



# **Tax Reforms and Compliance among Small and Medium Enterprises in Bungoma County, Kenya**

**Kevin Namaswa Kabisa<sup>a++\*</sup> and Salome Musau<sup>a#</sup>**

<sup>a</sup> *Kenyatta University, Nairobi, Kenya.*

## ***Authors' contributions***

*This work was carried out in collaboration between both authors. Both authors read and approved the final manuscript.*

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## **Abstract**

This study critically examined the conceptual and theoretical frameworks underpinning tax reforms and their influence on tax compliance among Small and Medium Enterprises (SMEs) in Bungoma County, Kenya. SMEs are vital to economic development through employment creation, innovation, and contributions to government revenue; however, tax compliance among SMEs remains low, particularly in rural areas. A systematic literature review was conducted using peer-reviewed journals, government reports, and policy documents published between 2018 and 2025. The study adopted Economic Deterrence Theory, Institutional Theory, and the Slippery Slope Framework to analyze how enforcement mechanisms, institutional trust, and policy reforms affect SME compliance. Data extraction focused on technological, administrative, policy, and educational reforms affecting SMEs in Bungoma County. Findings indicate that technological reforms enhance efficiency in tax administration but are constrained by poor digital infrastructure and low digital literacy among SME owners. Policy reforms simplify compliance processes and promote voluntary

<sup>++</sup> PhD Student; <sup>#</sup> Lecturer;

\*Corresponding author: Email: [Kabisakevin@gmail.com](mailto:Kabisakevin@gmail.com);

adherence, while administrative reforms improve transparency and accountability. Educational reforms strengthen taxpayer knowledge, recordkeeping, and overall compliance. The study concludes that tax reforms significantly influence SME compliance, but their effectiveness depends on proper implementation, accessibility, and stakeholder support. Future research should empirically evaluate the impact of these reforms on SME behavior using quantitative methods, explore longitudinal compliance trends, and investigate the moderating effects of trust in tax authorities.

*Keywords: Tax reforms; tax compliance; small and medium enterprises; digital taxation.*

## **1. Introduction**

Small and Medium Enterprises (SMEs) play a crucial role in Kenya's economic development, contributing to employment creation, innovation, and government revenue (Ramatu & Kasim, 2020). Taxes collected from SMEs fund essential public services such as healthcare, education, and infrastructure development. Compliance with tax regulations fosters a stable business environment, attracts investment, and strengthens the economy (Abdi et al., 2024).

Tax reforms are designed to improve the efficiency, fairness, and effectiveness of revenue collection. These reforms may include simplifying tax processes, reducing rates, broadening the tax base, eliminating loopholes, or implementing digital platforms for filing and payment. Simplified tax systems encourage voluntary compliance, reduce administrative costs, and integrate informal businesses into the formal economy, thereby broadening the tax base and enhancing fiscal sustainability (Kabisa et al., 2023).

The cost of tax compliance significantly influences SMEs' behavior. High administrative costs, accounting fees, and complex regulations increase the burden on SMEs, particularly those with limited financial and human resources. These challenges may lead SMEs to delay filings, underreport income, or operate informally, limiting the effectiveness of tax reforms (Mutisya, 2024). Compliance costs also affect investment decisions, as businesses may prioritize survival over tax obligations. Governments have attempted to mitigate these barriers through tax simplification measures, digital solutions, and incentives aimed at encouraging SMEs to comply (Kabisa et al., 2022).

Perceptions of fairness and institutional trust are critical determinants of compliance. SMEs are more likely to adhere to tax regulations when they perceive the system as fair, transparent, and accountable. Conversely, concerns over corruption, mismanagement, or complexity can lead to tax avoidance. Educational programs and awareness campaigns have been shown to enhance taxpayer knowledge, improve recordkeeping, and promote voluntary compliance among SMEs (Chepkorir & Wanjala, 2023).

Despite these reforms, SMEs in Bungoma County continue to face compliance challenges, including limited digital literacy, high administrative costs, and insufficient access to tax education. These challenges highlight the need for targeted interventions and localized research to assess the effectiveness of reforms.

This study, therefore, reviews conceptual, theoretical, and empirical literature on tax reforms and SME compliance in Bungoma County. It identifies existing knowledge gaps, such as the lack of empirical evidence on long-term compliance trends, the interaction between enforcement and institutional trust, and the differential impact of reforms on SMEs of varying sizes. Future research should include empirical investigations, longitudinal studies, and assessments of SME perceptions to inform policy and improve compliance outcomes.

### **1.1 Statement of the Problem**

Small and Medium Enterprises play a pivotal role in Kenya's economic development, contributing significantly to employment creation, innovation, and poverty reduction. Despite their importance, tax compliance among SMEs remains low, posing a challenge to national revenue collection. In response, the Kenyan government has implemented various tax reforms, including the introduction of digital tax systems adjustments to turnover tax, increased VAT registration thresholds, and the introduction of sector-specific levies (Mutisya, 2024).

However, these reforms have yielded mixed results. While some measures aim to simplify tax processes and reduce the burden on small businesses, others have introduced new compliance obligations that many SMEs find difficult to navigate. For instance, mandatory integration with digital platforms like eTIMS imposes technical and financial challenges on informal and resource-constrained SMEs. Moreover, abrupt changes in tax rates and thresholds—such as the increase in turnover tax and the introduction of new digital economy taxes—have created uncertainty and resistance within the SME sector.

Many SMEs either underreport income, delay filing, or operate informally to avoid tax obligations. This not only reduces the effectiveness of tax reforms but also undermines government efforts to expand the tax base and promote equity in tax administration. There is, therefore, a pressing need to investigate the extent to which recent tax reforms have influenced tax compliance behavior among SMEs in Kenya, and to identify the key challenges and enablers of compliance in this sector.

## **1.2 Objective of The Study**

- i. To review the extent of conceptual and theoretical literature on the concept of tax reforms and compliance among small and medium enterprise in Bungoma county.
- ii. To review the relevant empirical literature on the aspect of tax reforms and compliance among small and medium enterprise in Bungoma county.
- iii. To identify emerging conceptual, theoretical and empirical gaps from relevant literature on tax reforms and compliance among small and medium enterprise in Bungoma county.
- iv. To propose a suitable theoretical framework in response to the gaps to be identified for guiding future research on tax reforms and compliance among small and medium enterprise in Bungoma county.

## **2. Theoretical Review**

This study is anchored on three key theories that explain tax compliance behavior and provide a foundation for understanding how tax reforms influence Small and Medium Enterprises (SMEs) in Bungoma County: Economic Deterrence Theory, Institutional Theory, and the Slippery Slope Framework. Collectively, these theories explain compliance from enforcement, institutional, and integrative perspectives.

### **2.1 Economic Deterrence Theory**

Economic Deterrence Theory, formally applied to tax compliance by Allingham and Sandmo (1972), posits that taxpayers are rational and self-interested. They decide whether to comply by comparing the expected benefits of tax evasion with the anticipated costs, where the cost is the probability of detection multiplied by the severity of penalties. A taxpayer will comply when the expected penalty outweighs potential gains from evasion (Allingham & Sandmo, 1972).

The theory assumes rational behavior, adequate information, and purely economic cost–benefit analysis. Increasing audit rates and penalties is predicted to raise compliance. However, it overlooks psychological, social, and moral influences, and assumes perfect rationality, which may not reflect real-world decision-making. Recent studies indicate that compliance levels are often higher than predicted even when audit probabilities are low, suggesting that deterrence alone cannot fully explain behavior (Alm & Malezieux, 2021). Despite these limitations, the theory provides a strong foundation for analyzing enforcement reforms, such as audits and penalties, implemented by the Kenya Revenue Authority to influence SME compliance in Bungoma County.

### **2.2 Institutional Theory**

Institutional Theory, advanced by Meyer and Rowan (1977), posits that individuals and organizations conform to rules due to the need for legitimacy, social acceptance, and alignment with institutional norms, rather than purely economic motivations. In the context of taxation, compliance is influenced by perceptions of fairness, transparency, accountability, and the efficiency of tax institutions.

The theory assumes that individuals respond to institutional pressures, that trust enhances legitimacy, and that efficient, transparent systems encourage voluntary compliance. Compliance is shaped not only by enforcement but also by the credibility of governing institutions. Limitations include potential overemphasis on legitimacy and underestimation of economic incentives, and the delayed effect of institutional reforms on behavior. Empirical evidence supports that perceived fairness and administrative efficiency significantly improve voluntary compliance (Alm & Malezieux, 2021). This theory is relevant to this study as it explains how digitization and administrative reforms in Bungoma County can strengthen institutional trust, enhancing SME compliance.

### **2.3 Slippery Slope Framework**

The Slippery Slope Framework, developed by Kirchler (2007), integrates deterrence and trust by proposing that tax compliance is influenced by the power of authorities and taxpayers' trust in them. Strong enforcement promotes enforced compliance, while high trust fosters voluntary compliance. Sustainable compliance occurs when authority power and trust operate in balance.

The framework assumes that taxpayer behavior is influenced by both coercive mechanisms and intrinsic motivation. Overreliance on punitive enforcement can undermine trust, while trust without credible monitoring may encourage opportunistic behavior. Measuring these dimensions empirically is complex, and contextual differences may affect outcomes. Economic constraints, such as liquidity challenges, may also affect compliance independently of trust or enforcement.

Empirical validations include Kirchler et al. (2008), who demonstrated that both trust and perceived authority power significantly influence compliance. Cross-cultural analyses by Kogler et al. (2013) confirmed that trust and power independently and jointly predict compliance intentions, supporting the framework's robustness.

The Slippery Slope Framework is particularly relevant to this study as it provides an integrated lens to examine how enforcement reforms and institutional trust interact to influence SME compliance in Bungoma County. Future research should empirically test the moderating role of trust in compliance behavior and evaluate the long-term impact of enforcement reforms on SMEs in rural counties.

### **2.4 Empirical Review**

This section reviews empirical studies on tax compliance among SMEs, focusing on technological, administrative, policy, and educational reforms. The review highlights existing research gaps, methodological approaches, and findings relevant to Bungoma County. It emphasizes the need for robust empirical evidence and conceptual clarity in understanding compliance behavior. This approach provides a foundation for examining how reforms influence SME compliance locally. The review also identifies areas for future research to support evidence-based policy and SME growth.

#### **2.4.1 Technological Tax Reforms and Compliance**

Technological reforms have become critical in improving tax compliance among SMEs in Kenya. Digital systems such as iTax and electronic tax registers streamline filing and payment processes, enhancing efficiency (Mutua et al., 2022). Despite national adoption, SMEs in Bungoma County lag due to limited internet access and low digital literacy (Ng'ang'a et al., 2021). Mobile-based platforms have shown potential in improving compliance rates among rural enterprises. Further studies are needed to quantify these effects specifically for SMEs in Bungoma.

SMEs face barriers to technology adoption, including resistance to change and lack of technical support (Wekesa et al., 2023). Limited familiarity with digital interfaces discourages consistent tax reporting. Evidence from other counties indicates that SMEs with higher digital literacy report better compliance (Mwangi & Njeri, 2020). Interventions should include targeted training programs and hands-on support. Enhanced technology adoption could significantly reduce administrative burdens for SMEs.

Government incentives can encourage SMEs to adopt digital tax tools (World Bank, 2022). Subsidized digital platforms and awareness campaigns have improved uptake in other regions. Bungoma County currently lacks

such localized initiatives, limiting effectiveness. Integrating technology with administrative and educational reforms can amplify compliance outcomes. Isolated technological reforms are insufficient without broader systemic support.

Despite progress, research gaps remain regarding long-term technology adoption in rural SMEs. Few studies measure sustained use and compliance impact (Otieno et al., 2022). Limited analysis exists on how digital tools interact with cultural attitudes toward taxation. Future studies should use quantitative and longitudinal designs. Evidence from such research will guide effective, context-specific digital interventions.

#### **2.4.2 Administrative Tax Reforms and Compliance**

Administrative reforms, including simplified registration, filing, and payment procedures, are essential for SME compliance (Kiprono et al., 2021). Complex bureaucratic processes discourage voluntary reporting. SMEs in Bungoma face unique administrative challenges due to limited local support and oversight. Streamlining administrative procedures reduces compliance costs and improves confidence in tax institutions. Trust in authorities, particularly KRA, strongly influences compliance behavior (Ndungu et al., 2020).

Perceptions of corruption and inefficiency undermine SME confidence in local administration (Karanja et al., 2021). Even with streamlined procedures, inconsistent enforcement diminishes reform effectiveness. Transparency and accountability are key in promoting voluntary compliance. SMEs are more likely to adhere to regulations when they perceive fairness and professionalism. Strengthened local oversight can improve compliance rates in rural counties.

Recent administrative reforms under the Tax Procedures (Amendment) Act, 2024, aim to simplify processes (Republic of Kenya, 2024). Implementation in Bungoma, however, is uneven due to capacity and resource constraints. Evidence shows SMEs respond positively to reforms when support structures, such as advisory offices, are provided (Gitau & Muturi, 2022). Participatory approaches, where SMEs provide feedback, also enhance reform outcomes. Administrative efficiency alone is insufficient without trust-building and engagement.

Significant research gaps remain regarding administrative reforms' impact in rural areas. Few studies evaluate compliance before and after reforms (Kamau et al., 2021). Comparative analysis across counties is limited, reducing generalizability. Future research should explore links between administrative efficiency, trust, and SME behavior. Longitudinal and mixed-method studies would provide stronger evidence for policy development.

#### **2.4.3 Tax Policy Reforms and Compliance**

Tax policy reforms influence SME compliance by shaping incentives and perceived fairness. High tax rates are often viewed as punitive, especially for small enterprises with limited income. SMEs in Bungoma report challenges with disproportionate taxation. Simplified policies and tax incentives, including exemptions for startups, can encourage compliance. Clear and locally relevant guidelines improve adherence and reduce mistakes.

Complex tax legislation creates barriers to compliance (Mutisya, P. (2024).). SMEs often struggle to interpret policies, leading to unintentional non-compliance. Counties with simplified tax codes report higher adherence levels. Policymakers should ensure clarity and practicality when designing tax laws. Engaging SMEs in policy formulation improves policy relevance and compliance.

Policy predictability impacts voluntary compliance (Omollo et al., 2022). Frequent changes or retroactive amendments create uncertainty, particularly in rural areas with limited information access. Evidence indicates that educational initiatives combined with clear communication improve compliance. Alignment between policy clarity and administrative support strengthens outcomes. Predictable and transparent policies enhance trust and SME adherence.

Research gaps exist in evaluating cumulative effects of policy reforms (Mwangi, P., & Njeri, L. (2020).). Most studies examine single policies rather than integrated approaches. Longitudinal data tracking SME responses to

policy changes is scarce. Future research should assess the combined impact of tax rate adjustments, incentives, and simplification. Such evidence will inform comprehensive strategies to improve compliance in Bungoma.

#### **2.4.4 Educational Tax Reforms and Compliance**

Educational reforms are critical in shaping SME compliance behavior (Kamotho et al., 2021). Many SME owners lack knowledge of tax obligations, filing procedures, and benefits of compliance. Taxpayer education programs have improved compliance rates, though coverage in Bungoma remains limited. Targeted, context-specific training fosters a culture of voluntary compliance. Collaboration between KRA, county governments, and business associations is key.

Awareness alone is insufficient without practical guidance. Workshops, digital tutorials, and support centers provide step-by-step assistance for SMEs. Rural SMEs often have less exposure to such resources compared to urban enterprises. Strengthening educational outreach in Bungoma is essential to reducing non-compliance due to ignorance. Ongoing monitoring ensures programs remain effective and relevant.

Educational reforms also increase trust in the tax system (Wambua et al., 2022). Knowledgeable taxpayers perceive fairness and understand taxation rationale. Sustained education programs improve voluntary compliance. Localized content addressing SME challenges enhances engagement and knowledge retention. Integration with technological and administrative support amplifies compliance outcomes.

Research gaps remain regarding the long-term impact of education on SME compliance (Ngugi et al., 2021). Few studies assess knowledge retention and behavioral change over time. Limited research evaluates integration of education with policy and technological reforms in rural counties. Future studies should use mixed methods to examine both knowledge acquisition and compliance behavior. Evidence from these studies will guide effective interventions for SMEs in Bungoma.

### **3. Research Methodology**

This study examined the methodologies applied by past research within the context of Bungoma County to identify existing knowledge gaps. A detailed review of previous studies enabled the researcher to present the relationships between key variables under investigation, including tax reforms, tax compliance, tax education, and their effects on the efficiency of the Kenya Revenue Authority (KRA). The approach involved critically analyzing empirical and theoretical studies to determine how different reform strategies have influenced SME compliance. By synthesizing these findings, the study identified patterns, trends, and gaps in the literature. This methodology also facilitated the development of a conceptual understanding of the interactions among technological, administrative, policy, and educational reforms in the local context.

### **4. Finding Emerging Knowledge Gaps**

There is limited understanding of how tax reforms affect SMEs in Bungoma compared to other economic sectors. Most existing studies focus on urban counties or larger enterprises, providing insufficient evidence on the long-term impacts of reforms on SME revenue generation and growth. In addition, there is a lack of insight into how SME owners in Bungoma adjust their behaviors in response to changes in tax policies and administrative procedures. Research gaps also exist regarding the equity implications of tax reforms for SMEs of different sizes and income levels. Furthermore, few studies have analyzed the practical challenges encountered during the implementation of tax reforms at the county level, including enforcement capacity and administrative efficiency.

There is also a need for more comparative research between counties and regions to assess the effectiveness of various tax reform strategies on SME compliance. Public attitudes among SME owners toward tax reforms remain underexplored, yet these perceptions significantly influence voluntary compliance behavior. Another key gap lies in understanding how technological reforms, such as the adoption of I Tax and mobile tax platforms, impact tax administration efficiency among SMEs in Bungoma. Addressing these gaps would provide a more comprehensive view of the relationship between tax reforms and compliance. Future studies should adopt both quantitative and qualitative approaches to capture behavioral responses, institutional effectiveness, and technological adoption trends.

#### 4.1 Proposed Theoretical Model

Fig. 1 presents the conceptual framework.

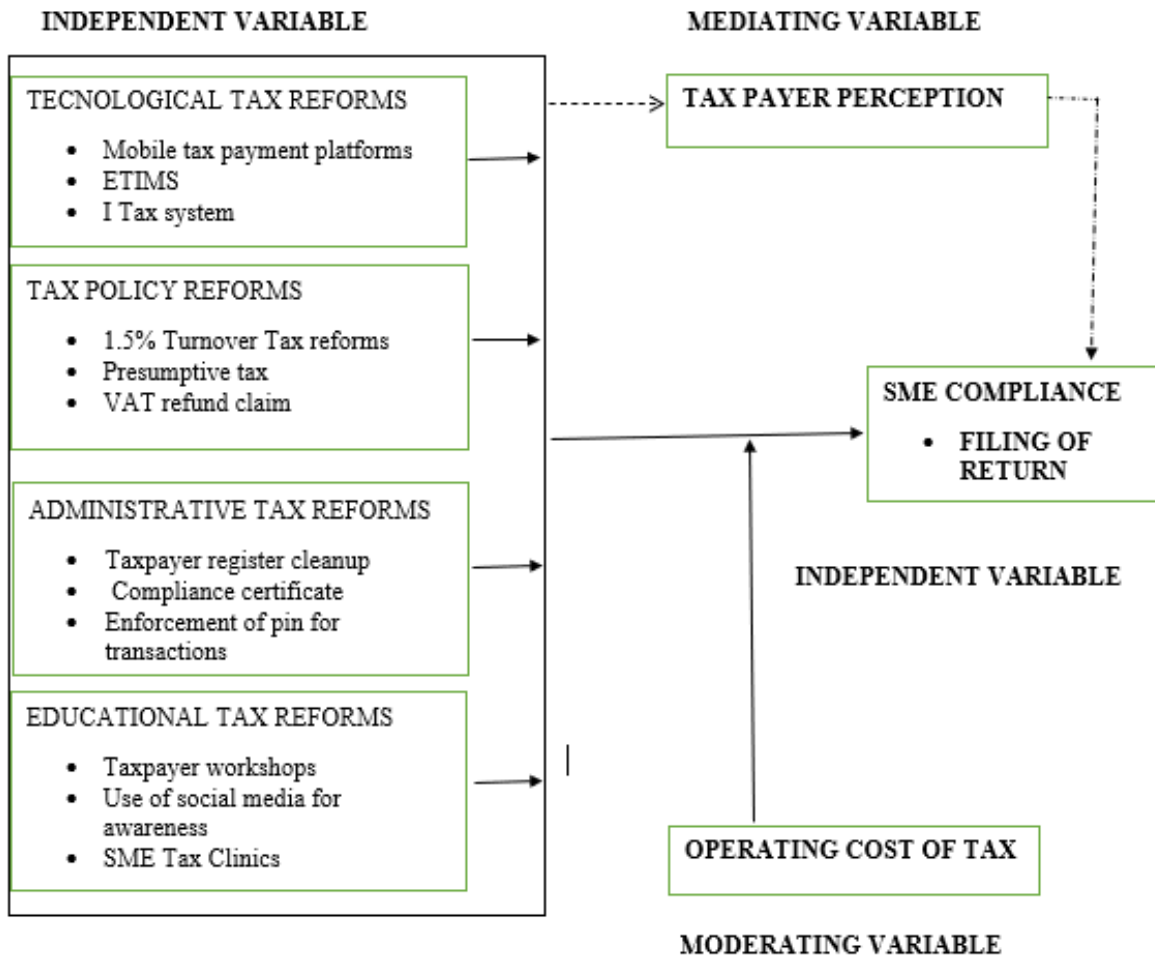


Fig. 1. Conceptual framework

#### 5. Conclusion and Future Research

The review of literature indicates that tax reforms play a critical role in influencing SME compliance in Bungoma County. Technological reforms, such as digital tax platforms and iTax, improve efficiency but face challenges related to low digital literacy, poor internet connectivity, and resistance to change among SME owners. Administrative reforms streamline tax registration, filing, and payment procedures, yet their effectiveness depends on transparency, accountability, and local enforcement capacity. Tax policy reforms shape compliance through clarity, fairness, and predictability, while educational reforms enhance taxpayer knowledge and foster a culture of voluntary compliance. Collectively, these reforms demonstrate the need for integrated strategies that address technological, administrative, policy, and educational dimensions simultaneously.

Despite these insights, significant gaps remain in the empirical evidence. Few studies provide longitudinal data or quantitative analysis on the long-term effects of reforms on SME compliance and revenue generation. Comparative studies between counties are limited, reducing understanding of contextual variations. Public perceptions of reforms, behavioral responses of SME owners, and the role of trust in tax authorities remain underexplored. Similarly, the interaction between technological adoption, policy clarity, and educational initiatives has received insufficient attention, particularly in rural contexts like Bungoma.

Future research should adopt mixed-method approaches to capture both quantitative compliance outcomes and qualitative insights into SME behavior. Longitudinal studies tracking the effects of integrated reform strategies over time would provide robust evidence of causal relationships. Comparative studies across multiple counties can identify best practices and contextual factors influencing reform effectiveness. Additionally, studies should examine how trust in tax authorities, public perceptions, and SME engagement interact to shape compliance behavior. Research evaluating the practical challenges of reform implementation, including administrative capacity, enforcement, and resource constraints, will provide actionable recommendations for policymakers.

By addressing these gaps, future studies can inform evidence-based strategies to improve SME compliance, optimize tax administration, and strengthen revenue collection in Bungoma County. Integrating technological, administrative, policy, and educational reforms in a coordinated manner will be critical for designing sustainable and effective tax compliance interventions tailored to the needs of SMEs in rural counties.

### Disclaimer (Artificial Intelligence)

Author(s) hereby declare that NO generative AI technologies such as Large Language Models (ChatGPT, COPILOT, etc) and text-to-image generators have been used during writing or editing of this manuscript.

### Competing Interests

Authors have declared that no competing interests exist.

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