# THE IMPACT OF INTEGRATED TAX MANAGEMENT SYSTEM ON LARGE CORPORATE TAXPAYERS COMPLIANCE.

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# DECLARATION

I, Amos Ochola James, hereby declare that this research project is my original work and my own effort and that it has not been submitted to other institution of higher learning for any academic purposes..

Date:

Signature: …………………………………...                    …………………

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This project has been submitted for examination with my approval as the university supervisor

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## DEDICATION

To my dear wife Domsiana Anyango, my niece Christine Lavender and my children Kimberly and Kyla Manuela for their continued support and encouragement.

# ABSTRACT

Tax compliance has become the key administrative approach for both personal and corporate taxation in developed countries and the premise of this study was investigate the impact of Integrated Tax Management system on Large Corporate Taxpayers Compliance. Central to the motive of the introduction of ITMS tax system is an increase in the efficiency of tax collection for the tax authority; however, of more vital importance is the need to enable this without having an unacceptable detrimental effect on the other key characteristics of a well-designed tax system. This requires the development of public awareness of tax laws, and improvements in voluntary compliance.

According to prior studies on this topic one of the main facilitating factors in achieving these aims is the development of the level of tax knowledge among taxpayers. To explore the interaction the system real setting the introduction of ITMS filing tax system on large corporate tax payers is used as a case tax system for this study. Data was collected using structured questionnaire administered to random sample of 33 top corporate tax payers in Kenya. Five stages were used to facilitate the analysis. Stage 1, using the t-test and ANOVA, focuses on the characteristics of taxpayers' knowledge including gender, ethnicity, educational level and income level. Stage 2 attempts to describe the relationship between tax knowledge and tax compliance using multiple regressions. Stage 4 examines taxpayers' compliance determinants more widely than tax knowledge.

The results suggested that tax knowledge on the introduction of ITMS has a significant impact on tax compliance even though the level of tax knowledge varies significantly among respondents. The results also indicate that tax compliance is influenced specifically by probability of being audited, penalties, Tax knowledge and the tax system. Results of this study answer such questions as which various taxpayer characteristics of tax knowledge affect compliant behavior. The results of this study can inform policymakers on the extent to which the introduction ITMS is important on corporate taxpayers compliance.

## TABLE OF CONTENTS

## LIST OF ABBREVIATIONS

| | |
|---|---|
| EAC | East African Community |
| DC | Developing Countries |
| DTD | Domestic Tax Department |
| GDP | Gross Domestic Product |
| ICT | Information and Communications Technology |
| ITMS | Integrated Tax Management System |
| KRA | Kenya Revenues Authority |
| OECD | Organization for Economic Co-operation and Development |
| OTPR | Office of Tax Policy Research |
| PIN | Personal Identification Number |
| PWC | Price Waterhouse Coopers |
| RARMP | Revenue Administration Reform and Modernization Programme |
| R&D | Research and Development |
| TAT | Technology Acceptance Theory |
| TPB | Theory of planned behavior |
| USA | United States of America |
| VAT | Value Added Tax |
| WDI | World Development Indicator |

# CHAPTER ONE

# INTRODUCTION

## 1.1 Background of the Study

Integrated tax management information systems represent the central data station, which fuels almost all daily operations of modern Tax Administrations anywhere in the world. However, tax administrators in many developing countries still have to cope with paper-based, largely manual tax information systems – or, at best, with data systems supported by very limited, outdated and inadequate computer hardware and software. Early efforts to modernize tax information systems of developing countries through projects financed by international development agencies always present a mix of special challenges Heseltine (1998). An integrated tax information system accurately collects and links information on all payments and liabilities within the tax system with customs duties and payment, with land ownership and taxation, and with motor vehicle registration is an incredible force against tax evasion,Feld and Frey (2002) therefore feels that this concentration of taxpayers is well reflected, for instance, in the comprehensive surveys on tax compliance by Andreoni.Erard and Feinstein (1998) and Slemrod and Yitzhaki (2002).

Andreoni, Erard, and Feinstein (1998) define taxpayers' compliance as the willingness to obey tax laws in order to obtain the economy equilibrium of a country. Kirchler (2007) perceived a simpler definition in which tax compliance is defined as the most neutral term to describe taxpayers' willingness to pay their taxes. A wider definition of tax compliance by Song and Yarbrough (1978) suggested that due to the remarkable aspect of the operation of the tax system that it is largely based on self assessment and voluntary compliance, tax compliance should be defined as taxpayers' ability and willingness to comply with tax laws which are determined by ethics, legal environment and other situational factors at a particular time and place. Alm (1991), Jackson and Milliron (1986) defined tax compliance as the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments.). Compliance in pure administrational terms therefore includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year (if required) and following the required payment time frames Ming Ling, Normala and Meera, (2005). In contrast, the wider perspective of tax compliance requires a degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation.

Large Corporate Taxpayers are those organizations whose annual turnover is in excess of Kshs 750M, it covers the administration of Income Tax, VAT, Domestic Excise and Agency Taxes /Levies in respect of all Banks and Insurance companies irrespective of turnover threshold, Manufacturers of Wines and Sprits irrespective of turnover threshold, State Corporations, Head Office operations of Central Government Ministries and Departments, Local Authorities with city Status and Individual of High Net Worth.

The Kenya Revenue Authority (KRA) has embarked on an aggressive program to modernize and automate revenue administration. Among the KRA's impressive, recent accomplishments is the integration of formerly separate departments for income taxes and value added taxes under a new Domestic Tax Department (DTD); acquisition and implementation of a modernized customs system (SIMBA); and development of a KRA-wide Information and Communications Technology (ICT) strategy, Plumley (2002). Electronic filing of tax returns is increasingly used by tax administrators around the world to reduce the data capture overhead during returns processing and to increase security and confidentiality of taxpayer data. Other advantages of e-filing are reduced paper storage for taxpayers and the tax authority, faster and more accurate return filing process.

The taxpayer registration process/module of the Integrated Tax Management System have the primary responsibility of the managing the PIN database for both individuals and legal entities (corporations, partnerships, parastatals, etc.). As part of the Redesigned Business Processes the VAT and PIN databases are merged into one database. The taxpayer recruitment function (currently housed in Taxpayer Services) is to recruit persons/entities which have income or revenue liable for tax but are currently not in the tax net.

### 1.1.1 Tax Administration in Kenya

The Kenya Revenue Authority, hereinafter referred to as KRA or the Authority ,was established on 1st July 1995 under an act of Parliament, the KRA Act Cap 469, as a central body for the assessment and collection of revenue, for the administration and enforcement of the laws relating to revenue and provisions for connected purposes. It is mandated to administer and enforce the laws relating to revenue as contained in the first schedule to the Act. The main laws are the Income Tax Act (Cap.470), Value Added Tax Act (Cap 476), the Custom and Excise Act (Cap. 472) and the Traffic Act (Cap 403).the authority is therefore charged with the responsibility of collecting revenue on behalf of the government.

In its mission statement, KRA aims to promote compliance with Kenya's tax trade and border legislation and regulation by promoting the standards set out in the taxpayers charter and responsible enforcement by highly motivated and professional staff thereby maximizing revenue collection at the least possible cost for the socio – economic well being of Kenyans. The Taxpayers Charter outlines five primary obligations on taxpayers; 1) to fill timely returns/Custom entries; 2) to make accurate reports on all returns/entries; 3) to pay the required taxes voluntarily and timely; 4) to give revenue officers maximum cooperation and accord them their due respect and freedom to carry out their lawful duties; 5) to disclose and produce all relevant information, records and documents to tax officials. The Economic Recovery Strategy for Wealth and Employment Creation, which was implemented by the new regime from 2003 to 2007, was successful in reversing the economic decline of the past two decades. In 2007, for the first time since the 1970s, the annual rate of real GDP growth reached 7%. While the post 2007 election violence and onset of the global financial crisis resulted in a slump in real GDP growth in 2008, to 1¾% (IMF, 2010), it is projected that GDP growth will be about 5% in 2010.

In the short-to-medium there are four key fiscal governance drivers. First, an expensive bureaucracy, as reflected in Kenya's wage bill to GDP ratio compared to other countries in the region, needs to be sustained. In 2007/08 the wage bill to GDP ratio was estimated to be 7.4% (IMF, 2010), which was the highest amongst EAC countries. Second, there are ambitious social welfare goals that are reinforced in the Bill of Rights in Kenya's new (2010) Constitution. Third, elite capture of fiscal governance, as depicted by two initiatives by Members of Parliament (MPs) in recent years – in terms of introduction of the Constituency Development Fund, which is under the control of individual MPs, and the arbitrarily high self-pay awarded by MPs. Fourth, the ambitious development goals for the country as aptly captured in Kenya's Vision 2030. This underlies the recourse to using infrastructure bonds, amounting to about KShs 52 billion in 2009 and 2010 (equivalent to about US$650 million). Nonetheless, given the comparative resilience of

Domestic Revenue Mobilization in Kenya over the years, barring any unforeseen adverse political or socio-economic developments, Kenya's fiscal governance trajectory is fairly solid.

### 1.1.2 Measurements and Ways of Improving Tax Compliance.

The major components of compliance measurements are the indicators that track compliance trends using a set of proxy measure derived from a variety of internal and external data sources which include the number of individual and firms registered and filling income tax returns in comparison to statistic on the population, trend in the percentage of returns filed in time by tax type, correct reporting of Net VAT/Gross Sales Totals revenue tracked against changes in consumer expenditure and levels of imports, trends in extent of unreported income/ aggregate income(e.g. as measured by random audit programs or macro measures, percentage payments trend of tax paid in time by revenue type and the trend in the value of year –end debt inventory(gross debt and collectable debts) as a percentage of net annual revenue collection.

Tax compliance can be improved through effective and efficient enforcement of penalties and interest on non compliance, tax audits, electronic use in returns filling and tax payers services, tax payers education and tax administration systems modernization.

### 1.1.3 Tax Reforms: Sequencing, Implementation and Results

In the perspective of the authors, there are two main epochs in the reform of tax policies and administration in Kenya. The first epoch generally corresponds to the Tax Modernization Programme (TMP) that was launched in 1986 and was under implementation until the new government in 2003. The main elements of the policy thrust under the first phase of the TMP included: raising and maintaining revenue as a ratio of GDP at 24% by 1999/2000; expanding the tax base; rationalizing the tax structure to make it more equitable; reducing and rationalizing tax rates and tariffs; reducing trade taxes and increasing them on consumption to support investment; and sealing leakage loopholes (Moyi and Ronge, 2006). During this epoch VAT was introduced in 1990, and the KRA was established in 1995.

It is noteworthy that during the TMP epoch, in terms of fiscal decentralization, the Single Business Permit (SBP), which is arguably the most progressive feature of Kenya's local government system was introduced (in 1999) to replace a number of local licenses and revenues-raising permits on local businesses.

The second epoch is the on-going Revenue Administration Reform and Modernization Programme (RARMP), which was launched in FY2004/05 by the new KRA top management that had been appointed by the NARC government (2003-2007). The goal is to transform "KRA into a modern, fully integrated and client-focused organization". The strategic thrust is to harness Information and Communication Technology (ICT) applications to drive the modernization of the tax administration. In this regard, for example, the e-Filing system and Simba 2005 online system in customs are working. Key changes to tax policy have revolved around: pursuit of equity; further widening the tax base; promoting increased investment; and reducing the tax compliance burden. The reforms under the RARMP epoch were not specifically anticipated in the TMP. In other words, there was no specific initiative to sequence between the two programmes. Furthermore, there are aspects of certain tax policy initiatives that transverse the two programme, and elements of which are also to be found in the pre-TMP period. In the latter context, two observations are pertinent. Policy initiatives are not particular to any reform epoch. In this regard, it is noted that some tax policies cannot be located as once-off changes in a long-term strategic trajectory. Rather, they need to be monitored, evaluated and changes effected, where appropriate, on a regular basis. Thus, the issue of sequencing does not arise with respect to, for example: (i) widening the tax base; and (ii) aligning tax policies with the national development strategies and policies.

## 1.2 Research Problem

The weakest link in the operations of Tax Administrations in many developing countries is the absence of a complete, computerized Taxpayer Accounting System, i.e., a system which includes a comprehensive current account, ledger accounting, external controls, audit trails, internal controls, and system validation. The integration of formerly separate departments for income taxes and value added taxes, Computerization of tax and revenue authorities can contribute to reaching the goal of good financial governance which improves accountability and transparency of the revenue authorities, provision of accurate and complete records of financial transactions like assessment and payments of taxpayers which in a modern system are virtually impossible to prepare and maintain manually. Most empirical studies of integration and taxation have focused on the first explanation, tax competition, but have failed to address the impact of integrated tax system on corporate taxpayers. These studies find surprisingly little evidence for the notion that increased integration leads to lower tax rates, however, the main implication of tax competition. This research will investigate whether using integrated computerized tax management system on corporate tax payers can produce better results by capturing tax evaders, lowering tax rates, making it easy for the tax administrators to do carry out audit trails and to also aid in the processes of tax refunds whenever deemed necessary.

A research carried out by African Development Bank on Domestic Resource Mobilization for Poverty Reduction in East Africa in Kenya (2010) showed the resent reforms and development in the tax system but did state how to analyze how to match impacts of tax integration management system. For many years, most tax and revenue authorities/administrators have believed that their activities have a positive impact on the total amount of funds collected from the corporate taxpayers and taxpayer services. Little information or research has been presented in Kenya or otherwise, to quantify this impact, or even verify that it exists. The interest of most researchers has been centered on the deterrent effects of audits, although Plumley (2002).Large amounts of taxes are collected from the easy-to-tax areas such as public wage earners while enforcement of collection among small business enterprises is difficult. Tapping into this group of taxpayers can significantly increase the revenue collection.

According to Thuo (2004), there are no services that one possibly gets from the KRA, unless the authority privatizes it debts collection in which it is extremely good at. Consequently, it is unlikely that the KRA will look into business angle of taxation and tax body seems to completely ignore the fact tax, though an important factor is hardly ever driving force when making business decisions. Another study by Ambali (2009) suggested a need for improvement in the implementation of the online e-Filing to ensure that the system conform to the public e-filers' satisfaction as the result for users' retention only indicate moderate level. He also said that the overall level of the e-Filing usage among taxpayers is still low, despite many campaign activities by KRA to increase the level of e-Filing usage in the country.

A research carried out by Magutu and Wanjohi on tax payer attitude, behavior and tax compliance in Kenya (2010) the challenge of lack of knowledge of tax Compliance behavior towards a tax system is serious on the grounds that it may have played part in the Kshs. 3.4

billion short fall in 2005/2006 (Daily Nation, August 5, 2006) even after aggressive marketing by KRA in the print and electronic media. Does the introduction of integrated tax management system results in a positive impact on large corporate tax payer's compliance?

### 1.3 Objective of the Study

To investigate and establish the impact of the integrated tax management information system on corporate taxpayers' compliance behavior in Kenya.

### 1.4 Value of the Study

The results of the study will be useful in filling the gaps that have been left by the previous studies on integrated tax management system in Kenya and also to the following group of people

The management of KRA will use the study to understand how effective the authority's activities are on the levels of taxpayer's data becoming integrated so as to be able to access one system and look for better ways of raising compliance rates and hence maximize revenue.

The policy officials at the Treasury may also use the study to understand the impact of integrating various income collection points into one system. The study will also assist them to understand how the integrated system will ease the burden of taxpayers on filling their returns.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Introduction

This chapter provides a discussion of the theoretical and the empirical literature explaining and related to this study. There are three theories that explain the impact of integrated tax management system on the corporate taxpayers. These theories are, Technology Acceptance Theory, Theory of Planned Behavior and Standard Economic Theory. The Technological Acceptance Model explains the taxpayers' intention and behavior, the other two theories states the effects of integrated tax management system on the changes in the amounts of revenue collected.

The empirical studies on the effects of integrated tax management system in different countries show that there is a positive e-filing and compliance. Study carried out in Taiwan shows that the integrated tax system lacks evidence in its effect upon corporate tax.

## 2.2 Review of Theories

There are several theories on integrated tax management system some of which include:

### 2.2.1 Crowding Theory

According to Fidel and Frey (2002) a model of tax system of any tax authority should be developed based on Crowding theory, which establishes systematic relationship between internal intervention (in this case, how a tax system and compliance) and intrinsic motivation (in, this case corporate taxpayer behavior and compliance).The emphasis needs to be placed on the empirical analysis of theoretical propositions derived from integrated tax management system on tax compliance. Previous researcher's studies on tax compliance have been particularly concerned with determining the absolute effect of integrated tax system on compliance. Researchers propose Crowding Theory to explain the conceptual model that users' compliance will be determined by the degree toward information system or new technology. Crowding theory is constructed on the foundations of perceived usefulness and perceived ease of use and how it motivates the taxpayers to comply. Perceived usefulness refers individual believe improve the degree of job the model place more emphasis on perceived ease of use would positively affect perceived usefulness. Exogenous variables such as environment are also the antecedent that induces perceived usefulness and perceived ease of use. Thus, is based on both important perceptive factors as perceived usefulness and perceived ease of use. CT is widely applied on the researches of information technology. Liu and Arnett (2000) examine the significant variables to build a successful website based on crowding theory. Gefen et al. (2003) combine Integration and rust to propose an integrate model for explaining online consumer behavior. Pavlou (2003) proposes e-commerce acceptance model of online consumers by separating applying experiment designs and survey.

Follow-up studies such as Horst, Kuttschreuter and Gutteling (2007) discuss whether or not the government of Netherlands should serve the public with electronic government like other countries do. The study integrates Crowding factors, the experiences of the public, perceived risk and faith. The empirical results show that the premise of e-government is that people fully trust the governmental organization and that they highly identify with information technology. As the result of the empirical study, scholars find CT is not only to apply to examine new information technology accept intention or behavior, and further to ensure CT suitable for the explanation of online user behavior issues (Liu and Arnett, 2000; Gefen et al., 2003; Pavlou, 2003;Horst et al., 2007).

### 2.2.3 The Standard Economic Theory

According to this theory by Ellingham and Sanmo (1972) taxpayers weigh the expected utility on the benefits of the integrated tax management system and the uncertain prospect of detection for non compliance by the system? The basic point advanced by theorists of this school is that the rational taxpayer’s main goal is to maximize their financial position. Consequently; they will continuously attempt to evade taxes whenever the benefits from tax delinquency outweigh the risk of detection, punishment and penalties imposed by integrated tax management system for non compliance. This theory explains that compliance will be directly related to integrated tax management system this is because of ease of detection of non compliance by the system. The standard economic analysis thus concludes that since compliance decisions are based on an assessment of costs, benefits and systems used by the tax system, high probabilities of detection for non-compliance, large penalties of detection for non-compliance and large penalties for discovered violators would encourage greater compliance, hence maximizing tax revenue stems.

### 2.2.2. Theory of Planned Behavior (TPB)

Early studies mainly focus on theory of reason action (TRA) as identified by (Fishbein and Ajzen, 1975).TRA is based on the fundamental variables of attitude and behaviors on integrated tax management system system. The two variables are seen to have a positive effect on corporate taxpayers' compliance towards anew tax system. Attitude is an individual's positive or negative evaluation of self-performance of a particular system. The concept is the degree to which performance of the behavior is positively or negatively valued. Subjective norm . However, the basic hypothesis of TRA states that the occurrence of behavior is based on volitional control of one's willpower (Fishbein and Ajzen, 1975). Thus, the behavior occurs mostly from one's willing. Thus, Ajzen (1985) modifies TRA and further proposes the theory of planned behavior (TPB). Ajzen (1985) proposes TPB to explain and predict human behavior patterns. TPB extends the theoretical framework of TRA and adds perceived behavioral control to account for individuals' uncontrollable factors. TPB is founded the three factors as perceived behavioral control, attitude, and subjective norms. Hence, behavioral intention is influenced by perceived behavioral control, attitude, and subjective norms. Actual behavior is, in turn, determined by behavioral intention. Among all, perceived behavioral control refers to individual's perceived ease or difficulty of performing the particular behaviors. Empirical results show that attitude and perceived behavior control would positively affect people's intention to use internet banking. The empirical results show that subjective norms, attitude, and perceived behavior control are the major factors affecting consumers' continuous intention of internet shopping. In addition, equity concept which is respected by accounting scholars (Jackson and Milliron, 1986; Efebera et al., 2004) is also omitted in the pre-factors. To sum up, the empirical results of the above-mentioned literatures prove that TPB could be applied to explain the behavioral process of human being engaged in or accepted information technology.

### 2.3 Concept of Integrated Tax System

Computerization of tax and revenue authorities can contribute to reaching the goal of good (financial) governance. It improves accountability and transparency of the revenue authorities. Nevertheless, while reforming and modernizing the tax system is an essential part of improving domestic resource mobilization, such a reform will be sustainable only in conjunction with more profound changes in the administrative and political structure of a state. Efficient internal revenue collection is a major step towards self-sufficiency and independence. To realize this goal, Developing Countries (DC) have a difficult starting position. Industrialized Countries (IC) are organizationally and technologically better equipped and thus better placed to utilize their (tax) resources more efficiently. Whereas ICs generally manage to capture about 90% of the given tax potential, in DCs this can be as little as around 40%. Taxes can be dichotomized into direct taxes and indirect taxes. The income tax is a direct tax. Indirect taxes include the sales tax, also called consumption tax. Other indirect taxes include the value added tax (VAT), excise tax, estate tax, gift tax, employment tax, and user fees. The VAT is applied at each stage of production for the value added to the goods. As with all taxes, the tax burden ultimately falls on the consumer because companies can reclaim taxes paid.

The payment of tax is obligatory duty of every citizen whether natural or corporate citizen. As a civic duty, it is expected that citizens will voluntarily comply with such obligation but that is not the case with some citizens. Alm Martinez-Vazquez and Schneider (2003) acknowledged that most people do not like to pay taxes as a result; it is difficult for tax authority to impose and collect taxes anywhere and anytime. In order to ensure compliance with tax rules and regulations, tax system made up of tax laws, tax policy and tax administration is in place. According to Marti (2000), the existence of tax system forces individuals and organizations to give part of their income to the government as tax payment. Silvani (1992) added that the goal of tax administration is to foster voluntary compliance.

Tax compliance can be described as the degree to which a taxpayer obliges to tax rules and regulations. James and Alley (2004) indicated that the meaning of tax compliance concept can be given from different perspectives but they define tax compliance as “…the willingness of individual and other taxable entities to act in accordance within the spirit as well as the letter of tax law and administration without the application of enforcement activity. McBarnett (2003) identifies three forms of compliance, which include committed compliance, capitulative compliance and creative compliance.

Committed compliance is the willingness to discharge tax obligations by taxpayer without grumbling. While capitulative compliance is the reluctant in discharging of tax obligations by taxpayer and creative compliance refers to any act by taxpayer aimed at reducing taxes by redefining income and deductible expenditure within the confine of the law. In his contribution, Kirchler (2007) submitted that compliance might be voluntary or enforced compliance. Voluntary compliance is made possible by the trust and cooperation ensuing between tax authority and taxpayer and it is the willingness of the taxpayer on his own to comply with tax authority's directives and regulation.

### 2.3.1 Tax Compliance in Kenya

Kenya is ranked among low-income countries or low compliance countries with hard task of ensuring efficient and effective tax administration. In order to ensure tax compliance, hence raising more revenue. Administration of tax in Kenya is by Kenya Revenue Authority established through an Act of Parliament on July 1st 1995 (Cap 469). "Kenya Revenue Authority is supposed to promote compliance with Kenya's tax ensure responsible enforcement by highly motivated and professional staff thereby maximizing revenue collection at least possible cost for the social- conomic well being of Kenyans" (CIAT, 2006). The purpose of Kenya Revenue Authority is assessment, collection, ministration and enforcement of tax laws with professionalism governed by integrity and fairness (CIAT). To achieve this purpose, KRA is divided into regions such as North Region, Rift Valley Region, Western Region, Southern Region and Central Region and departments such as Customs Services Department, Domestic Services Department, Road Transport Department and Support Services Department. KRA administers different types of taxes under different Laws (Acts) such as Income Tax, Value Added Tax, Custom duties and Excise Tax among many others. Hence, KRA is supposed to ensure taxpayers comply with the respective tax laws.

Integrated tax system is enforced on taxpayers who are unwilling to pay their taxes through the threat and application of audit and fine (Kirchler, 2007). In its submission, Organization for Economic Cooperation and Development (OECD, 2003) categorized tax compliance into administrative compliance and Technical compliance. Administrative compliance is made up of reporting compliance, procedural compliance and regulatory compliance and it is generally concerned with complying with the rule relating to lodging and payment of tax while technical compliance is concerned with meeting up technical requirement of tax laws in computation of tax liability. Franzoni (2000), Chatopadhyay and Gupta (2002) stated that compliance with tax laws involves true reporting of the tax base; correct computation of the tax liabilities; timely filling of tax returns and timely payment of the amount due as tax. Any behavior by the taxpayer contrary to the above constitutes noncompliance.

### 2.3.2 On-line Tax Filing

There are three ways to file tax which are manual filing, on-line tax filing and two-dimensional bar code tax filing (Efebera et al., 2004; Briggs, 2008). This study focuses on integrated on-line tax filing that is defined as individual taxpayers or companies file their taxes via internet. Internet security assurance service has provided Kenyan on-line tax filing system with reasonable guarantee of secure transaction mechanisms, such as information disclosure, transaction transmission, information privacy, in order to reduce perceived risk of taxpayers' on-line tax filing. Because governments in various countries pay high attention to the electronic services, there are many studies on on-line tax filing. For examples, Warkentin et al. (2002) discuss the factors affecting the public to use e-government services, including cultural variables, trust, perceived risk, and perceived behavioral control. However, this research is a descriptive paper which only out the theme but lack of empirical investigation on the feasibility of the research framework. Hsu and Chiu (2004) investigate the acceptance model of the public toward e-government service based on TPB.

The empirical result shows that taxpayers' continuance intention is determined by TPB factors (self-efficiency, perceived controllability) and satisfaction. In further studies, Efebera et al. (2004) employ TPB to explore the determinants of on-line tax filing which include subjective norms and legal sanctions. The contributions of this literature are to (1) increase the importance of low-income individual taxpayer in tax compliance model; (2) add vertical, horizontal and exchange equity as the new variables that affect the intension of tax compliance. The on-line tax filing acceptance model of taxpayers can be explained effectively with the integration of TPB factors (perceived behavioral control and subjective norms) and tax equity perceptions (horizontal, vertical and exchange equity). Fu et al. (2006) believe that the Taiwan government still needs the help of information technology in multi-aspect. They integrate partial TPB factors and partial TAM factors to investigate the determinants affecting taxpayers on the choice of tax filing methods. Empirical results show that perceived usefulness is one of the TAM factors affected on-line taxes filing intention; while subjective norms and self-efficacy are the TPB factors affected on-line tax filing intention.

### 2.3.3 Integrated Tax System in Informal Sector

The informal sector is a fast growing segment of Kenya's economy, but tax evasion remains particularly high. "According to the 2006 Kenya economic survey, the informal sector constitutes 72% of the working population. The sector has grown by 32.7% during the past four years to 6.5 million workers" (Iarossi, 2009). The informal segment of the agricultural sector constitutes the largest portion of the economy, and employs the largest segment of people. However, it presents unique challenges to tax administration for several reasons. First, it is a high risk and uneven source of income for its operators. As a consequence, for example, past efforts to tax it through presumptive income tax failed due to: many unrecorded open air markets; delays and a failure to make payments to producers by many government controlled marketing boards; unpredictable profit and cash flows for growers of export crops arising from global market variations; and a high reliance on rain fed agriculture, which exacerbates the unpredictability of farmers‟ incomes. Second, most of the labor is provided by the family and therefore it is hard to audit revenue streams and costs. Third, it attracts much politics which often blurs the real issues and results in resistance to required policy and legislative changes.

The trade segment of the informal sector has also been booming. But again, there are particular challenges around trying to bring this segment into the tax net. In one respect, informal trading businesses increasingly operate through small scale outlets, popularly called Bazaars (i.e. many operators trading in a big store), whereby the identity of individual operators is difficult to confirm. In another but related respect, many such outlets may be operated by an individual using different PINs. This way, for example, it is easy for the individual to avoid paying even turnover tax.

### 2.4 Rationalizing Tax Exemptions

There is an array of tax exemptions given by GoK. The more prominent ones are around the EPZ, once-off capital investment deductions, the 150% capital deduction, exemptions given on withholding tax, and the zero rating of VAT payable for goods and services procured by public bodies, privileged persons and institutions etc. Many research studies on tax exemptions and incentives confirm the conclusions of a 2008 IMF assessment of the investment incentive regimes offered in Kenya and Tanzania, that these are not important in attracting foreign investment. Rather such incentives create distortions and result in the loss of tax revenues. In addition, the socio-economic rationale for VAT zero rating is questioned in that in most instances, it does not result in lowering consumer prices for the targeted beneficiaries. In the latter perspective, it has been argued that zero rating of local products may benefit business people as windfall profits. Nonetheless, it can be expected that, at least politically and diplomatically, cases of tax exemptions and incentives will arise. Therefore, a key challenge is in rationalizing them.

### 2.5 Tax Reform Objectives and Computerization

Economic growth, equitable development, and financing of an adequate level of social public expenditure for growth, while limiting budget deficits, are conditions for financial assistance usually required of developing countries' governments by international development agencies. These conditions are usually linked with requirements to reform the developing countries' tax policies and Tax Administration. Therefore, major tax administration/policy reform objectives often define the overall context of many modernization projects funded by international development agencies. Such objectives expressed in various ways on different projects): Broaden the tax base, Strengthen the organization and its management, Control tax evasion, Improve tax collections, Facilitate voluntary compliance for taxpayers. In modern reality, attainment of each of the reform objectives is inextricably dependent on the successful design and implementation of computerized, integrated tax information systems.

**2.6 Review of Empirical Studies**

Plumley (2002) is of the view that very few empirical studies have attempted to investigate the effects of the integrated income tax management system on corporate tax. Most of those that have attempted to do so have focused almost exclusively on the impact of audits. As Tanzi (2007) points out tax administration determines the real (or effective) as opposed to the statutory tax system .there is need to differentiate between tax policies from tax administration. In Kenya, promulgation of tax policy is the domain of the Ministry of Finance (Treasury), while tax administration is vested in the Kenya Revenue Authority (KRA). The operational metaphor for the relationship between KRA and the Ministry is Principal and agent. For the purposes of this study, the tax administration referred to both KRA and the treasury. This is because according ton Tanzi (2007), tax administration is tax policy.

Empirical literature reviewed suggests that there are some research gaps regarding the integration of the tax management system. Ambali (2009) suggested a need for improvement in the implementation of the online e-Filing by the Kenya Government departments to ensure that the system conform to the public e-filers' satisfaction as the result for users' retention only indicate moderate level. He also said that the overall level of the e-Filing usage among taxpayers is still low, despite many campaign activities by KRA to increase the level of e-Filing usage in the country. This finding is very similar to the statistical reports on the usage record for the previous years and also is in line with similar disappointing numbers of the e-Filing users reported by Izatun (2008). In order to make sure e-Filing system can fully satisfied users, the technology system used by IRBM must has this criteria; usefulness, ease of use, facilitating conditions and security and users' intention to continue using the e-Filing system. According to Zaherawati et al. (2009), perception towards e-Filing of the tax payers' perception towards e- Filing is influenced by the way they identify the usefulness of the e-filing system which is perceived usefulness.

Empirical evidence on the ground shows there has been hostility between the taxpayers and tax collectors on issue relating to tax compliance- how about tax evasion cases reported daily in our local newspaper (Daily Nation, July 7, 2006, pg 3) as a result of lack of proper system to fast track the operation and transactions of business entities in Kenya. Empirical review by past researchers has shown that taxpayers are able to complete the filing easier if the government provide a more user-friendly on-line tax filing system (simple operation, easy-to-understand interface, and check the tax exemptions automatically) (Ramayah et al., 2009). The possibility of using on-line tax filing will be increased at the same time. Thus, this paper infers that higher perceived ease of use will on the other hands allow the taxpayers to know the advantages of the system only if it is easy to operate (Warkenting et al., 2002). They will also have a positive attitude toward the system. When users perceive that the system is easy to operate, they will have more positive attitude hence comply.

Past research has indicated that it is reasonable to assume that tax authorities seek to use their resources in an optimal way. It is also reasonable to assume that tax administration seek to collect the tax correctly payable according with the tax laws. Therefore as part of the process in allocating resources to achieve maximum effectiveness, it is appropriate to identify areas (issues and\or taxpayers) of low or non – compliance, and then be able to rank them. Brooks (2001) states that many tax administrations today have within their corporate objectives or goals the improvement of integrated tax system. Potentially, these administrations may have difficulty in establishing their performance against this objective, especially so if there is no effective way of measuring any move in compliance levels over time. It is expected that many administrations currently measure the effectiveness of their integrated tax system improvement strategies solely on revenue return, which is ,of course ,not synonymous with compliance improvement. For the future, such administrations need to develop ways to measure trends in taxpayer compliance to measure their overall effectiveness (OECD, 2003).

From information quality perspective, personalization, completeness, relevance, easy of understanding and security quality dimensions are used to measure electronic information system content issue (Delone and Mclean, 2004). While, based on Chang et al. (2005), information quality has been defined by the degree to which users are provided with quality information regarding their needs. In practices, the e-Filing system benefits taxpayers because tax returns are sent electronically to the KRA which saves taxpayers' time and also in this system, promotion campaign, the tagline 'easy to use, accurate and safe to use were used (Ann, 2010). As a user of e-filing system, we need a convenience and usefulness services in order to get quality information.

Service quality or in another words, overall support delivered by the service provider towards electronic information system, are measured using assurance, empathy, responsiveness quality dimensions (Delone and Mclean, 2004). Service quality is the key to measure user satisfaction (Pitt et. al., 1995). As a user, the most important aspect of service quality in e-Filing system is security. As stressed out by KRA CEO, the e-Filing system is secure and it is difficult to get into anyone's personal tax file because they need to enter personal identification number (PIN) and a password (The Star Online, April 27th, 2007). Meanwhile, in Malaysia, the adoption of the electronic tax-filing is voluntary. Ann (2010) suggested that a system that is usefulness and easy to use are important for taxpayers to voluntarily e-file their tax returns. Thus, the government should increase its efforts to promote the usefulness and user-friendliness of the e-Filing system. There are several studies conducted to develop measurement instruments for electronic service quality in the area of online retailing service quality, web site design quality, and online service quality.

## 2.7 Conclusion

The literature review has provided a clear indication regarding the effect of integrated tax management system on the corporate taxpayers. Both the theoretical literature and empirical literature have shown that e-filing and integration of taxpayer information with indicators like individual PIN registration, return filled in time and percentage of the tax paid in time by the revenue type, and improved the annual tax collection and revenue growth

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Introduction

In this chapter, the research methodology followed in the study is discussed. This includes the research design, sampling design, measuring instruments and data analyses.

## 3.2 Research Design

This study used a descriptive research design. According to Sarma and Misar (2006) descriptive research is define as fact finding study conducted to know the state of affairs as exist. In descriptive research the researcher has no control over the variables, report only objectively what had happened and tries to find out the causes of the variables and their behavior. In this study, it was particularly useful to investigate the relationship and strength between the dependent and independent variables.

## 3.3 Population

A population is a well defined or specified set of people, group of things, households, services or events that are being investigated Ngechu (2004). The population was made up of 589 large corporate taxpayers registered as at 31$^{st}$ December 2011 from State Corporations, Ministries, Local Authorities and Private Sector with annual turnover in excess of Kshs.750 Million.

## 3.4 Sample

The sampling unit for this study was derived using Systematic sampling as a statistical method which involves the selection of elements from a frame. In the list of registered Large Corporate Tax Payers, every thirtieth tax payer was selected for the study. According to Mugenda and Mugenda (2003), 10% sample size of a population of 300 and above is adequate whereas a population of less than 300 requires a sample of 30%, hence a sample of 40 Large Corporate Tax Payers. A survey of the 40 Large Corporate registered with KRA was conducted; the questionnaires was addressed to Financial Controllers of the Large Corporate Tax Payers. It is assumed that the Financial Controllers are in the board of management and are most informed about the tax payments issues. This study used annual incomes and return data of the year 2011.

### 3.5 Data Collection

The methodology used in this study involved a self – administered questionnaire to gather data from the Financial Controllers of selected taxpayers in Kenya. In some cases, telephone follow-up inquiries were used to increase the response rate. This method helped to gather dada on the integrated income tax management system on their various incomes. According to Sproul (1998), a self-administered questionnaire is the only way to elicit self –reports on people's opinions, beliefs and attitudes. A questionnaire also guarantees anonymity and confidentiality and therefore encourages honest responses from the respondents. The questionnaire contained both closed and open ended items, which was ideal to collect respondent's opinions, views and attitudes. Mugenda and Mugenda (2003) are of the view that open ended items permit a greater depth of response and gave an insight into the respondents' feelings, backgrounds, hidden motivation and decisions. The questionnaire was divided into sections representing the various variables adopted for study. Each section contained closed, structured and an open – ended question(s) which seeks any views from the respondent's which might not have been captured by the researcher. The researcher collected both qualitative and quantitative data.

#### 3.5.1 Data Validity and Reliability

An instrument is considered reliable if the results of a study can be reproduced under a similar methodology (Joppe 2000). Reliability is therefore the extent to which measures yield consistent results (Zikmund 2000). To be considered reliable, the measuring instrument must be free of errors and the results or observations must be replicable or repeatable (Joppe, 2000). The consistency or reliability implied in the research instrument relates to three issues namely (1) the degree to which a measurement, given repeatedly, remains the same (2) stability of a measurement over time and (3) the similarity of measurements within a given time period (Kirk and Miller 1986). Reliability of a measuring instrument was established by determining the association between the scores obtained from different administrations of the instrument (Joppe, 2000).

Validity of the measuring instrument determines whether the research truly measures that which it was intended to measure or how truthful the research results are (Joppe 2000, Jones 1993, Smit 1991).

### 3.6 Data Analysis

Both quantitative and qualitative analysis data was obtained from the study. For quantitative data, analyze it for and the statistical package for social science (SPSS – 12) was used to tabulate and analyze the data. Percentages, means and frequency distribution tables were used to describe the data. Relationships between the independent and dependent variables were established by means of regression analysis to test for any differences in the respondent's feelings towards the tax integration system.

#### 3.6.1 Model Specification

The model used was multiple regressions. Hair, Black, Babin and Anderson (2006) claimed that stepwise multiple regressions are the best method used to predict multivariate association as it eliminates automatically any independent. Two measurements of tax compliance were tested (direct and hypothetical questions).The association between integrated. Compliance measurements are the through the use of indicators that track compliance trends using asset of proxy measures derived from internal external data sources.

$$TCDIR_i = \alpha + \beta_1 TNRES_i + \beta_2 TNEMPLOY_i + \beta_3 TNEFILING_i + \beta_4 TNINTETAX_i + \beta_5 TNAWARE_i + \beta_6 TNTOTAL_i + \beta 7 AGE_i + \beta_{10} EDUC_i + \beta_{11} COURSE_i$$

**(Equation 1)**

Where:

$TCDIR_i$ - Tax compliance score

$TNRES_i$ – Tax knowledge about responsibilities and rights

$TNEMPLOY_i$ – Tax knowledge about employment income

$TNEFILING_i$ - Tax knowledge about e-filling

$TNINTETAXS_i$ – Tax knowledge about integrated tax system

$TNAWARE_i$ -Tax knowledge about awareness of offences, penalties and fines

$TNTOTAL_i$ - Total tax knowledge score

$AGE_i$ – Age of the firm

$EDUC_i$ - Education level the financial controller

$COURSE_i$ - Experience of attending tax courses

$TCHYP = \alpha + \beta_1 TNINTEF_i + \beta_2 TNMORDN_i + \beta_3 TNRTURNT_i + \beta_4 TNONLREG_i +$
$B_5 TNTURNOV_i + \beta_6 TNPENALT_i + \beta_7 TNTOTAL_i + \beta_8 TNINFIL_i$

**(Equation 2)**

Where:

TCHYP - Tax compliance score (hypothetical questions)

$TCDIR_i$ - Tax compliance score (direct questions)

$TNINFEF_i$ – Tax knowledge about efficiency of integrated tax system

$TNMORDN_i$ – Tax knowledge about tax modernization programs

$TNRTURN_i$ – Tan knowledge about E-filling system

$TNLREG_i$ - Tax knowledge about online registration

$TNTURNOVER_i$ - Tax knowledge about the make up of firms total turnover

$TNAPENALT_i$ - Tax knowledge whether the company has been penalized

$TNTOTAL_i$ - Total tax knowledge score

The multiple regression model was used to of $\alpha_0$ and $\beta i$ which explains the relationship between the independent variable and dependent variable. It the best method used to predict multivariate association.

Estimated coefficient of correlation *R* and estimated coefficient of determination $R^2$ was used to explain the relationship between the dependent and independent variable *T*-test was used to asses the significance of individual betas and standardized b-coefficients were compared (beta weights) to judge relative predictive power of independent variables and overall model. *F*-statistic was used to test the significance level of the null hypothesis.

# CHAPTER FOUR

## DATA ANALYSIS, RESULTS AND PRESENTATION

### 4.1 Introduction

This chapter describes the results of the study starting with summary of the survey, remainder of this chapter will then be divided into the following sections: Stage1 – to examine the level of taxpayers' knowledge ;Stage 2 –to examine the association between tax knowledge in various aspects and tax compliance based on hypothetical and direct questions; Stage 3 – to examine the association between tax knowledge and tax compliance; Stage 4 to identify factors impacting tax compliance behavior by using both hypothetical and direct questions and Stage 5 – to identify determinants of tax compliance with control variables. Data was collected from the field using structured questionnaires.

#### 4.1.1 Response Rate

The study achieved a response rate of 77.5% that is 31 taxpayers out of 40 chosen for this study responded by returning the completed questionnaire .This response rate is commendable given the jittery reactions witnessed in the studies dealing with taxation issues especially on compliance

### 4.2 Descriptive Statistics

This section explains the characteristics of taxpayers' knowledge. Some demographic variables including, Total income education level, E-filing; religion, probability of being audited were tested using T-tests, ANOVA

**Table 4.2.1 Mean difference between variables (t-test)-A7 (Attended Courses)**

| | A | MEAN OF TAX COMPLIANCE VARIABLES | SD | t |
|---|---|---|---|---|
| B1 | Yes | 18.76 | 5.45 | 5.45 |
| | No | 17.63 | 5.58 | |
| B2 | Yes | 5.91 | 2.68 | 9.40 |
| | No | 6.56 | 2.70 | |
| B3 | Yes | 27.49 | 5.15 | 8.338 |
| | No | 26.30 | 5.14 | |
| B4 | Yes | 18.76 | 5.45 | 6.491 |
| | No | 17.63 | 5.58 | |
| B5 | Yes | 32.46 | 5.91 | .743 |
| | No | 32.01 | 6.32 | |
| B6 | Yes | 18.13 | 5.63 | .987 |
| | No | 18.56 | 5.34 | |
| B7 | Yes | 13.86 | 3.85 | .903 |
| | No | 14.14 | 3.62 | |
| B8 | Yes | 10.68 | 2.89 | 20.921 |
| | No | 9.52 | 9.52 | |

**Source: Research Findings**

Taxpayers who had attended tax courses had a mean of 18.76 (SD=5.45) compared to 17.63 (SD= 5.8).The two groups had significant mean difference with respect to their tax knowledge on B2 and B8 with t=9.40 and 20.921 respectively ($p<0.01$)

**Table 4.2.2: Mean difference between variables (t-test) – A8 – Audited (Frequency )**

| | A | MEAN OF TAX COMPLIANCE VARIABLES | SD | f |
|---|---|---|---|---|
| B1 | Yes | 25.45 | 6.73 | 1.569 |
| | No | 26.56 | 5.08 | |
| B2 | Yes | 6.97 | 2.47 | 1.417 |
| | No | 6.42 | 2.71 | |
| B3 | Yes | 34.58 | 17.63 | 1.579 |
| | No | 30.97 | 16.89 | |
| B4 | Yes | 17.72 | 4.97 | .011 |
| | No | 17.82 | 5..59 | |
| B5 | Yes | 24.65 | 5.34 | 6.168 |
| | No | 22.65 | 6.23 | |
| B6 | Yes | 18.94 | 5.81 | .325 |
| | No | 18.42 | 5.36 | |
| B7 | Yes | 14.22 | 3.67 | .056 |
| | No | 14.07 | 3.65 | |
| B8 | Yes | 10.50 | 3.35 | 2.159 |
| | No | 9.70 | 3.20 | |

**Source: Research Findings**

Table 4.2.2 Table describes the relationship between tax knowledge and experience of being audited by the Inland Revenue Board (KRA). According to Table 4.2.2, there was no significant mean difference between experience of being audited and tax knowledge level in general (A8:B1). However, as for A8:B5 and A8:B8, there were significant mean differences between experienced and non-experienced taxpayers in relation to knowledge about awareness of offences, penalties and fines (B8) with $t = 6.168$ ($p < 0.01$) and 2.159 ($p<0.10$) respectively.

**Table 4.2.3 Stepwise multiple regression-tax knowledge and tax compliance direct question (TCDIR)**

| Variable | Coefficient | t | Significance |
|---|---|---|---|
| Constant | 49.060 | 17.531 | .000 |
| $TNRES_i$ | .413 | 5.327 | .000 |
| $TNREB_i$ | .614 | 4.750 | .000 |
| $TNTOTAL_i$ | .314 | 2.756 | .060 |
| $TNTOTAL_i$ | .067 | 2.510 | .012 |
| R | .36 | | |
| $R^2$ | .126 | | |

**Source: Research Findings**

*Note:*

$$TCDIR_i = \alpha + \beta_1 TNRES_i + \beta_2 TNEMPLOY_i + \beta_3 TNDIVINT_i + \beta_4 TNPERSREL_i + \beta_5 TNCHILDREL_i + \beta_6 TNREB_i + \beta_7 TNAWARE_i + \beta_8 TNTOTAL_i + \varepsilon_i$$

*Where:*

$TCDIR_i$ - *Tax compliance score (direct questions)*

$TNRES_i$ - *Tax knowledge about responsibilities and rights*

$TNEMPLOY_i$ - *Tax knowledge about employment income*

$TNDIVINT_i$ - *Tax knowledge about dividend and interest*

$TNPERSREL_i$ - *Tax knowledge about personal relief*

$TNCHILDREL_i$ - *Tax knowledge about child relief*

$TNREB_i$ - *Tax knowledge about rebates*

$TNAWARE_i$ - *Tax knowledge about awareness of offences, penalties and fines*

$TNTOTAL_i$ - *Total tax knowledge* score

Results show that knowledge about child relief, responsibilities and rebates appears to be significantly correlated with tax compliance (TCDIR). As shown in Table 4.2.3, by examining t statistics for the constant and four independent variables, estimated regression shows that estimated coefficient for constants, B2, B6,B7 and B1 were statistically significant at 1% level (as $p$ value < 0.01). All significant variables had a positive effect on tax compliance. Estimated coefficient of correlation ($R$ = 0.36) shows a reasonable linear correlation between tax knowledge and tax compliance.

**Table 4.2.4 Stepwise multiple regression-tax knowledge and tax compliance hypothetical question (TCHYP)**

| Variable | Coefficient | t | Significance |
|---|---|---|---|
| Constant | 23.184 | 22.901 | .000 |
| $TNRES_i$ | -.532 | -10.466 | .000 |
| $TNREB_i$ | -.119 | -4.291 | .000 |
| $TNTOTAL_i$ | .106 | 4.028 | .000 |
| $TNTOTAL_i$ | .121 | -2.757 | .006 |
| R | .419 | | |
| $R^2$ | .176 | | |

**Source: Research Findings**

*Note:*

$$TCDIR_i = \alpha + \beta_1 TNRES_i + \beta_2 TNEMPLOY_i + \beta_3 TNDIVINT_i + \beta_4 TNPERSREL_i + \beta_5 TNCHILDREL_i + \beta_6 TNREB_i + \beta_7 TNAWARE_i + \beta_8 TNTOTAL_i + \varepsilon_i$$

The estimated coefficient of correlation ($R$ = 0.419) and the estimated coefficient of determination, ($R^2$ = 0.176) indicate a linear correlation between tax knowledge and tax compliance. The $F$ statistic stand at 43.15, ($p$ = 0.000) was substantiated at 1% significance level, implying that the null hypothesis that the regression coefficient are all zeros can be rejected at 1% level of significance.

**Table 4.3 Regressions Results and Analysis**

| | Coefficient | t | Significance. |
|---|---|---|---|
| (Constant) | 20.773 | 9.979 | .000 |
| PROBAUDIT | -.247 | -5.131 | .000 |
| GOVSPEND | .090 | 1.923 | .055 |
| EQUITY | .049 | .773 | .439 |
| PENALTY | -.042 | -.897 | .370 |
| FINCONS | -.279 | -5.136 | .000 |
| CHANGES | .030 | .479 | .632 |
| GROUP | -.200 | -4.545 | .000 |
| ROLE | .015 | .281 | .779 |
| TNTOTAL | -.008 | -.963 | .336 |
| GENDER | 1.208 | 4.505 | .000 |
| INCOME | .581 | 4.020 | .000 |
| EDUCATION | .-.012 | -.093 | .926 |
| COURSE | -.007 | -.021 | .983 |
| AUDITED | -.183 | .262 | .793 |
| | | | |
| **Model fit**: | | | |
| R | .504 | | |
| $R^2$ | .254 | | |
| Std. error | 4.052 | | |
| F statistic | 23.06 | | |

**Source: Research Findings**

*TCHYP = 20.7733 +-0.247(PROBAUDIT) +.090(GOVSPEND)+.049(EQUITY) +-.049( PENALT) +-.279(FINCONS) +.030( CHANGES) +-.200(GROUP) + -.02( ROLE)*

Table4.3 summarizes the results of the supplementary regression model which incorporated several control variables. Results show that the model is significant at $p < 0.01$ level (F statistic 23.06), while the R is estimated at .504. FINCONS, PROBAUDIT, GROUP and GOVSPEND appear to be the determinants of tax compliance incorporated with the control variables. The supplementary regression model also suggested that FINCONS remain the most important determinants of tax compliance (r= -.279). PROBAUDIT, GROUP, and GOVSPEND become the next most important determinants of tax compliance ($p<0.01$).

In relation to the significance of the control variables results show that GENDER, INCOME and AGE appear to be significantly and positively correlated with tax compliance behavior. Specifically, the association between GENDER and TCHYP was positive and significant ($p<0.001$)., consequently. The association between INCOME and TCHYP was also positive and significant ($p<0.001$), thus that higher income earners are significantly more compliant. The association between AGE and TCHYP was also positive and significant ($p<0.001$), hence supporting older people are significantly more compliant. Finally, other control variables: EDUCATION, COURSE and AUDITED, had no significant association with TCHYP.

## 4.4 Interpretation of the Findings

In summary, this study found that tax knowledge is an important element in the tax compliance. With respect to the significance of control variables, results show that INCOME and EDUCATION appear to be significantly correlated with tax compliance behavior. Specifically, the association between INCOME and TCDIR was negative and significant ($p<0.001$), consequently supporting hypothesis that lower income earners are significantly more compliant.

It was also found that the association between EDUCATION and TCDIR was negative and significant ($p<0.001$), consequently supporting hypothesis that highly educated taxpayers are significantly less compliant. Finally, other control variables: GENDER, AGE, COURSE and AUDITED, had no significant association with TCDIR.

Conversely, multiple regression tests suggest an additional factor, namely GOVSPEND as an additional determinant. Again, TNTOTAL becomes the main factor with Beta coefficient of .254 followed by PROBAUDIT (β = -.106), GROUP (β = -.078) and FINCONS (β = -.068). These results suggest that high tax knowledge would increase tax compliance and tax knowledge also becomes the main factor in determining compliance.

Results suggest that tax knowledge had a significant impact on tax compliance both in direct and hypothetical questions, and consequently support the hypothesis (Tax knowledge is positively associated with attitude towards tax compliance behavior). Filling the gap as suggested by several scalars. This study suggested that knowledge about employment income, awareness of offences, penalties and fines, taxpayers' responsibilities and rights, child relief and rebates, appears to be significantly correlated with tax compliance behavior, thus rejecting the null hypothesis, these positive relationships illustrate that taxpayers with higher tax knowledge potentially tend to be more compliant.

The *F* statistic (*F*= 37.82, *p* = 0.000) was substantiated at 1% significance level, implying that the null hypothesis that regression coefficients were all zeros can be rejected at 1% level of significance. Thus the estimated regression was efficient for prediction.

Taxpayers who have attended a tax course would be expected to have better tax knowledge in comparison with taxpayers who have never attended a tax course. However, in a new Kenya in which tax laws and regulations keep on changing, a course attended in the previous one or two years might not be as useful anymore as new regulations are brought into place i.e. tax course knowledge is likely to be rendered of only limited use within fairly short periods. This may however not be true for all types of tax course e.g. those courses aimed at general tax system knowledge has proven that attending tax courses significantly increases tax knowledge but central to this study is the need to determine if this association increases tax compliance behavior.

Further analysis at found that out of six control variables examined; only three of them were positively significant. Consistent with results in Stage3, gender, income level and age were significantly correlated with tax compliance (refer Table 4.3). Higher income earners and older taxpayers were more compliant while other control variables such as education level, tax courses attended and experience of being audited by the tax authority were insignificant.

Some studies have claimed that being audited has a positive impact on tax compliance (taxpayers who have ever been audited by a tax authority will be more compliant. These findings evidenced that in self assessment system, tax audits play an important role and to increase voluntary compliance. Audits rates and the thoroughness of audits could encourage taxpayers to be more prudent in completing their tax returns. Similarly, taxpayers will also report all income and claim the actual deductions to ascertain their tax liability. In contrast, taxpayers who have never been audited might attempt to leave unreported their actual income and make false deductions. The acts of transparency and the facilitation of communication to the taxpayer themselves increases compliance.

Efficient tax system also has positive relation with the tax compliance hence the introduction of ITMS will improve the tax compliance rates many different claims by different authors explaining the impact of ITMS on taxpayers compliance have been explored and analyzed vis-à-vis the findings of the study. Competing explanations to the various arguments have also been shown .It was not, however possible to confirm the relationship between taxpayers compliance and some of the prepositions because of lack of relevant comparative data from other groupings of taxpayers Future work should attempt to explore the linkages between transparency, communication, and compliance in more depth and by use of different techniques.

# CHAPTER FIVE

# SUMMARY, CONCLUSION AND RECOMENDATION

## 5.1 Summary

The study examines the impact of ITMS system on the large corporate taxpayer's compliance. Although there are issues pertaining to the implementation of ITMS, from taxpayer's perspectives, the study also tried to establish how ITMS could enhance their tax collections, efficiency and the usage of human resource in assessing all tax returns. The impact of ITMS on compliance in relation to the knowledge of several factors affecting the tax payer's awareness was measured through the use of structured questionnaire and the regression analysis model was used to analyze the data.

It was established that the authority to determine the tax system lies with tax administrators, taxpayers ultimately have to comply with any system that is introduced, even if they perceive that the system is unfair. However as compliance is not an absolute, levels of tax compliance will vary based on a variety of factors and the levels may change from year to year as the tax system changes. Managing the levels of compliance are therefore key challenges that the tax administrator has to resolve. It was further established that the main factors that affect the tax payer's compliance is how the taxman can improve his system of tax administration and how to make the taxpayers be aware of the new tax systems and legislation. The study also found that other potential variables which are evidenced by other researchers in other study settings as significant factors affecting tax compliance are penalties and tax audits.

## 5.2 Conclusion

This study breaks new ground in answering the important question of what the tax administration in Kenya can do to foster better taxpayer compliance. The study found that use of ITMS as tax system knowledge is an important element in the modern tax administration. Greater tax knowledge is believed to have a positive impact on compliance according to prior literature. The findings could be an important input, particularly to the KRA in general in designing their various tax systems in order to enhance compliance and achieve the missions of Corporate Tax Targets.

It can be concluded that the increase of voluntary compliance, the encouragement of administrative efficiency and the improvement of fairness and equity are the key motivating factors for the introduction of ITMS. However, one of the main barriers in implementing ITMS is voluntary compliance, which involves many factors such as audit probability, taxpayer knowledge, attitude and the taxpayer's perceptions of fairness within the system.

To answer these issues, several questions need to be addressed such as: what are the factors that make taxpayers less compliant with introduction of ITMS? Do the changes to the actual mechanisms themselves of filing, assessment and administration encourage taxpayers to be less compliant or are there other contributory factors that also influence their behavior that users of ITMS also need to consider in managing voluntary compliance in ITMS is a possible explanation that taxpayers are not intentionally less compliant but appear to be so because they have insufficient tax knowledge to operate correctly in the ITMS environment?

**5.3 Policy Recommendation**

The primary goal of revenue authority is to collect the taxes and duties payable in accordance with the law and to do this in such a manner that will sustain confidence in the tax system and its administration. The actions of taxpayers whether due to ignorance, recklessness or deliberate evasion as well as weaknesses the in the tax administration means that instances of failure to comply with the law are inevitable. Therefore, tax administration should have in place strategies, structures and systems to ensure that non-compliance with tax law is kept to minimum. An important insight in the development and computerization of tax administration on compliance programme is that it must be well balanced. It should include a good mix of both proactive and reactive systems as well as systems that covers all aspects of compliance management from education through enforcement and prosecution.

Tax law and systems by their very nature are subject to frequent changes. Every year the annual budget speech introduces new systems, laws, amend or to cancel existing one .These frequent changes can make the system confusing as well as complicate the tax system. After many a few years these changes and amendments become so many that the taxpayer find it difficult to know which system to follow. There is need therefore for the tax administration to undertake periodic consolidation of the tax system so that it can have all the changes compiled into one system to which both tax taxpayers and tax administration can have easy and ready to access.

Tax system should be designed to leave economic behavior unaffected so as to minimize efficiency losses associated with the system. The tax system should not only avoid economic behavior distortion but should also yield sufficient revenues to fund socially useful expenditure without producing substantial inequity. A more useful guideline is that the tax system should be as neutral as possible that is, minimize discrimination in terms of tax rate that can be applied.

## 5.4 Limitations of the Study

It is acknowledged that this study has a number of limitations. First, the tax knowledge questions and the scope of questions asked in the questionnaire were only limited to some section of Income Tax Act (CAP. 470). These sections only cover some levels of tax knowledge. This study unable to determine all levels of tax knowledge as stipulated in the act as it this would have been time consuming and made the questionnaire lengthy, hence low response rates would potentially occurred.

Secondly, the use of a survey questionnaire might be less reliable, especially when the information sought on tax is sensitive, potentially incriminating or embarrassing. Actual behavior of the subjects may vary from the responses given. Acknowledging this constraint, however, it is believed that this is the most suitable way to predict taxpayers' compliance behavior, as direct questions (face to face) might lead respondents to answer the questions dishonestly and could be potentially embarrassing for respondents.

Improved survey measures of tax compliance and various potential tax compliance determinants such as occupational status, religiosity, marginal tax rates and culture could improve the reliability of the empirical results and further reduce the risk of measurement error. This study was unable to include those variables at the same time. Therefore, to balance this issue, two approaches (direct and hypothetical questions).

The types of approaches used in measuring tax knowledge and tax compliance (i.e. by using a survey instrument) might provide limited results, and different research designs (such as interviews or an experiment) could produce different results.

**5.5 Suggestions for Further Studies**

The area of tax education related to tax knowledge and levels of compliance offers opportunities for additional research. Instead of using a survey, other methods of data collection i.e. interviews may provide different results. It is expected that two-way communication via an interview could produce other meaningful results; however, non-anonymous methods such as interviews can be problematic in revealing the truth, especially when questioning respondents regarding tax compliance matters, as failure to appropriately address the questions would harm or embarrass respondents

Other determinants which were not tested in this study such as political affiliation, cultural influence and religiosity could also be explored in the future. This study was unable to include these variables because these variables require a series of questions in order to be accurately measured , hence these factors were excluded from this questionnaire but could be included in future studies to examine their impact on the explanatory power of the models used.

Further study should also be undertaken on tax legislation reforms as an environmental base for strategic position taken to generate funds, and at the same time manipulate social as well as political demands of the nation.

There is need to conduct more research, by the tax administration and other researchers on the suitability of various taxes, tax law and enforcement activities as well as the tax amnesties and quality services to be able to conclusively determine their role in enhancement of tax compliances. A comprehensive study of small, medium and large taxpayers will also give more insight into this subject.

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## APPENDIX I

### LIST OF REGISTURED LARGE CORPORATE TAX PAYERS

1 SAFARICOM LTD
2 SAFARICOM STAFF PENSION SCHEME
3 VODAFONE KENYA LIMITED
4 TELKOM (K) LTD
5 AIRTEL NETWORKS (K) LTD
6 (CELTEL B.V.)
7 DIAGEO (K) LTD
8 KENYA BREWERIES LTD
9 KENYA MALTINGS LTD
10 BRITISH AMERICAN TOBACCO LTD
11 BAT EQUITORIAL AFRICA AREA LTD
12 BAT KENYA TOBACCO CO LTD
13 ALLIANCE ONE TOBACCO (KENYA) LIMITED
14 MASTERMIND TOBACCO (K) LTD
15 OZZBECO (K) LTD
16 NAIROBI BOTTLERS
17 COCA-COLA JUICES KENYA LTD
18 KENYA COMMERCIAL BANK LTD
19 SAVINGS & LOAN KENYA LTD
20 STANDARD CHARTERED BANK (K) LTD
21 BARCLAYS BANK OF KENYA LIMITED
22 EQUITY BANK LTD
23 COOPERATIVE BANK OF KENYA LIMITED
24 CFC STANBIC BANK LIMITED
CFC BANK LIMITED STAFF RETIREMENT
25 BENEFIT
26 CFC PROPERTIES LTD
CFC STANBIC HOLDINGS LIMITED (NOW CFC
27 STANBIC)
28 TEACHERS SERVICE COMMISSION
29 TEACHERS SERVICE COMMISSION - WCP
MWALIMU COOPERATIVE SAVINGS & CREDIT
30 SOC LTD
31 UNIVERSITY OF NAIROBI
KENYA ELECTRICITY GENERATING COMPANY
33 LIMITED
34 KENYA PORTS AUTHORITY
35 KENYA POWER & LIGHTING COMPANY LTD
36 KENYA AIRWAYS LTD
37 KENYA PIPELINE CO LTD

38 KENYA SHELL LIMITED
40 CONSTRUCTION
41 BAMBURI CEMENT LIMITED
42 NATION MEDIA GROUP LIMITED
43 NATION NEWSPAPERS LTD
44 NAKUMATT HOLDINGS LIMITED
45 NAKUMATT INVESTMENTS LTD
46 MUMIAS SUGAR COMPANY LTD
MUMIAS OUTGROWERS SACCO SOCIETY
47 LIMITED
48 AMIRAN KENYA LIMITED
49 CAPITAL FISH (K) LIMITED
50 CHEMELIL SUGAR COMPANY
51 DEVJI MEGHJI & BROS LTD
52 EAST AFRICAN GROWERS LIMITED
53 EASTERN PRODUCE KENYA LIMITED
54 GICHEHA FARMS LTD
55 GICHEHA HOLDINGS LIMITED
56 GICHEHA INVESTMENTS LIMITED
GLOBAL TEA AND COMMODITIES (KENYA)
57 LIMITED
58 HOMEGROWN KENYA LTD
59 ILARA DAIRY LIMITED
61 INTERNATIONAL CONTROLS LTD
62 JAMES FINLAY KENYA LIMITED
63 KAKUZI LIMITED
64 KAPKOROS TEA FACTORY COMPANY LTD
KENYA HORTICULTURAL EXPORTERS (1977)
65 LTD
66 KENYA NUT CO LTD
67 KENYA PLANTERS CO OP UNION LTD
68 KENYA SEED COMPANY LIMITED
69 KENYA TEA DEVELOPMENT AGENCY LIMITED
70 KENYA TEA PACKERS LTD
71 KINGSHOLME LTD
72 KIPKEBE LTD
73 LIMURU TEA CO LTD
74 LIPTON LIMITED/UNILEVER TEA
75 LOUIS DREYFUS KENYA LIMITED
76 M J CLARKE LIMITED
77 MOGOGOSIEK TEA FACTORY CO LTD
78 MUHORONI SUGAR COMPANY LIMITED
NEW KENYA COOPERATIVE CREAMERIES
79 SOCIETY LTD
80 NZOIA SUGAR COMPANY LIMITED
81 OSERIAN DEVELOPMENT

82 REA VIPINGO PLANTATIONS LIMITED
83 RISING SUN KENYA (EPZ) LIMITED
84 SASINI TEA & COFFEE LTD
85 KARUTURI LIMITED
86 SIMLAW SEEDS CO LTD
87 SOTIK HIGHLANDS TEA ESTATES LTD
88 SOUTH NYANZA SUGAR CO LTD
89 STANSAND (AFRICA) LTD
90 SUNRIPE (1976) LTD
91 KIBOS SUGAR & ALLIED INDUSTRIES
92 THIKA COFFEE MILLS LIMITED
93 UNILEVER TEA KENYA LIMITED
94 VAN REES B V
95 VEGPRO KENYA LIMITED
96 WANANCHI MARINE PRODUCTS KENYA LTD
97 WEST KENYA SUGAR COMPANY LIMITED
98 WILHAM KENYA LTD
99 YARA EAST AFRICA LIMITED
100 CHAI WAREHOUSING LIMITED
101 BROOKSIDE DAIRY LIMITED
102 EAST AFRICAN SEA FOOD LIMITED
103 KENCHIC LIMITED
103 SPIN KNIT DAIRY LIMITED
104 AAA GROWERS LIMITED
105 AFRICA TEA BROKERS LTD
106 AGRIFRESH KENYA LIMITED
107 AGRO IRRIGATION AND PUMP SERVICES LIMITED
108 ALIBHAI RAMJI MOMBASA LIMITED
109 ASSIA ANIMAL HEALTH LIMITED
110 CHAI TRADING COMPANY LIMITED
111 CHEBUT TEA FACTORY CO LTD
112 DIAMOND COFFEE CO LTD
113 ELDORET PACKERS LTD
114 FRIG-O-KEN LTD
115 GITHUNGURI DAIRY FARMERS
116 IBERO (KENYA) LTD
117 INDU FARM EXPORT PROCESSING ZONE LIMITED
118 ISLAND FARMERS CO LTD
119 MEA LIMITED
120 MOUNT ELGON ORCHARDS LIMITED
121 MUDETE TEA FACTORY COMPANY LIMITED
122 NGERE TEA FACTORY LTD
123 PRIMAROSA FLOWERS LIMITED
124 RANFER TEAS KENYA LIMITED

126 SANGANA COMMODITIES KENYA LIMITED
127 SHAH KANJI LALJI & SONS (K) LTD
128 SOCFINAF COMPANY LTD
129 SOTIK TEA CO LTD
130 SUERA FLOWERS LTD
131 TAYLOR WINCH COFFEE LTD
132 UNITED TEA COMPANY LIMITED
133 MORENDAT LIMITED
134 EVEREST ENTERPRISES LTD
135 KIBOS PULP AND PAPER MILL
136 KIBOS POWER LIMITED
137 KIBOS DISTILLERS LIMITED
138 KTDA MANAGEMENT SERVICES LTD
139 C CZARNIKOW SUGAR EAST AFRICA LIMITED
140 DEVCHAND KESHAVJI KENYA LTD.
141 PETER MULEI & SONS LIMITED

## APPENDIX II

## LETTER OF INTRODUCTION

**Amos Ochola James**

**P.O.Box 4319-00200,**

**Nairobi.**

**To: ___________________________**

**___________________________**

**___________________________**

**Dear Sir/Madam,**

**RE: INTRODUCTION LETTER FOR MR. AMOS OCHOLA JAMES**

I'm an MBA student in the School of Business, University of Nairobi. In partial fulfillment of the requirements of the degree of Master of Business Administration (MBA), I'm conducting an academic research project titled the "**The Impact of Integrated Tax Management System on Large Corporate Taxpayers Compliance**".

Your participation in this exercise will be highly appreciated as an integral part of this study, hence the request for your assistance to fill out this questionnaire.

The results of this research are for educational purposes only and will be treated with utmost confidentiality.

Thank you in advance for your cooperation.

Amos Ochola James

MBA STUDENT

## APPENDIX III

## QUESTIONNAIRE

**Section A: General (please tick [ ] where appropriate.**

1. Confirm the position you hold in the organization?

    1. Managing Director [ ]

    2. Accountant [ ]

    3. Public Relations Officer [ ]

    4. Others. [ ]

   (Specify)……………………………………………….

2. For how long has your business been in existence?

    1. 2 years and below [ ]

    2.3-4 years [ ]

    3. 5-6 years [ ]

    4. Over 6 years [ ]

3. Which Tax District currently handles your tax matters at KRA?

    1. West of Nairobi [ ]

    2. East of Nairobi [ ]

    3. South of Nairobi [ ]

    4. North of Nairobi [ ]

4. What is the nature of your business?

1. Manufacturing [ ]
2. Oil and Service Sector [ ]
3. Agriculture and Wholesalers [ ]
4. Banks and Insurance [ ]
5. Government and Parastatals [ ]
6. Construction [ ]

5. Have you attended Any Tax training course at KRA Yes/No

If yes (Specify)………………………………………..

**SECTION B (TAX COMPLIANCE) (Tick or circle where appropriate)**

**{Note: [1] = Not at all, [2] = Once, [3] = Twice, [4] Thrice [5] Always}**

6. How often has your company submitted annual income [1] [2] [3] [4] [5]

   tax returns to KRA over the past 5 years?

7. How often do you think your company's annual income

   tax returns and accounts submitted to KRA were correctly [1] [2] [3] [4] [5]

   Stated in the past 5 years.

8. How often did the company pay annual self- assessed income tax

   Liabilities over the past 5 years to KRA by the due date? [1] [2] [3] [4] 5]

9. How often is your company audited by KRA officials [1] [2] [3] [4] [5]

   in the past 5 years?

10. How Often has your company failed to file returns in time [1] [2] [3] [4] [5]

Please state your opinion for each given statements using the following scale
1. Strongly disagree
2 .Disagree
3. Not certain
4 .Agree
5 .Strongly agree

I wish **TO COMPLY** with tax laws for the following reasons

| | | | | | | |
|---|---|---|---|---|---|---|
| 11. | If I detected not reporting my exact income, I believe that the tax authority is tolerant towards my offence and most probably it will escape without any punishment | 1 | 2 | 3 | 4 | 5 |
| 12. | I believe the tax authority has limited capability to investigate all income reported to them in the year 2011 so I have an opportunity to not report my exact income | 1 | 2 | 3 | 4 | 5 |
| 13. | I believe that the probabilities of being detected by the tax authority for not declaring the exact income that I receive in the year 2011 are low. | 1 | 2 | 3 | 4 | 5 |
| 14. | I pay about the same amount of taxes as others making the same income | 1 | 2 | 3 | 4 | 5 |
| 15. | Higher income earners should pay more taxes than lower income earners | 1 | 2 | 3 | 4 | 5 |
| 16. | The tax return is easy and simple to complete | 1 | 2 | 3 | 4 | 5 |

**SECTION (C) INTERGRATED TAX MANAGEMENT STSTEM COMPLIANCE**

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

Yes [ ] No [ ]

18. How can you assess the overall performance of Integrated Tax Management?
System?

Excellent [ ] Very Good [ ] Fair [ ] Poor [ ]

19. Which method is your company using to file returns, Manual/Online?

If manual then why (Specify)………………………………………………………..

20 Does your Company have access to KRA Website?

Yes [ ] No [ ]

21. Do you believe that the introduction of integrated tax information system has reduced the rate of late filling of return?

Yes [ ] No [ ]

If No why (Specify)……………………………………………………………………….

21. Do you make most of your tax inquiry online or you visit KRA Offices

(Specify)…………………………………………………………………………………………

22. Is the KRA Online Tax Services user friendly?

Yes ☐ No ☐

(Specify)……………………………………………………………………………………….

23. What are the benefits you have experienced with the introduction of integrated tax system?

………………………………………………………………………………………………..

……………………………………………………………………………………………….

……………………………………………………………………………………….........

24. What are the weaknesses you have experienced with the online filing system? What are your suggestions on the way forward……………………………………………………………..…….

……………………………………………………………………………………………........

…………………………………………………………………………………………………

**I do indeed appreciate the time your have taken to answer all the questions to the best of your ability.**

**Amos Ochola James**

**Thank you and God bless you.**