THE IMPACT OF USING ELECTRONIC TAX REGISTER ON VALUE ADDED TAX COMPLIANCE IN KENYA: A CASE STUDY OF CLASSIFIED HOTELS IN NAIROBI.

BY

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2010

DECLARATION

I, declare that this project is my original work and that it has not been presented for a degree in any other university for academic credit.

Signed _____ Date 17/11/2010

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D61/P/8373/04

This research project has been presented for examination with my approval as the university supervisor.

Signed _____ Date 18/11/2010

Nicholas T. T. Simiyu

DEDICATION

I dedicate this work to my loving wife, Mrs. Grace Mwaniki my children Patra and Ian and my parents, for always believing in me, for seeing me through my education and for constantly encouraging me to strive for excellence. I love you all and may God Almighty continue to shower you with everlasting blessings.

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LIST OF ABBREVIATIONS

ECR	Electronic Cash Register
ESD	Electronic Signature Devices
ETR	Electronic Tax Register
GDP	Gross Domestic Product
ICPAK	Institute of Certified Public Accountants of Kenya
IMF	International Monetary Fund
KRA	Kenya Revenue Authority
OECD	Organization of Economic Co-operation and Development
POS	Point of Sale
VAT	Value Added Tax

ABSTRACT

The main objective of the tax reforms and modernization program embarked on by Kenya was to enhance compliance with tax regulations. This would be achieved through tax policies aimed at ensuring effectiveness of tax mechanism and increase in revenue. One measure the government took was to introduce electronic tax registers across all industries. This research intended to establish the impact of Electronic Tax Registers on VAT compliance among classified hotels in Nairobi. The objectives of the study were to determine the impact of Electronic Tax Registers on VAT compliance among classified hotels in Nairobi and to identify factors affecting VAT compliance among classified hotels in Nairobi.

This study adopted the survey research design which was most appropriate as it entailed gathering of both primary and secondary data from classified hotels in Nairobi. The population consisted of all classified hotels, which were registered for VAT from year 2004 to 2008. The research study used both primary and secondary data. Primary data was obtained through self-administered questionnaires.

The research findings indicated that there was an increase in VAT declared with the introduction of Electronic Tax Registers. ETR machines can then be deemed to enhance VAT collection resulting from more accurate VAT reporting. It can be concluded that the classified hotels have adopted and complied with the requirements of VAT. The study recommends that the tax office should therefore strive to ensure full adoption of the ETR machines since they increase the VAT declared.

CHAPTER ONE: INTRODUCTION

1.1 Background Information

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

Globally, the trend has been moving from direct taxation to indirect taxation. Apparently, indirect taxes are becoming more important as the burden of direct taxation fall globally. It is important to note that countries all over the world have reformed or are attempting to reform their tax system. This is after the realization that taxation is a sensitive instrument and if properly used, it can give handsome dividend. If resorted to indiscrimination, it can damage the very foundation of progress. According to Chad and Wolf (1973), a number of countries have made efforts to deal with weak tax administration as well as reduced tax evasion and avoidance. Chad and Wolf (1973), indicate that as in other economic policies where reforms have been successful, a number of common elements have been present and these include; a well thought program of action support for major policy makers and systematic implementation and monitoring, aiming at broader and simpler tax basis on which lower rates are imposed. Procedural demands that complicated administration are minimized (Chad and Wolf, 1973).

Countries all over the world have reformed or are attempting to reform their tax systems, with the main impetus being the increasing complexity of tax codes, narrow tax bases and concerns with horizontal equity. Like many developing countries, the Kenya tax system has undergone a number of changes. These changes are aimed at first ensuring that as many individuals as possible are brought into the tax net. Secondly, due to the changing aspects of the economy, the tax systems must be seen to reflect those realities. Indeed, the most important motivation for the less developed countries tax reform is the need to raise more revenue. It is necessary that there be quantitative measure to evaluate success in stimulating public resources through tax policy. One such measure is the responsiveness of tax revenue structure to national income. Mwikali (2006)

quoting Kusi (1998) says that the response of revenue to national income is known as productivity of tax system, which traditionally was measured using buoyancy and elasticity.

Kenya's attempt to reform the tax system was initiated under the tax modernization program in 1980's with the aim of raising more revenue. Jenkins and Kou (2000) recommends that if a government of developing countries wants to rely on Value Added Tax (VAT) over time, it must move aggressively to broaden the base and enhance compliance as part of necessary reforms. From the Kenyan tax reform experience, it can be established that an essential precondition for the reform of tax administration is the simplifying of the tax system in order to ensure that it can be applied effectively in the generally low compliance contexts of developing economies. According to VAT Act part III, A tax to be known as Value Added Tax, shall be charged in accordance with the provision of this Act on the supply of goods and services in Kenya and on importation of goods and services into Kenya. This implies that all services and goods provided in Kenya are vatable excluding that is specifically exempted by third schedule. Therefore, accommodation, food, and drinks attract Value added tax.

A hotel is an establishment that provides lodging and usually meals and other services for travelers and other paying guests (Matanda, 2005). This view was also extended by mittra (2001). He defined a hotel as a building where rooms and usually meals are provided for the people in return for payment. The hotel industry has a direct link to the tourism Industry and therefore any changes in the later have a direct impact on the former. According to the economic survey (2005), the government has put in place several measures to market the country as a tourist destination. The steps have born fruits.

In accordance with the Regulations 2 of the hotels and restaurants Regulations 1988, the hotels and restaurants Authority has established classifications of hotels based on the set standards. The regulation classifies vacation hotels. town hotels and lodges into five classes denoted by stars, five being the highest stars, four stars, three stars, two stars and one stars being the lowest. This classification is carried out in the manner prescribed by the hotels and restaurants Authority published in the legal notice no 30 of February 16, 2001 of the Hotels and Restaurant Act. The Value Added Tax CAP 476 defines "hotel" as, Premises on which accommodation is supplied or available for supply with or without food or the services other than those specified in the Third

schedule in exchange for money or money's worth, and includes: premises known as service flats, service apartments, beach cottages, holiday cottages, game lodges, safari camps, bandas, holiday villas and other premises or establishment used for similar purposes

Tax compliance levels not only reflect the effectiveness of tax administration but also the taxpayer's attitude towards both taxation and government in general. In evaluating Kenya's tax system one should look at the criteria of efficiency, fairness and administrative feasibility both for specific tax instrument and for the tax regime (Karangi, Wanjala, Nyamunga, Okello, Pambah and Nyakan'go, 2005). Research shows that compliance for VAT and income taxes in 2005 were 55% and 35% respectively. This means that it is possible to reduce the tax burden of those currently paying taxes by raising the compliance rate. It is evident that the low compliance is mainly on administrative issue related to Kenya Revenue Authority (KRA), through significant compliance cost and these interfere with the willingness to pay taxes (Karangi, et al., 2005).

In a move to enhance compliance, the finance bill 2004 amended the value added tax Act giving the commissioner of VAT powers to require any person to use an electronic tax register. Pursuant to this, the minister of finance has issued "The Value Added Tax Act (Electronic Tax Registers) Regulations, 2004" vide Notice No. 110 on 8 October 2004. This also applies to the hotel industry, which by regulation is required to levy VAT and remit the same to the revenue authorities. Therefore, after amendment of the VAT act the hotel industry was required to adopt ETR (Electronic Tax Registers) and utilize the same for VAT collection purposes. This was to serve the objective of introducing Electronic Tax Registers, which was to enhance revenue disclosure by the taxpayer through enforcing improved and secure VAT record keeping.

An electronic tax register has been defined as an ordinary cash registers modified to have security features that guarantee the trustworthy of the fiscal memory. It has an embedded fiscal, write once, read only fiscal memory. The hardware is proven to comply with certain specifications and is therefore not easy to destroy or manipulate critical data. The data is well protected even in case of power failures or malicious attempts (Kumar, 2005).

1.2 Statement of the problem

There is a global concern today for how to make the economy move and set it on the desired growth path. Not much progress can be achieved unless the economy is at least marginally relieved of the high burden of taxation. To increase the tax revenue in line with growth in the economy there is need for major tax reforms. These reforms include measures to enhance compliance. Most tax authorities around the world undertake a mix of processing, services, enforcement, litigation, and sometimes-legislative activities many of which are aimed at improving taxpayer compliance. In carrying out those activities, it is important for a tax authority to be able to determine whether these activities are achieving the required outcomes, including determining whether they are having any impact on compliance (EOCD 1999).

In Kenya, there was a question of how to efficiently collect VAT payable by hundreds of thousands of small retail outlets. What would the government auditors do to secure fair auditing in the most efficient way and ensure that everyone pays taxes and VAT is collected from the end user? The answer was the introduction of Electronic Tax Registers (ETR). The fiscal technology is however not a guarantee to compliance. The ETR will only capture sales to the extent that they are entered into the electronic accounting system. Therefore, if a business chooses not to issue an electronic invoice or otherwise record the sale electronically, the ETR will not capture it. A key consideration for the success of ETR is therefore how KRA is going to ensure such unrecorded sales are entered, electronically, into the accounts of business.

ICPAK (2005) noted that the implementation of tax registers has not been successful in other countries like Turkey and Tanzania. The Electronic Tax Register (ETR) regime is too cumbersome for businesses that have a minimal number of transactions. The cost of implementing the FED would outweigh benefits to KRA from any incremental tax collected as a result of ETR (ICPAK, 2005). However, in a presentation on the implementation of ETR system by KRA (August 2006) it was argued that compliance had risen to over 35% of VAT registered taxpayers. In addition, there was expectation that the legislation amendment-requiring invoice to be ETR compliant will boost compliance to 80% by Dec 2006.

Mwikali (2006) noted that VAT is the most rigid tax system. The empirical analysis indicate that reform raised the productivity of the tax system with exception of the VAT. This implies that

further improvement are required in the area of reduction or rates, exemptions and increasing VAT administration capacity and hence compliance. Karun (1992) in his study on a survey of income tax avoidance by OS in Nairobi found out that weak legislation contributed largely to income tax avoidance. Wang'ombe (1999) carried out a study on the analysis of the productivity of the Kenyan tax system and some administrative factors and concluded that productivity of the Kenyan tax system could be improved if compliance and administration were improved. None of the previous studies has dealt with the impact of Electronic Tax Registers on VAT compliance. Based on this evaluation, there was a gap in literature to warrant a research to be conducted in tax reforms related to VAT and compliance. This research therefore intended to establish the impact of Electronic Tax Registers on VAT compliance among classified hotels in Nairobi.

1.3 Objectives of the Study

The objectives of the study were:

a) To determine the impact of Electronic Tax Registers on VAT compliance among classified hotels in Nairobi.
b) To identify factors affecting VAT compliance among classified hotels in Nairobi.

1.4 Importance of the Study

a). Kenya Revenue Authority

Just as a company management would have a very incomplete picture of the organization operations without being able to compute net profits on periodic basis, similarly the tax authority could have a much-distorted view of its operation if it did not develop up-to-date measures of taxpayer compliance (Brown and Mazur, 2003). The growing concern of tax administration throughout the world is on how to simplify the tax assessment system to encourage voluntary compliance. Thus, the issue of tax compliance is a major concern of many developing countries (Sanker, 2003).

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

installation of fiscal policy and the deterrent measure of enhancing tax revenue collection, will be more certain.

Indeed, at a meeting of tax commissioners from selected countries in January 2005, the topic of compliance measurement and evaluation was a subject of special discussion. The key points made by commissioners were that, accountability requirement and strategic compliance management consideration dictate the need for a comprehensive set of practical outcome thus reflecting a deficiency in agency reporting arrangement. They also noted that the practice to date across revenue bodies has largely been to report on compliance outputs (e.g. audit report, debts collected) rather than 'outcomes'. Therefore, the wide adoption of a set of practical measures could facilitate benchmarking across countries and assist administration in meeting their accountability obligations (OECD, 2008).

b). Tax Payer

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

c). Students of Taxation and Accounts

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

CHAPTER TWO: LITERATURE REVIEW

2.1 Tax Reforms

The best tax administration is not simply one that collects the most revenue. How that revenue is raised, the effect of the revenue generation effort on equity, on the political fortunes of the government and on level of economic welfare may be equally important. A poor quality tax administration may collect large amount from easy to tax sections such as wages earners, while being unable to enforce taxes on business enterprises and professionals. The level of collection is therefore a somewhat measure of effectiveness of tax administration (Bird and Janstcher, 1992). To enhance effectiveness most developed countries have reformed their tax administration. Similarly, developing countries have embarked on tax reforms as the economy and technology grow.

Holland (1987) Quoting the Hon R.O Douglas, Minster of finance in New Zealand in statement on taxation reforms and benefit presented declared; "The tax system has failed to keep up with changes in our society. It is unfair and seen to be unfair ordinary wage and salary earners on moderate income are paying too much of their incomes in taxes. High marginal taxes rates create a drag on economic growth by penalizing innovation, efficiency, handwork, and savings and diverting attention towards tax avoidance".

The revenue structures of most developing countries have not been most productive as desired. Too often, the growth in revenue has failed to catch up with government spending. These countries have had to reform their tax structures, with general objective of revenue and adequacy, economic efficiency, and simplicity (Osoro, 1993) the main element of the tax reform include using VAT to replace commodity taxes and minimizing corporate tax evasion among others.

More often, policy advice directed towards countries desiring to reform their tax system has emphasized on more stringent administrative changes to seal loopholes that encourage tax evasion. According to Morrisset and Izquierdo (1993), the main factors contributing to an improved revenue performance are changes in tax legislation, tax administration, and minimal tax evasion.

Generally, tax reforms in developing countries involve issues of economic policy as well as specific problems of tax structure design and administration (Musgrave 1987). Tax reform measures are mainly undertaken in order to restore buoyancy to revenues, strengthen modern taxes, and drastically reduce the complexity and lack of transparency of the system (World Bank. 1990)

Bird and Jantscher, (1992) observed that, in recent years virtually all attempts to reform tax administration have been centered on some form of computerization. In too many instance however, the expectation of greater effectiveness from computerization has not materialized. Evidence indicates that the more successful reforms did not merely involve computerizing antiquated process but also redesign and streamlining of systems and procedures. A study in Spain show that successful computerization must be accompanied by fundamental reorganization of both systems and procedures and cannot be used by itself to side step such needed reforms.

During the period 1964-77, the government of Kenya was able to finance all its current expenditures and part of development projects using the recurrent receipts. This was made possible flow of donor assistance. From the late 1970's, after a period of economic instability, the government experienced chronic fiscal deficit. Neither tax policy nor tax administration managed to mobilize additional resources on sustainable basis. To bring down the deficit it was imperative that the government improve domestic revenue mobilization.

The Kenya government adopted the tax modernization program in 1986. The program sought to raise the tax revenue GDP ratio from 22% in 1986 to 24% by mid 1990's, reduce compliance and administrative cost and improve tax administration by sealing leakage loopholes, making a wider use of computers and enhancing audit surveillance, and enhance the institutional capacity to manage tax policy by establishing effective database management systems. (Murrithi and Moyi, 2003)

According to Wagacha (1999), the Kenya tax reforms should seek to improve the efficiency and productivity of taxation, improve tax collection and administration while lowering the rate and gain tax effectiveness through greater tax elasticity. He observes that Kenya tax burden is high

by international standard and therefore the ultimate objective or a reform scheme should be to lower the excessive tax burden and efficiency cost of taxation (Wagacha, 1999).

2.2 Electronic Tax System

With the problem of efficiently controlling the VAT collections from hundreds of thousand of small retail outlets, there was a question of what the government auditor could do to secure fair auditing. What is the most efficient way to ensure everyone pays taxes and VAT? What can the authorities use to ensure fair play and equal opportunities for everyone? The answer to this question was the adoption of fiscal technology. In its basic form, fiscal technology is not only a technology but also a legally defined way to control key aspects of the way; business is done in retail sector (Kamar, 2005).

An adequate information system is essential in any situation in the current trend and in the present world. The key is to diagnose properly the situation prevailing in the country and advice on the adequate information technology. According to Silvan (1992), technology is necessary to ensure progress in tax administration. However, technology that is not sufficient is something to be regretted because it is relatively speaking the easiest part of the puzzle. Simply allocating in the budget of the tax administration a specific amount of money will guarantee the purchase of the most modern technology as far as the equipment is concerned. Many countries have spent many millions on computers equipment without being able to improve the effectiveness of the tax administration (Silvan, 1992).

In the Finance Bill 2004, the minister for finance through an amendment in the value added tax Act required that all registered taxpayers use electronic tax registers in accounting for their sales with effect from 1st January 2005. According to Price water House Coopers (2005), the ETR program is one of the tax administration reform measures that KRA has undertaken. It was introduced to ensure that registered taxpayer in the country properly records sales. This initiative was initially focused on improving compliance with VAT requirements; it was believed to have the capacity to transform revenue collection in this field, as it is the case with other countries.

2.2.1 Electronic Tax Devices

According to KRA, Electronic Tax Register is a cash register but with fiscal memory. It should have special security features such as seal, memory, serial number, special technique features

etc. According to KRA (August 2006) the main objectives of introducing ETR is to enhance revenue by enforcing improved and secure receipting and record keeping methodologies. This is because, firstly, some VAT registered person's keep specific records in a manner that has been overtaken by technological changes including use of computerized accounting packages. Secondly, in Kenya a number of traders do not remit all VAT collected and use it to finance their business activities. While other taxpayers maintain two sets of accounts, one for the taxman and the other for themselves (Kenya Revenue Authority, 2010).

Kumar (2005) classify the fiscal devices into;

Fiscal Electronic Tax Registers (FETRs). This fiscal devices are useful in the retail environment and are usually stand alone devices that print receipts and help the owner organize his shop, get report on his totals and perform a number of necessary operations without the need to use a more complicated PC based solution. The FETRs are ordinary cash registers modified to have security features that guarantee the trustworthy of the fiscal memory. An embedded fiscal, write once, read only fiscal memory. Hardware that is proven to comply with certain specifications. Therefore, it is not easy to destroy or manipulate critical data and that data are well protected even in case you have power failures or malicious attempts.

Fiscal POS Printers (FPs) – FPS are useful in large-scale retail outlets that are using stand-alone or networked pc based systems for their work. Typical installations are supermarkets and other multi-till installation. The FPs incorporates all features of FETR and can allow specialized firmware ensures that every receipt that is printed out from the fiscal printer is permanently in the fiscal memory. The only challenge in installing the FP is the integration with existing POS software since it is not only working as an output printer but also recording valuable taxable data. With whole suite of POS software in Kenya, this can become very serious challenge.

Fiscal Electronic Signature Devices (FESDs): The latest and most powerful development in fiscal is the FESD. It eliminates all challenge of the FP and still controls the data with supreme efficiency, reliability, and security. The technology is based on secure fiscal memory but is not used to write totals of turnover in it nor is it ever used stand – alone. It is targeted to be used as a peripheral to every accounting PC and electronically stamp every invoice printed by the accounting system in a way that ensure easy auditing and authenticates the electronic copies of

such documents. The fiscal Electronic Signature is designed to authenticate any PC – produced financial documents, no matter what this is. It may be invoice, a freight document or retail receipt. The electronic signature covers every little detail that is printed on a document and not only the price of the VAT that is written on a document. The Electronic signature assures the authorities that, if the electronic signatures match, every detail on a verified document is true and vice versa. Thus this device applies to any computer based, printed tax documents issued to a third party. Tax documents include every document in business-to-business transaction and every document in business to consumer transaction.

Deciding on which fiscal devices to use

According to a HLB Ashvir Bulletin of July 2005, the choice depends on the business operations and the financial accounting process that are employed. As general guide:

Electronic Tax Register (ETR) is a cash register that prints using its own printer and keeps a record of all transactions in a fiscal memory. It is applicable to organizations that use manual invoicing or those using a cash register.

Fiscal printer (FP) accepts data from a computer or point of sale system (POS) and registers the totals in a fiscal memory. An FP can be used in a business running a POS.

Electronic Signature Device (ESD) is normally used in an environment where the accounting documents are computerized and works as a PC peripheral. The ESD authenticates all accounting documents by providing a unique electronic signature.

However, unlike ETR, ESD does not store the financial totals in its fiscal memory. It stores the electronic signatures that are used to authenticate binary files saved in the computer. ESD can also be used in POS environment.

2.2.2 Electronic Tax Register- Tanzania Case

Electronic register was introduced in Tanzania in July 2002. These were to be used by VAT registered taxpayer to process their VAT returns as required by the low. The law requires VAT registered retailers to record their daily sakes and issue receipts through electronic cash register. An acceptable ECR should be capable to issue receipts for each transaction containing; name, address, VAT no. PIN of the supplier, date of supply, tax exclusive value of each category of

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good or services etc. other attribute on ECR include; backup master audit till roll, a permanent store of all entries, capability to store entries for up to 5 years, a battery backup against power failure and read display print facilities www.tra.go.tz). ECR was introduced in Tanzania mainly because retailer pose a great risk to VAT since most do not issue tax invoices or receipts and consumer do not have the culture of asking for a receipt or tax invoice.

A presentation of VAT conference by A.M Mkinda (www.itdpweb.org) established that in the first year of introduction of ECR, Tanzania estimated revenue increased by 19% in the first year but declined to only 13% in second year. This was attributed to a number of reasons which includes; resistance from business community, credibility of the scheme (loopholes that were experienced earlier on still existed). The ECR can not be used in remote areas where there is no electricity, retailers operating mobile shops such trucks selling soft drinks find it difficult to operate ECR and increase in VAT registration threshold has lead to massive deregistration.

IMF (2005) study on VAT refund found that precondition for successful reform is strong commitment on the part of government and key stakeholders. The premises and equipment necessary for automation may include new or rehabilitated offices, hardware, software, internal communication systems and connection to external networks, and they may also require the set-up of wireless network and links the introduction of ICT need to be accompanied by extensive capacity building

2.2.3 Electronic Tax Devises in Kenya

The following matters promoted the introduction of the ETR in Kenya, which was adversely affecting tax collection. The matters include poor record keeping amongst small and medium sized businesses, which affected correct tax declaration. The taxpayers' arguments were usually that they could not afford to purchase equipment that would enhance their record keeping and inability to employ bookkeepers to summarize their daily sales and reconcile stocks. There is also deliberate failure to charge VAT on sales by traders who openly ask purchasers whether the wish to pay tax or not, keeping various sets of records some of which are excluded from tax declaration. Manipulation of records for purpose of supporting tax payable, the use of fraudulent purchase documents in input tax deduction or chain of VAT refunds and in addition, long period taken by audits, which require reconciliation of numerous paper records, which are sometimes

not well kept. According to the VAT act, a person in possession of a tax invoice can only deduct input tax. In Kenya, the law now requires the issue of an invoice generated from an approved device and therefore input tax is not deductible on sales/invoice that has not been generated from approved devices.

Suppliers of vatable goods and services were required to maintain an ETD from 31st January 2006. The ETR regulations require that an electronic signature device authenticate all documents generated by an accounting system. Up to 31st December 2006, the entire value of ETD was recoverable by the taxpayer from KRA by offsetting it against the VAT payable. The VAT regulations have also been amended with effect from 16th June 2006 so as to require a tax invoice issued under the VAT act to be serially numbered and either generated through an ETD or attached to an ETD receipts containing details of the transaction. Through a Gazette notice dated 25th May 2005, the commissioner has powers to allow the claim of input VAT of non-electronic invoices in respect of any period commencing 15th June 2006 to 31st December 2006. Only where; the taxpayer can prove that he was a tax compliant, that the goods/service purchased could only be supplied by the non ETD compliant person And the supply was in respect of contracts obligations entered into before 15th June 2006

2.3 Argument for Electronic Tax Devices

The advantages of ETR and other fiscal devices is increased fear of being caught by revenue authority. Other motivational postures include improved accuracy and speed of filing returns, better control, management of business by traders, up to date sales information, less paper work and complexity, Audit, and returns can be online, less conflicts with taxman, shorter audits periods by taxman.

Tax Payers Attitude

An attempt to link tax compliance with morality and ethics was made in research carried out by Wallace and Wolfe (1995). In this research, compliance with tax law was used as sum agate for ethical behavior. The empirical research suggests that the threat of a tax audit prompted taxpayers to comply. The level of compliance was greater when the source was perceived to be readily and independently verifiable.

Pilkington (1998) Deterrence theory suggest that a significant number of taxpayer would evade tax. The Fear of detection or deterrence theory suggest that taxpayer will maximize their own self interest by performing a cost benefit analysis, comparing the benefits of evading tax with the penalties of being caught out evading tax. Thus, if obeying tax law is seen as a desirable attribute of ethical behavior and such behavior is enhanced by improved deterrents through audit procedures, then one means of encouraging ethical behavior is via improved audit procedures (Pilkington, 1998). According to some theorist, the perceived probability of being caught is a major motivating factor for complying with the law.

One of the earliest attempts to model taxpayer's compliance was done by Allingham and Sandom, (1972). According to the model the intuitive result that tax payer will voluntary report more income in response to either an increase in the probability of being detected, or an increase in the penalty imposed on those who are caught (Plumley, 1996). Allingham and Sandom (1972) view rational individual as maximizing the expected utility of the tax evasion gamble weighing the benefits of successful cheating against the risky prospects of detection and punishment. "Indeed the central point is that individual pays taxes because and only because of the fear of detection and punishment". Thus according them the obvious policy implication for administration option to close tax gap is to increase enforcement. Allingham and Sandom (1972) quoting the economic of crime model by Becker (1968) state that compliance depends upon enforcement.

Among the variables designed to measure the community hopes, fear and action in relation to taxpayers' responses is the motivational postures. According to Braithwaite (1995), motivational postures represent the ways in which individuals position themselves in relation to regulatory authority and are predisposition to compliance or non-compliance conduct. Braith, Reinhart, Mearns, and Graham (2001) measured five different motivational postures in the taxation context. This are: commitment, followed by capitulation resistance, game playing and disengagement.

According to Morgan and Murphy (2001) commitment posture towards the tax, system means that taxpayer feels a sense of moral obligation to pay their taxes and willing to pay the taxes with good will because they believe paying tax ultimately advantages everyone. "Capitulation" to the

tax system means that the taxpayer may not be happy with the tax office or tax system, but they acknowledge that it is a part of life and that taxes need to be paid. The "game-playing" adopt a game- playing posture like the game of finding the grey areas of tax law and enjoy the challenge of minimizing the tax they have to pay. The tax payer who are "disengaged" from the tax system are those who do not care that they are not doing the right thing and believe that the tax office cannot do anything to them if they choose not to pay taxes.

Tax Payers Attitude towards Tax System and Tax Office

A number of research have shown that taxpayer attitude about the tax system can affect their propensity to avoid tax. Murphy (2001) found that the equity and fairness on the tax system were correlated with views about paying tax in particular those taxpayers who were more likely to perceive the vertical inequity in the tax system to be great, to think they were paying more than their fair share of tax.

Murphy (2003) has shown that when people evaluate authorities they often refer to the procedural justice aspects of their encounter with that authority when making judgments. If they feel they have been treated poorly by an authority, people are likely to judge the procedural justice aspects of their encounter as unfair. Alternatively, if they feel they have been treated well by an authority, people are likely to judge the procedural justice aspects of their encounter as fair. In summary Murphy stated "regulators will need to acknowledge the importance of procedural justice in their dealings with tax payers or else run the risk of undermining levels of trust in the community, undermining their own power and their legitimacy. The risk of this occurring is that it could lead to widespread resistance among those being regulated.

Murphy (2004) findings have direct implications for any tax authority changed with enforcing citizen compliance with the law. What the findings specifically tell us is that regulators will need to move beyond enforcement strategies linked purely to deterrence if they wish to avoid widespread resistance against their procedures. He suggested that regulatory authorities who deal with non-compliance will instead need to move towards a more responsive strategy that takes into account the fact that sometimes people are motivated by cost and benefits but at other times, they are motivated by sense of social responsibility. In this way regulators will be more likely to

nature the goodwill of those with commitment to compliance while still having the ability to escalate to more interventionist forms of regulation if abuse of trust occur and persist.

2.4 Deterrence Theory

Why taxpayers do not comply with tax obligations is a topic that most revenue authority around the world should understand. Research has been done in trying to understand the tax compliance behaviour and taxpayer tendencies to evade or avoid tax. Murphy (2004) Quoting Gibbs (1968) and others noted that researchers become particularly interested in the effect of deterrence on compliance with laws. A number of research reported inverse relationships between the threat of legal punishment and the volume of crime, reported evidence of relationship between perceived risk of legal sanctions and self reported delinquency. These findings were taken by some to suggest that individual will only comply with rule and regulations when confronted with harsh sanctions and penalties.

According to deterrence views, people carefully asses' opportunities and risks, and disobey the law when the anticipated fine and probability of being caught are small in relationship to the profit to be made through non-compliance Murphy (2004). However many research have questioned the deterrence theory framework as the most appropriate model for explaining tax behavior. The recent study in the Australian context suggested that taxpayer attitude toward the tax system and the ways taxpayers feel treated by a tax authority are important in explaining taxpayer non-compliance (Braithwaite, Reinhert, Mearns, and Graham, 2001)

Trivedi, Shehata, and Mestelman (2005) explain the reason why taxpayers comply by two classes of theories. First, the economic based theories, which emphasize incentives. This theory suggests that taxpayer "play audit lottery". They make calculation of the economic consequences of different compliance alternatives (such as whether to or not to evade tax), the probabilities of detection and the consequences there of, and then choose the alternative for the desired level of risk. In contrast, the second class of theories assumes that psychological factors including moral and ethical concerns are also important to taxpayers and so taxpayers may comply even where the risk of audit is low.

Economic theories generally call for increased audit and penalties as the solution to compliance. However, the policy prescription of psychological theories leads to emphasize on changing individuals attitude towards the tax system by increasing its perceived fairness and making it easy to comply with the tax low through such measures as superior website information, increased telephone assistance and appropriate information technology (Trivedi, Shehata, and Mestelman, 2005).

Accuracy and speed

As per (KRA, Aug 2006) presentation on implementation of ETR, the main objective of introducing Fiscal devices is to enhance revenue by enforcing improved and secure receipting and record keeping methodologies. This is so because electronic devices are used to record sales data and issue receipts. It is a formal tool for tax compliance by holding in a secure way, financial data that can be investigated by revenue authority at any time. Electronic devices also help in reducing paper work, cut cost of records by taxpayers since daily/monthly/annual report will automatically be done and reduce tax audit period (Kenya Revenue Authority, 2010).

According to Brown and Mazar (2003) the electronic devices enhances three classes of compliance which are designed to answer the question of whether taxpayer files on time and if taxpayer report tax liability accurately and c) whether taxpayer pay the full amount reported tax liability.

Complexity of Returns and Records Keeping

According to KRA complexity of filing VAT returns is reduced with use of ETR. It seem reasonable to presume that the more complex the tax system, and the harder it becomes to comply with one tax obligation, the more likely people will become noncompliant either intentionally due to confusion or willfully out of frustration. On the other hand, the fewer opportunities there are to be non-compliant, the less non-compliance we expect (Plumley, 2004).

Sir George Young, British financial secretary to the treasury once remarked that " Government want business to concentrate on creating wealth and jobs and not complying with the regulation, that is why we are committed to reduce that burden whenever we can, so that compliance cost are reduced to the minimum".(tax compliance M policy paper 1995). According to Vadafrica

(2000), an ideal tax system should be simple and easy to implement complexity in the tax system to promote evasion and avoidance and therefore should be minimized as much as possible. Other factors that may affect compliance due to complexity of the system include complexity of VAT forms and requirement to file additional information, and multiplicity of record keeping. Unlike ordinary ECR, which is prone to falsification, ETR has a tax memory that carries information on tax. Tax memory is programmable read only memory with capacity to store data for at least 5 years or 1800 day transaction. ETR issue fiscal receipts, which are easily identifiable for inspection purposes and daily fiscal summary report with less paperwork (Odeny, 2004).

2.5 Tax Compliance Measures

The English dictionary define compliance as "the act or an instance of complying; obedience to a request command etc. From tax point of view, Vadafrica quoting Sanford et al, (1995) define compliance as "meeting the requirements laid down in complying with given tax structure and it involves collecting, remitting and accounting for tax.

OECD (1999) recognize that in considering the definitions of compliance, it is convenient to divide compliance into two key categories: Administrative compliance; which refer to compiling with the administrative rules of lodging and paying on time, this include compliance with reporting requirement, procedural compliance or regulatory compliance. Technical compliance, which is tax, calculated in accordance with technical requirement of the tax law or the taxpayer pay their share of tax in accordance with the provision of the tax law.

Sarker (2003) define tax compliance as the degree to which a taxpayer complies (or fail to comply) with the tax rules of his country. Most tax authority around the world undertake a mix of processing services, enforcement, litigation and sometimes legislation activities, many of which are aimed at improving tax payer compliance. It is thus important for them to be able to determine whether these activities are achieving the required outcomes. This is achieved by compliance measurement.

According to Brown and Mazur (2003), taxpayer compliance is a multi-faceted measure. One theoretical appealing way to define compliance is to consider three distinct types of compliance: payment compliance, filing compliance and reporting compliance. The three mutually exclusive

and exhaustive measures together provide a comprehensive look at overall taxpayer compliance. The filing compliance measures tracks the percentage of required returns that are timely filed. The reporting compliance measure tracks the percentage of true tax liability that is correctly reported and payment compliance measure tracks the percentage of reported tax that is timely paid.

Plumley (1996) recognizes three types of voluntary Compliance: filing compliance, reporting Compliance and Payment Compliance.

a) Filing Compliance: This is the timely filing of any required returns.

b) Reporting Compliance: The accurate reporting of income and of tax liability.

c) Payment Compliance: The timely payment of all tax liability.

For an ideal compliance system, Vadafrica (2000) identify the following questions of which the answer must be yes.

a) Are all persons who should pay tax obedient to the requirement of the VAT act tom register?

b) Are those registered obedient to the command that they must charge tax on all their taxable sales?

c) Are they remitting all the tax charged and collected?

d) Are they accounting for tax at the right time?

2.5.1 Use of Compliance Measure

The primary use of compliance measures is to provide the tax agent with indication of current state of voluntary compliance behaviors. The ultimate goal of the measures is to evaluate the effectiveness of programs designed to improve taxpayer's compliance. According to Brown and Mazur (2003), the reporting compliance study of individual taxpayer has several desired outcomes or goals. One goal is to gather the sort of strategic information about taxpayer compliance behavior that will allow the tax agent to allocate its resources to enforcement and other activities. The second goals recognize the deterioration of the worked selection formulas in use, due to reliance on dated data. A third goal is to collect data that will provide insight into the course of reporting errors to aid in providing improved taxpayer services. Fourth goal is to update estimate of the country tax gap.

Today, many tax administrations have within their corporate objective the improvement of taxpayer compliance. Potentially this administration may have difficulties in establishing their performance against this objective. It is expected that many administration currently measure the improvement strategies solely on revenue returns, which is not synonymous with compliance improvement. For the future such administration need to develop ways to measure trends in taxpayer compliance to measure their overall effectiveness (OECD, 2001). Thus, as tax authority seek to use their resources in optimal way, it is appropriate to identify areas of low or non-compliance and then be able to rank them.

Silvan (1992) says that estimating tax evasion may be important because choosing the correct enforcement strategy may depend on the level of evasion prevailing in a particular country. It is only through application of compliance measure that the level of evasion can be estimated. This measure will also ensue resources are applied where evasion is or seem to be high.

2.5.2 Compliance Measurement Methods

a) Audit based Studies

The ultimate goal of audit based compliance measure should be to determine, to the extent possible, the difference between each tax payer returns as lodged and how it should have been lodged. According to OECD (1999), the tax compliance measurement program, which uses data that resulted from selected return which were subjected to audit, is most widely used taxpayer compliance measurement program according to. Either random audit sample data or operational audit data can be used. However, Peereboom (1995) has noted a practical problem with the random allocation of taxpayer to different treatments in that tax auditors prefer to audit taxpayer at high risk instead of taxpayer believed to be compliant.

Like other taxes VAT can be evade. The development of effective audit program is crucial to increase the risk of being detected and punish those businesses not in compliance with VAT obligation. Thus the detection of offences, such as underreporting, over-reporting of VAT credits, and use of fake invoices, requires audits by well trained officers rather than desk verification (Ebrill, Keen, Bodin and Simmers, 2001). Thus the end products of tax audit program is ensuring that those business, organization and individuals required to file returns and or pay taxes are complying and doing so correctly with minimum burden.

b) Changes in Tax Returns

This is a more straightforward method for measuring compliance by comparing items on taxpayer returns forms from one period to another. While the quantity of return from data is significant and permits better trend information than trend using audit results, support for this methodology may be limited because of inability to take into account many impacts of the real world environment. It would seem that further research using this methodology should limited to relatively homogenous not complex taxpayer populations, and where suitable control groups can be found (EOCD, 1999).

One of the information frequently used to analyze compliance with VAT is the markup reported. Markup is the ratio of all sales to all purchases reported for the Vat during a specific period. A ratio or coefficient equal to or lower than 1 indicates that the taxpayer is reporting taxable annual sales equal to or lower than his taxable annual purchases. Experience has shown that taxpayer who report a low markup have a strong likelihood of turning out to be tax evader (Silvani, 1992). Generally, business in the same industry should report a markup that is in the same range as they experience same economic situation offer time.

c) Financial data Comparison.

This includes methods, which seek to predict the likelihood of a taxpayer or group of taxpayer being non-compliant by using comparison overtime of a number of key financial performance trend indicators. These trends include profitability, ratios, and capital structures ratios.

d) Surveys

This method uses the responses from sample taxpayers. Roth et al (op cit: 211) list the strength of surveys as their ability to capture a broad range of explanatory variables known only to taxpayers, notably their understanding of compliance requirements, relevant values and attitudes, expectations of risk and benefits of non compliance, and other events which affect a taxpayer's willingness to comply or not.

2.3.2 Methods of Improving Taxpayers Compliance

Sarker (2003) notes that it is widely accepted that the goal of an efficient tax administration is to foster voluntary tax compliance using all possible methods including penalties. An obvious approach and the most commonly used in developing countries, is to audit the financial records of retailers and impose penalties for fraudulent behavior. According to Berhan and Jenkins

(2005), if country tax authority does not have the accounting skills necessary to implement a comprehensive auditing program, there are others approaches available which include:

Physical spot checks: This method has been used in Argentina and Ecuador and has proved effective. As a customer leaves a store, they are asked by a tax official to show receipts for their purchases. In Japan, the spot assessment system was introduced by the fiancé ACT 1999. This system allows previously unregistered taxpayers to file a tax return on the spot with investigating tax officials. The spot assessment system is aimed at non-corporate persons who have not been previously assessed, and are carrying on any business or profession in any shopping center, commercial market or via small establishment (Sarker, 2003).

VAT Lottery: According to Berhan and Jenkins (2005), this is the most popular method of improving compliance. In countries like Indonesia and Taiwan, taxpayers submit their VAT receipts to be drawn at random, or random numbers may be generated and a VAT receipt number matched. In this system, prizes are awarded in periodic draws.

Incentives to final consumers: In their research on compliance cost in Northern Cyprus, Berhan and Jenkins (2005) found that the country have designed its system of VAT refunds to promote compliance by giving final consumers an incentive to request an official receipts from sellers. Final consumers who filed for refund until October 2000 were paid 5% of the value of taxable purchase. Subsequently the refund has been reduced to 2.5%. Thus, the individuals are required to collect invoices and receipts for the goods and services purchased during a four-month period. The receipts are then organized according to the month of purchase and submitted for refund through the employer.

Tax Counseling and other Taxpayers Services: Taxpayers need information and reminders of their obligation particularly during the peak tax filing period. Sarker (2003) found that in order to enhance tax compliance, the Japanese tax administration is providing its taxpayers with various services as guidance, education, consultancy etc. Public relation activities are carried out using the media and tax education is provided to schoolchildren. Taxpayers in Japan are also able to obtain consultation services via the telephone, facsimile and other media. Public relations, tax

education, tax consultancy and guidance are known as four pillars of tax compliance in Japan (Sarker, 2003).

Electronic Tax Registers: As discussed in the previous chapter, Kenya adopted this system to enhance compliance across all VAT taxpayers. Records produced by electronic registers can be used to determine the quantities of goods sold and to simplify the auditing and accounting process undertaken by the tax administration in its investigation work. Berhan and Jenkins (2005) found that in Italy the use of temper proof cash register that maintain a record of all transaction put through them proved rather effective at raising the level of VAT compliance, particularly small businesses.

2.6 VAT in the Hotel Industry in Kenya

In accounting for VAT, hotel industry is a high-risk area. This is mainly because of the frequency of cash transactions. Various challenges of controls are experienced by the hotels managers and thus accounting for VAT. The accountants may encounter difficulties in testing the credibility of declared cash takings as hoteliers make supplies of services where prices are not traceable from the cost of the goods purchased. The trade industry also covers a wide spectrum, ranging from the small family owned hotels and boarding houses, to the large private hotels and international chain establishments. There are a number of activities offered to guest in a hotel which are vatable. Checks should be made to ensure that takings received from such activities are accounted for. The following range of activities illustrates the large range of peripheral activities, which may be found at hotels. Laundry, swimming pool and saunas, morning tea, sports and games rooms, hire of sports equipment, newspaper charge, packed lunches, discos, room charges, telephone, internet, hairdressing, cash sales from tea rooms, and hot drinks.

Many hotels offer facilities for private functions such as wedding parties, banquets, conferences, and meetings. These tend to be accounted for outside the normal business accounting system and often bookings are under the personal control of the manager. This presents an opportunity for and VAT evasion and avoidance, particularly when cash payments are made.

In calculating the price of accommodation and restaurant services, the following shall be excluded; any charge made in respect of Catering Training and Tourism Development Levy; and

any service charge made in lieu of tips and gratuities, Provided that the proceeds of the service charged shall be distributed directly to the employees of the hotel or restaurant, in accordance with agreement between the employer and employees and the service charge shall not exceed ten percent of the price of the service excluding such service charge. VAT Act 9(4)

The VAT Rates in the Hotel Industry on hotel and restaurant services until June 2006 was less than the standard rates by 2%. This was to compensate for the two percent payable to the hotel and catering training levy. As at June 2006, the standard rate was 16 %, hotels, and restaurant 14%. With effect from 16th June 2006, the minister in the budget increased the VAT rate on hotel and restaurant from 14% to 16%.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter encompasses the research methodology to be used in the field. It focuses on the sources of data and their collection techniques, the sampling procedure to be adapted and tools for data presentation and interpretation. Research methodology is a system of explicit rules and procedure upon which research is based and against which claims for knowledge are evaluated (Nachmias, 1996). This chapter focuses on the sources of data and their collection techniques, sampling procedures to be adopted and tools for data presentation and analysis.

3.2 Research Design

This study was on the impact of electronic tax registers on VAT compliance among classified hotels in Nairobi. The study focused on classified hotels within Nairobi. This is because Nairobi is the capital city where all classes of hotels can be found, and their closeness to KRA thus the high chance of adopting policy and technology changes faster. In carrying out this study, the survey design which was most appropriate was adopted and it entailed gathering of both primary and secondary data from the hotels.

3.3 Population

The population consisted of all classified hotels, which were registered for VAT from year 2004 to 2008. This is because of homogeneity of the hotel industry and similarity of issue with regard to VAT. Suitable sampling frame was required for selection of the sample units. According to Cooper and Schindler (2000), a sampling frame is a list of elements from which the sample was actually drawn and was closely related to the population. Given the small number of respondents, the study conducted a census of the population (see appendix III)

3.4 Data Collection

The researcher used both primary and secondary data. Primary data was obtained through self-administered questionnaires with closed and open-ended questions (see appendix I). As much as possible, a 5-point likert scale was used to determine the impact of Electronic Tax Registers on VAT compliance in classified hotels in Nairobi. The closed ended questions enabled the researcher to collect quantitative data while open-ended questions gave the respondent to collect

qualitative data. The questionnaire was divided into two sections. Section one will be concerned with the general information about respondents. Section two will deal with the impact of Electronic Tax Registers on VAT compliance in classified hotels in Nairobi. Secondary data will be obtained from VAT 3 returns. The data covered the period before ETR introduction (2004), the year of ETR implementation (2005) and the year after ETR implementation (2006). This information was used to supplement information gathered from taxpayers' views. Financial data from actual returns as declared to KRA was also utilized.

3.5 Data Analysis

The collected data was thoroughly examined and checked for completeness and comprehensibility. The data was then summarized, coded and tabulated. Descriptive statistics such as means, standard deviation, and frequency distribution will be used to analyze the data. Data presentation was done by the use percentages and frequency tables. This ensured that the gathered information was clearly understood. The analysis examined the VAT for each classified hotels from 2004-2006.

The ETR was introduced to address the issue of revenue leakages as a result of sales that are not declared. For compliance to improve the sales declared at different time should change while purchases claimed by taxpayers as inputs remains constant. Using secondary data from VAT returns, ratios of VAT inputs and Outputs will be calculated for returns over the period of research. The data was split into samples representing returns before and after introduction of ETR. A paired T-Test was used to compare the two related sample for significant differences. According to Kothari (1990) a paired test is a test for comparing two related samples involving small values of n that does not require the variance of two populations to be equal. Mean scores of the likert scale were used to determine the factors considered by the hotels. The higher the mean score the higher a factor was considered to be affecting VAT compliance.

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents a detailed discussion of the research findings in an attempt to achieve the research objectives. Data analysis is carried out based on the objectives of the study.

4.2 Analysis of General Information

The respondents to this study were made up of 29 classified hotels in Nairobi to whom questionnaires were distributed to the respective accountants. However, only 20 were completed and returned, representing a 68.97% response rate.

4.2.1 Gender of the Respondents

The study sought to find out the gender of the respondents. It captured the gender of the respondents. Table 4.1 shows their response.

Table 4.1: Gender of the Respondents

	Frequency	Percent
Male	17	85.0
Female	3	15.0
Total	20	100.0

Table 4.1 shows that 85.00% of the respondents interviewed were in male with 15.00% of the respondents being female.

4.2.2 Fiscal Electronic Tax Registers

The study sought to find out the type of fiscal electronic tax registers that was used in the organizations. It captured the type of fiscal electronic tax registers and the results are shown in Table 4.2 below.

Table 4.2: Fiscal Electronic Tax Registers

	Frequency	Percent
ESD	14	70.0
ETR	6	30.0
Total	20	100.0

It is shown in Table 4.2 above, that majority (70%) of the respondents indicated that their organization used the ESD while 30% indicated that their organization used the ETR. The ESD is used where invoicing is computerized. On the other hand ETR is used where invoicing is done manually.

4.3 Factors Affecting VAT Compliance

The objectives of this study were to determine the impact of electronic tax registers on VAT compliance among classified hotels in Nairobi and to identify factors affecting VAT compliance among classified hotels in Nairobi.

4.3.1 Registration for VAT

The respondents were asked to indicate whether their organizations were registered for VAT and they all concurred indicating that they were registered. It is a requirement that any business setup with a point of sale has to issue a fiscal receipt generated from an electronic tax device hence the need to register for VAT.

4.3.2 Advantages of Registration for VAT

The respondents were asked to indicate whether they perceived if there was any advantage of being registered for VAT. The results are as indicated in the table 4.3 below.

Table 4.3: Advantages of Registration for VAT

	Frequency	Percent
Yes	19	95.0
No	1	5.0
Total	20	100.0

It is shown in Table 4.2 above, that majority (95%) of the respondents indicated that there were advantages of being registered for VAT while 5% indicated that there were no advantages of being registered for VAT. Once Registered for VAT the input VAT incurred on purchases can be offset against VAT charged on sales thus reducing the cost of good and services to the trader.

4.3.3 Complexity of the VAT System

The respondents were asked to indicate whether the VAT system in hotel business is complex or not. The results are as indicated in the table 4.4 below.

Table 4.4: Complexity of the VAT System

	Frequency	Percent
No	12	60.0
Yes	8	40.0
Total	20	100.0

As shown in the table, majority of the respondents (60.0%) indicated that the VAT system in the hotel business is not complex. The rest (40%) indicated that the VAT system in the hotel business was complex.

4.3.3 Acquisition of the ETR Machine

The respondents were asked to give their opinion on what influenced the acquisition of the ETR machine in their hotels. The results are as indicated in the table 4.5 below.

Table 4.5: Acquisition of the ETR Machine

	Frequency	Percent
Benefits arising from ETR's	11	55.0
Own willingness	6	30.0
Fear of been caught	3	15.0
Total	20	100.0

The respondent's indicated that acquisition of the ETR machine was through benefits arising from ETR's as indicated by majority (55.0%) of the respondents. Acquisition of the ETR machine through own willingness was cited by 30% of the respondents with rest, 15.0% of the respondents indicating that the ETR machine was acquired through fear of being caught. According to the deterrence theorists, the perceived probability of getting caught is a factor for complying with the law.

4.3.4 Honesty When It Comes To VAT

The respondents were asked whether people in the industry were generally honest when it came to VAT. The results are as indicated in the table 4.6 below.

Table 4.6: Honesty When It Comes To VAT

	Frequency	Percent
Yes	12	60.0
No	8	40.0
Total	20	100.0

The outcome was that people were generally honest when it came to VAT. 60% of the respondents indicated that the people in the industry were generally honest while 40% indicated that the people in the industry were not honest. This may be due to the commitment posture towards the tax system which means that the taxpayer feels a sense of moral obligation to pay their taxes and will pay their taxes with good will because they believe paying tax ultimately benefit everyone.

4.3.5 Inspection by the Tax Authorities

The respondents were asked whether their hotel establishment had ever been inspected by the tax authorities. The results are as indicated in the table 4.7 below.

Table 4.7: Inspection by the Tax Authorities

	Frequency	Percent
Yes	12	60.0
No	8	40.0
Total	20	100.0

Majority of the respondents (60%) indicated that their establishment had been inspected by the tax authorities and 40% indicated that their establishment had not been inspected by the tax authorities. This may be due to resistance towards the tax system which makes the taxpayer adopt a stand against the tax office thus forcing the tax authorities to inspect them. It may also be as a result of ensuring compliance with the laid down regulations that makes the tax authority inspect the establishments.

4.3.6 VAT Enforcement Mechanism

The respondents were asked whether the VAT enforcement mechanism by Kenya Revenue Authority was effective. The results are as indicated in the table 4.8 below.

Table 4.8: VAT Enforcement Mechanism

	Frequency	Percent
Yes	12	60.0
No	8	40.0
Total	20	100.0

Majority of the respondents (60%) indicated that the VAT enforcement mechanism by Kenya Revenue Authority was effective and 40% indicated that the VAT enforcement mechanism by Kenya Revenue Authority was not effective. This may be due to the tax office increased effort in auditing the organizations which are already filing returns.

4.3.7 High Taxes as Incentives for Tax Evasion

The respondents were asked whether the high tax rates create incentives for tax evasion by taxable persons and customers. The results are as indicated in the table 4.9 below.

Table 4.9: High Taxes as Incentives for Tax Evasion

	Frequency	**Percent**
Yes	18	90.0
No	2	10.0
Total	20	100.0

It is shown in Table 4.2 above, that majority (90%) of the respondents indicated that high tax rates created incentives for tax evasion by taxable persons and customers while 10% indicated that high tax rates did not create incentives for tax evasion by taxable persons and customers. This can be attributed to a game playing posture like the game of finding grey areas of the tax law and enjoy the challenge of minimizing the tax they have to pay.

4.3.8 Awareness of Obligations and Rights under the VAT Laws

The respondents were asked whether they were aware of all obligations and rights under the VAT laws. The results are as indicated in the table 4.10 below.

Table 4.10: High Taxes as Incentives for Tax Evasion

	Frequency	**Percent**
Yes	14	70.0
No	6	30.0
Total	20	100.0

It is shown in Table 4.10 above, that majority (70%) of the respondents are aware of the obligations and rights under the VAT laws which is a result of the trainings sessions conducted by the tax authority office on tax administration. 30% indicated they were not aware of the obligations and rights under the VAT laws.

4.3.9 Happiness with the Tax System or Tax Office

Respondent's were required to rate the statement that the taxpayer is not happy with the tax system or tax office but tax is part of life and needs to be paid. The results are as indicated in the table 4.11 below.

Table 4.11: Happiness with the Tax System or Tax Office

	Frequency	Percent
Strongly agree	9	45.0
Agree	9	45.0
Neither agree or disagree	2	10.0
Total	20	100.0

Majority of the respondents (90%) stated that they agreed with the statement that the taxpayer is not happy with the tax system or tax office but tax is part of life and needs to be paid. The remaining 30% indicated that they neither agreed nor disagreed with the statement that the taxpayer is not happy with the tax system or tax office but tax is part of life and needs to be paid. This can be attributed to capitulation which means that, a taxpayer may not be happy with the tax system or tax office, but they acknowledge that it is a part of life and that taxes need to be paid. They also believe that they should cooperate with the tax office; even if they feel the tax office is treating them poorly.

4.3.10 Requirements Followed By the Hotel in Its Operations

The Respondent's were required to indicate whether they followed requirements indicated below in their hotel establishments. Means for the requirements were established in order to provide a generalized feeling of all the responses. "Yes" responses were coded 1 and "no" responses were coded 2. Means closer to one implied that the requirement was followed as required by the ETR regulation, while means closer to 2 implied that requirement was not followed as required by the ETR regulation. The results are as indicated in the table 4.12 below.

Table 4.12: Requirements Followed By the Hotel in Its Operations

	Yes	No	Total	Mean
Printing of monthly reports	18	2	30	1.10
Regular maintenance of the ETR	18	2	30	1.10
Printing of daily reports	17	3	30	1.15
Printing of yearly reports	17	3	30	1.15

The respondents indicated that all the regulations regarding ETR usage were followed by the hotel establishments. The respondents ranked printing of monthly reports and regular maintenance of the ETR first with means of 1.10 each and printing of daily reports together with printing of yearly reports each with a mean of 1.15.

4.4 Impact of Electronic Tax Registers On VAT Compliance

The other objective of the study was to determine the impact of Electronic Tax Registers on VAT compliance among classified hotels in Nairobi.

4.4.1 Statements Regarding ETR and VAT Payments

The respondents were asked to rate how far they agreed to the following statements regarding ETR and VAT. The factors were to be rated on a scale of 1-5 with 1= Strongly Agree; 2= Agree; 3= Neither Agree nor disagree; 4= Disagree; 5= strongly disagree. These were analyzed by mean rankings of the responses obtained, which are as shown in table 4.13 below.

Table 4.13: Statements Regarding ETR and VAT Payments

	Mean	Std. Deviation	Rank
ETR has reduced the time it takes to prepare VAT returns at end month	1.95	1.191	1
ETR ensures accurate filing of monthly VAT returns	1.95	0.686	2
ETR ensures timely filing of monthly VAT returns	2.10	1.119	3
With ETR tax payers do not under declare VAT	2.20	1.105	4
ETR has helped increase sales declared for VAT	2.40	0.821	5
The monthly VAT returns have increased since you started using the ETR/ESD	3.05	1.191	6

It is illustrated in table 4.13 above that the respondents strongly agreed that ETR has reduced the time it takes to prepare VAT returns at end month and that the ETR ensures accurate filing of

monthly VAT returns both with a mean of 1.95. ETR ensures timely filing of monthly VAT returns was ranked third with a mean of 2.10. The statement that with ETR tax payers do not under declare VAT was ranked fourth with a mean of 2.20. At rank five was the statement that ETR has helped increase sales declared for VAT with a mean of 2.40. They neither agreed nor disagreed with the statement that the monthly VAT returns have increased since they started using the ETR/ESD with a mean of 3.05.

The respondents further indicated that the ETRs costs were at times prohibitive. They also state that they had previous systems/ software's which did all the computations. The hotel industry has several types of taxes which make computations difficult. Several points of service with separate bills being issued may lead to some bills not being captured on the ETR. Compliance should be a collective responsibility and the tax authority should give incentives to all parties to achieve this.

4.4.2 Analysis of VAT 3 Returns

The VAT 3 returns analysis was used to test the hypothesis that:

H0: There was no change in the VAT declared before and after introduction of the ETR machines.

H1: There was an increase in the VAT declared after introduction of the ETR machines.

Using secondary data from VAT returns, ratios of VAT inputs and Outputs were calculated for returns over the period of research. The data was split into samples representing returns before and after introduction of ETR. A paired T-Test was used to compare the two related samples for significant differences.

Table 4.14: Analysis of VAT 3 Returns

Paired Samples Test 2004 and 2006

Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference	t	df	Sig. (2-tailed)
			Upper			
.0345071	0.09908270	0.03302757	0.1106688	1.045	8	0.327

From the VAT 3 returns over the period of research, VAT ratios were calculated and statistical significance of the VAT declared was calculated. The data was split into samples representing returns before and after introduction of ETR. A paired T-Test was used to compare the two related samples for significant differences. The value of t = 1.045 lies in the rejection region which is beyond the critical value of 0.1106. The null hypothesis is rejected and the alternative hypothesis accepted. This indicates that there was an increase in the VAT declared after introduction of the ETR machines. There has been an increase in VAT declared with the introduction of Electronic Tax Registers. ETR can enhance VAT collection resulting from the requirement that the hotels issue a fiscal receipt thus more accurate VAT reporting.

4.5 Chapter Summary

This chapter presented a detailed discussion of the research findings while answering the research objectives. Data analysis is carried out based on the objectives of the study. Descriptive statistics such as means, and frequency distribution were used to analyze the data. Data presentation was done by percentages and frequency tables.

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CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter discusses the results gathered from the analysis of the data, as well as the conclusions reached. The chapter incorporates the various suggestions and comments given by the respondents in the interview. Findings have been summarized alongside the objectives of the study, conclusions have been drawn from the study and the recommendations for action are also given.

5.2 Summary of the Findings

The respondents to this study were made up of 29 classified hotels in Nairobi to whom questionnaires were distributed to the respective accountants, with 20 questionnaires being completed and returned, representing a 68.97% response rate. VAT 3 returns over the period of research were collected but only from nine hotels given the sensitivity of the financial data in question. Majority of the respondents interviewed were in male and they indicated that most of their organizations used the ESD. They all indicated that they were registered since it is a requirement that all business setups now register for VAT. All the respondents indicated that there were advantages of being registered for VAT, and the VAT system in the hotel business is not complex. Majority of the respondent's indicated that they acquired the ETR machine due to benefits arising from ETR's, though some of indicated that they acquired the ETR machine through own willingness or due to fear of being caught. According to the deterrence theorists, the perceived probability of getting caught is a factor for complying with the law.

The respondents further indicated that the people in the industry were generally honest when it came to VAT. This may be due to the commitment posture towards the tax system which means that the taxpayer feels a sense of moral obligation to pay their taxes and will pay their taxes with good will because they believe paying taxes ultimately advantages everyone. Majority indicated that their establishment had been inspected by the tax authorities. This could be attributed to the resistance towards the tax system which makes the taxpayer adopt a stand against the tax office thus forcing the tax authorities to inspect them and ensure compliance.

The respondents indicated that the VAT enforcement mechanism by Kenya Revenue Authority was not effective and may be due to the tax office not being able to administer the tax laws effectively. The respondents indicate that the high tax rates created incentives for tax evasion by taxable persons and customers. This can be attributed to a game playing posture like the game of finding the grey areas of the tax law and enjoy the challenge of minimizing the tax they have to pay. They were aware of all obligations and rights under the VAT laws which can be a result of the training offered by the tax office on tax administration. They however indicated that they were not happy with the tax system or tax office but tax is part of life and needs to be paid. This can be likened to capitulation that a taxpayer may not happy with the tax system or tax office, but they acknowledge that it is a part of life and that taxes need to be paid. They also believe that they should cooperate with the tax office; even if they feel thee tax office is treating them poorly.

The respondents indicated that the hotel establishments followed the requirements of printing of monthly reports, printing of daily reports, regular maintenance of the ETR and printing of yearly reports. The respondents agreed that ETR ensures timely filing of monthly VAT returns, it has reduced the time it takes to prepare VAT returns at end month and ETR ensures accurate filing of monthly VAT returns. They also agreed with the statement that the monthly VAT returns have increased since you started using the ETR/ESD. They neither agreed nor disagreed with the statement that with ETR tax payers do not under declare VAT and they further indicated that the ETRs did not suit their kind of businesses and they had previous systems/ software's which did all the computations.

From the VAT 3 form returns over the period of research were calculated. The findings of the T-test showed that this difference was statically significant. This indicated that the impact of Electronic Tax Registers on VAT compliance among classified hotels in Nairobi was positive as an increase in VAT declared was observed through the significant results. Therefore, an increase in VAT declared with the introduction of Electronic Tax Registers has been achieved. ETR machines can then be deemed to enhance VAT collection resulting from more accurate VAT reporting.

5.3 Conclusions

Based on the results form data analysis and findings of the research, one can conclude that Kenya has witnessed significant changes in many aspects of its economy over the last four decades, but like most developing countries, it has had to contend with the common problems that plague tax systems of developing countries. ETRs have been introduced to get the country out of the problems that plague tax systems of developing countries. From the research data, all the hotel establishments had acquired an ETR or an ESD though some hotels previously had software's which did all the computations. It can be concluded that the hotels had adopted and complied with the requirements of VAT and that the use of ETR ensures timely filing of monthly VAT returns, reduced time taken to prepare VAT returns at end month and ensures accurate filing of monthly VAT returns. The ETR has increased monthly VAT returns since its inception. There has also been an increase in VAT declared with the introduction of Electronic Tax Registers. It can thus be concluded that ETR machines can enhance VAT collection resulting from accurate sales and VAT reporting.

5.4 Recommendations

The taxpayer will be less likely to comply with a tax system they consider to be unfair. The enforcement approach adopted by the regulatory authorities should be fair and should create a good relationship between an individual and the authority so as to enhance compliance. The tax payers will always have a game playing posture where they perceive grey areas of the tax law and will then try to minimize the tax they have to pay. As such the tax office should develop an effective strategy that aims to enhance compliance. The tax office should build a bridge between themselves and the taxpayer. The tax office should also work with other agencies so as to increase the taxpayer's commitment to the tax system and seal loopholes so that one will not have an avenue for not declaring sales made. The tax office should also strive to ensure full adoption of the ETR machines since they increase the VAT declared. The tax authority should also seek to develop systems that can be integrated with previously acquired software's. They should also embrace technology and come up with an internet based that is easier to use.

5.5 Recommendations for Further Studies

Further research could be undertaken evaluate the impact of Electronic Tax Registers on VAT compliance in other industries. The classified hotels represent the more organized level in the

industry. Similar research should be done on small and medium enterprises in the hotel and other industries. A study on the level of ETR adoption and compliance among rural and urban companies could also be undertaken to establish if there is a difference in compliance between the two locations. A research should also be undertaken on how to improve the tax reporting system such that all sales are declared.

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APPENDIX

Appendix I: Questionnaire

PART A: GENERAL INFORMATION

1. Please indicate your Gender. Male [ ] Female [ ]
2. What is your designation .....
3. What Fiscalised Electronic Devise do you use in your organization?

ETR [] ESD [] others.....

PART B: FACTORS AFFECTING VAT COMPLIANCE

1. Are you registered for VAT?

Yes [ ] No [ ]

2. Do you think that there is any advantage of being registered for VAT?

Yes [ ] No [ ]

3. In your opinion, is VAT system in hotel business complex?

Yes [ ] No [ ]

4. Does your hotel have an ETR?

Yes [ ] No [ ]

5. In your opinion what influenced the acquisition of the ETR Machine?

Fear of being caught [ ]

Own willingness [ ]

Benefits arising from ETR's [ ]

6. Are people in your industry generally honest when it comes to VAT?

Yes [ ] No [ ]

7. Has your hotel ever been inspected by the tax authorities?

Yes [ ] No [ ]

8. Is the VAT enforcement mechanism by Kenya Revenue Authority effective?

Yes [ ] No [ ]

9. High Tax rates create incentives for tax evasion by taxable persons and customers.

Yes [ ] No [ ]

10. Are you aware of all obligations and rights under the VAT laws?

Yes [ ] No [ ]

11. The taxpayer is not happy with the tax system or tax office but tax is part of life and needs to be paid?

Strongly Disagree	[ ]	Neither agree or disagree	[ ]
Agree	[ ]	Strongly agree	[ ]

12. Are the following requirements followed by the hotel in its operations?

	Yes	No
Printing of daily reports	( )	( )
Printing of monthly reports	( )	( )
Printing of yearly reports	( )	( )
Regular maintenance of the ETR	( )	( )

13. Please, indicate how far you agree to the following statements regarding ETR and VAT payments. Use a five-point measurement scale as follows:

Key: **1**= Strongly Agree; **2**= Agree; **3**= Neither Agree nor disagree; **4**= Disagree; **5**= Strongly disagree

Compliance	**Strongly agree**	**Agree**	**Neither agree nor disagree**	**Disagree**	**Strongly disagree**
ETR has reduced the time it takes to prepare VAT returns at end month					
ETR ensures timely filing of monthly VAT returns					
ETR ensures accurate filing of monthly VAT returns					
The monthly VAT returns have increased since you started using the ETR/ESD					
ETR has helped increase sales declared for VAT					
With ETR tax payers do not under declare VAT					

14. Please indicate any other factor affecting VAT compliance in the hotel industry.....

.....

.....

.....

.....

15. Please give any other comment that you may deem useful for this exercise.

.....

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.....

PART C: DATA REQUEST

1. Please give the following details of the Financial Details of your hotel for the periods indicated.

YEAR	TURNOVER	COST OF GOODS SOLD
	Kshs.	Kshs.
2004		
2005		
2006		

2. VAT 3 Returns Collection Form.

PERIOD: YEAR 2004

Month	TAXABLE SALES	TAXABLE PURCHASES
JUNE		
JULY		
AUGUST		

PERIOD: YEAR 2005

Month	TAXABLE SALES	TAXABLE PURCHASES
JUNE		
JULY		
AUGUST		

PERIOD: YEAR 2006

Month	TAXABLE SALES	TAXABLE PURCHASES
JUNE		
JULY		
AUGUST		

Thank you very much for your cooperation.

Appendix II: Classified Hotels in Nairobi

Classified Hotels in Nairobi		
	Nairobi Classified Hotels-Over Three star	
No.	**Hotel**	**Classification**
1	Grand Regency Hotel	Five Star
2	Hilton Hotel	Five Star
3	Hotel Intercontinental	Five Star
4	Nairobi Safari Club	Five Star
5	Nairobi Serena Hotel	Five Star
6	Norfolk Hotel	Five Star
7	Palacina Hotel Residence and Suites	Five Star
8	Panari Hotel	Five Star
9	Sarova Stanely	Five Star
10	Safaripark Hotel & Casino	Five Star
11	Windsor Golf Hotel & Country Club	Five Star
12	Holiday Inn Nairobi	Four Star
13	Fairview Hotel	Four Star
14	Jacaranda Hotel Nairobi	Four Star
15	Sarova Panafric Hotel	Four Star
16	Utalii Hotel	Four Star
17	Ambassadeur Hotel	Three Star
18	Kasarani Sportsview Hotel	Three Star
19	Kenya Comfort Hotel	Three Star
20	Lenana Mount Hotel	Three Star
21	Marble Arch Hotel	Three Star
22	Meridien Court Hotel	Three Star
23	Silver Springs Hotel	Three Star
24	Sixeighty Hotel	Three Star
25	Boulevard Hotel	Two Star
26	Heron Court Hotel	Two Star
27	Kivi Milimani Hotel	Two Star
28	Kwality Hotel	Two Star
29	Sagret Hotel	Two Star