

**EFFECTS OF TAX REFORMS ON COMPLIANCE OF SMALL AND  
MEDIUM ENTERPRISES IN KENYA; CASE OF KISUMU TOWN**

**BY**

**ONYANCHA M. ONDIMU**

**D86/CTY/21708/2010**

**A THESIS SUBMITTED TO THE SCHOOL OF BUSINESS IN  
PARTIAL FULFILMENT FOR THE AWARD OF DEGREE OF  
DOCTOR OF PHILOSOPHY IN FINANCE OF KENYATTA  
UNIVERSITY, KENYA**

**JUNE 2015**

## **DECLARATION**

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Signed:.....Date: .....  
**Onyancha M. Ondimu (D86/CTY/21708/2010)**  
**Department of Accounting and Finance**  
**Kenyatta University**

This thesis has been submitted with our approval as the University Supervisors.

Signed:.....Date: .....  
**Prof. Alfred Osiemo, PhD**  
**Department of Accounting and Finance**  
**KCA University**

Signed:.....Date: .....  
**Dr. George K. Kosimbei, PhD**  
**School of Economics**  
**Kenyatta University**

## **DEDICATION**

My parents Meshack Onyancha and Olpha Moragwa, my uncle Simon Ombogo and Aunt late Susan Nyanchama; from whom I learnt the very basic pillar in life of hard work, self-discipline and for the first time business lessons.

My dear wife, Jemima Kemunto Ondimu and wonderful children Ashlyn Moragwa Ondimu and Bruce Ondimu who have inspired me and offered me moral and spiritual support to settle and do this work.

## **ACKNOWLEDGEMENT**

I do greatly acknowledge our Almighty God for his holy greatness and without whom I would not have made it. My utmost gratitude is to Jemima Ondimu together with my children Ashlyn and Bruce for giving me humble time, encouragement and full support during my entire of thesis writing period. Their support uplifted me whenever I felt like giving up.

I wish to thank my supervisors Prof. Osiemo and Dr. Kosimbei for their guidance throughout this thesis which was invaluable. My sincere appreciation goes to my lecturers whose enlightenment during coursework got me interested in this subject. I benefited from the scholarly advice of Dr. Samuel Mokaya of Jomo Kenyatta University of Agriculture and Technology; and Dr. Karanja Ngugi of Kenyatta University who through numerous meetings and telephone conversations provided invaluable criticisms and inputs that improved the quality of this research work. I am equally indebted to my employer KRA for providing enabling study environment.

I wish to specially thank all my colleagues at KRA for their encouragement and invaluable support which proved useful during my literature review. Special thanks go to Investigation and Enforcement department western region office team headed by Peter Iraki. To all my brothers and sisters; all of you are special. Finally, I am thankful to all who in their special ways made this thesis a success.

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## **OPERATIONAL DEFINITION OF TERMS**

Compliance	taxpayers willingly fully abide by the law, rules and regulations requiring them to pay taxes liable to them to tax authorities.
Compliance costs	costs over and above the actual payment of tax and over and above any distortion costs inherent in the nature of tax incurred by taxpayers in meeting the tax requirements.
Corporate tax	a direct tax on incomes made by corporate bodies as provided by the Income Tax Act Chapter 470.
Impact	an immediate and strong effect on operation of something.
Income Tax	a tax charged on income earned by a person whether resident or non-resident as defined under the Income Tax Act Chapter 470.
Small and Micro Enterprises	refers to businesses which employ one or more persons and enterprises in the formal sector employing up to 50 persons.
PAYE (pay as you earn)	a tax payment method in which an employer is required by law to deduct income tax from an employee's taxable wages or salary.
Presumptive taxation	involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts. The term presumptive is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method. An example is ToT.
Taxpayer	all income earning entities which include individuals, partnerships and companies
Revenues	refers to the gross proceeds received from taxes, fees, and other levies.
Tax	is a financial charge or levy imposed on an individual or a legal entity by a state.
Tax Modernization	refers to the creation, amendment, or repealing of numerous tax-

	related statutes and review of procedures and methods of work performance.
Tax reform	tax reform is enacted measures to achieve larger goals of an accountable and transparent government through improved revenue collection and tax policies.
Tax audit	is an examination of an individual or a corporation's tax return to verify its accuracy.
Tax evasion	entails taxpayers illegally and misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability.
Tax avoidance	is the legal use of tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law.
Value Added Tax	is a consumption tax levied on designated local supply of goods and services and on imports in accordance with the provisions of the VAT Act Chapter 476.

## **LIST OF ABBREVIATIONS AND ACRONYMS**

CPA (K)	Certified Public Accountant of Kenya
FGD	Focus group discussion
GDP	Gross Domestic Product
GOK	Government of Kenya
IEA	Institute of Economic Affairs
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
IT	Income Tax
Kshs	Kenya Shilling
KRA	Kenya Revenue Authority
SMEs	Small and Medium enterprises
OECD	Organisation of Economic and Cooperation Development
PBO	Parliamentary Budget Office
PAYE	Pay As You Earn
Ph.D	Doctor of philosophy
PIN	Personal Identification Number
Prof	Professor
SPSS	Statistical Program for Social Sciences (SPSS)
Tshs	Tanzania Shilling
TOT	Turnover Tax
UK	United Kingdom
UNDP	United Nations Development Program
USA	United States of America
VAT	Value Added Tax
WB	World Bank

## ABSTRACT

With increased expenditure there is demand for more tax revenue calling for revenue enhancement measures. In Kenya the SMEs are non-compliant despite having huge tax revenue potentials. From mid 1980s the government initiated tax reforms to enhance compliance by widening tax bases and improve tax administration. Consequently government reorganized KRA, changed personal relief (by 10%), granted amnesty on non-compliant taxpayers with arrears (up to 11 June 2004) and turnover tax at 3% (from 1 January 2008). However, SMEs sector are characterized with low compliance levels. It was important establish effects of tax reforms on tax compliance of SMEs in Kenya with use of Kisumu Town. Specifically the study sought to determine effects of turnover tax on compliance of SMEs determine effects the KRA tax administration reforms on SMEs compliance and establish behaviors of SMEs in Kisumu Town which affect tax compliance. The study adopted descriptor-exploratory research design with each Kisumu KRA officer and business constituted one sample unit and respondents. Samples of 275 (involving 219SMEs and 56 KRA officers) were selected from target population of 505 SMEs and 56 Kisumu KRA officers using stratified simple random sampling approach and census for KRA officers. The study used both primary (from questionnaires) and secondary data. These instruments were administered by the researcher with help of research assistants. Data collected were analyzed using both descriptive statistics (frequencies, percentages and means) and inferential statistics (Pearson's Moment of correlation, regression); using SPSS. The findings revealed that turnover tax system affects and accounts for 28.8% [ $r(214) = .439, p < 0.01$ ] SMEs' tax.KRA administrative reforms affects and accounts 36.8% SMEs tax compliance [ $r(214) = .617, p < 0.01$ ]. KRA was effective (mean rating of 3.869) but ineffective in facilitating SMEs to voluntarily comply. KRA was effective in providing taxpayers information and guidance. KRA was effective in use technology and in data warehousing. There is a fair rating of reducing compliance burden of the SMEs (mean responses being 3.562). SMEs tax behaviours negatively affects tax compliance [ $r(214) = -.542, p < 0$ ]. There was negative influence from the referent groups and SMEs (68%; 146) do not use tax agents. The turnover productivity for the last six year has been increasing from the time of start of tax reforms targeting SMEs in Kenya. This is based on the efficiency ratio of 0.35 percent in the year 2008 which has increased to the current 0.4. From the findings, the study concludes that the tax reforms and tax behaviours significantly affect tax compliance of the SMEs in Kisumu Town. The study recommends that: continuous emphasis on creation of awareness and monitoring of the compliance of the SMEs. Review the tax laws and more enforcement of the SMEs tax laws.KRA should carry out more profiling of the SMEs and research more on the SMEs to understand the SMEs. Publicize prosecution non-compliance; provide incentives for compliance and opportunity to voluntarily disclose before the application of penalties. There is need for the government to enhance SMEs' trust with the tax reforms for voluntary compliance.

# CHAPTER ONE

## INTRODUCTION

This chapter presented the background to the study, the statement of the problem, the objective of the study, research hypothesis, and significance of the study and scope of the study.

### **1. Background of the Study**

World over, taxation is one of the government policy instruments used to achieve equity and efficiency in the economy (Jackson & Mckee, 1992). Taxation is the known practical source of public finance in many economies, besides other sources like non-tax revenue such as user-fees and licenses charged for services rendered by government department and agencies and foreign aids (Marina & Kilis, 2002).

Tax system is the source of public finance in development projects such as provision of infrastructure like good roads, stable power supply, and stable water supply among others. All of which combine to create an enabling environment for businesses and in turn the economy at large to grow (Duanjie, *et al.*, 2002). Tax collected by governments depends on taxpayers' voluntary compliance whereby the taxpayers fulfil their tax obligation freely and completely. However, developing economies face challenges of raising sufficient tax revenue to finance the ever increasing public expenditures due to noncompliance amongst the taxpayers (Marti, 2010).

Countries in the Sub-Saharan Africa lack of sufficient revenue which results in large budget deficits. Except when short-term fiscal stimulus may be considered appropriate for

macroeconomic reasons, deficits generally lead into undesirable macroeconomic consequences such as crowding out private investment and increasing inflation. Preventing deficits requires good control over both the expenditure and revenue sides of government. The legislated budget must be structured each year to operate strictly within estimates of likely revenue receipts. However for long term basis effective tax strategies must be identified and implemented swiftly (James, 2008). There is need for appropriate tax systems with expanded tax base and improved compliance which can harness tax revenue (Pfister, 2009). In many economies in the world, small and medium-sized enterprises (SMEs) have emerged as the potential and unexploited tax revenue to address bedeviling fiscal deficits (Loeprick & Engelschalk, 2011).

According to World Bank (2007), SME includes those enterprises that are either a formally registered business, with an annual turnover of between Kenya Shillings 8 to 100 million, with an asset base of at least Kenya Shillings 4 million or employ between 5 to 150 employees. While in Kenya, the Sessional Paper No. 3 of 2004, SMEs as an enterprise with between 1 to 50 employees and the SME bill 2011 define MSEs based on the number of people/employees and the company's annual turnover.

The SMEs accounts contribute to 35-50 per cent of global Gross Domestic Products. SMEs are the dominant and vast majority of firms in many economies in the world (Venter & Clercq, 2007) for instance on average over 90% of the enterprises in developing countries like in Africa. SMEs play vital role in contributing towards economic development, increase household income and create jobs among (Cynthia, *et al.*, 2009).

In Europe, 99.8 percent of the business enterprises are small and medium-sized enterprises that employ two thirds of the total workforce (Cynthia, *et al.*, 2009). Small businesses play a similar role on the African continent. For example, in 2003 in Nigeria, small businesses were responsible for 95 per cent of formal manufacturing activity. In Ghana 70 per cent of the business firms are microenterprises with less than five employees and approximately 70 per cent of the Ghanaian workforce is employed in SMEs sector. This sector accounts for 75% of the total employment in Kenya while contributing 18.4 percent of the country's Gross Domestic Product (GDP), the sector has identified to be driver of vision 2030 (World Bank, 2007b).

SMEs are commonly characterized by uncertainty, innovation and evolution for instance in Nigeria are usually small, owner or family managed business offering basic goods and services, which tend to lack organizational and management structures with the urban ones tending to be more structural than their rural counterparts. SMEs are mostly sole proprietorships or partnerships although on the surface, they may be registered as Limited Liability Companies as such they are usually not separate legal entities. Olorunshola (2003) explains that this ownership style has led small and medium enterprises to have a simple management structure compounded few numbers of employees and the owners' low level of education. Since there is no legal personality between the small and medium enterprise and its owners, it means the lifespan of the enterprise is dependent on the lifespan of its owners that is there is no perpetual continuity.

The production process of the SMEs is labour intensive, with raw materials locally sourced; serve as suppliers to large established enterprises. Their management decision being

subjective since they are managed and controlled by the same individual and the employee-employer relationship found in most SMEs is predominantly informal. Further SMEs vary in sizes and organizational form; sizes varying from small retail outlets to highly paid professionals, and substantial manufacturing enterprises and while forms vary from sole proprietorships (with or without employees), small corporations (public or private), professionals and partnerships. The contributions SMEs usually make to tax revenue are lower than its contributions to output and employment (International Tax Dialogue, 2007).

Like other profit generating entities, SMEs are also expected to pay their taxes, but however, the concern is how much tax should they be levied. SMEs are volatile establishments that need special treatment. Most of them remain in the informal sector because they feel the cost of compliance is too high. And a considerable number of those who pay only do so because they are coerced by the authorities. Since the individual SME pays a very small amount of tax compared what the larger establishment would pay, tax authorities tend give the larger corporations more attention. This means a good number of SMEs get away with not paying their taxes hence revenue that would otherwise have been invested in development projects that will end up being of benefit even to the SMEs is lost. This therefore is a situation that needs to be corrected given that their overall tax revenue contribution hardly goes beyond five per cent of total tax collection (Mutua, 2011). They are commonly referred to as hard to tax taxpayers characterized by low tax compliance which can be either by ignorance or by intent (OECD, 2012).

The concepts of behavioral insights is an emerging area in an attempt to explain taxpayers' compliance more so of the SMEs. The functions of tax administration depend to some extent on the voluntary compliance of taxpayers based on self-assessment. In this context, there is

clearly potential to influence behaviour to improve compliance by understanding why taxpayers are compliant or not. This can inform the work of tax administrations across range of their functions in regards to record keeping, seeking advice of tax experts and influence of other business (Boame, 2009).

According to OECD (2012) a large number of voluntary compliance is possible from the SMEs if there are simplified tax laws and proper tax administrations. The tax administration must facilitate compliance which requires making sure that those who should be in the system are in the system and that they comply with the tax requirements. First, if taxpayers are required to register, the registration process should be as easy as possible. Systems must be in place to identify those who do not register voluntarily. Tax authorities should adopt an appropriate unique taxpayer identification system to facilitate compliance and enforcement. Second, tax authorities need a process for determining tax liabilities by either administratively or by some self-assessment procedure.

Tax reforms aims to enhance compliance and create public perception of the fairness of the tax laws hence impacting positively on compliant businesses. SMEs' tax reforms specifically include enacting special type of tax regime which is different from the normal tax regimes for large enterprises and administrative reforms. The special tax regimes for the SMEs includes granting of tax exemption as incentives for instance in India where agriculture is exempted from the income tax (Arachi & Santoro 2007). SMEs are taxed under presumptive tax like turnover tax based on a percentage of gross or adjusted net income of the enterprises or progressive based on SMEs' sectors. Turnover tax have been used Ukraine and Bolivia based on a standard flat rate tax on sales less limited expenses and in Uganda where all

industries with annual turnover above a given limit are taxed at a fixed percentage (Masinde, 2012).

In Egypt, SMEs are taxed under a uniform tax (or patent) on as business segment irrespective of the size or turnover of the individual enterprise or indicator based systems which use external indicators as proxy for business income (also used in Italy, Spain, and Argentina) (IFC, 2007). Further, taxation of SMEs can be based on agreement between taxpayer and the tax administration as used in Syria (OECD, 2012). However, according to Mage, (2011) despite these SMEs tax reforms, most developing countries where SMEs sector account for such a significant percentage of GDP (average 41%) continue to be tax non-compliant.

Tax compliance covers fulfilling all tax obligations as specified by the law freely and completely. SMEs constitute untapped revenue potential and an uneven playing field in many countries (International Tax Dialogue, 2007) as such they need to be captured by the tax net. However, though legislations are necessary regulator for protection of the business environment and security of the economic agents, for establishment of the necessary social security regulations, they may also hamper compliance and the growth of business through additional expenditures and administrative obstacles. Shahroodi, (2010) stated that for a tax system to be efficient, the tax policy needs to be designed such that the tax rates are appropriate and rational, the exemptions are lower in amount, the tax collection organization are more efficient, the tax burden should be lighter and the fight against corruption and tax evasion should be much more intense.

Tax policies can be designed in such a way that they do not only directly affect SMEs but also indirectly push for voluntary compliance and their growth. Yaobin (2007), emphasized

declared that special tax regimes for SMEs may be appropriate policy instruments for minimizing the cost of collection. Because awareness of the dangers of inadequate taxation of SMEs has grown because of the potential of uneven tax enforcement to cause distortions of competition, voluntary compliance by larger enterprises and by wage earners, (International Tax Dialogue, 2007), government intervention should help maintain balance while ensuring that countries exploit the social benefits from greater competition and entrepreneurship. SMEs taxation should be simple, consistent and predictable should to lower compliance and administrative costs, and hence reduce uncertainty faced by taxpayers as well as improve the levels of voluntary compliance (Kasipillai, 2005)

### **1.1. SMEs and Taxation in Kenya**

The major tax reforms in Kenya started from mid 1980s under tax modernization programs (TMP) since between before 1980s the government incurred minimal fiscal deficits and able to contain its expenditure within the recurrent revenue limits (Muriithi & Moyi, 2003). The aim of TMP was to enhance saving and investment, enhance equity, increase on compliance through low and rationalized tax rates, wider tax bases and improve tax administration by sealing leakage loopholes (Moyi & Ronge, 2006). The rationale for forming KRA in 1995 was articulated under TMP to improve tax administration and implement organizational reforms in order to modernize tax administration (Karingi & Wanjala, 2005).

The next phase in tax policies changes under NARC government (2003-2008) and coalition government (2008-2012) from 2003/04 to 2008/2009, so far have evolved around on ensuring equity, further widening of tax base, promote increase investment and reduce compliance costs. The change includes increase of personal relief by ten percent in

2004/05 and threshold turnover for VAT from Kshs. 3 million to Kshs. 5 million from 16<sup>th</sup> June 2006. An amnesty in 2004/05 on fines, penalties and interest on tax arrears prior to 11 June 2004, whereby the taxpayers were required to disclose and pay under-paid duties and taxes by 31 December 2004 (IEA, 2012).

With effect from 1 January 2008 the government introduced a turnover tax (ToT) at a tax rate of 3 per cent of gross receipts is applicable for businesses with an annual turnover of below Kshs 5 million. In 2008/09, the VAT Act was amended to exempt taxpayers who are subject to the turnover tax (IEA, 2012). The KRA's tax functions were reorganized with ICT driven to aid online self-assessment and to better align them with the other tax policy reforms. Further KRA continued educating and guiding taxpayers to settle taxes through banks and not KRA counters in order to reduce revenue leakages (IEA, 2012).

Despite tax reforms there is considerable revenue leakage with continued existence of untaxed informal sector exhibiting varied tax behaviors relative to formal sector. The taxpayers behaviours like not keeping records, negative attitudes and influence among the SMEs could have impact on tax compliance (Parliamentary Budget Office, 2011). The turnover tax targeted an additional 20,000 taxpayer and collect Kshs. 1 billion from the SMEs in the first year 2008 but is yet to be achieved. In the year ending 2009, turnover tax performed at 31% with a total of Kshs. 136 Million against a set target of Kshs.442. The recruitment totaled 3,517 in 2009/10 and 4,794 in 2010/11 while total revenues for 2010/11 were Kshs. 130 million. From Table 1.1 the 2011/12 target was Kshs. 147 million but however Kshs. 140 million was collected.

Table 1. 1: Turnover Tax Collection in Kshs Million

Financial year	Actual collection	Target	Per Rate
2007/2008	28	111	25%
2008/2009	136	441	31%
2009/2010	115	198	58%
2010/2011	129.3	143	90%
2011/2012	140	149	94%

Source: Kenya Revenue Authority (2012)

In the year 2008/09, TOT performed at 31% with a total of Kshs. 136 Million against a set target of Kshs.442 Million while in the year 2009/10 the performance was 31% which was above average but on a declining trend (Institute of Economic Affairs, 2012). Compared with the municipal council’s data, there are more businesses that are registered in the municipal councils than there are in KRA database. While also the number of SMEs taxpayers who are compliant is only 39 %( 236) against a registered SMEs total of 505 taxpayers in Kisumu tax station. The existence of a sizeable underground economy which has not been captured by KRA implies that indeed, there is room for KRA to expand the tax base and increase revenue collection (IEA, 2012).

According to the KRA (2012), the ToT revenue collection from Kisumu tax station contribution Kshs. 8.9 million which is 6 % of the total ToT revenue collected for the year 2012. While the number of compliant SMEs’ stands at 505 ToT taxpayers in Kisumu tax station which below the number businesses registered with Kisumu municipal. Also the number of SMEs taxpayers who are compliant is only 236 against a registered SMEs total of 505 taxpayers in Kisumu tax station (KRA, 2012).

Further Mage (2011) on tax administration has placed inadequate attention towards this sector and while this sector has continued to record growth yearly but remained unexploited. Between 2002 and 2008 the sector rose from 7.58% in 2002 to 16.61% in 2008 with

corresponding increase GDP tax potential percent from 2.52% in 2002 to 7.66% in 2008. Consequently, expanded SMEs' economy had increased revenue potential worth Kshs.63.5 billion in the year 2006, Kshs.69.73 billion in the year 2007 and Kshs.79.27 billion in the year 2008 (IEA, 2012).

According to Masinde (2012) the government will continue losing revenue in billions of shillings and given that SMEs sector continues to grow and level of tax compliance remains low making it difficult for the government to hit its revenue targets... Hence it important to understand effects of tax reforms on SMEs compliance. This creates the need for a proper tax reforms compliance study on SMEs in Kenya, using case of enterprises in Kisumu Town. Specifically, this study will establish how ToT, KRA administration reforms and SMEs tax behaviours affect compliance of the SMEs operating in Kisumu town and develop strategies that will improve tax compliance among the SMEs make policy recommendations based on these findings.

## **1.2. Statement of the Problem**

Many tax systems worldwide have undergone changes aimed at expanding the tax base and harness more tax revenues for public finance (Moyi & Ronge, 2006; OECD, 2012). SMEs accounts 90 per cent of the registered enterprises and contribute 35-50 percent global GDP have emerged as a new challenge to tax systems as their tax contribution hardly goes beyond 5 per cent (OECD, 2012). Kenyan Government enacted tax reforms like turnover tax and KRA tax administration to bring the SMEs sector into taxation into tax bracket. According to Kenya Parliamentary Budget Office (2011) SMEs make up of 98% of all registered businesses in Kenya, contribute 34.3 per cent to GDP, and with tax potential of Kenya shilling 79 billion but actual collection is less than one billion. The SMEs' have continued to

be non-compliant (Mage, 2012).

Clough *et al.* (2014) established that tax revenue loss in Kenya in the year 2013 was 8.3 per cent of the total revenue collection mostly from the SMEs. The uncollected revenues which besides impacting negatively on compliant taxpayers also deprived the government much required finance in provision of infrastructures for enabling business growth. Consequently the government has been under-collecting tax, given that it failed to achieve its target for the year ending 2012 by Kshs.10 billion (IEA, 2012). Although the Government has implemented tax reforms meant to improve compliance, it is not yet been established as to whether the said reforms have achieved tax compliance by SMEs as envisaged or not.

The study by the Institute of Economic Affairs (2012) focused on the informal sector and taxation. Also study by Lumumba *et al.* (2010) focused on taxpayers' attitudes and while Mage (2011) focused on the adoption of the IFRS by SMEs. In recognition of the role of tax reforms in improving the compliance of SMEs, and a scanty empirical literature on the outcomes of the reforms on compliance in SMEs in a Kenyan context, a detailed study on the subject matter was necessary. This is supported by Mayo (2012) that the government is could continue losing tax revenue from the SMEs sectors if equal measures like those of large enterprises are not emphasized. This study therefore sought to look at the effects of the tax reforms in terms of turnover tax, KRA tax administration reforms and SMEs tax behaviours on compliance in Kisumu Town.

### **1.3. Objectives of the Study**

The general objective of the study was to assess the effects of tax reforms on compliance of the small and medium-sized enterprises (SMEs) in Kenya, with reference to case of Kisumu

town. The specific objectives were to:

- i) Ascertain the effects of turnover tax on compliance of small and medium-sized enterprises in Kisumu town.
- ii) Determine effects of KRA tax administration reforms on compliance of small and medium-sized enterprises in Kisumu town.
- iii) Establish how behaviours of small and medium-sized enterprises in Kisumu Town affect tax compliance of SMEs in Kisumu town.

## **1.4. Research Hypothesis**

In achieving the objectives of the study, the following null hypotheses were tested:

H<sub>01</sub>: The turnover tax has no significant effect on tax compliance by SMEs in Kisumu town.

H<sub>02</sub>: There is no significant relationship between KRA tax administrations and tax compliance of SMEs in Kisumu town.

H<sub>03</sub>: Behaviours of small and medium enterprises in Kisumu Town have no effect on tax compliance of SMEs in Kisumu town.

## **1.5. Significance of the Study**

The study established the effects of the tax reforms on the compliance of the Small and Medium Enterprises in Kenya with reference to Kisumu town. The study would be important to the following group:

### **1.5.1. Enterprises**

The study documents tax reforms in terms of turnover tax, KRA administrative reforms and

tax behaviours which affect tax compliance. The study finding is necessary to SMEs enterprises to understand how tax reforms affect their enterprises.

### **1.5.2. Academicians and Researchers**

It is of value to the academicians and general public since SMEs tax issues have for a long time been viewed as a complex subject that should be left largely to tax experts and the government. This perception has contributed to the huge information gaps on issues of tax policy, tax administration and tax performance reaching the public. Academicians and researchers will use the research results as a reference material for further research.

### **1.5.3. Government or Policy Makers**

Tax reforms and compliance is important Tax policy decisions have different effects on different individuals, businesses and the economy at large. For instance taxation affects incomes and prices of goods and services, individuals and businesses react differently in response to changes in income, and in relative prices, emanating from taxation. Therefore, analysis of the effects of tax reforms on compliance of SMEs is critical for government decision makers and the public to make informed policy decisions. The tax reforms is critical to the government given the fact that the government to achieve vision 2030 tax collection and sustainability is recognized the most important element. Hence the study will go a long way to establish the effects of tax reforms on compliance of the SMEs and propose the mitigating measures that should be put in place in taxation of the SMEs in Kenya.

A better understanding of the SMEs and taxation can help policymakers design policies that not only encourage, nurture the culture of tax compliance and improve on tax revenue collection in the country but also design policies that encourage SMEs growth. This would

enable policy makers in using this as a basis for effective strategies for handling tax problems. The business community in Kenya would benefit from the study, since they would be able to establish how taxation affects them.

#### **1.5.4. General Public**

This study is useful general public who are widely interested in understanding the taxation of SMEs in Kenya. It also contributes to the literature due to the scarcity of publications about taxation and SMEs in Kenya.

#### **1.6. Scope of the Study**

The study focused on KRA tax officers in Kisumu station and SMEs in Kisumu town from the year 2006 to 2012 and tax reforms in; turnover tax and KRA tax administration reforms were initiated for the SMEs. The study was limited to the sample size which was a sizable proportion of the entire national population of SMEs in Kenya and KRA officers. The findings of the study therefore was generalized in the area of study only, although, a number of findings is expected to have valid implications for the whole country.

The number of studies focusing on the impacts of tax reforms on compliance of the SMEs in Kenya is limited more especially in Kisumu town. Hence, the contribution of this study is to enrich our understanding of this important field. Kisumu region is considered to be crucial if Kenya is to reach the growth targets of Vision 2030 of sustained economic growth of 10 percent per annum. The economic status of Kisumu has been growing in size due to increased trading opportunities which drives consumer spending (KPMG, 2008).

In Kenya, the National Baseline Survey of 1999 by ICEG and K-REP reported the number of

SMEs to be 1.3 million firms in Kenya, employing 2.4 million people. Whereby almost two-thirds of all SMEs are located in the rural areas and only one-third are found in urban areas.

Table 1. 2:Tax Revenue Collection in Per cent increment for all station

<b>Regions of KRA</b>	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>	<b>2012/13</b>
Southern	21	32	(1)	21
Western	26	76	14	16
Rift Valley	7	11	12	1
Northern	2	4	4	13
Central	3	4	10	18
Nairobi	5	7	10	7
Total Collection increments	34	11	19	17

Source: KRA, 2013

Western region has been increasing in revenue collection while Kisumu station collect 50 percent of the total revenue collection of the region. This justified why this study focused only on Kisumu Town and not the whole country. A sample of SMEs in Kisumu Town was studied to provide insights into the research questions presented. They were identified by the databases kept by KRA. The study's data collection was conducted between September 2013 and May 2014.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1. Introduction**

This chapter presents a review of literature on the subject under study and is structured on the various thematic areas namely theoretical models of tax compliance, approaches to taxation of SMEs, turnover tax in Kenya, KRA tax administration reforms, SMEs' tax behaviour empirical literature review, critical issues and gaps to be filled and conceptual framework.

#### **2.2. Theoretical Framework**

There are two broad schools of thought on the taxpayer compliance which were examined by this study to determine the relationship between the tax reforms and compliance of the SMEs in Kenya with reference to Kisumu town. Tax compliance is a complex phenomenon, given the chance, a lot of businesses and individual taxpayers will not pay taxes unless there is a motivation to do so. While some believe that the best way is to increase incentives (Feld & Frey, 2007) others believe the best way is to increase penalties. The tax compliance theories examined by this study were; economics based theories and psychology based theories. The first being the theory of economics that explain the change in taxpayer compliance behaviour and the second is concerned with the studies based on theories of psychology and sociology that explain the varying levels of taxpayer compliance.

##### **2.2.1. Economic Theory**

The theory of Economics on tax compliance commonly known as deterrence theory, suggest that taxpayers are moral utility maximizers and emphasize on incentives to compliance. The theory suggests that taxpayers are amoral utility maximizers- they are influenced by

economic motives such as profit maximization and probability of detection. The taxpayers 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 maximizes their expected after tax returns after adjusting for risk. This process is referred to as “playing the audit lottery” by Trivedi and Shehata (2005).

Taxpayers’ non-compliance presented by Allingham-Sandmo (A-S) model by Allingham and Sandmo (1972) is based on expected utility maximization schemes by the taxpayers. It has been assumed taxpayers to be utility maximizers in decisions of tax reporting and compliance, that is, taxpayers viewed tax evasion as worthwhile if the financial gains purely outweighed the financial costs (penalties). Likewise taxpayer is likely to break the law unless anticipated legal penalties (deterrence) exceeded the additional earnings that could be made by evading tax. The theories suggest that taxpayers’ behaviour is influenced by economic motives such as profit maximization and probability of detection based on the chances of audits and penalties as a solution to compliance problems (Trivedi & Shehata, 2005).

According to Devos (2012) this model presents the taxpayers at the time of filling tax return, time in reporting and payment and amount evaded. For instance a taxpayer a fixed endowment of income,  $Y$ , and choose amount to declare to tax authorities  $K$ , and taxed at the rate  $t$ . unreported income is not taxed, but the taxpayer faces chances of audit with probability  $P$ , penalised  $Q$  on unpaid taxes.  $P$  is a function of income tax reforms implemented to enhance chances of tax audits hence detection, also the taxpayer is influenced by the government expenditures  $G$ , the taxpayer chooses  $K$  to maximize the expected utility of evasion gamble. This framework suggests that there is a demand for declared income that depends upon  $Y$ ,  $t$ ,  $p$  and  $Q$ .

$$K = K(Y, t, p, Q, G)$$

K therefore is a function of probability of detection and penalty rate while the imports of t and Y depends upon the individual SME's attitude toward risk. Therefore according to the theory, in order to improve compliance, audits and penalties for non-compliance should be increased.

This theory believes in government's that are aggressive in seeking to stabilize the economy based on value judgment has the capacity to improve the economy. This theory supports the government's taking a bigger role in the economy and a more general confidence in the ability of government to intervene and manage effectively. Despite this theory fascination with uncertainty and his speculative talents in the marketplace, the theory presumed the government knowledge to be superior to that of the marketplace.

### **2.2.2. Psychological and Sociological Theory**

Recently, however, tax compliance studies have been based on fiscal and social a psychological theory which is not based on audits and penalties but however focusing on changing on the factors influencing individual decisions like behaviours among others. The proponents of this theory postulate that tax authorities should strive to ensure that they enact policies that influence the behaviors of the taxpayers positively towards tax compliance. 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 (Devos, 2012).

Research studies in this field have argued that the human element plays a vital role in individual taxpayer compliance decisions. Specifically, Smith and Kinsey found that peoples' social networks and associations help shape their perceptions, norms and attitudes which then influence their responses to perceived and actual sanctions (Devos, 2012).

Based this theory, rational choice see social interaction as a process of social exchange and according to this view, people are motivated by wants or goals that express their preferences (Scott, 2000). Consequently, tax evasion has negative effect on the society and can harm the economy in many ways. More often, punishment of tax evasion act as deterrence yet still many countries face the challenges of tax revenue collection. For instance during a recession period, when compliant tax payers are suffering real hardship, the need to deter, detect and prosecute those who evade tax is greater than ever. However many countries fail to detect and deter tax noncompliance which affect revenue collection (Trivedi & Shehata, 2005).

During the 1990s and early 2000s other variables appeared in fiscal psychology models which were also absent from the pure economic deterrence model. In particular, a study by Allingham and Sandmo (1992) employed the variable of exchange equity, where taxpayers assess the benefits they receive from the government in exchange for taxes paid. The study involved an experiment of a tax reporting exercise measuring the effect on compliance of the presence or absence of public goods. The findings were significant and indicated that when uncertainty was introduced compliance increased, despite the absence of public goods. The

authors undertook a number of other studies with respect to tax fairness issues during the 1990s which also produced significant results (Trivedi & Shehata, 2005).

The studies on the tax morale variable found that higher legitimacy for political institutions also led to higher tax morale. This was further evidenced in a study of developed and developing countries that tax morale and compliance is highest in the countries characterized by high control of corruption and low size of bureaucracy. It has been recommended that the revenue authorities to endorse tax morale approach to compliance that recognized the varying attitudes and behaviours of taxpayers (Alm & Michael, 2004).

It has been established that demographic variables, such as age, gender, marital status, education, culture and occupation, have an effect on fairness perceptions which ultimately affects compliance behaviour. Although tax fairness is but one factor in the maze that is taxpayer compliance, it has been a predominant factor for most governments and is claimed to be the main indicator of a successful tax system. New Zealand Government, for example, continuously placed great emphasis on this criterion. Consequently, fiscal psychologists maintain that a taxpayer's belief in the tax system rather than the penalty structure is more salient in generating compliance. Trivedi and Shehata (2005) concluded that some taxpayers' behaviour may follow economic theories while others may follow the psychological theories and a mixture of the two is also possible.

### **2.3. Approaches to Taxation of SMEs**

A simple way to deal with the problem of noncompliance among the SMEs is to legitimize their activities by allowing tax holidays or exemptions for certain sectors. These approaches create incentives for enterprises to re-create themselves in the image of exempted sectors

while it may be easy to administer. But this approach seems unlikely to make long-run sense in any circumstances as it may negatively affect compliance with the overall tax system. Also tax exemptions and holidays are difficult to rein in once they are established (Loeprick &Engelschalk, 2011).

Increased enforcement of existing tax law on this group is perfectly feasible in most countries if tax administrations and their political masters really want to do so. In practice, of course, many tax administrations concentrate unduly on the larger taxpayers, especially corporations which may be a dangerous strategy in the long run (Bird &Wallace, 2004).Better tax enforcement (and, perhaps, better taxpayer education and support services, especially at the lower end of the tax base distribution) is thus one important way to reach many of the SMEs (Nada &William, 2009).

The use of presumptive tax systems involves use simple and cost-effective techniques to capture domestic transactions and untaxed sources of among the SMEs. The presumptive taxation is based on turnover or gross income and involves the application of a uniform tax rate on a standard percentage of turnovers for all SMEs. It does not take into account different profit margins in the various business segments. An extension of this tax system is progressive tax whereby different business segments are treated uniformly but the tax rate increases according to the level of business turnover. To avoid major differences in the real (net) income tax burden, it is necessary to either apply different deductions from turnover for the calculation of the tax base or to apply different tax rates on turnover according to the average profit ratio (Waweru, 2007).

Sometimes the presumptive tax is based on the indicator based tax, like floor space of

business premises, number of employees, value of inventory, capacity of machinery, and number of years of operation of the business so as to estimate the actual income. Also, data about business inputs that can easily be obtained from third parties can be useful indicators, particularly data about electricity and water consumption. The base of an indicator-based tax is generally less easy to misreport than turnover or income, and may offer significant savings in tax compliance and tax administration costs. This tax is used in Poland and Spain where tax is collected from unincorporated businesses based on common indicators (OECD, 2012).

The SMEs can be taxed using a combination of turnover and indicator based systems as used in Argentina whereby the system provides clear counter-evasion features from a tax administration point of view. It is assumed that SMEs, which has an electricity consumption of 4,000 KW or which has business premises of 35m<sup>2</sup> cannot have a turnover of less than \$24,000, irrespective of the actual turnover declared (OECD, 2012).

The SMEs are taxed using the patent systems which are the least sophisticated version of a presumptive tax system. The characteristic of a patent is the application of a uniform tax on a business segment irrespective of the size or turnover of the individual business taxed. In practice, patent systems can be extremely simple and rudimentary: An example is the taxation of moving traders, artisans, and other low-income-generating activities in Kosovo that are subject to the payment of a quarterly patent of EURO 37.50 (Bird & Wallace, (2004).

The other SMEs' tax system is the agreed systems which require an agreement between the tax administration and the taxpayer represent the fourth option for systems design. The most prominent example of such an approach was the "Forfait" method in France which required an extensive collection of data and development of estimates of business profit expectations

by the tax administration. The taxpayer had to supplement this data collection by providing information on purchases, sales, and value of closing inventory, number of employees, wages paid, and number of cars owned. Based on these data the tax administration prepared an estimate of the MSE's net profit, which is then discussed and agreed with the taxpayer as used in the "Tachshiv" operated in Israel officially until 1975(Arachi &Santoro 2007).

### **2.3.1. Tax System Threshold**

Most tax laws in some countries often do not give proper definition of the term "SME" at all. They indirectly define small businesses by defining eligibility criteria for incentives and special regimes targeted at SMEs. The tax threshold is a typical example of such an approach. It defines up to what level of turnover a business is not required to register for tax without necessarily mentioning that the businesses below the registration threshold are to be qualified as SMEs. Such thresholds and eligibility criteria for special regimes may be found in several tax laws; therefore, there is no consistent approach in the tax system to determine which businesses are considered small businesses. The threshold for the application of Turnover tax system should be coordinated with the threshold for other taxes registration (Congdon *et al.*, 2010).

A large number of voluntary registrations increase the tax administration workload without contributing much to tax revenue collection. Despite this argument, voluntary registration should be made possible. Simplification of return filing affects both return frequency and complexity. The filing frequency for SMEs should be reduced to a maximum of four tax returns per year. The possibility of moving to annual or at least semi-annual filings should be considered. Tax administrations should consider simplifying returns by making tax forms

shorter or reducing paperwork requirements. To facilitate compliance with accounting requirements, cash accounting should be permitted (Walsh, 2012).

Businesses have different profit margins in relation to turnovers and it prudent for a turnover-based presumptive tax system to distinguish between traders and service SMEs when calculating tax liability. Also it is more appropriate to establish different levels of deductions from turnover and to apply the standard rate schedule on the amount of turnover minus standard deduction. Further differentiations according to business activities should not be envisaged, because borderlines between various service segments are not always clear, many businesses engage in various service activities, and disputes over the fairness of the differentiation may arise. A slightly progressive rate structure is recommended to reduce the difference in the tax burden between businesses in the top band of the presumptive system and businesses in the standard tax regime.

### **2.3.2. Compliance Costs**

The main factors contributing to a high compliance burden can established through the compliance cost surveys carried out for several years in several OECD countries. In developing countries, compliance cost analysis is a rather recent phenomenon and few data are available to compare findings from developed countries with compliance cost analysis in developing countries. Collecting information regularly on tax compliance costs and trends is important information for tax policy makers, tax agencies, and the business community in developing countries (Congdon *et al.*, 2010).

More technical assistance should therefore be provided by donor agencies to strengthen compliance cost analysis capacity in developing countries. OECD country data identify quite

clearly the major compliance cost factors for SMEs. A survey carried out in New Zealand in 2003 showed filing and reporting requirements; closely followed by advance tax payments not aligned with cash flows (Alm *et al.*, 2010).

There are several measures which have been proposed to improve on tax compliance like reduction in costs through less frequent filing and payments of a given amount of tax liability may involve reduced payments to government. Likewise, measures that adjust the statutory tax burden, or the way the tax burden is computed, may result in decreased (or increased) tax compliance costs. Another consideration is an analysis of the economic incidence of these costs that is how the burden of this total resource cost is reflected in higher consumer prices, reduced total returns to labour and reduced total returns to capital (Bankman, 2007).

The time or money forms part of expenditure by taxpayers in conforming to government requirements such as legislation or regulation. For example, people or organizations registered for value added tax have the extra burden of having to keep detailed records of all input tax and output tax to facilitate the completion of VAT returns. This may necessitate them having to employ someone skilled in this field, which would be regarded a compliance cost. Compliance costs normally include all costs associated with obeying the law, including planning and administration, in addition to the direct time and money spent filing paperwork (Congdon *et al.*, 2010).

The burden facing an SME is case specific and thus difficult to measure, a broad conclusion to be drawn is that the burden is high relative to large companies and relative to the tax compliance burden for payroll employees. This suggests that if the statutory tax burden on a given amount of labour and capital income is roughly the same for an employee as for a self-

employed individual, then the higher compliance burden for the latter would mean that the tax system is non-neutral, tending to discourage SME creation(Alm *et al.*, 2010)..

By reducing tax compliance costs and thereby lowering the overall tax burden on small businesses, simplification provisions help achieve more neutral tax treatment of firms of varying sizes, implying efficiency gains, and encourage compliance with (adherence to) the tax laws of a country, including operating in the formal” rather than informal (underground) economy and full reporting of all amounts required to determine the true tax base. The small business tax burden frequently is assessed by the tax administration instead of self-assessment by the taxpayer. Most taxes in the general tax system are self-assessed taxes, and a central tax administration that administers self-assessed taxes my not organizationally be prepared for agency assessment without major reorganization (Slemrod, 2007).

There are a number of areas where OECD governments can improve the tax climate for small firms and entrepreneurs. They can reduce progressivity in personal income tax rate schedules, which penalizes successful entrepreneurs and discourages risk-taking. They can lower taxes on income earned by entrepreneurs (capital gains, dividends and other income), which may discourage entrepreneurs, and remove the tax bias favoring longer-term assets, which can hinder the reallocation of capital towards start-ups. More liberal provisions for carrying-forward losses in corporate income tax would assist startups which take more time to become profitable. Governments also need to continue efforts to minimize tax compliance and administrative costs, which are especially burdensome for small firms (OECD, 2012).

Keeping of records of accounts is essential for all business operations and is one of the most important elements of running a successful business. For example, research into small

business in Australia concluded that one of the reasons that small businesses fail is inadequate, inaccurate or non-existent books and records (OECD, 2012).

The extent, nature, and detail of the records maintained will depend on the type of business and the information required. Records provide feedback on the effectiveness and profitability of operations on a regular basis. Good records enable a business to analyze growth and identify new opportunities. More importantly, good records provide evidence for the true value of a business. With regard to taxation, good records lead to more accurate reporting of income and expenses in business tax returns. There are a number of other features that could facilitate and encourage a transition from the presumptive into the standard regime. The possibility to claim and carry forward losses is an important element of the standard regime, which benefits SMEs during loss-making periods (Slemrod, 2007).

## **2.4. Tax Administration Reforms**

The primary aim of the tax modernization program (TMP) was to raise the revenue-to-GDP ratio from 22% in 1986 to 24% by the mid-1990s, although this target was increased to 28% in 1992 (Moyi, 2003). The intent of the reform was to increase revenue but with lower tax rates, broader tax bases, and closed loopholes. The broadening the tax base and closing loopholes would require bringing more individuals and businesses into the tax system, itself a challenge given the administrative weakness of the existing tax system. The main organizational change aimed at strengthening administrative capacity was the incorporation of the KRA in 1995.

Tax laws often do not require a proper definition of the term “SME” at all. They indirectly define small businesses by defining eligibility criteria for incentives and special regimes

targeted at SMEs. The tax threshold is a typical example of such an approach. It defines up to what level of turnover a business is not required to register for tax without necessarily mentioning that the businesses below the registration threshold are to be qualified as SMEs (Slemrod, 2007).

Such thresholds and eligibility criteria for special regimes may be found in several tax laws; therefore, there is no consistent approach in the tax system to determine which businesses are considered small businesses. Such consistency is also not absolutely necessary and may not even be desirable. However, a certain level of coordination is required. In particular, the threshold for the application of a simplified, presumptive tax system should be coordinated with the threshold for tax registration (Phillips, 2010).

The requirement to apply basic bookkeeping rules nominally may add to compliance costs. In fact, however, it supports proper business management and helps MSE owners to better control business operations and make investment decisions. The income tax compliance cost survey in India is revealing in this respect. While business owners complained about the complicated tax system and high compliance costs, they also found a number of important advantages in complying with the tax system: 62% of respondents found it to be an advantage for business operations that due to tax requirements income statements and balance sheets were better prepared (Brys, 2011).

The KRA centralized tax collection activities which had previously been undertaken by departments in the Ministry of Finance (Muriithi a&Moyi, 2003). Over the last ten years, the KRA has adopted internal management reforms aimed at combating corruption among revenue officers and improving taxpayer services. They are meant to have a certain degree

of financial and operational independence, for example to allow more flexible employment practices than exist in the public service, and as a means of providing insulation from unwarranted political influence and corruption. In the end, however, they rely on discretionary funding from the Ministry of Finance, so their independence from the government is not complete.

The tax authorities of OECD member countries often makes use of various compliance strategies, such as penalties, audits, and, infrequently, prosecutions. However, the enforcement strategies currently used are not applied consistently on an escalating basis of severity. Also, they tend to be applied in a routine manner without taking into account taxpayer's particular circumstances. There are few options for either the tax authorities' staff or the taxpayer if taxpayers do not fulfill their obligations by the due date. Enforcement strategies tend to be applied in a routine manner without taking into account circumstances which may create difficulty for individual taxpayers or for particular industries to meet their taxation obligations (Boame, 2009).

Smaller businesses are more likely to engage in tax evasion practices and either operate completely outside the tax net or hide a certain part of their business transactions from the tax inspector (Braithwaite, 2009). Tax systems provisions of various countries target small businesses so as to simplify their compliance requirements (like permitting simplified accounts, simplified tax calculations, less frequent filing) and thereby lower their tax compliance costs that is, lower the amount of time and resources required by firms to comply with the tax system (Phillips, 2010).

Offering some incentives to improve recordkeeping of businesses in the presumptive system

is important for facilitating compliance with general (simplified) recordkeeping requirements after migration into the standard regime. A sufficient level of recordkeeping also improves business management and planning. Despite these considerations, many presumptive systems provide little or no incentives for small businesses to improve their recordkeeping standards (Alm *et al.*, 2010).

In the case of indicator-based systems in particular, even basic records are not required for tax purposes. But improving recordkeeping practices is also challenging for turnover based systems. The most straightforward and transparent incentive is the application of a lower presumptive tax rate for small businesses meeting certain recordkeeping standards. Such an approach is applied in the presumptive tax system in Tanzania, which offers a substantial tax reduction to reward recordkeeping SMEs. A small business with a turnover of 10 Million Tshs, for example, only has to pay 1.24% of turnover as presumptive tax in case of recordkeeping compared to 2.91% of turnover without recordkeeping (Mutua, 2011).

However, despite these incentives, the actual level of recordkeeping among Tanzanian SMEs remains low and the majority of SMEs are taxed under the non-record keeping alternative of the system. This demonstrates that the mere provision of tax incentives is not sufficient to improve recordkeeping standards in the MSE community. It needs to be combined with extensive assistance and information campaigns on the importance and details of recordkeeping. The Tanzania Revenue Authority now has launched a major education campaign to assist SMEs in understanding the importance of recordkeeping and tax compliance, including the publication of a booklet on “Norms of Doing Business,” which is distributed free of charge to MSE owners(Boame, 2009).

Cooperation with the private sector, in particular small business associations, is important for successful compliance management. Consideration could be given to introducing some elements of associational taxation and involving small business associations in the tax collection process. A close cooperation with local governments (in particular information sharing) should be established (Alm *et al.*, 2010).

## **2.5. SMEs Tax Behaviours**

Increased compliance is desirable taking into account the benefits to society of having all persons participate in the financing of programs supporting economic and social development. Indeed, addressing tax compliance costs facing small businesses, as a key strategy to encourage economic development. Tax simplification for SMEs may improve the competitive position of small businesses and thereby encourage business creation and support business expansion. Entrepreneurs, when confronted with a tax system seen to be imposing too high a burden, in terms of the amount of tax to pay to government, and the compliance costs involved, may choose to operate in the informal economy to avoid these costs. Alternatively they may choose to not establish a business, deciding instead to seek or remain in employment associated with detection of tax fraud, the probability of detection, and after-tax returns from employment (OECD, 2012).

In most countries there is separation between tax policy and tax administration. Using behavioral insights to inform tax administration is a less developed area in the research literature. The work of a tax administration includes activities that cover both compliance and customer service. In most countries many of the functions of tax administration depend to some extent on the voluntary compliance of taxpayers based on self-assessment. In this

context, there is clearly potential to influence behaviour to improve compliance by understanding why taxpayers are compliant or not. This can inform the work of tax administrations across range of their functions (Boame, 2009). According to OECD (2012) several factors that determine the level of compliance in a taxpayer population have been identified and grouped among others record keeping, use of tax agents, referent groups and attitude.

The application of the standard taxation regime generally requires keeping appropriate books and records. For SMEs, complying with standard recordkeeping requirements not only is costly, but often exceeds the capacity and skills of the small business operator. Non-compliance with obligatory bookkeeping requirements, even if is unintentional, can severely hurt the small business. An analysis under the umbrella of the Small Business Survey Program in Australia showed that there is a direct link between poor recordkeeping and the likelihood of an amended assessment when the MSE has been subject to a tax audit. Once a business is selected for audit, those with poor recordkeeping systems and processes are more likely to have their assessments amended adversely (Walsh, 2012).

The authority should be able to identify, discuss, and co-design approaches to resolving significant tax administration issues facing SMEs and to identify, discuss, and small business tax. A special small business tax amnesty was introduced in South Africa in August 2006. According to private sector experts, insufficient publicity for the amnesty and suspicion in the MSME community about the true objectives of the amnesty contributed to its meager outcome. Guidelines should be provided to support tax agents in representing SMEs. Similar approaches could be followed on the tax policy side and with direct involvement of small

business representatives (OECD, 2012).

Non-compliance with the tax system does have a number of advantages for small businesses. Small businesses may gain a competitive advantage, as they are able to offer their goods and services at lower prices than their compliant competitors. They avoid frustration resulting from the obligation to comply with complicated tax procedures and from harassment by tax officials. However, disadvantages resulting from non-compliance with the tax system may largely exceed potential benefits (Masinde, 2012).

Compliance risks and attitudes in the small business segment of the taxpayer population are fundamentally different from large taxpayer compliance behavior. In case of larger businesses, the core risk for the tax system is the recourse to tax avoidance strategies. Smaller businesses are more likely to engage in tax evasion practices and either operate completely outside the tax net or hide a certain part of their business transactions from the tax inspector. The risk of detection of such tax evasion practices can be rather modest in countries with weak tax administration enforcement capacity or a high level of corruption in the tax administration (Mutua, 2011).

## **2.6. Empirical Literature Review**

According to Bird and Wallace (2004) the critical issue is whether the presumptive taxes are really effective first in bringing SMEs into the formal economy and force them to move into the normal tax system, while minimizing the number of firms that move from the normal tax regime into the simplified one. To be attractive for informal firms the methods need not only to be simple and based on readily available information to reduce compliance costs (as stressed by Thuronyi and Victor (2004), they should also provide for an effective taxation

that will be lower than that based on the normal tax rules. However, this would discourage firms from ever moving into the normal tax regime and attract firms that were in the formal sector to move to the presumptive regime, resulting in loss of revenue to the Tax Authority. One solution to this problem might be a periodical revision of the threshold for eligibility for the simplified regime and placing a time eligibility limit for the systems (Schiebold, 2011).

During the 1990s and early 2000s other variables appeared in fiscal psychology models which were also absent from the pure economic deterrence model. In particular, a study by Allingham and Sandmo (1992) employed the variable of exchange equity, where taxpayers assess the benefits they receive from the government in exchange for taxes paid. The study involved an experiment of a tax reporting exercise measuring the effect on compliance of the presence or absence of public goods. The findings were significant and indicated that when uncertainty was introduced compliance increased, despite the absence of public goods. The authors undertook a number of other studies with respect to tax fairness issues during the 1990s which also produced significant results (Trivedi & Shehata, 2005).

It has been established that demographic variables, such as age, gender, marital status, education, culture and occupation, have an effect on fairness perceptions which ultimately affects compliance behaviour. Although tax fairness is but one factor in the maze that is taxpayer compliance, it has been a predominant factor for most governments and is claimed to be the main indicator of a successful tax system. Evidence of this was found in a study by Tan who indicated that the New Zealand Government, for example, continuously placed great emphasis on this criterion. Consequently, fiscal psychologists maintain that a

taxpayer's belief in the tax system rather than the penalty structure is more salient in generating compliance (Ajzen & Fishbeins, 1991).

Tax compliance literature has emerged from a wide variety of disciplines, there has been a lack of consensus and agreement as to why people do or do not pay their taxes. Although it is acknowledged that taxpayer behaviour is influenced by a number of factors (both economic and non-economic) a variable that has lacked research attention in Kenya is the influence of tax reforms and their role in individual SMEs taxpayer compliance (Waweru, 2007).

Aristidis *et al.* (2005) evaluated obstacles and problems encountered by entrepreneurs business in Albania. The study established that the most important obstacles faced by entrepreneurs in Albania include unfair competition, changes in taxation procedures, lack of financial resources and problems related to public order. However the study bureaucracy and corruption were not to represent significant barriers to entrepreneurship. The study therefore recommended for changes of regulatory policies which should focus specifically upon small business and enterprise development should be implemented by the governments in order to achieve a transparent fiscal reform and create a more favorable business environment.

Small business owners play an important role in the tax system and the study by Bernadette *et al.*, (2012) highlighted tax compliance situation of small business owners the study found that three key aspects seem to distinguish small business owners' perceptions of their tax situation: small business owners are likely to perceive more opportunities not to comply than employed taxpayers; they are more likely to experience a lack of meaningful taxation knowledge; and they are more likely to face decision frames that render taxes as painful losses. The study recommend for a focus on strategies that aim to influence taxpayers'

perceptions of their own evasion opportunities, their level of legislative and procedural knowledge, and their sense of ownership of tax money. Such a strategy is suggested to be particularly likely to be effective in the phase of nascent entrepreneurship and in a climate of mutual trust between taxpayers and tax authorities.

Duanjie *et al.*, (2002) in their study on implications of tax policies on the growth of SMEs and entrepreneurships among the OECD members established that most tax systems are biased against SMEs and entrepreneurships and hence discourage startup of the SMEs. For instance they noted that tax systems favor debt over equity in financing through double taxation. They recommended for improvement for preferential tax treatment to SMEs and entrepreneurships by offering better tax climate for the SMEs among the OECD members. However this study did not clearly point out the benefits of taxation of SMEs and entrepreneurship.

Moyi and Ronge (2006) reviewed tax revenue performance as well as tax design and administration changes during the period 1996 - 2005 in order to identify priorities for further tax reform. The study established challenges that confront tax design include taxation of agriculture and the informal sector, repeal of tax holidays, high effective protection, high dispersion of tariff rates, detailed and rigid custom rules, poor response of VAT to reforms, 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. The study concludes that there should be more than reforms as the one done are not enough and also involve taxpayers in the formulation of tax policy and planning for any reforms.

Chang and Doina (2007) studied effects of corporate tax reforms since 1980 to 2004 among

six European Union member countries (Austria, Finland, France, Germany and UK) on SMEs' investment decisions under particular consideration of inflation. The study compared tax incentive effects of such reform on the small and medium sized enterprises investment decisions like the tax rates and depreciation rules. It was established that these reforms did not achieve positive results to SMEs and entrepreneurs for instance existed of tax non-neutrality between the financing methods which favors large firms with easier access to bank loans. However this study only covered corporate taxes and hence ignored other taxes which all affect SME.

Manzo (2011) examined corporate taxation and SMEs in Italy between the year 1997 and 2004. The author established that growth of SMEs and entrepreneurship is more sensitive to changes in corporate tax rate than larger and older firms which are attributed to difficulties in accessing debt financing. Further it was established that user cost of capital affects negatively the investment undertaken by the old and medium firms which implies that young firms are less profitable than older ones and therefore less affected by the corporate tax adjusted user cost of capital. This study enhances the study of Chang and Doina (2007) who had concluded that the objectives of the reforms have not been achieved.

A three-sector comparative (manufacturing, retail and businesses) study of the impact of taxation on small and medium sized enterprises in Gauteng South Africa was carried out by Venter and Clercq (2007). The study established that the size of an enterprise and the sector in which it operates has an impact on how the enterprise's tax responsibilities are administered and managed thereby influencing business decisions. Most of the small and medium sized enterprises in the business sector outsource their tax responsibility because of

inadequacies of necessary resources. The study recommends that the regulatory environment which affects small and medium sized enterprises should be reformed like reduction of interest and penalties charged as one of the tax relief measure. This study is in support of other studies (Duanjie *et al.*, 2002; Chang &Doina 2007; Brys 2011) which recommend for preferential tax treatments of the SMEs but which dwelt on the developed economies.

## **2.7. Literature Overview and Gaps**

The factors influencing tax compliance among taxpayers is well documented in the literature reviewed (Duanjie *et al.*, 2002; Thuronyi & Victor, 2004; Sandmo, 2004; Chang &Doina 2007; Brys 2011; Bernadette *et al.*,2012; Walsh, 2012). In recognition thereof, many policy makers were unanimous in making changes to their tax systems in their countries to capture these factors influencing tax compliance culminating into tax reforms. Tax reforms have been implemented in many economies in the world (Moyi &Ronge, 2006; OECD, 2012). However news aspects influencing tax compliance keep on emerging for instance SMEs taxation. This view is supported by Mage (2012)that world over government is still grappling on the best way to tax SMEs.

Previous studies focusing on tax reforms have concentrated on tax reforms on large and established enterprises in developed economies Europe and USA while ignoring developing countries like Kenya (Bird *et al.*, 2004; Aridis & Ersanja, 2005; Wenzel, 2005; Baldry, 2006; Arachi Santoro,2007;Venter & Clercq ,2007; Bernadette *et al.*, 2012). Despite the fact that the SMEs forms the majority of the (90 %) of the registered enterprises in and contribute to 35-50 percent of the global Gross Domestic Products but their tax contribution hardly goes beyond 5 per cent (OECD, 2012).A review of literature on the Kenyan context on tax

reforms and SMEs compliance revealed limited studies on the subject matter. The study found on the subject by the Institute of Economic Affairs (2012) focused on the informal sector and taxation.

In recognition of the role of tax reforms in improving the compliance of the Small and Medium Enterprises, and a scanty empirical literature on the outcomes of the reforms on compliance in SMEs in a Kenyan context, a detailed study on the subject matter was necessary. This is supported by Mayo (2012) that the government is could continue losing tax revenue from the SMEs sectors. This study therefore sought to look at the effects of the tax reforms in terms of ToT, KRA tax administration reforms and SMEs tax behaviours on compliance.

## **2.8. Conceptual Framework**

The study will focus on assessing functional relationship between a set of three tax reform variables against tax compliance of the SMEs in Kisumu Town. The explanatory variables are implementation of turnover tax (ToT), KRA tax administration reforms and the behaviours of Small and Medium enterprises in Kisumu town. The dependent variable is the Small and Medium enterprises' tax compliance. The conceptual framework is presented in Figure 2.1.

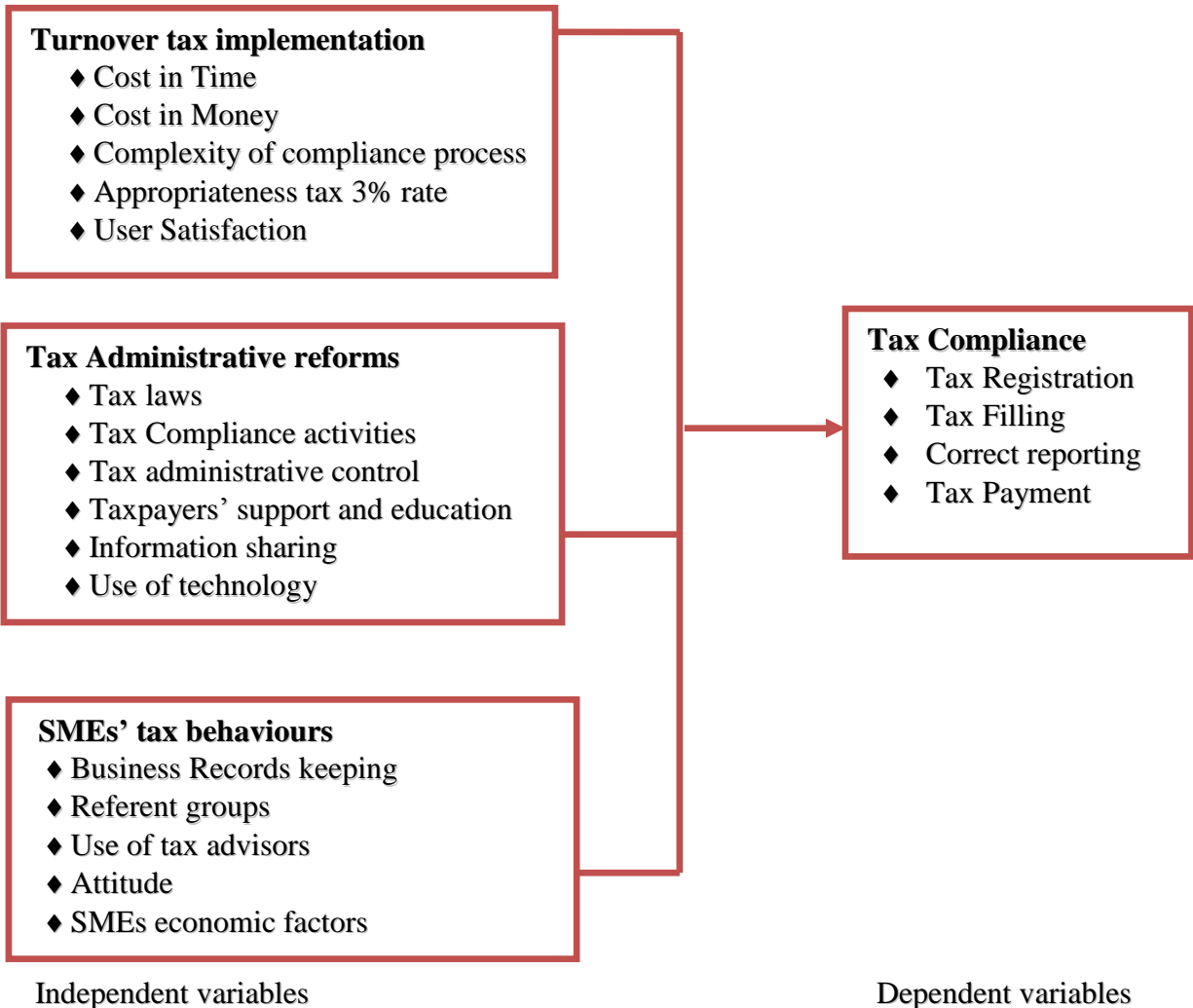


Figure 2. 1:Conceptual Framework

Source: Researcher (2014)

## 2.8. 1.Operationalization of Variables

The constructs used to measure each of the variables under study are as follow:

### 2.8.1. 1. Turnover Tax implementation

The turnover tax (ToT) is a presumptive tax which is departure from the general tax system to encourage compliance of Small and Medium enterprises (SMEs. The study sought to determine how the effects of turnover taxon tax compliance of SMEs in Kisumu. The

turnover tax was measured cost in time, cost in money, complexity of compliance process, appropriateness of 3% rate and user Satisfaction.

### **2.8.1.2. Tax Administrative Reforms**

The study reviewed the effectiveness of the KRA tax administration reforms in enhancing tax compliance of the Small and Medium Enterprises in Kisumu town. KRA tax reforms were assessed by current tax laws, tax Compliance activities, tax administrative control, taxpayers' support and education, information sharing, use of technology and KRA Staff training.

### **2.8.1.3. SMEs' Tax Behaviours**

The behaviours of the taxpayers are likely to influence the tax compliance of the taxpayers. According to the OECD, (2012) the behaviour of the individual entrepreneurs are likely to determine the tax compliance of the SMEs. The SMEs tax behaviour was measured by business records, referent groups, use of tax advisors, attitude, SMEs economic factors, SMEs activities.

### **2.8.1.4. SMEs' Tax Compliance**

The SMEs tax compliance was measured by the tax registration, tax filing, tax reporting and tax paid by the SMEs

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1. Introduction**

This chapter presents the methodology that was used in carrying out the study namely the research design, target population, sampling frame describing the sample size and how it was selected, data collection instruments and their administration, data analysis techniques and tools, the expected output.

#### **3.2. Research Design**

The study adopted a descripto-explanatory research which uses both descriptive and explanatory research design. This research design allowed a detailed description and analysis of the variables under study; descriptive allows describing and presenting their accurate profiles as it exists without influencing it in any way and explaining their relationship without manipulation as supported by Saunders *et al.* (2009). Further explanatory research design produces results that are holistic, contextual and rich in detail on the subject of the study. This design allowed inductive and deductive reasoning to arrive at generalization of the study findings on tax reforms and SMEs' compliance in Kenya.

Further this research design was appropriate for this study since the problem under study was structured and well understood, therefore requiring precise rules and procedures regarding collection and analysis of data to test the hypotheses as supported by Bryman and Bell (2007). According to Jagongo (2009) no single design exists in isolation and combining different designs in one study increases validity of the findings..

### 3.3. Target Population

The target population was SMES registered with KRA Kisumu and tax compliance officers in KRA Kisumu tax station. Each of tax compliance officer and SME manager constituted the main respondents. The study determined the influence of tax reforms on tax compliance of SMEs from the perspective of both KRA officials and SMEs enterprises.

Based on the statistics obtained from the Human Resources Department at KRA in 31<sup>st</sup> June 2013, there were approximately 56 revenue officers in Kisumu tax station. While from compliance section of KRA on 31<sup>st</sup> June 2013 there were 505 registered SMEs taxpayers. This gives a total population of 561.

Table 3. 1. Target Population

<b>Business Sector(Strata)</b>	<b>Total count</b>
Trade sector	308
Manufacturing sector	46
Construction sector	57
Service sector	94
<b>Kisumu KRA</b>	
Station manager	1
Section heads	4
Supervisors	11
Officers	40
<b>Total</b>	<b>561</b>

Sources: KRA(2014)

### 3.4. Sampling Process and Selection

Since the number of SMEs in Kisumu were spread in wide geographical area within Kisumu Town, it would not have been easy to find all of them based on the time required and high cost of data collection and analysis. Hence sampling was the only way for minimizing these challenges for the SMEs in Kisumu but for the KRA officers the study used census. According to Kotari (2006), sampling enables the researcher to estimate unknown characteristics of the population and make generalization with overall accuracy.

### 3.4.1. Sample Size

After defining of the target population of 561 (Table 3.1), the sample size was determined based on required level of precision of statistical results, accuracy level, time and cost. The study chose confidence level at 95 per cent with corresponding z-score of 1.96 and with error margin of 5 per cent. Hence the study assumed that data collected using as sample size would have a 95% chance of being right (level of confidence) with a 5 % chance of being wrong. The samples size for this study was determined by using the formulae suggested by Krejcie and Morgan (1970);  $S = X^2NP (-P)/ d^2 (N-1) +X^2P (1-P)$ .

Where;

**S**=required sample size

**N**=given population size

**P**=Population proposition that for table construction (.50 is assumed as this magnitude yields the maximum possible sample size required).

**d** = the degree of accuracy as reflected by amounting error that can be tolerated in the fluctuation of a sample proportion  $p$  about the population proportion  $p$ - that is the degree of accuracy expressed as a proportion.

$x^2$ = table value of chi square for one degree of freedom relative to the desired level of confidence, which is 3.841 for the .95 confidence level.

Inserting the required information into the formulae gives:

N= 505 Target population of the SMEs enterprises

P=0.50

D=0.05

$X^2$  =3.841

Substituting the above values

$$S_1 = \frac{3.841 \times 505 \times 0.50(1-0.50)}{0.0025(505 - 1) + 3.841 \times 0.50(1-0.50)}$$

= 219 sample size of the SMEs

While for KRA staff the study used census to select all the respondents in the target population. The number of respondents was determined using stratified sampling. Stratified sampling was because the population of SMEs was divided into four subgroups or strata based on the business sector and KRA officers into four subgroups or strata depending on the job description. Then research applied proportionate stratification based on each stratum's share of the total population as presented Table 3.2. By stratification, the study avoided problem of sample selection bias, ensure that all the important units are involved in the study.

$$R = \frac{C \times S}{N}$$

Where R = respondents in a stratum

C = Stratum population

S = desired population

N = target population

Table 3. 2:Sampling Frame

<b>Business Sector</b>	<b>Population</b>	<b>Sample Proportion%</b>	<b>Sample size</b>
General Trade sector	308	43.2	133
Manufacturing sector	46	43.2	20
Construction sector	57	43.2	26
Service sector	94	43.2	41
<b>Total</b>	<b>505</b>	<b>43.2</b>	<b>219</b>
<b>Kisumu KRA</b>			
Station manager	1	100%	1
Section heads	4	100%	4
Supervisors	11	100%	11
Officers	40	100%	40
<b>Total</b>	<b>56</b>	<b>100%</b>	<b>56</b>

Source: Researcher (2014)

Therefore, the sample size of the study comprised of 56 KRA compliance officers in Kisumu and 219 enterprises from the SMEs registered with KRA Kisumu tax station and operating within Kisumu Town.

### **3.4.2. Selection Techniques**

The respondents of the study were selected using both purposive and simple random sampling techniques. According to Bryman and Bell (2007) purposive sampling is

judgmental sampling techniques which enable a researcher to collect desired information from specifically identified respondents to achieve the study objectives. The respondents were selected according to KRA officers and SMEs respondents. Then proportionate stratified random sampling was used in the study for equal chance in selection to the individuals in the population. A list of all SMEs operating within Kisumu Town and KRA tax officers were obtained in order to construct a sampling frame from which the individual respondents was picked and included in the sample. After constructing a sampling frame by numbering 0 to 504 (for SMEs) and a total of 219 SMEs respondents were randomly selected with the aid of a computer together with the 56 KRA officers a total 275 respondents was chosen. With the random number method, the names corresponding with the numbers selected by the computer were identified and picked up to the required sample size of 275 who constituted the respondents surveyed in the study. Then respondents were selected based on the proportion in each stratum up to 275.

### **3.5. Preparation for Data Collection**

In order to collect data on variables, questionnaires were developed based on the research objectives. These questionnaires were then pilot tested and the outcome was used to improve on the questionnaires for the final data collection. After the approval of the research proposal by Kenyatta University' Graduate School, the researched obtained a research permit from National Council for Science and Technology to carry out research in Kisumu Town. The research assistants were identified and trained on data collection, research technicality and ethical issues. The research assistants participated in the pilot testing with questionnaires as part of practical training.

### **3.6. Data Collection Instruments and Procedure**

To obtain quantitative and qualitative data, the study used questionnaires, primary and secondary document analysis.

#### **3.6.1. Questionnaires**

Questionnaires were the main research instruments used in this study for data collection. The questionnaires were vital in deriving quantitative interpretation on the effect of tax reforms on compliance of SMEs within Kisumu Town. The study used both open and closed ended questionnaires in this study for all the respondents that are SMEs and KRA compliance officers in Kisumu station. According to Kotari (2006) questionnaires have the ability to gather data of a large sample size, save time, and uphold confidentiality of the respondents. While according to Orodho (2005) a combination of open and closed ended questions produces and provides a situation of generalization.

The questionnaires were administered by the researcher assisted by research assistants; directly (by hand delivery) to the respondents at their work station (for KRA officers) and business premises (for SMEs) so as to increase response rate. To limit a delay in response rate from the respondents who preferred interview instead of filling the questionnaires, the researcher read and filled the responses on their behalf.

The questionnaires had one fifty seven (57) items grouped into five sections namely; section with general information on respondents, section two turnover tax system, section three tax administration reforms, and section four had SMEs tax behaviours and lastly section five had SMEs compliance. Only section one had nominal data while the section two, three, four and

five had question based on Likert scale to collect interval data (1=strongly disagree; 2= Disagree; 3= neither agree nor disagree; 4= Agree and 5= Strongly Agree).

The questionnaires were developed based on the study objectives. The required data on variables were based on opinion, behaviours, attributes, knowledge and skills. The opinion data was how respondents feel and believe about tax reforms and compliance. The behaviour was on what respondents did in the past and what they are likely to do in future in regard to tax compliance. The knowledge embraces understanding of aspects of taxation and while skills relates to experience in handling tax issues of the SMEs.

### **3.6.2. Review of Documents**

The study reviewed primary documents which contained information on compliance of the SMEs in Kisumu tax station and therefore it provided information which is considered raw since there is no interpretation which has been given to the information collected. Further these documents contain unbiased and originally captured information. The document review is vital in research since it enables researcher to track what happened, when it happened and who was involved (Hedrick, 1993). These documents were available at Kisumu tax station and Kisumu municipal council and they include: the reports on SMEs registered and in operation in Kisumu town by Municipal council of Kisumu and reports on SMEs tax compliance by Kisumu tax station on SMEs registered, filing returns and making payments to KRA. Further KRA (2006) on internal domestic taxes department operational manual were reviewed together with the compliance and debt management. Also sources of SMEs tax information in Kisumu tax station like circulars, annual work plan, reports, and training materials on SMEs which were not available anywhere else for this study but only accessible

in Kisumu were reviewed. The information which may not be in documents review was captured by the questionnaires.

The secondary data on tax reforms and Small and Medium enterprises (SMEs) compliance was gathered from published reports, journals and KRA revenue collections from SMEs among others. Secondary data review was necessary for the study since it helped the researcher clarify theories on tax reforms and SMEs compliance and know the current studies on taxation of SMEs on which the current study is based. The secondary data review enabled the researcher to avoid duplication in study and hence make a significant contribution to knowledge.

Secondary data was reviewed in Kenyatta University library, Kenya Revenue Authority library, Kenya National library and websites especially those dealing with taxation of SMEs and compliance.

### **3.7. Determining the Quality of Research Instruments**

After the approval of the research proposal by the University, a pilot study was conducted to a randomly selected 24 SMEs and two KRA officers' in Kakamega town whose participants did not participate in the main study. The pretested respondents had similar characteristics as those of the actual respondents in Kisumu but were not informed that it was a pretest. The pilot study corrected ambiguities in the research instrument before its actual administration and helped determine whether the statistical tools used may be useful for effective results in the ultimate study. Further the pilot study ensured that the questionnaires were clearly phrased and wordings understood by the respondents, arranged in logical and easy to follow

sequence, relevant and are not personal, discouraging and time consuming in nature to the respondents.

### **3.7.1. Validity Test**

Validity involves the degree to which obtained results from data analysis actually represent the phenomenon under study and can be tested by consensual judgements by experts (Kotari, 2006). One the type of validity is criterion which determines whether a test reflects a certain set of abilities and while content validity involves whether operational definition of a variable reflects the true theoretical meaning of a concept.

This study considered content validity and the researcher reviewed both published and unpublished sources so as to develop an initial item pool that reflected the desired content domain. Further the researcher review from previously published literature on “tax reforms and compliance” for instance in OECD (2012) supports use of questionnaires as a research instrument seems to be the most commonly used instrument.

Construct validity: Based on the study objectives, individual questions were developed so as to reveal whether the wording of items used to measure a concept were related to that concept or one of it dimension. The purpose of this check was to ensure that each measure adequately assessed the construct it purported to assess.

Face validity: Then the questionnaires were subjected to checks by the experts (supervisors and others)for clarity, word choice, time frame and response set to ensure that the instruments are carefully defined, with no language barriers and good to administer.

Content Validity: In the study validity was measured using content validity index (CVI) which is given by:

$$\text{CVI} = \frac{\text{Number of items declared valid}}{\text{Total number of items in questionnaire}}$$

Based on the pilot test results together with supervisors' views as well as other expert opinion, 52 items out of 57 were established to be valid with CVI of 0.92 which is higher than the popular cut-off point of 0.6 according to David and Thomas (2006). Hence the items in the questionnaires were considered valid and could measure the study variables accordingly.

### 3.7.2. Reliability Test

The questionnaires were tested for reliability during the pilot test of 24 SMEs and two KRA officers' in Kakamega. Reliability is the extent to which any measuring procedure gives the consistent results on repetition. Even though there are different forms of reliability, this study used internal consistency reliability whereby several items in the questionnaire ought to measure same general construct by producing similar results. The reliability of the study will be measured using Cronbach's Alpha as given by Glien and Gliem (2003) in the following equation. According to David and Thomas (2006) Cronbach's Alpha is used with both dichotomous and continuous data..

$$\text{Whereby } \alpha = \frac{n}{n-1} \left( 1 - \frac{\sum Vi}{V_{test}} \right)$$

$n$  = number of questions

$Vi$  = variance of scores on each question

$V_{test}$  = total variance of overall scores (not %'s) on the entire test

The reliability test result is presented in Table 3.3.

Table 3. 3: Reliability Test Result

Variables	Cronbach's Alpha	Items	Cases
Turnover Tax	0.81	13	26
KRA tax Administration reforms	0.83	28	26
SMEs Tax behaviours	0.94	15	26
Tax Compliance	0.89	4	26

**Note: n = 26**



Source: Survey data (2014)

From the test in Table 3.3 the reliability coefficient for turnover tax 0.81; for KRA tax administration reforms was 0.83; SMEs tax behaviours was 0.94 and that co tax compliance was 0.89. According to David and Thomas (2006) the reliability test with Cronbach's Alpha more than 75% (.75) is good but greater than 95% (.95) is not desirable because it indicates the items may be entirely redundant. While alpha of less than 75% would imply that the scores are close together and unless the respondents truly are close in ability hence the test may not be useful. Since the Cronbach's Alpha were over 0.75, it was appropriate to infer that the scales used in the study were consistent and reliable.

### **3.8. Measurement of Research Variables**

The scales which were used in this study were nominal scales, Likert scale and percentages. The personal variables were measured using nominal scale while the scale percentages from 1% to 100% of the individual rating and Likert scale which represented interval scale: ranging from one to five was used on turnover variables, KRA tax administration reforms variables and SMEs tax behaviours.

Table 3. 4: Summary of sources of data, and type of data

Variable	Source of Data	Operationalization in questionnaire	Measurement of variable
General information	KRA officers SMEs managers	Section A	Nominal
<b>Independent Variables</b> <ul style="list-style-type: none"> <li>• Turnover Tax</li> <li>• Tax administration</li> <li>• SMEs tax behaviours</li> </ul>	 KRA officers SMEs managers	Section B, C& D	Interval
<b>Dependent Variable</b> <ul style="list-style-type: none"> <li>• Registration</li> <li>• Return filing</li> <li>• Reporting</li> <li>• Payment</li> </ul>	 KRA officers SMEs managers	Section E	Interval

Source: Adopted from the questionnaire (2014)

### 3.9. Data Preparation and Processing

The data collected from the field were typed into word processor, edited to eliminate repetitions and inconsistencies and classified on the basis of response homogeneity and subsequent tabulation for the purpose of inter-relating the variables under study. The total number of questionnaires distributed to target respondents was 267 for the study. Then data was lastly entered into SPSS (version 17).

### 3.10. Method of Analysis of Qualitative Data

Qualitative data generated from the field was transcribed and summarized based on themes and sub-themes in relation to the objective under study. This was necessary in comparison of data for any connections for interpretation of research into the effects of tax reforms on compliance of SMEs in Kisumu. Qualitative data was skillful collected, properly familiarized with the collected data by reading and understanding the data inform of notes taken. Then thematic framework was identified through writing of noting and writing memoir in the

margin of the text for ideas and concepts arising from texts. The descriptive statements were developed and analysis was carried out on the data. Then the researcher highlighted and sorted out quotes and made comparisons for both within and between cases before lifting the quotes from their original context and rearranging them under appropriate thematic content.

### **3.11. Methods of Analysis of Quantitative Data**

The refined quantitative data were analyzed so as to describe the basic features of the data in the study and present quantitative description in a manageable form, with the aid of SPSS (version 17). This analysis was necessary to reach a conclusion that extend beyond the immediate data and make inferences from the data to more general condition. The analyses used in this study were: Pearson's Product Moment and Linear Regression analysis.

The general model on effects of tax reforms on tax compliance of the SMEs in Kisumu Town was tested using enters multiple regression analysis to develop the model.

### **3.12. Analytical Model**

This study was based on two theories; first, economics utility theory developed by Allingham and Sandmo (1972), which is based on economic utility such that taxpayer are likely not comply with tax laws unless anticipated legal penalties (deterrence) exceeded the additional earnings that could be made by evading tax and only rational self-interest citizens will voluntary comply. The second theory is the theory of psychology and sociology which based on changing the factors influencing individual decisions. While the literature supports that the tax reforms combines the two theories on tax evasion on SMEs will enhance compliance (IFC, 2007).

Table 3. 5: A Summary of the methods of data analysis

VARIABLES	Statistical Analysis Used	Reasons
Turnover Tax Implementation	Pearson's Moment of Correlation	To establish the direction of the relationship between implementation of turnover tax and SMEs tax compliance.
Tax administration reforms	Pearson's Moment of Correlation	To establish the effects of Tax administration reforms on compliance
SMEs Tax Behaviours	Pearson's Moment of Correlation	To obtain the most popular SMEs tax behaviours affecting compliance.
Effects of Tax Reforms on Compliance	Multiple Regression analysis	To generalize a model on tax reforms and compliance of SMEs.

Source: Survey data (2014)

*Pearson Product Moment Correlation Coefficient:* The research hypotheses were tested using Pearson's Moment of Correlation with value of correlation coefficient **r** between-1through0to+1. This test was therefore, conducted to determine the effect of tax reforms (independent variables) on the tax compliance of the SMEs (dependent variables). The statistical model used to test correlation coefficient was;

$$r = \frac{n(\sum xy) - (\sum x)(\sum y)}{\sqrt{[n\sum x^2 - (\sum x)^2][n\sum y^2 - (\sum y)^2]}}$$

Where;

N=Number of values or elements

X= First Score

Y=Second Score

$\sum XY$ =Sum of the product of first and Second Scores

$\sum X$ =Sum of First Scores

$\sum Y$ =Sum of Second Scores

$\sum X^2$  =Sum of square First Scores

$\sum Y^2$  =Sum of square Second Scores

*Multiple Regressions:* Multiple regression analysis was used to evaluate the relationships of three independent variables (turnover tax, KRA administrative reforms and SMEs tax behaviours) on the tax compliance of the SMEs in Kisumu town (dependent variable).

Consequently the following equation can be deduced;

$$TC = f(X) \dots\dots\dots 3.1$$

Where

*TC* is Tax Compliance

*X* is explanatory variables representing tax reforms

This model was used to determine the relationship between the independent variables and dependent variables under study. All the potential independent variables in the model were included and those that are not statistically significant be eliminated. Tax compliance was measured using the average proportion of the compliance measuring aspects that are returns filing, tax paid, and registration and correct reporting.

For enter regression with all the potential independent variables is given in equation 3.2.

$$TCR_i = (ToT, KRA, MSEbev) \dots\dots\dots \text{(Equation 3.2)}$$

Where:

- TCR<sub>i</sub> - Tax compliance score
- ToT<sub>i</sub>- Turnover tax implementation
- KRA<sub>i</sub>-KRA tax administration reforms
- MSEbev<sub>i</sub> – SMEs tax behaviours

*ANOVA:* this test was used to determine whether the model works in explaining the variable relationships; the impact independent variables on the dependent variable in a regression analysis.

### **3.13. Ethical Considerations**

During the study, the researcher upheld ethical standards for instance:

**Informed consent:** before study respondents' consent were sought, got permission from the relevant authorities and ensured that only questions that are directly related to the study were administered. In addition, no inducement was given to respondents and for individual unwilling to be part of the research, he/she were permitted to opt out of it or delegate to one of his or her junior.

**Confidentiality:** the respondents were assured that the information they provided would not be treated with utmost confidentiality and would be published as anonymous statistical data.

**Plagiarism:** all major works and statements in the study were dully cited with source clearly indicated, within text and properly referenced.

**Research assistant:** research assistants were also oriented in the ethics of the research.

## **CHAPTER FOUR**

### **PRESENTATION AND DISCUSSION OF FINDINGS**

#### **4.1. Introduction**

This chapter presents the study findings analyzed using descriptive and inferential statistics. The findings are presented in the following thematic areas: response rate; demographic characteristics of the respondents; turnover tax system; testing hypothesis one; KRA tax administration reforms; testing hypothesis two; SMEs tax behaviours; testing hypothesis three and finally the hypothesized model of tax reforms and SMEs tax compliance.

#### **4.2. Response Rate**

Research's data collection instruments (questionnaires) were administered within a period of four weeks. A total of 214 questionnaires were successfully completed and returned. The data collected represented a response rate of 77.82% (214) given that a total of 275 respondents were targeted. This percentage was enough to continue with the study based on Finchman (2008) that a response return rate of more than 60% is enough for study to continue.

The collected data was assessed based on the response rate and subsequently accepted as a close representation of the entire target population since feedback was ascertained from all the two groups (SMEs in Kisumu town and KRA officers in Kisumu tax station) that had been identified by the researcher for study. From the two groups that were targeted for information, contributions were all recorded. The findings are presented in Table 4.1.

Table 4. 6. Responses Rate

<b>Business Sector</b>	<b>Questionnaires issued</b>	<b>Questionnaires filled&amp; returned</b>	<b>Response rate</b>
General Trade sector	133	106	80%
Manufacturing sector	20	16	80%
Construction sector	26	22	85%
Service sector	40	26	65%
<b>Total</b>	<b>219</b>	<b>170</b>	<b>77.6%</b>
<b>Kisumu KRA</b>			
Station manager	1	1	100%
Section heads	4	3	75%
Supervisors	11	8	72.7%
Officers	40	32	80%
<b>Total</b>	<b>56</b>	<b>44</b>	<b>78.6%</b>

Source: Survey data (2014)

Out of the 269 questionnaires issued to the targeted respondents, only respondents from KRA station manager groups returned fully filled questionnaires (100%) ready for analysis. However, one KRA section head together with two KRA officers plus twenty-three from general trade sector, sixteen from service and construction sectors combined and two from manufacturing did not return the questionnaires and could not be reached after several attempts were made to contact them, but in vain and hence were not available to return the questionnaires they had been issued with. Further, seventeen questionnaires from various support groups were rejected for further analysis because they were inconsistent and not fully filled. All the non-returned and rejected questionnaires, negligibly affected the study's findings and ultimate generalizations.

### **4.3. Demographic Characteristics of the Respondents**

As a preliminary intent to measure the quality of responses from the respondents, the study explored the gender of the respondents, age characteristics, level of education, forms of business organization and level of experience in tax matters. This information was necessary

establish how each demographic characteristic are related to study variables.

### 4.3.1. Demographic Gender of the Respondents

The first demographic trait of the respondents tested was gender. The study tested the quality of respondent in regard to gender composition and the findings are in Figure 4.1.

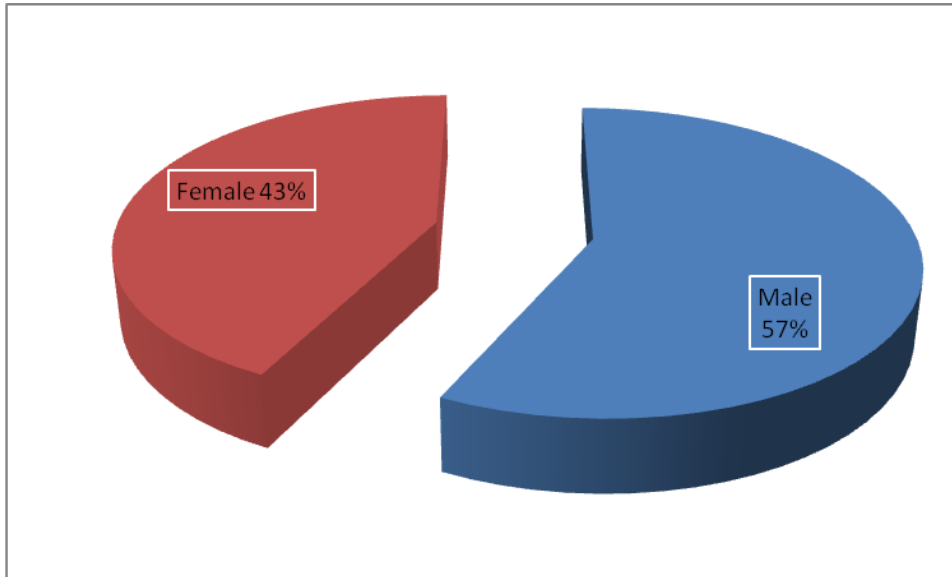


Figure 4. 1: Gender distribution of the respondents

Source: Survey data (2014)

The gender of the total respondents was male 60.3 per cent (129) and female 39.7 per cent (85). The findings in figure 4.1 imply that that majority of the respondents were males and therefore SMEs in Kisumu town are male dominated. The gender of the respondent taxpayer is vital factor in determination of the tax compliance according to Walsh (2012) gender have a role to play in regard to tax compliance in that female taxpayers are risk averse hence tend to be more tax compliant than the male counterparts.

### 4.3.2. Demographic Age of the Respondents

The demographic age of the respondents of the study was vital since it indicated the quality

of respondents in regards to handling and exposure to taxation. The study tested respondents' age distributions as a measure of the quality of the sample characteristics in providing quality data and the findings are presented in Figure 4.2.

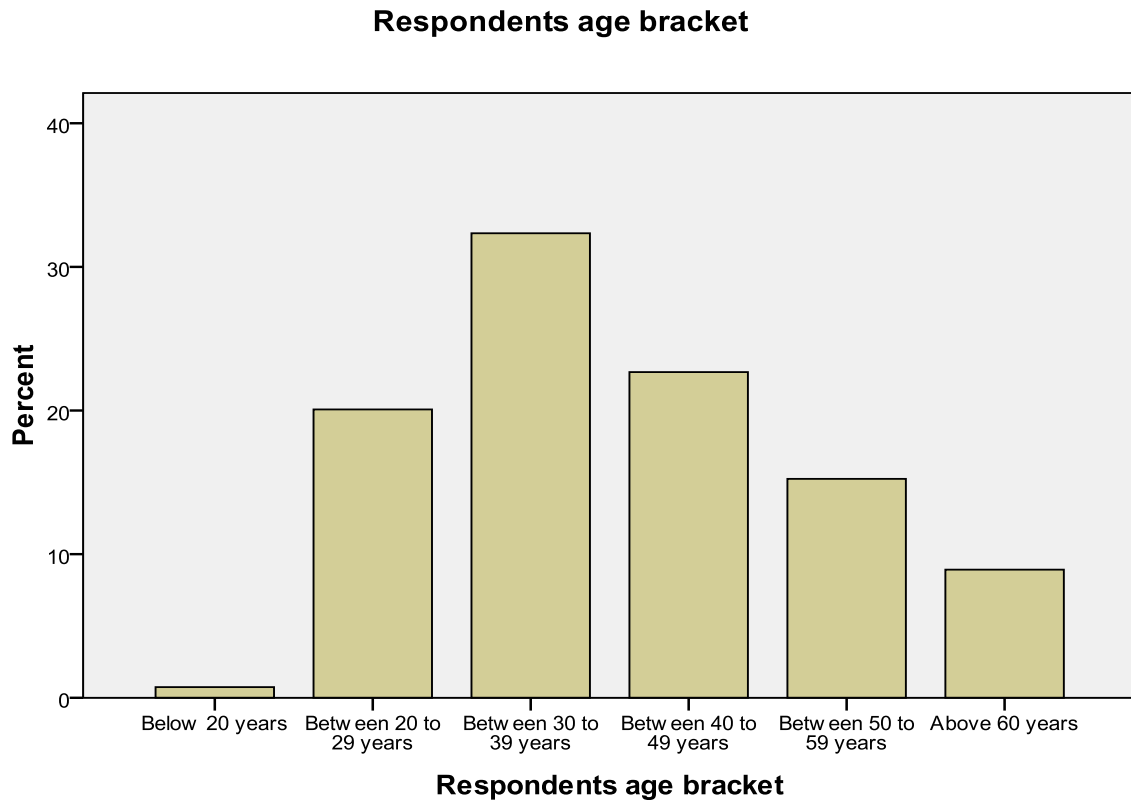


Figure 4. 2: Age distribution of the respondents  
Source: Survey data (2014)

From the study findings, 32.3% (69) of the all the total respondents were in their 30s and 22.7% (49) in their 40s which in total 56 % (120) of respondents were above 30 years. They are businessmen who have had experience in running of businesses and were the most appropriate age groups to include in this study. According to OECD (2012) demographic age of the owners or proprietors of Small and Medium enterprises (SMEs) affects their tax compliance for instance older people are more tax compliant, perhaps as they are generally

more risk averse than young people who are risk taker.

### 4.3.3. Respondents' Level of Education

Further to the ascertainment of the quality of respondents in providing quality data, the study sought to determine the education level of the respondents. Educated people are better informed of tax laws, which should positively influence compliance, but they have better knowledge of opportunities for tax evasion. The findings on the level of the respondents are presented in Figure 4.3.

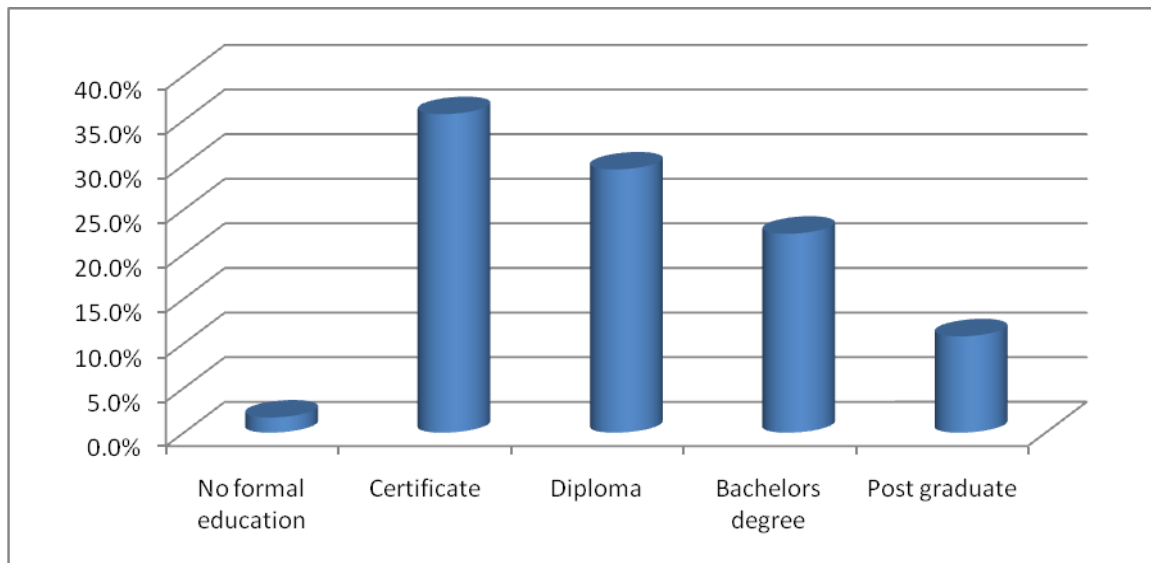


Figure 4. 3: Education level of the respondents  
Source: Survey data (2014)

The study established that most of the respondents are educated and they were able to interpret the tax laws and comply with it. Most of the respondents 35.7% (76) had basic education that is certificate, 29.5% (63) had diploma and 22.3% (48) had bachelors' degree; leaving only 1.7% (4) with no formal education. The respondents without formal education were assisted by the research team to answer the questionnaires while the rest of the respondents were given self-administered questionnaires. Hence all the respondents not only

were well suited to understand and answer questions of the study but also they would have the ability to read tax laws since most of the respondents had basic education.

#### 4.3.4. Respondents' Business Structure

Further to the ascertaining of the quality of the respondents in providing quality data, the respondents were asked the type of their organization. The findings are presented in Table 4.2.

Table 4. 7: The Respondents' business structure

	Frequency			Percentage
	SMEs	KRA	Total	
Sole proprietorship	96	-	96	44.9
Partnerships	42	-	42	19.6
SACCOs	23	-	23	10.7
Limited company	9	44	53	24.8
Total	170	44	214	100.0

Source: Survey data (2014)

According to the study findings, majority 44.9% (96) of the SMEs respondents were operating as sole proprietorship and 19.6% (42) were operating as partnerships and 10.7% (23) as SACCOs. Only 25.8% (63) of the respondents indicated that their organization were limited companies. From the study data most of the respondents were operating as sole proprietors and self-employed. . According to Venter (2007) sole proprietors and the self-employed people are less compliant in average and have high compliance costs and more opportunity to evade taxes.

#### 4.3.5. Respondents' Working Experience

The experience of the respondents that is SMEs managers and KRA officers in Kisumu was

another demographic variable considered under the study. Respondents with more experience are likely to provide quality data as compared to inexperienced respondents. The finding is presented in Table 4.3.

Table 4. 8: Distribution of respondents by working experience

Work experience	Frequency			Percentage
	SMEs	KRA	Total	
Less than 2 years	6	1	7	3.3
2 - 3 years	18	3	21	9.8
4- 6 years	27	5	32	15.0
7- 8 years	49	12	61	28.5
9- 10 years	44	15	59	27.6
More than 10 years	24	8	34	15.9
Total	170	44	214	100.0

Source: Survey data (2014)

The study established that only 3.3% (6 SMEs and 1 KRA) had been in their organization for less than two years and 9.8% ( 18 SMEs and 3KRA officials ) had been with their organization between two and three years. While all the rest of the respondents had been with their organization for more than four years in handling tax matters, implying that they were knowledgeable and experienced in their work in regard to taxation. For the years in service in the organization, then the respondents were taken to have acquired experience at different levels and hence they are people who have handled tax matters. The SMEs tax reforms were implemented in the year 2006 and hence respondent with more than six years have participated in carrying out duties which are related to tax reforms. . According to Walsh (2012) educated and experienced people may be better informed of tax laws, which should positively influence the tax compliance, but however may present risk of tax avoidance.

### 4.3.6. Turnover Tax Revenue Collected

The study analyzed secondary data on the turnover tax revenue collection from the SMEs in Kenya. The findings are presented in Figure 4.4.

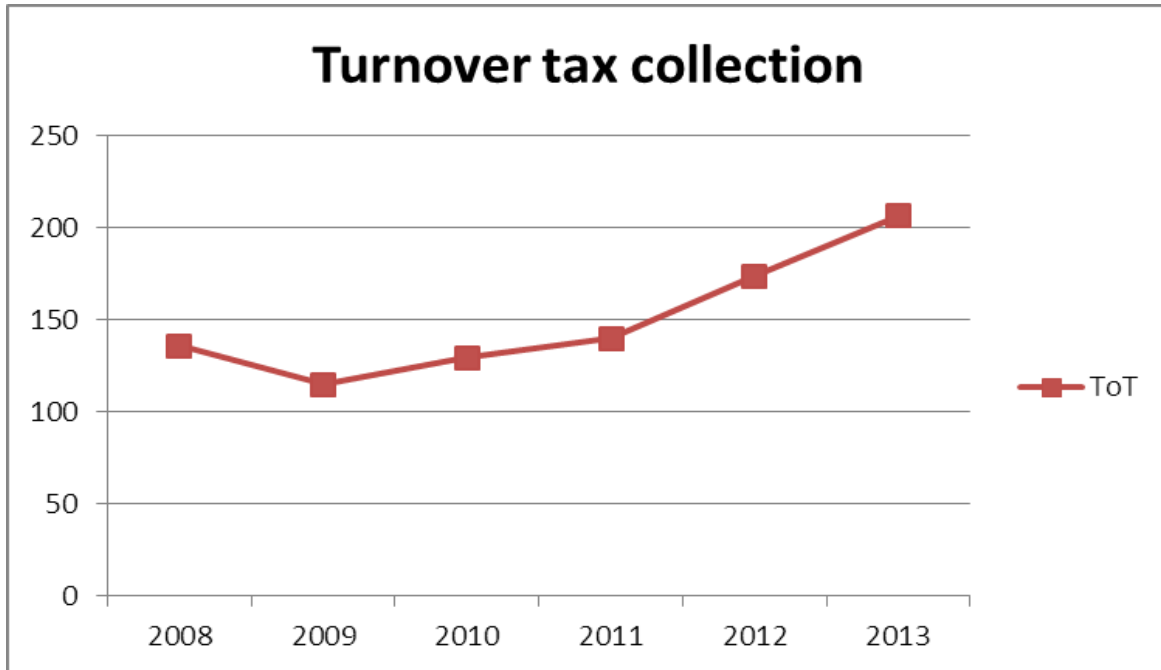


Figure 4. 4: Turnover tax revenue for the period 2009- 2013  
Source: Survey data (2014)

The revenue collection in Kenya from turnover tax has been increasing steadily from the year 2008 to the year 2013. In the year 2007/2008 with efficiency ratio of 0.35 percent implies that if the turnover tax rate is increased by one percent point, turnover share in the GDP proportion of SMEs is expected to increase by 0.35 of 100 percent. The efficiency ratio has continued to increase to 0.41 percent in the year 2013. The efficiency ratio remains low because the tax revenue from the SMEs has continued to be below one percent of the total revenue collected by the KRA. According to Waweru (2007), turnover tax was implemented to enable SMEs in Kenya comply with the tax requirements with ease. This study analyzed

the revenue collection from turnover tax using efficiency ratio (E) which is the share of the turnover tax in the GDP proportion of the SMEs divided by turnover rate of 3 percent. According to Ebrill *et al.* (2001), high efficiency ratio implies better the performance of the turnover tax.

#### **4.4. Turnover Tax System**

The study findings on the effects of implementation of turnover tax on compliance of SMEs in Kenya with reference to Kisumu Town are presented in this section. The study sought to determine whether the implementation of turnover tax contributed to enhancement of tax compliance of SMEs operating Kisumu Town. The respondents were tested on parameters which measured the effects of the turnover tax on tax compliance. The specific parameters analyzed in the study were turnover tax awareness, cost in time, cost in money, complexity of compliance process, turnover tax rate of 3 percent appropriateness and user satisfaction.

The study sought the views of the respondents through the use of Likert question to measure the level of agreement or disagreement with items that were formulated to elicit their opinions based on their experience and understanding of the turnover tax. The Likert question on 5-likert scale where strongly disagreed =1; disagreed -2; neither agreed nor disagreed =3; agree = 4 and strongly agreed = 5. On the scale of 1 to 2 it is assumed as noncompliance or non-awareness to turnover tax; as from 4 to five is taken as compliance and hence awareness to turnover tax while 3 is between compliance and non compliance. The data collected were analyzed with the aid of descriptive statistics (the mean). The findings are presented in Table 4.4.

Table 4. 9: Effects of Turnover Tax on compliance

Turnover effects	SMEs	KRA	Overall
	N=170	N=44	Mean N=214
Change in cost in time	2.44	2.68	2.56
Change in financial costs	2.43	2.92	2.68
Less complexity in compliance process	3.27	3.63	3.45
Turnover tax rate of 3 percent appropriateness	3.09	3.12	3.11
User satisfaction with turnover tax	3.47	3.69	3.58
Awareness of Turnover tax	4.46	4.32	4.39

Source: Survey data (2014)

The awareness of the turnover tax received the highest rating: 4.46 from the SMEs and 4.32 KRA with the overall mean score of 4.39. From the study findings, it was established that the respondent agreed that there was awareness on the turnover tax implementation. The findings are consistent with the findings by OECD (2012) who established that for presumptive tax system to be effective in taxation of SMEs there is need for creation of the awareness among. Therefore, it is clear that all the respondents were aware of the turnover tax implemented by the government.

The study also sought to establish whether the implementation of the turnover tax had reasonably reduced time in compliance of the SMEs in Kenya. The study tested the responses of the respondents in regard to the time spent in complying with the turnover tax requirements. The change in time spent in complying with the turnover tax received the lowest rated at 2.44 by SMEs and 2.68 by KRA with the overall mean being 2.56 which was above average. The findings established that the respondents were positive in regard to time spent in compliance with the turnover tax. The results imply that the turnover tax implementation did reduce the time spent in compliance to turnover tax. The study is

consistent with the contention by Waweru (2007) that turnover tax system should enable the SMEs to comply with ease and with minimal time wastage. Further according OECD (2012) the presumptive tax system should enable taxpayers to comply easily and at the reduced time

The responses from both respondents (SMEs at 2.43 and KRA at 2.92) had mean of 2.68 which was above average in rating the statement that the implementation of the turnover had changed the financial costs incurred in complying. According to International Finance Corporation (2007) costs associated with compliance include costs to file taxes in term of cost in penalties, material cost for compliance, third party like tax agents and use of software. However from the study findings, it was established such costs had been minimized by the introduction of the turnover tax. The findings suggest that there was some perceived change in costs. The study concurs with Waweru (2007) and Institute of Economic Affairs (2012) that turnover tax reduces the cost of compliance among the SMEs taxpayers so as to comply.

According to the study findings, less complexity of the compliance process on the turnover tax received the lower rating among the respondents (3.27 by the SMEs and 3.63 by the KRA) with an overall mean of 3.45. The result suggests that the respondents were positive in regard to turnover tax compliance process. This implied that the compliance process was characterized by fewer errors in returns. The study established that the turnover tax is less complex to the SMEs operating within Kisumu Town. The study findings are consistent with the study by the Institute of Economic Affairs (2012) that tax system of the SMEs taxpayers should not be complex to enhance voluntary compliance.

The user satisfaction with implementation of the turnover received ranking of 3.47 by the SMEs and 3.69 by KRA officials with the overall mean being 3.58 which was above

average. From the study findings, respondents were positive in that they were satisfied with the implementation of the turnover tax. The study results suggest that the respondents were encouraged with the implemented turnover tax. The findings are consistent with the contention by Thuronyi and Victor (2004) on the presumptive tax on the hard to tax taxpayers in the economy.

The attributes of turnover tax rate of 3 percent was appropriate, had the rating of 3.09 for the SMEs and 3.12 among the KRA respondents with the overall mean being 3.11 which was average. The study findings established that there was a neutral rating from the business which tended either agrees or disagree with the statement. Respondents tended to neither agreeing nor disagreeing with that turnover tax implementation was turnover tax rate of 3 percent was appropriate to the SME business in Kisumu town. From the study findings it was established that most SMEs business do not use online filing, e-payment and reporting their tax online, but they were using manual system of turnover tax.

#### **4.4.1. Turnover Tax and Experience Level**

To determine the relationship between turnover tax and experience of respondents a regression was executed. Based on the correlation matrix executed the findings are presented in Table 4.5.

Table 4. 10: Regression of Turnover Tax and Level of Experience in Organization

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.846	.153		18.176	.000
	Number of years worked in your organization	.150	.059	.443	3.957	.000

Source: Survey data (2014)

The study established a low but significant relation between experience and turnover tax system ( $r(214) = .443, P < 0.01$ ). The model summary produced the adjusted  $R^2$  of 0.194 (19.4%) which implies that experience alone contributes about 19.4 per cent to awareness of turnover tax. This result suggests that level of experience does have an effect on the turnover tax system awareness. Specifically the study result suggest that the more a person does his job or stays in business the more he/she accumulate information about the turnover tax which is necessary to aide in tax compliance.

It therefore follows that SMEs who have had experience in dealing turnover tax are more likely to be compliant than those who have never handled turnover. These findings are consistent with those of a study by International Finance Corporation (2007) on informal sectors which concluded that non-compliant firms will continue to remain non-compliant simply because they are not aware of turnover tax. This is in line with a contention by Trivedi and Shehata (2005) that the more the taxpayers understand the tax system the more likely that they comply voluntarily. When the taxpayers are aware of turnover tax then it would mean that they have understood and have information on the turnover tax system and they are likely to comply.

#### 4.4.2. Turnover Tax and Education levels

The study sought to establish whether the level of education contributes to awareness of turnover tax and hence compliance of the SMEs. It was important establish whether the level education that individual taxpayer had resulted into the awareness of turnover tax.

Table 4. 11: The relationship between Education level and Turnover tax

		Turnover tax system	Highest education level attained
Turnover tax system	Pearson Correlation	1	.165**
	Sig. (2-tailed)		.227
	N	214	214

Source: Survey data (2014)

As show in Table 4.6, the study established that there was no significant relationship between the level of education and turnover tax awareness. From table 4.7, the study established that there was no significant contribution of education towards turnover tax [ $r(214) = .165, P > 0.05$ ]. This was attributed to the fact that the respondents had specialized in different areas like in education, health, and finance and general basic education which different from tax education. Hence respondents had certificates, diplomas and degrees in different area of specialization but not in tax matters.

The result suggest that the educational level of SMEs alone is not enough for them to be compliant, however they need turnover tax awareness and use of tax advisors if need be. The results contradict the findings of Walsh (2012) who found that education makes taxpayers better informed on tax matters. However the study supports the findings of Institute of

Economic Affairs (2012) that taxpayers especially those in informal sectors should be sanitized on taxation and even more enforcement enhanced amongst these taxpayers.

#### 4.4.3. Turnover Tax and Position in Organization

The higher the position of a person in any organization comes with the greater responsibilities, and hence for an individual taxpayer to perform well, he or she must be conversant with turnover tax laws. Therefore it was important to the study to determine whether the position of person occupied in the organization enhances his or her awareness of the tax laws within the individual SMEs organization. The analysis of the position of respondents was analysed using regression test as presented in Tables 4.7 and 4.8.

Table 4. 12: Relationship between Turnover tax and position

		I am aware of Turnover tax system	Position in the organization
Turnover tax system	Pearson Correlation	1	.436*
	Sig. (2-tailed)		.000
	N	214	214

Source: Survey data (2014)

According to the study findings in Table 4.7, correlation test established that there was a low significant relationship between awareness of turnover tax system and position [ $r(214) = .436, P < 0.01$ ]. The finding implies that higher positions in an organization would be aware of turnover tax system than the lower positions.

Table 4. 13: Regression of Turnover Tax and Position

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.960	.212		9.256	.000
	Position in organization	.159	.071	.436	2.240	.006

Source: Survey data (2014)

From the regression analysis, an adjusted  $R^2$  of .185 which meant that the position contributed only 18.5% to the awareness of turnover tax and while there was low positive relationship  $\beta = .436$ ,  $p < 0.01$  respectively. The contribution of position towards awareness of turnover tax is low meaning that individual SMEs to gain awareness of turnover tax without necessarily occupying specific position in the organization.

This is made position by the KRA support programs to taxpayers like brochures, booklets and seminars. Based on the study findings, it can be concluded that the SMEs taxpayers are aware of turnover tax by virtue of their operations. Hence the findings support the study by Karingi and Wanjala (2005) who established that some sectors of the SMEs are non-compliant due to ignorance.

#### 4.4.4. Testing of Hypothesis one

The first hypothesis (H01) stated that *turnover tax have no significant effect on tax compliance by Small and Medium Enterprises in Kisumu town*. To test this hypothesis, Pearson's Moment of Correlation was carried out to establish the effects of turnover tax on compliance of the SMEs in Kisumu town and the findings are as presented in Table 4.9.

Table 4. 14: Correlations between Turnover Tax and SMEs Tax compliance

		Turnover Tax	SMEs Tax Compliance
Turnover Tax	Pearson Correlation	1	.439**
	Sig. (2-tailed)		.000
	N	214	214

\*. Correlation is significant at the 0.01 level (2-tailed).

Source: Survey data (2014)

According to study findings, there was a moderate positive significant relationship between turnover tax and SMEs tax compliance [ $r(214) = .439, p < 0.01$ ]. The result suggests that turnover tax has effect on tax compliance of the SMEs in Kisumu town.

The study sought to test the extent to which the postulated model works in explaining the variable relationships. It was established that turnover tax variables accounted for 28.8% of the variance in SMEs tax compliance in Kisumu town. Therefore the findings established that there was a significant relationship between turnover tax and compliance of SMEs in Kisumu Town.

Table 4. 15: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.438 <sup>a</sup>	.291	.288	6.29597
a. Predictors: (Constant), Turnover tax b. Dependent Variable: Tax compliance				

Source: Survey data (2014)

The result suggests that the implementation of turnover had positive significant effects on compliance of SMEs taxpayers in Kisumu town. From this study results, it can be concluded that implementation of turnover tax has a real effect on tax compliance of the SMEs in Kisumu town and hence in Kenya. Specifically, study results suggest that with the

implementation of turnover tax under the tax reforms the compliance of SMEs in Kisumu town has increased. The results therefore imply that a tax reform has effects of enhancing compliance of SMEs in Kisumu and hence in Kenya. The null hypothesis is thus rejected.

#### 4.5. Tax Administration Reforms

This study sought to determine whether KRA tax administration reforms were effective in enhancing compliance of the SMEs in Kisumu town. The specific KRA administrative reforms aspects measured were tax laws application, tax compliance activities, tax administrative control, taxpayer support and information sharing and use of technology. The respondents were asked to rate how effective tax administration reforms in enhancing compliance of SMEs whereby they were supposed to rate 1 for very ineffective, 2 for ineffective, 3 for partially effective, 4 for effective and 5 for very effective.

##### 4.5.1. Tax Laws to Non-Compliant SMEs

The study sought to determine whether KRA has been effective in application of the tax laws to enhance compliance among the SMEs in Kisumu Town. The findings are presented in Table 4.11.

Table 4. 16: Application of Tax laws to non-compliant SMEs

Tax laws Applications	Respondents		Overall mean N= 214
	SMEs(mean) N= 170	KRA (mean) N= 44	
Amend laws close loopholes and reduce ambiguities	2.210	2.4321	2.321
Application of fines/penalties	3.824	3.9140	3.869
Opportunity to voluntarily disclose before the application of penalties	2.017	1.932	1.974

Source: Survey data (2014)

According to the study findings, the study established that application of the fines or

penalties to non-compliant taxpayers was effective with the mean rating of 3.869 which tended to rank 4 which is effective. The second tax application was amendment of laws to close loopholes and reduce ambiguities with a mean rank of 2.321. However the opportunity to voluntary discloses before the application of penalties received the lowest ranking of ineffective in enhancing compliance. The results suggest that KRA was effective in application of fines and penalties to non-compliant taxpayers but ineffective offering opportunity to enhance voluntary compliance.

This study finding implied that most of the respondents had the view that the tax laws for SME are not able to enhance compliance because the tax law contains loopholes for tax evasion and is hard to understand. Further the KRA has not given the non-compliant taxpayer opportunity to voluntary complied before application of fines according to the Boame (2009) tax amnesty to non-compliant taxpayer encourages voluntary compliance. The ability to understand the tax laws that is the rates of tax, filing and paying dates influences the compliance of the taxpayers (Lumumba *et al.*, 2010). The tax laws should be amended to enable taxpayers understand them for easy of compliance by reducing any ambiguities and anomalies.

#### **4.5.2. Tax Compliance Activities**

The KRA administration activities which target non-compliant SMEs in Kenya is vital to enhance compliance. The study sought to determine effectiveness of KRA administrative reforms in terms of compliance activities like audits, compliance visits and SMEs registration and review. The findings are presented in Table 4.12.

Table 4. 17: Tax Compliance Activities

Tax Compliance Activities	Respondents		Overall mean N= 214	Standard deviation
	SMEs (mean) N= 170	KRA (mean) N= 44		
Reviews, investigations and audits	3.268	3.360	3.3140	0.1973
Unannounced field visits, walk-ins and mock purchases	3.080	3.206	3.1429	1.1986
Registration and enterprise reviews (i.e. checking registration details and ensuring registered entities are real)	3.078	2.957	3.0178	1.0317

Source: Survey data (2014)

Based on the study findings, it was established that most of the respondents were indifferent (mean =3 and the standard deviation is insignificant) as to whether reviews, investigation and audits of the non-compliant SMEs was effective or not. Further the respondents indicated that they their accounts have never been reviewed by KRA nor had any unannounced visits, walk-ins and done any mock purchases which can enhance deterrence of non-compliance by the taxpayers. However for those respondents who indicated that their organization had regular contacts with KRA like audits and reviews and were compliant. The study supports the study by Sandmo (2004) and supported by Waweru (2007) who suggest that the tax administrative activities audits, checks of returns and other reviews enhances voluntary compliance.

#### **4.5.3. KRA Tax Administrative Controls**

The study sought to determine how effective are KRA administrative reforms in enhancing compliance by reviewing administrative controls. The administrative controls tested were compliance burden reduction and tax compliance requirement. The findings are presented in Table 4.13.

Table 4. 18: Tax Administrative Controls

Tax Administrative controls	Respondents		Overall mean N= 214	Standard deviation
	SMEs (mean) N= 170	KRA (mean) N= 44		
Reducing compliance burden	3.491	3.633	3.5620	0.3861
Enforcing invoicing/receipting requirements	3.536	3.681	3.6085	0.923
Requiring tax compliance certificates	3.924	4.084	4.004	1.725

Source: Survey data (2014)

The major aspect tested of performance of the KRA administration is compliance burden to SMEs in Kisumu Town. The analysis of the responses of the SMEs business managers and KRA officer who participated in the study revealed that there is a fair rating of reducing compliance burden of the SMEs with the mean responses being 3.562 with insignificant standard deviation as indicated in Table 4.13. From the open ended questions it was revealed by most of the respondents 51% that KRA had simplified the procedures and there was convenient way of making payments of tax and the issue of transparency and integrity.

The main aim tax compliance certificate is to ensure that any business dealing with government is a compliant on all tax requirements in that it has filed returns and paid tax due. This explained how the SMEs business managers and KRA officer rated the tax compliance certificates in enhancing compliance. The rating of the respondents was the tax compliance certificates were effective in enhancing compliance of the SMEs in Kisumu Town. The compliance tax certificate has been strictly applied and is a requirement for all public procurements in Kenya. Most of the businesses have contacted KRA for the aim of securing compliance certificate. This implies that the getting of certificate of compliance has been major target of most business in Kisumu Town. The study concurs with Walsh (2012) that tax administrative should reduce compliance costs and encourage voluntary compliance. The

study findings are in line with the those of Moyi and Ronge (2006); Waweru (2007); Mutua (2011) and OECD (2012) that Kenya government introduced reforms targeting SMEs in Kenya with the platform for enhancing voluntary compliance.

#### 4.5.4. Taxpayers Support and SMEs Information

To enhance compliance of taxpayer, the tax administrator must provide information to the taxpayer so as educate them on how comply. KRA provide information through brochures, booklets and seminars which provide guidance to taxpayers to comply.

Table 4. 19: SMEs information

SMEs support and information	Respondents		Overall mean N= 214	Standard deviation
	SMEs (mean) N= 170	KRA (mean) N= 44		
Providing information and guidance to help taxpayers comply (e.g. brochures, booklets, seminars)	4.304	4.480	4.392	1.273
Publicizing prosecution cases of non-compliance	1.834	1.908	1.871	0.826
Incentives for compliance (e.g. rewards/awards to the best taxpayers)	1.467	1.527	1.497	0.361
Use of informants and tax evasion referral hotlines or websites	2.816	2.930	2.873	0.1417
Getting information from Government departments	3.817	3.973	3.895	1.124
Use of primary research (e.g. surveys of taxpayer groups) to understand behaviour and identify issues/risks	2.872	2.990	2.931	1.830

Source: Survey data (2014)

From findings in Table 4.14, most of the respondents agreed that KRA administrative approach was ineffective like Publicizing prosecution cases and the consequences/penalties of non-compliance (with overall mean of ranking of 1.871) and offering incentives for compliance; for instance rewards/awards to the best taxpayers (overall mean rank being 1.497). The study concurs with Mage (2011) that when evasion is made public, tax evaders

are usually willing to comply and avoid public shame.

Use of informants and tax evasion referral hotlines or websites (with the overall mean ranking of 2.873) and use of primary research to understand behaviour and identify issues/risks (overall mean rank being 2.931) neither did nor elicit varied responses as to either effective or ineffective from the respondents. While respondents were KRA was effective in as to regard to providing information and guidance to help taxpayers comply , for instance brochures, booklets, and seminars (overall mean rank being 4.392) and getting information from other government departments (with overall mean rank 3.895). The tax administrative policies help in enhancing compliance of the taxpayers. The study findings is in support to Walsh (2012) who established that tax authorities should make it easier to comply and hard for non-compliance.

#### 4.5.5. Use of Technology

The study sought to determine whether the KRA implementation and use of technology was effective in enhancing compliance among the SMEs in Kisumu Town. The specific parameters tested were use computers in audit and data mining and training of KRA staff.

Table 4. 20: KRA use of Technology

Technology Use	Respondents		Overall mean N= 214	Standard deviation
	SMEs (mean) N= 170	KRA (mean) N= 44		
Computer-assisted verification and audit activities	4.382	4.560	4.471	1.311
Data warehousing and data mining	3.896	4.056	3.976	0.819
Compliance training provided to KRA staff	3.723	3.577	3.650	1.273

Source: Survey data (2014)

Based on the study findings in Table 4.15, it was established that technology use in audits received the highest rating with the overall mean of 4.471 and in data warehousing and mining which implied that KRA was effective in use of technology in enhancing compliance of the taxpayers in Kenya. Further compliance training to KRA staff was effective in enhancing compliance of the SMEs in Kisumu Town. The result suggests that the use of technology by KRA enhance compliance of the taxpayers like the findings of literature reviewed (Leonard & Zeckhauser, 1987; Karingi & Wanjala, 2005; James, 2008; Nada & William, 2009; Ojochogwo & Ojeka, 2012; Walsh, 2012) which recommend for the use of technology by the tax authority.

#### 4.5.6. Testing of Hypothesis Two

The second hypothesis ( $H_{02}$ ) stated that *there is no significant relationship between KRA tax administrations and tax compliance of Small and Medium Enterprises in Kisumu Town*. The study employed a Pearson's Moment of Correlation analysis test whether there was any relationship between the KRA tax administration reforms and tax compliance of the MSEs in Kisumu town and the findings is give in Table 4.16.

Table 4. 21: Correlations between KRA administration reforms and SMEs Tax compliance

		KRA administration reforms	SMEs Tax Compliance
KRA administration reforms	Pearson Correlation	1	.617**
	Sig. (2-tailed)		.000
	N	214	214

\*. Correlation is significant at the 0.01 level (2-tailed).

Source: Survey data (2014)

According to study finding in Table 4.16, there was a positive significant relationship between KRA administrative reforms and SMEs tax compliance [ $r(214) = .617, p < 0.01$ ]. The result suggests that KRA administrative reforms variable affects compliance of the SMEs in Kisumu town. This shown by the value of Pearson’s Moment of Correlation coefficient of  $r$  value equal to .617 while the  $p$ -value is less than 0.01 implying that the KRA administrative reforms have the effect of enhancing compliance of the SMEs taxpayers.

Further study tested the extent to which the postulated model works in explaining the variable relationships. It was established that variable KRA administrative reforms accounted for 36.8% of the variance in SMEs tax compliance in Kisumu town.

Table 4. 22: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.617 <sup>a</sup>	.381	.368	8.591

a. Predictors: (Constant), KRA Tax Reforms

Source: Survey data (2014)

Therefore the study established that there was a significant relationship between KRA administrative reforms and compliance of SMEs in Kisumu Town. The result suggests that the implementation of KRA administration reforms had positive significant effects on compliance of SMEs taxpayers in Kisumu town. This study results suggest that KRA administration reforms enhances compliance of the SMEs in Kisumu town and hence in Kenya. Specifically the study result suggest that as result of the implementation of KRA administration reforms under the tax reforms policies more SMEs have started to comply. The null hypothesis is thus rejected. The study findings support the objectives of the tax reforms in Kenya as suggested by Nada and William (2009) and Masinde (2012). Further, the

study findings are in line with IFC (2007) which recommends effective tax administration policies to enhance taxation of the taxpayers in informal sectors.

#### 4.6. SMEs Tax Behaviours

The study sought to establish the effects of the tax behaviours of the SMEs compliance on tax compliance. The specific variable analyzed were SMEs business records, referent groups, fairness in taxation, SMEs' economic factors, and use of tax agents. Based on their experience, respondents were asked to choose items which best described their business attributes which affects tax compliance. The rates were whereby they were supposed to rate 1 for Never, 2 for rarely, 3 for sometimes, 4 for always. Hence this section presents the findings on the tax behaviours in relation to tax compliance while using case of SMEs in Kisumu Town.

##### 4.6.1. SMEs Business Records

The study using the responses of the SMEs managers and KRA officials, sought to determine the behaviours which influences the tax compliance.

Table 4. 23: Keeping of Business Records

Business are well maintained	Respondents		Overall mean N= 214	Standard deviation
	SMEs (mean) N= 170	KRA (mean) N= 44		
All business records are well maintained	3.167	3.514	3.341	0.694
All business transaction are well recorded	2.645	2.364	2.505	1.434

Source: Survey data (2014)

From the study findings (Table 4.18), it was established that respondents (with the overall mean of 3.341 for keeping of records and 2.505 for recording of transactions) have partially complied in keeping up to date records and books of accounts. Further the respondents

indicated that the most common books of accounts kept were receipt books, cash books, invoices, balance sheets, profit and loss accounts. From the study what came clear was that most of the respondents indicated a desire to conform to book keeping behaviours amongst the SMEs in Kisumu Town which affect their tax compliance. This finding is line to Lumumba *et al.* (2010) which found out that most SMEs partially keep business records in Kenya.

#### 4.6.2. SMEs Referent Groups

Further the social norms in the society where the taxpayer lives may influence his or her behaviours to be either compliant or not. The aspect of the social norms which was tested by this study based on the responses of the KRA and SMEs managers in Kisumu Town were neighbors, customers and competitors among others.

Table 4. 24: The influence from the business neighbors, competitors and customers

Referent groups	Respondents		Overall mean N= 214	Standard deviation
	SMEs (mean) N= 170	KRA (mean) N= 44		
Business competitors do not report and pay tax honestly	3.544	3.271	3.407	1.311
We are not aware of what our customers and competitors are doing	1.783	1.932	1.850	0.819

Source: Survey data (2014)

The study findings in Table 4.19, indicates that more than respondents with the overall mean of 3.407 agreed that they are aware of business and referent groups not reporting and paying taxes. While with the overall mean of 1.850 which tended to respondents not agreeing that they are not aware of what the customers and competitors are doing. The standard deviation was insignificant. The result suggests that, there was negative influence from the neighbors,

competitors and customers who are not reporting and paying tax honestly. The study is line with OECD (2010) that society members whether taxpayers or not tend to conform to social norms and the behaviours of others strongly influences an individual’s choices. Consequently social norm have impact on tax compliance. Therefore the social norms influence the tax behaviours whereby when referent groups are non-complaints then the business is influenced.

### 4.6.3. Fairness in Taxation

The study sought the views of the respondents to establish whether there was any held view of fairness by the SMEs in Kisumu Town and the findings are presented in Table 4.20.

Table 4. 25: A feeling that the business is paying a fair share of tax

Paying fair share of Tax	Respondents		Overall mean N= 214	Standard deviation
	SMEs (mean) N= 170	KRA (mean) N= 44		
Government is achieving its tax objectives and is fighting corruption	2.372	2.266	2.319	0.694
A feeling that the businesses are paying a fair share of tax	1.987	1.727	1.857	0.819
Business profits are high when operating illegal business, underreporting profits etc	2.066	2.238	2.152	0.203

Source: Survey data (2014)

Most respondents agreed that government is rarely achieving its tax and fighting corruption (overall mean 2.319, the standard deviation is insignificant) and business profits are rarely influenced by tax (overall mean 2.152, insignificant standard deviation). While there was a general feeling that the businesses are not paying fair share of tax (mean 1.857, standard deviation insignificant). The result suggests that government is not meeting its tax objectives and there is a feeling among the SMEs that fair tax is not being paid and while taxation is not based on profits of the business. The finding by this study confirm to Ojochogwo and Ojeka (2012) that motivation to pay tax by the taxpayer is influenced by fairness that is both how a

person is treated by the administration individually and perceptions of fairness of the taxation system in the general. Perceptions of fairness reduce noncompliance of taxpayers and further Brys (2011) who established that compliance is influenced by attitude of the taxpayer.

#### 4.6.4. SMEs Economic Factors

The study tested the economic factors of the taxpayers based on the aspects which measured whether the respondents were operating in cash economy and had economic hardships and the findings are presented in Table 4.21.

Table 4. 26: Economic Conditions of the SMEs

SMEs economic activities	Respondents		Overall mean N= 214	Standard deviation
	SMEs (mean) N= 170	KRA (mean) N= 44		
The business experiences financial constraints	3.673	3.390	3.5321	0.492
Businesses are mainly operating in cash economy	3.454	3.974	3.714	0.1886

Source: Survey data (2014)

Based on the study findings, majority agreed that most businesses experience financial constraints (overall mean 3.5321, standard deviation insignificant) and their business operate in cash economy (overall mean 3.714, standard deviation insignificant). The above statement reflects the personal norms around the tax evasion. It is established that economic conditions of the SMEs affects their tax compliance. Accordingly the study supports the findings by Bernadette *et al.* (2012) that the economic condition of the taxpayer influences its tax compliance since businesses with liquidity problems are likely to consider evading taxes (Braithwaite, 2009). Hence the economic conditions of the taxpayer affect its compliance in that those businesses with favorable economic conditions are likely to be compliant relative to those with unfavorable economic base.

#### 4.6.5. Use of Tax Agents

The study requested the respondents to provide responses which measured whether they do employ the services of tax agents and the findings are as shown in Table 4.22.

Table 4. 27: How often organization employs the services of the tax agents

		Frequency	Percent	Cumulative Percent
Valid	Never	80	37.4	37.4
	Rarely	44	20.6	58.0
	Sometimes	44	20.4	78.4
	Always	46	21.6	100.0
Total		214	100	

Source: Survey data (2014)

According to the study data in Table 4.22, majority 68% (146) indicates that majority of the respondents do not involve the services of the tax agents in their work. The result suggests that most of the accounting and tax work are self-prepared within the business organization. Based on the study result most of the SMEs do not always involve tax agents and this study findings concur that tax professional influences that compliance behaviours of the taxpayers and tax agents usually help taxpayers to comply with the tax requirements by assisting in filing of tax returns and preparation of financial statements.

#### 4.6.6. Testing of Hypothesis Three

The third hypothesis ( $H_{03}$ ) stated that *Tax Behaviours of Small and Medium Enterprises in Kisumu Town have no effects on tax compliance.* A correlation analysis was used to test whether there was any relationship between the SMEs tax behaviours and compliance and the findings is give in Table 4.23.

Table 4. 28: Correlations between Turnover Tax and SMEs Tax compliance

		Turnover Tax	SMEs Tax Compliance
Turnover Tax	Pearson Correlation	1	-.542**
	Sig. (2-tailed)		.000
	N	214	214

\*. Correlation is significant at the 0.01 level (2-tailed).

Source: Survey data (2014)

The study established a significant negative relationship between taxpayers' behaviours in Kisumu town and their compliance. This is shown by the value of Pearson's coefficient of value equal to -.542 while the p-value is less than 0.01 implying that taxpayers' behaviours variables have the negative effect on compliance of the SMEs taxpayers.

Further, from the model summary, SMEs tax behaviours accounted for 29.1% of the variance in tax compliance in Kisumu town. Therefore the findings established that there was a significant relationship between turnover tax and compliance of SMEs in Kisumu town.

Table 4. 29: Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	-.542 <sup>a</sup>	.294	.291	7.144

a. Predictors: (Constant), tax behaviours variables

Source: Survey data (2014)

The result suggests that SMEs tax behaviours in Kisumu town had a significant negative effect on the tax compliance [ $r(214) = -.542, p < 0$ ]. This implies that the SMEs behaviours negatively affected their tax compliance given the tax reforms implemented by the government. The hypothesis is thus rejected. The study supports the OECD (2012) that tax

behaviors are key in designing any tax system for the SMEs in any economy and recommends use of behavioral insights to inform tax policy makers on how to improve on tax compliance. The tax reforms should encourage voluntary compliance of taxpayers like self-assessments.

#### 4.7. Hypothesized Model of Tax reforms and SMEs' Tax compliance

In this section the model of the study is presented whereby all the established relationship between the independent and dependent variables under the study are established. The dependent variable that is small and medium enterprises tax compliance is related to the tax reforms variables (turnover tax, KRA administration reforms and SMEs tax behaviours). The model establishes the effects of the tax reforms on compliance of the SMEs in Kisumu Town. The findings are presented in Tables 4.25.

Table 4. 30: Model Summary of with SMEs Compliance as dependent Variable

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.782 <sup>a</sup>	.612	.598	9.7363

- a. Predictors: (Constant) turnover tax, KRA tax administration reforms and SMEs tax behaviours
- b. Dependent Variable: SMEs tax compliance

Source: Survey data (2014)

From the study findings, the adjusted R square of 0.598 suggests that the model accounts for 59.8% of the variance in the tax compliance SMEs in Kisumu Town. The regression equation is useful for making predictions on SMEs tax compliance after tax reforms. These results suggest that turnover tax, KRA tax administration reforms and SMEs tax behaviours really have effect on the compliance SMEs in Kisumu town.

Table 4. 31: ANOVA <sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	18520.269	3	4630.067	94.244	.000 <sup>a</sup>
	Residual	1209.141	211	5.0381		
	Total	19729.411	214			

a. Predictors: (Constant), SMEs tax behaviours, Turnover Tax, Tax administration

b. Dependent Variable: Compliance

Source: Survey data (2014)

According to the study findings, the study model accounts significantly more variance in tax compliance than would be expected by chance. The study has established variables Turnover tax reforms and KRA administration reforms increases tax revenue due to increased SMEs compliance. While the variable SMEs behaviours, has the effects of reducing SMEs tax compliance in Kisumu town and hence in Kenya.

Table 4. 32: Coefficients of the Multiple Regression Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-2.845	1.052		-1.987	.000		
	Turnover Tax	6.156	.521	.535	9.408	.000	.540	1.852
	Taxadministration	2.210	2.139	.520	6.089	.000	.438	2.283
	SMEsbehaviours	-1.694	.746	-.619	-11.269	.000	.340	2.941

a. Predictors: (Constant), SMEs tax behaviours, Turnover Tax, Tax administration.

b. Dependent Variable: Tax Compliance

Source: Survey data (2014)

According to the study findings, collinearity statistics measured the correlation between the predictor variables and varied between 0.3 and 0.5. According to Saunders (2007) collinearity varies between 0 and 1 and the closure to zero the tolerance value is for a variable, the stronger the relationship between this and the other predictor variable and the

VIF is the alternative measure of collinearity which is the reciprocal of the tolerance. The study findings had collinearity not closer to zero but closer to one.

A multiple regression was conducted by the study to examine whether there was any effect of the Kenyan government implementing tax reforms on compliance of the SMEs in Kenya based on the case of the SMEs in Kisumu Town. Three hypotheses were tested: (i) The implementation of turnover tax has no significant effect on tax compliance by SMEs in Kisumu Town (ii) There is no significant relationship between KRA tax administrations and tax compliance of SMEs in Kisumu Town. (iii) Behaviours of Small and Medium enterprises in Kisumu Town have no effect on tax compliance. Using enter method, a significant model emerged ( $F_{3, 211} = 94.244, p < 0.0005$ ). Adjusted R square = .598.

According to the study model, significant independent variable established were turnover tax KRA administration reforms variable were positively and significantly correlated with the criterion variable. Hence this indicated that turnover tax implementation and KRA administration have positive effect on the tax compliance of the SMEs in Kisumu Town while SMEs tax behaviours had significant negative effect on tax compliance of the SMEs. So the study rejected the null hypotheses and recommend for the following model, since it accounts for significantly more variance in the tax compliance of the SMEs than would be expected by chance and hence tax reforms have effects on the tax compliance of the SMEs in Kenya.

Based on the study finding in the model is written as;  $TCR_i = (.535 * ToT) + (.520 * KRA) + (-.619 * MSEbev) - 2.845$ . The hypothesized model was used by the study so as to produce a reliable conclusion that tax reforms affects compliance of the SMEs in Kenya based on

Kisumu Town. In determining the model, the study used four independent variables (turnover tax, KRA administration reforms and SMEs tax behaviours) against a criterion variable (tax compliance of the SMEs). All the relationship between the dependent and dependent variables were linear relationship.

The turnover productivity for the last six year has been increasing from the time of start of tax reforms targeting SMEs in Kenya. This is based on the efficiency ratio of 0.35 percent in the year 2008 which has increased to the current 0.41 percent given the large increment of the proportion of SMEs in the GDP but low tax contribution. This indicates that the reforms have positive relationship to revenue productivity from the SMEs.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1. Introduction**

This chapter presents a summary of the findings, conclusion and recommendations. Policy implications and suggested areas for further studies are also presented.

#### **5.2. Summary of the Findings**

The general objective of the study was to assess the effects of tax reforms on compliance of the Small and Medium Enterprises (SMEs) in Kenya, using case of enterprises in Kisumu Town. The study formulated three objectives and the findings discussed in chapter four. The study established that most of the SMEs are dominated by male entrepreneurs who are in late 40s in age and with at least basic education. Majority of the SMEs have considerable experience in that they have existence during the period in which reforms were initiated by KRA.

##### **5.2. 1. Turnover Tax Revenue Collection**

The revenue collection in Kenya from turnover tax has been increasing steadily from the year 2008 to the year 2013. This study analyzed turnover tax revenue using efficiency ratio (E). In the year 2007/2008 with efficiency ratio of 0.35 percent implies that if the turnover tax rate is increased by one percent point, turnover share in the GDP proportion of SMEs is expected to increase by 0.35 of 100 percent. The study established that the compliance through turnover tax revenue collection has continued to increase as given increased efficiency ratio to 0.41 percent in the year 2013. The efficiency ratio remains low because the tax revenue from the

SMEs has continued to be below one percent of the total revenue collected by the KRA.

## **5.2. 2. Turnover Tax**

From the first objective, the study sought to establish effect of turnover tax system on compliance of small and medium enterprises in Kisumu town. The study sought to determine effects of turnover tax on the tax compliance of SMEs operating Kisumu town. The specific parameters analyzed in the study were turnover tax awareness, cost in time, cost in money, complexity of compliance process, turnover tax rate of 3 percent appropriateness and user satisfaction.

All the respondents were aware of the turnover tax implemented by the government because awareness of the turnover tax received the highest rating. From the study findings, it was established that the respondent agreed that there was awareness on the turnover tax implementation. The turnover tax implementation did reduce the time spent in compliance to turnover tax based on the responses of the respondents in regard to the time spent in complying with the turnover tax requirements. The change in time spent in complying with the turnover tax received the lowest rated but was above average implying that the respondents were positive in regard to time spent in compliance with the turnover tax.

The study established that such compliance costs had been minimized by the introduction of the turnover tax based on above average mean responses. The findings suggest that there was some perceived change in financial costs. Further, turnover tax is less complex to the SMEs operating within Kisumu Town. According to the study findings, less complexity of the compliance process on the turnover tax received the above average rating among the respondents with an overall mean of 3.45. The result suggests that the respondents were

positive in regard to turnover tax compliance process. This implied that the compliance process was characterized by fewer errors in returns

The respondents were encouraged with the implemented turnover tax. The user satisfaction with turnover received ranking with the overall mean being 3.58 which was above average. From the study findings, respondents were positive in that they were satisfied with the implementation of the turnover tax.

Respondents were neutral to the contention that tax rate of 3% was appropriate to the SME business in Kisumu town. The attributes of turnover tax rate of 3% was appropriate, had the rating of 3.09 for the SMEs and 3.12 among the KRA respondents with the overall mean being 3.11 which was average. The study findings established that there was a neutral rating from the business which tended either agrees or disagree with the statement

Finally, a Pearson's Correlation Coefficient test was carried out to establish the effects of turnover tax on compliance of the SMEs in Kisumu town. According to study finding in Table 4.10, there was a moderate positive significant relationship between turnover tax and SMEs tax compliance [ $r(214) = .439, p < 0.01$ ]. The result suggests that turnover tax has effect on tax compliance of the SMEs in Kisumu town. The turnover tax variables accounted for 39.6% of the variance in SMEs tax compliance in Kisumu town. Therefore the findings established that there was a significant relationship between turnover tax and compliance of SMEs in Kisumu Town.

The result suggests that the implementation of turnover had positive significant effects on compliance of SMEs taxpayers in Kisumu town. From this study results, it can be concluded that implementation of turnover tax has a real effect on tax compliance of the SMEs in

Kisumu Town and hence in Kenya. Specifically, study results suggest that with the implementation of turnover tax under the tax reforms the compliance of SMEs in Kisumu town has increased. The results therefore imply that tax reforms have effects of enhancing compliance of SMEs in Kisumu and hence in Kenya. The null hypothesis was rejected.

### **5.2. 3. KRA Administration Reforms**

Objective two assessed the effects of KRA tax administration reforms on compliance of Small and Medium enterprises in Kisumu Town. The specific items measured were tax laws application, tax compliance activities, tax administrative control, taxpayer support and information sharing and use of technology.

The study established that application of the fines or penalties to non-compliant taxpayers was effective with the mean rating of 3.869 while amendment of laws to close loopholes and reduce ambiguities received a mean rank of 2.321. The results suggest that KRA was effective in application of fines and penalties to non-compliant taxpayers but ineffective offering opportunity to enhance voluntary compliance. This implied that most of the respondents had the view that the tax laws for SME are not able to enhance compliance because the tax law contains loopholes for tax evasion and is hard to understand. Further the KRA has not given the non-compliant taxpayer opportunity to voluntarily comply before application of fines.

Based on the study findings in Table 4.13, it was established that most of the respondents were indifferent as to whether reviews, investigation and audits of the non-compliant SMEs was effective or not. Further the respondents' accounts have never been reviewed by KRA nor had any unannounced visits, walk-ins and done any mock. However for those

respondents who indicated that their organization had regular contacts with KRA like audits and reviews and were compliant.

There is a fair rating of reducing compliance burden of the SMEs with the mean responses being 3.562 with insignificant standard deviation as indicated in Table 4.14. From the open ended questions it was revealed by most of the respondents 51% that KRA had simplified the procedures and there was convenient way of making payments of tax. The rating of the respondents was the tax compliance certificates were effective in enhancing compliance of the SMEs in Kisumu Town. Most of the businesses have contacted KRA for the aim of securing compliance certificate.

KRA administrative approach was ineffective like Publicizing prosecution cases and the consequences/penalties of non-compliance (with overall mean of ranking of 1.871) and offering incentives for compliance (for instance rewards/awards to the best taxpayers) (overall mean rank being 1.497). Use of informants and tax evasion referral hotlines or websites and use of primary research to understand behaviour and identify issues/risks (overall mean rank being 2.931) neither did nor elicit varied responses as to either effective or ineffective from the respondents. While respondents were KRA was effective in providing information and guidance to help taxpayers comply and getting information from other government departments.

KRA was effective in use technology use in audits and in data warehousing. Further compliance training to KRA staff was effective in enhancing compliance of the SMEs in Kisumu Town. The study employed a Pearson's Correlation analysis test whether there was any relationship between the KRA tax administration reforms and tax compliance of the

SMEs in Kisumu town. There was a positive significant relationship between KRA administrative reforms and SMEs tax compliance [ $r(214) = .617, p < 0.01$ ] implying that KRA administrative reforms variable affects compliance of the SMEs in Kisumu town.

The KRA administrative reform variable accounted for 36.8% of the variance in SMEs tax compliance in Kisumu town. Therefore the findings established that there was a significant relationship between KRA administrative reforms and compliance of SMEs in Kisumu Town. It was concluded that there was a significant effects of KRA administrative variables on compliance of SMEs in Kisumu Town.

The result suggests that the implementation of KRA administration reforms had positive significant effects on compliance of SMEs taxpayers in Kisumu Town. This study results suggest that KRA administration reforms significantly have effects of enhancing compliance of the SMEs in Kisumu town and hence in Kenya. Specifically the study result suggest that as result of the implementation of KRA administration reforms under the tax reforms policies more SMEs have started to comply. The results therefore imply that KRA administration reforms have effects of enhancing compliance of SMEs in Kisumu and hence in Kenya. The null hypothesis was rejected.

#### **5.2. 4. SMEs Tax Behaviours**

On the effects of SMEs tax behaviours on tax compliance the study analyzed SMEs business records, referent groups, fairness in taxation, SMEs' economic factors, and use of tax agents. There was negative influence from the neighbors, competitors and customers who are not reporting and paying tax honestly. With the overall mean of 3.407 agreed that they are aware of business and referent groups not reporting and paying taxes.

Most respondents agreed that government is rarely achieving its tax and fighting corruption and there was a general feeling that the businesses are not paying fair share of tax. The result suggests that government is not meeting its tax objectives and there is a feeling among the SMEs that fair tax is not being paid and while taxation is not based on profits of the business.

Majority agreed that most businesses experience financial constraints (overall mean 3.5321, standard deviation insignificant) and their business operate in cash economy. Majority 68% (146) of the SMEs do not involve the services of the tax agents in their work. The result suggests that most of the accounting and tax work are self-prepared within the business organization.

A correlation analysis was used to test whether there was any relationship between the SMEs tax behaviours and compliance. The finding established a significant negative relationship between taxpayers' behaviours in Kisumu town and their compliance. The result suggests that SMEs tax behaviours in Kisumu town had a significant negative effects on the tax compliance [ $r(214) = -.542, p < 0$ ]. This implies that the SMEs behaviours were negatively affecting their tax compliance given the tax reforms implemented by the government. Therefore the taxpayers' behaviors had significant negative effect on tax compliance. The null hypothesis was rejected.

The turnover productivity for the last six year has been increasing from the time of start of tax reforms targeting SMEs in Kenya. This is based on the efficiency ratio of 0.35 percent in the year 2008 which has increased to the current 0.41 percent given the large increment of the proportion of SMEs in the GDP but low tax contribution. This indicates that the reforms have positive relationship to revenue productivity from the SMEs.

### **5.3. Conclusions**

This study analyzed the contribution of tax reforms on compliance of the SMEs in Kenya with reference to case of Kisumu Town. The thesis contained three objectives. This section draws conclusion based on each objective.

Based on the findings of study on the effects of the turnover tax on tax compliance, it can be concluded that turnover tax implementation significantly contributes to the tax compliance of the SMEs in Kisumu Town. In relation to KRA administration reforms, it can be concluded that KRA tax administration reforms influences tax compliance of the SMEs taxpayers in Kisumu town.

Lastly the conclusion SMEs tax behaviours negatively affect the tax compliance of the SMEs in Kisumu Town. The study concludes that the tax reforms targeting SMEs should be based on the ability to elicit voluntary compliance from the SMEs in Kenya.

### **5.4. Recommendations of the study**

Based on the study's findings, the following recommendations are made on the effects of the implementation of tax reforms on compliance of the SMEs in Kisumu Town.

The finding in objective one indicated that turnover tax have significant effect on the compliance of the SMEs. This study recommends that more resources be put on the turnover tax to bring more SMEs who are non-compliant to into tax bracket. There should be continuous emphasis on turnover tax among the SMEs by the KRA. SMEs business should embrace online filing and payments

The findings in objective two indicated that there was a positive relationship between the KRA administrative reforms and compliance. KRA should do more in implementing reforms and for instance publicize of prosecution of non-tax compliant, provide incentive for compliance given, provide opportunity for voluntary compliance. More audits and checks should be carried out. It is clear from the study that when SMEs taxpayers do not comply.

The finding from the last objective was there is negative effects of the taxpayers' behaviours and tax compliance of the SMEs in Kisumu town. The tax reforms should enhance voluntary compliance from the SMEs in Kenya but not only concentrate on penalties and fines on non-compliant SMEs. Reforms should create an environment in which compliance is promoted among the SMEs. KRA should work together with public and other stakeholders like professionals like Institute of Certified Public Accountants of Kenya among others in encouraging good accounting practices.

## **5.5. Policy Implications**

The main theme of the study was to establish effect of tax reforms on compliance of small and medium enterprises in Kenya, with reference to case of Kisumu town. A study of tax compliance among the SMEs is important for policy makers, policy implementers, Practitioners and the SMEs businesses in Kenya.

Since the findings and recommendations revealed that tax reforms are important in enhancing compliance among the SMEs in Kenya, it means that tax laws should be further reviewed and strengthened to seal loopholes which are being exploited by the non-compliant SMEs. More awareness on the tax compliance among the SMEs should be enhanced and a policy which clearly classify and entity as a SMEs be implemented.

There is need for the government to enhance SMEs' trust with the tax reforms for voluntary compliance. The government should use besides audits and fines more psychological factors to change tax behaviours of the SMEs for instance tax reforms awareness, personal and social norms, distributive and procedural fairness.

## **5.6. Suggestions for Further Research**

The study recommends further research in the following areas:

- a) Since this study covered tax reforms on tax compliance, further studies are recommended on other factors affecting tax compliance among SMEs.
- b) In this study, behaviour was treated as an independent variable affecting tax compliance which revealed a negative relationship. The study recommends further study where behaviour is treated as an intervening variable to enable comparison of results towards making conclusive generalizations on the role of behaviour on tax compliance.
- c) The study focused on SMEs only whereas tax compliance is a statutory requirement for all business. Arising thereof, the study recommends further studies on tax compliance by large enterprises in Kenya

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## APPENDICES

### APPENDIX A: QUESTIONNAIRE

S/NO...../2014

This questionnaire seeks to collect information in regard to a study that seeks to assess the effects of tax reforms on compliance of the SMEs in Kenya; case of Kisumu Town. The nature of the study is academic, and information you provide will be treated with **utmost confidentiality** and will only be published as anonymous statistical data.

**NB:** Please note that you can answer any of the questions on a separate piece of paper in case the space provided is absolutely limiting.

#### SECTION A: GENERAL INFORMATION

1. Name (optional).....

2. Sex: Male [ ] Female [ ]

3. Age bracket (choose one)

Below 20 years	20-29 years	30-39 years	40- 49 years	50-59 years	Above 60 years
1	2	3	4	5	6

4. Highest education level attained

Certificate	Diploma	Bachelor's degree	Masters degree	Others
1	2	3	4	5

5. Your occupation level in the organization: (choose one).

- a) Technical [ ]
- b) Lower management [ ]
- c) Middle management [ ]
- d) Top management [ ]

6. Number of years worked in your organization (Please select one)

< 2 years	2 to 3 years	4 to 6 years	7 to 8 years	9 to 10years	> 10 years
1	2	3	4	5	6

**SECTION B: TURNOVER TAX SYSTEM**

Please choose the statement that best describes your opinion and experience in regard to turnover tax. 1=Strongly disagree; 2= Disagree; 3= Neither agree nor disagree; 4= Agree and 5= Strongly Agree.

<b>Cost in Time</b>	
8. I am aware of turnover tax system	[    ]
9. Few hours are spent in complying with turnover tax	[    ]
10. There is perceived reasonable changes in compliance cost (time)	[    ]
<b>Cost in Money</b>	
10. There is high cost to comply with the turnover tax	[    ]
11. There is perceived reasonable changes in compliance cost (money)	[    ]
<b>Complexity of compliance process</b>	
12. Taxpayer error rates is high	[    ]
13. There are several enquiries on the turnover tax	[    ]
<b>Appropriateness of Turnover tax</b>	
14. Turnover tax system is appropriate to our business	[    ]
15. Business file returns on line i.e e-filing	[    ]
<b>User Satisfaction</b>	
16. There is clarity on turnover tax system	[    ]
17. We are satisfied with the turnover tax system	[    ]
18. What are the actions taken by KRA for those SMEs who are non compliant	
.....	
.....	

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.....

19. Please provide us with information in regard to Turnover tax that you feel in regard to the tax system, tax rate, filing and payment.

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*(Please use separate paper provided and attach it to this tool in case the space provided is limiting)*

**SECTION C: TAX ADMINISTRATION REFORMS**

Based on your experience please choose and tick the following KRA administration strategies. 1=Very ineffective; 2= Ineffective; 3= Partially effective; 4= Effective and 5= very effective. (If not used don't tick)

<b>Tax laws on e.g TOT, rental income</b>	
20. Amended laws to close loopholes/reduce ambiguities and anomalies	[    ]
21. Application of fines/penalties for non compliant taxpayers	[    ]
22. Tax amnesties	[    ]
<b>Tax Compliance activities</b>	
23. Reviews, investigations and audits	[    ]
24. Unannounced field visits, walk-ins and mock purchases	[    ]
25. Registration and enterprise reviews (i.e. checking registration details and ensuring registered entities are real)	[    ]
<b>Tax Administrative control</b>	

26. Exemption of SMEs from collecting VAT	[ ]
27. Reducing compliance cost/burden on taxpayers (e.g. by simplifying procedures, providing more convenient payment options)	[ ]
28. Enforcing ETR invoicing/receipting requirements	[ ]
Introducing record keeping and accounting codes	
29. Requiring tax clearance certificates (e.g. for tendering for government projects )	[ ]
<b>Taxpayer support and education</b>	
30. Providing information, tools and guidance to help taxpayers comply (e.g. brochures, booklets, seminars)	[ ]
38. Publicizing prosecution cases and the consequences/penalties of non-compliance	[ ]
31. Incentives for compliance (e.g. rewards/awards to the best taxpayers)	[ ]
32. Opportunity to voluntarily disclose before the application of penalties	[ ]
33. Use of informants and tax evasion referral hotlines or websites	[ ]
<b>Information sharing</b>	
34. Government departments (e.g. immigration, ministries etc)	[ ]
35. Private sector organizations (e.g. banks).	[ ]
36. Use of primary research (e.g. surveys of taxpayer groups) to understand behaviour and identify issues/risks	[ ]
<b>Use of technology</b>	
37. Computer-assisted verification and audit activities	[ ]
46. Data warehousing and data mining	[ ]
<b>Staff training</b>	

38. Compliance training provided	[   ]
48. Please provide us with information in regard to KRA tax administrative reforms enacted which have affected SMEs.	
.....	
.....	
.....	
.....	
.....	
<i>(Please use separate paper provided and attach it to this tool in case the space provided is limiting)</i>	

**SECTION D: SMEs' TAX BEHAVIOURS**

Base on your experience, which of the following statements commonly describes business attributes. Please rate how problematic the following tax evasion and avoidance behaviour/activity is: 1=Never; 2=Rarely; 3= Sometimes; 4=Always

<b>Record Keeping practices</b>	
39. All business records are well maintained	[   ]
40. No business transaction are recorded	[   ]
<b>Tax agents</b>	[   ]
41. Tax agents are helping the Business to comply with tax requirements	[   ]
42. We have never used tax agents in the business	[   ]
<b>Referent Groups (Customers and suppliers)</b>	
43. Business neighbors and competitors are reporting and paying tax honestly	[   ]
44. We are not aware of what our customers and suppliers are doing	[   ]
<b>Attitude</b>	
45. Government is achieving its tax objectives and is fighting corruption	[   ]
46. A feeling that the business is paying a fair share of tax	[   ]
57. Business profits are high when operating illegal business, underreporting profits	[   ]
<b>Taxpayer Activities</b>	

48. Not declaring income/under-reporting income	[ ]
49. Over-claiming expenses	[ ]
50. Operating in cash economy	[ ]
51. Bribing tax officers	[ ]
52. Colluding and conspiring with suppliers	[ ]
53. What are the strategies which can be implemented to ensure everybody pays tax to reduce unfair competition?	
.....	
.....	
.....	
.....	
<i>(Please use separate paper provided and attach it to this tool in case the space provided is limiting)</i>	

**SECTION E: SMEs' COMPLIANCE**

With each statement below, kindly tick the approximate percentage you associate with each of the case. 1- is about 10%; 2-is about 20%; 3- is about 30%; 4- is about 40%; 5 – is about 50%; 6- is about 60%; 7- is about 70%; 8- is about 80%; 9- is about 90%; 10- is about 100%

<b>Business</b>	
54. Filing of tax returns	[ ]
55. The tax paid is	[ ]
56. The registered business in regard to total business in operation in Kisumu	[ ]
57. Correct reporting is	[ ]

**END.**

Thank you for taking your time to answer this Questionnaire. If you wish to receive the results of this study or require more information, kindly contact me in the following email address: oonyancha@gmail.com.

**APPENDIX B: Table for Determining Sample Size from a give population**

N	S	N	S	N	S	N	S	N	S
10	10	100	80	280	162	800	260	2800	338
15	14	110	86	290	165	850	265	3000	341
20	19	120	92	300	169	900	269	3500	246
25	24	130	97	320	175	950	274	4000	351
30	28	140	103	340	181	1000	278	4500	351
35	32	150	108	360	186	1100	285	5000	357
40	36	160	113	380	181	1200	291	6000	361
45	40	180	118	400	196	1300	297	7000	364
50	44	190	123	420	201	1400	302	8000	367
55	48	200	127	440	205	1500	306	9000	368
60	52	210	132	460	210	1600	310	10000	373
65	56	220	136	480	214	1700	313	15000	375
70	59	230	140	500	217	1800	317	20000	377
75	63	240	144	550	225	1900	320	30000	379
80	66	250	148	600	234	2000	322	40000	380
85	70	260	152	650	242	2200	327	50000	381
90	73	270	155	700	248	2400	331	75000	382
95	76	270	159	750	256	2600	335	100000	384

Note: "N" is population size  
 "S" is sample size.

Source: Krejcie and Morganl (1970)

## APPENDIX C: Letter of Approval by K.U. Graduate School



KENYATTA UNIVERSITY  
GRADUATE SCHOOL

E-mail: [dean-graduate@ku.ac.ke](mailto:dean-graduate@ku.ac.ke)

Website: [www.ku.ac.ke](http://www.ku.ac.ke)

OUR REF: D86/CTY/21708/10

The Permanent Secretary,  
Ministry of Higher Education, Science & Technology,  
P.O. Box 30040,  
NAIROBI

Dear Sir/Madam,

RE: RESEARCH AUTHORIZATION FOR MR. ONYANCHA M. ONDIMU REG. NO.  
D86/CTY/21708/10

---

I write to introduce Mr. Ondimu who is a Postgraduate Student of this University. He is registered for Ph.D. Degree programme in the Department of Accounting & Finance in the School of Business.

Mr. Ondimu intends to conduct research for a proposal entitled, "Effects of Tax Reforms on Compliance of Small and Micro Enterprises in Kenya: Case of Kisumu Municipality".

Any assistance given will be highly appreciated.

Yours faithfully,

MRS. LUCY N. MBAABU  
FOR: DEAN, GRADUATE SCHOOL

RM/cao

## APPENDIX D: Research Approval by NACOSTI



### NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY AND INNOVATION

Telephone: +254-20-2213471,  
2241349, 310571, 2219420  
Fax: +254-20-318245, 318249  
Email: secretary@nacosti.go.ke  
Website: www.nacosti.go.ke  
When replying please quote

9<sup>th</sup> Floor, Utalii House  
Uhuru Highway  
P.O. Box 30623-00100  
NAIROBI-KENYA

Ref: No.

Date:  
18<sup>th</sup> March, 2014

NACOSTI/P/14/1835/875

Onyancha M. Ondimu  
Kenyatta University  
P.O.Box 43844-00100  
NAIROBI.

#### RE: RESEARCH AUTHORIZATION

Following your application for authority to carry out research on *"Effects of tax reforms on compliance of Small and Micro Enterprises in Kenya; Case of Kisumu Municipality,"* I am pleased to inform you that you have been authorized to undertake research in **Kisumu County** for a period ending **31st December, 2014**.

You are advised to report to **the County Commissioner and the County Director of Education, Kisumu County** before embarking on the research project.

On completion of the research, you are expected to submit **two hard copies and one soft copy in pdf** of the research report/thesis to our office.

DR. M. K. RUGUTT, PhD, HSC.  
FOR: SECRETARY/CEO

Copy to:

The County Commissioners  
The County Directors of Education  
Kisumu County.



National Commission for Science, Technology and Innovation is ISO 9001: 2008 Certified

## APPENDIX E: Letter of Approval by Kisumu County Commissioner



OFFICE OF THE PRESIDENT  
MINISTRY OF INTERIOR AND COORDINATION OF NATIONAL GOVERNMENT

Telephone: Kisumu 2022219/Fax: 2022219  
Email: [ckisumucounty@gmail.com](mailto:ckisumucounty@gmail.com)

COUNTY COMMISSIONER  
KISUMU COUNTY  
P.O. BOX 1912-40100  
KISUMU

Ref: CC/KC/EDU (179)

9<sup>th</sup> April, 2014

Deputy County Commissioner  
**KISUMU EAST SUB COUNTY**

**RESEARCH AUTHORIZATION**  
**ONYANCHA M.ONDIMU – KENYATTA UNIVERSITY**

This is to inform you that the above named student has been granted authority to undertake a research study on "***Effects of tax reforms on compliance of Small and Micro Enterprises in Kenya: case of Kisumu Municipality***". The research will be carried out in your Sub County and the period ends 31<sup>st</sup> December, 2014.

The purpose of this letter is to ask you to accord her any necessary assistance she may require during the research period.

  
 **L. A. ODERO (OGW)**  
COUNTY COMMISSIONER  
**KISUMU COUNTY**

Copy to:

✓ Onyancha M. Ondimu  
Kenyatta University  
P. O. Box 48844-00100  
**NAIROBI**