a tax return []
 Late filing of tax return []

SECTION B: TAX COMPLIANCE

1. Please rate the following statements on a scale of 1-5 where 1= Strongly Agree and 5=Strongly Disagree.

	1	2	3	4	5
	Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
I file all my income tax returns on time.					
I file all my VAT returns on time.					
I deduct PAYE and remit the amounts on time.					
I deduct withholding tax on professional fees and remit to KRA on time.					
I pay all my taxes within the required time frame.					

SECTION C: DETERMINANTS OF TAX COMPLIANCE

Adoption of ITMS

1. Please rate the following statements on a scale of 1-5 where 1= Strongly Agree and 5=Strongly Disagree.

	1	2	3	4	5
	Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
I use ITMS for filing PAYE returns					
I use ITMS for filing VAT returns.					
I use ITMS for filing income tax returns.					
I use ITMS for paying my taxes					

Tax compliance cost

2. Please rate the following statements on a scale of 1-5 where 1= Strongly Agree and 5=Strongly Disagree.

	1	2	3	4	5
	Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
The cost of filing a tax return is high					
The cost of hiring a tax agent is high					
The cost of travelling in order to file a return is high.					

Tax knowledge and education

3. Please rate the following statements on a scale of 1-5 where 1= Strongly Agree and 5=Strongly Disagree.

	1	2	3	4	5
	Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
I know how to declare actual income received from all sources to the tax authority					
I know how to keep records/documents pertaining to income and expenditure for a period of seven years after submission of the Tax Return					
I understand that I should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period					
I know which income should be included or excluded in determining the taxable income					

Tax fines and penalties

4. Please rate the following statements on a scale of 1-5 where 1= Strongly Agree and 5=Strongly Disagree.

	1	2	3	4	5
	Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
The penalty rates are very low and I can afford to pay the penalty					
The enforcement is very weak					
Serious enforcement and penalty by the KRA may result if I do not comply					

Perceived opportunity for tax evasion

5. Please rate the following statements on a scale of 1-5 where 1= Strongly Agree and 5=Strongly Disagree.

	1	2	3	4	5
	Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
Since the supporting documents do not need to be sent to the KRA, I can manipulate the figure in the tax return					
If detected not reporting my exact income, I believe that the tax authority is tolerant to my offence and most likely I will escape without punishment.					
I believe the tax authorities have limited capability of detecting tax evasion.					