

**FACTORS INFLUENCING TURNOVER TAX COMPLIANCE IN THE  
KENYA REVENUE AUTHORITY DOMESTIC TAXES DEPARTMENT IN  
NAIROBI COUNTY**

**BY**

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**A Research Project Report submitted in partial fulfillment of the requirement  
for the Award of The Degree of Master of Arts in Project Planning and  
Management of The University of Nairobi**

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**DECLARATION**

This is my original work and has not been presented for award of a degree in any other university or any other institution of higher learning for examination.

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

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## **DEDICATION**

I dedicate this research project report to my parents, Mr and Mrs Mukabi, brothers and sisters; you have been my rock and motivation as I pursued this course. To my wonderful girlfriend Velma Lipesa, and my friends who have supported me all through, I would not have made it without your moral as well as financial support, understanding and perseverance during my period of study.

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## **ABBREVIATIONS AND ACRONYMS**

<b>CBD</b>	Central Business District
<b>DTD</b>	Domestic Taxes Department
<b>IT</b>	Income Tax
<b>KRA</b>	Kenya Revenue Authority
<b>LTO</b>	Large Taxpayer Office
<b>MST</b>	Medium and Small Taxpayers
<b>PAYE</b>	Pay As You Earn
<b>PIN</b>	Personal Identification Number
<b>SPSS</b>	Statistical Package for Social Sciences
<b>TCMP</b>	Taxpayer Compliance Measurement Program
<b>TOT</b>	Turnover Tax
<b>VAT</b>	Value Added Tax

## ABSTRACT

Taxation is the avenue through which persons both corporate and individuals contribute towards revenues of their country or tax jurisdictions they operate in. On the other hand taxation is the most important avenue through which governments generate revenue necessary for development projects and recurrent expenditure. This study sought to identify the factors influencing turnover tax compliance in the Kenya revenue authority domestic taxes department in Nairobi County. The researcher outlined a detailed literature review and identified the variables for this research to be taxpayers' perception of the tax system, taxpayers' level of awareness, enforcement efforts by the revenue authority and costs of compliance. A target population of 560 taxpayers was selected and given the large population of taxpayers in Nairobi County, a total sample size of 56 was picked as representative, to be the focus of this study. A descriptive survey design was used. Stratified sampling technique was used to create a sampling frame ensuring that different and diverse types of entities were included in the survey. 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 Findings from the study reveal that all the identified factors have a direct influence on the tax compliance efforts by taxpayers in the turnover businesses. The perceptions of taxpayers towards the tax system greatly determine the level of compliance for turnover tax. The findings suggest that taxpayers are not aware of their responsibilities; however, the result also indicated that other factors like cost of compliance and complicated systems result into the low levels of compliance. Taxpayer's perception of tax system is inclined to change due to changing tax knowledge. This suggests that increased tax knowledge may have significant impact on perception of tax system. The recommendations of the study are; K.R.A should undertake intensive and increased sensitization of turnover, K.R.A should train their staff diligently on customer service, and K.R.A should ensure all taxpayers who fall under turnover tax are registered. The insights of this research will help address the factors influencing turnover tax compliance in the Kenya revenue authority domestic taxes department in Nairobi County.

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background of the study

Tax is a compulsory contribution to the support of government, levied on persons, property, income, commodities, transactions, etc., now at fixed rates, mostly proportional to the amount on which the contribution is levied (Oxford English Dictionary). In general compliance is conforming to a rule, such as a specification, policy, standard or law. In taxation there is no standard all embracing definition of compliance adopted across all tax compliance studies, however, tax compliance has been used and to mean compliance with registration requirements, reporting requirements meaning taxpayers file required tax returns at the proper time, and that the returns accurately report tax liability in accordance with the internal revenue code, tax payments are done in time as per the given provisions and court decisions applicable at the time the return is filed are honoured.

Turnover tax is a tax under the Income Tax Act Cap 470 laws of Kenya introduced under the subsidiary legislation; The Income Tax (Turnover Tax) Rules 2007. The rule was to take effect from the 1st January, 2008, by any resident person whose income from business is accrued in or derived from Kenya, and turnover does not exceed five million shillings during any year of income. However, notwithstanding the provision, turnover tax shall not apply to; rental income and management or professional fees or training fees; the income of incorporated companies; or any income which is subject to a final withholding tax under the Act.

Efforts have been made to move from Tax noncompliance which is a range of activities that are unfavourable to a state's tax system. This may include tax avoidance, which is tax reduction by legal means, and tax evasion which is the criminal non-payment of tax liabilities. The use of the term 'noncompliance' to refer to tax avoidance, however, is not universal or standard, and similar terms are also used differently by different authors. (Wenzel, 2005).

Although governments must spend money on tax collection activities, some of the costs, particularly for keeping records and filling out forms, are borne by businesses and by private individuals. These are collectively called costs of compliance. More complex tax systems tend to have higher compliance

costs. This fact can be used as the basis for practical or moral arguments in favour of tax simplification (such as the Fair Tax or One Tax, and some Flat Tax proposals). 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.

Tax compliance is a concern of governments around the world. In the United States (U.S.) alone, non-compliance is estimated to cost the federal government over \$300 billion annually. However, traditional economic models of tax compliance, which primarily emphasize enforcement and detection variables, are unable to explain current levels of compliance. In fact, particularly in the United States, compliance is much higher than these economic models would suggest. (Bobek, Roberts and Sweeney 2007). Tax evasion is a universal phenomenon that takes place in all societies and economic systems including both developed and developing countries. In the US, it is estimated that the extent of tax gap (the difference between taxes owed and taxed filed) for 2001 were US\$ 353 billion (IRS, 2006). This concern is particularly severe for developing countries given the rapid growth of investment in their economies and their lack of adequate experience in dealing with this problem. In China, the tax evasion by multinationals resulted in revenue loss amounted to US\$ 3.88 billion each year (Asia Times, April 11 2007). In Hong Kong, the Inland Revenue department reported that about US \$ 1.15 billion was collected from 2003 - 07 back tax and penalties (IRD, 2007).

Kenya Revenue Authority's functions include providing advice on matters pertaining to the administration and collection of revenue; enhancing efficiency and eliminating tax evasion; facilitating economic stability and controlling exit and entry points to the country (Parliamentary Budget Office). KRA has since its formation launched various revenue compliance initiatives with a goal to transform into a modern, fully integrated and client-focused organization and increase revenue compliance levels for increased collections. Among the initiatives are automation and integration of ICT into the tax collection, the issuance of unique personal identification numbers (PINs), intense training to its staff, tax payer education seminars, use of ETR machines, among others.

The research on factors influencing turnover tax compliance in the Kenya Revenue Authority domestic taxes department in Nairobi County, will seek to give recommendations that KRA can put in place so as to build a culture of tax compliance among its taxpayers from bottom up.

## 1.2 Statement of the problem

Tax compliance has evolved into a major research topic in economic psychology. The issue has been approached from various viewpoints shedding light on different aspects of taxpayers' behaviour. Attitudes were measured, prevailing social norms and lay theories explored, which people have in mind when to fulfil their annual tax declarations (Kirchler, 2007).

The taxpayers' attitude on compliance may be influenced by many factors, which eventually influence taxpayer's behaviour. Those factors which influence tax compliance and/or non-compliance behaviour are differing from one country to another and also from one individual to another (Kirchler, 2007). They include; taxpayers perceptions of the tax system and Revenue Authority (Ambrecht, 1998); peer attitude / subjective norms; taxpayers' understanding of the tax system / tax laws (Silvani, 1992); motivation such as rewards (Feld, Frey and Targler, 2006) and punishment such as penalties (Allingham and Sandmo, 1972); cost of compliance (Le Baube, 1992); enforcement efforts such as audit; probability of detection; difference across - culture; perceived behavioural control (Furnharn, 1983); ethics / morality of the taxpayer and tax collector; equity of the tax systems; demographic factors such as sex, age, education and size of income (Murphy, 2004) and use of informants.

The empirical results indicate that tax compliance leads to increases in income and audit rates or decreases in tax rates. Compliance is also greater when the individuals perceive some benefits from a public good funded by the tax payments while changes in fine rates appear to have little effect on tax compliance behaviour (Alm 1992). It therefore appears that there are additional tax policy instruments beyond the standard prescription of enforcement actions that government can enact to achieve its desired degree of compliance with the tax laws. In short, governments should pursue a range of approaches in its efforts to promote compliance (Alm 1992). Thus, the payment of fines and penalties appear for overdue taxes. Thus, there arises the need to allow audit by tax collectors if deemed necessary, especially if they suspect that there is some kind of some tax non-compliance. (Barbutamisu 2011).

In Kenya in the large taxpayer's bracket, compliance levels are high as these firms are professionally managed. However, in the medium taxpayer's bracket the levels of compliance start dropping and are very low in the small taxpayer's bracket. In order to give special attention to this budding low income

enterprises which came to be known as turnover taxpayers, the subsidiary legislation; The Income Tax (Turnover Tax) Rules 2007 was introduced under the Income Tax Act Cap 470 laws of Kenya. This category of taxpayers runs as sole proprietors, family businesses or businesses in the informal sector. They are therefore low in financing and rarely engage any professionals to advice or run the affairs of the business. The spirit of the law envisioned proper management of this taxpayers resulting to higher collections and bringing under the tax net as many taxpayers as possible. This however, has not been achieved and it's apparent that many taxpayers falling under this class do not pay taxes. The tax head is also the performing very poorly as compared to the other tax heads yet it has and continues to have great potential in netting the small traders and increasing the authority's revenue collection. The study therefore seeks to focus on why despite the introduction of such a simplified law, turnover taxpayers continue being noncompliant thus resulting to low collections in this class of taxpayers. In this regard, this study was conducted, focusing on factors influencing turnover tax compliance in the Kenya Revenue Authority domestic taxes department in Nairobi County.

### **1.3 Purpose of the study**

The purpose of this research is to establish the factors influencing turnover tax compliance in the Kenya revenue authority domestic taxes department in Nairobi County.

### **1.4 Objectives of the study**

This study is guided by the following objectives:

1. To establish how taxpayers' perception of the tax system influence turnover tax compliance in Nairobi County.
2. To assess how taxpayers' level of awareness influence turnover tax compliance in Nairobi County.
3. To establish how enforcement efforts by the revenue authority influence turnover tax compliance in Nairobi County.
4. To establish how costs of compliance influence turnover tax compliance in Nairobi County.

## **1.5 Research questions**

This research was guided by the following research questions:

- 1.To what extent does taxpayers' perception of the tax system influence the turnover tax compliance levels in Nairobi County?
- 2.To what extent does taxpayers' level of awareness influence the turnover tax compliance levels in Nairobi County?
- 3.How do enforcement efforts influence the turnover tax compliance levels in Nairobi County?
- 4.To what extent do the costs of compliance influence turnover tax compliance levels in Nairobi County?

## **1.6 Significance of the study**

This study sought to generate useful insights that can be used by the government, the tax authority as well as all stakeholders in order to boost tax compliance levels by the small taxpayers who fall under turnover tax and general tax collection in our country and consequently propel economic growth. To the taxpayers the study hopes to highlight the challenges that turnover tax payers' operating in Kenya face in trying to comply with tax laws and measures the revenue authority can put into place to reduce this challenges. This information is useful as it will help the revenue authority in addressing the challenges and put in place proper mechanisms to boost compliance levels.

## **1.7 Basic assumptions of the study**

It was assumed that the respondents would be co-operative and provide accurate information when responding to the research questions. The research also assumes that the sample size chosen was adequate to enable the researcher draw a valid conclusion and recommendations on the research topic.

## **1.8 Limitations of the study**

Time constraint was a limiting factor because the study had to be concluded within a short period of time. Being a self-sponsored student funds were limited. There was no assurance that the respondents would return all the questionnaires duly completed, nor the guarantee that those interviewed would respond to all the questions put forward to them. Being a sensitive project in matters of tax some taxpayers were not willing to participate in the study for fear that it would expose their non-compliance.



## **1.9 Delimitations of the study**

The area of research was within the convenience of the researcher, this made it easy for data collection, cheaper and less tedious. The taxpayers' fear of participation was overcome by explaining to them the intent of the study and issuing the transmittal letter as well as the supervisors contact for verification purposes.

## **1.10 Definitions of significant terms used in the study**

**Costs of compliance:** is expenditure of time or money in conforming with government requirements such as legislation or regulation .They are those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax.

**Enforcement efforts:** This are all the efforts put up by the various tax authorities to ensure compliance with various tax rules and regulations. This could either be rewards, punishments, audits and legal prosecutions.

**Levels of awareness:** Awareness is the state or ability to perceive, to feel, or to be conscious of events, objects, or sensory patterns.

**Revenue audit gap:** A more immediate target for Revenue activity in that it refers to the difference between the amount of tax that would be collected if all registered taxpayers were audited and the amount they voluntarily pay under self-assessment. Analysis of the results of cases selected at random for audit provides Revenue with useful information on trends in compliance.

**Tax Evasion:** The illegal evasion of taxes by individuals, corporations and trusts. Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authorities to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts actually earned, or overstating deductions.

**Tax Gap:** An economic concept covering all recorded and unrecorded economic activity in the State. It is defined as the difference between tax collected and the tax that should have been collected if every liable person complied with their obligations.

**Taxpayers Perception:** Perception is the act or faculty of perceiving, or apprehending by means of the senses or of the mind; cognition; understanding. This is thus how taxpayers perceive or understand the tax systems put in place in their area of operation.

**Turnover tax Enterprises:** These are those taxpayers who fall under the medium and small taxpayer's office whose total annual turnover is below Ksh.5 million and above half a million (500,000). These enterprises are usually sole proprietorships.

### **1.11 Organization of the study**

The project is divided into five chapters;

Chapter one provides a background on the meaning and introduction of tax compliance. The Chapter further states the statement of the problem, research objectives and research questions that the study aims to answer. The significance of the study and definitions of terms as used in the study are indicated in the same chapter.

Chapter two outlines the various schools of thought that have been brought forward with regard to tax compliance and compliance in general. The variables of the study are discussed with reference to studies conducted by other researchers as well as published material on the same. A summary of the literature review concludes the chapter.

Chapter three outlines the research design and methodology to be used for purposes of completing the study. It also describes in details, the research design, target population, the sample, sampling procedure to be adopted as well as the data collection instruments.

Chapter four provides the projects process of reducing data to interpretable form using statistics; data analysis, the process of offering for consideration or display of collected data; presentation and the search for meaning and implication of research results in order to make inferences and draw conclusions and relate to the theory; interpretation.

Chapter five is the final chapter of the research project. It wraps up the research project and will give summary of findings, discussions of the findings, conclusions and recommendations of the study and gives suggestions on areas of further research.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

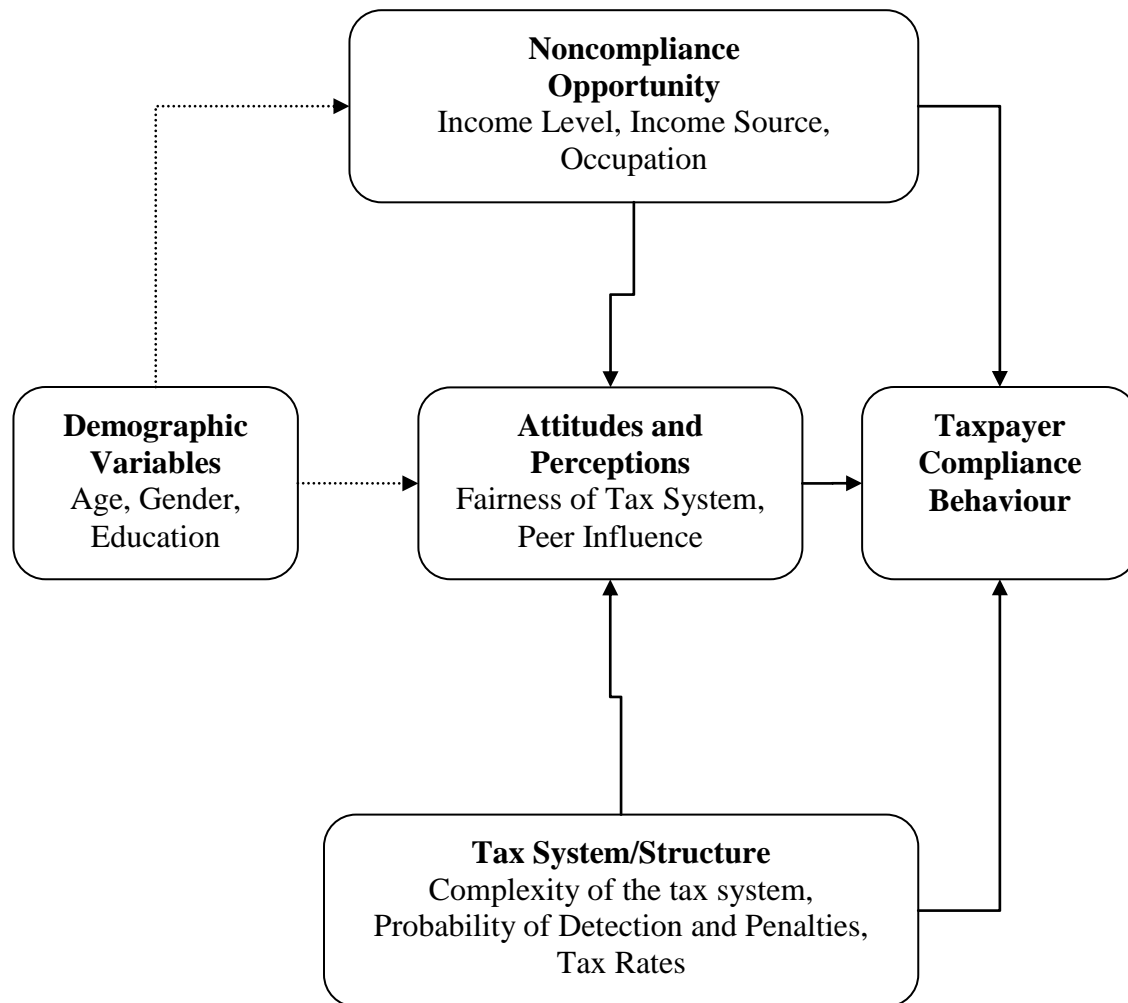
This chapter outlines the various schools of thought on turnover tax compliance. It identifies the various theories put across by various scholars in relation to tax compliance. For the research questions identified in Chapter One, the researcher highlights the findings of different authors, on the factors influencing turnover tax compliance, presenting the results of their studies. The chapter also analyses literature related to other factors that may influence turnover tax.

#### **2.2 Theoretical framework**

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

##### **2.2.1 Fischer tax compliance model**

Tax compliance determinants based on Fischer model (Fischer 1992) have been an important subject of research in developed countries over the past couple of years. Fischer tax compliance model provides a framework for understanding the influence of socio-economic and psychological components on taxpayers' compliance decision. These factors are categorized by Fischer and associates (Fischer 1992) into 4 groups in his expanded model (Fischer Model): Demographic (e.g.- age, gender and education), Noncompliance opportunity (e.g. income level, income source and occupation), Attitudes and perceptions (e.g. fairness of the taxsystem and peer influence) and Tax system/structure (e.g. complexity of the tax system, probability of detectionand penalties and tax rates). Thus Fishers' model of taxcompliance incorporates economic, sociological andpsychological factors into a comprehensive one. The Fisher model is illustrated in below and elaborated in the following sections.



**Fischer Tax Compliance Model**

The relationship between demographic variables and tax compliance has long been of interest (Tittle, 1980). Three major personal characteristics for which there is evidence of a relationship are age, gender and education (Jackson and Milliron, 1986). The Fischer model suggests that demographic variables indirectly affect taxpayer compliance by their impacts on noncompliance opportunities, attitudes and perceptions.

In the Fischer model, noncompliance opportunity can affect taxpayer compliance directly through income level, income source and occupation and indirectly through attitudes and perceptions. Almost all the theoretical models indicate that as income rises, tax evasions should increase over most ranges (Andreoni 1998). Vogel (1974) finds that respondents who report an improvement in individual financial/income status during the past 5 years are more likely to commit tax evasion than those who report a deterioration of their financial/income status during the same period.

Taxpayers vary in terms of the opportunities available to them to overstating expenses and understating incomes. Greater tax noncompliance opportunity is generally resulted from self-employment and income sources not subject to withholding taxes. In one of the first tax compliance studies, Groves (1958) argues that income source has a significant impact on tax compliance. Sutherland (1949) argues that tax evasion is considered as a white-collar crime, committed by an individual of respectability and high social status in the course of performing their employment. The Fischer model suggests two major considerations for altering taxpayers' attitudes and perceptions to tax compliance are the fairness of the tax system and peer influence. Fairness of tax system is widely believed by tax administrators and the taxpayers that growing dissatisfaction with the fairness of tax system is the major causes for increasing tax noncompliance.

Peer influence refers to taxpayers' associations and include friends, relatives and colleagues (Jackson and Milliron, 1986). The peer influence is reflected in an individual's expectations in relation to the approval or disapproval of that tax noncompliance behavior. Grasmick and Scott (1982) indicate that respondents with peers who practice tax noncompliance are more likely to commit as well. The survey conducted by Mason (1975) finds that people committing tax noncompliance are more likely to discuss tax matters with their peers.

It is widely acknowledged that the extent of tax compliance in many developing countries has been decreasing. The underdeveloped tax system/structure is one of the major causes for this phenomenon. In the Fischer Model, the effectiveness of tax system is affected by complexity of tax system, probability of detection and penalties and tax rates.

Partial refinement to this model has been suggested by incorporating another important environmental factor -culture and the interaction effect between noncompliance opportunity and tax system/structure on tax compliance. Culture is considered to be a powerful environmental factor that affects the taxpayer's compliance. In fact, ethical values influenced by social norms may prohibit taxpayers from engaging in tax evasion (Blanthorne and Kaplan, 2008). Hofstede identifies four underlying societal values; individualism, power distance, uncertainty avoidance and masculinity. Chan (2000) suggests that the cultural dimension affecting tax compliance is collectivism and individualism. In Hofstede's model, individualism and collectivism refer to the degree of interdependence a society maintains among individuals.

The cultural dimension of individualism relates to the degree of integration a society maintains among its members. A high individualism culture is signified by people focusing on themselves rather than on the group to which they belong. Under this perspective, an individual is seen as separable from and independent of a group affiliation. People in such low individualism culture as Chinese citizens, they tend to be collectivists who are expected to follow and subscribe to the values of their in-groups in order to gain peer acceptance and social status (Hofstede, 1991). In contrast, a high individualism culture such as US citizens is signified by people focusing on themselves rather than on the group to which they belong. Under this perspective, they view themselves as distinct entities and place great value on individual rights. These cultural differences may have a direct impact on ethical values and moral development and ultimately affecting tax compliance decisions.

### **2.2.2 The logic of behavior: Consequences vs. Appropriateness**

At the broadest level, questions of compliance are questions about behavioral motivations. What leads a state, firm, or individual to act in compliance with laws? James March and Johan Olsen, divides the basic logic of human action into the "logic of consequences" and the "logic of appropriateness."

The “logic of consequences” views actors as choosing rationally among alternatives based on their calculations of expected consequences, whereas the “logic of appropriateness” sees actions as based on identities obligations, and conceptions of appropriate action. While not mutually exclusive, these broad categories provide a useful starting point for discussing the particular international and domestic theories of compliance, and the specific approaches that flow from these different logics of action. (Guzman 2003).

### **2.2.3 The Economic Theory of Tax Compliance with special Reference to Tax Compliance Costs**

In the classic Allingham and Sandmo (1972) paper, a moral but risk averse taxpayer, with true income  $Y$ , chooses the fraction of income to declare to tax authorities to maximize her expected utility of income. The policy environment is given by the legally mandated income tax function,  $T(Y)$ , the penalty rate on detected but underpaid taxes,  $p$ , and the probability of tax audit and detection. For simplicity, we assume a proportional tax function with tax rate  $t$  there. The fraction of income reported voluntarily to tax authorities (or the level of compliance) is denoted by  $x$ . The taxpayer’s decision problem can be written as:  $\text{Max}E(U) = (1-p)U[YN] + pU[YC]$

This model predicts that, provided the expected additional payment on detection  $p(1+p)tY$  is below the tax due when income is reported honestly ( $tY$ ), the taxpayer will not comply fully, choosing to report less than 100 per cent of her income. However, there will be greater compliance if there is stricter enforcement either by raising  $p$ .

In studies attempting to empirically verify the AS model, it has been pointed out that since expected additional payments if evasion is detected observed in practice are always less than taxes due, taxpayers would always evade taxes if they behaved in accordance with the AS model. Tax evasion, however, is not resorted to by all taxpayers, in evidence from countries like the USA. This has prompted an enormous number of extensions of the AS model over the past 30 years, leading to the identification of many of the compliance determinants reviewed above. (Das-Gupta 2004).

#### **2.2.4 Prospect Theory: An Analysis of Decision under Risk**

The theory is developed for simple prospects with monetary outcomes and stated probabilities, but it can be extended to more involved choices. Prospect theory distinguishes two phases in the choice process: an early phase of editing and a subsequent phase of evaluation. The editing phase consists of a preliminary analysis of the offered prospects, which often yields a simpler representation of these prospects. In the second phase, the edited prospects are evaluated and the prospect of highest value is chosen.

The function of the editing phase is to organize and reformulate the options so as to simplify subsequent evaluation and choice. Editing consists of the application of several operations that transform the outcomes and probabilities associated with the offered prospects. The major operations of the editing phase are described as; coding; People normally perceive outcomes as gains and losses, rather than as final states of wealth or welfare. Combination; Prospects can sometimes be simplified by combining the probabilities associated with identical outcomes. Segregation; Some prospects contain a riskless component that is segregated from the risky component in the editing phase. Cancellation; the essence of the isolation effects described earlier is the discarding of components that are shared by the offered prospects.

Following the editing phase, the decision maker is assumed to evaluate each of the edited prospects, and to choose the prospect of highest value. The evaluation of strictly positive and strictly negative prospects follows a different rule. In the editing phase such prospects are segregated into two components: the riskless component, i.e., the minimum gain or loss which is certain to be obtained or paid; the risky component, i.e., the additional gain or loss which is actually at stake.

The equations of prospect theory retain the general bilinear form that underlies expected utility theory. However, values are attached to changes rather than to final states, and that decision weights do not coincide with stated probabilities. These departures from expected utility theory must lead to normatively unacceptable consequences, such as inconsistencies, intransitivity's, and violations of dominance. Such anomalies of preference are normally corrected by the decision maker when he realizes that his preferences are inconsistent, intransitive, or inadmissible. In these circumstances the anomalies implied by prospect theory are expected to occur. (Kahneman and Tversky 1979).



### **2.3 Taxpayers perception and tax compliance levels**

Perception towards tax and its general compliance levels has been identified as one of the major factors that influence compliance, even in the theories as explained in Section 2.2 of this study. Fischer says tax evasion is a universal phenomenon that takes place in all societies and economic systems including both developed and developing countries and it's influenced by many factors among them attitudes and perceptions.

The growing dissatisfaction with the fairness of tax system is the major causes for increasing tax noncompliance. This is in contrasting between the benefits received for the tax given and the equity of the taxpayer's burden in reference to that of other individuals. Its thus seen that taxpayers who believe that the tax system is unfair are more likely to commit tax noncompliance behavior.

Social psychologists have offered several explanations why knowing a tax evader might cause an honest taxpayer to consider evasion. Lerner, 1998 suggests that people need to believe the world is just. Consequently, when people observe an unjust event, they may cope by punishing the harm-doer, compensating or blaming the victim, or denying the injustice by reasoning that justice will prevail in the next life. In some cases, such as tax evasion, one might seek justice by engaging in the activity oneself. When someone violates a standard, they incur a psychological cost-guilt whether or not others discover the behavioural violation. However, if others of perceived high moral character violate a law, then one's behavioural standard may change. For example, Kaplan and Reckers, 1985 provide experimental evidence that subjects were more likely to evade taxes when they observed a taxpayer of perceived high moral character evading.

In contrast, as noted above, the effect of others' behaviour does not require consensus about the esteem-worthiness of an action, and one's response to the action is independent of detection. Social norms can affect tax compliance because individuals tend to seek the respect of others (McAdams 1997). Social stigma is associated with tax evasion and this stigma (the view of acceptable compliance behaviour) varies from country to country (or region to region). Thus, social norms create an additional flow from the evader class to the honest class (beyond the flow created by enforcement). In total, then, evaders feel pressure to become compliant, as a result of both enforcement and social norms.

As the consensus about a norm increases, its effect on others increases, initially at an increasing rate and later at a decreasing rate. The effect of a social norm on behaviour eventually levels off as the proportion of the population adopting the norm approaches 100 per cent. Consequently; the effect of others' behaviour, triggering a flow from honesty to susceptibility; the effect of a social norm, causing some evaders to become honest each period; an enforcement effect triggering a shift from evasion to honesty and an enforcement effect on the flow from susceptibility to evasion.

Tax fairness consists of at least two different dimensions. “One dimension appears to involve the equity of the trade - the benefits received for the tax given. The other dimension appears to involve the equity of the taxpayer’s burden in reference to that of other individuals” Jackson and Milliron, 1986. Thus unfairness of the tax system may reflect taxpayers’ perceptions that they are overpaying taxes in relation to the value of the services provided by government or in relation to what other taxpayers pay. Porcano, 1984 finds that taxpayers’ need and ability to pay are the most significant variables related to perceptions of fairness of the tax system. Other surveys conducted by Scott and Grasmick, 1982 and Spicer and Lundstedt, 1976 indicate that respondents who believe that the tax system is unfair are more likely to commit tax noncompliance behavior.

#### **2.4 Level of Awareness and tax compliance levels**

Awareness is the state or ability to perceive, to feel, or to be conscious of events, objects, or sensory patterns. In biological psychology, awareness is defined as a human's or an animal's perception and cognitive reaction to a condition or event. It is knowledge or understanding of a subject, issue, or situation (Macmillan Dictionary). This knowledge can be gained through one’s own perceptions or by means of information. Education, as a demographic variable relates to the taxpayers’ ability to comprehend and comply or not comply with the tax laws (Jackson and Milliron, 1986). The aspects of education has been distinguished: “the general degree of fiscal knowledge and the degree of knowledge involving evasion opportunities” (Groenland and Veldhoven, 1983). This knowledge is considered to be important for attitudes towards tax compliance. Persons both corporate and individuals are subject to taxation. The amount of taxes you owe is based on your income. You must pay taxes throughout the year. People who earn more income have higher tax rates than those who earn less, this means tax rates get progressively higher the more you earn. You can reduce your taxes by taking advantage of various tax benefits. Finally, it's up to you to take control of your tax situation.

First of all, every person, organization, company, or non-profit organisation is subject to the income tax. "Subject to income tax" means that people and organizations must report their income and calculate their tax. Some organizations are exempt from tax. But they still have to file returns, and their tax-exempt status could be revoked if the organization fails to meet certain criteria. Secondly, you are taxed on your income. Income is any money you earn because you worked for it or invested for it. Income includes wages, interest, dividends, profits on your investments, pensions you receive, and so forth. Income does not include gifts. You are not taxed on gifts you receive, such as inheritances and scholarships. Thirdly, you must pay your taxes throughout the year. This is called "pay as you earn." For most people, it means your income taxes are taken out of your salary and sent directly to the authority. At the end of the year, you have paid in a certain amount of taxes. If you paid in more than what you owe, the government refunds the amount over what you owed. This is called a tax refund. If you haven't paid enough to cover what you owe, then you have a balance due. And you must pay this amount due by April 30th of the following year, or the government will charge you interest and penalties on the amount you haven't paid in. Fourthly, the tax system is progressive, meaning people who make more money have a higher tax rate, and people who make less money have a lower tax rate. Your tax rate will change depending on how much money you made that year. This idea of fairness is the motivation for all sorts of tax benefits. For example, you can reduce your total income if you contribute money to retirement account, home ownership savings plan among others. Finally, we are in the era of self-assessment so people are free to arrange their financial affairs in such a way to take advantage of any tax benefits under the tax laws provided (Perez, 2005).

As the tax law has become increasingly complex, complexity has come to be recognized as a possible reason for tax noncompliance (Jackson and Milliron, 1986). In the context of tax compliance decisions, complexity should include two dimensions, excessive detail in the tax rules and numerous computations required. Taxpayers should be able to understand the tax rules for computations by which they are to be taxed. These tax rules should aim to be simple, understandable and clear in order to enhance tax compliance. In general, complexity of tax system should increase as the number of criteria specified by tax laws increase. Clotfelter, 1983 reveals that complexity of tax system has been associated with greater underreporting of tax. Milliron, 1985 also finds that complexity has a significant effect on tax compliance decision.

## **2.5 Enforcement Efforts and tax compliance levels**

To spur tax compliance, two opposite set of tax enforcement approaches are used: the coercive and persuasive approaches. The coercive approach advocates hard actions and the persuasive approach advocates collaborative working with the taxpayers. Little attention has been paid to understand the combined effects of these conflicting approaches. Spurring tax compliance is a commonly experienced challenge for tax authorities in developed and developing countries (Silvani 2008). In response to this challenge, which largely depends on taxpayer's type and size, tax authorities have innovated diverse compliance approaches and techniques. Approaches used to address small and large business tax compliances differ due to the risks they impose and the revenues they provide to the tax system (Baer 2002; OECD.2009).

Large corporate taxpayers (also referred to as large taxpayers) provide the majority of tax revenues to the tax system and play an instrumental role to its revenue imperatives. Large taxpayers are different from other taxpayers not only for the huge tax revenues they provide, but also for the risks and complexities they exert to the tax system. Tax authorities across the world have created Large Taxpayer Office (LTO) to secure tax compliance of the large taxpayers by employing an approach that tends to rely more on the persuasive than the coercive instruments (Donnelly and Heneghan, 2010). In the small and medium taxpayers division the coercive philosophy also called deterrence or stick based approach is common, where taxpayers conform to their tax obligations if they are punished for non-compliances (Allingham and Sandmo, 1972).

In general, higher audit probabilities and severe penalties encourage tax compliance. Probability of detection refers to the likelihood that the tax authorities will discover an individual's noncompliance and seek to remedy the evasion. Individuals normally would like to evade their tax liabilities entirely and the only reason they might not do so is that there is some non-zero probability of being caught (Massimo, 1993). Raising the probability of detection will increase tax compliance and tax audit represents one of the effective detective measures used by tax authorities (Alm, 1991). In fact, tax audits are considered to have both direct deterrent effect on the taxpayers actually audited and indirect deterrent effect on taxpayers not audited (Alm 2004). However, the study by Beron,1990 reveals that tax audit exert only a modest positive effect on tax compliance.

Another important factor affecting tax compliance is the relationship between tax compliance and the severity of sanctions. The idea is that fear of penalties prohibits tax noncompliance behavior. Establishing an effective system to penalize tax evaders is an important measure to encourage tax compliance. Taxpayers will be more likely to comply if noncompliance may result in severe penalties. The persuasive or the collaborative approach views that respectable treatment of the taxpayers with a chance of participation in the taxation process may enhance tax compliance. Coercive instruments enforce obedience to tax obligation by external material, for instance, tax penalty, whereas persuasive instruments induce compliance by means of psychic influence on the taxpayers, for instance, taxpayer service. An obvious question arising is which set of instruments is more important to the understanding of small and medium tax compliance and why.

## **2.6 Costs of Compliance and tax compliance levels**

Tax compliance costs are those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax (Sandford, 1989). These costs of compliance can be categorised into the following depending on where they are incurred; Accounting Costs; Economic Costs; Lobbying Costs; Training Costs and Lost Revenue. The real cost of taxation goes beyond the amount that is written on the cheque to the authority. The most important cost of taxation is compliance. Compliance are the real cost associated with calculating and making the payment. These costs can be substantial, especially for businesses.

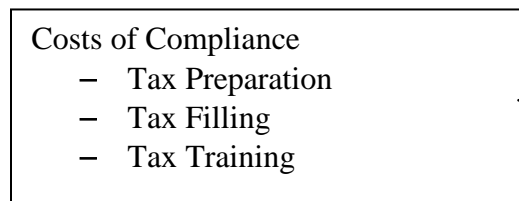
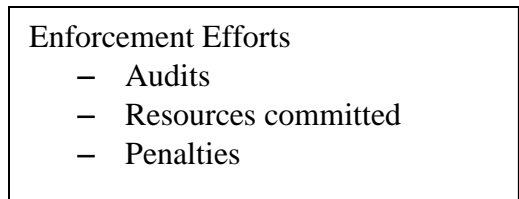
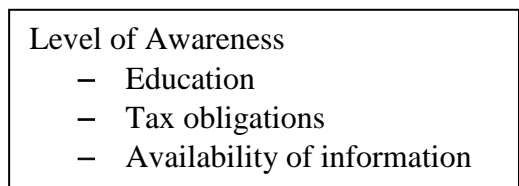
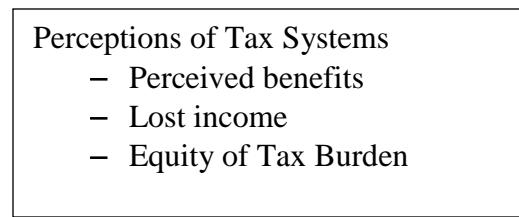
The costs of tax preparation can vary, but unlike the taxes themselves, preparation costs don't get any smaller for low-income people. At times, they can even get larger. One way of measuring the compliance costs associated with taxation for businesses is to measure the number of hours it takes a business to calculate and pay its taxes. Taking the time to just figure out what you owe, calculate it, then send it in, requires a business to give up a more productive activity. In response to this concern about tax compliance costs, governments have often endeavoured to implement tax policies in the form of concessions that produce favourable outcomes for the small business sector (Pope, 2008). Such special tax concessions for small business fall mainly into two categories: positive concessions that provide a lower rate of taxation, an exemption or an accelerated deduction; and relieving concessions that excuse the taxpayer from requirements otherwise imposed (Payne, 2003).

Empirical evidence has suggested that progressive versus flat tax rate is the significant structural variable in association with tax compliance behavior (Clotfelter, 1983). Research using experiments typically find that high tax rates are linked to less tax compliance (Friedland 1978) using the audited tax returns for individual taxpayers in Jamaica. This is because the high tax rates make the whole issue of tax compliance more expensive to the business people as it reduces their profits. In this regard since businesses must make more profits to stay afloat they misdeclare and hide their incomes among other things resulting to noncompliance.

## 2.8 Conceptual Framework

The conceptual framework is a diagrammatic representation of the variables that influence tax compliance as will be discussed in this study. The four independent variables and the dependent variable are as indicated in the figure below. The conceptual framework of this study is presented below.

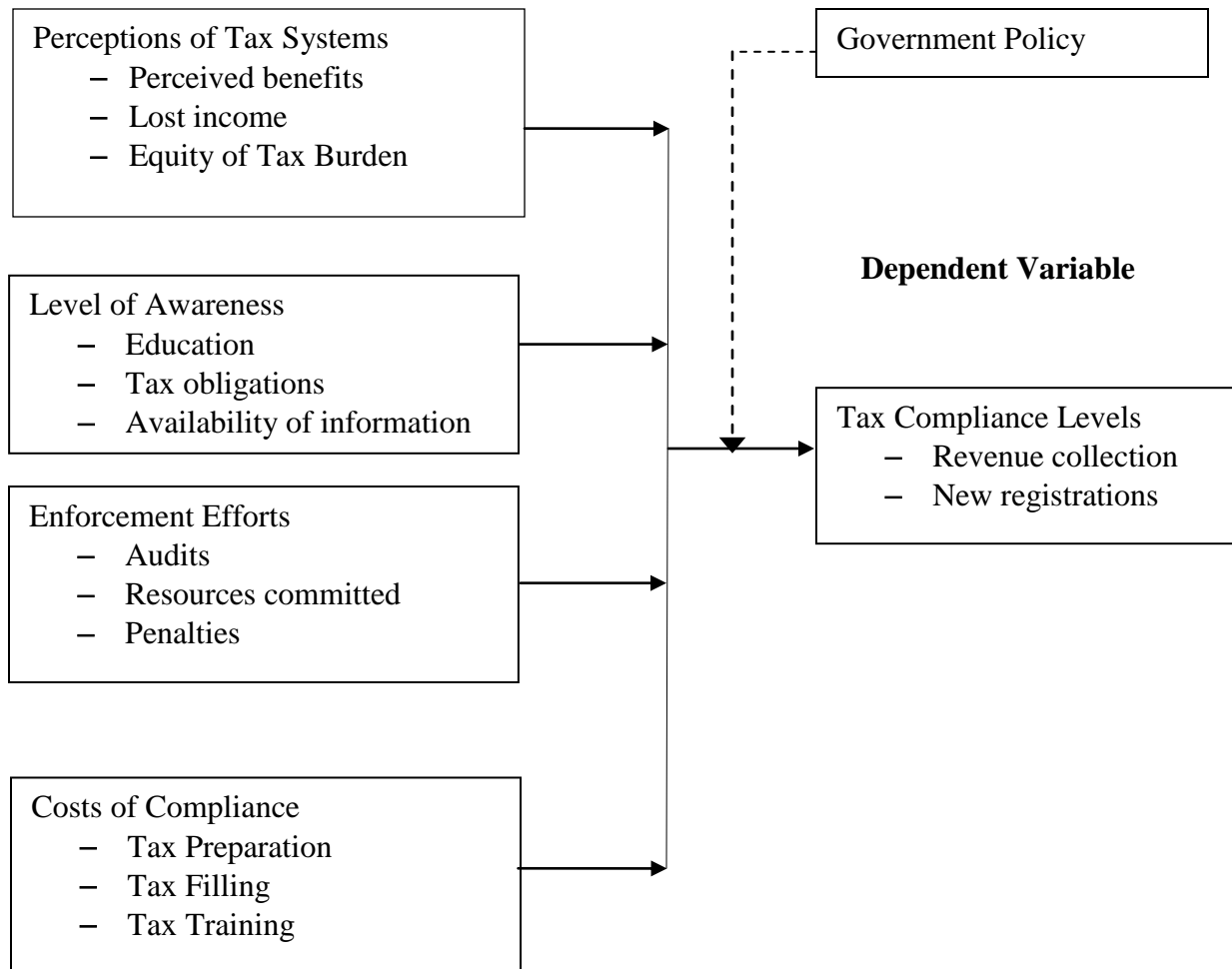
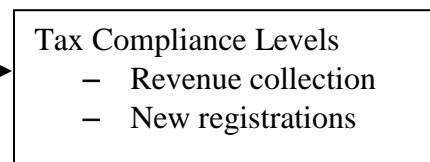
### Independent Variables



### Intervening Variable



### Dependent Variable



**Figure 1 Conceptual Framework**

## 2.9 Research Gap

The main theoretical approaches to tax compliance have commonly been divided into the economic deterrence approach, and the wider behavioural approach which incorporates both social and fiscal psychological approaches. Despite the number of factors which have been examined under this model, the early pioneering work of Jackson and Milliron shows that there is no unanimous agreement on any one of these factors, thus indicating a positive relationship with taxpayer compliance. The social/fiscal psychological model on the other hand, focuses on psychological variables which include moral values and the perception of fairness of the tax system and the tax authorities. This approach has often been used in empirical research (K. Devos 2008).

The basic model of individual choice is centred on the individuals choice of the total amount of income to declare. However, this decision is not really a single choice but actually consists of a number of other decisions on the reporting of income types , personal exemptions, deductions, credits, tax schedules, and chances of detection of fraudulent claims certainly vary across these many choices. More analysis of the multidimensional nature of reporting decisions is needed. Individual willingness to comply can change over time in response to such events as the establishment of a tax amnesty and the erosion of other people's willingness to pay taxes. Evolutionary game theory seems a promising avenue for the investigations of these dynamics of tax evasion (Friedman 1991).

More importantly, however, our research needs to recognize that a theory of taxpayer compliance must really consist of a “full house” of theories each explaining the behavior of different individuals at different times. Any tax administration must also recognize that it must address this “full house” of behaviors in devising policies to ensure compliance. Consequently a government compliance strategy based only on detection and punishment may well be a reasonable starting point for tax administration but not a good ending point. Instead, what is needed is a multifaceted approach that emphasizes enforcement, but that also emphasizes the much broader range of actual motivation that explain why people pay taxes.



## **2.10 Summary of literature review**

A lot has been learned about tax compliance and administration in the past years. We have more and better estimates and deeper understanding of the factors that motivate individuals to cheat or not comply with tax laws. We know much more about the magnitude of individual behavioral responses and many other approaches both from empirical and experimental work. However, it should also be apparent that enormous amounts remain to be learned about tax compliance and administration.

The existing studies reviewed in this research provide a useful starting point for assessing factors that affect compliance as a whole and tax compliance in particular. Despite the fact that the researchers have investigated factors that determine tax compliance clear understanding of the level of non-compliance by individuals and businesses that are liable to pay tax is a basic requirement for effective management of taxpayer compliance.

The research outlined in this paper aims to address this gap and to gain insight into the factors that influence low tax compliance and consequent low revenue collections by the government from turnover taxpayers. It is expected that the findings will help decision makers and particularly Revenue Authorities gain a better understanding of this group of taxpayers and enabling them to design new ways of handling them.

## **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 research 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**

This study adopted a descriptive research design. A descriptive research design was 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 Coopers and Schindler (2003), descriptive design discovers and measures the cause and effect of relationships between variables. Mugenda and 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 has used a descriptive design because it enables the researcher collect large quantity of in-depth information about the population being studied. The study is designed in a cross-sectional survey in an attempt to obtain information from respondents regarding tax compliance or non-compliance. A sampling design was appropriate as the data required for analysis needed to be collected from a large population. The unit of analysis for the study is the individual taxpayer who qualifies for registration under turnover tax. Coopers and Schindler (2003) observed that descriptive studies are structured with clearly stated questions to be investigated. The descriptive design was selected in this study because it would allow the researcher to gather numerical and descriptive data to assess the relationship between the variables. This made it possible for the researcher to produce statistical information on the factors influencing turnover tax compliance in Kenya Revenue Authority domestic tax department in Nairobi County.

### **3.3 Target population**

A population element is the subject on which the measurement is being taken and is the unit of study (Donald Cooper 2010). The population of interest for this study comprised of 560 turnover taxpayers created from information received from the K.R.A records of taxpayers operating in Nairobi County. Nairobi County was of particular focus for this study due to its large concentration of business entities and diversity which will make it easier for the researcher to get a representative sample and use less time and money.

### **3.4 Sampling size and Sampling Procedures**

Sampling is a means of selecting a part of a group from a population to represent the characteristics of the entire group or the population of interest. The advantage of sampling is that reduced the length of time needed to complete the study and cuts costs. In addition, collecting data from fewer cases means that one can collect more detailed information (Saunders, Lewis and Thornhill, 2000). According to Coopers and Schindler (2003), a sampling frame is a list of elements from which the sample is actually drawn and is closely related to the population. By adopting this approach, the researcher ensures that the sampling frame is current, complete and relevant for the attainment of the study objectives.

The study adopted both non-probability and probability sampling techniques. Coopers and Schindler (2003) argued that stratified random sampling increases a sample's statistical efficiency and provides adequate data for analyzing the various sub-populations. This method provides a more representative sample than strictly random sampling does. The study therefore adopted stratified sampling, a probability sampling technique, to ensure the sample selected is representative. The study population was stratified into five mutually exclusive subgroups. The subgroups are composed of five sectors under which majority of turnover enterprises fall; retail, boutiques, beauty, repairs and groceries.

A stratum is a subset of the population that shares at least one common characteristic. This procedure ensures homogeneity within each stratum. Within each of the five strata's, purposive sampling and non-probabilistic sampling technique will be used to arrive at the desired sample. A total sample of sixty six (56) will be selected from the target population based on the 10 – 30% sampling rule from each stratum (Mugenda, 2003). This would be an ideal number considering the time and resources

available and also considering the large population. Using the 10% rule the following is the stratified sampling frame from the population of interest.

**Table 3:1 Stratified Sampling Frame**

	<b>Sector</b>	<b>Population</b>	<b>Sample</b>
<b>1</b>	<b>Retail</b>	100	20
<b>2</b>	<b>Boutiques</b>	150	15
<b>3</b>	<b>Repairs</b>	150	15
<b>4</b>	<b>Groceries</b>	60	6
<b>5</b>	<b>Beauty</b>	100	10
	<b>TOTAL</b>	<b>560</b>	<b>56</b>

### **3.5 Data collection Instruments**

The study employed primary data collection method of a self-made questionnaire. The questionnaire adopted structured open ended as well as closed questions. The responses in the questionnaires helped in gaining an in-depth understanding of the factors influencing turnover tax compliance in the Kenya revenue authority domestic taxes department in Nairobi County.

The questionnaire was structured based on the research questions. It is divided into two major sections: the first section seeks to ask personal information about the respondents and their businesses. The second section seeks information relating to the factors influencing tax noncompliance or compliance by taxpayers, with particular reference to the variables of this research.

### **3.5.1 Validity of Research Instrument**

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.

In addition, Crocker and Algina 1986 have pointed to the importance of a theoretical foundation by noting that constructs cannot be defined only in terms of operational definitions but must also have demonstrated relationships to other constructs or observable phenomena. “Validity evidence is built over time, with validations occurring in a variety of populations. Comprehensive literature reviews on measurement approaches are therefore critical in guiding the selection of measures and measurement instruments. (Winterstein, 2008).

The content validity of the research instrument for this study was determined through consultation with my supervisor and 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. The researcher performed the pilot test with a randomly selected sample of ten turnover tax payers.

### **3.5.2 Reliability of Research Instrument**

Reliability of an instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trials. To test the reliability of the questionnaire as a research instrument, a test retest was carried out and a reliability coefficient computed. This helped establish the extent to which the questionnaire elicits the same responses every time it is administered. The results obtained assisted the researcher in revising the questionnaire to ensure it covered the objectives of the study. Reliability estimates are used to evaluate; the stability of measures administered at different times to the same individual (test-retest reliability). The findings were found to be consistent with a reliability coefficient of one and therefore the questionnaire proved to be a reliable research instrument. Reliability coefficients range from 0.00 to 1.00 with higher coefficients indicating higher levels of reliability (Winterstein, 2008).

According to classical test theory, any score obtained by a measuring instrument (the observed score) is composed of both the “true” score, which is unknown, and “error” in the measurement process. The true score is essentially the score that a person would have received if the measurement were perfectly accurate. The process of developing and validating an instrument is in large part focused on reducing error in the measurement process. There are different means of estimating the reliability of any measure. According to Crocker and Algina 1986 the test developer has a responsibility to identify the sources of measurement error that would be most detrimental to useful score interpretation and design a reliability study that permits such errors to occur so that their effects can be assessed.

### **3.6 Data collection Procedures**

Data collection procedures began upon approval of the proposal after it was approved. An introduction letter was issued to the sampled entities for consent to collect data from the respondents. The questionnaires were administered to the respondents directly by the researcher because most businesses in the study area were in close proximity to each other. For those respondents who were not available for a sit-in filling of the questionnaire, it was e-mailed to them. The interviews were conducted by the researcher personally at a time and place convenient to the respondents to provide an environment in which the respondents would feel free to participate.

### **3.7 Data analysis method**

The collected data was edited and entered into a computerized system to enable carrying out of descriptive statistical analysis of the data. The data was coded, presented in a thematic manner and classified on the basis of common characteristics and attributes. Thereafter, the raw data was assembled and tabulated in form of statistical tables to allow for further analysis as well as factor in detection of errors and omissions. Consequently, the data was analyzed using descriptive statistics and in particular, using the mean as a measure of central tendency. The data was then tabulated and the most appropriate tables chosen to present the findings. Tables were used to enable reading of specific values and to facilitate ease of data presentation. The tool used to analyze the data is Statistical Package for Social Sciences (SPSS) software.

### 3.7 Ethical issues

The researcher obtained an informed consent from the respondents before undertaking to collect data. Objectives of the research were explained and made known to the respondents so as to solicit their informed consent. High level of confidentiality on the information provided by respondents through interview or questionnaires was maintained.

### 3.8 Operationalization of variables

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

**Table 3.2 Operationalization of Variables**

<b>Objective</b>	<b>Variable</b>	<b>Indicator</b>	<b>Scale</b>	<b>Tools of Analysis</b>	<b>Type of Analysis</b>
To what extent does taxpayers' perception of the tax system influence their tax compliance levels	Perception of tax systems	Perceived benefits Lost income Equity of Tax Burden	Nominal	Percentages  Percentages  Frequencies	Descriptive statistics  Inferential Statistics
To what extent does taxpayers' level of awareness influence tax compliance levels	Level of awareness.	Education Tax obligations Availability of information	Nominal	Mean  Percentages	Descriptive statistics  Inferential Statistics
To what degree do enforcement efforts by the revenue authority influence the taxpayers' level of tax compliance	Enforcement efforts	Audits Resources committed Penalties		Mean  Percentages	Descriptive statistics

To what extent do the costs of compliance influence tax compliance	Costs of compliance	Tax Preparation Tax Filing Tax Training	Ratio	Percentages  Mean	Descriptive Statistics
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## CHAPTER FOUR

### DATA ANALYSIS, PRESENTATION AND INTERPRETATION

#### 4.1 Introduction

This chapter presents the data analysis, presentation and interpretation of findings on the data collected from respondents on the factors influencing turnover tax compliance in the Kenya Revenue Authority domestic taxes department in Nairobi County. The main objective of the study was to evaluate the factors that influence tax compliance levels in relation to perception towards the tax system, level of awareness, enforcement efforts by KRA and the cost of compliance. The study sampled sixty six (66) respondents within Nairobi County and the data was interpreted as per the research questions.

#### 4.2 Response rate

The study targeted a total of 66 respondents on the factors influencing turnover tax compliance in the Kenya revenue authority domestic taxes department in Nairobi County. Out of the 66 questionnaires issued, 51 were returned giving a 77% response rate as shown in Table 4.1. According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% is rated very good. This implies that based on these assertions; the response rate for this study, 77% is very good.

**Table 4.1: Response Rate**

<b>Response</b>	<b>Questionnaire administered</b>	<b>Questionnaires filled and returned</b>	<b>Percentage</b>
<b>Total</b>	66	51	77%

#### 4.3 Demographic information

The study found it important to establish the demographic information in order to evaluate the factors that influence the turnover tax compliance in the Kenya revenue Authority domestic taxes department in Nairobi County. The demographic information of the respondents included gender, age, level of education, business activity, turnover PIN registration and tax obligations.

### 4.3.1 Gender Distribution

The researcher sought to determine the gender distribution of the respondents and the findings are shown in Table 4.2.

**Table 4.2: Gender of respondents**

<b>Gender</b>	<b>Frequency</b>	<b>Percent</b>
Male	17	33.3
Female	34	66.7
<b>Total</b>	<b>51</b>	<b>100.0</b>

The findings of the study indicated that the dominant group, the majority of the respondents who participated in the study, were female who accounted for 66.7% while their male counterparts accounted for 33.3%. This indicates that majority of the people who have small businesses are females as they accounted for double the number of the males

### 4.3.2 Age Category

The researcher sought to determine the age category under which the respondents fall and the findings are shown in Table 4.3.

**Table 4.3: Age of respondent**

<b>Age of respondent</b>	<b>Frequency</b>	<b>Percent</b>
20-30	22	43.2
31-40	17	33.3
41-50	4	7.8
above 50	8	15.7
<b>Total</b>	<b>51</b>	<b>100.0</b>

The findings reveal that most participants are in the age bracket of between 20-30 representing 43.2 % followed by 33.3% who are aged between 31-40 years. The study further reveals that 7.8% of the respondents were aged between 41-50 years and 15.7% were above 50 years. It can therefore be observed from the findings of the study that most of respondents were aged between 20-40 making a total of 76.5%. This means that majority of the small business enterprise owners are youths who according to the law fall under the age of 18-35 years.

### 4.3.3 Level of Education

The study also found it of importance to determine the participants' level of education which was crucial for this study as the respondents' level of education eliminates the bias of uneducated respondents. The findings are presented in Table 4.4.

**Table 4.4: Level of education**

<b>Level of education</b>	<b>Frequency</b>	<b>Percent</b>
Primary	3	5.8
Secondary	15	29.4
Technical/vocational	8	15.7
Undergraduate	20	39.2
Post graduate	5	9.8
<b>Total</b>	<b>51</b>	<b>100.0</b>

The results of the findings reveal that most respondents are undergraduates accounting for 39.2% while 9.8% are postgraduates. 15.7% of the respondents were educated up to technical level, 29.4% up to secondary level and 5.8% up to primary. The findings of the study show that the respondents had reasonable education to execute the roles assigned to them as taxpayers effectively and efficiently and make prudent decisions especially because above those with at least secondary education were above 90% of the respondents.

### 4.3.4 Type of business activity

The respondents were asked to indicate their main business activity and the findings are presented in Table 4.5.

**Table 4.5: Type of business activity**

<b>Type of business</b>	<b>Frequency</b>	<b>Percent</b>
Boutique	10	19.6
Beauty	10	19.6
Groceries	6	11.8
Repairs	2	3.9
Retail	23	45.1
<b>Total</b>	<b>51</b>	<b>100.0</b>

As shown in table 4.5, the majority of respondents, 45%, engage in retail activities. This was followed by those engaging in boutiques and beauty, both at 19.6%, Groceries took 11.8% and repairs were 3.9%. Many of the respondents here seemed to engage in retail shops where they supplied little of everything followed by boutiques and beauty shops. This could easily explain why the majority of the respondents were women; many of them dealing with boutiques and beauty shops.

#### 4.3.5 Annual turnover

The researcher found it important to ask the respondents to indicate their business' average annual turnover, as this factor helps identify the correlation between income levels, the cost a taxpayer attaches to compliance and compliance in terms of tax payments. Table 4.6 shows the results of the findings

**Table 4.6: Annual turnover**

<b>Annual Turnover</b>	<b>Frequency</b>	<b>Percent</b>
500,000 -1M	27	52.9
1M-2M	14	27.5
2M-3M	4	7.8
4M-5M	6	11.8
<b>Total</b>	<b>51</b>	<b>100.0</b>

Respondents with an annual turnover of 500,000-1Million accounted for 52.9%, making the majority followed in a distance by 27.5% who revealed they had annual turnover of 1M- 2M while 7.8% indicated that their annual turnover is between 2M-3M , and 11.8% said their turnover ranged between Ksh 4 million and Ksh 5million. Many of the respondents forming 80.4% had an annual turnover of between kshs 500,000 to 2M.

#### 4.3.6 Personal Identification Number

The researcher inquired as to whether the respondents' business had a PIN. This was to determine if the businesses are registered for tax purposes as the PIN is a mandatory requirement for all operating businesses. The findings are presented in Table 4.7.

**Table 4.7: Does your Business have a PIN**

<b>Have a PIN</b>	<b>Frequency</b>	<b>Percent</b>
Yes	41	80.4
No	10	19.6
<b>Total</b>	<b>51</b>	<b>100.0</b>

As shown in Table 4.7, 80.4% of the businesses have a personal identification number while only 19.6% did not. Majority of the respondents have a PIN according to the results of the findings and are therefore duly registered for tax purposes.

#### **4.3.7 Tax obligations met.**

The respondents were requested to indicate which tax obligations they met and the results were tabulated in the Table 4.8.

**Table 4.8: Tax Obligations met by respondents**

<b>Tax Obligations met</b>	<b>Frequency</b>	<b>Percent</b>
VAT	2	3.9
Income Tax	12	23.5
TOT	15	29.4
VAT & PAYE	2	3.9
None	12	23.5
VAT & Income Tax	8	15.7
<b>Total</b>	<b>51</b>	<b>100.0</b>

The results reveal that 3.9% paid for VAT only, then 23.5% paid for Income tax only, the majority 29.4% paid for TOT, 3.9 % paid for VAT and PAYE together, 15.7% paid for VAT and income tax while 23.5% of all the respondents paid zero taxes for their businesses. This indicates a general misunderstanding of the tax obligations that this types of businesses falls under. Turnover taxpayers do not qualify for Income tax and VAT tax obligations however from the results shown above the majority of the taxpayers are have the wrong tax obligations.

#### 4.4 Perception Towards tax systems

With regard to the attitudes and perceptions towards the tax system, the respondents were gauged on their belief on supporting the government to pay taxes, motivation of the tax systems, ease of application of tax compliance rules laws, what they believe the tax was used for and if KRA had put enough measures to encourage payment of tax. The results were as follows.

When asked if the respondents thought that paying taxes was everyone’s obligation, their answers were as follows on Table 4.9

**Table 4.9: Do you think paying taxes is everyone's obligation**

Is taxes everyone’s obligation	Frequency	Percent
Yes	39	76.5
No	12	23.5
<b>Total</b>	<b>51</b>	<b>100.0</b>

According to 76.5% of the respondents who form the majority, they believed that paying taxes was everyone’s obligation, 23.5% thought that paying taxes was optional and for some people.

They were then asked to gauge their beliefs on a Likert scale and these were the responses in Table 4.10.

**Table 4.10: Statements respondents agreed or disagreed with on a scale**

	Statements	Rankings									
		Strongly disagree	%	Disagree	%	Not sure	%	Agree	%	Strongly agree	%
a)	I believe it’s my obligation as a citizen to support the government by paying taxes	0	0%	2	3.9%	6	11.8%	14	27.5%	29	56.8%
b)	The tax system in place motivates me to voluntarily comply with my tax obligations.	8	15.7%	21	41.2%	8	15.7%	14	27.5%	0	0%
c)	I find it hard to comply with the tax laws as they are complicated	0	0%	6	11.8%	6	11.8%	31	60.8%	8	15.7%

<b>d)</b>	I see no point of paying taxes when it is being misused by individuals in government	<b>8</b>	<b>15.7</b> %	<b>12</b>	<b>23.5</b> %	<b>7</b>	<b>13.7</b> %	<b>16</b>	<b>31.4</b> %	<b>8</b>	<b>15.7</b> %
<b>e)</b>	I feel that there is a lot that can be done on our tax systems to ease the work of preparation of tax returns and payment.	<b>0</b>	<b>0%</b>	<b>2</b>	<b>3.9</b> %	<b>0</b>	<b>0%</b>	<b>8</b>	<b>15.7</b> %	<b>41</b>	<b>80.4</b> %
<b>f)</b>	I feel that I can pay my taxes in all obligations without being followed	<b>4</b>	<b>7.8</b> %	<b>5</b>	<b>9.8</b> %	<b>8</b>	<b>15.7</b> %	<b>24</b>	<b>47.1</b> %	<b>10</b>	<b>19.6</b> %
<b>g)</b>	K.R.A has put in place enough measures to ensure that taxpayers know of their obligations and reparations of noncompliance.	<b>14</b>	<b>27.5</b> %	<b>23</b>	<b>45.1</b> %	<b>8</b>	<b>15.7</b> %	<b>2</b>	<b>3.9%</b>	<b>4</b>	<b>7.8%</b>

According to the Table 4.10 with regard to perception towards the taxation system, 84.3% of the respondents believe that it is their obligation to support the government by paying taxes with 56.8% strongly agreeing so. 11.8% were not sure while 3.9% disagreed with that view. The respondents (56.9%) however disagreed that the system in place motivates them to voluntarily comply with tax obligations. 15.7 were not so sure about the system motivation while 27.55 agreed that the system in place motivates them to comply. 76.5% of the respondents agreed that they find it hard to comply with the tax laws because they are complicated. 11.8 Respondents disagree while the same percentage are not sure about the system being complicated.

When asked if they think that the taxes they pay is being misused by individuals in the government , 47.1% agreed that they believed so, while 39.2% disagreed with that statement, 13.7% however were not sure whether they agree with that statement or not. Majority of the respondents (96.1%) agreed that they felt a lot could be done on the tax systems to ease the work of preparation of tax returns and payments with 80.4% strongly agreeing. Only 3.9% disagreed with that statement believing that everything has been done to ease the process.

More than half of the respondents (66.7%) felt that they could pay their tax obligation without being followed while 15.7% were not sure, 17.6% felt they had to be followed for them to meet their tax obligations. When asked if they believed that KRA has put in place enough measures to ensure that taxpayers know their obligations and reparation of noncompliance, 72.6% disagreed, 15.7% were not sure while 11.7% agreed that KRA has tried to do the best it can.

#### 4.5 Levels of awareness.

Respondents were asked a few questions to determine their awareness on KRA and how easily accessible information on taxes is and the responses were captured below.

##### 4.5.1 Tax trainings attended

The respondents were asked if they had ever attended tax training for their businesses and 49% admitted to have attended a training of some kind while 51% stated that they have never undergone through any training about taxes. The 49% (which is 25 from our sample size) who attended training were asked who conducted or organized the training they attended and the findings were presented in the Table 4.11.

**Table 4.11: Who had organized the training?**

Who organized the training	Frequency	Percent
KRA	17	68
Education Institution	5	20
Others	3	12
<b>Total</b>	<b>25</b>	<b>100.0</b>

From the analysis of the study findings of the 25 trained respondents, majority were trained by KRA making 68% of the total, 20% were trained by educational institutions while undertaking their courses, 3% admitted to have been trained by other people including friends and their accountants. This indicates despite KRA having not reached all taxpayers it has put a lot of effort in trying to train and equip taxpayers with the right tax knowledge.



#### 4.5.2 Challenges in attaining tax information

The study, in an effort to gauge accessibility of tax information asked the respondents where they would go to look for tax information and Table 4.12 displays the responses.

**Table 4.12: If you required any information on taxes where would you go?**

Where to go to get Tax information	Frequency	Percent
A cyber cafe attendant	2	3.9
KRA website	16	31.4
Friend/ relative	11	21.6
KRA Office	22	43.1
<b>Total</b>	<b>51</b>	<b>100.0</b>

From the response, 43.1% said they would go directly to the KRA offices to get this information, 31% said they would visit the KRA website, 21.6% said they would ask a friend or relative for information and 3.9% answered they would ask help from a cyber café attendant to gather information. The study also sought to find out if the respondents faced any challenges when it came to accessing information on tax issues and 92.2% said they faced enough problems trying to access this information while 7.8% answered that they were okay while it came to accessing this information. The respondents were then asked to state in order of seriousness the problems and hindrances they experienced and the results were presented on Table 4.13.

**Table 4.13: ratings of challenges experienced while accessing information on tax issues**

Problem/ Hindrance	Not	%	Serious	%	Very	%
	Serious					Serious
Conflicting information from different sources	10	19.6	27	52.9	14	27.5
KRA website lack enough information on various tax procedures	8	15.7	27	52.9	16	31.4
System slow / not functioning	4	7.8%	14	27.5	33	64.7

Long queues in gaining access to KRA offices	2	3.9%	6	11.8%	43	84.3%
Technical details on brochures and tax Acts that I don't understand	6	11.8%	21	41.2%	24	47%
Delay in receiving feedback on queries raised	7	13.7%	12	23.5%	32	62.7%
Lack of internet to download forms for filling returns	19	37.3%	16	31.4%	16	31.4%
High fees charged by tax consultants and other professionals	7	13.7%	20	39.2%	24	47.1%

From the data collected it can be seen that the respondents found out that information was conflicting from different sources when it came to taxation with 52.9% thinking this was serious and 27.5% agreeing that this was very serious. The study further revealed that The KRA website lacked enough information regarding various tax procedures with 52.9% stating this was serious while 31.4% stated that this was very serious. 64.7% stated that the system was slow and sometimes not functioning this being very serious for them while 27.5% thought it was serious enough to desire attention. The most serious problem as the respondents stated 84.3% were the long queues experienced in gaining access to KRA offices.

Others stated that the technical details on brochures and tax Acts were too complex to be easily understood 41.2% and 47.1% said that the delay in receiving feedback on queries raised was both serious and very serious respectively. Lack of internet to download forms for filling was not seen as a serious problem by 37.3% as the majority 62.8% thought it was a serious issue. The respondents also stated that the tax professionals and consultants charged very high fees which they were not comfortable with. Other challenges raised away from the ones stated on the questionnaires were that the filling returns could be done online but most of the time the system is down, unavailable and uncooperative staff members with negative attitudes, decentralization of PIN issuing so that taxpayers can easily access the personal identification number, tax training should be done by KRA and KRA offices should be made accessible.

#### 4.6 Enforcement efforts

The study sought to look at the enforcement procedures put in place to make sure that compliance is being achieved at 100% and the results revealed that only 7.8% of the respondents have been audited on tax issues while 92.2% have never been audited. The study at least revealed that the 7.8% have been audited within this financial year.

When asked how regular the respondents wanted KRA to visit their business their response was tabulated in the Table 4.14.

**Table 4.14: How regularly do you think KRA should visit your business?**

Regularity of KRA visits	Frequency	Percent
Monthly	2	7.8
Annually	24	47.1
Never	21	41.2
Other	2	3.9
<b>Total</b>	<b>51</b>	<b>100.0</b>

The study revealed that 47.1% of the respondents were willing to have KRA visit them once a year, 41.2% said that they would love it if KRA never visited them at any appointed time while 7.8% stated they would like KRA to be doing monthly visits to their businesses. Others said that bi annual visits would be appropriate. The high number of taxpayers who did not want to be visited is a clear indication that they had something to hide or they were not compliant.

The study sought to gauge the feelings of the respondents by asking if the benefits of tax evasion outweighed the cost of paying taxes and the responses were tabulated as follows:

**Table 4.3: The benefits of tax avoidance and evasion outweigh the cost of paying taxes**

Benefits of tax avoidance outweigh cost?	Frequency	Percent
Strongly Agree	16	31.4
Agree	6	11.8
Not sure	8	15.7
Disagree	7	13.7
Strongly Disagree	14	27.5
<b>Total</b>	<b>51</b>	<b>100.0</b>

Majority of the respondents 42.2% agreed that the benefits of avoiding taxes outweighed the costs involved in paying the same taxes with 31.4% strongly agreeing so. 15.7% were not sure while 41.2% disagreed with that statement with 27.5% strongly disagreeing.

#### 4.7 Cost of compliance.

The researcher enquired from the respondents the cost of compliance they incur and the results were tabulated in the Table 4.16.

**Table 4.16: Cost of compliance**

Statements	Yes	%	No	%	Not Sure	%
Do you know on average how much you spend on tax computations?	7	13.7%	8	15.7%	36	70.6%
Are you aware of the tax due dates that relate to your business.	33	64.7%	8	15.7%	10	19.6%
Have you ever filed a tax return and paid the tax thereon for your business?	31	60.8%	16	31.4%	4	7.8%
If yes, did you file and pay the correct taxes for your business?	29	56.9%	20	39.2%	2	3.9%

From the table above, we can see that the results revealed that majority (70.6%) of the respondents were not sure how much they spend on tax computations and only 13.7% knew how much they spent on the same. The study also sought to check if the respondents were aware of the tax due dates relating to their businesses and discovered that 64.7% were aware, 15.7% were not and 19.6% knew there were dates but were not sure which ones they were.

When asked if they have ever filed and paid taxes as required, the study revealed that 60.8% have ever at one time paid the taxes as required, 31.4% said they have never and 7.8% were not sure. When asked if they paid the correct taxes, 56.9% said they did, 39.2% said they did not and 3.9% were not sure whether they paid the right tax or not.

The researcher wanted to investigate who was responsible for computations and filing tax returns in the respondents business and 49% stated that they themselves handle the tax computation for their businesses, 35.3% stated they left that business for the accountant, 11.8% said they called on their friends or relatives to do it for them while the other 3.9% revealed they let the tax consultant compute it for them.

The researcher also wanted to know if the respondents who were business owners knew how to calculate the tax due to them. The study revealed that 31.4% knew how to, 13.7% were not sure and majority who were 54.9% admitted to not knowing how to calculate.

The research then sought to know what the respondents felt was the most expensive tax compliance issue and the results were tabulated in Table 4.17

**Table 4.17: What do you feel is the most expensive tax compliance issue?**

<b>Most expensive tax compliance issue</b>	<b>Frequency</b>	<b>Percent</b>
Accounting Cost	6	11.8
Economic Costs	19	37.3
Training costs	6	11.8
Low revenue	20	39.2
<b>Total</b>	<b>51</b>	<b>100.0</b>

According to the data collected, 39.2% of the respondents felt that low revenue was the most expensive cost when it came to compliance, economic costs followed closely with 37.3% respondents, then accounting and training costs took a tie at 11.8% of the respondents.

**4.8 Recommended changes KRA should put in place to make it easier to comply with tax rules and regulations.**

The study sort to know what would help the respondents to be more compliant with the tax rules and regulations by asking open ended questions. One of the questions sought to discover the greatest factor influencing noncompliance and the respondents stated that some of the reasons were: cost of taxes being high hence reducing profit by a huge margin, lack of knowledge, training and proper information, not understanding the complex tax rules, lack of easy access to KRA offices and their services, misappropriation of taxes received through KRA by government and lack of friendly KRA officials, negative attitude towards KRA and its undertakings, non-user friendly systems put by KRA and finally lack of a one stop shop where all tax matters can be addresses.

But majority more than 50% stated that lack of information and complexity of the system was the biggest contributor to their noncompliance. The researcher then asked what needed to be put in place to encourage taxpayers to be more compliant with their tax obligations and the following responses were given : more than 60% of the respondents said that KRA should do more civic training and broadly inform people of such trainings through media and print, creation of better, easier and friendly systems for compliance, government to have accountability and transparency when it comes to dealing with these taxation money, reduction of tax rates to put more friendly rates that make sense, KRA should ensure everyone liable for taxation should be registered and follow up done promptly for equity sake, KRA to do customer services trainings for their staff to ensure proper handling of taxpayers and friendliness amongst them, leading by example and they should reduce penalties on the taxes so that taxpayers can stop running away.

The researcher also asked if KRA fully computerized their operations and procedures if it would help with tax compliance. 63.1% said it would go a long way in helping compliance, 15.7% were not sure and they said it could help. However, 21.2% did not see computerization of tax systems as a good idea and would prefer to have the procedures remain the way they are; manual. Will help in making compliance or not will not help them with compliance. This proves the high correlation between adoption of progressive tax compliance procedures and level of education.

Finally the researcher asked how KRA should change their approach towards taxpayers to make it easy for them to be approached as the only authority on tax information and assistance. The answers given ranged from improving their customer skills and services and have call centers, to have more advertisement on media and trainings, supply easily consumable information to taxpayers and create interaction between the two, decentralize operations and improve their online platform and should be genuine in giving information and stop being corrupt.

## **CHAPTER FIVE**

### **SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

In this chapter the research findings are summarized, conclusion and recommendations to the study are drawn and research gaps are identified for future studies as the study aimed at determining factors influencing turnover tax compliance in the Kenya Revenue Authority domestic taxes department in Nairobi County.

#### **5.2 Summary of findings**

The researcher sampled 56 respondents who owned businesses, 51 of the targeted respondents filled in and returned the questionnaires, giving a 91% response rate. Relying on the responses given by the respondents, the researcher came up with findings which were used to make conclusions and give recommendations. From the study findings, the female group was dominant forming 66.3% and also majority of the respondents fell under the age group of 20-40 years old making them youths as per laws of the land. They are also educated as 70.6% have gone through universities hence in a position to make informed choices when it comes to tax. Many of the respondents are in the retail business forming 45.1% followed by boutiques and beauty shops at 19.6% each. Most of the business have an annual turnover of between 500,000/- and 2M making 80.4%. The same percentage (80.4%) represents the registered businesses which have a PIN number. This means that 80.4 % of the respondents have tax payment obligations.

##### **5.2.1 Perception towards tax system and tax compliance**

Majority of the respondents 76.5% believe that it is everyone's obligation to pay taxes with 84.3% agreeing that it is their obligation as citizens to support the government by paying taxes. Many of the respondents disagreed that the system in place motivates them to voluntarily comply with their tax obligation with 15.7% not sure whether they agreed or not. A huge number 76.5% stated that they found it hard to comply with the tax laws because they are complicated which means they do not understand the tax laws clearly.

47.1% of the respondent's stated that they see no point of paying taxes when it is being misused by individuals in government, 39.2% seemed to disagree while 13.7% were not sure. Most of the respondents (96.1%) felt that there is a lot that can be done on the tax systems to ease the work of preparation of tax returns and payment. 66.7% felt that they can pay their own tax obligations without being followed, 15.7% were not sure of the same. Most respondents disagreed (72.6%) that K.R.A has put in place enough measures to ensure that taxpayers know of their obligations and reparations of noncompliance.

As much as the respondents view the taxes in a positive manner, they seem to believe that the way they are supposed to be delivered or the whole system of taxation is wanting and there is system failure from the organization in charge. This therefore indicates there is much that the authority needs to do in order to change the general perception of the taxpayers indoor to increase turnover compliance and tax compliance levels in general.

### **5.2.2 Levels of awareness and tax compliance**

In regards to awareness, the respondents were asked if they have ever attended any tax training, and 49% said that they have while the rest had never attended any. When asked who had organized the training from the 49%, 80% said it was KRA, 12% learnt from friend and families and 8% learnt from education institutions. The respondents were then asked the challenges they faced in attaining tax information with regard to where they would look for that information 74.5% stated they would look for it in the KRA website and offices while the rest said they would look for information from friends and relatives. The respondents were then asked about where they would go if they needed information on taxes, 43.1% stated they would go to the KRA office and 31.4% said they would visit the KRA website; others said they would ask the cyber attendant to help them and the rest ask information from friends. A question was asked to gauge challenges when it came to accessing information on tax issues and 92.2% said they faced enough problems. The serious problems sated were conflicting information from different sources 79.5%, the KRA website lacking information 83.5%, slow systems took 92.2 % on the scale of seriousness, with long queues taking the highest at 96.1% seriousness. Most clients found the brochures and pamphlets too complex to understand while lack of feedback from KRA offices was gauged to be 86.2% serious. Lack of internet download forms had a serious percentage of 62.8% and high fees charged by consultants gained 86.3% seriousness. This shows that there are many



challenges that taxpayers experience in an effort to access information relating to tax therefore hindering their compliance efforts.

### **5.2.3 Enforcement Efforts and tax compliance**

The study sought to look at the enforcement procedures put in place to make sure that compliance is being achieved at 100% and discovered that auditing is not being done for clients with only 7.8% having been audited of the total number of respondents. Majority of the respondents 54.9% wanted to be visited at least once a year by KRA with 7.8% of them being of the opinion that monthly visits would be appropriate so as to mitigate on the penalties and interests that become chargeable years later. The rest 37.3% never wanted to be visited by KRA for fear of being penalized for tax noncompliance. 43.2% of the respondents believed that the benefits of tax avoidance outweighed the cost of paying, showing that many people though not the majority do not take the taxation exercise positively.

### **5.2.4 Cost of Compliance and tax compliance**

From the findings, 70.6% were not sure on how much they spend on tax related compliance efforts, 25.3% were not sure or aware of the tax due dates, 39.2% had never filed a tax report while some were not even sure. This shows that as some respondents were not concerned at all about their tax payment regime some even ignoring it intentionally. The researcher also found out after asking the business owners if they knew how to calculate their own taxes only 31.4% knew how to do it, the rest were either not sure and some did not know how to. The research also found out that the respondents felt that economic costs were the highest cost in tax compliance efforts. This is because it involves the cost of the paying the tax liability than the benefit the best alternative investment would have provided if chosen. It may be expressed as the total of opportunity cost (cost of employing resources in an alternative activity) and the accounting costs (cash outlays). Economic cost differs from accounting cost because it includes opportunity cost hence most expensive in comparison to accounting, training and low revenue costs.

### **5.3 Discussions of the findings according to the Objectives set for the study.**

This section gives a detailed discussion of the findings from this study as per the objectives that the study sought to achieve.

#### **5.3.1 Perceptions of the tax system and tax compliance**

Tax knowledge was found to have a positive and significant relationship with the taxpayer's perception of the tax system. The findings suggest that taxpayers are sensitive to the effects of their noncompliance behavior on the risks of detection and criminal prosecution and that these risks have important effects on their efforts in trying to conceal their noncompliance. Our results portray an image two types of taxpayers, one who is an informed, rational taxpayer who structures his noncompliance gambles to keep the risks of detection and criminal prosecution down to acceptable levels, and two a non-informed taxpayer who as a result is not compliant but when faced by the realization puts their efforts in trying to conceal the noncompliance. This conclusion has a number of important implications. Our results concerning the influence of the taxpayer's non-compliance choices on risk perceptions underscore an argument advanced by Graetz (1986) and Dubin and Wilde that detection risk is not exogenous but a function of the level of noncompliance. Our findings concerning the risk of criminal prosecution extend this argument, indicating that the perceived probability of criminal prosecution is also a function of the taxpayer's noncompliance behavior. This suggests that increased tax knowledge may have significant impact on perception of tax system. This is contrary to (Lin and Carrol (2000) who examined the linkage between increases in tax knowledge on perceptions and found that increased tax knowledge did not have a significant impact on perceptions of fairness. However, the result is inconsistent with findings of other researchers (Knut Eriksen, 1996) who found strong influence of increased tax knowledge on their respondent's perception of the fairness of the tax system and further against Roberts (1994), who reported that: misperception probably plays a major role in shaping fairness evaluations.

Variations across respondents on the assumptions they impute may confound the interpretation of results concerning the influence of risk perceptions on behavior or, conversely, behavior on risk perceptions. A second generalization of the argument put forth by Graetz follows from what we call the "substitution effect" (Klepper and Nagin, 1989). The substitution effect predicts that individuals with superior evasion opportunities will be less aggressive in exploiting noncompliance on inferior

opportunities than individuals without superior opportunities. This prediction is a manifestation of cross-line item linkages in detection risk.

Especially for inferior evasion opportunities, the results suggest that the perceived risk of detection is a function not only of the extent of noncompliance on that (inferior) opportunity but also of noncompliance elsewhere on the return. It is this linkage that gives rise to the substitution effect. (Nagin, *Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution*, 1989). If the cost of criminal prosecution is perceived to be so high any non-zero chance of criminal prosecution is an absolute deterrent, the difference in alternative deterrent measures of perceived severity is understandable. If a non-zero chance of criminal prosecution is an absolute deterrent, marginal increases in the perceived risk of criminal prosecution above the zero threshold should be inconsequential to behaviour. Thus, the general failure of prior studies to find evidence of a deterrent effect for severity may be attributable to the specification of the severity measure and not to the absence of a severity effect on deterrence. They contend that the general null findings concerning the deterrent effect of severity of punishment are attributable to a failure to control for differences among individuals in the personal consequences of being punished with a specific formal sanction. (Nagin, 1989). In conclusion, tax knowledge relates positively with perceived tax system fairness.

### **5.3.2 Taxpayers' level of awareness and tax compliance**

A major conclusion that the study can draw is that tax awareness and compliance is that a large proportion of the population does not have adequate tax information. Few of them with some information do not have the kind of information that encourages voluntary tax compliance. The information available to them is limited to tax rate and the fact that penalties exist for not paying. Information about what things good tax money is used for or could be used for are not available and so is information about actually penalizing offenders. 'We expect government to distribute taxes in a manner that is fair and reasonable. We also expect government to collect taxes through a system that is fair and reasonable' (Braithwaite, 2007). If awareness is low, it will not be a surprise that compliance is also low. What an individual does not believe in he may not be party. If a taxpaying citizen understands that there are no truly free gifts from the state, since taxpayers cover the cost of providing them, the aversion shown towards the state solution is likely to grow higher (Csontos, 1998).

This thus strengthens existing linkage between awareness and compliance. There is therefore the challenge to increase the level of awareness to be able to improve compliance. The study also concluded that demographic variables have influence on level of awareness and the extent of compliance to tax law and practices. People on specific types of jobs, by the nature of their job and otherwise, may have more tax information than others may, while the more education and individual acquire generally, the better informed he is. There are also job types that make tax avoidance more difficult than others do. While on the other hand it may be possible for a wealthy individual to buy his way, pass tax payment. Tax compliance drive will therefore work better if demographic variables are included in tax programs. With the overall long term objective of improving voluntary compliance through an enhanced understanding of responsible citizenship, the authority ought to engage a multifaceted initiative to take stock of its existing responsible citizenship activities, explore what other tax administrations do, and identify partnership opportunities to engage additional government departments.

### **5.3.3 Enforcement efforts by the revenue authority and tax compliance**

The largest part of the tax gap is attributable to taxpayers under the jurisdiction of the Small Business and Self-Employed Division, which includes individuals with business income and partnerships. Present not only great opportunities for tax evasion but also a strong financial incentive to do so. In fact, in their fascinating article on cash business owners, Professors Joseph Bankman and Stuart Karlinsky report that one of the justifications used by cash business owners for underreporting is the need to do so to remain competitive. Because of rampant noncompliance in the cash business sector, “all else being equal, absent policy changes that lead to more accurate reporting (and a different before-tax return to labor and capital), an ‘honest’ taxpayer should do worse in the cash sector than other taxpayers in that sector, and worse than she would do in the non-cash sector.”

This suggests that noncompliance in the cash business sector may be akin to a prisoner’s dilemma, with the dominant strategy being to cheat, assuming that the taxpayer does not simply leave the sector entirely. That is, even if penalties were high enough that cheating would be irrational when considered under the economic model discussed above, which considers the taxpayer in isolation; it might be rational for a taxpayer in a competitive market to evade. Tax noncompliance is a complex issue with a multitude of causes. The traditional response to noncompliance is enforcement, and the intuitive

prediction provided by economic modeling that increased audit rates and higher sanctions each increase tax compliance has been confirmed by a number of studies. In addition, innovative research by the governments of Minnesota and Australia suggest that compliance can be influenced by reports to taxpayers that compliance is higher than many people think it is.

Although enforcement of the tax laws and fostering of a compliance norm are sometimes viewed as inconsistent, the evidence suggests that enforcement does not undermine compliance norms. Enforcement not only produces direct revenue, but also increases revenue from “voluntary” compliance. That means that, even if theoretically, enforcement was to have a positive compliance effect in terms of deterrence and a negative effect with respect to compliance norms, overall enforcement increases voluntary compliance. Moreover, enforcement does not seem to be inconsistent with efforts to foster a compliance norm. In addition, because taxpayers are heterogeneous, it is likely that some taxpayers respond better to enforcement and some to normative appeals. A study found that those taxpayers who believed that there was a higher likelihood that small tax cheaters would be detected had a lower belief in the normative acceptability of underreporting compared to other taxpayers. Taken together, these results support the theory that, because of the presence of taxpayers who are “conditional cooperators,” there may be two stable equilibrium for taxpayer communities: compliance and noncompliance. Thus, for example, with respect to the highly compliant taxpayers under the jurisdiction of the authority, KRA can continue to use high levels of document matching and low levels of audits, perhaps combined with a letter informing taxpayers that compliance is higher than they might think. In contrast, where evasion is a major problem, as it is with respect to the turnover businesses, enforcement can be increased to the tipping point for compliance equilibrium.

#### **5.3.4 Costs of compliance and tax compliance**

Lawmakers have long used the tax code for purposes far beyond simply collecting revenue to fund the federal government. Through the insertion of specialized tax provisions, the tax code is used to achieve policy and political aims as well. But these special provisions come at a price: economic growth is foregone, higher accounting costs are incurred, more lobbyists are hired to protect tax advantages, and revenue is lost as a result of collection inefficiencies. The estimated hidden costs of tax compliance are in million, and that’s part of the billions in revenue gap in unreported taxes. In order to achieve a stronger economy and higher revenues, reforms need to simplify the economic and accounting burden

of complying with federal taxation. The burdens of these costs often fall inequitably on smaller companies and on individual taxpayers. An overly complex and cumbersome tax code favors companies and individuals with well-paid accountants and lawyers. Both history and international reforms point legislators toward how best to achieve a more productive and equitable revenue system.

This study has established that the cost of complying with the tax system is the compliance costs, which are ultimately borne by the taxpayers, who in turn pass those costs over to their customers, workers, and shareholders of the corporation. This dwarfs the taxpayers' cash flows forcing them to opt for tax avoidance or evasion resulting to tax non compliance. As a fraction of revenues raised, these compliance costs are lower than estimates that have been made. What this survey has not, and could not, establish is whether any particular tax simplification is a good idea. That is because simplicity is but one criterion of many against which the tax system ought to be evaluated. But simplicity has been an oft-overlooked criterion, and quantitative estimates of the cost of overlooking it are a first step toward keeping it in the forefront of policy debates (Blumenthal,1993).

#### **5.4 Conclusions.**

Findings from the study reveal that all the identified factors have a direct influence on the tax compliance efforts by taxpayers in the turnover businesses. The perceptions of taxpayers towards the tax system greatly determine the level of compliance for turnover tax. The study determined the relationships between the awareness of tax authority responsibilities by the taxpayers and compliance behavior. The findings suggest that taxpayers are not aware of their responsibilities; however, the result also indicated that other factors like cost of compliance and complicated systems result into the low levels of compliance. Taxpayer's perception of tax system is inclined to change due to changing tax knowledge. Therefore, KRA has to some extent done a lot to educate its taxpayers but there is still more that needs to be done like creation of friendly systems and training its officers on customer service skills. This may probably increase the level of compliance.

The statistical findings of this study confirm the existence of a causal relationship between tax knowledge, perceived tax fairness, costs of compliance against tax compliance. This adds to the overwhelming evidence that emphasizes the relevance of behavioral aspects in situations of studying tax compliance trends. The traditional economic analysis (deterrence components) should be used with limitation in order to understand the clear cause of the continuous noncompliance. Therefore small

taxpayers' compliance can be predicted basing on how much tax knowledge they possess and how they perceive the equitability of the income tax system. It can be concluded that taxpayers' knowledge about taxes and their perception of how fair the tax system is, affect tax compliance.

### **5.5 Recommendations of the study**

Based on the findings of this study, the researcher came up with several recommendations to encourage higher levels of turnover tax compliance in the KRA domestic taxes department in Nairobi County and they are:

1. K.R.A should undertake intensive and increased sensitization of small taxpayers to make them aware of the turnover tax system, how it works and advantages of using it so that they can understand and appreciate it.
2. They should also train their staff diligently on customer service so that when these taxpayers who have limited knowledge on taxes approach them they can be able to help them and train them on the application of turnover tax.
3. K.R.A should ensure all taxpayers who fall under turnover tax are registered and follow ups done promptly to avoid biasness and increase peer influence to comply with the turnover tax rules.

### **5.6 Suggestions for further research**

This study proposes the following areas for further study:

1. An investigation to examine turnover tax awareness creation as the responsibility of the tax authority.
2. An assessment of the impact of motivational factors; such as rewards and punishments; such as penalties have on turnover tax compliance.
3. An investigation into how peer pressure influence turnover tax compliance.
4. An assessment of the impact of demographic factors; such as sex, age, education and size of income have on turnover tax compliance.

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## **APPENDICES**

### **APPENDIX I: LETTER OF TRANSMITTAL**

Dave Ndegwa Mukabi

P.O Box 12626-00100

Nairobi, Kenya.

mukabi220@gmail.com

Dear Respondent,

I am a student of the University of Nairobi pursuing a Master of Arts Degree in Project Planning and Management. I am conducting academic research on the factors influencing turnover tax compliance in the Kenya revenue authority domestic taxes department in Nairobi County. I'm writing to invite you to participate in the research by filling in the questionnaire.

My research project focuses on Perception towards Tax System, Levels of Awareness, Enforcement Efforts and Costs of Compliance. 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.

Thank you.

Yours Sincerely,

Dave Ndegwa Mukabi.

Tel: 0723-918-394

**APPENDIX II: QUESTIONNAIRE.**

**QUESTIONNAIRE FOR FACTORS INFLUENCING TURNOVER TAX COMPLIANCE IN THE KENYA REVENUE AUTHORITY DOMESTIC TAXES DEPARTMENT IN NAIROBI COUNTY.**

**Instructions**

This questionnaire is designed to collect information on the factors influencing turnover tax compliance in the Kenya revenue authority domestic taxes department in Nairobi County.

The information obtained will only be used for academic purposes and shall be treated in utmost confidence. You are requested to complete this questionnaire as honestly and objectively as possible.

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

**SECTION A: GENERAL INFORMATION**

1. Kindly indicate your gender: Male  Female

2. Kindly indicate your age category:

20 – 30  31 - 40  41 – 50  Above 50

3. Level of Education Attained:

Primary  Technical / Vocational

Secondary  Postgraduate

Undergraduate

4. What is your main business activity?

Boutique  Beauty  Groceries

Repairs  Retail

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

Between Kshs 500, 000 and Kshs 1 million

Between Kshs 1 million and Kshs 2 million

Between Kshs 2 million and Kshs 3 million

Between Kshs 3 million and Kshs 4 million

Between Kshs 4 million and Kshs 5 million

6. Does your business have a Personal Identification Number (PIN)?

Yes  No

7. If yes, what are your obligations?

VAT

PAYE

Income Tax

TOT

**SECTION B: FACTORS INFLUENCING TAX COMPLIANCE**

**2. Perception towards Tax System**

1. Do you think paying taxes is everybody's obligation?

Yes  No

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

		<b>1</b> <b>Strongly</b> <b>Disagree</b>	<b>2</b> <b>Disagree</b>	<b>3</b> <b>Not</b> <b>Sure</b>	<b>4</b> <b>Agree</b>	<b>5</b> <b>Strongly</b> <b>Agree</b>
a)	I believe it's my obligation as a citizen to support the government by paying taxes					
b)	The tax system in place motivates me to voluntarily comply with my tax obligations.					
c)	I find it hard to comply with the tax laws as they are complicated					
d)	I see no point of paying taxes when it is being misused by individuals in government					
e)	I feel that there is a lot that can be done on our tax systems to ease the work of preparation of tax returns and payment.					
f)	I feel that I can pay my taxes in all obligations without being followed					
g)	K.R.A has put in place enough measures to ensure that taxpayers know of their obligations and reparations of noncompliance.					

**3. Levels of Awareness**

1. Have you ever attended any tax training?

Yes  No

2. If yes, who had organized the training?

Kenya Revenue Authority

Education Institution

Non-Governmental Organization

Other (specify).....

3. If you required any information on taxes where would you go?

A cyber café attendant did it for me

KRA website

A friend / relative

KRA offices

Other (specify) .....

4. Do you face any challenges in trying to access information on tax issues?

Yes  No

5. If yes, how would you rate the challenges experienced?

Tick your opinion on a scale of 1-4; where 1= ‘Not Serious’ and 4 for ‘Very serious ‘

<b>Problem/ Hindrance</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>
Conflicting information from different sources				
KRA website lack enough information on various tax procedures				
System slow / not functioning				
Long queues in gaining access to KRA offices				
Technical details on brochures and tax Acts that I don't understand				
Delay in receiving feedback on queries raised				
Lack of internet to download forms for filling returns				
High fees charged by tax consultants and other professionals				

6. What additional challenges not listed above have you experienced in dealing with tax matters?

.....  
.....

**4. Enforcement Efforts**

1. Have you ever been audited on tax issues?

Yes  No

2. If yes when?

.....

3. How regularly do you think KRA should visit your business?

Weekly  Monthly  Annual  Never

Other (specify)

.....

4. How much has your business committed in an effort to be compliant?

.....

5. The benefits of tax avoidance and evasion outweigh the cost of paying taxes

Strongly Agree  Agree  Strongly Disagree

Not Sure  Disagree

6. Which ways have you found to be mostly used by KRA in an effort to enforce tax compliance?

.....

.....

**5. Costs of Compliance**

1. On average how much do you spend on tax computations?

Yes  No  Not Sure

2. Are you aware of the tax due dates that relate to your business.

Yes  No  Not Sure

3. Have you ever filed a tax return and paid the tax thereon for your business?

Yes  No  Not Sure

4. If yes, did you file and pay the correct taxes for your business?

Yes  No  Not Sure



5. Currently, who is responsible for computation and filing tax returns for your business?

- |                  |                          |                  |                          |
|------------------|--------------------------|------------------|--------------------------|
| Yourself         | <input type="checkbox"/> | Tax Consultant   | <input type="checkbox"/> |
| Accountant       | <input type="checkbox"/> | Office Assistant | <input type="checkbox"/> |
| Friend/ Relative | <input type="checkbox"/> |                  |                          |

6. I am able to correctly calculate the tax that I am due to pay.

- |          |                          |          |                          |
|----------|--------------------------|----------|--------------------------|
| Agree    | <input type="checkbox"/> | Disagree | <input type="checkbox"/> |
| Not sure | <input type="checkbox"/> |          |                          |

7. What do you feel is the most expensive tax compliance issue?

- |                  |                          |                |                          |
|------------------|--------------------------|----------------|--------------------------|
| Accounting Costs | <input type="checkbox"/> | Training Costs | <input type="checkbox"/> |
| Economic Costs   | <input type="checkbox"/> | Lost Revenue   | <input type="checkbox"/> |

**6. What would you want changed to make it easier to comply with tax rules and regulations?**

1. In your opinion, what would you say is the greatest factor that has influenced your noncompliance with regard to taxes?

.....  
.....

2. What changes do you feel KRA need to put in place to encourage taxpayers to be more compliant in their tax obligations?

.....  
.....

3. Do you think if KRA fully computerizes its operations and procedures it will make it easier for you to be more tax compliant?

.....  
.....

4. How would you like KRA to change its approach towards taxpayers that would make it easier for you to approach the authority for tax information and assistant?

.....  
.....