

**THE EFFECTS OF COMPLIANCE COST ON TAX COMPLIANCE OF
COMPANIES LISTED AT THE NAIROBI SECURITIES EXCHANGE**

BY

EVANS DAVIES MOGENI

D61/79334/2012

**A RESEARCH PROJECT SUBMITTED TO SCHOOL OF BUSINESS,
UNIVERSITY OF NAIROBI IN PARTIAL FULFILMENT OF THE AWARD
IN MASTER OF BUSINESS ADMINISTRATION (FINANCE OPTION)**

OCTOBER, 2014

DECLARATION

I, the undersigned, declare that this research project is my own original work presented to University of Nairobi. The work has not been presented for award of a degree or any other award in any University or Institution of higher learning.

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

MOGENI EVANS DAVIES

D61/79334/2012

Declaration by the Supervisors

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

Signature Date

MR. CYRUS IRAYA

LECTURER SCHOOL OF BUSINESS,

UNIVERSITY OF NAIROBI

ACKNOWLEDGEMENT

My special thanks go to The Almighty God for giving me a gift of life, good health, protection, love, care, blessings and strength with sober mind that was able to think and came up with these fresh ideas throughout my research period. I also wish to acknowledge the efforts of my family members for their moral support and encouragement throughout the entire research period. I also take this opportunity to salute the guidance and directions accorded to me, also acknowledge the professional efforts of my supervisor, Mr. Cyrus Iraya, for his professional guidance and relentlessly guiding me with a lot of enthusiasm and interest for remarkably never failing to be available when I need his assistance which enabled me to compile this project research. Finally, I thank my family for supporting me throughout my studies. I can't express my gratitude in words for my family whose unconditional love has been my greatest strength.

I acknowledge the constructive influence of lecturers for positively influencing my way of thinking and on whose shoulders I lean today. I also appreciate the encouragement of true friends who have enable me to sojourn this far. Writing such a thesis could seldom by possible without the knowledge gained over the academic year in the course of studying as an inquisitive student.

DEDICATION

This research project is dedicated; to my parents Andrew and Hellen; for their parental love, guidance and humble upbringing; to my Loving wife; Nancy Magoma for being a strong pillar stone throughout my MBA course. Your emotional and material support throughout my studies was immeasurable. I have been deeply humbled by the knowledge acquired and support accorded to me during my studies at the university.

To my brothers; Duke, Walter, Victor and Joseck, Sisters Rose and Lydia for understanding that your brother had to read.

To my good friend, Nyamisa Nyakundi, though your degree is not from academic field, you kept reminding me to finish my project even though you did not understand what it was all about. indeed you are my inspiration. My Family and all those who gave me financial and moral support, May the almighty God bless you all.

LIST OF ABBREVIATIONS

CBD	-	Central Business District
CMA	-	Capital Markets Authority
ETR	-	Electronic Tax Registers
FISD	-	Financial Information Services Division
KRA	-	Kenya Revenue Authority
MP	-	Members of Parliament
NSE	-	Nairobi Securities Exchange
OECD	-	Organization for Economic Cooperation and Development
PIN	-	Personal Identification Number
SAS	-	Self-Assessment System
SIIA		Software and Information Industry Association
UK	-	United Kingdom
USA	-	United States of America

ABSTRACT

The main issue faced by all tax authorities is that it has never been easy to persuade all taxpayers to comply with the regulations of a tax system. The study specifically sought to determine the effect of tax compliance cost, tax education and knowledge, fines and penalties and perceived opportunity for tax evasion on tax compliance in the companies listed at the NSE. The study was guided by Theory of Planned Behavior. The study used a census survey of all the sixty two listed companies. Data was collected using structured questionnaire, coded, keyed and analyzed quantitatively using both descriptive and inferential statistics. The study findings showed that compliance cost had the negative effect on level of tax compliance. However, tax knowledge and education had positive effect on level of tax compliance among the tax payers. Similarly, fines/penalties had positive effect on level of tax compliances, while perceived opportunity for tax evasion had negative effect. The study provides some preliminary evidence that imposing fines/penalties and provision of tax knowledge and education among these companies will improve tax compliance. Conversely, high compliances cost and high opportunity for tax evasion will reduces tax compliance among registered firms. Thus, tax compliance cost should be in a way that does not encourage taxpayers to evade tax. There should be stiff enforcement of fines and penalties to deter tax evasion. Additionally, tax authorities should simplify processes involved in filling of returns and payment of taxes.

Key words: Taxation, Tax Compliance, Nairobi Securities Exchange

TABLE OF CONTENTS

DECLARATION.....	i
ACKNOWLEDGEMENT.....	ii
DEDICATION.....	iii
LIST OF ABBREVIATIONS	iv
LIST OF TABLES	viii
CHAPTER ONE	1
INTRODUCTION.....	1
1.1 Background of the study	1
1.1.1 Tax Compliance cost.....	5
1.1.2 Tax Compliance.....	7
1.1.3 Effects of Compliance Costs on Tax Compliance	9
1.1.4 Nairobi Securities Exchange.....	11
1.2 Research Problem	12
1.3 Research Objective	13
1.4 Value of the study	14
CHAPTER TWO	15
LITERATURE REVIEW	15
2.1 Introduction.....	15
2.2 Theoretical Framework.....	15
2.2.1 Cost of service theory	15
2.2.2 Benefit theory.....	16
2.2.3 Deterrence theory.....	16
2.3 Determinants of income tax compliance.....	16
2.4 Empirical Review.....	19
2.5 Summary of Literature Review.....	23
CHAPTER THREE	25
RESEARCH METHODOLOGY	25
3.1 Introduction.....	25
3.2 Research Design.....	25
3.3 Target Population.....	26
3.4 Data Collection	26
3.6 Data Analysis.....	27
CHAPTER FOUR.....	29
DATA ANALYSIS, PRESENTATION AND DISCUSSION	29
4.1 Introduction.....	29
4.2 Descriptive Statistics.....	29
4.2.1 Tax compliance level	30
4.2.2 Tax Compliance Cost.....	31
4.2.3 Fines and Penalties.....	32
4.2.4 Perceived Opportunity for Tax Evasion	33
4.3 Correlation Analysis	35
4.4 Regression Analysis.....	36
4.12 Model Coefficients.....	38
4.13 Discussion of the findings.....	40

CHAPTER FIVE	44
SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS ..	44
5.1 Introduction.....	44
5.2 Summary of findings.....	44
5.3 Conclusion and Recommendations.....	46
5.4 Limitations of the Study.....	48
5.5 Further Research Recommendations	49
REFERENCE.....	50
APPENDIX 1: COMPANIES LISTED AT NSE	54
APPENDIX II: QUESTIONNAIRE	57
APPENDIX III: TIME FRAME.....	64

LIST OF TABLES#

Table 4.1: Tax Compliance Level.....	31
Table 4.2: Tax Compliance Cost.....	32
Table 4.3: Fines and Penalties.....	33
Table 4.4: Perceived opportunity for tax evasion.....	34
Table 4.5: Correlation Statistics.....	36
Table 4.6: Model Summary	37
Table 4.7: Analysis of Variance.....	38
Table 4.8: coefficient Model.....	40

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

In the recent years, tax systems in most governments in the world have undergone significant changes as many countries across ideological spectrum and varying levels of development have undertaken reforms. In many developing countries, pressing fiscal imbalance was the driving force in the sector. In this regard, tax policy was employed as a principal instrument to correct severe budgetary pressures (Ahmad and Starn, 1991). In others, transition from plan market necessitated wide ranging tax reforms.

Taxation is one of the important elements in managing national income, especially developing countries and has played an important role in civilized societies since their birth thousand years ago (Lymer and Oats, 2009). 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, this does not mean all payments to the government are tax payment: charges sells or other levies on services to the citizens. Tax compliance by a citizen implies compliance with all statutory obligations specified in tax law, including registration as taxpayer maintaining required records, filing timely, accurate tax returns and paying taxes correctly and on time.

Taxes influence the investment, financing and dividend decisions of companies (Scholes and Wolfson, 1991). They also affect individual decisions about how to spend income (Slemrod and Bakija, 2004). Tax administration and compliance issues

determine the broad evolution of tax system. Therefore, when processes and changes in the economy cannot be explained on a level necessary using standard economic theory of the different processes, one has to turn to other branches of science including social psychology. Such a tendency is gaining momentum also upon identification of the reasons for payment of taxes, failure of payment, avoidance of tax liabilities and tax evasion (Slemrod and Bakija 2004).

The issues of tax compliance cost and compliance level are as old as the collection of taxes and will be a target for research as long as taxes exist (Scholes and Wolfson, 1991). It should be noted, however, that avoidance of paying taxes is a growing problem in most countries like Kenya. Kenya like other developing countries seeks to apply the tax weapon so as to meet the objective of raising enough revenue and ensuring that revenue is raised in ways that are equitable. In order to achieve all the necessary targets, the government must continue engaging all taxpayers (employers, employees and self-employed groups.) on the fight against tax evasion.

Income tax is one of the major sources of revenue in Kenya and it has been organized such that it can serve various individuals. But while these individuals aim to raise income for their day to day activities, the government must also earn and it is only through tax compliance that it can raise them. Income compliance may not be realized if the tax payers still feel that the sector is undermanaged when the accounting system has not been managed well. It is believed that voluntary tax compliance can achieve greater value and KRA (the body which is charged with responsibility of managing the country's tax collection) must be put more efforts to ensure taxpayers comply with the law (Slemrod and Bakija, 2004).

In Kenya, ensuring that taxes are collected from the taxpayers has always been a challenge for the tax administrators. It has been easy to collect taxes from landlords who collect rent and cash, operators of small business (for instance kiosks) or large corporations that contract out to hardware's. It has been more difficult to collect taxes from illegal business activities, which among others includes drug dealers and goods smugglers. It should be recognized that the under economy has been diverse even more globally but if these traditional forms of tax evasion are not prevented, then the government may not realize its objective of revenue collections. Another element believed to aid tax evaders is the information technology and this is a very complicated system where tax administrators and taxpayers can cooperate to defraud the company money (Ahmad and Starn, 1991).

In addition, income tax is a direct tax imposed in a business income, employment income, as well as benefits, pensions, and investment income. The Kenyan law requires that everyone with a chargeable income is issued with a PIN from Domestic Tax Department, KRA. Personal identification Number (PIN) is a crucial document where the individual can be allowed to transact business (privately and officially). For instance goods clearance, banking services, water and electricity meter installation. All taxpayers are required by law to remit taxes annually (Moyi and Ronge, 2006).

At the theoretical level, income taxation is applied to achieve broad objectives of income redistribution and revenue mobilization in practice, Kenya has relied heavily on income taxation on the basis of collection rather on the basis of abstract principles of equity (Moyi and Ronge 2006). It should be noted that increased domestic revenue

generation will only lead to improved development outcomes if the revenue is translated into productive public expenditure. Therefore the government with support from KRA must ensure that taxpayers; must comply with tax payment in order to change the development focus of its land. Existing work tends to present tax reform as primarily technical challenge has to politics; while importance of political consideration is given secondary attention. Yet there is compelling evidence that in the long term measures to increase dialogue; transparency, equity and bargaining are essential to build a culture of tax compliance (Lieberman, 2002).

Tax law is regarded as extremely complex and difficult to understand by most members of the general public. A typical taxpayer has neither the time nor the inclination to gain a good understanding of the complexities of the income tax legislation and associated case law. At best, by using the literature supplied by the tax office, a conscientious taxpayer may gain a reasonable overview of the provisions that directly relate to their present circumstances. However, this will naturally be the tax collectors' perspective of how the law should apply. Ordinary taxpayers cannot expect to understand the taxation implications of all the various possible rearrangements of their income and expenditure patterns that might conceivably be possible. For this they are dependent on the advice of experts or their faith in the overall equity and justice of the tax system. (Moyi and Ronge, 2006)

The greatest barrier to equity in the application of tax laws in developing countries is the failure to effectively tax the personal incomes of many elites. Significant improvements could dramatically improve both revenue and the legitimacy of the tax system. (Lieberman,2002). Unfortunately, improving income taxation is among the

most administratively and politically challenging tax reform objectives. During the 1980s and 1990s direct taxes received reduced attention in tax reform programmes due to doubts about whether developing countries had the administrative capacity, and political commitment, to collect income and wealth taxes effectively. Administratively, direct taxes require that the tax administration effectively monitor the economic activities and assets of taxpayers, in order to estimate tax liabilities. Yet, while these administrative challenges are real, there is also an urgent need not to allow ‘capacity constraints’ to be used as a blanket excuse for inaction, as there are many countries that have achieved significant gains in recent decades.(Ahmad and Stern,1991)

In Kenya, there seems to be a general perception that it is still possible for taxpayers to manipulate their affairs in order to escape significant amounts of tax whether legally or illegally. There is regular media coverage of cases in which apparently wealthy citizens have been alleged to pay little or no income tax. Therefore,whether this perception is accurate or not a section of the accounting and legal professions stands to gain considerably from its very existence. Even if they were convinced of its overriding simplicity and justice it is unlikely that they would be tempted to draw attention to the ease and equity of the tax system (Lieberman, 2002).

1.1.1 Tax 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 (Sandford, Godwin and 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).

Another argument to investigate these compliance costs is that high tax rates and complex tax legislations can induce fraud. Earlier research (Franzoni, 1998) concluded that companies will create a kind of resentment against authorities who impose too high levies and too complex tax systems. This will incentivize (illegal) tax avoiding systems because of the high financial advantages and the low condemnation rates (Franzoni, 1998). In addition, because of the complexity of the system, the companies often need to rely on external tax professionals who by means of sophisticated tax avoidance engineering will minimize tax payments (Franzoni, 1998).

Finally, the general introduction of the VAT regime in almost all countries has raised interest in identifying and quantifying the impact of the new system on tax compliance costs (Evans, 2003). Acknowledging the fact that high compliance costs diminish competitiveness of the country in terms of taxation attractiveness, public services have become increasingly interested in ways to simplify their tax legislation systems.

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).

1.1.2 Tax Compliance

Tax compliance is the degree to which a taxpayer complies with the tax rules of his country, for example by declaring income, filing a return, and paying the tax due in a timely manner.

Individuals differ on how to define the term tax compliance, but according to Brown and Mazur (2003), tax compliance is a multi-faceted measure and theoretically, it can be defined by considering three distinct types of compliance such as payment compliance, filing compliance and reporting compliance. OECD (2001) advocates dividing compliance into categories in considering definitions of tax compliance. These categories are administrative compliance and technical compliance where the former refers to complying with administrative rules of lodging and paying otherwise referred to as reporting compliance, procedural compliance or regulatory compliance and the latter refer to complying with technical requirements of the tax laws in calculating taxes or provisions of the tax laws in paying the share of the tax.

Income tax compliance applies to all salaried categories and it requires that people pay their tax promptly to prevent penalties. To The government should create tax compliance culture through education by creating - for example - pamphlets to familiarize members of the public with the notion of taxation and instill compliance. Moreover, the government can use newspapers, TV advertisements, and public meetings with taxpayers. The purpose of these activities is to develop among the general public a better understanding of the role of the income tax system and of the relationship between proper taxpaying and good citizenship. However in Kenya today little has been done in terms of awareness on voluntary compliance but what are seen around are the threats by the revenue authority to offer penalties on tax evasions.

When working in a country, it is essential to ensure that your tax affairs comply with the rules and regulations of the country in which you work as well as those of your home country. Failure to do so means that you are breaking the law and that can result in heavy fines or even imprisonment.

The issue of tax compliance is extremely important both to those concerned with the key role. The increased tax yields can play a role in restoring macroeconomic balance and those concerned with tax policy and its effects on the economy in general. The level of tax collection though important is an unsophisticated measure of the effectiveness of tax administration. A more accurate measure is the level of compliance. Facilitating compliance involves such elements as improving services to taxpayers by providing clear instructions, easy to fill forms and assisting and educating them on their duties and obligations.

Tax compliance is measured in three ways that is payment, filing and reporting compliance

The three measures provide different views of the compliance puzzle, and when placed next to one another provide a comprehensive picture of the overall level of compliance. The filing compliance measure tracks the percent of required returns that are timely filed. The reporting compliance measure tracks the percent of true tax liability that is correctly reported. The payment compliance measure tracks the percent of reported tax that is timely paid. The remainder of this paper provides a closer examination of the specific compliance measures followed by a discussion of how the strategic compliance measures relate to existing operational measures that target enforcement of the Tax Code. These will give a comprehensive look at overall tax payer compliance.

1.1.3 Effects of Compliance Costs on Tax Compliance

According to the study by Economic Commission for Africa (2001), the policy and regulatory environment in many African countries was still wanting in many respects,

the policies impose high costs of doing business (Beyene, 2002). As well, complicated tax systems make it difficult and expensive for some taxpayers to comply with policies and procedures owing to the costs associated with record keeping and the need for specialized information to comply with complex tax laws (Bird & Wallace, 2003). This has placed more pressure upon small enterprises in developing countries (Uganda inclusive) to operate outside official reporting system (Kayaga, 2007), since the tax rules increase the labour costs which in turn provide a great incentive to avoid costs by working in the shadow economy of non reporting (Schneider & De soto, 1989).

Borrowing from economics, high compliance costs results in a deadweight resource costs on

society, distorted production decisions, reduced investment, higher deficits, reduced tax equity and adverse price movements; consequently, resentment of high compliance cost may lead to increased noncompliance and lower tax yields (Chattopadhyay and Das-Gupta, 2002). They further suggest that large compliance costs could be responsible for the high tax gap in developed countries given the fact that such economies relatively have efficient tax administration. Additionally Niemiowski, Baldon & Wearing, (2003) proposed that some taxpayers put off tax reporting and completing returns because they could not afford to use the tax agents even when they wanted to do so.

Tax compliance costs studies has shown that tax compliance costs are huge and regressive but the relationship between the tax compliance costs and tax compliances is almost ignored. This study will investigate this relationship and the findings confirm that tax compliance costs will have significant negative impact on tax

compliance behaviour. Furthermore, these results will be consistent across gender though studies show that women will significantly comply than men participants. Also, the findings will be consistent across ages and education tested.

1.1.4 Nairobi Securities Exchange

The NSE comprises approximately 62 listed companies in various sectors of the economy with a daily trading of over USD 15 million and a total market capitalization of approximately USD 15 billion. It is licensed and regulated by capital market authority. It has the mandate of providing a trading platform for listed securities and overseeing its member firms. It is under the management of Mr. Peter Mwangi, who was appointed by the NSE board on Nov 2008 to be the new Chief executive officer when Mr, Mwebesa resigned. Aside from equities, government and corporate bonds are also traded on the NSE. Automated Tax system started in 1994 which raised sixty million in that year. average tax is twelve million per a month. The NSE introduced an automated tax system which ensures that all transaction are automatic and are executed as per the laid down framework of the organisation. The automated tax system has now been linked to KRA thereby allowing electronic trading and transfer of tax. Almost all NSE listed companies have PIN, including multinationals and subsidiaries

In July 2011, the Nairobi Stock Exchange Limited, to ensure tax compliance, changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In the same year, the equity settlement cycle moved from the previous T+4 settlement cycle to the T+3 settlement cycle. This

allowed investors who sell their shares, to get their money three (3) days after the sale of their shares. The buyers of these shares, will have their CDS accounts credited with the shares, in the same time which led to improved tax collection. According to Kato (2005), a company needs to fulfil the following tax compliance requirements in order to be efficiently listed on the securities exchange; certificate of incorporation, financial requirements, status of securities, directors and senior management expertise and experience, securities commission authorization, and finally disclosure of company information. This will ensure that duly registered companies will participate in the exchange ,hence complying with tax. As of March 2012, the Nairobi Securities Exchange became a member of the Financial Information Services Division (FISD) of the Software and Information Industry Association (SIIA).

1.2 Research Problem

In recent past, KRA, reported increase in the tax collection (Daily Nation, Friday 13th august 2012). Therefore, one of the most interesting features of systems of income taxation is their essentially voluntary nature, but this is not the case since income tax payers are a reminded to pay their tax. In some instances, they are forced by penalty or even prosecution in case one fails to remit taxes. However, it is debatable on what might have affected the tax compliance cost and behavior, thus the basis for this research.

Growing evidence indicates there has been hostility between the tax payers and tax collectors on issues relating to tax compliance. How about tax evasion cases reported daily in the local newspapers? (Daily Nation, July 7, 2006). Although complaints by the public on tax payable received responds from KRA through the introduction of online payment, individuals still don't pay taxes promptly.

The KRA introduced Electronic Tax registers (ETRs) in 2005 to minimize compliance cost and ensure full remittance of VAT by firms. This was resisted through street demonstration by the public. It should be noted that customer service activities are very crucial in this field. These activities include such functions as taxpayer's service, returns processing, and the administration of tax reforms and publications. Some of the customer service initiatives aimed at improving voluntary compliance that are required includes expanded telephone assistance for taxpayers, improve taxpayers education (Vazzquez 2005), something KRA had been trying to organized to create awareness, simplified tax, forms among others. This way it should be recognized that most tax payers want to comply with the law, KRA effects in these areas are designed to make it as easy as possible for them to be fully compliant so that tax collection would not be influenced. There many studies that explain the behavior of tax compliance in a more realistic situation. They focus on the effects of compliance cost, respectively on economic and non-economic factors (Nicoleta, 2011).however, these studies have not revealed to what extent these effects of tax compliance cost have affected tax collection. This research will investigate the effects of tax compliance cost on tax compliance level on companies listed at Nairobi Securities Exchange.

1.3 Research Objective

To examine the effect of compliance cost on tax compliance level on companies listed at Nairobi Securities Exchange.

1.4 Value of the study

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

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

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter introduces and discusses key areas that the researcher examined in the process especially for post studies. It may include among others introduction of the study, critical review of tax compliance concept and its summary.

2.2 Theoretical Framework

A theory is a set of systematically interrelated concepts, definitions and propositions that are advanced to explain and predict phenomena or facts. In this sense, we have many theories and use them continually to explain or predict what goes around us.

Theories can be used to predict future facts that should be found. Schindler and Cooper (2013).

2.2.1 Cost of service theory

The cost of service theory was developed by Myers (1984). He argues that based on the treatment of it, is that a payment for public service is equal to the cost of services rendered. This theory is open to many objections like the method of specific payment for public service does not result in justice in the distribution of burdens of taxation. The main implication of this theory is that is that citizens are not entitled to any direct benefits from the state but instead they should reimburse the government the cost incurred in the provision of government services. This is because, the idea of purchase and sale between the citizens and state leads to untenable conclusions respecting the nature of state. It is not possible to distribute advantage among individuals and to

charge them in the proportion. Also, citizens are at liberty to refuse the services of the state and by refusing is able to escape the necessity of paying taxes

2.2.2 Benefit theory

The theory was put forward by Krauss (1896). This theory maintains that justice in taxation is secured by taxing each citizen in the proportion to the benefits he derives from the activity of state. It is also known as insurance theory or quid pro quo theory of taxation. It implies that taxes should be paid by those people who receive the direct benefit of government programs and projects out of the taxes paid. However, it has some objections; the weak and poorer people receive great benefits from the government in the form of free education e.t.c. Though they receive the greatest benefit, they are however least able to bear the burden of taxation

2.2.3 Deterrence theory

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 behaviours. Proponents of deterrence theory believe that people choose to obey or violate the law after calculating the gains and consequences of their actions.

2.3 Determinants of income tax compliance

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).

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 will be 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).

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.

The effects of compliance cost on knowledge and education 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) hence reducing the possibility of tax evasion. 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). 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.

2.4 Empirical Review

Researches indicate that tax compliance has been extensively studied and reviewed (for instance Andreaoni et al 1998; Jackson and Milliron 1986); Long and Swingen 1991). There is no doubt that tax administration is a major problem confronting all revenue authorities – for instance in the USA– the internal revenue services has gone to considerable trouble to estimate the amount of tax revenues which are not under tax system (Aslley 2004). However, the academic thought about this growing problem has a development from the earliest studies which contemplated the tax administration

that is considered as a marginal or residual activity; to recent instances of losses in the sector consisted of underreporting, with smaller proportions attributable to non-filing of returns and overstating tax deductions.

Early research in Australia (Tittle, 1980) testing the tax compliance level of males versus females reports that females are more likely to comply to tax. Traditionally, “females have been identified with conforming roles, moral restraints and more conservative life pattern” (Jackson and Milliron, 1986). All these attributes may promote higher tax compliance. Experimental study conducted by Baldry (1987) also finds that females tend to tax compliance by more than males do. Jackson and Jaouen (1989) also reveal a significant gender difference by treatment group from a pool of potential jurors. However, the study by Houston and Tran (2001) indicates a higher proportion of tax evasion committed by women than men.

Ying (1960), carried out a study which applies a series of statistical test to a six year daily series of determinants and tax compliance at the New York securities exchange. He wanted to know reasons why some firms don't comply to taxation. He normalized the trading volume by the number of shares outstanding to avoid any bias from issues with larger number of outstanding shares. In his findings, he established that small volume in shares usually feel the weight of taxation hence tax evasion from these small companies with low volume of shares since the returns are very low.

Tax morale is one of the determining factors of tax compliance, which has a significant impact on payment of taxes as well as avoidance. Tax compliance is therefore one of the most neutral terms for describing the willingness of the taxpayers

to pay taxes (Kirchler 2007). Essentially it means that the person declares voluntarily and pays in a timely manner all of their liabilities. While opening the other side most tax noncompliance is associated with illegal means of avoiding taxes or with tax evasion

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

The importance of how one’s economic status is perceived was demonstrated by Vogel (1974). Taxpayers who reported improvement of their economic status were less compliant than others who reported deterioration on of their financial well-being. A positive relation of firms income and tax compliance also found empirical support. Other studies found no relation of income level and tax compliance. Self-reported compliance behavior was not related to income among Swedish taxpayers (Warneryd & Walerud, 1982) and American (Porcano, 1988). Collins and Plumlee (1991) also found decreased compliance among participants with higher income. Fishlow and Friedman (1994) found decreased compliance at low income-level firms archival-

empirical data from Argentina, Brazil and Chile, three countries with low economic growth and high inflation rates.

A negative relation of income earned by firms and tax compliance is reported by Slemrod (1985), who analyzed archival data from the United States' Treasury tax file for 1977. Consistently, Weck-Hannemann and Pommerehne, (1989) found lower compliance among high income earning SMEs in archival data on Swiss taxpayers. Baldry, (1987) manipulated participant firms income (among other variables) and found lower compliance at higher income-levels

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

Olweny and Omondi(2011) investigated the effect of determinants of tax compliance on the firms listed at the Nairobi Securities Exchange, Kenya. The study focused on the effects of the determinants and compliance level at the NSE. It used monthly time series data for five years, a period between January 2008 to December 2013.they found out that tax compliance cost, perceived opportunity for tax evasion etc affect tax compliance level among firms.

Maina and Sakwa (2012), carried out a survey of the tax compliance status of firms listed on the NSE using the z-score model in order to assist in suggesting the non compliance implication. The study established that the firms listed in the NSE do not always exhibit a healthy financial position hence a possibility of tax evasion. They further argued that it is generally assumed that firms within the same sector should not differ in terms of tax compliance since they operate under the same legal framework. The finding however indicate that the compliance status of these firms differ from one company to another. They suggested that this is because the financial health of the firm is affected by various factors e.g inflation and corruption. They therefore concluded that the compliance of these listed firms differ from one sector to another since they do not exhibit similar financial strength.

2.5 Summary of Literature Review

To summarize, most empirical studies on the determinants of tax support the assumption that high tax burdens have negative impact on compliance. However, the strong connection of income and determinants makes final conclusions difficult (Andreoni, Erard, & Feinstein, 1998; Slemrod, (1985). In experimental studies it is hard to separate the effects of tax rates and income, if both variables are varied at the same time. From the literature , it can be concluded that determinants has greater potential to reduce to reduce tax evasion, given the increased rate of tax avoidance. Most of the literature id from other countries, most of which are developed and whose firms' strategy on taxation is different from that of Kenya. If anything, they suggest that pushing too far and ignore determinants of tax may harm compliance by firms(Finegold et al,2007,Christensen,et al,2010 and Kaymak & Bektas,2008).They conclude that non tax compliance has a negative impact on the economy.

A few studies however, identified a positive relationship between the percentage of determinants and firms compliance. Finegold et al (2007) observed that analysis that featured determinant variable found out that having these determinants associated with higher levels of compliance since firms tend to evaluate themselves. This result held true for firms of all sizes, but the effects of determinants on performance will be greater for all firms. Other studies, however, like (de Andres, Arofra &Copez,2005) gave a negative relationship.

However, there are some questions in the literature that which needs to be filled to help address the problems. The literature review identifies not only what has been studied, but does not give us the reasons why all these studies and investigations on determinants of tax compliance were conducted in developed like Western Europe and North America countries but failed to address the relationship between them on the performance of firms listed at the NSE in developing countries such as Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter examines the research design adopted so as to meet the objectives stated in chapter one of this study. It also looks at the target population sample design, data collection procedures and instruments and how the data was analyzed. Finally, it examines the limitation of the study.

3.2 Research Design

A research design is a plan, structure and strategy conceived in order to obtain answers to research questions and control variables. The study was descriptive in nature. The descriptive research design is useful in this study because it provides data about the population being studied, it seeks to describe the characteristics of the social phenomenon as well and information was collected without alteration of the source data. Also, the researcher examined and extracted information from documents that contain participants' data. It involved data collection from existing records from which deductions can be made. Its aim was to record the state of the objective as opposed to the exploratory and experimental research designs. Here, the characteristics of the population of the study are known and it was associated with predictable environment. This view is supported by Kothari (2005) who asserted that the descriptive approach of the design is mostly associated with stability in environment and with a defined population of study. The method ensures that data is collected with precision on which defines its reliability, accuracy which defines validity with minimal error.

3.3 Target Population

For purposes of this study, the population was all the sixty two (62) firms listed at the NSE as at 31st July 2014. See appendix 2 .this source was selected as data is publicly available and reliable as it will be drawn from audited financial statements. Secondly, NSE has been characterised by surviving companies. This enabled the researcher to use descriptive observation of data collected to achieve objective of the study. A census survey was undertaken.

3.4 Data Collection

Data that was used to compile this report was obtained through secondary and primary sources as well as NSE database and capital market authority. This primary data which formed the bulk of the information make use of structured interview questionnaires (see appendix II). The secondary sources comprised of professionals journals books, financial reports, reports and accepted publications on income tax compliance. The researcher designed a defaulted structured questionnaires and checklist forms and distribute them to the respondents who then filled- most of which will be self-administered on while other by the researcher data was collected and reports and other publication was scrutinized in the NSE offices.

Interviews both structured and non-structured was conducted in various respondents with the aim of validating the questionnaires. The research tools that was used included exercise books and pens to makes and enter respective data. In addition computers and mobile phones in situations that require them.

3.6 Data Analysis

Questionnaires received from respondents was checked for completeness with repeat calls being made for incomplete questionnaires to maintain the number of respondents. Categorization and coding was then done and data entered into SPSS for windows version 20 for analysis. Both descriptive and inferential tests was used in the analysis. Data was described or summarized using descriptive statistics such as mean and frequencies, which help in meaningful describing of the distribution of responses. Various inferential statistics was used to infer population characteristics from the sample. Pearsons correlation coefficient was used to establish relationships between variables.

A Multiple linear regression model was used to predict tax compliance using the four independent variables in the study: tax compliance cost, tax knowledge and education, fines and penalties and corruption. In addition, the β coefficients for each independent variable generated from the model was subjected to a z –test, in order to test each of the hypotheses under study. Pearson’s correlation coefficient was used to establish relationships between variables. The regression model used to test is shown below:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \text{ Where;}$$

Y - Tax compliance

α – Constant

ε - Error term

$\beta_1, \beta_2, \beta_3$ and β_4 – Coefficient indicating rate of change of tax compliances as tax compliance cost, tax knowledge and education, fines and penalties and perceived opportunity for tax evasion change

X_1 - tax compliance cost

X_2 - tax knowledge and education

X₃ - tax fines and penalties

X₄ - perceived opportunity for tax evasion

ε - Error term

All the above statistical tests were analyzed using the Statistical Package for Social Sciences (SPSS), version 20. All tests were two-tailed. Significant levels were measured at 95% confidence level with significant differences recorded at $p < 0.05$.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND DISCUSSION

4.1 Introduction

This chapter presents results of the study based on the formulated objectives and hypotheses as presented in chapter one. The chapter analyzes the variables involved in the study and estimate the conceptual model described in chapter two. 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. Hypotheses are also tested with the study accepting or failing to accept them depending on the p values and t test value.

4.2 Descriptive Statistics

This summarizes the simple characteristics of the relationship between compliance cost and tax compliance level in regard to companies listed at the Nairobi Security Exchange as indicated below. The result of tests on all variables of the model were considered i.e. compliance cost, fines and penalties, tax knowledge and education and perceived opportunity for tax evasion.

The study findings established that the descriptive statistics of tax compliance cost, fines and penalties and perceived opportunities for tax evasion. The findings are presented in table 4.2.

	Mean	Standard deviation
Tax Compliance level	5.61	2.60
Compliance cost	3.46	1.03
Fines and penalties	3.18	1.473
Perceived opportunity for tax evasion	3.126	0.93536

From the study findings, the tax compliance level was 5.61 in these firms as shown by mean of 5.61. the study findings established the compliance cost as the highest as shown by mean of 3.46 followed by fines and penalties as shown by mean of 3.18 then perceived opportunity for tax evasion with a mean of 3.126 and finally for knowledge and education as shown by a mean of 2.7336.

The findings were as indicated in these tables below:

4.2.1 Tax compliance level

The results in table 4.4 reveal that most of real estate owners do not file their tax returns on time (mean = 2.9). They also do not pay the right amount of taxes on time (mean = 2.71). These results indicate low levels of tax compliance among the real estate investors. From the above findings, monitoring compliance requires establishing and maintaining current accounts of taxpayers and management information systems covering both ultimate taxpayers and third party agents such as banks or tax consultants involved in the tax system as well as appropriate and prompt procedures to detect and follow up on non-filers, nil filers and delayed payments. Such measures require establishing both a reasonable risk of detection as well as applying penalties effectively. The ideal approach is to combine these measures so as

to maximize their effect on compliance as it were, to move a country from a “low compliance to a high compliance environment” (Masinde and Makau , 2010)

Table 4.1: Tax Compliance Level

	Mean	Standard deviation	Skewness	Kurtosis
The firm files its return on time	2.9	2.34	0.74	1.523
The business pays the high amount of taxes on time	2.71	0.26	-1.84	2.8
Total	5.61	2.60	-1.1	4.323

4.2.2 Tax Compliance Cost

Findings on tax compliance cost shows that respondents were satisfactory on the cost of filling a tax return (mean=2.95) 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= 2.87).

Similarly, the cost of travelling in order to fill a return is fair (mean=3.46).

Table 4.2: Tax Compliance Cost

	Mean	Standard deviation	Skewness	Kurtosis
How do you rate the cost of filing tax return	2.95	1.343	0.178	-1.403
The cost of hiring tax agent or find the cost of travelling in order to file return	2.87	1.414	-0.343	-1.226
Total	3.46	1.03	-0.344	-0.422

4.2.3 Fines and Penalties

Findings on Fines and Penalties reveal that the enforcement is not very strong (mean=3.37), respondents were not certain on whether the penalty is lower than their tax saving due to not complying with tax laws (mean=3.08). Finally, respondents seemed unsure on whether serious enforcement and penalty by the KRA may result if they do not comply (mean=3.06).

Table 4.3: Fines and Penalties

	Mean	Standard deviation	Skewness	Kurtosis
Penalty rates are very low and I can afford to pay	3.21	1.185	0.016	-1.151
Enforcement is weak	3.37	1.298	-0.323	-1.004
I believe that the penalty is lower than my tax saving due to not complying with tax laws	3.08	1.882	-0.077	-1.145
Serious enforcement and penalty by the KRA may result if I don't comply	3.06	1.389	-0.006	-1.219
Fines and penalties	3.18	0.89536	0.59	-0.058

4.2.4 Perceived Opportunity for Tax Evasion

Regarding findings on Perceived opportunity for tax evasion in table 4.5, 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 =4.27), 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=2.78), respondents disagreed 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=2.4) and they were uncertain on the probabilities of being detected by the tax authority for not declaring the exact income that they receive

(mean=2.74).In general, findings on perceived opportunity for tax evasion was found to be (mean=3.126)

Table 4.4 Perceived opportunity for tax evasion

	Mean	Standard deviation	Skewness	Kurtosis
Since the supporting documents do not need to be sent to KRA, I can manipulate the figure in the tax return	4.27	0.788	-1.348	2.778
If detected not reporting my exact income, I believe that the tax authority is tolerant towards my offence and most probably I will escape without any punishment	2.78	1.417	0.037	-1.452
I believe the tax authority has limited capability to investigate all income reported to them so I have an authority not to report my exact income	2.4	1.362	0.473	-1.078
I believe that the probabilities of being detected by the tax authority for declaring the exact income that I receive are low	2.74	1.317	0.121	-1.239
Tax evasion	3.126	0.93536	0.195	-1.242

4.3 Correlation Analysis

Correlation statistics is a method of assessing the relationship between variables/factors. To be precise, it measures the extent of association between the ordering of two random variables although, a significant correlation does not necessarily indicate causality but rather a *common linkage* in a sequence of events. Thus, the study analyzed the relationships that are inherent among the independent and dependent variables as well as among the independent variables/ factors. The results regarding this were summarized and presented in table 4.9 Pearson Correlations results in table 4.9 showed that tax knowledge and education was positively and significantly correlated to tax compliance ($r=0.675$, $p<0.05$). Thus tax knowledge and education had 67.5% positive relationship with tax compliance. Tax fines and penalties was the second component to be positively related with tax compliance ($r = 0.710$, $p<0.05$) an indication that tax fines and penalties had 71% significant positive relationship with tax compliance. Perceived opportunity for tax evasion was significantly associated with tax compliance as shown by($r = -0.269$, $p<0.05$) implying that perceived opportunity for tax evasion had a 26.9% negative relationship with tax compliance. Finally, tax compliance cost was significantly positively correlated to tax compliance ($r=-0.613$, $p<0.05$).Therefore, Tax compliance cost had 61.3% negative relationship with tax compliance.

Table 4.5: Correlation Statistics

	Level of tax compliance	Tax compliance cost	Tax knowledge and education	Tax fines and penalties	Perceived opportunity for tax evasion
Level of tax compliance	10				
Tax compliance cost	-0.613**	1			
Tax knowledge and education	0.675**	0.664**	1		
Tax fines and penalties	0.710**	0.483**	0.513**	1	
Perceived opportunity for tax evasion	-0.269**	0.001199**	0.262**	0.239**	1

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

4.4 Regression Analysis

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 four independent factors: 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 0.804 which indicated that the model predicted over 80% of the change in the independent variable. This relationship was significant considering the coefficient of determination value of 0.647. The model was adequate in this case as indicated by the Durbin-Watson statistic value of 1.929 which is in the range of 1 to 2.

Table 4.6: Model Summary

R	R ²	Adjusted R ²	Std Error of the estimate	Durbin Watson
0.804	0.647	0.638	0.56069	1.929

Predictors:

Tax compliance cost, Tax knowledge and education, Tax fines and penalties, perceived opportunity for tax evasion

Dependent variable: Tax compliance level

Source: Survey Data 2014

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 75 that contributed by the residual mean sum of squares. The F-ratio was 75.739 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 4.7 Analysis of Variance

Sum of squares

Sum of squares	Degree of freedom	Mean square	Statistic	Significance
119.05	5	23.81	75.739	0.000
65.075	207	0.314		
184.124	212			

Dependent Variable: Tax compliance

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 Model Coefficients

The regression results in table 4.8 show that each of the predicted parameters in relation to the independent factors were significant; $\beta_1 = -0.317$ (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 compliance cost and tax compliance level. This indicates that for each unit increase in the negative effect of tax compliance cost, there is 0.317 units decrease in tax compliance level. Furthermore, the effect of tax compliance cost was stated by the t-test value = 6.531 which implies that the standard error associated with the parameter is less than the effect of the parameter.

The table also shows that $\beta_2 = 0.331$ (p-value = 0.000 which is less than $\alpha = 0.05$) which indicates that we reject the null hypothesis stating that there is no significant relationship between tax knowledge and education and tax compliance. This implies that for each unit increase in tax knowledge and education, there is up to 0.331 unit increase in tax

compliance. Also the effect of tax knowledge and education is shown by the t-test value of 6.557 which implies that the effect of tax knowledge and education surpasses that of the error by over 6 times. The value of $\beta_3 = 0.111$ (p-value = 0.021 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 0.111 units increase in tax compliance. The effect of tax fines and penalties is stated by the t-test value = 2.334 which indicates that the effect of tax penalties and fines is over 2 times that of the error associated with it.

The findings also showed that β_4 was -0.194 (p-value = 0.000 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis that states that there is no significant relationship between perceived opportunity for tax evasion and tax compliance levels. This implies that there is up to 0.194 unit decrease in tax compliance for each unit increase in perceived opportunity for tax evasion. The rule of thumb was applied in the interpretation of the variance inflation factor (VIF). From table 4.12, the VIF for all the estimated parameters was found to be less than 4 which indicate the absence of multi-collinearity among the independent factors. This implies that the variation contributed by each of the independent factors was significantly independent and all the factors should be included in the prediction model.

Table 4.8 coefficient Model

	Standardize d coefficient	Standardized coefficient	Collinearity statistics		
	B	Std error	Beta	T	Sig
Constants	-0.391	0.274	-	-1.428	0.155
Tax compliance cost	0.302	0.046	-0.317	-6.531	0.000
Tax knowledge and education	0.386	0.059	0.331	6.557	0.000
Tax fines and penalties	0.169	0.072	0.111	2.334	0.021
Perceived opportunity for tax evasion	-0.208	0.057	-0.194	-3.646	0.000

Dependent variable: Tax compliance

Source: (Survey data, 2014)

4.13 Discussion of the findings

As stated that tax compliance cost has no significant effect on tax compliance level, research findings show inconsistency with the hypothesis hence, compliance cost was negatively correlated to tax compliance level (coefficient estimate ($\beta_1 = -0.317$, p value =0.000). High compliance cost has been found to diminish the competitiveness of the country in terms of taxation attractiveness thus tax authorities are interested in making the tax legislations simpler in order to avoid this situation. 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.

In terms of internal and external costs, Blumenthal and Slemrod, (1996) argue that internal costs are generated by the accounting and administration department of the company who will prepare all the required information by the fiscal authorities and consult when it is deemed necessary. External costs are generated from the service of lawyers, accountants and other advisors and are easier to identify and quantify as compared to the internal costs, these factors contribute to compliance cost and affect tax compliance by real estate owners. Tax knowledge and education has no significant effect on tax compliance. Research findings are not in agreement with the hypothesis (coefficient estimates ($\beta_2 = 0.331$, $p \text{ value} = 0.000$)). A high level of tax knowledge and education contributes immensely to tax compliance. This in agreement with studies by Kasipillai, Norhani, and Noor, (2003) that knowledge relates to compliance due to its effect on understanding about taxation regulations and information pertaining to the opportunity to evade tax.

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). Education programs organized by the tax authority or other public education institutions are needed to enhance taxpayers' ability to understand Self assessment system since it involves calculation of amount of tax needed to be paid. If tax knowledge is enhanced tax payers will readily accept forms of payment of tax like the SAS (Self Assessment system). Chan et al. (2000) argues that greater education leads to high compliance since individuals who are well educated understand well the tax system, have high levels of moral development and thus they are highly likely to comply. Findings from the tax administration view point revealed that educating taxpayers on their social responsibility to pay tax would in turn influence tax payers to comply with the payment of tax. Therefore, assisting taxpayers by ensuring proper flow of quality information through media and educating them results in high compliance in paying tax hence potential to yield greater revenue than if it were spent on enforcement activities. Findings that shows tax fines and penalties have no significant effect on tax compliance. Research findings are not in agreement with the hypothesis since fines and penalties has coefficient estimate ($\beta_3 = 0.111$, p value =0.021), hence hypothesis 3 does not hold. Higher fines simply reduce the cases of tax evasion thus encouraging 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.

Conclusion on control variable number 4 states that perceived opportunity for tax evasion has no significant effect on tax compliance. Research findings show inconsistency with the hypothesis; hence perceived opportunity for tax evasion was correlated to tax compliance, (coefficient estimates ($\beta_4 = -0.194$, p value =0.000). Opportunities to evade tax may lead to an increase in intended as well as unintended non-compliance. The study findings are in agreement with Robben et al. (1990b) that an experimentally induced opportunity to cheat increased non-compliance regardless of whether the participants actually intended to be non-compliant or not. (Antonides and Robben, 1995) assert that many taxpayers perceive opportunities for evading small amounts while only a minority perceive opportunities for evading larger amounts. The study findings are also in agreement with (Slemrod et al. (2001) in a study where taxpayers were informed that their tax files would be closely examined. Small business owners who had an opportunity to evade payment of tax reacted to this message by increasing their tax payment in order to avoid errors. This confirms that those taxpayers facing high opportunities for evasion might feel less certain about how to pay their taxes correctly. Consequently, threats may also elicit partly unintentional over-reporting; just to be on the safe side (Ahmed and Braithwaite, 2005). It is therefore noted that opportunity for tax evasion is a key constituent of companies listed at the Nairobi Securities Exchange.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of key data findings, conclusions drawn from the findings highlighted and recommendations thereof. The general objective of this study is to analyze the determinants of tax compliance in firms listed at NSE in Kenya. The target population consists of all listed companies during the study period; According to NSE records, there are 62 registered companies as at July 31st, 2014. The study also made inference on the hypothesis that compliance cost, tax knowledge and education, fines and penalties and perceived opportunity for tax evasion have no significant effect on tax compliance level.

5.2 Summary of findings

The study collected data by way of questionnaires from the sixty two listed companies for a period spanning from 2011 to 2014. With regard to data collected on questionnaires, of pertinent importance of this study included details of the interviewee, time the company has been in existence, annual turnover and monitoring activities. Data was analyzed, using SPSS version 17, upon which results were presented using tables. Inferences of the findings were then discussed in the succeeding sections.

Findings on gender revealed that there are more male than females among the respondents indicating that more men than female are NSE investors. It was also affirmed that majority of the respondents were between the age bracket of 50-60 years

and they. It was also brought to light that majority of respondents were fairly educated, those with a diploma contributing the highest percentage followed by those with an undergraduate degree affirming that there were moderate levels of literacy among the respondents. Findings on information about the NSE affirmed that majority of the firms have been in operation for between 6-10 years confirming the recent boom in the sector. In terms of annual turnover, majority of the estates have a turnover below 5 million.

Findings on tax characteristics acknowledges that the use of E-filing was unknown to most of the respondents and majority of the respondents have never been audited as compared to those who have been audited and a small percentage of the respondents have attended a formal taxation course organized by KRA or university.

The study found that compliance levels among these firms is low. 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. On matters pertaining being penalized by KRA as a result of not filing tax returns, majority of the respondents have not been penalized. The study also found out that most of the respondents under reported their income and over claimed deductions. 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. The study also examined the effect of tax knowledge and education on tax compliance level. The findings show a strong positive relationship between the two implying that enhanced knowledge on taxation will in turn enhance

tax compliance. 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.

The study having evaluated the effect of perceived opportunity for tax evasion on tax compliance level concluded that there is a negative relationship between the two implying that a perceived opportunity for tax evasion will lead to lower levels of tax compliance.

5.3 Conclusion and Recommendations

The study found out that companies specific factors fines and penalties, perceived opportunity for tax evasion, tax knowledge and education and compliance cost have significant effect on tax compliance level among these registered companies.

The study therefore recommends that these factors should be taken into account by the management to avoid tax evasion that may result due to poor management of the same.

The study further recommends that KRA should put in place measures that oversee tax management so as to carefully and responsibly manage the variables in accordance with the laid down requirement to boost tax compliance level.

These study findings provide direct evidence that tax compliance cost 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 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.

From 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. The study 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, real estate owners will be encouraged to comply since they will keep accurate records for taxation purposes in order to avoid fines and penalties. Also, tax knowledge and education has a significant effect on tax compliance. Thus the tax system should not only provide a clear and simple guideline on how to fill tax returns but also enhance taxpayer education services to enable the taxpayers understand their rights and obligations as taxpayers. This way tax compliance levels will increase. Finally, perceived opportunity for tax evasion has a significant effect on tax compliance, therefore the tax system should target individuals at all levels of income to seal loopholes that may encourage tax evasion. Tax systems should also enhance surveillance and monitoring

to ensure that all the taxpayers are brought into the tax net. Specifically, for real estate investors, mapping of all the properties should be done to ensure that they are recruited into the tax net.

5.4 Limitations of the Study

Non-cooperative respondents who were not willing to discuss personal finances issues. This was overcome by instilling confidence in them through assurance that the information is purely for academic purposes.

Another challenge was assessing companies tax files of the respondents to determine to compliance level. This was overcome by seeking approval from KRA management after convincing them of the importance of this study to them

The study looked at the variables under study for a limited period between 2011 to 2014 a period of three years, which might not necessarily be period long enough to justify a representative conclusion of the findings.

The study also majored on firms listed at Nairobi Securities Exchange and thus the findings may not reflect clearly as to whether they can also apply a similar manner to the other companies in Kenya.

Further, the study centered on compliance cost to measure tax compliance but did not explore other measures to determine tax compliance. Hence, the findings are not conclusive as to whether the relations between independent variables relate the same way to other determinants.

5.5 Further Research Recommendations

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. There is need for further studies to carry out similar study for a long period of time.

A similar study should also be carried out on the relationship between financial performance and prevailing macroeconomic situation in a country, to tax compliance of companies which should take consideration of four variables.

Further research should be conducted on the same topic with different companies and extending the years of the sample.

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APPENDIX 1: COMPANIES LISTED AT NSE

Eaagads Ltd
Kapchorua Tea Co. Ltd
Kakuzi
Limuru Tea Co. Ltd
Rea Vipingo Plantations Ltd
Sasini Ltd
Williamson Tea Kenya Ltd
Express Ltd
Kenya Airways Ltd
Nation Media Group
Standard Group Ltd
TPS Eastern Africa (Serena) Ltd
Scangroup Ltd
Uchumi Supermarket Ltd
Hutchings Biemer Ltd
Longhorn Kenya Ltd
Safaricom Ltd
Car and General (K) Ltd
CMC Holdings Ltd
Sameer Africa Ltd
Marshalls (E.A.) Ltd

Barclays Bank Ltd
CFC Stanbic Holdings Ltd
I&M Holdings Ltd
Diamond Trust Bank Kenya Ltd
Housing Finance Co Ltd
Kenya Commercial Bank Ltd
National Bank of Kenya Ltd
NIC Bank Ltd
Standard Chartered Bank Ltd
Equity Bank Ltd
The Co-operative Bank of Kenya Ltd
Jubilee Holdings Ltd
Pan Africa Insurance Holdings Ltd
Kenya Re-Insurance Corporation Ltd
Liberty Kenya Holdings Ltd
British-American Investments Company (Kenya) Ltd
CIC Insurance Group Ltd
Olympia Capital Holdings ltd
Centum Investment Co Ltd
Trans-Century Ltd
B.O.C Kenya Ltd
British American Tobacco Kenya Ltd

Carbacid Investments Ltd

East African Breweries Ltd

Unga Group Ltd

Eveready East Africa Ltd

Kenya Orchards Ltd

A.Baumann CO

APPENDIX II: QUESTIONNAIRE

The purpose of this survey is to analyze the effects of tax compliance cost on the firms listed at Nairobi Securities Exchange with the aim of formulating policies aimed at enhancing tax collection. All responses/answers provided in this survey will only be used for academic purposes and will be kept confidential.

SECTION A: BACKGROUND INFORMATION OF THE RESPONDENTS

1. Gender: Male

Female

2. What is your age bracket?

AGE BRACKET	TICK APPROPRIATELY
20-30	
30-40	
40-50	
50-60	
Above 60	

3. What is your highest level of education?

Level of Education	Tick Appropriately
High School	
Certificate	
Certificate/Diploma	
Degree/Professional	
Masters	
PHD	

Other(Specify)

.....

**SECTION B: BACKGROUND
INFORMATION OF THE COMPANY.**

1. What is the name of your COMPANY
NAME?

(Optional).....

2. How many share do you have at NSE?

.....

3. How long has the business been in the
business?

YEARS	TICK APPROPRIATELY
0-5	
6-10	
11-20	
OVER 21	

4. What is your annual turnover?

TURNOVER	TICK APPROPRIATELY
Below 5 million	
5-10 MILLION	
11-15 MILLION	
16-20 MILLION	
OVER 21 MILLION	

5. Have you ever used E-filing to file your tax returns?

YEARS	TICK APPROPRIATELY
0-1	
1-2	
2-3	
OVER 3	

6. Have you attended/passed any formal taxation course/training organized by KRA or university or other?

Yes No

7. Have you ever been audited by KRA

Yes No

7a) If Yes, how many times?.....

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

	Yes	No
Not filing a tax return		
Late filing of tax return		

9. Have you ever engaged in the following?

	Yes	No
Under reporting income		
Over claiming deductions		

SECTION C: TAX COMPLIANCE LEVEL

Tick Appropriately.

Strongly disagree (1) Disagree (2)

Not Certain (3) Agree (4) Strongly agree (5)

	1	2	3	4	5
The business files its tax returns on time					
The business pays the right amount of taxes on time					

SECTION D: TAX COMPLIANCE COST

Tick Appropriately.

Very High (1) Low (2) fair (3)

High(4) Very High (5)

	1	2	3	4	5
How do you rate the cost of filing a tax return					
How do you rate the cost of hiring a tax agent					
How do you find the cost of travelling in order to file a return					

SECTION E: FINES AND PENALTIES Strongly disagree (1) Disagree (2) Not

Tick Appropriately.

Certain (3) Agree (4) Strongly agree (5)

	1	2	3	4	5
The penalty rates are very low and I can afford to pay the penalty compared to compliance cost					
The enforcement is very weak					
I believe that the penalty is lower than my tax saving due to not complying with tax laws.					
Serious enforcement and penalty by the KRA may result if I do not comply					

SECTION F: PERCEIVED OPPORTUNITY FOR TAX EVASION

Strongly

Tick Appropriately.

disagree (1)

Disagree (2)

Not Certain (3)

Agree (4)

Strongly agree

(5)

	1	2	3	4	5
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 towards my offence and most probably it will escape without any punishment.					
I believe the tax authority has limited capability to investigate all income reported to them so I have an opportunity not to report my exact income					
I believe that the probabilities of being detected by the tax authority for not declaring the exact income that I receive are low.					

Strongly disagree

(1) Disagree (2)

Not Certain (3)

Agree (4) Strongly

agree (5)

SECTION G: TAX KNOWLEDGE AND EDUCATION

Tick Appropriately.

	1	2	3	4	5
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 I should obtain a tax payer identification pin number					
I know which income should be included or excluded in determining the taxable income					

APPENDIX III: TIME FRAME

Activity (days)	June	July	August	September	October	November
Proposal development						
Presentation of proposal						
Project development						
Submission of project						