

**THE EFFECT OF TAX PAYER EDUCATION ON VALUE ADDED TAX
COMPLIANCE BY MOTOR VEHICLE PART DEALERS IN NAIROBI
CENTRAL BUSINESS DISTRICT**

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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF
MASTERS OF BUSINESS ADMINISTRATION OF
THE UNIVERSITY OF NAIROBI**

OCTOBER 2014

DECLARATION

I, the undersigned, declare that this research project is my own work and has never been presented in any other university or college for a degree or any other award.

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ACKNOWLEDGEMENT

It has been an exciting and informative study period in the University of Nairobi and I feel privileged to have had the opportunity to carry out this study as a demonstration of knowledge gained during the period of studying for my master's degree. The long and challenging journey that has led to the successful completion of this MBA programme would not have been without the incredible support and encouragement of many people I interacted with.

First and foremost I am indebted to the all-powerful God for all the blessings he showered on me and for being with me throughout the study. I would also like to record my special thanks and utmost gratitude to my supervisor Mr. Mirie Mwangi as well as my moderator whose professional guidance and wisdom made it possible for me to successfully undertake and complete the study.

DEDICATION

This research project is dedicated to my beloved Husband for his love and moral support and also to my dear parents for the sacrifices they made in educating me.

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LIST OF ABBREVIATIONS

CBD - Central Business District

DTD - Domestic Taxes Department

KRA - Kenya Revenue Authority

LDCs - Less Developed Countries

V.A.T- Value Added Tax

ABSTRACT

Tax compliance is defined as the degree to which the tax paying community meets the tax obligation as set out in the appropriate legal and regulatory provisions Maxwell, (2003). He adds that compliant tax payers make timely, proper and accurate declaration to the tax authority and voluntarily settle all the due tax liabilities. Taxpayer compliance depends on economic incentives embedded in the tax structure and the effectiveness in detecting and penalizing non-compliance. At the margin, people engage in tax evasion when the expected benefits (lower taxes) are equal to the expected costs (bribes, punishment). The main objective of the study was to determine the effects of taxpayers' education on the level of Value Added Tax compliance among the motor vehicle spare parts dealers in Nairobi CBD. The study employed a descriptive research design. Descriptive approach was integrated with survey design so as to collect comprehensive qualitative and quantitative data that enriches the outcome of the study. The study targeted all the motor vehicle spare parts dealers in the Nairobi CBD as the population of the study. Nairobi CBD is composed of 33 streets and an estimated number of 97 motor vehicle part dealers (Nairobi City Council, 2013). The study collected primary data. Semi-structured questionnaires were used; that is, with open and close-ended questions for qualitative and quantitative data respectively. The study targeted one person per motor vehicle parts dealers; either business owners or managers. A pilot test was conducted on 10 motor vehicle parts dealers in Industrial area to test the reliability and validity of the research instruments. The filled-in questionnaires were edited for consistency. The study established that tax compliance cost result to non-compliance of tax by motor vehicle dealers. Costs increase with the number of taxes that an entrepreneur is subject to, the complexity of the tax rules, the frequency of submitting tax returns, and the number of levels of government involved in levying and collecting tax. The study concludes that tax knowledge and education has a significant effect on tax compliance. Finally, perceived opportunity for tax evasion has a significant effect on tax compliance, therefore the tax system should target all motor vehicle dealers at all levels of turnover to seal loopholes that may encourage tax evasion. Tax systems should also enhance surveillance and monitoring to ensure that all the taxpayers are brought into the tax net. Specifically, motor vehicle spare part dealers, registering of all the firms for VAT should be done to ensure that they are obliged to file their returns.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Maxwell, (2003) defines tax compliance as the degree to which the tax paying community meets the tax obligation as set out in the appropriate legal and regulatory provisions. He adds that compliant tax payers make timely, proper and accurate declaration to the tax authority and voluntarily settle all the due tax liabilities. Taxpayer compliance depends on economic incentives embedded in the tax structure and the effectiveness in detecting and penalizing non-compliance. At the margin, people engage in tax evasion when the expected benefits (lower taxes) are equal to the expected costs (bribes, punishment).

Taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago Lymer and Oats, (2009). In every jurisdiction, tax authorities are empowered to collect revenue from taxpayers. Although taxpayers report their income and pay their tax liabilities properly, there are many taxpayers do not bring about budgetary deficit in governments. When faced with tax moral dilemmas, generally taxpayer education helps guide taxpayers on how to act rightly and justly Torgler and Schneider,(2007). Similarly, Tan and Chin-Fatt (2008) aver that not only knowledge but an understanding of the tax system may have an effect on taxpayers' perceptions of fairness and attitudes towards compliance. In order to better understand the issues on compliance in taxation, this research project project reviews and discusses how taxpayer's education enhances compliance.

1.1.1 Taxpayer Education

Taxpayers' education can be described as a method of educating the people about the whole process of taxation and why they should pay tax. Taxpayer education assists taxpayers in meeting their tax obligations to the government. The primary existence of taxpayer education is to encourage voluntary compliance amongst taxpayers. Taxpayer education is one of the strategies of improving service delivery to the tax payers. Improving service delivery is critical to enhance voluntary tax compliance. Lack of voluntary tax compliance compels revenue authorities to use costly and coercive methods for tax enforcement (Fjeldstad and Ranker 2003).

The education component is expected to deal with non-compliance practice among the taxpayers especially in the informal sector (Kimingu and Kileva, 2007). This is based on the possibility of non-compliance being unintentional, where the taxpayer is not aware of his/her tax obligations or fails to fulfill his/her tax obligations due to ignorance of tax laws and procedures or may be intentional due to the compliance attitudes (Christina, Deboral and Gray, 2003). Taxpayer education program serves to: create taxpayer awareness of laws and procedures, educate taxpayers on their tax responsibilities and rights, assist and motivate taxpayer to comply voluntarily, assist taxpayers on reporting the correct income and amount of tax, maintaining close relationship between the tax authority and the taxpayer continuously, and, instill public confidence in taxation system (Oyedele, 2009).

Thus, tax education enables the taxpayer to understand tax laws and procedures as well as creating positive tax compliance attitude (Normala, 2007; Roak and Stephen, 1994). The tax authorities have given special attention on the business, by simplification of the tax laws procedures, associations, annuals taxpayers' appreciation day, and integrity enhancement as among the strategies (Kianuka,

2004; Kimungu and Kileva, 2007). Tax Education to the business owners becomes necessary when the objective of raising tax revenue, at the changing environment; particularly from the official tax assessment is considered (Normala, 2007).

1.1.2 Value added Tax Compliance

Tax compliance refers to the degree to which taxpayers meet their obligations under the tax law (Kimungu and Kileva, 2007). All individual taxpayers and businesses should fulfill their obligations under the law to register for tax purposes, and to voluntarily declare and pay on time their tax liabilities (Christina, Deboral and Gray, 2003). Tax compliance is a continuum that ranges from deliberate and determined non-compliance to unwilling compliance to unwitting compliance due to lack of knowledge of taxpaying procedures and legal requirements and finally willing and quasi-voluntary compliance. Tan and Chin-Fatt (2008) state that tax compliance by taxpayers can be viewed in terms of whether such compliance is achieved voluntarily (i.e. quasi-voluntary compliance) or corrected by enforcement actions carried out by the revenue administration (i.e. enforced compliance).

To ensure tax compliance, there are four basic tax compliance obligations of citizens and businesses that generally must be administered by all revenue administrations in accordance with their respective tax laws: registration (identification); filing (submission of tax returns on time); declaration (correctly report tax liabilities); and, payment (on time as stipulated in the law). A non-compliant taxpayer is one who fails to satisfy any one or more of these aspects and poses a risk to revenue collection. McKerchar (2003) stated that non-compliance may be as a result of a deliberate decision by the taxpayer, or it may be unintentional. McKerchar , thus, posits that there are no quick fixes to improving taxpayer compliance, instead what is required is a concerted, long-term coordinated and comprehensive plan

that uses a complimentary range of policy instruments underpinned by a solid legal based (Brautigam, 2008). Non-compliance may be due to taxpayer ignorance, inability or intent. Thus, tax administrations' approach to enhancing compliance generally has three main components: taxpayer education and outreach, i.e. to ensuring that taxpayers are aware of their legal obligations; taxpayer services, i.e. to secure that tax payment and processing are relatively simple and easy; and deterrence and enforcement, i.e. credible deterrent and consequence for those who seek to avoid their obligations (Olowookere and Fasina, 2013).

Economic theories of tax compliance are also referred to as deterrence theory. According to Trivedi and Shehata (2005), economic theories suggest that taxpayers “play the audit lottery,” i.e. they make calculations of the economic consequences of different compliant alternative, such as whether or not to evade tax; the probability of detection and consequences thereof, and choose the alternative which maximizes their expected after tax return/profit (possibly after adjustment for the desired level of risk).

1.1.3 Effect of Tax Payer Education on Value Added Tax Compliance

Tax education to the citizens becomes necessary when the objective of raising tax revenue, at the changing environment; particularly from the official tax assessment is considered (Normala, 2007). At the same time, achieving tax compliance and improving revenue generation is not an easy task (Kimungu and Kileva, 2007). However, this problem can be minimized through tax education as it imparts payer knowledge and skills that allow the taxpayer to pay taxes, including an understanding of why paying tax. Braithwaite (2003) demonstrated that taxpayer compliance largely depends on having a favorable attitude towards the tax system, and in particular on considering that it is generally a fair and just system.

Acceptance of the fairness of taxation is deriving from 'identification' with the state and a general confidence that its tax system treats everyone equitably (Picciotto 2007). Tax education benefits taxpayers as there seem to be difficulty in to achieving: greater clarity, less complexity, and a simpler and fairer tax structure. According to Olowookere and Fasina (2013), while most taxpayers want to do the right thing and pay their fair share of tax, they do not want to pay more than is necessary. Voluntary compliance amongst taxpayers is, thus, heightened when taxpayer education and enforcement functions are balanced to achieve the desired output in tax compliance (Misra, 2004). Tax administration is a key public sector responsibility that touches the lives of citizens and their businesses on a daily basis.

Failure to understand the taxation system leads to less compliance since most people will avoid it because they do not know what they should pay as and why they should pay tax. Educating the people about the whole process of taxation and why they should pay tax will encourage compliance. Most of the taxpayers can then be expected to react positively towards tax drives and a reduction in evasion. Ogundele (2004) asserts that to comply with tax laws, taxpayers need to have adequate tax knowledge.

Previous studies have evidenced that general tax knowledge has a very close relationship with taxpayers' ability to understand the laws and regulations of taxation, and their ability to comply with them (Singh, 2003; Mohamad Ali *et. al.*, 2007). Terkper (2007) advanced the reason that tax payers demonstrate various degrees of compliance owing to factors such as lack of understanding of the tax laws; improper book keeping and apathy towards government. To Young *et al.* (2013), the rules should be simple and clear allowing taxpayers to read and understand the requirement and the rules they need to follow easily and quickly. Otherwise, tax payers' intentions of compliance may reduce.

Therefore, continuous education programmes and effective monitoring mechanisms must be taken into account by tax authorities to ascertain that taxpayers have a good and reasonable knowledge and understanding of tax matters. However, the awareness and attitude of the taxpayer himself is more important since the effectiveness of tax education depends on the readiness, acceptance and honesty of taxpayers.

1.1.4 Motor Vehicle Spare Parts Dealers in Nairobi Central Business District

The rapid industrialization and modernization in Kenya has resulted in an increased demand for capital goods such as machinery, lubricants, spare parts, ball bearings and other mechanical goods and accessories. The market for automobile spare parts, in particular, has been an attractive sector (Maina, 2007). With the liberalization of the economy, used imported motorcars from Japan and Dubai far outnumber the new motor cars registered annually (Gachie, 2013). About 70% of vehicles on our Roads are second hand. Maintenance of this huge number of second hand vehicles lead to increased demand for second hand spares. As a result, the Kenyan economy has become flooded with these parts that are usually imported from different countries (KEBS, 2009).

Places in Nairobi where motor vehicle spare parts are sold are Ngara area, Industrial Area, Dandora and Kariobangi. Within the central business district, spare parts are mostly sold along River Road, Kirinyaga and Grogon Roads. Historically, the establishment of motor vehicle parts business in the NCBD, Kirinyaga and Grogon Road was promoted by the segregation of Nairobi resulting into this area being occupied by members of the Asian origin who resided and conducted business on the same premises.

During these early days, the Asian community in Kenya had a higher financial access and knowhow on any business involving importation logistics in comparison to the indigenous population. However, with the advent of market liberalization in the early 1990s, motor vehicle parts business has drawn participants from various backgrounds. The increased demand for vehicle maintenance by people working within the NCBD has contributed to the establishment of vehicle service centres around the city centres, neighborhood, in return this has attracted a motor vehicle parts Motor vehicle spare parts dealers in Nairobi CBD in the lower part of Nairobi Central Business District (NCBD) along Kirinyaga Road.

Studies 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) and outward resistance from taxpayers for example the protest by taxpayers over implementation of Electronic Tax Registers. This does not exempt the vehicle dealers as there have been claims on tax evasion from them.

1.2 Research Problem

Tax compliance is a major problem for many tax authorities and it is not an easy task to persuade taxpayers to comply with tax requirement even though 'tax laws are not always precise' (James and Alley, 2004). Aksnes (2011) discussed some reasons why taxpayers may be non-compliant and these include flexible tax morale; low education; rules that are too complicated to follow; taxable activities that are manipulated to avoid tax; a perception that the risk of being caught is low; aversion towards the public sector; and a culture of corruption.

Although V.A.T is an important contributor to total government tax revenues accounting for over 30% of the revenues, the complexity its implementation requires the cooperation of the tax-payers making taxpayer education very paramount. Odusola (2006) posits that revenue realized from V.A.T is low because of the low level of literacy, poor relationship between taxpayers and income tax authorities, and the inadequate number, or complete absence, of trained and qualified accountants on the staff of the tax authorities. Kenya suffers from revenue loss due to the problems of tax non-compliance and tax evasion. On average, about 30 per cent of all taxpayers fail to submit their V.A.T returns, and many each year face prosecution for failing to file complete returns (Onditi, 2013). Motor vehicle parts dealership in Nairobi is characterized by micro, small and medium enterprises, and is fairly unregulated making administration a challenge, and giving rise to high cases of tax evasion (Oloro, 2006 and Mwambingu, 2013). Maina (2007) avers that the low level of tax compliance by motor vehicle part dealers comes from a number of factors which include lack knowledge in accounting and tax laws. Firms in motor vehicle spare part business face problems in tax compliance due to lack of knowledge on V.A.T tax administration and bad attitude towards taxation in general (Gachie, 2013). This, thus, calls for tax education within the sector.

Although knowledge about taxation is assumed to be important for preference and attitudes towards taxation and compliance thereof, there is little research that explicitly considers how taxpayers' education influences tax compliance (Olowookere and Fasina, 2013). Most of the researches done tax compliance have, however, concentrated on the effects various penalties and inducements have on overall decision to comply (Olowookere and Fasina, 2013). Simiyu (2003) did a study on factors influencing taxpayers' voluntary compliance among local authorities. This study, therefore, seeks to fill-in the knowledge gap by answering the following questions: to what extent has taxpayer education

been conducted in the motor vehicle spare parts dealers? How has the taxpayer education impacted on the motor vehicle spare parts dealers' attitude towards taxation and the consequent compliance?

1.3 Objective of the Study

To determine the effects of taxpayers' education on the level of Value Added Tax compliance among the motor vehicle spare parts dealers in Nairobi CBD.

1.4 Value of the Study

The government will use information obtained from the study as a basis for policy formulation of tax education by businesses in auto spare parts and also in the formation of strategies to promote an enabling environment for their tax compliances. The findings of the study will assist KRA to determine the main barriers to compliance and establish proper and adequate mechanisms to be adopted to ensure success of the program.

The researchers, scholars and academicians will find the report valuable in understanding one of the fastest growing sectors of the economy: motor vehicle spare parts dealers. The study will thus contribute to the existing body of knowledge in the area of compliance. The finding of the report was used as a basis for further research on this subject. This research may also reduce the need to reinvent the whole wheel every time a study on motor vehicle parts business is conducted.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter looks at the impact of taxpayers education on Value Added Tax compliance from a theoretical perspective citing the works of different authors outlining arguments for and against in relation to the study. This information is sourced from different publications for instance; magazines, journals, articles, books amongst others.

2.2 Theoretical Review

To begin with, a theory is a scientific phenomenon that has been tested and proven over time. Attempts to provide a theoretical grounding to the practice of taxation are reflected in taxation theories, the evolution of which took place together with the development of various directions in economic thought.

2.2.1 Optimal Taxation Theory

Optimal tax theory is the study of how best to design a tax to minimize distortion and inefficiency subject to raising set revenues through distortionary taxation (Mayshar, 1990). Development of the theory of optimal taxation began in the nineteen seventies, though its origins go back forty years to a 1927 paper by the short lived genius, Frank Ramsey. The basic premises of the theory are that a government wishes to raise a given sum through taxation that taxes distort economic choices, and the question at issue is how the taxes should be set in order to minimize the distortion which does occur (Mankiw, Weinzierl and Yagan, 2009).

A neutral tax is a theoretical tax which avoids distortion and inefficiency completely (Ramsey, 1927). Other things being equal, if a taxpayer must choose between two mutually exclusive economic projects (investments) that face the same pre-tax risk and returns, the one with the lower tax or with a tax break would be chosen by the rational actor. With that insight, economists argue that generally taxes distort behavior (Slemrod and Yitzhaki, 1996).

The theory of optimal taxation is normative, essentially assuming that policy is made by a benevolent dictator who respects individual preferences as well as some 'social' preference for equality. One can choose to dismiss this body of theory by pointing out that actual policy makers typically represent specific interest groups and that actual policies tend to reflect some compromise between conflicting interests rather than the maximization of a Bergson-Samuelson social welfare function (Auerbach, 1986) .

Optimal Taxation Theory is a welfarist approach, meaning that it considers distributive justice to be solely some function of individual utility. Optimal tax theory recognizes the indeterminacy of comparing utility across different human beings. The foundational piece in the optimal tax literature relating to distributive justice is Mirrlees' 1971 paper. Mirrlees (1971) assumes that individuals differ only on one exogenous characteristic—ability—which determines their utility and wage rate. V.A.T compliance adopts a uniform computational method which proportionately apply to all Motor vehicle spare parts dealers in Nairobi CBD; being about equality.

2.2.2 Presumptive Taxation Theory

Presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts. According to Ahmad and Stern (1991), presumptive

taxation covers a number of procedures under which the `desired' base for taxation (direct or indirect) is not itself measured but is inferred from some simple indicators which are more easily measured than the base itself. It indicates that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method (Thuronyi, 1996).

According to Thuronyi (1996), presumptive techniques may be employed for a variety of reasons. One is simplification, particularly in relation to the compliance burden on taxpayers with very low turnover (and the corresponding administrative burden of auditing such taxpayers). A second is to combat tax avoidance or evasion (which works only if the indicators on which the presumption is based are more difficult to hide than those forming the basis for accounting records).

Third, by providing objective indicators for tax assessment, presumptive methods may lead to a more equitable distribution of the tax burden, when normal accounts-based methods are unreliable because of problems of taxpayer compliance or administrative corruption. Fourth, rebuttable presumptions can encourage taxpayers to keep proper accounts, because they subject taxpayers to a possibly higher tax burden in the absence of such accounts. Fifth, presumptions of the exclusive type can be considered desirable because of their incentive effects—a taxpayer who earns more income will not have to pay more tax. Finally, presumptions that serve as minimum taxes may be justified by a combination of reasons (revenue need, fairness concerns, and political or technical difficulty in addressing certain problems directly as opposed to doing so through a minimum tax) (Thuronyi, 1996).

2.2.3 Flat Rate Model

A flat tax is a tax system with a constant marginal tax rate. Typically the term *flat tax* is applied in the context of an individual or corporate income that was taxed at one marginal rate (Rabushka, 1995)

Unlike the current system, a flat tax is simple, fair, and good for growth. Unlike the current system, which discriminates based on the source, use, and level of income; a flat tax treats all taxpayers equally, fulfilling the "equal justice under law" principle. And unlike the current system, which punishes people for contributing to the nation's wealth, a flat tax would lower marginal tax rates and eliminate the tax bias against saving and investment, thus ensuring better economic performance in a competitive global economy (Forbes, 2005).

2.3 Determinants of Value Added Tax Compliance

2.3.1 Tax Knowledge and Education

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

Taxation knowledge is necessary to increase public awareness especially in areas concerning taxation laws, the role of tax in national development, and especially to explain how and where the money collected is spent by the government (Mohd, 2010). Attitude towards tax compliance can be improved through the enhancement of taxation knowledge. When a taxpayer has a positive attitude towards tax, this will reduce his or her inclination to evade tax payment.

2.3.2 Fines and Penalties

Fines and penalty rates may substitute each other due to their multiplicative linkages as long as

neither of them is set to zero (Kirchler et al 2007). Higher fines simply make evading taxes more hazardous for taxpayers and should deter them from evasion. Empirically, the deterrent effect of fines could not always be supported. The observed effects were weaker than expected and some studies even suggest that an increase of penalties can have undesirable effect and result in more tax avoidance (Kirchler et al, (2007). Alm et al., (1992) supports the evidence that fines do affect tax compliance though the impact was virtually zero. Friedland *et al.*, (1978) compliance was strongly affected by the amount of fines than by audit probabilities. Several studies however found no support for the deterring effects of fines since it was weak (Andreoni, 1998). Some of the findings suggest that a policy based on deterrence is effective only in combination with frequent Audits (Kirchler et al., 2007).

2.3.3 Perceived Opportunity for Tax Evasion

Business owners are often mentioned as a high-risk group in terms of tax compliance because their opportunities to evade are high. Opportunity has often been documented as a major explanatory factor in non-compliance (Webley, 2004). In particular, if incomes are not subject to automated third-party reporting, or if taxes are not withheld at source (e.g. in cases of receiving gross incomes or cash payments), opportunities to evade taxes exist (Williams and Round, 2009).

The link between opportunity and non-compliance seems to have at least two different facets. First, in cases where people do not deliberately capitalize on opportunities, the specific circumstances leading to evasion opportunities might still lead to non-compliance. Opportunities usually come about when tax filings are not entirely automated. Through the lack of automation tax filing procedures are more likely to become error prone even without intent to capitalize on the entailed

opportunities.

Consequently, opportunities may lead to an increase in intended as well as unintended non-compliance. For instance, Robben et al. (1990b) show that an experimentally induced opportunity to cheat (more possibilities to deduct non-deductible expenses) increased non-compliance regardless of whether the participants actually intended to be non-compliant or not.

2.3.4 Tax Environment Policy

Compliance costs tend to increase with the number of taxes that an entrepreneur is subject to, the complexity of the tax rules, the frequency of submitting tax returns, and the number of levels of government involved in levying and collecting tax (Tanzi and Zee, 2000). For example, in most countries, businesses must contend with a V.A.T system (unless the business falls under a V.A.T exemption threshold) not faced by an employee. Business income tax also introduces complexities not relevant to an employee that pays tax only on labour income and non-business investment income. Complexities may multiply where more than one level of government is involved in levying and/or administering a tax and rules and procedures are not well co-ordinate (Thisen, 2003).

This outcome, with small businesses placed at a competitive disadvantage relative to larger firms, implies an inefficient allocation of capital, with underinvestment in small businesses relative to a situation where the fixed component of compliance burden on small businesses is lessened through simplification measures (Thisen, 2003). Thus, reduced compliance costs can bring improved efficiency resulting from more uniform tax treatment of businesses. A second efficiency consideration is that increased compliance, when resulting in increased tax revenues, may enable reduced effective tax rates on one or more possibly more elastic tax bases, with possible efficiency gains (Adams, 1993).

Simplification provisions of various types can be expected to impact small businesses differently, given the heterogeneity of the small business population. In particular, certain measures may directly encourage business creation and tax compliance for some small businesses, but not others, suggesting the need to analyze a range of measures (Wickerson, 2003). For example, allowing simplified accounting or less frequent filing of tax returns may be of little practical consequence to small businesses with very low turnover (e.g. street vendors) that may regard the tax compliance burden of a relatively simple regular tax system as excessive (Glenday, 2002).

With assistance of professional tax advisors who know about the loopholes in tax law, businesses engage in tax avoidance (Slemrod, Blumenthal, and Christian, 2001). Tax results depend on definitions of legal terms which are usually vague. For example, vagueness of the distinction between "business expenses" and "personal expenses" is of much concern for taxpayers and tax authorities. More generally, any term of tax law, has a vague penumbra, and is a potential source of tax avoidance (Pasternak and Rico, 2008).

2.3.5 Tax policy reforms and tax administration reforms

Commenting on the ability of local authorities to levy and collect tax revenues from peasant farmers, Davey, (1974) indicated that it is crucial for the local authority to have knowledge in identifying individual members of predominantly rural and self-employed population, assessing their means and extracting money from them. He emphasized that taxing farmers so as to release additional output without curbing their enterprise was eminently one for local efforts, since it is only in the locality that their taxable capacity can be discovered adequately.

This can be easily achieved if it is apparent to the tax payer that a substantial part of the revenue is spent on providing goods and services that benefit the rural community.

2.4 Empirical Literature

Adari (1997) indicates that tax reform has raised the productivity of the tax system with the exception of sales tax/V.A.T in spite of the base growing faster than the income. In Kenya, V.A.T has been perceived as a tax of the future and one that was to shift the tax structure away from direct taxation towards consumption taxation. There has been a low response of revenue from V.A.T seems to have performed dismally despite the perception and the high expectations that followed its introduction. Christina, Deborah and Gray (2003), Conducted a study to determine the economic and behavioral factors affecting tax compliance among taxpayers in the United States of America. The objective of the study was to determine the economic and behavioral factors, affecting the tax compliance among tax payers, in the Arkansas City tax penalty amnesty system.

Arkansas City had announced an amnesty system, whereby the non-compliant traders were waived of the penalties and fines provided that they were ready to pay their tax liability supposed to be paid and they did not pay. Using questionnaires administered to the participants of this amnesty program, the respondents identified factors that made them not to pay their taxes due, within the statutory period and not declaring the correct taxable income, as complexity of the tax laws, ability to pay, ignorance of the tax laws, and the perceptions of high tax rates and unfairness of the tax system. A significant portion of non compliance was unintentional, caused by the complexity of tax laws and ignorance, as most of the tax payers did not understand their tax liabilities or their tax obligations.

The results confirmed that there was a significant positive relationship between taxpayers' knowledge of the tax matters, and the voluntary tax compliance. However there is need to carry out a similar study, because the environment in which the study was carried out is different. Rasshid and Noor (2004) conducted a study to evaluate the influence of tax knowledge on the tax compliance behavior among the taxpayers in Malaysia. The objective of the study was to investigate the effect of the presence of tax knowledge and understanding, on the level of tax compliance behavior. Analyzing the data collected using questionnaires, to compare the compliance behavior of taxpayers with significant level of tax knowledge with those without tax knowledge. Statistical findings, confirmed that those with tax knowledge, had higher level of compliance than those without.

The results indicated a significant relationship between the level of tax knowledge and the level of tax compliance. Nevertheless there is need to carry out similar study presently, because the environment, in which the study was carried out is different, and the study only compared the behavior of those taxpayers with significant level of tax knowledge to those without tax knowledge. The study to be conducted need to establish and incorporate the relationship between the level of tax compliance.

Therkildsen (2004) said that the act of tax counseling improves on tax compliance of tax payers, hence increasing performance in revenue collection in a country. He found out that the objective of tax counseling is to assist taxpayers in matters related to tax and encourage the voluntary submission of accurate tax returns and payment of taxes. Generally, tax counseling offices provide advice on the interpretation and application of tax laws, procedures for filing returns and applications. Ahmed and Braithwaite (2005) compared a sample of Australian small business owners with employed taxpayers and found that they did not differ in terms of the following factors: subjectively perceived deterrence

from non-compliance; subjective probability of being caught for tax evasion; preference for aggressive tax planning; cooperation with and resistance against tax authorities; attitudes towards equity issues; personal norms of tax honesty; tax morale; and the level of admitted tax evasion.

Ayoki et al (2005) argues that low tax compliance is a matter of serious concern in many developing countries, limiting the capacity of their governments to raise revenues for developmental purposes. They further said it is commonly acknowledged that many factors contribute to this weakness: corruption, a large informal sector, weak legal systems, ambiguity in tax laws, high marginal tax rates, paucity of adequate information and accounting systems, a culture of noncompliance, and ineffective tax administration. Kakembo (2007) said that attitudes and intentions to pay taxes also greatly affect the level of tax payers' compliance. A taxpayer with high intentions to pay will always have a positive attitude towards meeting his tax obligations and hence likely to be very compliant.

The prompt payment of all taxes is a critical concern of all nations because it is positively associated with economic growth, IMF (2007). Prompt payment of tax is important and is a tool for redistributing income since it increases revenue collection. Matovu et al (2009) added that there is no doubt that tax compliance is a national issue and of high interest to government. Kakembo (2007), in his study revealed that tax compliance is significantly positively related to revenue collection. Mutuality one of the components of relational norms was also found to be significantly related to tax compliance. He said Intention to pay taxes is also significantly positively related to attitudes and tax compliance which would help to increase on domestic revenue. He further said that relational norms greatly influence the tax payer's intentions to pay taxes. Attitudes and intentions to pay taxes also greatly affect the level of tax payer's compliance.

Kayaga (2007), did a study of Tax Policy Challenges Facing Developing Countries. The study was conducted in the context of Uganda. The findings demonstrated that Uganda's approach to tax policy does not take into consideration prevailing domestic social phenomena like the HIV/AIDS epidemic, the ongoing civil war in Northern Uganda, the expanding informal sector, and barriers to effective tax administration, all of which are rapidly eroding the tax base. The study concludes that the Ugandan Government should focus tax policy on promoting equity, participation, and growth for all sectors of the population.

Normala (2007) conducted a study to examine the influence of tax education, as a proactive approach to enhance the voluntary tax compliance, among the taxpayers, in Malaysia. There as a move from the official assessment of taxes, to self-assessment system, in 2004. Under the self-assessment system, tax payer has to his tax liability, pay taxes to revenue authority, later on the revenue authority conducts audit to establish the accuracy of the declarations in returns and payment. This system requires high voluntary tax compliance. Using questionnaires administered to the taxpayers and the tax officials, the respondents confirm the increase in the tax knowledge increase the level of voluntary tax compliance. The statistical findings, confirm that there is a significant relationship between the level of tax education and voluntary tax compliance.

Aruwa (2008) did a study on the relevance and the problems of Value Added Tax (V.A.T) in Nigeria. He surveyed Vatable Nigerian organizations, revenue staff and the public to gain insight into how V.A.T is administered, its relevance in revenue generation, savings and consumption of consumers and the problems hindering its efficiency. Both secondary and primary data were used and descriptive statistics as tool for analysis. The survey shows that a majority of the Federal Inland Revenue Service

(FIRS) staff perceive that they are not adequately equipped technically and administratively to handle V.A.T operations, V.A.T able organizations have inappropriate knowledge of V.A.T operations, the government at the three tiers in Nigeria have raised substantial revenue from V.A.T but it is presently perceived as been underutilized due to high rate of tax evasion, lack of record keeping by business enterprises, use of unqualified FIRS staff and low V.A.T education is found among the V.A.T able organizations and the public. It was found that these organizations treat V.A.T as cost contrary to expectations. Evidence from the way V.A.T revenue is being shared among the three levels of government in Nigeria suggests that this revenue is being re-injected into the economy through public expenditure. Kamau, Mutiso and Ngui (2012) did a study on tax avoidance and evasion as a factor influencing 'creative accounting practice' among companies in Kenya. The study randomly collected and analyzed data from 36 accountants working for various companies in Kenya. The results of the study established creative accounting is widely practiced among companies in Kenya and that tax avoidance and evasion the major factors contributing to practice of creative accounting.

Machogu and Amayi (2013) did a study on the effect of taxpayer education on voluntary tax compliance, among Motor vehicle spare parts dealers in Nairobi CBD. Specifically, the study looked at the level of taxpayer education among Motor vehicle spare parts dealers in Nairobi CBD, the level of voluntary tax compliance among the Motor vehicle spare parts dealers in Nairobi CBD and the effect of taxpayer education on the level of voluntary tax compliance among entrepreneurs. The study used both primary and secondary data. From the findings: 85% of the respondents, admitted to have gained understanding on the basic tax laws and procedures; 78.7% of the respondents agreed that through the taxpayer education, they had been able to understand and become aware of their taxpayer rights and obligations; 83% of the respondents agreed that taxpayer education helped them in understanding

clearly the procedure of paying taxes. Besides, culminating from the tax education: 80% of the returns were lodged timely of which 67% declared accurate tax liability, while the remainder contained errors; and, 78% of those who were required to pay taxes, paid within the stipulated time frame according to the law. Onditi (2013, in Kenya. The findings indicated that three key aspects distinguish small business owners' perceptions of their tax situation: small business owners are likely to perceive more opportunities not to comply than employed taxpayers; they are more likely to experience a lack of meaningful taxation knowledge; and they are more likely to face decision frames that render taxes as painful losses.

2.5 Summary of Literature Review

The above literature has clearly established tax compliancy has direct effect on the domestic revenue collection of a country, implying that an increase in the number of tax compliant persons in a country leads to increased revenue collection. This can help the country to realize its goals and objectives as set out in the budget and that's why the growing concern of tax administrations throughout the world is on how to simplify and encourage voluntary tax compliance. However, the literature fails to establish the effect of taxpayers' education on V.A.T compliance. This creates the need for the tax agents to improve their image by building trust and public confidence. The research was carried out using descriptive design in soliciting for information. From all the studies reviewed above, it's clear that past research has tried to study the area but from a shallow perspective and no one has actually done the research in Kenya hence, the research tried to seek solutions to the problem statement which are mentioned later in chapter four and five.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter is a blueprint on how the research was conducted. It outlines the research design, target population, sample design and procedures, data collection instruments, data analysis, limitations of the study and research ethics.

3.2 Research Design

The study employed a descriptive research design. According to Kothari (2012), descriptive research design includes enquiries on phenomena or association among them and describes the data in order to draw conclusions about the population characteristics or phenomenon being studied. A researcher in this context seeks to measure such items as for example, frequency of shopping, preferences of people, or similar data.

Additionally, the description is accurate, factual and systematic making it appropriate for the study. Descriptive approach was integrated with survey design so as to collect comprehensive qualitative and quantitative data that enriches the outcome of the study. Therefore, the approach enabled the study establish the effects of taxpayers' education on V.A.T and the level of compliance.

3.2 Target Population

The study targeted all the motor vehicle spare parts dealers in the Nairobi CBD as the population of the study. Nairobi CBD is composed of 33 streets and an estimated number of 97 motor vehicle part dealers (Nairobi City Council, 2013).

3.3 Sample Design

The study used probability sampling and there after stratified random sampling method in gathering information from the respondents. Stratified random sampling technique ensured that all motor vehicle spare parts dealers within all the streets within the CBD are included in the sample. Stratification will achieve at this by grouping the heterogeneous population into homogenous subsets (per street) to ensure representativeness. Random sampling technique was used to sample individual dealers within the stratum as it eliminates bias since each member of the target population has an equal chance or probability of being selected.

3.4 Data Collection

The study collected primary data. Semi-structured questionnaires were used; that is, with open and close-ended questions for qualitative and quantitative data respectively. Questionnaire as research instrument for data collection was considered as they are less costly, use less time, require less administration effort inherent in instruments like interviews and useful in obtaining objective data (Marshall and Rossman, 2006). Furthermore, questionnaires have standardized answers that make it simple to compile data. The study targeted one person per motor vehicle parts dealers; either business owners or managers.

Questionnaires gave the respondents adequate time to respond to the questions owing to their busy schedules. The research study mostly relied on primary data but also secondary data to some extent was considered depending on the relevance and the validity of the secondary data to my research study.

3.4.1 Data Validity and Reliability

A pilot test was conducted on 10 motor vehicle parts dealers in Industrial area to test the reliability and validity of the research instruments. Based on their response and comments the questionnaire was reviewed to accommodate any changes. Reliability which is defined as a measure of the degree to which a research instrument yields consistent results or data after repeated trials was carried out to test the internal consistency of the measurements (Mugenda and Mugenda, 2003).

Reliability was tested using Cronbach's Alpha with a predetermined threshold of 0.7 (Marczyk, DeMatteo and Festinger, 2004). Values above 0.7 indicate presence of reliability while values below signified lack of reliability.

Validity is the accuracy and meaningfulness of inferences, based on the research results. Face, construct and content validity was measured by seeking the opinion of lecturers and other professionals (in tax administration) on the adequacy of the research instruments in achieving the objectives of the study. Based on their opinions, the instrument was adjusted by deleting and adding some questions or by changing the structure or lexical density of questions as appropriate

3.5 Data Analysis

The filled-in questionnaires were edited for consistency. The data generated was qualitative and quantitative. Therefore, descriptive analysis techniques were used; consistent with the research design. Using Package for Social Sciences (SPSS 21), the quantitative data was coded to enable the responses to be grouped into categories. Descriptive statistics such as frequencies, percentages, mean and standard deviation was used mainly to summarize the data.

Likert scale was used ranking factors in accordance to their weighted means. Tables, charts and graphs was used in presenting the analyzed data. Qualitative data was analyzed using content analysis. That is, the data was categorized into themes and analysis, thereof, based on the prevalence of the themes and subthemes in addition to their relevance to the topic. This enhanced the descriptive analysis. Multiple linear regression analysis will also be used. The regression analysis was of the form:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$$

Where; Y - Tax Compliance

α - Constant

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

X1 - tax compliance cost

X2 - tax knowledge and education

X3 - tax fines and penalties

X4 - perceived opportunity for tax evasion

ϵ - Error term

The study used analysis of variance (ANOVA) test and t-significance to establish the significances of the relationship between tax payer education and V.A.T compliance. The study used Pearson Correlation analysis to test the relationship between the two variables by measuring the existence, direction (positive or negative) and magnitude of such linear relationship.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The main objective of the study was to investigate the effect of taxpayers' education on the level of V.A.T compliance among the motor vehicle spare parts dealers in Nairobi CBD.

4.2 Response Rate

The study targeted a sample size of 97 respondents from which 82 filled in and returned the questionnaires making a response rate of 85%. This response rate was satisfactory to make conclusions for the study.

4.3 Data Validity

Reliability of the questionnaire was evaluated through Cronbach's Alpha which measures the internal consistency. Cronbach's alpha was calculated by application of SPSS version 20 for reliability analysis. The value of the alpha coefficient ranges from 0-1 and may be used to describe the reliability of factors extracted at 0.5 significance level from dichotomous and or multi-point formatted questionnaires or scales.

Table 4.1: Reliability Coefficients

| Scale | Cronbach's Alpha | Number of items |
|-----------------------------|-------------------------|------------------------|
| Tax Compliance | 0.754 | 5 |
| Tax Compliance Cost | 0.765 | 5 |
| Tax Knowledge and education | 0.814 | 5 |
| Tax Fines and Penalties | 0.803 | 5 |
| Perceived Opportunity Cost | 0.714 | 5 |

Source: Research Findings

A higher value shows a more reliable generated scale. Cooper and Schindler (2008) have indicated 0.7 to be an acceptable reliability coefficient. Table 4.1 shows that Tax Compliance had the highest reliability ($\alpha=0.814$) followed by Tax Compliance Cost ($\alpha=0.803$), Tax Knowledge and education ($\alpha=0.803$), then Tax Fines and Penalties ($\alpha = 0.765$) and Perceived Opportunity Cost ($\alpha=0.754$). This illustrates that all the five scales were reliable as their reliability values exceeded the prescribed threshold of 0.7 (Mugenda and Mugenda, 2008).

4.4 Descriptive Statistics

The descriptive statistic considered was mean and standard deviation. Tax compliance showed a mean of 2.5141 with a standard deviation of 0.0193. This implies that dealers are barely tax compliance. Tax compliance cost had a mean of 3.5141 with a standard deviation of 0.1899 indicating that tax compliance cost is high for the motor vehicle dealers. Tax knowledge and education had a mean of 1.7818 with a standard deviation of 0.5364. The result shows that motor vehicle dealers are not informed and educated on the tax compliance.

Table 4.1: Descriptive Statistics Results

| Variable | Tax Compliance | Tax Compliance Cost | Tax Knowledge and education | Tax Fines and Penalties | Perceived Opportunity Cost |
|-----------|----------------|---------------------|-----------------------------|-------------------------|----------------------------|
| Mean | 2.5141 | 3.5141 | 1.7818 | 3.5641 | 1.25 |
| Median | 6.95 | 8.22 | 48.7728 | 14.395 | 2.68 |
| Minimum | 3.51 | 2.54 | 46.9983 | 96.143 | 1.16 |
| Maximum | 1.74 | 1.411 | 54.9903 | 31.11 | 7.87 |
| Std. Dev. | 1.0193 | 2.1899 | 1.5364 | 1.0034 | 2.36 |

Source: Research Findings

A mean of 3.5641 with a standard deviation of 0.0034 indicates that motor vehicles dealers agreed that they have been fined for tax evasion. Perceived opportunity, with a mean of 1.2515 and standard deviation of 0.3486 does not influence motor vehicles dealers to evade paying tax.

4.5 Correlation Analysis

The study sought to establish the relationship between taxpayers’ education and the level of V.A.T compliance among the motor vehicle spare parts dealers in Nairobi CBD. Pearson Correlation analysis was used to achieve this end at 99%, 95% and 90% confidence levels. The correlation analysis enabled the testing of study’s hypothesis that level of education has a significant effect on tax compliance.

Table 4.2: Correlation Analysis

| | Y | X ₁ | X ₂ | X ₃ | X ₄ |
|---------------------------------------|---------|----------------|----------------|----------------|----------------|
| Tax Compliance | 1 | | | | |
| Tax Compliance Cost | -.775** | 1 | | | |
| Tax Knowledge and Education | -.670* | .521 | 1 | | |
| Tax Fines and Penalties | -.637* | .254 | .214 | 1 | |
| Perceived Opportunity For Tax Evasion | -.042** | -.141 | -.165 | -.468 | 1 |

Author: Research Findings

4.6 Regression Analysis

4.6.1 Model Summary

R-square values present the strength of the relationship between Tax compliance and independent variables. From the adjusted determination coefficients, generally moderately strong linear relationships were established between dependent and independent variables. Adjusted R-square value 0.419 was established. Their R-squared value of 0.423 was established and this implies that 42.3 % of the variation in dependent variable is attributed to the changes in the independent variables. Being that

the DW statistics were close to the prescribed value of 2.0 for residual independence, it can be concluded that there was no autocorrelation.

Table 4.3:Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | .526 | .423 | .419 | .12928 | 1.859 |

Author: Research Findings

4.6.2 Analysis of Variance

Analysis of Variance’s (ANOVA) F-test was used to make simultaneous comparisons between two or more means; thus, testing whether a significant relation exists between variables (dependent and independent variables); thus, helping in bringing out the significance of the regression model.

Since the value ($p=0.038$) were below 0.05, it can be concluded that the regression models were significant

Table 4.4 ANOVA

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|-------|------------|----------------|----|-------------|-------|------|
| 1 | Regression | .290 | 1 | .048 | 2.770 | .038 |
| | Residual | .419 | 4 | .021 | | |
| | Total | .708 | 5 | | | |

Author :Research Findings

4.6.3 Regression Coefficients

Table 4.5: Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|----------------------------|-----------------------------|------------|---------------------------|--------|---------|
| | B | Std. Error | Beta | | |
| (Constant) | .433 | 1.247 | | .347 | .03251 |
| Tax Cost | .002 | .001 | -.427 | -2.797 | .011584 |
| Know & Education | .009 | .055 | .038 | -.170 | .025605 |
| Tax Fines & Penalties | .050 | .105 | .074 | .475 | .030541 |
| Perceived Opportunity Cost | .241 | .021 | -.251 | 1.891 | 0.0188 |

a. Dependent Variable: Tax compliance

b. Independent variables: Tax cost, knowledge and education, tax fines and penalties, tax opportunity cost.

All the explanatory variables are statistically significant at 5% level of significance in explaining the variation in Firm's profitability. $TC = 0.433 - 0.427TC + 0.038KE + 0.074FP - 0.251TOC$

4.7 Discussion of Research Findings

The study objective sought to investigate the effects of taxpayers' education on the level of Value Added Tax compliance among the motor vehicle spare parts dealers in Nairobi CBD. The study finding established that the study variables, tax cost, knowledge and education, tax fines and penalties and tax opportunity cost affect complying with Valued Added Tax (VAT) and other taxes for taxpayers in Kenya. These findings are in line with (Sandford, Godwin and Hardwick, 1989), studies in United Kingdom (UK) in the 1970s and 1980s.

Their findings established that Tax compliance costs as the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities in that these compliance costs is that high tax rates and complex tax legislations can induce fraud. This finding concludes that firms will create a kind of resentment against authorities who impose too high

levies and too complex tax systems. This will incentivize (illegal) tax avoiding systems because of the high financial advantages and the low condemnation rates. In addition, because of the complexity of the system, the companies often need to rely on external tax professionals who by means of sophisticated tax avoidance engineering will minimize tax payments.

The study findings established that influence of knowledge on compliance behaviors has been assessed as one of the factors in compliance is related to the taxpayers' ability to understand taxation laws, and their willingness to comply. The aspect of knowledge that relates to compliance is the general understanding about taxation regulations and information pertaining to the opportunity to evade tax. The study found out that taxation knowledge is necessary to increase public awareness especially in areas concerning taxation laws, the role of tax in national development, and especially to explain how and where the money collected is spent by the government . The study findings also established that attitude towards tax compliance can be improved through the enhancement of taxation knowledge. When a taxpayer has a positive attitude towards tax, this will reduce his or her inclination to evade tax payment.

The study recommended that self-assessment system (SAS) requires taxpayers to understand all the laws and regulations that govern taxation. This is necessary because taxpayers will have to calculate themselves the amount of tax they need to pay and make the payment. These study findings are in line with studies done by Mohani, (2001) which affirms that taxpayers will readily accept any new system introduced, like the SAS, if they have ample knowledge to understand the system. Thus, education programs organized by the tax authority or other public education institutions are

needed to enhance taxpayers' ability to understand Self-assessment system and to increase their confidence in fulfilling their responsibilities as taxpayers. More, their study established that greater education is directly linked to a likelihood of compliance. Educated taxpayers may be aware of noncompliance opportunities, but their potentially better understanding of the tax system and their higher level of moral development promotes a more favorable taxpayer attitude and therefore greater compliance.

Findings on the effect of fines and penalty rates results established that they substitute each other due to their multiplicative linkages as long as neither of them is set to zero. Higher fines simply make evading taxes more hazardous for taxpayers and should deter them from evasion. Empirically, the deterrent effect of fines could not always be supported. The observed effects were weaker than expected and some studies even suggest that an increase of penalties can have undesirable effect and result in more tax avoidance. Alm et al., (1992) supports the evidence that fines do affect tax compliance though the impact was virtually zero. Since the study findings indicate that compliance was strongly affected by the amount of fines than by audit probabilities.

Several studies however found no support for the deterring effects of fines since it was weak some of the findings suggest that a policy based on deterrence is effective only in combination with frequent Audits. From the tax administration viewpoint, researchers have concluded that compliance could be influenced by educating taxpayers of their social responsibilities to pay and thus their intention would be to comply. As a behavior problem, tax compliance depends on the cooperation of the public. There are greater gains in assisting compliant taxpayers meet their fiscal obligations rather than spending more resources pursuing the minority of non-compliers.

Assisting tax payers by improving the flow and quality of information or education them (e.g., TV campaigns) in to becoming more responsible citizens has the potential to yield greater revenue than if it were spent on enforcement activities. The higher the penalty and the potential audit probability the greater discouragement for potential tax evasion.

Indeed, it has been shown that those actually evading perceive increased opportunities to do so. Overall, actual opportunities can increase both intentional and unintentional evasion. Although such a distinction is theoretically and practically meaningful, it is difficult to determine whether filing errors were intentional or not. For example, in a study by Slemrod et al. (2001), taxpayers were informed that their tax files would be closely examined. Those with considerable opportunities to evade, including small business owners, reacted to this message by increasing their tax payments significantly. Even though this might indicate severe tax evasion – as assumed by Slemrod et al. (2001) increased tax payments in response to the prospect of being audited may also originate from increased willingness to avoid errors. Those taxpayers facing high opportunities for evasion might feel less certain about how to pay their taxes correctly (Ahmed and Braithwaite, 2005), and consequently, threats may also elicit partly unintentional over-reporting; just to be on the safe side.

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

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents discussions of the key findings presented in chapter four, conclusions drawn based on such findings and recommendations there-to. This chapter will thus be structured into conclusion, recommendations and areas for further research.

5.2 Summary of Findings

Tax compliance cost was established to be statistically significant at 5% level of significance. A unit increase tax compliance cost will lead to 0.427 units decrease in tax compliance. This implies that the cost incurred by the motor vehicle dealers negatively impacts on their abilities to comply with the tax regulations. The finding is consistent with (Tanzi and Zee, 2000) who postulates that costs tend to increase with the number of taxes that an entrepreneur is subject to, the complexity of the tax rules, the frequency of submitting tax returns, and the number of levels of government involved in levying and collecting tax. Businesses must contend with a V.A.T system not faced by an employee. Business income tax also introduces complexities which increases the cost of tax compliance. Increased compliance affects efficiency resulting from more uniform tax treatment of businesses.

The study finding established that tax knowledge and education has positive impact on tax compliance. Tax knowledge and education is statistically significant at 95% confidence level in explaining the variation tax compliance. A unit increase in tax payer's knowledge in tax and education will lead to 0.038 units increase in tax compliance. According to (Mohd, 2010), taxation knowledge is necessary to increase public awareness especially in areas concerning taxation laws, the role of tax in national

development, and especially to explain how and where the money collected is spent by the government. Knowledge of tax payers on importance of remitting tax, how the state spend the revenue and the consequence of tax evasion helps in improving tax compliance. KRA fines and penalties on tax defaulters have positive effect on tax compliance. As shown in the estimated model above, a unit increase in tax fines and penalties lead to 0.074 units increase in tax compliance. The finding implies that fines imposed on the tax defaulters force tax payers to remit tax to KRA. Higher fines make evading taxes more hazardous for taxpayers and deter them from evasion. Kirchler et al. (2007) suggest that a policy based on deterrence is effective in combination with frequent Audits to improve tax compliance among the tax payers.

The study findings established that influence of knowledge on compliance behaviors has been assessed as one of the factors in compliance is related to the taxpayers' ability to understand taxation laws, and their willingness to comply. The aspect of knowledge that relates to compliance is the general understanding about taxation regulations and information pertaining to the opportunity to evade tax. The study found out that taxation knowledge is necessary to increase public awareness especially in areas concerning taxation laws, the role of tax in national development, and especially to explain how and where the money collected is spent by the government. The study findings also established that attitude towards tax compliance can be improved through the enhancement of taxation knowledge. When a taxpayer has a positive attitude towards tax, this will reduce his or her inclination to evade tax payment.

The study also established that tax opportunity cost negatively impacts on tax compliance by the tax payers. A unit increase in tax opportunity cost leads to 0.251 units decrease in tax compliance. Tax

opportunity cost come with non-automation of tax filings. Consequently, opportunities may lead to an increase in intended as well as unintended non-compliance.

5.3 Conclusion

From the result above in chapter four, the study established that tax compliance cost result to non-compliance of tax by motor vehicle dealers. Costs increase with the number of taxes that an entrepreneur is subject to, the complexity of the tax rules, the frequency of submitting tax returns, and the number of levels of government involved in levying and collecting tax. The cost involved in remitting tax by motor vehicles dealers discourage them from complying with tax. Businesses must contend with a V.A.T system not faced by an employee. Business income tax also introduces complexities which increases the cost of tax compliance. Increased compliance affects efficiency resulting from more uniform tax treatment of businesses people.

Tax knowledge and education positively attributes to low non-compliance of tax by tax payers. Tax payers who are informed on the purposes of paying tax, the rules and regulations of taxation, principle of taxation are more likely to pay tax thereby increasing the level of tax compliance. Fines and penalties imposed by KRA on tax evaders have been established to positively impacts on tax compliance. Tax payers aware of penalties and fines involved for defaulting in tax remittance are more likely to comply with tax regulations. Penalties come in form of heavy fines, revocation of business license and even imprisonment. Higher fines make tax evaders tax compliance and consequently result to tax compliance. The findings revealed that tax opportunity cost has negative effect on tax compliance. Lack of tax automation filing procedures has contributed to tax non-compliance

by motor vehicles dealers. Opportunities cost lead to an increase in intended as well as unintended non-compliance.

Finally, the study concludes that tax knowledge and education has a significant effect on tax compliance. It is therefore prudent for the tax system to enhance education on how to file tax returns and the importance of paying tax.

5.4 Recommendations

Based on the study findings, KRA authority should introduce automation of tax fillings to reduce the cost of tax filling. Introduction of tax filling automation increases the level of tax compliance and this increase the revenue collection by the central government. Tax authority has enhance their capability to investigate all income reported to them to enhance accountability.

The public should be educated on the tax policies and regulation. Public awareness need to be enhanced on the benefits of paying tax to change the attitudes of tax payers on tax remittance. Tax payers should be educated to understand that they should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period. Tax authorities should enhance the probabilities of detecting tax defaulters by assessing the exact income generated by tax payers. KRA needs to enforce rules and regulation as enshrined in the taxation act. Tax evaders should be subjected to the rule of law and punished. Strict rules should be imposed by tax authority to reduce incidence of tax evasion by tax offenders.

Tax officials should be exposed to adequate and continuous training; both at home and abroad, for a better understanding of recent domestic and international tax issues, which could then be utilized, to

formulate successful tax compliance strategies. The working conditions of tax officials also need to be improved in order to motivate them to carry out their duties in a more efficient and professional manner.

The capability to detect fraud or evasion is crucial to tax compliance. As it would not be practical to audit all cases, the fear of being caught would be sufficient to act as a deterrent. Ideally, when a case is selected for audit a tax official will be required to visit the premises of the taxpayer. The tax returns will have to be scrutinized under the supervision, or be jointly examined with a senior tax official so that the discretionary powers being exercised by tax officials are not abused. The tax authorities should undertake criminal prosecution in respect of cases involving fraud or evasion, and where appropriate publish the names of tax evaders which will act as a deterrent

Finally, perceived opportunity for tax evasion has a significant effect on tax compliance, therefore the tax system should target all motor vehicle dealers at all levels of turnover to seal loopholes that may encourage tax evasion. Tax systems should also enhance surveillance and monitoring to ensure that all the taxpayers are brought into the tax net. Specifically, motor vehicle spare part dealers, registering of all the firms for VAT should be done to ensure that they are obliged to file their returns.

5.5 Limitations of the Study

The main limitation of the study was the inability to include all motor vehicle spare parts dealers in the Nairobi CBD, that is licenced and non licenced motor vehicle spare parts dealers in the Nairobi CBD. The findings of the study therefore may not necessarily reflect the true position for the all motor vehicle spare parts dealers in the Nairobi CBD due to the differences in their supervision and reporting.

The time period captured in the study was also limited . This meant that only data for study year was used. While all the data collected was used in the analysis, the limited period of time can portentially affect the interpretation of the findings. The study would have benefited from an extended period of time from which extensive data would have been collected.

The study concentrated on only Motor Vehicle Spare Part dealers in Nairobi Central Business district. the findings of the study therefore may not necessarily reflect the true position for the all motor vehicle dealers in kenya, however it should be extended to other parts of the country. The study was also carried out only on one line of business. It should be carried on other lines to obtain objective conclusions as different industries and sector have different operational environment.

The study concentrated only on VAT form of tax while there are other forms of taxation such as income tax, customs and excise among others. Other forms of taxation have a significant influence on compliance. This should be put into consideration on future researches.

5.6 Suggestions for Further Research

The study suggests that similar studies should be done on other firms as the relationship adduced does not conform to the rule of thumb or one-size-fits-all mantra as different industries and sector have different operational environment. This might affect the relationship between tax payer's education and tax compliance. There is need for further studies to carry out similar tests for a longer time period of time.

In future, researchers should replicate this study to cover the whole country. A study on the self-assessment system can also be carried out to determine its effectiveness on enhancing tax

compliance levels. Further the study should also put into consideration the influence of Economic conditions on tax compliance.

As measures are being put in place to get business owners register their businesses, it is recommended that the registrar to intensify the efforts in order to get complete records. This will ensure adequate records on private businesses be it small, medium or large and help draw them into the tax net. This will increase domestic revenue generation and subsequently good governance.

Again, as the study revealed, most motor vehicle spare part dealers are unaware of the tax system in Kenya. Some people do not even know what constitute Value Added Tax. It is therefore recommended that the KRA educate the public on understanding the tax system, record keeping as mentioned earlier on, the basis of computing their V.A.T return. This can be achieved through tax education seminars and talks organized at periodic intervals and such media, as television, posters, radio, handbills and mobile vans should be used to assist tax campaigns. To ensure that the intended target is fully reached, it is also recommended that education be given in the local languages of the people who are being educated.

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APENDICES

APPENDIX I: QUESTIONNAIRE

My names are Mercy Ndirangu, a Masters of Business Administration student at the University of Nairobi. I am undertaking an academic research on “THE EFFECT OF TAXPAYER EDUCATION ON VALUE ADDED TAX COMPLIANCE BY MOTOR VEHICLE PART DEALERS IN NAIROBI CENTRAL BUSINESS DISTRICT”. The following questionnaire has been designed to capture the views and information from target respondents for the purpose of this study. The collected data was analyzed and appropriate recommendations used for the benefit of the taxpayers. The information given by the respondent shall be handled in strict confidentiality. I humbly request you to spare a few minutes of your time to answer the following questions as objectively as possible. Your cooperation is highly appreciated.

Instructions: Please read the questions and answer them either by filling in the blank spaces or ticking the check boxes [/] or tables

PART A: GENERAL INFORMATION

1. Name of the business

.....

2. What is your highest level of education?

Primary School [] Secondary school [] Tertiary education [] University education []

3. For how long have you been operating in this sector?

0 – 2 years [] 3 – 5 years [] 6 – 10 years [] 10 years & above []

4. What is your monthly turnover?

Up to 10000 [] 10001 – 20000 [] 20001 – 30000 [] Above 30001 []

5. Have you attended/passed any formal taxation course/training organized by KRA?

(i) Yes [] (ii) No []

6. Have you ever been audited by KRA?

(i) Yes [] (ii) No []

(iii) If Yes, how many times?.....

7. Do you have a tax compliance certificate?

(i) Yes [] (ii) No []

SECTION B: TAX COMPLIANCE LEVEL

| | | | | | |
|---|--|---|---|---|---|
| Tick Appropriately. | Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly | | | | |
| | 1 | 2 | 3 | 4 | 5 |
| The business files its tax returns on time | | | | | |
| The business pays the right amount of taxes on time | | | | | |

SECTION C: TAX COMPLIANCE COST

| | | | | | |
|--|---|---|---|---|---|
| Tick Appropriately. | Very High (1) Low (2) fair (3) High(4) Very High (5) | | | | |
| | 1 | 2 | 3 | 4 | 5 |
| How do you rate the cost of filing a tax return | | | | | |
| How do you rate the cost of hiring a tax agent | | | | | |
| How do you find the cost of travelling in order to file a return | | | | | |

SECTION D: FINES AND PENALTIES

| Tick Appropriately. | Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly | | | | |
|---|--|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| The penalty rates are very low and I can afford to pay | | | | | |
| The enforcement is very weak | | | | | |
| I believe that the penalty is lower than my tax saving due to not | | | | | |
| Serious enforcement and penalty by the KRA may result if I do not comply | | | | | |

SECTION E: PERCEIVED OPPORTUNITY FOR TAX EVASION

| Tick Appropriately. | Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5) | | | | |
|--|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| Since the supporting documents do not need to be sent to the KRA, | | | | | |
| If detected not reporting my exact income, I believe that the tax authority is tolerant towards my offence and most probably it will | | | | | |
| I believe the tax authority has limited capability to investigate all income reported to them so I have an opportunity not to report my | | | | | |
| I believe that the probabilities of being detected by the tax authority | | | | | |

SECTION F: TAX KNOWLEDGE AND EDUCATION

| Tick Appropriately. | Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5) | | | | |
|--|--|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| I know how to declare actual income received from all sources to | | | | | |
| I know how to keep records/documents pertaining to income and expenditure for a period of seven years after submission of the Tax | | | | | |
| I understand that I should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period | | | | | |
| I know I should obtain a tax payer identification pin number | | | | | |
| I know which income should be included or excluded in determining the taxable income | | | | | |

THANKS FOR YOUR COOPERATION

APPENDIX II: SUMMARY OF INFERENTIAL TABLE RESULTS

Correlation Analysis

| | Y | X ₁ | X ₂ | X ₃ | X ₄ |
|---------------------------------------|---------|----------------|----------------|----------------|----------------|
| Tax compliance | 1 | | | | |
| Tax compliance cost | -.775** | 1 | | | |
| Tax knowledge and education | -.670* | .521 | 1 | | |
| Tax fines and penalties | -.637* | .254 | .214 | 1 | |
| Perceived opportunity for tax evasion | -.042** | -.141 | -.165 | -.468 | 1 |

Author: Research Findings

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | .526 | .423 | .419 | .12928 | 1.859 |

Author: Research Findings

ANOVA

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|-------|------------|----------------|----|-------------|-------|------|
| 1 | Regression | .290 | 1 | .048 | 2.770 | .038 |
| | Residual | .419 | 4 | .021 | | |
| | Total | .708 | 5 | | | |

Author :Research Findings

Regression Coefficients

Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|----------------------------|-----------------------------|------------|---------------------------|--------|---------|
| | B | Std. Error | Beta | | |
| (Constant) | .433 | 1.247 | | .347 | .03251 |
| Tax Cost | .002 | .001 | -.427 | -2.797 | .011584 |
| Know & Education | .009 | .055 | .038 | -.170 | .025605 |
| Tax Fines & Penalties | .050 | .105 | .074 | .475 | .030541 |
| Perceived Opportunity Cost | .241 | .021 | -.251 | 1.891 | 0.0188 |

a. Dependent Variable: Tax compliance

b. Independent variables: Tax cost, knowledge and education, tax fines and penalties, tax opportunity cost.

Appendix III: Budget

| Item | Amount (Shs) |
|-----------------------------|---------------------|
| Travelling expenses(to CBD) | 10,000 |
| Research assistant wages | 10,000 |
| Photocopier services | 4,000 |
| Printing services | 6,000 |
| Internet services | 3,000 |
| Stationery | 1,000 |
| Miscellaneous expenses | 1000 |
| TOTAL | 35,000 |
| | |

Source, Researcher (2014)