FACTORS AFFECTING RENTAL INCOME TAX COMPLIANCE AMONG LANDLORDS IN KILIFI MUNICIPALITY

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Factors affecting rental income tax compliance
DECLARATION

This research project is my original work and has not been presented for examination in any other University.

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DEDICATION

I dedicate this research work to my lovely family in particular my wife Janice, my son Joseph and daughter Joy for their ever growing support in my life especially during the process of my studies at Kenyatta University. Further dedication goes to my creator for giving me the necessary strength and encouragement in my life.
ACKNOWLEDGEMENT

This work has been a result of collective efforts of many stakeholders ranging from institutions to individuals. I may not mention all of them but through this sentence I wish to appreciate their support without apportioning the level of appreciation. But my supervisor Mr. James Rugami cannot go without my special acknowledgement for his relentless support and guidance. My lecturers who imparted cutting edge knowledge and skills during the course also deserve a special mention on this page.
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### ABBREVIATIONS AND ACRONYMS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>IEA</td>
<td>Institute of Economic Affairs</td>
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<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<td>SAPs</td>
<td>Structural Adjustment Programmes</td>
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<td>SPSS</td>
<td>Statistical Package For Social Sciences</td>
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<td>USA</td>
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<td>VAT</td>
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ABSTRACT

An effective and efficient tax administration system is integral to any country’s well being. There are many challenges that hamper the setting up of an efficient and effective tax system in Kenya. Despite the fact that there are many studies related to tax compliance for developed country, there is however paucity of study on tax compliance for developing countries especially for Kenya. The general objective of this study was to investigate factors affecting rental income tax compliance among landlords in Kilifi Municipality in Kenya. This study adopted a descriptive survey design. The target population of this study was all landlords in Kilifi municipality while the accessible population was those landlords residing within the municipality. Simple random sampling and convenience sampling was used to identify individual respondents. The study aimed to reach out to a sample of at least 400 respondents but only 163 responded and returned the questionnaires. Primary information was gathered by use of a structured questionnaire. Questionnaire responses were sorted, coded and input into the statistical package for social sciences (SPSS) for production of diagrams, tables, descriptive statistics and inferential statistics. Microsoft excel was also used to complement SPSS especially in production of diagrams and tables. The results revealed that landlords felt that they should not be taxed like other Kenyans because they were doing a housing duty which should be provided by the Government. This was further supported by landlords who strongly felt that rental income tax rate was not equitable compared to other business taxes. They felt aggrieved by the tax arrangements and viewed the tax as a burden placed on them by the Government without adequate considerations and consultations. Majority of the respondents felt that payment of taxes was not commensurate of the benefits they get from Government. Also the landlords did not have a very healthy perception towards the revenue authority and the Government in regards to taxation matters and approach. Landlords felt that the Government was not providing them with the investment incentives which are given to other sectors while they were required to meet the same tax obligations. It recommended to the Government and KRA to employ strategies that would improve the perception and integrity of tax payers. The management of taxes should be devolved to very local levels in order for KRA to appreciate the difficulties landlords face when developing their properties in order to know the incentives required to enhance compliance. It is recommended that a further study be conducted to establish whether political regime has an influence of tax compliance while also a replica cross sectional study is also recommended to establish whether the same factors explain tax compliance across various counties in Kenya.
CHAPTER ONE: INTRODUCTION

1.1 Background

The exact meaning of tax compliance has been defined in various ways. Kirchler (2007) perceived a simpler definition in which tax compliance is defined as the most neutral term to describe taxpayers’ willingness to pay their taxes. Similarly, tax compliance is also defined by several tax authorities as the ability and willingness of taxpayers to comply with tax laws, declare the correct income in each year and pays the right amount of taxes on time (IRS, 2009; ATO, 2009; IRB, 2009). Another definition of tax compliance is a person’s act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority (Singh, 2003). Furthermore, tax compliance has also been segregated into two perspectives, namely compliance in terms of administration and compliance in terms of completing (accuracy) the tax returns (Chow, 2004).

The payment of tax is obligatory duty of every citizen whether natural or corporate citizen. As a civic duty, it is expected that citizens will voluntarily comply with such obligation but that is not the case with some citizens. Alm Martinez-Vazquez and Schneider (2003) acknowledged that most people do not like to pay taxes as a result; it is difficult for tax authority to impose and collect taxes anywhere and anytime. Kirchler, Hoelz and Wahl (2008) said that government has primary interest and responsibility in ensuring that citizens follow this civic duty and behave in compliance with provision of tax laws irrespective of their social status.

Goradichenko, Martinez-Vanzquez and Peter (2009) and Vela (2007) stated that tax evasion is a universal and growing phenomenon. Research evidences available have shown that the problems of tax evasion cut across the globe from developing countries to developed countries. For instance, Embaye (2007) also reported that evasion is considerable in U.S with about 16% overall noncompliance for individual income tax. The concept related to tax evasion is tax
avoidance, which is described as creative compliance in McBarnett (2003). However, according to Arogundade (2005) and Sandmo (2005) there is conceptual distinction between tax evasion and tax avoidance. The distinction between these two concepts hinges on the legality of taxpayer’s actions. Arogundade (2005) said that the similarity of both concepts is that they lead to leakages in tax revenue.

Sundomo (2005) distinguishes the two concepts from legal perspective. He said that tax evasion is carried out in violation of the law, therefore is illegal while tax avoidance is carried out within the legal framework of the tax law in order to reduce one’s tax liability, therefore tax avoidance is legal. Everest-Phillip and Sandall (2009) argued that public governance quality is necessary to have good tax system and equally good tax system is essential to achieve public governance quality. Citizens support government in its responsibilities through the provision of finance in form of tax payment. What is happening in government therefore, should matter to the taxpayers because they provide the finance for its sustenance. As a result, governance affairs may have either positive or negative influence on the compliance behavior of the taxpayers.

Compliance in pure administrational terms therefore includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year (if required) and following the required payment time frames (Ming Ling, Normala and Meera, 2005). In contrast, the wider perspective of tax compliance requires a degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation (Singh and Bhupalan, 2001). In line with Singh and Bhupalan (2001); Somasundram (2005) claimed that the wider perspective of compliance becomes a major issue in a self assessment system since the total amount tax payable is highly dependent on the levels of tax compliance this perspective reveals, although it is inevitable that tax authorities will seek to ‘influence’ the areas taxpayers have influence over determining to reduce the risks of non-compliant behavior they face otherwise for example through continuously conducting tax audits of different sorts and other means such as various compliance influencing activities including tax education.
1.1.1 Tax Compliance in Kenya

Kenya is ranked among low-income countries or low compliance countries with the hard task of ensuring efficient and effective tax administration in order to ensure tax compliance, hence raising more revenue. Administration of tax in Kenya is done by Kenya Revenue Authority (KRA) established through an Act of Parliament of July 1st 1995 (Cap 469). The purpose of Kenya Revenue Authority is assessment, collection, administration and enforcement of tax laws with professionalism governed by integrity and fairness (CIAT, 2006). To achieve this purpose, KRA is divided into regions such as North Region, Rift Valley Region, Western Region, Southern Region and Central Region and departments such as Customs Services Department, Domestic Services Department, Road Transport Department and Support Services Department. KRA administers different types of taxes under different Laws (Acts) such as Income Tax, Value Added Tax, Custom duties and Excise Tax among many others. As shown in the figure 1.1 below, Kenya rental income tax is one of the highest in the African continent.

Figure 1.1: Rental Income Tax Rates

Source: (kra.go.ke 2012)

Kenya introduced the Tax Modernization Programme in 1986 with the hope that this would, among other things, enhance revenue collection, improve tax administration and reduce compliance and collection costs. As in most African countries, the tax reforms became part of the larger Structural Adjustment Programmes (SAPs) that were incorporated in the economic
Restructuring agreement between the Government of Kenya and the International Financial Institutions (Wanjiru, 2010).

Even though there have been many tax reforms, Kenya’s tax code is still complex and cumbersome, characterized by uneven and unfair taxes, a narrow tax base with very high tax rates and rates dispersions with respect to trade, and low compliance. Additional challenges include tax systems with rates and structures that are difficult to administer and comply with; are unresponsive to growth and discretionary policy hence low productivity; raise little revenue but introduce serious economic distortions; treat labour and capital in similar circumstances differently; and are selective and skewed in favour of those with the ability to defeat the tax administration and enforcement system (Karingi, Wanjala, Nyamunga, Okello, Pambah, & Nyakang, 2005).

There are many challenges that hamper the setting up of an efficient and effective tax system in Kenya. The structure of the economy such as the ratio of the formal verses informal economy; and the size of the agriculture sector pose challenges in the tax design and administration. Other impediments include: repeal of tax holidays, high effective protection, high dispersion of tariff rates, detailed and rigid custom rules, poor response of VAT to reforms, weak capacity to process large volumes of returns and refunds for zero-rated transactions. In addition, Kenya’s tax system is burdensome in terms of time taken to prepare and submit tax returns (Karingi, Wanjala, Nyamunga, Okello, Pambah, & Nyakang, 2005).

Other challenges include poor quality of basic data (to estimate optimal taxation, forecast revenues adequately, and undertake micro-simulations and tax modelling) and politics. Politics have been a major impediment in the recent past, and as an IEA report stated that an unfriendly political economy that is not amenable to rational tax policy may prevent significant tax reforms. The political elite, who possess high personal income, wealth and property, may use their political influence to oppose the imposition of wealth and property taxes (Karingi, Wanjala, Nyamunga, Okello, Pambah, & Nyakang, 2005). This precisely explains the current situation in which twice the legislatures have collectively ensured that the legislations that were to initiate
taxation on benefits/allowances to MPs and other constitutional offices were not enacted initially.

In 2008 the Finance Bill submitted by the then Ministry of Finance had included proposals for taxation on benefits/allowances to the MPs, but the MPs threatened not to pass the finance bill if the clauses on taxes were not expunged. This would have paralysed the governments operations and so the finance minister acceded to their demands. A similar attempt in 2010 by the government and through the proposed constitution has led to parliamentarians demanding for a pay increases that would cover the new taxation requirement, again defeating the purpose for which the taxation is being introduced – which is to increase domestic revenue. An additional pay would result in a zero sum game since the intended increase in domestic revenues will be used up as salaries to the MPs (Omondi, 2006).

1.1.2 Kilifi Municipality

Kilifi County is located on the Coastal Line bordering Tana River, Taita Taveta, Mombasa and Kwale. Number of constituencies (2010): Malindi, Magarini, Kaloleni, Ganze and Bahari. Population of Kilifi are 1.1 million. Male is 48% and female is 52%. Poverty Level: 68% of population lives below the poverty line. Density is 450 people per km², growth rate is 3.05%. Main Economic Activities/industries: Agriculture, Tourism, Manufacturing and Fishing.

1.2 Statement of the Problem

While on the other side of the coin is the poor tax regimes based on inappropriate tax policies and laws, poor tax design and inefficient tax administration in most of the developing countries has led to low compliance. The OECD 2010 reports indicate that its member countries (the developed countries) have regularly raised a total share of tax revenue above 35% of the GDP. This is far much higher than the developing countries tax revenue proportion to GDP which has been in the range of 15% to 22% to GDP (OECD, 2010).

A 2006 study by the French Ministry of Foreign Affairs (MAE) on strengthening local taxation in Africa, based on surveys in Benin, Cameroun, Ghana, Mali and Mauritania, showed that
people often refused to pay tax because they could see little in return in terms of government services or investments. The study showed that this circle of non-compliance is hard to break. Lack of resources and a lack of capable local administration staff resulted typically in low quality goods and services to citizens. Moreover, local tax administrations often lacked the motivation to pursue the collection of taxes from which services could be provided (Wanjiru, 2010).

Most researchers (Torgler, 2003; McBarnet, 2003 and Murphy and Harris, 2007) on tax compliance focused their attention on the Western World and some Asian countries. Socio-cultural factors are important components in the lives of a people and given the deep-rooted and pervasiveness of these in the Kenyan societies, there is a clear need for more empirical research on the factors involved in the decision making process regarding compliance, since a better understanding of these factors can give birth to strategies that improve compliance. It is therefore, the focus of this study to subject tax compliance to empirical analysis in the Kenyan context. According to James, Murphy and Reinhart (2005), tax laws cannot cope with every eventuality and has to be supplemented with administrative procedures and decisions and just as importantly, in order to work, it has to have a reasonable degree of willing compliance on the part of the taxpayers themselves.

Despite the fact that there are many studies related to tax compliance for developed country, there is however paucity of study on tax compliance for developing countries especially for Kenya. Some related studies, in particular (Lumumba, Wanjohi and Magutu, 2010; Omondi, 2010; Moyi & Ronge, 2006 and Karingi, Wanjala, Nyamunga, Okello, Pambah, & Nyakang, 2005) have investigated the relationship between education, tax audit and tax evasion; and also discussed about ethics on tax evasion in Kenya. None of them have looked specifically at the factors affecting tax compliance on rental income. Realizing the significant effect of tax evasion on an economy and a lack of study in this area for Kenya, this study attempts to fill the gap. Specifically, this study attempts to estimate factors that cause tax non compliance and their relative contribution in Kenya.
1.3 Objectives

1.3.1 General Objective
The general objective of this study is to investigate factors affecting rental income tax compliance among landlords in Kilifi Municipality in Kenya.

1.3.2 Specific Objectives
This study sought to address the following specific objectives which formed the inference for the research questions.

i. To find out whether the level of taxpayers’ understanding of a tax system and tax laws on rental income tax influences compliance among landlords in Kilifi Municipality

ii. To investigate the effect of penalties on rental income tax compliance among landlords in Kilifi Municipality

iii. To ascertain the effect of taxpayers perceptions on the revenue authority on rental income tax compliance among landlords in Kilifi Municipality

iv. To establish whether integrity of the taxpayer and tax collector influence rental income tax compliance among landlords in Kilifi Municipality

1.4 Research Questions
This study sought to address the following research questions;

i. What is the effect of taxpayers’ level of understanding of the tax system and tax laws on rental income tax compliance among landlords in Kilifi Municipality?

ii. Do penalties affect rental income tax compliance among landlords in Kilifi Municipality?

iii. What is the effect of taxpayer’s perceptions of the revenue authority on rental income tax compliance among landlords in Kilifi Municipality?

iv. Does integrity of the taxpayer and tax collector affect rental income tax compliance among landlords in Kilifi Municipality?
1.5 Significance of the study

The study is relevant to the following stakeholders:

At the end of every year, as government prepares budget for the ensuing year, forecasting what it expects to receive and what it tends to spend. The bulk of receipts, which are through taxation, serve as a source of government revenue. These revenues are used to develop both human and infrastructure of the country in the form of hospitals, schools, roads and to carry out essential services like electricity, water and sanitation, but sadly enough majority of the citizenry who by statutory provision are qualified to honour their tax obligation to the state fail to do so thus denying the state the needed revenue to carry out these classes of projects. It is assumed that these categories of people would come to understand the purpose of taxation.

The arguments that tax authorities are inefficient and are therefore not proactive in collecting taxes are thought of sound reasoning, but however, the culture of the Kenyan not to pay tax and even not hear the world ‘tax’ is so rooted in the Kenyan from the colonial days to modern day Kenya. This research is expected to be of benefit to Revenue officials who are saddled with the responsibility of ensuring that taxpayers are not negligent in paying their taxes. It can also assist in knowing why taxes are evaded. The outcome of this research can enable them to have a better understanding of why tax payers evade taxes. Therefore, when these reasons are adequately appraised, it is expected that it can in turn translate to the provision of necessary infrastructure for the society when the resources are judiciously utilized.

This research would enhance the rental income earner to honour their tax obligation for the government to honour its responsibility. It is assumed that all things being equal, at the end of this research the citizenry will not be antagonistic about the tax collection system and thus honour their tax obligation.

The impact of tax compliance on the operations of Kenya Revenue Authority in Kenya and indeed the economy at large is of interest to researchers and industry practitioners. This study can serve as a stepping stone for new research on taxation. Besides, researchers and students in the field of banking and finance who want to know more about taxation, its causes
and possible ways of preventing it can also find the study beneficial. This research is also expected to be of benefit to researchers and students of accounting since it is an important aspect of taxation. Hence, it serves as a reference point for future researchers and a blue-print for policy makers.

1.6 Scope of the study
The area of consideration for the study is Kilifi Municipality. The commercial activities commonly found in Kilifi municipality are: Pharmacy Shops, Chemical/Drugs Store Operators, Seamstress and Tailors, Plumbers and Pipe fitters, Hairdressers and beauticians, Auto Mechanics, Carpenters & Joiners and Masons. Therefore for the purpose of this research we shall target the landlords of this Municipality who receive monthly rent from various tenants. The study was conducted during the period December 2012 to February 2013 and only covered the variables stated in the specific objectives.

1.7 Limitations
It well known that, no job or occupation whether small or big may be very easy to undertake. Finance is a major problem for many undertakings; as a lot of funds are needed to come out with a very comprehensive research work like this. There was the problem of getting the needed data both primary and secondary, as in the case of primary data, respondents had the notion that they would be exposed to the tax officials. These kinds of fear were allayed by assuring the respondents that the study was for academic purposes only and confidentiality was to be observed regarding all disclosed information.

1.8 Definition of Key Terms
Ethics: The rules or standards governing the conduct of a person or the members of a profession (Collins English Dictionary, 2003).
Integrity: The quality of being honest and having strong moral principles. The state of being whole and undivided. (Collins English Dictionary, 2003)
Landlord: One that owns and rents land, buildings, or dwelling units. A man who owns and leases property. (Collins English Dictionary, 2003)

Morality: concern with the distinction between good and evil or right and wrong; right or good conduct. An essential and distinguishing attribute of something or someone; adhering to moral principles; according with conscience or morality; conformity to one's own sense of right conduct (Collins English Dictionary, 2003).

Motivation: the psychological feature that arouses an organism to action toward a desired goal; the reason for the action; that which gives purpose and direction to behavior (Collins English Dictionary, 2003).

Non-Resident: not living in. An individual who mainly resides in one region or jurisdiction but has interests in other region. In the region where he or she does not mainly reside, he or she will be classified by government authorities as a non-resident. (Investopedia, 2012)

Non-Resident Landlord: In this study refers to those landlords who own commercial buildings in Kilifi Municipality but they do not reside in those buildings or within their vicinity. (Author, 2013)

Penalty: a payment required for not fulfilling a contract (Collins English Dictionary, 2003).

Tax: is a financial charge or other levy imposed on an individual or a legal entity by a State or a functional equivalent of a State (for example, secessionist movements or revolutionary movements). Taxes are also imposed by many sub-national entities. Taxes consist of direct tax or indirect tax, and may be paid in money or as its labour equivalent (often but not always unpaid). In essence, tax is seen as pecuniary burden put upon individuals or property to support the
government in its oversight activities of a nation and exacted by legislative authority (Black’s Law Dictionary, 2010).

**Taxation:** is a compulsory payment or transfer of resources from private to public sector levied on the basis of the determined criterion and without reference to specific benefits received in order to accomplish some of the nation’s economic and social objectives (Black’s Law Dictionary, 2010).

**Tax evasion:** is defined as a deliberate and willful practice of not disclosing full taxable income in order to pay less tax. It is a violation of tax laws whereby the tax due by a taxable person is unpaid after the minimum specified period (Richardson, 2008)

**Tax avoidance:** The use of legal methods to modify an individual's financial situation in order to lower the amount of income tax owed. This is generally accomplished by claiming the permissible deductions and credits (investopedia, 2012).

**Tax audit:** can be defined as an examination of an individual or organisation’s tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state. Tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax return (Kircher 2008).

**Tax compliance:** can be defined as an ability of a tax liable body to submit accurate, complete and satisfactory returns in conformity with tax laws and regulations of the state to the authority for the purpose of tax assessment (Kircher 2008).

**Tax collector:** someone who collects taxes for the government (Collins English Dictionary, 2003).
CHAPTER TWO: LITERATURE REVIEW

2.0 Introduction

This chapter reviews literature in the area of strategic management. It starts by reviewing the theories that are relevant to this area of study. The concept of this study is also figuratively depicted in order to provide a succinct idea of the study themes and variables.

2.1 Theoretical Literature Review

This section provides a review of some theories which form the epistemological foundations of the study. The theories are mainly oriented towards behavioural reason for compliance tendencies among human beings.

2.1.1 Theory of Planned Behavior

Theory of planned behavior is an important theory which presents within the scope of the social psychology and tries to explain human behaviors. This theory was developed by Ajzen (1991) and it is just the improved form of the Theory of Reason Action suggested by Ajzen and Fishbein (1970) in order to explain conscious behaviors. According to this theory, behaviors of the individuals within the society are under the influence of definite factors, originate from certain reasons and emerge in a planned way (Erten, 2002). Nevertheless, the ability to perform a particular behavior depends on the fact that the individual has a purpose towards that behavior. As for the factors determining the purpose towards the behavior, they are attitude towards behavior, subjective norms and perceived behavioral control (Erten, 2002). Factors counted above are also under the influence of behavioral beliefs, normative beliefs and control beliefs (Ajzen, 2002).

Intention is the basis of this theory and performance of a behavior or its transformation into a different behavior depend on the intention that the individual has generated towards the behavior. Ajzen, described intention as the factor indicating the degree of individual efforts in order to
perform a certain behavior (Ajzen, 1991). Intention is explained by attitudes towards behavior, individual norms and perceived behavior controls (Klee & et al. 2000). Attitude includes the evaluations made by the individual who will perform the behavior regarding the act of that behavior.

Subjective norm refers to the opinions of the other individuals who are important for individuals that will perform the behavior or are taken as reference as regards to this behavior. Finally, perceived behavior control specifies the difficulty level of the performance displayed by an individual. This element can sometimes affect the behavior directly. For example, in case the behavior control does not depend on the desire of the individual, in other words, if there is any legal sanction, perceived behavior control can affect the behavior directly. As a conclusion, the Theory of Planned Behavior posits that individuals' intentions, together with their perceived control over the behavior determine whether or not they will actually engage in the behavior.

It has been observed that empirical studies carried out within the scope of the Theory of Planned Behavior mostly examine behaviors that individuals report and that the studies examining the behaviors that individuals perform is rather scarce in number (Chang, 1998; Allen, 2004). This is because of the fact that observing the individual behaviors is rather costly in terms of time and money (Erten, 2002). The aim of this study is also to analyze the behaviors reported by the taxpayers included in this study instead of observing the behaviors of the individuals regarding tax compliance.

2.1.2 Intrinsic Motivation Theory

Other sciences like sociology and psychology have stressed the importance of behavior based on moral and ethical considerations. In economic analysis, internalized values are taken as exogenously given and not influenced by prices or regulations. (Becker 1976 and Hirshleifer 1985). However, a view economists such as Hirschman (1965) and Sen (1977) took the relationship between external and internal motivation into account. Frey (1997) demonstrates that intrinsic versus extrinsic motivation are also relevant for explaining compliance behavior. He looks at tax morale as a particular kind of intrinsic motivation. It is an attempt to introduce a
psychological effect into economics without giving up the rational choice framework. His approach includes a crowding out effect of intrinsic motivation in the analysis of tax compliance. Increasing monitoring and penalties for noncompliance, individual will notice that extrinsic motivation has increased, which on the other hand crowds out intrinsic motivation to comply with taxes. Thus, the net effect of a stricter tax policy is unclear. If intrinsic motivation is not recognized, taxpayers get the feeling that they can as well be opportunistic. This puts into account the relevance of policy instruments in supporting or damaging the intrinsic motivation. Intrinsic motivation depends on the application of policy instruments. Frey (1997) claims that tax morale is not expected to be crowded out if the honest taxpayers perceive the stricter policy to be directed against dishonest taxpayers. Regulations which prevent free riding by others and establish fairness and equity help preserve tax morale.

Taxpayers have unique innate characteristics which determine the actions they on particular requirements of life. The need for tax compliance is of paramount importance but taxpayers actions towards compliance are sometimes dictated by intrinsic motives of the taxpayers.

2.1.3 Economic Based Theories

They are also known as deterrence theory and they place emphasis on incentives. The theory suggests that taxpayers are moral utility maximizers. They are influenced by economic motives such as profit maximization and probability of detection. As such they analyze alternative compliance paths for instance whether or not to evade tax, the likelihood of being detected and the resulting repercussions and then select the alternative that maximises their expected after tax returns after adjusting for risk. This process is referred to as “playing the audit lottery” by Trivedi and Shehata (2005). Therefore according to the theory, in order to improve compliance, audits and penalties for non-compliance should be increased.

Taxpayers take steps towards compliance if they are able to see how they can benefit of fear of penalties and punishment. This theory is relevant to this study because one of the objectives is to establish whether penalties initiate compliance behavior among taxpayers.
2.1.4 Psychology Theories
Psychology theories on the other hand posit that taxpayers are influenced to comply with their tax obligations by psychological factors. They focus on the taxpayers' morals and ethics. The theories suggest that a taxpayer may comply even when the probability of detection is low. As opposed to the economic theories that emphasize increased audits and penalties as solutions to compliance issues, psychology theories lay emphasis on changing individual attitudes towards tax systems (Trivedi & Shehata, 2005).

The Psychology theory therefore implicates that the Taxpayers' morals and ethics are ingrained in level of integrity of the tax payer and tax collector. The integrity of a tax payer is important in determining his level of compliance. This is quite applicable in the Kenyan situation because many corrupt tax payers have low compliance levels compared to honest tax payers.

2.1.5 Theory of Crime
The theory of crime asserts that people are rational actors who behave in a manner that will maximize their expected utility. In the early 1970s, Alligham and Sandmo (1972) interlinked on the economics of crime to the taxation context. They examined taxpayer's decision to evade taxes when they were filling out their tax returns and examined the relationship between penalty rate for tax evasion at the time, the probability of detection, and degree of tax evasion engaged in. What they found was that there was a relationship between these variables; with a higher penalty rate and probability of detection deterring individuals from evading their taxes. In the 1980s, therefore, many scholars began to question the value of deterrence alone in regulating behavior. They began to focus their attention on researching compliance rather than deterrence and began to realize the importance of persuasion and cooperation as a regulatory tool for gaining compliance. In fact, research has shown that the use of threat and legal coercion, particularly when perceived as illegitimate, can produce negative behavior; these actions are more likely to result in further non-compliance (Murphy & Harris 2007), creative compliance (McBarnet, 2003), criminal behavior or opposition (Fehr & Rokenbach 2003).
2.2 Empirical Literature Review
This section discusses literature from various sources regarding tax compliance and also brings out gaps in literature that this study seeks to address.

2.2.1 Taxpayers' Understanding and Tax Compliance
The influence of knowledge on compliance behaviour has been proven in various researches Mohamad Ali et al (2007). Harris (2009) divided tax knowledge into two aspects, namely, knowledge through common or formal education received as a matter of course and knowledge specifically directed at possible opportunities to evade tax. In the first case, the level of education received by taxpayers is an important factor that contributes to the general understanding about taxation especially regarding the laws and regulations of taxation Eriksen and Fallan (2006). 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). Given evidence that tax knowledge affects understanding of taxpayers, an obvious explanation that has been raised by previous researchers e.g. Singh, (2003), Eriksen and Fallan, (2006) Harris (2009) is whether enhancement of tax knowledge will increase tax compliance.

Eriksen and Fallan (2006) claimed that ‘knowledge about tax law is assumed to be important for preferences and attitudes towards taxation. There is little research that explicitly considers how attitude towards taxation is influenced by specific knowledge of tax regulations’. The research done by Eriksen and Fallan (2006) has illustrated the importance of tax education in a tax system. They suggested that fiscal knowledge correlates with attitudes towards taxation and tax behaviour can be improved by a better understanding of tax laws (Eriksen and Fallan, 2006).

Kasipillai et al. (2003) showed that other factor that causes tax evasion is tax culture. They evaluated the influence of education on tax compliance among undergraduate students in Malaysia, and found that there is a close relationship between education and tax compliance. Studies in India by Jain (2007) also found that complicated tax structure, dishonest staff, high tax
rates and high tax rate on sales are factors that cause high black money in India. Among large number of studies related to tax evasion, only limited number of these studies investigated the phenomena of tax evasion for Malaysia. Among these studies, we can point to the study of Kasipillai et al. (2003) that investigated the influence of education on tax avoidance and tax evasion by using questioner method.

According to the Fischer Model, non compliance opportunities can affect tax compliance both directly and indirectly through attitudes and perceptions. Chan, Troutman, and O’Bryan (2010) investigate the direct and indirect effects of two noncompliance opportunities, namely educational and income level. Previous literature supports the direct, negative relationship between educational level and taxpayer compliance but a direct relationship between income level and tax compliance is unclear.

Chan et. al. (2010) also postulate that greater education is directly linked to a likelihood of compliance. They argue that educated taxpayers may be aware of non compliance 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. Chan et. Al (2010) also suggested that those with a higher education level are more likely to have a higher level of moral development and higher level attitudes toward compliance and thus will tend to comply more.

Hite and Hasseldine (2011) investigate the current developments in the USA, highlighting that tax academics need to emphasise teaching and development. In other countries, tax education, as well as tax development is not as good as in the USA. Their study was expected to be able to help academics in other countries to adapt what has been done in the USA, especially in teaching methodology (in tax courses) so that other countries can learn how to educate taxpayers more effectively and efficiently.

Traditionally, the US taxation courses are taught within accounting departments only. The first paper introduces students to personal taxation; by the end of the course, the students will be able
to prepare the tax return. The weaknesses of this method had been commented upon by Jones and Duncan (2005). They noted that this narrow approach in the long run does not fulfill the education needs for the students because most students are not aiming to become accountants or tax professionals. Jones and Duncan (2005) added that a first taxation course should be broader in nature so that the students will be able to relate taxation aspects to other related fields such as accounting, financial economics and perhaps law. This scenario happened in other countries as well, when the education systems itself indirectly narrowed the students’ mindset to be focused only on a taxation field without then relating this to other fields (Craner and Lymer, 2009). A formal tax education is only taught to accounting students in higher learning institutions. Other than this, they could not easily find any tax related courses but in other countries such as the USA, there are a lot of accounting (tax) education programmes offered to the public. While the education levels become more important in increasing tax compliance across countries,

Mohani (2011) suggested that one of the measures to increase voluntary compliance is by assuring that taxpayers have a certain level of qualifications, ability and confidence to exercise their tax responsibility. In contrast, the most recent study, by Richardson (2008) also revealed that there is a negative association between education and compliance.

2.2.2 Penalties and Tax Compliance

Tax audit is one of the most effective policies to protect the behaviour of tax evasion. The level of tax audit can be determined by two elements: one is how many taxpayers are selected for audit and the second is how much intensive the audit is. The first element is easily measured by the number of audited taxpayers divided by the total number of taxpayers. However, the second element is so difficult to measure due to no published information about the process of tax audit. It is commonly measured by the first element to indicate the level of tax audit for practical comparison (Hyun, 2005). Tax audit generates administrative cost. As a constraint of the fixed administration cost, an increase in the level of tax audit is required to decrease the level of other administrative functions, like taxpayer service, tax collection etc.
Empirical studies on the impact of fines on tax compliance did not find the clear picture theoretical analyses provide. In sum, the relation of fines and tax compliance also shows inconsistent findings. Some experiments showed that fines are slightly higher related to tax compliance than audit probabilities are (Park and Hyun, 2003). Keeping constant the expected value of a tax but changing audit probabilities and fines for non-compliance, it showed that compliance increased significantly with higher fines, but not with higher audit probabilities. Other experiments, on the contrary, showed that fines and tax compliance are not related, but audit probabilities and tax compliance are. In the current framework, it would be argued that the interpretation of fines matters. In an antagonistic climate, fines can be a part of the game of “cops and robbers”; in a synergistic climate, they can be perceived as an adequate retribution for behavior that harms the community. Fines are therefore connected to trust and power. Fines that are too low could be perceived as indicator that the authorities are weak and unable to control the wrongdoers, undermining trust among honest taxpayers. Fines that are inappropriate because a taxpayer involuntarily made a mistake resulting from ambiguous tax laws, or fines that are exorbitantly high, would undermine the perception of retributive justice and induce tax evaders to try even harder to regain their “losses” incurred by those fines (Kirchler et al., 2008).

The increasing tax avoidance and tax resistance due to an increase of fines puts into question how fines should be assessed to be effective. On the one hand, fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on taxpayers. On the other hand, if fines are too high, the tax system would be perceived as unjust and unfair and taxpayers would use any possibility to legally avoid their taxes. In most countries, fines are relative to the evaded tax. However, depending on the income of the accused such a system might yield too low fines to have deterrent effects. An alternative would be to adjust the fine to the income of taxpayers. In an experimental survey study by Muehlbacher, Hölzl and Kirchler, (2008) income-adjusted fines had more impact on the sentenced taxpayer’s intention to commit the same offense again than fines which were solely adjusted to severity of evasion fact (Kirchler et al., 2007).
The structure of penalty system may be different in the countries: can be various types of penalty rate by the different tax subjects or different structure of penalty rates by the types of taxpayer. So, penalty rates have been separately applied by the different tax subjects like the individual income tax, capital income tax, value added tax etc. Furthermore, the penalty rates for each tax subject are differentiated by the different types of evasion, like non-filing, timely filing but under-reporting, no bookkeeping of invoices, receipts etc. Or, the penalty rates are differently applied to the types of taxpayers, depending upon their evaded behaviours. If some taxpayers had the intentional evasions, the penalty rate is much higher than that of unintentional evasions (Hyun, 2005). As two kinds of evaded behaviour are most common in analyze of tax compliance and are timely filing but underreporting, and non-filing. If the countries have the same system that tax authority prosecutes some intentional and malicious tax evaders for criminal responsibility, after tax audit. This system might play an important role in increasing the level of penalty rates for the behaviour of tax evasion. The number of prosecuted cases by tax authority might be an important indicator to compare an additional penalty rate between countries.

Torgler, 2003), Torgler, 2005 and Torgler, 2007) has explored in a series of studies the determinants of tax morale. He finds that tax morale in the Central/Eastern European Countries (CEE) is significantly higher than in countries of the Former Soviet Union (FSU) (Torgler, 2006). In explaining both interpersonal and cross-country differences he finds that all trust variables are highly significant (trust in legal system, trust in government, satisfaction with national officers, and evaluation of the political system) and correlate positively with a higher tax moral, whereas corruption affects tax morale negatively. (Hammer et al, 2009) from economic university of Gothenburg, using Swedish individual survey data, they analyze the perception of tax evasion in terms of ten different taxes. They find large variation across taxes, highlighting the important of studding different taxes separately rather than treating tax evasion as one common phenomenon. They focus on the importance of trust in taxpayers and in politicians. Those who do not trust their fellow citizens are more likely to believe that they are evading taxes, but distrust in politicians to be perceived as trustworthy in order to be able to collect taxes for maintaining the welfare state.
Gordon and Li (2009) explore how forecasted policies change if firms can successfully evade taxes by conducting all business in cash, thereby avoiding any use of the financial sector. The forecasted policies are now much closer to those observed. Interest in tax evasion over the last 50 years in both academic and political circles has received increasing attention because of deep inequalities and soaring government deficits (Olatunde, 2010).

2.2.3 Taxpayers’ Perceptions and Tax Compliance

Attitudes represent the positive and negative evaluations that an individual holds of objects. It is assumed that attitudes encourage individuals to act according to them. Thus, a taxpayer with positive attitudes toward tax evasion is expected to be less compliant than a taxpayer with negative attitudes. Attitudes towards tax evasion are often found to be quite positive (Kirchler et al., 2008). Many studies on tax evasion found significant, but weak relationships between attitudes and self-reported tax evasion (Trivedi, Shehata, and Mestelman, 2004). A model of tax evasion behavior developed by Weigel, Hessing and Elffers (1987) considers social and psychological conditions, including attitudes and moral beliefs about tax evasion’s propriety, as antecedents of tax compliance. Data collected from fined tax evaders and honest taxpayers showed that attitudes explain in part self-reported tax evasion, but are insignificant predictors of actual behavior. However, the correlations between self-reported tax non-compliance and attitudes are significant but fairly weak. These findings suggest a rather complicated relationship between tax evasion and attitudes, nevertheless we can be confident in our general prediction that if tax attitudes become worse, tax evasion will increase (Lewis, 2002).

The attitudes are important for both the power and the trust dimension. On the one hand, favorable attitudes will contribute to trust in authorities and consequently will enhance voluntary tax compliance. On the other hand, attitudes towards the authorities will be relevant for the interpretation of the use of power as benevolent or malicious. Tax attitudes in general also depend on the perceived use of the money collected and therefore are connected to knowledge (Kirchler et al., 2008) compliance, this view of individual choices within a social environment is missing, only the threat of external sanction e.g. audits and penalties generate compliance. The fact that informal institutions can affect compliance has been excluded from the model.
Furthermore, if it is true that the threat of external punishment is important, it is also true that informal institutions, such as codes of behavior and honesty can also constraint people's choices. If others behave according to a socially accepted mode of behaviour, the individuals will also comply and pay taxes as long as they believe that compliance is a social norm. Polinsky and Shavell (2010), present a survey of the economic theory of public enforcement of law, emphasize the aspect of social norm, that social norms can be seen as a general alternative to law enforcement in channeling individuals behaviour. However, some points remain unexplained—how do these norms arise in the first place and how can these norms be changed by deliberate government policies? There are limits for a government to increase compliance using traditional policies such as audits and fines. Therefore, if the government can influence a norm, tax evasion can be reduced by policy activities. Also, taxpayer may be aware that their evasion could damage the welfare of the community they live in. As a consequence, evasion can produce psychological costs. People may not be comfortable with dishonesty. However, when a taxpayer is convinced that he pays too much tax compared with the provided public goods, his psychological costs will be reduced.

Recently, Feld and Frey (2002) analyze how tax authorities treat taxpayers. Using a data set of tax authorities' behaviour (26 cantonal tax authorities), they found that tax authorities of the cantons with more direct participation rights, compared with cantons of less democracy, treat taxpayers more respectively and are less suspicious if taxpayers report too low incomes. On the other hand, not submitted tax declarations are more heavily fined. This empirical work indicates the importance of differences (here political participation right) for explaining the relationship between taxpayers and tax authorities which influences tax morale. Tax compliance is not just a function of opportunity, tax rates, probability of detection and so on but of each individual’s willingness to comply shaped by tax morale. This means that if tax morale is favorable, tax compliance will be relatively high. Tax rates influence taxpayers’ decision to comply with tax laws.

Economic factors in relation to tax compliance refer to actions which are associated with the costs and benefits of performing the actions (Loo, 2006). Hasseldine (2003), Song and...
Yarbrough (2008) and Torgler and Schneider (2005) assumed that taxpayers are rational economic evaders who likely would assess the costs and/or benefits of evasion. They would attempt to minimize their tax liability, for example, by intentionally under reporting their income and would enjoy tax savings if they were not detected by the tax authorities. On the other hand, they would be willing to pay more, including a penalty, if they were caught (Song and Yarbrough, 2008).

The main objective of imposing certain taxes on the public is to generate revenues for the government for public expenditure (Shanmugam, 2003; Lymer and Oats, 2009). However, there are other functions of taxes as suggested by Lymer and Oats (2009) including to reduce inequalities through a policy of redistribution of income and wealth so that income gap between the rich and the poor is not as significant. According to Lymer and Oats (2009) tax systems are also designed for social purposes, such as discouraging certain activities which are considered undesirable and protecting the environment. For instance, the excise taxes on alcohol and tobacco are (at least partly) exercised to decrease consumption and thus encourage a healthier lifestyle. Taxes are also expected to ensure economic goals through the ability of the taxation system to influence the allocation of resources including transferring resources from the private sector to the government to finance the public investment programme, the direction of private investment into desired channels through such measures as regulation of tax rates and the granting of tax incentives.

The more modern approach to tax compliance has benefited from many contributions from different disciplines. There is a range of factors that might influence taxpayer's behavior. For instance, work in sociology has identified a number of relevant variables such as age, gender, race and culture. The role of individuals in the society and accepted norms of behavior have also shown to have a strong influence (Wenzel, 2002). Also Polinsky and Shavell (2010), present a survey of the economic theory of public enforcement of law, and emphasize the aspect of social norms, that can be seen as a general alternative to law enforcement in channeling individual behavior. There are limits for a government to increase compliance using traditional policies
such as audits and fines. Therefore, if the government can influence a norm, tax evasion can be reduced by policy activities.

A study conducted by Richardson (2008) suggested that the role of a government has a significant positive impact on determining attitudes toward tax. His study attempted to investigate the determinants of tax evasion across 47 countries including the USA, the UK, Argentina, Thailand, Canada, Chile and Brazil. Richardson also suggested that the government should increase their reputation and credibility in order to obtain trust from the taxpayers.

An effective and efficient tax administration system is integral to any country’s well being, it is as a result of this that Baurer (2005) believes that the tax administration must provide an even playing field for business by ensuring that all taxpayers meet their tax filing and paying requirements. The tax administration must balance its educational and assistance role with its enforcement role. Many of the difficulties with the tax authorities are the consequence of poorly conceived tax policies and a lack of certainty regarding future policy changes.

Kasipillai & Jabbar (2006) assert that some cases non-compliance may mean an outright failure to pay levied taxes. Fagbemi, Uadile and Noah (2010) found that it is prevalent in developing countries and it hinders development thereby leading to economic stagnation and other socio-economic problems. Chipeta (2002) identified tax rates as one of the causes of tax evasion. He pointed out that a higher tax rate increases taxpayers’ burden and reduces their disposable income therefore, the probability of evading tax is higher. Small taxpayers under the regular system of taxation are discriminated against, since the compliance requirements, cost of compliance and tax rate are the same for both small and large enterprises. Reducing the compliance costs and tax rate increases the small enterprises profit margin. It also increases the Government’s tax revenue, since the simplified provisions for small and medium enterprises reduce the size of the informal economy and the number of non-complying registered taxpayers (Vasak, 2008).
2.2.4 Integrity and Tax Compliance

In the tax integrity literature, tax integrity is conceptualized as the honesty of a person to pay taxes and upholding strong moral principles, which can be regarded as individual willingness or moral obligation or belief that paying taxes is a contribution to the society (e.g. Torgler, 2007; Kirchler 2007; Schmölders 2006). Also, tax morale can be explained by general apprehension of ethical behaviour. If we consider the content of the term “morale”, the tax morale can be handled as a practice to pay taxes positioned in the deep folds of human being awareness.

Tax morale is judged to be one of the factors of tax compliance, which has affect on taxpayer behaviour to pay taxes or to evade them. It can be supposed that tax compliance is the most neutral term to describe the taxpayer’s readiness to pay taxes (Kirchler 2007). In general it means that an individual declares tax returns voluntarily, pays tax obligations timely and guarantees that his/her accounting for the taxation process shall be in compliance with the valid norms prescribed by tax law (OECD 2008).

The OECD believes that a taxpayer is tax compliant, if all characterizations of all the taxpayer’s basic obligations are properly performed: economic activity legal registration, timely presentation of a tax declaration or tax return, correct presentation of information and timely paid tax payments (OECD 2009). Hence, individuals who fail to perform, at least one of the taxpayer’s basic obligations, can be regarded noncompliant by character. Therefore, the term “non-compliant” shall characterize, beside tax evasion, also intentional or unintentional compliance (Webley et al. 2010).

In literature, there are two interesting theories that enable us to integrate moral constraints in a rational taxpayer model. The first theory is an altruistic approach (Chung 1976). Here taxpayers are not only interested in their own welfare but also concerned about the general welfare. The decision to evade is constrained by the knowledge that their evasion will reduce the amount of resources available for social welfare. The second is the “Kantian” morality approach (Sugden 1984). This approach broadly related to Kant’s definition of morality, is based on assumption that a fair tax is a tax which a taxpayer believes to be fair for all to pay. A false declaration will
generate anxiety, guilt or a reduction in taxpayer’s image. It is assumed that a taxpayer feels these costs only if he believes that his tax share is not higher than what is defined fair. If he is paying a higher amount, evasion can be seen as a sort of self-defense (Webley et al. 2010).

Besides attitudes, norms are important determinants of tax compliance. Behavioral intentions are determined also by subjective norms (Ajzen, 1991). Norms are behavioral standards on three different levels: the individual level, the social level and the national level (Kirchler et al., 2008). On the individual level, norms define internalized standards on how to behave. Individual norms are related to moral reasoning, authoritarianism and Machiavellianism, egoism, norm dependency and values. There is considerable overlap between individual norms, values and tax ethics: the more developed the moral reasoning or tax ethics, the more likely is voluntary compliance (Trivedi et al., 2003). On the social level, norms are usually defined as prevalence or acceptance of tax evasion among a reference group (Wenzel, 2005). Social norms are related to the behavior of reference groups, for example friends, acquaintances or vocational group. If taxpayers believe that non-compliance is widespread and approved behavior in their reference group, they are likely to be non-compliant as well. The relationship between social norms and tax compliance is complex. Wenzel (2004) argues that social norms should elicit concurring behavior only when taxpayers identify with the group to whom the norms are ascribed.

Taxpayers then internalize the social norms and act accordingly. On the level of national norms, norms become cultural standards, often mirrored in the actual law. Several authors suggest that trust in political leadership and administration will lead to voluntary tax compliance when favorable national norms are established (Fjeldstad, 2004). In general, if the norms held by taxpayers favor tax compliance, voluntary tax compliance will result. Thus, norms encompass both power and trust. First, national norms find their expression in tax laws and the role given to tax authorities, having a direct influence on their power. Second, social norms such as the belief that tax evasion is a petty crime and widespread hinder the work of tax authorities, in particular when there is no countervailing norm of community. A norm where all citizens are perceived as contributing their fair share would certainly help to increase trust in the authorities (Kirchler et al., 2008).
Orviska and Hudson (2002) and Trivedi, Shehata and Mestelman (2004) found a significant (but weak) relationship between tax evasion and ethics. Elffers, Weigel and Hessing (2002) earlier found that ethics, attitudes and moral beliefs impacted upon tax compliance behavior according to their psychological model of tax compliance. In summary, as suggested by previous studies (see Kirchler et. al., 2008; Trivedi et. al., 2004; Orviska and Hudson, 2002; Jackson and Milliron, 1986), attitudes and ethics remain important in determining evasion behavior. Based on Ajzen (1991) the theory of reasoned action or the intention to evade will encourage a taxpayer to behave negatively toward taxation and thus attempt to under-report income. On the other hand, attitudes towards the tax authority are also important as tax attitudes and ethics generally depend on perceived use of the money collected by the government (Kirchler et. al., 2008).

2.3 Summary and Study Gaps

Measuring compliance behaviour would seem to be simple, but the problem is to find a measure which allows the researcher to directly study how compliance is changed with a change in an underlying tax-related parameter, such as the audit rate. Thus, directly asking the participants about their own past involvement in tax evasion is not sufficient. What is needed is a compliance indicator which can be repeatedly measured with changes in policy parameters. One possibility is to ask hypothetically about tax evasion behaviour and how it would differ if a specific change occurred.

The findings of many studies suggest that taxpayers’ attitudes towards the tax system and the way taxpayers feel treated by a tax authority are important in explaining taxpayer non-compliance. Related to the tax system itself, there is specific evidence to suggest that perceptions of unfair tax burdens can affect taxpayers’ views about paying tax and can go on to affect their compliance decisions. Taxpayers’ behavior towards tax system has evoked great attention among many Revenue Authorities in the World especially in Developed Countries. However, it is debatable on what has been done towards the study of taxpayers behavior towards tax system in developing countries as they concentrate more in studies which would increase their budgets.
“bottom-line” in terms of huge revenue collection and enforcement efforts at the expense of studies on taxpayers behavior which would make increase in this tax revenue to be realized and enforcement efforts work. Perhaps the less developed countries are not to blame as they run on “budget deficits” hence, scarce resources to see through such studies which are perceived as adding no direct value to revenue collection. Realizing the significant effect of tax evasion on an economy and a lack of study in this area for Kenya, this study attempts to fill the gap. Specifically, this study attempts to estimate factors that cause tax non compliance and their relative contribution in Kenya.
2.4 Conceptual Framework
The goal of a conceptual framework is to categorize and describe concepts relevant to the study and map relationships among them. The conceptual framework for this study is figuratively depicted below under figure 2.1

Figure 2.1 – Conceptual Framework – Tax Compliance

Independent Variables

- Taxpayers’ Understanding
- Penalties
- Taxpayers’ Perceptions
- Integrity

Dependent Variable

- Rental Income
- Tax compliance

Intervening Variables

- Government policies
- Risk Preference
- Financial Condition

Figure 2.1: Conceptual Framework
Source: author (2013)
CHAPTER THREE: RESEARCH METHODOLOGY

3.0 Introduction
This chapter describes the methods that were used to prepare for the study, collect data and analyse. The specific areas included are the target population, sampling technique, sample size, data collection method, research instruments, pilot testing, instruments, and data collection procedures and data analysis.

3.1 Research Design
Research design is the blueprint for the collection, measurement and analysis of the data. It is a plan and structure of investment so conceived as to obtain answers to research questions (Coopers & Schindler, 2006). The study utilized a descriptive research design. Descriptive survey designs are used in preliminary and exploratory studies, to allow researchers to gather information, summarize, presents data and interpret it for the purpose of clarification (Creswell, 2003). According to Orodho & Kombo (2002), descriptive design is used when collecting information about people's attitude, opinions and habits.

Descriptive survey design has been used in other studies. For example, Wanjau (2010) used descriptive survey design to investigate the role of quality in growth of SMEs in Kenya while Mwirigi (2011) used descriptive exploratory design to identify and analyze the role played by supply chain relationships in enhancing the growth of small enterprises in Kenya.

3.2 Population
A population has been defined as the total collections of element about which inferences are made and refers to all possible cases which are of interest for a study Sekaran, (2008). Other scholars like Smith (2011) view population as the large collection of all subjects from where a sample is drawn. For the purpose of this study, the target population was the entire group of
landlords operating in Kilifi municipality in Kenya as at 31st October, 2012. The accessible population was all the landlords residing within Kilifi municipality because there are landlords who are non-residents while other are based out of Kilifi and the logistics of reaching them may prove to be cumbersome. When the population of the study is small and located in a narrow geographical area, the target population is closely comparable to the accessible population (Mugenda and Mugenda, 2003).

3.3 Sample and Sampling technique

Mugenda (2010) defines sample frame as the list of accessible population of people, events or documents that could be included in a survey and from where the researcher can pick a sample to collect data. The sampling frame for this study consisted of the list of landlords as available with the town council of Kilifi. This sample frame was chosen because the town council is responsible for all physical developments within the municipality and was better placed to locate all building structures within the municipality. Also all building plans were approved and monitored by the council. Gill and Johnson (2002) describes a sampling frame as a list of members of the research population from which a random sample may be drawn.

Different scholars have defined the term “sample” in various ways. For example, scholars like Muganda (2010) and Spiegal (2008) define a sample as a part of the total population. Orodho and Kombo (2002) view a sample as a finite and representative number of individuals or objects in a population to be studied. On the other hand, Kothari (2004) describes a sample as a collection of units chosen from the universe to represent it. Gerstman (2003) state that a sample is needed because a study that is insufficiently precise is a waste of time and money.

The study selected a sample size of about 400 landlords using Fisher, Laing & Stoeckel (1983) formula. The formula is recommended where the population is large and/or undefined in terms of size. Landlords in Kilifi municipality comprise of a large number and they are undefined in terms of size due to lack of an official database of landlords in Kenya. The formula is as stated below. 

\[ n = \frac{Z^2pq}{d^2} \]
Where:

- \( n = \text{the desired sample size (if the target population is greater than 10,000)} \)
- \( Z = \text{the standard normal deviation at the required confidence level (1.96)} \)
- \( p = \text{proportion in the target population estimated to have characteristic being measured (0.50)} \)
- \( q = 1 - p \) (0.50)
- \( d = \text{the level of statistical significance set (0.05)} \)

The above information is substituted in the formula as follows

\[
n = \frac{(1.96)^2 \times 0.5 \times 0.5}{0.05^2} = 384
\]

Based on the workings the sample size of the study will comprise of 384 respondents.

The study used (0.5) to be the values of “p” and “q” in the formula. Fisher et al. (2003) recommended that if there are no estimates available in target population assumed to have the characteristics of interest, 50% should be used for the proportion of the target population with characteristic being measured.

The study employed simple random and convenience sampling to select the 400 landlords who were the respondents of the study. Also at some intervals convenience sampling was used for those landlords who would voluntarily want to participate in the study after they learned that their counterparts were participating in a tax compliance study.

### 3.4 Data Collection Instruments

The study used a questionnaire obtain primary data. Yang (2008) states that the questions or statements in a questionnaire in a study are directly related to the research questions. In development of a survey questionnaire, the variables for which information needs to be collected have to be identified followed by their operational definition. According to Newing (2011), questionnaires consist of a series of specific, usually short questions/statements that are either asked verbally by an interviewer, or answered by the respondent on their own (self-administered). A likert scaled questionnaire was utilized because it is possible to convert responses into quantitative format for ease of data analysis using computer based software.
3.5 Data Collection Procedure

The questionnaires were self administered. Cooper and Schindler (2006) support the use of questionnaires over personal interviews in descriptive studies because self administered surveys typically cost less. Four hundred (400) questionnaires were randomly and conveniently administered to landlords. Due to the confidentiality and sensitivity of the information Auta (2010) recommends that the questionnaire should be designed in a manner that will not require the respondents to reveal their names or identities.

3.6 Pilot Test

To check the validity and reliability of the questionnaires in gathering the data required for purposes of the study, a pilot study was carried out. The purpose of pilot testing is to establish the accuracy and appropriateness of the research design and instrumentation (Saunders, Lewis & Thornhill 2007). Newing (2011) states that the importance of field piloting cannot be overemphasized; you will almost always find that there are questions that people fail to understand or interpret in different ways, places in the questionnaire where they are not sure where to go next, and questions that turn out simply not to elicit useful information. Cooper & Schindler (2006) concur that the purpose of pilot test is to detect weaknesses in design and implementation and to provide proxy for data collection of a probability sample. Sekaran (2008) reinforces that pilot test is necessary for testing the reliability of instruments and the validity of a study.

Baker (1988) states that the size of a sample to be used for piloting testing varies depending on time, costs and practicality, but the same would tend to be 5-10 per cent of the main survey. According to Cooper and Schindler (2006) the respondents in a pilot test do not have to be statistically selected when testing the validity and reliability of the instruments. In this study, data collection instrument, which is a questionnaire, was tested on 5% of the sample of the questionnaires to ensure that it is relevant and effective. It tested tested on nineteen (19) respondents.
3.6.1 Reliability of the Data Collection Instrument

Reliability refers to the repeatability, stability or internal consistency of a questionnaire (Jack & Clarke, 1998). Cronbach’s alpha was used to test the reliability of the measures in the questionnaire (Cronbach, 1951). According to Sekaran (2003), Cooper & Schindler (2003), Cronbach’s alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale.

The questionnaire responses were input into statistical package for social sciences (SPSS) and Cronbach’s alpha coefficient was generated to assess reliability. The results of the reliability test produced a Cronbach Alpha correlation coefficient of 0.789. The closer Cronbach’s alpha coefficient is to 1, the higher the internal consistency reliability (Sekaran, 2003). A coefficient of 0.7 is recommended for a newly developed questionnaire and therefore 0.789 is adequate for this study.

3.6.2 Validity of Data Collection Instrument

Validity refers to whether a questionnaire is measuring what it purports to measure (Bryman & Cramer 1997). McMillan & Schumacher (2006) describe validity as the degree of congruence between the explanations of the phenomena and the realities of the world. While absolute validity is difficult to establish, demonstrating the validity of a developing measure is very important in research (Bowling, 1997). This study used both construct validity and content validity. For construct validity, the questionnaire was divided into several sections to ensure that each section assessed information for a specific objective, and also ensured that the same closely ties to the conceptual framework for this study. To ensure content validity, the questionnaire was subjected to thorough examination by two independent resource persons, who were randomly selected among the Kenya revenue authority managers. The resource persons were asked to evaluate the statements in the questionnaire for relevance and whether they were meaningful, clear and loaded of offensive. On the basis of the evaluation, the instrument was adjusted appropriately before subjecting it to the final data collection exercise. Their review comments
were used to ensure that content validity was enhanced. The project supervisor also reviewed the questionnaire for its content and construct validity.

3.7 Data Processing and Analysis

Burns and grove (2003) define data analysis as a mechanism for reducing and organizing data to produce findings that require interpretation by the researcher. De Vos (2002) goes ahead and describes data analysis as a challenging and creative process characterized by an intimate relationship of the researcher with the participants and data generated. According to Hyndman (2008), data processing involves translating the answers on a questionnaire into a form that can be manipulated to produce statistics. This involves coding, editing, data entry, and monitoring the whole data processing procedure. After data was obtained through questionnaires, it was prepared in readiness for analysis by editing, handling blank responses, coding, categorizing and keyed into statistical package for social sciences (SPSS) computer software for analysis. The statistics generated were frequencies, descriptive statistics and inferential statistics. Microsoft excel was also used to complement SPSS especially in production of diagrams and tables.
4.0 Introduction

This study sought to investigate the factors affecting rental income tax compliance among landlords in Kilifi Municipality in Kenya. The study had four objectives which guided the structuring of the research questions and the questionnaire. Data was gathered by use of self-administered questionnaires. The findings of the study are presented based on the objections of the study.

4.1 Response Rate

Four hundred questionnaires were distributed to randomly selected landlords within the Kilifi municipality. A research assistant was deployed and guided on the distribution of the questionnaire. Due to the need of penetrating and reaching out to the respondents, a resident of Kilifi was used as the research assistant. This choice of a research assistant was motivated by the sensitivity of tax related matters among landlords in Kenya and this eased the resistance and data collection challenges that the researcher could have faced.

Among the 400 questionnaires distributed, 163 were duly filled and returned for analysis. This represented a response rate of 41%. Saunders, Lewis and Thornhill (2007) suggest that an average response rate of 30% to 40% is reasonable for deliver and collect survey method. Sekaran (2003) recommends 30% as an adequate response rate for descriptive surveys. Based on these assertions, this implies that the response rate for this study was adequate to be relied upon to make reliable conclusions on the population of study.

4.2 Sample Demographics

This section provides details on basic information regarding the respondents in terms of their gender, the period they have been landlords and their knowledge about tax matters.
4.2.1 Gender

Figure 4.1 shows that out of the 163 respondents, 15% were females and 85% were males. This kind of distribution is synonymous to the African culture where most immovable property like buildings are owned by men and therefore most commercial buildings in Kilifi municipality are therefore owned by men. In many African families, men are the sole bread winners and they tend to own most of the income generating assets of the family as depicted by the results on figure 4.1.

![Circle graph showing 15% females and 85% males](image)

**Figure 4.1: Respondents by Gender**

4.2.2 Period of Landlordship

A statement of the questionnaire sought to establish the period within which the respondents had been landlords. Table 4.1 indicates that 67% of the respondent landlords had been landlords for a period of more than 6 years. This shows that majority of the sampled houses have been in existence for more than 6 years. Thirty three percent of the respondents had been landlords for a period below six years with 15% having been landlords for a period below one year. This shows that commercial building have been on the rise in the recent past within Kilifi municipality.
Table 4.1: Period as Landlord

<table>
<thead>
<tr>
<th>Period</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than one year</td>
<td>25</td>
<td>15.3%</td>
</tr>
<tr>
<td>One to two years</td>
<td>7</td>
<td>4.3%</td>
</tr>
<tr>
<td>Three to five years</td>
<td>23</td>
<td>14.1%</td>
</tr>
<tr>
<td>Six to seven years</td>
<td>41</td>
<td>25.2%</td>
</tr>
<tr>
<td>More than seven years</td>
<td>67</td>
<td>41.1%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>163</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

4.2.3 Basic Tax Knowledge

The questionnaire contained some questions to gather the level of knowledge and appreciation of tax information that the respondents possessed. Table 4.2 has results regarding whether the landlords had ever heard about taxation on rental income, wherein, 88% agreed while 12% had not heard about it. Ninety three percent of the respondents agreed that they had previously interacted with Kenya Revenue Authority (KRA) officials. On the respondents views on whether the Government was using tax revenue is a good way, 92% felt that the Government was not using tax revenues in good way.

Table 4.2: Basic Tax Knowledge

<table>
<thead>
<tr>
<th>Statement</th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Have you ever heard of taxation of rental income</td>
<td>88%</td>
<td>12%</td>
<td>100%</td>
</tr>
<tr>
<td>Have you had an opportunity to interact with Kenya revenue authority officials</td>
<td>93%</td>
<td>7%</td>
<td>100%</td>
</tr>
<tr>
<td>Do you think the government is utilizing tax revenue well</td>
<td>8%</td>
<td>92%</td>
<td>100%</td>
</tr>
</tbody>
</table>

4.3 Frequency and Descriptive Analysis

This section presents results and findings based on the objectives of the research. Data analysis is presented in terms of frequency of responses and the mean score of the responses for each objective. The correlation and regression analysis is also presented in order to appreciate the influence of the independent variables on the dependent variables.
4.3.1 Compliance among Landlords on Taxation of Rental Income

The key dependent variable of the study was the rental tax compliance and the results are presented on Table 4.3. Eighty three percent of the respondents felt that landlords should not be taxed like other Kenyans. This is supported by 91% who strongly felt that rental income tax rate was not equitable compared to other business taxes. Eighty eight percent felt that tax on rental income should be suspended which is further supported by 94% who felt that landlords were playing the role of Government of providing housing. The mean score of the responses for this section was 2.98 which show that there was more disagreement than agreement with the statements in the questionnaire.

Results on Table 4.3 indicate a frictional feeling by the landlords regarding the existence of tax on rental income. The responses show that majority of the landlords in Kilifi municipality feel aggrieved by the tax arrangements and view the tax as a burden placed on them by the Government without adequate considerations and consultations. The extent to which the respondents agreed or disagreed with particular statements is clearly indicative of the feelings of the landlords.

These findings are supported by the theory of reason action suggested by Ajzen and Fishbein (1970) in order to explain conscious behaviors. According to this theory, behaviors of the individuals within the society are under the influence of definite factors, originate from certain reasons and emerge in a planned way (Erten, 2002). Nevertheless, the ability to perform a particular behavior depends on the fact that the individual has a purpose towards that behavior. As for the factors determining the purpose towards the behavior, they are attitude towards behavior, subjective norms and perceived behavioral control. Factors counted above are also under the influence of behavioral beliefs, normative beliefs and control beliefs.
### Table 4.3: Rental Income Tax Compliance

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Agree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Disagree</th>
<th>Mean Likert Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Landlords should be taxed like other Kenyans</td>
<td>83.4%</td>
<td>6.7%</td>
<td>3.1%</td>
<td>6.7%</td>
<td>0%</td>
<td>1.33</td>
</tr>
<tr>
<td>Rental income tax rate is equitable in that it is equal to business tax rate</td>
<td>91.4%</td>
<td>4.9%</td>
<td>0%</td>
<td>3.7%</td>
<td>0%</td>
<td>1.16</td>
</tr>
<tr>
<td>Tax on rental income should be suspended</td>
<td>0%</td>
<td>12.3%</td>
<td>0%</td>
<td>39.9%</td>
<td>47.9%</td>
<td>4.23</td>
</tr>
<tr>
<td>Landlords are playing the role of government by providing housing and hence should not be taxed</td>
<td>0%</td>
<td>5.5%</td>
<td>0%</td>
<td>87.7%</td>
<td>6.7%</td>
<td>3.96</td>
</tr>
<tr>
<td>Income from rental business is too little for the government to follow</td>
<td>0%</td>
<td>13.5%</td>
<td>0%</td>
<td>69.3%</td>
<td>17.2%</td>
<td>3.9</td>
</tr>
<tr>
<td>I believe that all landlords should be taxed like other businessmen</td>
<td>36.2%</td>
<td>44.8%</td>
<td>0%</td>
<td>19%</td>
<td>0%</td>
<td>2.02</td>
</tr>
<tr>
<td>Rental business should be allowable as an investment allowance to encourage landlords assist government in provision of decent housing to citizens</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>71.8%</td>
<td>28.2%</td>
<td>4.28</td>
</tr>
</tbody>
</table>

### 4.3.2 Influence of taxpayers’ understanding of a tax system and tax laws on rental income tax compliance

The first objective of the study was to find out whether the level of taxpayers’ understanding of a tax system and tax laws on rental income tax influences compliance among landlords in Kilifi Municipality. The objective was assessed using statements on a likert scale questionnaire. The results on Table 4.4 reveal that 100% of the respondents felt that KRA had not conducted adequate training on taxation of rental income before its introduction while 85% appreciated that rental income is a taxable source of income. Regarding whether they were aware of the consequences of non-payment of rental income tax, 92% were aware of that the Government or KRA could auction their property for failure to pay taxes.
The results on table 4.4 show that tax payers can take an opposite position on tax matters even when they are well aware of the consequences and personal tax obligations. These findings are corroborated by Eriksen and Fallan (2006) who claimed that knowledge about tax law is assumed to be important for preferences and attitudes towards taxation. Eriksen and Fallan (2006) illustrated the importance of tax education in a tax system. They suggested that fiscal knowledge correlates with attitudes towards taxation and tax behaviour can be improved by a better understanding of tax laws. The findings are further supported by Chan et. al. (2010) who postulate that greater education is directly linked to a likelihood of compliance. They argue that educated taxpayers may be aware of non compliance 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. They also suggested that those with a higher education level are more likely to have a higher level of moral development and higher level attitudes toward compliance and thus will tend to comply more.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree Strongly Agree</th>
<th>Mean Likert Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>KRA should have conducted adequate training to all Kenyans before introducing rental income tax</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>71.8%</td>
<td>28.2%</td>
</tr>
<tr>
<td>I understand that rental income is taxable</td>
<td>9.2%</td>
<td>6.1%</td>
<td>0%</td>
<td>62.0%</td>
<td>22.7%</td>
</tr>
<tr>
<td>I know you can have your property auctioned by the government of you don’t pay taxes</td>
<td>8.0%</td>
<td>84.0%</td>
<td>0%</td>
<td>8.0%</td>
<td>0%</td>
</tr>
<tr>
<td>Kenyan tax laws are punitive to hardworking citizens</td>
<td>8.6%</td>
<td>13.5%</td>
<td>0%</td>
<td>56.4%</td>
<td>21.5%</td>
</tr>
<tr>
<td>I have attended a tax awareness education on taxation of rental income</td>
<td>11.0%</td>
<td>36.2%</td>
<td>0.6%</td>
<td>36.8%</td>
<td>15.3%</td>
</tr>
<tr>
<td><strong>Overall Likert Mean Score</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>3.39</strong></td>
</tr>
</tbody>
</table>
4.3.3 Effect of penalties on rental income tax compliance among landlords

Table 4.5 presents results on the effect of penalties on compliance of with rental income taxation. Seventy seven percent of the respondents were aware of the existence of penalties applied to taxpayers for failure to pay taxes. Sixty six percent agreed that they did not care about the penalties related to taxation non compliance. This is supported by 80% who failed to pay rental income tax because they were aware of other landlords with bigger buildings and they were not paying taxes. Majority of the respondents felt that payment of taxes was not commensurate of the benefits they get from Government.

The results on Table 4.5 indicate that landlords in Kilifi were aware of the consequences of non-compliance with tax matters but they did not care very much about the penalties because they had seen many landlords who never complied but were still free of the penalties. These findings are consistent with empirical studies conducted by Park and Hyun (2003) on the impact of fines on tax compliance but did not find a relationship. They found that compliance increased significantly with higher fines, but not with higher audit probabilities. Other experiments, on the contrary, showed that fines and tax compliance are not related, but audit probabilities and tax compliance are. They asserted that in an antagonistic climate, fines can be a part of the game of "cops and robbers"; in a synergistic climate, they can be perceived as an adequate retribution for behavior that harms the community. Fines are therefore connected to trust and power. Fines that are too low could be perceived as indicator that the authorities are weak and unable to control the wrongdoers, undermining trust among honest taxpayers. It is therefore important for KRA to evaluate the penalties and fines related to rental income taxation with a view to balancing revenue generation and compliance levels.
Table 4.5: Taxpayer penalties and Tax Compliance

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean Likert Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>I know there are penalties for tax non-compliance</td>
<td>7.4%</td>
<td>15.3%</td>
<td>0%</td>
<td>55.2%</td>
<td>22.1%</td>
<td>3.69</td>
</tr>
<tr>
<td>I don’t care about the penalties for tax default because I know how to</td>
<td>9.8%</td>
<td>23.3%</td>
<td>0%</td>
<td>47.9%</td>
<td>19.0%</td>
<td>3.43</td>
</tr>
<tr>
<td>buy my way out</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I know people with bigger houses than mine and they don’t pay taxes and</td>
<td>7.4%</td>
<td>12.3%</td>
<td>0%</td>
<td>60.1%</td>
<td>20.2%</td>
<td>3.74</td>
</tr>
<tr>
<td>hence I also don’t care as much</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Landlords even construct roads and they are never compensated by</td>
<td>19.6%</td>
<td>80.4%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1.8</td>
</tr>
<tr>
<td>government and hence why pay the taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paying taxes is not good because we don’t get equal returns from the</td>
<td>27.6%</td>
<td>72.4%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1.72</td>
</tr>
<tr>
<td>government</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Overall Likert Mean Score</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>2.88</strong></td>
</tr>
</tbody>
</table>

4.3.4 Effect of taxpayers perceptions on the revenue authority on rental income tax compliance among landlords

The third objective of the study was to establish the effect of taxpayer perceptions on KRA on compliance among landlords in Kilifi. Fifty nine percent of the respondents agreed that KRA has been doing its work of explaining why landlords should pay taxes on their rental income. Ninety two percent felt that it was not easy to deal with KRA officers when discussing tax disputes. There were 88% who felt that the tax system in Kenya is interested in pursuing the hard earnings of poor hard working people while ignoring the rich who could yield more tax revenue for the Government.

The results on Table 4.6 show that landlords in Kilifi did not have a very healthy perception towards the revenue authority and the Government in regards to taxation matters and approach. These findings are supported by Kirchler et. al (2008) who found that tax attitudes in general also depend on the perceived use of the money collected and therefore are connected to knowledge compliance. Further similar evidence is found by Trivedi, Shehata, and Mestelman (2004) who also found that tax evasion had a weak relationship with taxpayer attitudes. They
also reported complicated relationship between tax evasion and attitudes. On the other hand Kirchler et. al (2008) found that attitudes towards the tax authority are also important as tax attitudes and ethics generally depend on perceived use of the money collected by the government.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean Likert Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>KRA explains well on why landlords should pay taxes</td>
<td>8.0%</td>
<td>31.9%</td>
<td>0%</td>
<td>44.8%</td>
<td>15.3%</td>
<td>3.28</td>
</tr>
<tr>
<td>It is easy to deal with KRA officers in case of a tax dispute</td>
<td>8.0%</td>
<td>84.0%</td>
<td>3.7%</td>
<td>4.3%</td>
<td>0%</td>
<td>2.04</td>
</tr>
<tr>
<td>The government does not help us to lay infrastructure and hence there is no need to pay rental income taxes</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>79.8%</td>
<td>20.2%</td>
<td>4.2</td>
</tr>
<tr>
<td>The Kenyan tax system only pursues the poor and the middle class and hence as a landlord I don’t see the need to pay taxes</td>
<td>0%</td>
<td>8.0%</td>
<td>3.7%</td>
<td>70.6%</td>
<td>17.8%</td>
<td>3.98</td>
</tr>
<tr>
<td>KRA is good at chasing small taxes like from the landlords and fails to chase big tax revenues and hence the reason why landlords should not pay taxes</td>
<td>0%</td>
<td>0%</td>
<td>4.3%</td>
<td>81.0%</td>
<td>14.7%</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Overall Likert Mean Score</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>3.52</strong></td>
</tr>
</tbody>
</table>

4.3.5 Influence of integrity of the taxpayer and tax collector on rental income tax compliance

The fourth objective of the study was to establish the effect of landlord integrity on compliance with payment of rental income taxation. Results on Table 4.7 show that 97% of the respondents were concerned with the return they get from the tax payments because they felt that KRA was just collecting taxes with no regard to the service rendered to the landlords by the Government. Eighty nine of the respondents agreed that they did not care about paying taxes because they felt that it was their right to retain all the monies collected from rent. Landlords also felt that the
Government was not providing them with the investment incentives which are given to other sectors.

The findings indicate that the sampled landlords have taken a position that has made them develop an integrity which is not supportive to taxation. The integrity had developed antagonistic stance with the tax authorities and leading to low levels of integrity in terms of payment of taxes. The finding on the effect of integrity on tax compliance resonates with those of Orviska and Hudson (2002) and Trivedi, Shehata and Mestelman (2004) who found a significant (but weak) relationship between tax evasion and ethics. Elffers, Weigel and Hessing (2002) also found that ethics, attitudes and moral beliefs impacted upon tax compliance behavior according to their psychological model of tax compliance.

Table 4.7: Taxpayer Integrity and Tax Compliance

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean Likert Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>KRA are just after collecting taxes and not the services offered to landlords and tenants</td>
<td>0%</td>
<td>0%</td>
<td>3.1%</td>
<td>82.2%</td>
<td>14.7%</td>
<td>4.12</td>
</tr>
<tr>
<td>I don’t care whether I pay taxes or not, it’s my hard earned money</td>
<td>0%</td>
<td>8.0%</td>
<td>3.1%</td>
<td>74.8%</td>
<td>14.1%</td>
<td>3.95</td>
</tr>
<tr>
<td>KRA looks for smalls omissions and assess huge penalties instead of advising citizens, then I don’t care about my taxes</td>
<td>0%</td>
<td>8.0%</td>
<td>3.1%</td>
<td>64.4%</td>
<td>24.5%</td>
<td>4.06</td>
</tr>
<tr>
<td>I have no duty to pay taxes because I believe the government should not be taking my money</td>
<td>0%</td>
<td>12.3%</td>
<td>2.5%</td>
<td>66.3%</td>
<td>19.0%</td>
<td>3.92</td>
</tr>
<tr>
<td>Government should give landlords incentives like they give other investors in order to encourage tax compliance</td>
<td>0%</td>
<td>0.6%</td>
<td>2.5%</td>
<td>86.5%</td>
<td>10.4%</td>
<td>4.07</td>
</tr>
</tbody>
</table>

**Overall Likert Mean Score**

4.02

4.4 Inferential Statistical Analysis

This section presents analysis of the questionnaire responses in a way that produced deductions or inferences from statistical coefficients. The coefficients included in the analysis are the
Pearson correlation, coefficient of determination, beta coefficient, F-test statistics, t-test statistics and the p-value

4.4.1 Bivariate Correlation

Table 4.8 shows the correlation and significance levels between the dependent variable and the independent variables. The correlations between rental income tax compliance and the independent predictors are weak and only taxpayer perception was significant at 0.05. The results indicate that there could be other factors which are available which have stronger positive correlations with tax compliance. The correlations between the predictors variables are indicated on table 4.8.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Indicator</th>
<th>Tax Compliance</th>
<th>Understanding of Tax</th>
<th>Taxpayer Motivation</th>
<th>Taxpayer Perception</th>
<th>Taxpayer Integrity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Compliance</td>
<td>Pearson Correlation 1, Sig. (2-tailed)</td>
<td>0.086, 0.274</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Understanding of Tax</td>
<td>Pearson Correlation 0.117, Sig. (2-tailed)</td>
<td>0.793, 0.000</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxpayer Motivation</td>
<td>Pearson Correlation 0.167, Sig. (2-tailed)</td>
<td>0.595, 0.000</td>
<td>0.581, 1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxpayer Perception</td>
<td>Pearson Correlation 0.053, Sig. (2-tailed)</td>
<td>0.124, 0.000</td>
<td>0.062, 0.276, 1</td>
<td>0.000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.4.2 Regression Analysis

Table 4.9 shows that the combined correlation between the rental income tax compliance and the predictor variables of 99.2% which is a strong positive correlations. The R-square also called the coefficient of determination of 98.4% reveals that the combined effect of the predictor variables could explains 98.4% variations in the rental income tax compliance in Kilifi municipality. This shows that the model and the predictor variable used to test the rental tax compliance can explain 98.4% of the tax compliance issues in Kilifi municipality.
Table 4.9: Regression Model Fitness

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>R</td>
<td>0.992</td>
</tr>
<tr>
<td>R Square</td>
<td>0.984</td>
</tr>
<tr>
<td>Std. Error of the Estimate</td>
<td>0.38951</td>
</tr>
</tbody>
</table>

Table 4.10 shows that the model is highly significant at 0.05 in explaining the rental income tax compliance in Kilifi municipality. The sum of squares explained by the predictors variables are quite large compared to the residual. This agrees with the coefficient of determination.

Table 4.10: ANOVA Results

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>1442.366</td>
<td>4</td>
<td>360.592</td>
<td>2376.69</td>
<td>0.000</td>
</tr>
<tr>
<td>Residual</td>
<td>24.123</td>
<td>159</td>
<td>0.152</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1466.49</td>
<td>163</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 4.11 shows the regression of the individual predictor variables against the dependent variable of rental income tax compliance. Taxpayers' perception and taxpayers' integrity have a beta value which shows that a unit change in either of them caused a 48.6% and 31% change in rental income tax compliance respectively. Subsequently both taxpayer perception and taxpayer integrity were significant at 0.05 in explaining the level of rental income tax compliance. This means that KRA should use strategies that target taxpayers' perceptions and integrity for achieving maximum compliance with taxation on rental income.

Table 4.11: Regression Output

<table>
<thead>
<tr>
<th>Variable</th>
<th>Beta</th>
<th>Std. Error</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Understanding of Tax</td>
<td>-0.008</td>
<td>0.078</td>
<td>-0.104</td>
<td>0.918</td>
</tr>
<tr>
<td>Taxpayer Motivation</td>
<td>0.010</td>
<td>0.075</td>
<td>0.132</td>
<td>0.895</td>
</tr>
<tr>
<td>Taxpayer Perception</td>
<td>0.486</td>
<td>0.088</td>
<td>5.551</td>
<td>0.000</td>
</tr>
<tr>
<td>Taxpayer Integrity</td>
<td>0.310</td>
<td>0.055</td>
<td>5.601</td>
<td>0.000</td>
</tr>
</tbody>
</table>
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction
This chapter summarizes the findings of the study and makes recommendations on the subject areas covered. The summary, conclusions and recommendations are organized and based on the study objectives. Based on the findings and gaps encountered in the course of the study and in the interest of promoting research and academic discourse, areas for further research are recommended.

5.1 Summary
The study had four objectives which guided the data collections and analysis. The results and analysis were organized based on the four objectives. The following is a summary of the findings.

The landlords felt that they should not be taxed like other Kenyans because they were doing a housing duty which should be provided by the Government. This was further supported by landlords who strongly felt that rental income tax rate was not equitable compared to other business taxes. Kilifi landlords further supported that tax on rental income should be suspended. The responses show that majority of the landlords in Kilifi municipality feel aggrieved by the tax arrangements and view the tax as a burden placed on them by the Government without adequate considerations and consultations.

The respondents felt that KRA had not conducted adequate training on taxation of rental income before its introduction while they appreciated that rental income is a taxable source of income. The landlords were aware of that the Government or KRA could auction their property for failure to pay taxes. The landlords were aware of the existence of penalties applied to taxpayers for failure to pay taxes and they knew that tax payment is a citizenry. Majority of the respondents felt that payment of taxes was not commensurate of the benefits they get from Government.
The landlords agreed that KRA was been doing its work of explaining why landlords should pay taxes on their rental income but they felt it was not easy to deal with KRA officers when discussing tax disputes. They felt that the tax system in Kenya was interested in pursuing the hard earnings of poor hard working people while ignoring the rich who could yield more tax revenue for the Government. This indicated that landlords in Kilifi did not have a very healthy perception towards the revenue authority and the Government in regards to taxation matters and approach.

Landlords felt that the Government was not providing them with the investment incentives which are given to other sectors while they were required to meet the same tax obligations. The findings indicate that the sampled landlords had taken a position that has made them develop an integrity which was not supportive to taxation. The integrity had developed antagonistic stance with the tax authorities and leading to low levels of integrity and compliance in terms of payment of taxes.

5.2 Conclusion

Based on the findings of the study it can be concluded that compliance with taxation issues was low on the part of income from rental properties. The compliance levels will need to be addressed by use of well targeted strategies which would end up improving the image of the Government and revenue authority. Landlords and possibly the other citizens were not ready to comply with tax regulations because there is a feeling is denial due to failure of clear evidence of the advantages of paying taxes.

A notable finding was that taxpayers are aware of their obligation to pay taxes but they were not ready to comply. This shows that being trained and educated on tax matters was not enough to enhance compliance with payment of taxes. The government in conjunction with Kenya Revenue Authority (KRA) should not assume that training and communication was adequate to enhance compliance. Kenya Revenue Authority had held many seminars in the Kilifi region but it had not
significantly changed the compliance levels and hence the need to re-evaluate the training strategy.

Fines and penalties did not seem to be an adequate deterrent to manage truant landlords. The findings show that penalties could even increase the level of non-compliance as landlords could also adopt a hard position. Fines and penalties are likely to introduce the ‘cops and robbers’ attitude and complicate compliance initiatives.

Landlords felt that they were not provided with adequate incentives to motivate them to invest in housing yet they were given the same tax status like the other investors who enjoyed investment incentives. This shows that the landlords are aware of the investment regime and hence the Government should review housing sector incentives in order to maximize tax revenue compliance and returns from real estate sector.

5.3 Recommendations
The regression analysis revealed that the most statistically significant variables in explaining rental income tax compliance were the taxpayers’ perceptions and the taxpayers’ integrity. The Government and KRA should employ strategies that would improve the perception of tax payers. This could be done through aggressive and friendly promotional campaigns on why citizens ought to pay taxes. The tax management officers of the Government and KRA should also undergo intensive citizen and tax payer management courses. Such courses should be structured in a way that will help to improve the interaction between the tax payers and the officers.

The management of taxes should be devolved to very local levels in order for KRA to appreciate the difficulties landlords face when developing their properties in order to know the incentives required to enhance compliance. This strategy will assist by taking the tax officers to the people compared to the current situation where tax officers only meet tax payers when there are tax audits and investigations. This has so far made tax payers to view tax officer with suspicion and therefore leading to hide and seek game.
Kenya Revenue Authority should invest in a detailed action research and it should be continuous in nature to ensure constant capturing of issues and challenges as they arise on the ground. This kind of action research should encompass all relevant stakeholders at the grass root level. This will ensure the capturing of every miniature detail from the stakeholders on how to manage tax matters in a better way.

Computerization of tax records and business transactions should be pursued by the Government as an effort to have a seamless system of records management. One of the reasons why rental income tax compliance is low is because the landlords collect their rental income in form of cash from the tenants. The real estate sector is also not well computerized and hence making it difficult to know who owns which property in the country. This makes it quite difficult to track tax defaulters and evaders and therefore the strong case for extensive and intensive computerization of Government information management systems.

5.4 Areas for Further Research
Arising from the findings of the study, it is recommended that a further study be conducted to establish whether political regime has an influence of tax compliance. A replica cross sectional study is also recommended to establish whether the same factors explain tax compliance across various counties in Kenya.
REFERENCES


*Andrew Young School of Policy Studies international conference*. Atlanta: University of Georgia.


McBarnet, D. (2001). When compliance is not the solution but the problem: From changes in law to changes to attitude. Canberra: Australian National University, Centre for Tax System Integrity.


Omondi, F. (June 2010), “Budget blurs line between tax evasion and avoidance,”


APPENDICES

Appendix I: Letter of Introduction

Date…………………………

District Commissioner/Town Clerk
Kilifi District/Kilifi Municipal Council
Kilifi – Kenya

Dear Sir,

RE: COLLECTION OF RESEARCH DATA

I am a postgraduate student of Kenyatta University pursuing Master of Business Administration. Currently I am planning to conduct a study that I trust will add value to the Kenyan economy and your office too. The study is titled “factors affecting rental income tax compliance among landlords in Kilifi municipality.” My study seeks to appreciate the factors that may be affecting compliance of rental income tax. Questionnaires will be issued to randomly selected landlords and they will be requested to fill them. Research assistants will be deployed to assist in the distribution of questionnaires and collecting them from the sampled landlords.

I therefore request you to kindly allow my research assistants to issue questionnaires to randomly selected landlords within Kilifi Municipality. The responses provided by the landlords will be handled with utmost confidentiality and ethical standards will be observed. The findings of this study will be used exclusively for academic purposes.

Yours Sincerely

Kevin M. Kuria
Appendix II: Questionnaire

*This questionnaire is meant to gather information regarding your views on compliance with rental income tax regulations in Kenya*

**CONFIDENTIALITY CLAUSE:**
The responses you provide will be used for academic research purposes, will be strictly confidential and will be handled ethically.

**SECTION 1: BASIC INFORMATION**

1) Kindly indicate your gender
   - Male [ ]
   - Female [ ]

2) For how many years have you been a landlord?
   - Less than 1 Year [ ]
   - 1-2 Years [ ]
   - 3 to 5 years [ ]
   - 6 to 7 years [ ]
   - More than 7 years [ ]

3) Have you ever heard of taxation of rental income?
   - Yes [ ]
   - No [ ]

4) Have you had an opportunity to interact with Kenya revenue authority officials?
   - Yes [ ]
   - No [ ]

5) Do you think the government is utilizing tax revenue well?
   - Yes [ ]
   - No [ ]
## SECTION 2: RENTAL INCOME TAX COMPLIANCE

The following are statements relating to rental income tax compliance in Kenya. Please insert a tick on your extent of agreement or disagreement with each statement.

<table>
<thead>
<tr>
<th>No</th>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Landlords should be taxed like other Kenyans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Rental income tax rate is equitable in that it is equal to business tax rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Tax on rental income should be suspended</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Landlords are playing the role of government by providing housing and hence should not be taxed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Income from rental business is too little for the government to follow</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>I believe that all landlords should be taxed like other businessmen</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Rental business should be allowable as an investment allowance to encourage landlords assist government in provision of decent housing to citizens</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
SECTION 3: FACTORS AFFECTING RENTAL INCOME TAX COMPLIANCE

The following are statements relating the factors affecting income rental income tax compliance in Kenya. Please insert a tick on your extent of agreement or disagreement with each statement.

Key: 1=strongly disagree, 2= disagree; 3=neutral; 4= agree; 5= strongly agree

<table>
<thead>
<tr>
<th>No</th>
<th>Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>UNDERSTANDING OF A TAX SYSTEM AND TAX LAWS</td>
</tr>
<tr>
<td>1</td>
<td>KRA should have conducted adequate training to all Kenyans before introducing rental income tax</td>
</tr>
<tr>
<td>2</td>
<td>I understand that rental income is taxable</td>
</tr>
<tr>
<td>3</td>
<td>I know you can have your property auctioned by the government if you don’t pay taxes</td>
</tr>
<tr>
<td>4</td>
<td>Kenyan tax laws are punitive to hardworking citizens</td>
</tr>
<tr>
<td>5</td>
<td>I have attended a tax awareness education on taxation of rental income</td>
</tr>
<tr>
<td></td>
<td>PENALTIES</td>
</tr>
<tr>
<td>1</td>
<td>I know there are penalties for tax non-compliance</td>
</tr>
<tr>
<td>2</td>
<td>I don’t care about the penalties for tax default because I know how to buy my way out</td>
</tr>
<tr>
<td>3</td>
<td>I know people with bigger houses than mine and they don’t pay taxes and hence I also don’t care as much</td>
</tr>
<tr>
<td>4</td>
<td>Landlords even construct roads and they are never compensated by government and hence why pay the taxes</td>
</tr>
<tr>
<td>5</td>
<td>Paying taxes is not good because we don’t get equal returns from the government</td>
</tr>
<tr>
<td></td>
<td>TAX PAYER PERCEPTION ON THE REVENUE AUTHORITY</td>
</tr>
<tr>
<td>1</td>
<td>KRA explains well on why landlords should pay taxes</td>
</tr>
</tbody>
</table>

64
<table>
<thead>
<tr>
<th>No</th>
<th>Statements</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>It is easy to deal with KRA officers in case of a tax dispute</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>The government does not help us to lay infrastructure and hence there is no need to pay rental income taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>The Kenyan tax system only pursues the poor and the middle class and hence as a landlord I don’t see the need to pay taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>KRA is good at chasing small taxes like from the landlords and fails to chase big tax revenues and hence the reason why landlords should not pay taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**INTEGRITY OF THE TAXPAYER AND TAX COLLECTOR**

<table>
<thead>
<tr>
<th>No</th>
<th>Statements</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>KRA are just after collecting taxes and not the services offered to landlords and tenants</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>I don’t care whether I pay taxes or not, it’s my hard earned money</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>KRA looks for smalls omissions and assess huge penalties instead of advising citizens, then I don’t care about my taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>I have no duty to pay taxes because I belief the government should not be taking my money</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Government should give landlords incentives like they give other investors in order to encourage tax compliance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**SECTION 4: OTHER FACTORS AFFECTING RENTAL INCOME TAX COMPLIANCE**

Kindly state and describe other factors that affect the compliance of rental income tax.

..........................................................................................................................................................
..........................................................................................................................................................
..........................................................................................................................................................
..........................................................................................................................................................

*Thank you for your cooperation.*