FACTORS INFLUENCING AN INDIVIDUAL'S INCOME TAX COMPLIANCE: A CASE OF SELECTED MSEs IN KASARANI CONSTITUENCY.

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G62/69340/2011

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS OFTHE MASTER OF LAWS DEGREE

UNIVERSITY OF NAIROBI

AUGUST 2015

DECLARATION

The research project is my original work and has never been presented at any other university

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Signed……………………….......... Date…………………………

This research project has been submitted for examination with my approval as University Supervisor

PROF: PROFESSOR ARTHUR ESHIWANI

Signed……………………….......... Date…………………………

DEDICATION

To the entire Machogu's family whose diligence, fortitude and unity are always a source of inspiration.Last but not least to my husband Titus Nyakundi for his financial and moral support and children Paul, Sarah and Lucy for their patience.

ACKNOWLEDGEMENT

I would like to thank those who assisted me in the preparation of this thesis. I am especially indebted to my supervisor Prof. Arthur Eshiwani without his guidance and support this work would not have been finalized. I am extremely grateful to those who encouraged me to pursue the studies leading to an award of a master of the law degree.

Finally, and most importantly, I would like to thank God for providing me with strength, peace and good health and all that was needed to make this study a success. At the end of it all, all praise is due to His name.

ABSTRACT

Various factors are thought to influence income tax compliance. A number of studies show a relationship between various economic, social and political factors. In light of this, the current research sought to assess whether the quality of public governance, taxpayers' attitudes and ethnicity influence income tax compliance. Based on the paper, despite a presence of many studies on the topic, there is limited research on the Kenyan case. Hence, delving into the topic is significant in highlighting a Kenyan case. Moreover, results from past studies show mixed results, hence there is a need for clarity on the topic. Behind this backdrop, the study was carried out to assess the influence of the three factors on income tax compliance within the context of micro and small level enterprises.

Using the purposive sampling method, data was collected from fifty five enterprises. After the data collection, the use of both qualitative and quantitative analysis, the influence of the factors on income tax compliance is established. Based on the study results, the quality of public governance, attitudes and ethnicity influence income tax compliance. Based on the idea that the study relies on a hypothetical scenario where respondents are required to rate statements, it is recommended that future studies consider employing an approach that facilitates eliciting behaviour. Besides, future studies should employ probabilistic sampling approaches from diverse geographic locations to enhance the level of representativeness.

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CHAPTER FIVE

FINDINGS,CONCLUSION AND RECOMMENDATIONS

LIST OFACRONYMS

CED	Customs and Excise Department
DTD	Domestic Tax Department
GDP	Gross Domestic Product
GOK	Government of Kenya
KRA	Kenya Revenue Authority
LTO	Large Taxpayer Office
LTU	Large Taxpayer Unit
MSEs	Micro and Small Enterprises
PAYE	Pay As You Earn
PIN	Personal Identification Number
TCC	Tax Compliance Certificate
TOT	Turnover Tax
VAT	Value Added Tax

CHAPTER ONE

INTRODUCTION OF THE STUDY

1.0 Introduction

This chapter introduces the background of the study, states the statement of the research problem, significance of the study, the research approach, literature review and the theories of research. Research methodology, base, objectives, questions, hypotheses, and limitations are discussed under the research approach while the theories of research discussed include the psychological and economic theories.

1.1 Background

The primary purpose of taxation is to raise revenue for government expenditure. Most of the government's fiscal requirements should be raised by taxation. The government spends part of the money on services which private enterprises cannot provide such as defence, law and order. It also pays for Services such as social security benefits and education are also paid for by the government (Morse and William, 2000, p. 4).

Another purpose for taxation is the redistribution of wealth and income. Generally income tax should be progressive and that some government revenue should be spent on welfare services. That was why the poll tax was so unpopular. An unpopular tax is a failure because it loses politicians votes and it proves too expensive to collect (Morse and William, 2000, p. 4).

The imposition of tax is also necessary to control the economy but control is also exercised by adjusting the money supply and credit. Customs duty is an example of using tax to control behaviour. Imported leather used to have a very high customs duty. Its aim being to protect the Scottish leather industry. This tax was successful because it collected no money (Morse and William, 2000, p. 5).

Taxes are used as a kind of social control. An example is the taxing of alcohol and tobacco. Taxes may also be used to make sure people pay the full price for something. This is the idea of a pollution tax (Morse and William, 2000, p. 5).

Tax compliance is viewed as the degree to which a taxpayer obliges to tax rules and regulations.(James and Alley 2004, p.7) indicated that the meaning of the tax compliance concept can be taken from different perspectives before proceeding to define tax compliance as "the willingness of an individual and other taxable entities to act in accordance and within the spirit as well as the letter of tax law and administration without the application of enforcement activity". (McBarnett, 2003) also contributes to the understanding of the concept by observing that there are three forms of compliance, which include committed compliance, creative compliance and capitulative compliance. Committed compliance is the willingness to discharge tax obligations by a taxpayer without grumbling. However, creative compliance refers to any act by a taxpayer aimed at reducing taxes by redefining income and deductible expenditure within the confines of the law. On the other hand, capitulative compliance is the observance of tax obligations albeit reluctantly. Despite the role played by taxation, tax non-compliance exists.

The problem of tax non-compliance is as old as taxes themselves. Tax non-compliance and tax evasion exists in every country and Kenya is no exception. According to (Jackson and Jones,1985; Worsham, 1996), tax evasion and tax non-compliance is a serious problem. Tax non-compliance is the "illegal tax evasion" (Cuccia, 1994). It occurs due to failure to perform a timely filing or submission by taxpayers of all required tax returns, when not accurately reporting the tax liability in accordance with the tax laws, when there is a non-payment or late payment on the tax due, an understatement of income, and overstatement of expenses (Singh, 2003). Measuring tax non-compliance is difficult because it involves individuals and firms concealing the true level of their assessable income whether intentionally or unintentionally.

According to (Young, 1994), The Inland Revenue Services of USA indicated that there are 64 factors that are related with tax non-compliance by taxpayers or companies. Among the factors that are commonly used by previous researchers relating to tax non-compliance among individual taxpayers is tax complexity.

(Milliron, 1985), concluded that the impact of tax complexity on tax compliance is a bit more complicated because of the interaction of two factors i.e. perception of fairness and opportunity for non-compliance. Taxpayers are more prone to tax non-compliance where the tax systems are complex (Beck, Davies & Jung, 1991). Besides deliberate under reporting tax complexity also influences non-compliance by causing misinterpretation of rules, omissions and unintentional errors (Gupta, 2002). There will be a subsequent reduction of tax non-compliance by making tax systems less complicated leading to an increased perception of fairness on the tax system (Beck et al, 1991). Simplifying the tax system may not effectively deter tax non-compliance and tax complexity may not necessarily be considered to be unfair (Adam and Sheffrin, 2002).

Sour (2001) found that tax compliance rate will be increased by increasing the probability of audit. Significantly higher levels of taxable income were being reported due to increase in the probability of audit (Beck et al., 1991). On the other hand, tax non-compliance will increase when an audit detection rate decrease, (Lederman, 2003) .There may be a substantial impact on tax compliance by a small increase in detection risk (Carnes & Englebrecht, 1995) whilst Income reported will increase through an increase in audit rate (Dublin & Wilde, 1988). In increasing tax compliance among taxpayers, (Carnes and Englebrecht, 1995) found that perceptions of audit detection risk are more effective than actual detection risk.

(Spicer and Becker, 1980) concluded that the tax non-compliance of taxpayers will significantly increase when they perceive themselves to be victims of tax inequity. Taxpayers' morale increases when tax officials treat them with respect. The taxpayers will avoid tax if tax officials solely rely on deterrence (Frey & Feld, 2002). Kenya is a good example to illustrate the point.

Following the ascendancy into power by the Jubilee government, taxation increased. One of the reasons cited for the widening of the rates of taxation to include Value Added Tax (VAT) on basic commodities was that the government needs more funds to finance service delivery. Measures of this nature have seen Kenya increase the tax burden on its citizens, and in the process made the country among those with the highest tax burdens. Despite the upward trend, the needs of the country in reference to revenue for maintaining public services continue to expand. Despite the growing demands for additional revenue, the Kenyan citizenry do not wholly embrace the idea of taxation (Moyi and Muriithi, 2003). This is clear based on the notion that the taxpaying culture in Kenya remains discouraging when compared against its peers. For instance, individuals who wield political and economic power refuse to cooperate on tax matters, as they do not approve of taxation activities. On the other hand, the vast majority of Kenyans lack both the political and the economic power. The latter cadre of the citizenry perhaps feel the tax burden more and they are unwilling to remit their taxes due to the difficulties they face (Lumumba, Wanjohi, Magutu & Mokoro, 2010). Based on this realisation, it is evident that nobody enjoys paying taxes. The mere fact that people do not enjoy paying taxes implies that those charged with the task of tax collection will face difficult times when executing their duties. The taxpayers and the tax collectors develop mutual mistrust as a result. In this relationship, tax collectors view taxpayers as criminals while the latter perceive the former as State exploitation agents (KRA, 2004).

Hostility on the part of taxpayers demonstrates that given a choice, a big percentage of taxpayers would not remit their taxes. Thus, comprehending the conduct of taxpayers in regard to the factors that influence taxpayers' decisions to or not to comply would be a fundamental step towards streamlining tax compliance. For that reason, the main objective of the study is to understand the factors that influence income tax compliance.

1.2 Statement of the Research Problem

The informal sector plays an important economic role in Kenya. According to a study conducted by the parliamentary budget offices, it accounts for 77% employment. According to the Economic Survey 2012, it contributes over 25% to the GDP. However, it provides a potential cover for tax evasion, where tax administration and or enforcement are influenced by corrupt actions. Considering that in the formal economy tax evasion would be more difficult, entrepreneurs in the informal economy would attempt to evade all taxes they can.

Tax evasion reduces national revenues and therefore has the potential to reduce the government's ability to expand on national programs. This may lead to additional tax burdens (Hope, 1993). In Kenya and other African countries tax evasion is on the rise but quantification of such evasion is almost impossible.

The goal of any tax administration according to(Silvani, 1992) is to foster voluntary tax compliance and hence reduce the tax gap. The tax gap is the difference between the tax revenue which would be raised under hypothetical, perfect enforcement of taxes and the actual tax revenue. A policy intended to fight tax evasion is a policy to narrow the tax gap. By June 2012, Kenya's public debt had ballooned to Sh. 17 trillion which is equivalent to 48% of the GDP. The debt was hovering to 50% mark, which is considered unimaginable and unsustainable. Even after aggressive marketing by KRA in the print and electronic media, there is still an existing tax compliance gap in Kenya. Two International Monetary Fund (IMF) experts, Carlos Silvani and Katherine Baer, estimated the tax gap for Kenya to be over 40%, (KIPPRA, 2005).

Tax compliance is a problem to many countries as measured by tax to GDP ratio, (Cobham, 2005). The study therefore sought to focus on the factors influencing an individual's income tax compliance.

1.3 Significance of the Study

Based on a review of literature, it emerges that despite a number of studies addressing tax compliance, there is lack of clarity on which factors influence income tax compliance. Hence, the current study is significant in enlightening the tax authorities the factors that influence income tax compliance. Therefore, they would be able to devise appropriate mechanisms to eliminate instances of income tax evasion. By so doing, the government will have increased revenue collection. In addition, the study would contribute towards understanding the prevailing levels of income tax compliance. The small and micro enterprises will also find the study useful in that it will help them understand their obligation behind tax payment. It will also be helpful as a source of reference by other scholars, business people and students who may be interested with the information in the future.

1.4 Research Approach

In this section, the research approach employed by the study is laid out. Since the researcher sought to establish the factors that influence income tax compliance, she employed field research approach guided by a cross-sectional research design. Through the use of the purposive sampling technique, a sample was selected for the study.

1.4.1 Research Methodology

The research involved income earners among MSEs in Kasarani Constituency. The results were generated on the factors influencing an individual's income tax compliance. Data was collected from fifty five business enterprises. The data was collected using structured questionnaires which were directly delivered to the individuals. They were collected within two weeks. The respondents were not to write their names on the questionnaire forms in order to protect their confidentiality.

The questionnaire was divided into the following parts:-Part 1 contained the demographic profile which is the business type, position of respondent, number of employees working for the organisation, age, ethnic composition, sex and marital status of the respondents. In Part 2 Questions relating to the attitude of taxpayers were considered. Part 3 considered questions relating to the quality of public governance while Part 4 considered question relating to the cost of non-compliance.

The current study employed the purposive sampling technique. The purposive sampling is a non-probability sampling method which permits a researcher to decide the study subjects (Wiederman, 1999). Such decisions are based on an inclusive criteria encompassing: willingness and capacity to participate or to be in possession of special knowledge (Wiederman, 1999). The focus in selection was on subjects who could contribute appropriate data on the basis of depth and relevance.

The data that is normally used in the empirical and experimental tax compliance studies is categorized into the following types, which are, audit data, survey data, data from tax authority, and data obtained from laboratory experiments according to Andreoni et al. (as cited in Kim et al., 2006). Survey data is chosen as the main source of data in this study. However, field data in the tax non-compliance is usually incompletely collected because tax non-compliance is illegal and evaders will not disclose honestly as mentioned by (Cummings et al, 2006). In order to enhance the data collection process and enable the data to be collected more completely the data in this study is gathered from both primary and secondary sources.

The first hand data which is normally collected through the responses from target respondents by means of survey form or questionnaire and face-to-face or phone interview is referred to as primary data. Self-reporting either on hypothetical scenarios or tax-related questionnaires is the most frequently used data collection method in tax compliance studies (Jabbar & Pope, 2008). In the current study, a self-administered questionnaire was hand delivered to potential respondents.

Secondary data is the information that is derived from the journals or articles that are published by other researchers either in digital form or printed materials. In order to get an overall insight of the research topic and as guidance in doing the current study, secondary data is important. The secondary data in this research is collected mainly through Google Scholar, a useful function from Google.com that enables users to reach the published journals within the desired topic. The other databases that are provided e-journals which are done by researchers include, EBSCOhost, Emerald, Science Direct and others. These databases are available in online library. Another that is considered as a secondary source of information is reference books.

The data collected from questionnaire which is filled by respondents is analyzed by a Statistical Package for the Social Sciences (SPSS) version 20 . To analyze the data in the present research, both descriptive and inferential analysis were employed. In portraying the characteristics of a variable, descriptive analysis is used (Chua,2013).The researchers are allowed to present their data in a more meaningful way, like frequency, mean, median, mode, range, percentage, ratio, by the use of descriptive analysis.

T-test is used to analyze the difference between two variables by comparing their means, where “t” means two (Nardi, 2006, p. 72). To determine whether both variables are significantly difference in t-test, the result of t-value is compared with the critical t- value. If the computed t-value is greater than 2.0, then it is said to be statistically significant difference (Nardi, 2006, P. 71).

Questionnaire is employed as a primary data collection method, and referring to secondary sources, like journals, articles and books published by other researchers gave a wider view and revealed the research topic in detail, in this research.

The data collected is presented using tables. The data is transformed into percentages to ease its analysis. The use of descriptive and inferential statistics is employed in analysing the data. In describing the data, the focus is on the characteristics of the organizations that were sampled. Under inferential statistics, the use of mean and standard deviation were considered.

1.4.2 Research Base

Since the study focuses on the factors influencing income tax compliance within the context of micro and small enterprises, the population for the study was MSE owners. The area of study is Kasarani Constituency located in Nairobi County. For that reason, MSE leaders in Kasarani Constituency formed the study population. Therefore, MSE leaders are the units of observation.

The Kasarani constituency is an electoral area in Kenya located in Nairobi County. Thus, the constituency is one of the seventeen constituencies in Nairobi. It covers an area of 152.6 square kilometres and has a relatively limited geographical space. However, the area has a dense population, estimated at around two hundred thousand.

The primary reason for selecting Kasarani constituency was based on the idea that it is an urban set-up with a population that is informed on tax requirements and with residents of different cultural backgrounds. Besides, the location has many of MSEs which form the population for the study.They are characterized by a variety of shops, bars and restaurants, food vending, salon and hair dressing, mini supermarkets, workshops, hotels and guest houses, and tailoring. Other reasons for selecting the area were the proximity, time and costs. Proximity applies in the sense that the area is close to the researcher's residence and place of study. Hence it was possible to save both on time and costs associated with accessing the research base.

1.4.3 Research Objectives

The main research objective is to assess the factors that influence income tax compliance. Towards attaining that objective, the study's specific objectives include:

1. Understanding the influence of taxpayers' attitudes on income tax compliance
2. Understanding the influence of the quality of public governance on income tax compliance
3. Comprehending how cost of non-compliance influences income tax compliance

1.4.4 Research Questions

The study's main research questions focus on the factors that influence income tax compliance. Hence, the study addressed the following questions.

1. How do taxpayers' attitudes influence income tax compliance?
2. To what extent does the quality of public governance influence income tax compliance?
3. To what extent does the cost of non- compliance influence income tax compliance?

1.4.5 Research Hypotheses

The hypothesis (H_1) is that the attitude of taxpayers influences income tax compliance. Attitudes are known to influence how people make decisions on many issues. Tax compliance is one such aspect that is subject to the attitudes that taxpayers hold. For instance, if taxpayers hold that the tax system is unfair, then they are unlikely to comply voluntarily. Moreover, the taxpayers may refuse paying taxes if they feel that the taxes are not used properly.

Secondly, the hypothesis (H_1) is that the quality of public governance influences income tax compliance.

Quality of services citizens receive is deemed an influential factor in tax compliance. In practice, citizens pay taxes in anticipation of basic services such as building roads and enhancing security. Hence, whenever taxpayers deem that the services they receive are inadequate, they become inclined to evade taxes.

Thirdly, the hypothesis (H_1) is that the cost of non-compliance influences income tax compliance.

The additional tax costs that are incurred in the future in the event that a taxpayer engages in non-compliance activities and therefore be charged for evasion will influence income tax compliance. Taxpayers will comply where the non-compliance costs are high and vice versa.

1.4.6 Research Limitations

The current study was conducted in Kasarani Constituency. Such cases offer information relating to specific aspects or regions only. This implies that cases may be isolated at times. Hence, they may not present the real picture on the ground. If cases fail to represent the whole population of a study, then findings from such studies would be limited. This rests on the idea that scientific research should present opportunities to generalise study findings. To overcome the situation, a researcher needs to compare the study to other findings and establish the association.

In the current times, changes in diverse aspects have soared to a critical level. By way of example, attitudinal changes may take place over a short time span. Such changes may alter the levels of tax compliance. Consequently, findings of this research may be rendered less useful. Subsequently, this paper remains a tentative piece that is subject to review by other scholars at any appropriate moment.

This research seeks sensitive information on business. As such, respondents especially those working as retail workers would find it difficult to divulge information. This could be premised on the idea that the information given could be used in other ways other than those presented to them. However, the researcher assured the respondents and made it clear that information given was to be used only for the purposes of this study.

1.5 Literature Review

1.5.1 Income Tax Compliance and Taxpayers' Attitudes

Tax compliance is a complex term. (Brown and Mazur, 2003) observed that the term is multifaceted although it can be defined based on compliance types (filing compliance, reporting compliance and payment compliance). However, according to the (Organisation for Economic Cooperation and Development 2001), categorizing compliance into administrative and technical is advocated. The former relates to satisfying administrative rules on lodging and paying (which refers to reporting compliance), regulatory and procedural compliance. The latter focuses on meeting the technical expectations of tax law requirements in terms of calculating taxes or being truthful and accurate in tax determination.

In theory, views of both the taxpayers and tax collectors are that tax compliance is adhering to taxation laws. According to Silvani (1992) the primary objective of tax administration is to enhance voluntary tax compliance. (Cobham 2005) reported that tax compliance is a problem among many countries although major improvements continue being made. Low-income countries remain the most affected by low levels of compliance.

With specific reference to (Ajzen's 1991) theory of planned behaviour, attitudes gravitates on a person's views about his/her behaviour. Attitudes are also viewed as being either positive or negative. In reference to taxation, taxpayers' attitudes can be taken as positive or negative views on tax compliance. Whereas, positive attitudes foster compliance, negative attitudes promote non-compliance. As an example, the following factors: taxpayers' perceptions of a tax system or revenue authority,(Ambrecht, 1998) ; peer attitude, (Toumi et al, 2000); taxpayers' understanding of operations of a tax system, (Silvani, 1992);motivation/rewards of compliance, (Feld, Frey and Torgler,2006) ; punishment/penalties,(Allingham and Sandmo, 1972); the cost of compliance, (Slemrod, 1992); enforcement efforts,(Allingham and Sandmo, 1972); work ethics, (Furnham, 1983); morality of taxpayers, (Trivedi and Shehata, 2005) and government image, (Le Baube,) influence taxpayers' attitudes, which in turn influence their willingness to comply or not to comply.

1.5.2The Quality of Public Governance and income Tax Compliance

Public governance quality influences tax compliance. Where there is public governance quality, the tax system ought to be good and where the tax system is good then there should be public governance quality. (Everest Phillip and Sandall, 2009).

What happens in governments should matter to taxpayers because they provide finances inform of tax payment for its sustenance. Therefore, the compliance behavior of taxpayers may be affected by governance affairs either positively or negatively.

In analyzing the relation between the taxpayers and governments, it was concluded that tax compliance is influenced by vertical contacts (Levi, 1988). According to him, the contract between the taxpayers and government is a vertical contract, referred to as a quid pro quo of taxation. These contracts focus on whether the taxpayers access public goods in exchange for the taxes paid.

According to the quid pro quo argument, complying with tax law provisions partly depend on whether the services provided by government are sufficient in exchange for taxes paid (Lassen, 2003).

This argument is supported by (Levi, 1988) who argued that if the taxpayers perceive that the rate of exchange from tax to political goods is low, then the taxpayers will feel that the government has not complied with the contract and as a result voluntary tax compliance declines. The argument by (Levi, 1988) was supported by (Besanco, 2003) who stated that there is a social contract between the governments and taxpayers which embodies effective delivery of services.

Alm, McCleuard and Schulze (1992) made observations supporting (Lassen, 2003) who argued that taxpayers may feel the attractiveness of the quid pro quo contract diminished leading to lower tax compliance where the services provided by the government are not as expected or the exchange rate is low due to corruption.

Another who supported Lassen's argument is (Torgler, 2003). He noted that when the government's integrity goes down, hence fail to honor their honesty, an individual's tax compliance may be low. He concluded that positive actions by governments may cause taxpayers to develop positive attitudes and commitment to tax system and payment resulting to improved compliance.

In reviewing the relation between the quality of public governance and compliance further, (Everest Philips and Sandall, 2009) concluded that there is a connection between public governance quality and taxation and that quality governance delivers good tax systems which facilitate good governance. Where there is good governance, quality public goods should be provided to the public and where governments have failed to provide services such as public amenities and infrastructure in exchange for tax payment, citizens also become reluctant in tax payment. There is a significant positive association between the benefits derived from services provided by the government to its citizens and the willingness of taxpayers to pay taxes. (Alm, Martinez – Vazquez and Achneidler, 2003).

1.5.3. Tax service quality perception and income tax compliance.

Organizations now acknowledge that operating within the public sector need to be accompanied with the extension of quality customer service as they are critical strategic issues to be addressed with the logical extension of the principles of marketing to the public sector. (Donnelly, Darlymple, Wiskniewki & Curry 1995), The issue of service quality is more critical with the new administrative philosophy known as the New Public Management (Brysland & Curry, 2001).

The issue of service quality is as critical to tax offices as they provide numerous services to taxpayers just like any other public sector organizations (OECD, 2005 & 2007).

The services that are commonly provided by revenue offices are in three categories. They are information, interaction and transaction. Transaction is the core service while information and interaction provide support to transaction.

The goal of any tax administration is to offer better services to taxpayers. In the modern society, they should offer services to citizens and in the process become more and more specialized. (Karingi, Wanjala, Pamba and Nyakang'o, 2005).

This argument was supported by stating separately that the manner in which taxpayers are treated in the course of the tax service provision has an impact on their compliance behavior(Feld and Frey, 2006).According to (Torgler, 2007) the willingness of taxpayers to corporate with tax authority will increase, if the authority sees itself as service institution and provide quality service and treat taxpayers as partners .The delivery of quality service to taxpayers will strengthen their willingness to comply with tax laws voluntarily and as a consequence contribute to the overall level of tax compliance (OECD, 2007).

Tax offices are increasingly becoming aware of the necessity to accord taxpayers the status of customers as many tax authorities such as those of Australia, France, Sweden, UK and the US have reconstructed their approaches towards taxpayers by giving them more consideration to their tax service needs and treating them as clients.

1.5.4 Cost of Non-Compliance and Income Tax Compliance

The cost of non-compliance refers to the additional tax cost that is expected to be incurred in future where a taxpayer engages in non-compliance activities and is charged for tax evasion.Some of the factors that affect tax non-compliance include; tax penalty (Davis et al., 2002), opportunity to evade tax (Collins, Milliron and Toy, 1992), social responsibility (Fortin, Lacroix & Villeval, 2007) ethics (Bobek & Radkte, 2007), enforcement (Frey & Fled, 2002), moral reasoning (Singh, 2003), and tax deduction (Singh, 2003)

Any extra tax costs that is expected to be incurred in future, if a taxpayer engages in non-compliance activities, for example, fines, penalties or even imprisonment might be charged towards evasion. When tax non-compliance activities are detected and the possibility of the non-compliance is being detected by tax authority, it is necessary for taxpayers to know the consequences of future tax costs if he/she intends to engage in tax non-compliance activities (Hai and See, 2011). Tax audit will be conducted by tax authorities to find out those who have engaged in non-compliance activities and transactions. The taxpayer will then be penalized if caught engaging in non-compliance activities once the audit is complete.

Before taxpayers decide to engage in non-compliance activities, it is a norm that they weigh the benefits to be derived from it and find out whether they are greater than the fines or punishment when caught later based on the economic model (Bărbuţă-Mişu, 2011). The models of tax non-compliance, the deterrence model and the pure gamble model explain this concept better. Future tax costs, which include fines, penalties and imprisonments, are related to the deterrence theory in tax non-compliance which was first formulated by (Allingham and Sandmo,1972). In order to maximize the expected utility derived from the benefits after tax penalty, the taxpayers have to make the decision whether to evade and how much to evade. It also depends on the level of risk preference of the taxpayers. On the other hand, the considerations from various aspects and moral constraints are neglected by the pure gumble model. Under this model, the taxpayer who engages in tax non-compliance merely wants to evade tax, assuming *as a game against .nature* (Bosco &Mittone, 1997).

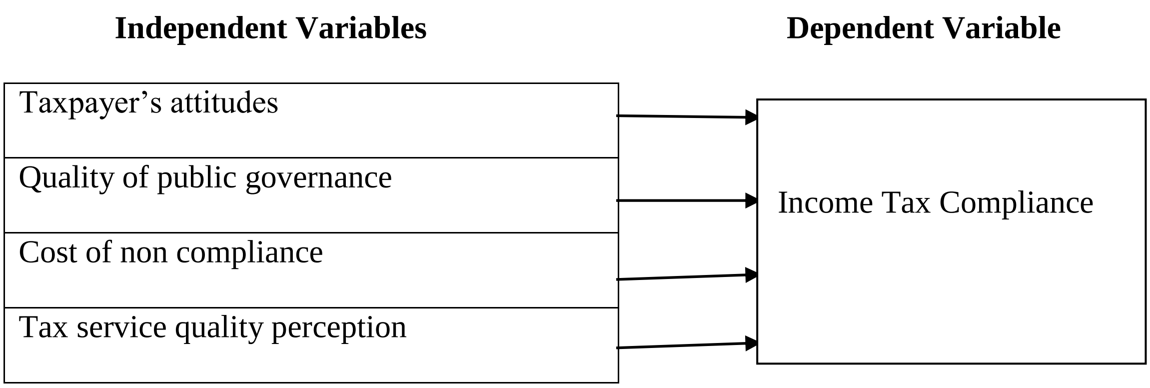
(Friedland, et al. 1978; Christiansen, 1980) observed that higher compliance level will be achieved as a result of increase in fines as compared to tax audit. Even then, a taxpayer would definitely subvert the perception towards fairness within the tax regime, if he or she unintentionally made a mistake or misinterpreted the complex and ambiguous tax law but was charged with inappropriate or high fines (Kirchler, et al., 2008). According to (Obid, 2004), both fines and tax audit do have significant impact on the level of tax compliance, although this will greatly undermine the taxpayers' confidence if they felt the existence of unfairness in the tax system.

One of the important elements in the existence of perceived unfairness in tax system is corruption. The impact of fines towards the level of compliance is significantly positive under normal circumstances (Obid, 2004). However, the relationship between fines and level of compliance is distracted if corruption exists. This is because the taxpayer would be given a second chance and discharged from the wrongdoing if tax officers tend to receive bribery even with the implementation of higher fines or penalties.

If the total amount of corruption is weighed less than the fines and penalties, as if there is a reduction in the audit probability and probability of detection, and then taxpayers may find ways and take risk to evade tax. This is a situation of "a general loss of trust in public institutions" (Cummings, et al, 2006). According to (Bărbuţă-Mişu, 2011) there is no clear picture on the relationship between fines and tax compliance.

One of the most useful means to deter the tax non-compliance behavior is tax audit (Bărbuţă-Mişu, 2011). Tax authorities can increase the level of compliance, by increasing audit probability and field audit through visiting the taxpayers premises as this may induce the 'fear factors' towards taxpayers (Obid, 2004). However, the fear factors have both advantages and disadvantages which may create an up-to- date tax obligation over the system inwards that affect taxpayers in a positive way, whilst create the pressure of honesty and integrity on taxpayers negatively.

(Mason and Calvin, 1978) concluded that whoever perceived there is a lower chance of being caught is most likely to engage in tax non-compliance activities. Taxpayers tend to pay less tax than they are supposed to pay if there is a low probability of detection (Kirchgassner, 2010) while the amount of tax declared will be increased if there is an increase in the probability of detection (Allingham & Sandmo, 1972). (Torgler, 2005) found out that audit have negative impact on tax non-compliance. Frey and Feld (as cited in Kirchgässner, 2010), found that there is a significant impact of tax audit towards tax compliance level. Others like (Bosco $ Mittone, 1997; Bărbuţă-Mişu, 2011) show weak effects or no significant impact between tax audit and compliance level. It has been proved that the involvement in tax non-compliance activities reduced drastically after the implementation of higher fines and massive tax audit (Kim, et al., 2006). In conclusion the study conducted by (Hai and See, 2011) unswervingly confirmed that the taxpayers' decision making on tax non-compliance is positively influenced by future tax costs.



The diagram, illustrates that the quality of public governance, attitudes, cost of non-compliance and tax service quality perception influence income tax compliance.

1.6 Theories on Tax Compliance

1.6.1 Psychological and Economic Theory

The use of both psychology and economic theories is critical in informing this study. Based on the psychological theories on tax compliance, the assumption is that psychological factors such as ethical and moral concerns heavily influence the behaviour of taxpayers. Thus, taxpayers are likely to pay their taxes even if penalties are absent. These theories de-link the element of tax compliance from the punitive measures advanced against non-compliance.

Shifting focus to the economic theories, the main idea revolves around deterrence. (Trivedi & Shehata, 2005) observed that taxpayers are rational individuals who engage in calculations to determine the economic effects of the way they conduct their businesses. Based on this idea, taxpayers would review the existing compliance alternatives before making choices. Therefore, a taxpayer may avoid paying taxes in instances that they feel that they can do so undetected. On this evidence, it is discernible that taxpayers are amoral and issues of ethics do not influence the decisions that they make. As such, the theories advocate for the use of punitive measures to deter taxpayers from attempting to evade tax payments.

The two schools present diametrically opposed views on taxation; hence, the one to use in assessing how taxpayers respond to tax policy depends on the preferences of the assessor. It appears that the two elements of morality and ethics play a role. At times, it is necessary to combine both the psychological and the economic schools in order to get an enlarged view on the issue of tax administration and compliance, an aspect that this study embraces.

Both the psychological and economic theories are important in tax compliance. For the economic theory, an increase in audit and penalties is a solution to tax compliance.

The behaviour of taxpayers is influenced by profit maximization and probability of detection (Trivedi & Shehata, 2005), and under-reporting (Cobham, 2005). The Psychology theories focus on changing individual attitudes towards tax system. Some taxpayers' behaviour will follow economic theories, others will follow psychological theories while others will follow the two (Trivedi & Shehata, 2005). The taxpayers who apply the two theories are prevented from tax evasion through the economic theories for fear of punishment and they would also feel that they are under a moral obligation to pay taxes under the psychological theories hence, tax compliance.

1.7 Chapter Breakdown

Chapter ONE lays out the background of the study, the statement of the research problem, the significance of the study, the research approach, literature review and the theories of research. Under the approach are the research methodology, the research base, research objectives, the hypotheses and limitations of research. The theories of the research are psychological and economical.

Chapter TWO informs of the conceptual framework upon which the study is based. It entails tax evasion, concept of MSEs, reasons why MSEs are prone to tax evasion and measures to be put in place to reduce tax evasion among the MSEs.

Chapter THREE explains the administration of taxes by the Kenya Revenue Authority, taxation of MSEs and tax returns, and income tax.

Chapter FOUR provides for data presentation, analysis and findings. The surveyed units are presented before analysis of the data.

Chapter FIVE entails a summary of the conclusion of the study, its findings , recommendations to the Kenya revenue authority and lastly implications for future studies.

CHAPTER TWO

CONCEPTUAL FRAMEWORK

2.0 Introduction

This chapter presents a review of the conceptual framework upon which the study is based. Discussed is tax evasion, the concept Micro and Small enterprises-MSEs, the reasons why MSEs are prone to tax evasion and lastly measures to be put in place to reduce tax evasion thus improving tax compliance among the MSEs.

2.1 Tax evasion

This refers to illegal and intentional actions taken by individuals to reduce their legally due tax obligations. Individuals and firms can evade taxes by under-reporting incomes, sales, or wealth, by overstating deductions or by failing to file appropriate tax returns. Both intentional evasion and unintentional non-compliance, which is due to calculation of errors and inadequate understating of tax laws is non-compliance (Robben et al, 1990; Webley, 2004).

Tax compliance is the full payment of all taxes due (Braithwaite, 2009) while tax non-compliance is the difference between the actual amount of taxes paid and the amount of taxes due. The occurrence of tax non-compliance is more inclined towards small businesses rather than towards large business in many countries (Schuetze, 2002).

2.2 Concept of Micro and Small Enterprises (MSEs)

The MSEs largely operate within the informal sector. The definition of MSEs differs by industry and country. The micro and small enterprises Act has defined a micro enterprise as a firm, trade, service, industry or business activity which employs less than ten people and whose annual turnover does not exceed five hundred thousand shillings. It has also defined a small enterprise as a firm, trade service, or a business activity whose annual turnover ranges between five hundred thousand and five million shillings and employs between ten and fifty people.

The organization for Economic Corporation and Development (2004, P. 10), characterised small businesses as sole proprietor, partnership and corporate forms of organizations. They also include individual return filers who have income from self-employment, even if it is not their primary source of income. All these ventures are centred around a single individual, or in the case of team founders – on closely related people for a similar conceptualization of small businesses as individuals (Studdard & Munchus, 2009).

These individuals usually make or are accountable for, all managerial and operative decisions including revenue generation and taxation. Their behaviours are crucial to the ventures success. Hence the small business owners can be viewed as individuals whose behaviour is largely determined by their emotional and rational perception of taxation which is unlikely to be their core area of expertise.

2.3 Reasons why small and micro enterprises are prone to tax evasion.

2.3.1 Perceived opportunity.

The small business owners need to self-assess and self-report their income and pay taxes out of their pocket. They pay their income tax; need to take account of various types of business taxes such as corporate tax, property taxes and payroll taxes; they need to collect sales taxes such as VAT; and they need to withhold taxes such as personal income taxes in the case of having at least one employee (Christensen et al, 2001).

Due to the self-reporting and limited control over underlying money flows, they have the opportunity for non-compliance. Their opportunities to evade are high. The opportunity exists if incomes are not subject to automated third-party reporting, or if taxes are not withheld at source for example in cases of receiving gross incomes or cash payments. (Shane, 2003; Shaver and Scott, 1991; Williams and Round 2009).

2.3.2 Complexity and knowledge requirements.

Small business owners must be knowledgeable about the different compliance measures and requirements in order to pay appropriate taxes .The need to apply differential taxation rules depending on the amount of income or the characteristics of the taxpayer among small business owners is a reason for non-compliance (Joulfaian and Rider, 1998).

The small businesses bear a higher compliance burden due to the tedious compliance procedures required by tax authorities as observed by (Eichefelder and Schom, 2008).

Substantial knowledge about the procedural aspects of tax laws is required. However this is a challenge since tax laws tend to be changed frequently (Chittenden et al, 2003), are more complex and ambiguous than laws in general (Carners and Cuccia, 1996). Often, tax laws are too complex to be understood by laymen (Kirchler, 2007) a characteristic of many small business owners.

The small business owner managers deal with the knowledge deficiencies by seeking the help of tax practitioners but tend to handle part of the tax paying process themselves (Coolidge et al, 2009) and will have to keep necessary records. In order to be informed to keep the records and to fill out the forms imply that acquiring taxation knowledge is costly in terms of time. It is also costly in terms of money to get the tax literature and tax practitioners.

The tax systems are complicated with numerous processes for example licensing. These make it difficult and expensive for the small firms to act in good faith. Compliance costs have been shown to be highest for small businesses (Chittenden et al, 2005; European Commission, 2004; JOumard, 2002; Pope and Abdul-Jabbar, 2008) if incomes are low (Blumenthal and Slemrod, 1992).

The type of knowledge acquired matters: the general knowledge in terms of education and tax specific knowledge influence the ability and willingness to comply or evade. General knowledge will be used to evade just as it is used to comply. Tax specific knowledge will lead to an increase in compliance; the assumption being to learn about taxes will also mean to learn about their function in the society. Hence tax specific knowledge is necessary to enable the small business owners to comply and increase their willingness to comply.

Majority of the workers in the informal sector have low education background. Therefore they lack skills on and access to online tax registration and returns. Even those with modern education lack computer skills that can enable them to use the online services for tax registration and returns. Most prospective entrepreneurs are not aware of business start-up regulations and taxation procedures due to lack of effective information dissemination strategies on government policies. The lack of access to accurate information prevents the sector from entering into the formal economy.

2.3.3 Decision Frames

Small business owners pay their taxes out of their pocket, and thus dispose of their gross income. It is a loss frame to pay tax share out of one's own pocket. Paying taxes typically constitutes a loss for small business owners, which constitutes a non-gain for taxpayers whose taxes are withheld at source. The perceived pain of a loss is greater than the perceived pain caused by an equally sized non-gain (Idson et al; 2000) according to research based on "prospect theory" (Kahneman and Tversky, 1979).

The theory is of the idea that people are more risk – seeking in the loss domain than in the gain domain. It may not only be painful for the small businesses owners to pay taxes but the loss framing might also make them risk-seeking. This could lead to tax non-compliance.

Even if the small business owners acted as collectors only they are more likely to frame paying taxes as the loss of something which was previously theirs and are more likely to view paying their taxes as a limitation to their freedom. After tax payment, the small business owners are frequently made aware of the limiting losses by experiencing an additional "loss".

Tax decisions for small business owners are individual decisions which are likely to depend on the psychological perception of the situation. The small business owners face circumstances that translate into a verse decision influences. As a result of their individual nature and their specific tax situation they find it difficult to understand and comply with taxation procedures, they face decision frames that favour non-compliance, and they have and are likely to perceive enhanced opportunities not to comply.

The measures to tackle tax non-compliance ought to be based on knowledge about the factors leading to non-compliance. Measures beyond tax audit are needed to tackle non-compliance (Kirchler, 2007).

2.4 Measures to address Tax evasion among small and micro enterprises.

2.4.1Simplifying the taxation process (Joumard, 2002). The measures are needed on structural and on an individual level where perception takes place. The tax system requires structural changes in order to change the non-compliance opportunities. The increasing influence of electronic data storage and transfer has contributed to a reduction in opportunities and is likely to do so in the future.

2.4.2 Decreasing the perceived opportunity

Taxpayer opportunity perception matter most. Increasing the salience of detection likelihood or consequences is one of the ways of reducing the perceived opportunities. However; Voluntary compliance may be reduced by the salience of punishment which has the potential to create a threatening image of tax authorities (Murphy, 2004). Therefore the salience of norm-adhering behaviour should be increased. New ways of decreasing perceived opportunities in a non-threatening manner, or consequences of different ways of communicating, changes evasion opportunities for example being sent information material on the perceived opportunities.

The taxpayers have to be in a position to understand and cope with the administrative and legal requirements in addition to simplifying taxation factually. Increasing the small business owner's level of tax knowledge is one of the possible solutions. Involuntary non-compliance goes down As taxpayers learn, for example, how to complete forms involuntary non-compliance goes down (Antonides and Robben , 1995).

The taxpayers learn how to comply and how to evade with increase in tax knowledge. (Andreoni et al, 1998). Therefore, increased tax knowledge could lead to both a decrease in unintended non-compliance and an increase in intended tax evasion depending on the effect of knowledge on tax morale and compliance intention. Taxation knowledge should be acquired in ways that increase the salience benefits of a taxation system.

For small business owners to learn and meet the knowledge requirements, the availability and accessibility of information may not be sufficient. It should be ensured that information transfer takes place and is followed by an increase in tax competency and tax morale. To enable both outcomes, there should be a climate of mutual trust between taxpayers and authorities (Kirchler et al, 2008).

2.4.3 Decision Frames

It is recommendable to discourage The application of a "loss" frame should be discouraged in order to diminish the pain of paying taxes and hence the willingness to comply. Taxpayers should be encouraged to book tax payments on separate mental accounts, according to the mental accounting literature (Thaler, 1999). The feelings of ownership of tax money and thus feelings of loss when taxes are due may be avoided by having separate tax accounts Establishing separate mental accounts for tax money can be done by making it clear to the small business owners that the tax money is only collected and never possessed and also focus on net prices.

According to (Simiyu, 2003), Many approaches are needed to reduce the tax gap because there is no single approach which is likely to fully and cost effectively address non-compliance. This is because it has many causes and spans different types of taxes and taxpayers.

CHAPTER THREE

TAX ARRANGEMENT AND ADMINISTRATION IN KENYA

3.0 Introduction

This chapter entails the administration of taxes by The Kenya Revenue Authority (KRA) in both small and large enterprises, taxation of MSEs and tax returns, and income tax.

3.1 Kenya Revenue Authority

KRA (cap469) was established on 1st July 1995 by an act of Parliament. The authority is charged with the overall responsibility of collecting tax revenue on behalf of the Government of Kenya (GOK).The mission of KRA is to promote tax compliance within Kenya (CIAT, 2006). Towards this mission, KRA has been mandated to play a critical role in the Kenyan economy. The roles include advice on matters pertaining to the administration and the collection of revenue under written laws.

The Kenya Revenue authority is supposed to assess, collect, administer and enforce tax laws with a high degree of professionalism as indicated by (CIAT, 2006). Integrity and fairness must also be seen to prevail in the conduct of KRA. In order to attain its goals, the KRA is divided into departments and regions (Kenya Revenue Authority, 2013). The regions include: the North Region, the Western Region, Southern Region, the Rift Valley Region and Central Region. On the other hand, the departments include: Domestic Services Department, Road Transport Department, Customs Services Department and Support Services Department. It is also noted that KRA is in charge of the administration of different types of taxes as directed by various laws such as Income Tax, Excise Tax and Custom duties, Value Added Tax, among many more.

The Kenyan tax system and the organization of the Kenya revenue authority are critical in understanding tax administration and structure. The responsibility of collecting tax falls within the two major departments of the KRA: the Customs and Excise Department (CED) and the Domestic Tax Department (DTD) (Republic of Kenya, 2010). The DTD has a mandate over corporate and personal income taxes, VAT on domestically manufactured goods, withholding tax and small taxes. Up until, 2005, the CED was in charge of the collection of excise tax (for both domestically produced goods and imports), VAT on imports and all trading taxes. However, in July 2005, the role of collecting domestic excise tax was handed to the DTD.

The KRA operates seventeen regional branches, also known as stations (Muriithi & Moyi, 2003). Out of the seventeen, four of them are in Nairobi, while two are in Mombasa. Despite the fact that the functions of the Nairobi branches are determined geographically, they are located within the same building and, they serve as KRA's central administration unit. One among the seventeen stations, the Large Taxpayer Office (LTO) serves clients not tied to specific geographic locations. The LTO was created in 1998 to monitor and provide taxpayers with services that contribute bulky revenue (Muriithi & Moyi, 2003). Besides the stations, smaller satellite facilities are available to provide a limited array of services such as taxpayer registration, payment facilities, and tax forms.

For an entity to be considered a large taxpayer and be put under the control of LTO, such an entity must have an annual turnover of at least one billion shillings (Republic of Kenya, 2010). In addition, business organizations such as financial institutions, banks, and finance companies are treated as LTOs irrespective of their turnover rates. Given parastatals and government agencies are also included in the LTO category. There are over three hundred companies that are under the control of LTO, which contribute up to sixty per cent of the country's tax revenue.

An internal problem emerges because of the use of LTOs which focuses on auditing and tax payment services to high-end clients leading to a situation where tax is not collected by a relevant office or station (Muriithi & Moyi, 2003). The transfer of tax responsibility to the LTO has attracted some resistance as some stations lose a big fraction of the revenue that they collect. In principle, the transfer of tax payment to the large office should not hinder performance since branches are not judged based on the revenues that they collect.

In order to enhance transparency on the part of the large taxpayers, LTO targets to audit about thirty-three per cent of firms under its control every year (Muriithi & Moyi, 2003). Although the coverage rate among medium sized companies is lower, a target of ten per cent is deemed as appropriate.

KRA has initiated many reforms geared towards modernizing tax administration systems with the primary objective of lowering tax collection costs. The establishment of the Large Taxpayers Unit (LTU) in 2003 is indicative of such measures. The revenue collection body established the LTU in order to enhance tax compliance with a view to achieving greater control over taxpayers, to improve the auditing and increase levels of compliance of large taxpayers.

The tax system in the country is moving towards the direction of self-assessment as business firms and individuals are required to calculate their taxes before submitting their returns and payments. On the other hand, administrative assessment which requires that revenue officials calculate every taxpayer's liability using the data supplied by the taxpayer still goes on. In practice, the calculation process has a continuum between the two extremes which involve auditing. With the merger of the VAT and Income departments under the DTD, auditing activities have become harmonized. The consolidation of the two departments allows the KRA to conduct joint audits on VAT and income taxes such as PAYE which is responsibilities discharged by employers. According to (KRA, 2005), two thousand audits were carried out which raised over five billion shillings. In a bid to improve compliance, the KRA operates an audit book, and often works on educating taxpayers.

The Kenyan tax system has both the direct and indirect elements of taxation. The primary advantage is that it helps the fiscal framework to overcome economic fluctuations besides contributing to the lowering of the tax burden to a particular sector of the economy or segment of taxpayers. It is also noted that the Kenyan tax system has kept changing leading to a shift from the over reliance on indirect to direct taxes. As (Karingi et al. 2005) observed, the policy shift is aimed at reducing the burdens associated with income taxation with a view to enhancing a saving and investment culture in the country.

The Kenya Revenue Authority (KRA) has been implementing a new online platform –iTax- in order to enhance tax compliance by making it easier for tax payers to pay taxes and file returns. However the system has not proved to be user friendly and also capacity issues need to be addressed.

The other methods that KRA has employed to increase levels of tax compliance is the introduction of the Personal Identification Number (PIN) and Tax Compliance Certificate (TCC). The two facilities are critical in verifying the tax status of individuals besides allowing for the authentication of tax compliance (Kenya Revenue Authority, 2013). For some time now, the PIN has grown in stature as any individual or entity wishing to carry out business requires it to enter and close transactions. For instance, opening a bank account or completing a land or motor vehicle transaction requires one to have a PIN. Similarly, a TCC is necessary for business entities that aspire to carry out business with governmental agencies. In practice, TCC is given to organizations which have a clean tax record. The validity of a TCC lasts for a period of six months. The easing of accessibility of the two facilities is a major statement by KRA to enhance tax compliance since they are accessible online.

3.2 Taxing MSEs and Tax Returns

Based on the literature, in Kenya, MSEs operate largely within the informal sector. The (Economic Survey, 2012) shows that the sector contributes up to 77% of the total employment in the country. In 2007, the government introduced a Turnover Tax (TOT) under the Finance Act of 2007 based on the provisions of the Income Tax Act, Cap 47. The introduction of the tax was aimed at raising revenue from the informal sector. Based on the KRA, The Act which took effect in January 2008 applies to every resident whose business turnover does not exceed 5 million shillings, at the rate of three per cent of the turnover. The tax applies to trading, and professional/vocational businesses. However, the tax does not apply to individuals whose turnover is lower than five hundred thousand in a year.

It is an indirect tax based on the value of goods in question rather than being flat taxes and is applicable to a production process or stage. It is calculated on gross income without and deductions at a very low rate (KIPPRA, 2006). It will be calculated by simply applying a tax rate to a taxable turnover (McCluskey, 2005).

The turnover tax is collected by third parties and not the government itself. To demonstrate how much was collected on behalf of the government; the information is submitted at the time taxes are paid. (Parkin, 2006).

The challenges that affect the TOT adoption rate according to a study done by (KRA, 2010) are the large size of the informal sector which makes recruitment difficult, lack of training on TOT staff, inadequate attention by the tax administration towards the informal sector, mobility of the MSEs making compliance difficult and poor attitude towards government and taxation (Mwangi, Gachoka & Siagi, 2010).

In order to transact business with the Kenya Revenue Authority, persons aged eighteen years or more should possess a computer generated PIN (Kenya National Bureau of Statistics ,2012). The persons must also fill and submit self-assessment annual tax returns on various dates as specified by the body. For individuals (sole proprietors and employees), they are required to submit their returns before 30th June each year. Corporate entities such as trusts or limited liability companies, they are expected to submit their returns on, or before the end of the 6th month upon the lapse of the accounting period. For TOT taxpayers, they are required to file their returns quarterly, on, or before the twentieth day after the quarter.

3.3 Income Tax

MSEs in Kenya are subject to income and other direct taxes either as individuals receiving profits from unincorporated businesses or as corporate taxpayers. The taxation of both individuals and corporations is mainly governed by the Income Tax Act. According to the income tax laws relating to businesses in Kenya, the tax compliance requirements are:

Keeping of up to date books of accounts by businessmen, acquiring of Personal Identification Numbers (PIN) by all potential taxpayers, determining the taxable income according to the stipulated rules and regulation, accurate determination of tax liability, filing of returns on income by the prescribed date, paying of tax dues by the prescribed date, payment of fines and penalties for overdue taxes and allowing of audit by tax collectors where it is necessary.

Those who have income from salaries would be subject to higher compliance as compared to those with Income from self-employment or business (Madeo, Schepanski and Uecker, 1987). Non-compliance is significant and it varies with source of income (Fledman and Slemrod, 2005). When taxpayers who are at high income bracket are compared to those in the lower income bracket, those in the high income bracket tends to be tax non-compliant (Harwood, Larkins & Vazques, 1993). Tax non-compliance among individual taxpayers may also be affected by different levels of distribution of income. This may be due to the feeling of taxpayers that it is acceptable to under-report small amount of income (Worsham, 1996). However, other researchers (Spicer& Becker, 1980) argued that income appears to have no significant relation to tax non-compliance.

The Kenya Income Tax Act was commenced on 1st January 1974 after the dissolution of the East African Community Management Act. The Income Tax Law is contained in the Income Tax Act, Cap 470 of the Laws of Kenya and the regulations stemming from it. The Act has 13 schedules and 14 parts. Part ii of the Income Tax Act Cap 470 highlights and gives direction on the imposition of income tax. Income tax shall be charged for each year of income upon all income of a person, whether resident or non-resident, which accrued in or was derived from Kenya. According to Sec 3(1) subsection (2) the four sources of income are employment, business, rental and dividend (interest)

The collection of income tax has kept rising from the 1991/92 financial year to date. For instance, in that fiscal year, the tax collected was Kshs. 7 billion (Marina & Danijela, 2002). However, by 2009/10, the amount collected had risen to Kshs. 216 billion (Parliament Budget Office, 2010). The substantial growth has been attributed to the work done by KRA to reform tax collection and the expansion registered in the economy. The increase in taxes has enabled the government to expand its service delivery to the public.

The tax structure in Kenya is skewed towards Valued Added Taxes and income tax, since the two contribute the largest percentage to total revenue. For instance, between 2005 and 2012, income tax accounted for approximately 36.3 per cent of the total government revenue (Statistical Annexe to the Budget Speech for FY 2007/08 & 2011/12). VAT ranked in the second position as it averaged 25 per cent during the same period. Therefore, income tax is the most important tax in Kenya.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.0 Introduction

This chapter covers data presentation, analysis and findings. This research paper documents the factors influencing an individual's income tax compliance. A case of selected MSEs in Kasarani Constituency, Nairobi County. Data was collected from fifty five small and micro enterprises in Kasarani constituency.Data analysis was done quantitatively using percentages, mean and standard deviation. For ease analysis, procedure within Statistical Package for Social Sciences (SPSS) version 20 was used. The responses from closed ended questions were coded before analysis. The data was presented using tables.

Table 1 contains the demographic profile which includes the business type, position of the respondent, number of employees, ethnic composition, age, sex and marital status of the employees.

Table 2 contains the analysis of attitude of taxpayers on income tax compliance.

Table 3 contains analysis of the quality of public governance on income tax compliance.

Table 4 contains the analysis of cost of non-compliance on income tax compliance.

Table 1 Descriptive Statistics of Respondents

Business Type	**Frequency**	**Percentage**
Workshops	12	22%
Salon and hair dressing	13	23.5%
Bars and restaurants	13	23.5%
Mini-supermarkets	17	31%
Position/designation		

Owner	20	36.36%
Employee	35	63.63%
Employees		
3-6	37	67.27%
7-10	13	23.64%
11-14	2	3.64%
15	3	5.45%
Age		
Below 35	9	16.36%
36–45	8	14.55%
46–55	26	47.27%
Above 55	12	21.82%
Ethnic Composition		
Kikuyu	16	29.09%
Luo	7	12.72%
Kamba	9	16.36%
Others	23	41.81%
Sex		
Male	33	60%
Female	22	40%
Marital status		
Single	19	34.55%
Married	36	65.45 %

Source : Author (2015)

Based on table one, the type of business organisations surveyed were divided into four groups: workshops, salon and hair dressing, bars and restaurants and mini-supermarkets. Further, the table demonstrates that 22% of the organisations were workshops, 23.5% salon and hair dressing, 23.5% bars and restaurants, and 31% were mini-supermarkets. Hence, the supermarkets had the highest representation while workshops had the least representation in the sample.

The other attribute that was considered was the designation of the respondents. Based on table one, those who took part in the study were either owners or employees of the organisations. Whereas 36.36% of the participants were owners, the remaining 63.64% were employees of the organisations. Similarly, the number of employees studied was recorded. From the findings, thirty-seven out of the fifty-five (67.27%) organisations employed between three and six employees while 23.64% employed between seven and ten, 3.64% employed between eleven and fourteen and 5.45% employed fifteen employees.

The study also sought data about the ages of the respondents. As the table demonstrates, the ages of the respondents was spread between those below 35 years to those above fifty-five years. Based on the table 16.36% of the respondents were below the age of thirty-five. Similarly, the table demonstrates that 14.55% fell between the age of thirty-six and forty-five. The majority of the respondents fell between the age of forty-six and fifty-five while the remaining 21.82% were aged above fifty-five.

Owing to the nature of the study, it was also necessary to establish the ethnic composition of the study participants. From table one, the composition of ethnic groups is grouped into four categories: Kikuyu, Kamba, Luo and Others. As the table demonstrates, Kikuyu participants accounted for 29.09% of the study respondents. On the other hand, the Luo study participants accounted for 12.72% while the Kamba represented 16.36%. Finally, the other tribes accounted for the larger percentage of participants as they had 41.81% of the study participants.

The sex and marital status attributes were investigated. According to the study findings, thirty-three out of fifty five (60%) of the participants were male while 22 (40%) were female indicating male dominance in the area of micro and small Enterprises. Based on the marital status attribute, 19 out of 55 (34.55%) of the respondents were single while 36 (55.45%) turned out to be married.

4.1 Attitude of Taxpayers and Income Tax Compliance

After presenting data about the descriptive characteristics of the respondents, the focus shifts to the attitude of taxpayers and income tax compliance. Hence, the next table shows data relating to the responses given concerning attitude and income tax compliance. It should be noted that the columns contain the statements on attitude while the rows contain data for each respondent. The table however only presents data for the first thirty respondents while the remaining respondents' data is attached as appendix.

Table 2 - Attitude of Taxpayers and Income Tax Compliance

Statement no.	1	2	3	4	5	6
Respondent no.						
1	3	4	3	3	2	3
2	4	2	4	3	2	4
3	4	4	4	4	4	3
4	4	3	4	3	3	4
5	3	4	4	3	4	4
6	4	1	2	2	4	1
7	3	2	4	4	3	4
8	4	2	4	4	4	4
9	2	2	1	2	3	4
10	4	2	3	2	3	4
11	2	1	2	1	1	3
12	4	4	4	4	4	4
13	4	3	4	3	4	4
14	4	4	3	3	4	3
15	4	3	2	4	3	4
16	3	4	3	4	4	3
17	3	4	4	1	3	2
18	4	4	4	4	4	4
19	4	2	3	2	4	3
20	3	3	2	4	1	3
21	4	4	4	3	4	3

22	4	3	4	4	4	4
23	3	4	2	3	4	4
24	2	1	4	2	4	3
25	2	1	1	2	3	2
26	4	1	2	2	4	4
27	4	2	4	4	4	4
28	4	2	3	2	3	3
29	4	4	3	3	4	4
30	3	4	3	4	4	3
Mean	3.47	2.8	3.13	2.97	3.4	3.4
SD	0.73	1.16	0.97	0.96	0.89	0.77
Overall mean	3.24	0.90				

Source: Author (2015)

The following table shows a summary of the mean and standard deviation on attitudes. The values are used in the assessment of the influence attitudes have on income tax compliance.

Summary of Mean and Standard Deviation

Mean	3.47	2.8	3.13	2.97	3.4	3.4
SD	0.73	1.16	0.97	0.96	0.89	0.77
Overall mean	3.2375	0.90				

Source: Author (2015)

In assessing the attitude of taxpayers, six items were presented to the study respondents. The respondents were required to indicate the extent to which they agreed with the statements. The first item assessed was whether the respondents would not report the tax returns if paid in cash. Based on the findings, the mean is 3.47 while the standard deviation is 0.73. The mean of 3.47 when rounded off to the nearest whole number is 3. According to the key provided, 3 represents “agree” not to report that in the tax returns. Besides, the small standard deviation shows that most people are clustered around the mean hence they hold the idea that they do not have to pay taxes when paid in cash.

Under the second item, the mean is 2.8 while the standard deviation is 1.16. The mean of 2.8 rounded off to the nearest whole number becomes 3. In reference to our key, 3 imply to ‘agree’ that omission or understatement of taxable income is not wrong. The standard deviation being 1.16, the indication is that people have varied attitudes on the issue although a big percentage perceives omission or understating as not being a wrong. However, it is noted that the high value of the standard deviation implies that a sizable proportion of respondents agree that understating income is wrong.

The next item also borders on stating of income. The item on whether it was obvious for law-abiding citizens to understate their income occasionally was put before the respondents. Based on the results, the mean of 3.13 and standard deviation of 0.97 affirms the view that the respondents felt it was in order for law-abiding citizens to understate their income on occasions. However, the high value of the standard deviation indicates that the issue was divisive as a sizable number of respondents either disagreed or were uncertain. Nevertheless, the high value of the mean confirms that the attitude about payment of taxes and obedience to the law is conflicting. The position is held in regard to the view that law-abiding citizens should always honour their tax responsibilities.

It is noted that one of the attributes useful in assessing taxpayers’ attitudes is their perception on the negative effect by failing to honour their tax obligations. Based on the study results, the mean is 2.97 while the standard deviation is 0.96. The mean of 2.97 and standard deviation of 0.96 shows that the respondents held that it was not wrong to avoid paying income tax since such an action did not hurt anybody. Nonetheless, the high value of the standard deviation shows that the issue was conflict-ridden as a considerable number of respondents either disagreed or were uncertain regarding the issue.

The issue of governance also stretches to the attitude of taxpayers on how the government spends their taxes. Thus, respondents were required to respond on the attribute. Based on the study results, the mean is 3.4 while the standard deviation is 0.89. The implication of the findings is that respondents agreed that since the government uses taxes extravagantly, then it was not wrong to understate their taxable income. The standard deviation of 0.89 shows a substantial deviation from the mean although the non-compliance attitude based on perceived government extravagance remains immense.

The last aspect considered under the attitudes of taxpayers bordered on fellow businessmen's attitude towards income tax payment. In line with this, respondents were required to exhibit their attitudes on paying taxes in regard to their compatriots' income tax payment behaviour. From the results, the mean is 3.4 while the standard deviation is 0.77. The findings demonstrate that businessmen were more inclined towards failing to pay their rightful income tax, if their counterparts did not also pay their correct taxes. Besides, the relatively small standard deviation shows that most people are clustered around the mean hence they hold the idea that they do not have to pay taxes when other businessmen are not paying accordingly.

Based on the overall results, the average score is 3.24 while the standard deviation is 0.90. It means that the attitude of the respondents is not supportive of a compliance culture. However, a standard deviation of 0.90 indicates a presence of considerable discrepancy in the way people perceive their obligations to remit their taxes as required by the law.

In establishing the statistical significance of the results, the t-test is applied. Reference is made to the t-table to find the alpha and t values before a determination is made.

Calculation of t

Below is the formula for calculating the t statistic.

$$t = \frac{\overline{x} - \mu_0}{s/\sqrt{n}}$$

$\overline{x}$ is sample mean

s is sample standard deviation

n is sample size

mean- 3.24

SD- 0.90

n- 55

μ_0- 0.02

(3.24-0.02)/(0.90/7.4) =

3.22/0.12=26.6777

Result

t-value	26.6777
degrees of freedom	54
two-tailed p-value	< 0.0001

95% confidence intervals

Upper	3.4808
Lower	2.9942

The calculated t value is greater than the critical t, implying that the null hypothesis is not accepted. The position is held since the t value falls outside the acceptance region (between 2.99 and 3.48). The hypotheses under taxpayers' attitudes were:

H0: There is no relationship between taxpayers' attitudes and income tax compliance.

H1: There is a relationship between taxpayers' attitudes and income tax compliance.

Thus, the study finds that a relationship exists between the taxpayers' attitudes and income tax compliance.

4.2 Quality of Public Governance and Income Tax Compliance

After reviewing the case of attitudes and income tax compliance, attention shifts to the quality of public governance and income tax compliance. The next table presents data on the responses of study participants on the issue of governance and income tax compliance. It should be noted that the columns contain the statements on public governance while the rows contain data for each respondent. The table however only presents data for the first thirty respondents while the remaining respondents' data is attached as appendix.

Table 4 - Public Governance and Income Tax Compliance

Statement	1	2	3	4	5
Respondent					
1	2	1	3	2	1
2	3	2	1	3	2
3	2	2	3	3	2
4	2	3	2	2	3
5	3	4	4	3	1
6	1	1	2	2	2
7	3	2	3	3	1
8	4	2	4	2	1
9	2	2	3	2	2
10	1	2	3	2	2
11	2	1	2	1	1
12	2	4	2	3	3
13	2	3	1	3	3
14	2	2	1	3	2
15	1	1	4	2	1
16	0	1	2	1	2
17	3	4	1	1	3
18	2	2	2	4	1
19	4	1	3	2	2
20	3	2	3	1	1
21	1	2	3	2	2

22	2	3	2	2	1
23	2	4	1	3	2
24	3	1	1	1	2
25	4	1	4	2	4
26	1	1	2	1	1
27	2	2	1	1	2
28	2	2	2	2	2
29	2	4	2	2	3
30	2	4	2	1	1
Mean	2	2.04	2.51	2.05	1.64
SD	0.97	0.94	0.88	0.78	0.87
Overall mean n SD	2.15	0.88			

Source : Author (2015)

Under the issue of the quality of public governance and income tax compliance, one of the statements put before the respondents bordered on their understanding of tax rates and requirements. Based on the results, the mean value is 2 which tallies with the response, uncertain. The implication is that the understanding of tax laws is unclear among the study participants. However, a standard deviation of 0.97 indicates that the participants are scattered relatively away from the mean implying that there is a reasonable percentage of respondents who understand the tax requirements while a similar percentage does not understand.

The second attribute considered under the quality of public governance is the perceived level of justice on the tax system. The mean of 2.04 and standard deviation of 0.94 demonstrate mixed results. Overall, the mean shows that tax payers are divided on whether the tax system is just or not. However, as argued above, a standard deviation of 0.94 is indicative that there are those who perceive the tax system as just while others do not.

The influence that neighbouring taxpayers have no compliance was also tested. Respondents were required to indicate their views on how neighbours complied with tax requirements. From the results, the mean of 2.51 indicates that the respondents believed their neighbours were paying their taxes. However, the standard deviation of 0.88 shows that a substantial proportion still doubted the extent to which their neighbours were complying with their tax obligations.

When the issue of remitting taxes to avoid penalties was put before the respondents, their responses averaged 2.55 while the standard deviation was 0.94. The implication is that over fifty per cent of the respondents paid their taxes because they were avoiding being fined. The high value of the standard deviation confirms a considerable variation in their behaviour.

In a bid to understand whether respondents paid taxes because there was a possibility of being detected, respondents were required to rate the statement concerning detection on non-compliance. The mean of 2.23 and standard deviation of 0.81 demonstrate mixed results. Overall, the mean shows that taxpayers were divided on whether the tax system could detect non-compliance or not.

Respondents were also expected to rate their tax compliance based on its obligatory nature. As the results show, the respondents indicated uncertainty on whether they paid taxes because such was an obligation since the mean is 2.05. The standard deviation of 0.78 is significant as it indicates considerable dispersion from the mean.

Finally, the influence of government commitment to the fight against corruption was considered. Based on the results, the mean of 1.64 indicates that taxpayers did not agree with the statement as a basis for their tax compliance.

The overall mean of 2.15 shows that the quality of public governance does not support the culture of compliance among taxpayers. However, a standard deviation of 0.88 indicates a considerable dispersion in the way people perceive their obligations to remit their taxes as required by the law.

t calculation

Mean- 2.15

SD- 0.88

n- 55

μ_0- 0.02

(2.15-0.02)/ (0.88/7.4)

2.13/0.12 = 17.5

Result

t-value	17.5
degrees of freedom	54
two-tailed p-value	< 0.0001
95% confidence intervals	
Upper	2.3879
Lower	1.9121

The calculated t value (15.79) is greater than the critical t (1.9 – 2.3), implying that the null hypothesis, which is H0: There is no relationship between the quality of governance and taxpayers' income tax compliance is not accepted. Instead, the alternative hypothesis which is, H1: There is a relationship between the quality of governance and taxpayers' income tax compliance, is not rejected. Thus, the study finds that a relationship exists between the quality of public governance and income tax compliance.

4.3 Cost of Tax Non-Compliance and Income Tax Compliance

After reviewing the case of quality of public governance and income tax compliance, attention shifts to the cost of non-compliance and income tax compliance. The next table presents data on the responses of study participants on the issue of cost of non-compliance and income tax compliance. The columns contain the statements on cost of non-compliance while the rows contain data for each respondent. The table however only presents data for the first twenty respondents while the remaining respondents' data is attached as appendix.

Responses on Cost of non-Compliance

Statement	1	2	3	4
Respondent				
1	4	4	4	2
2	1	4	3	2
3	4	4	2	3
4	4	2	4	2
5	4	3	4	3
6	4	3	2	3
7	3	3	3	3
8	4	3	4	3
9	3	4	1	2
10	3	4	3	3
11	1	2	3	2
12	4	4	4	1
13	4	4	2	1
14	4	4	3	3
15	4	2	2	2
16	3	2	3	2
17	2	4	2	1
18	4	4	2	2
19	3	4	3	4

20	3	4	2	3
Mean	3.33	3.4	2.55	2.23
SD	0.88	0.81	0.94	0.81
Average mean	2.88			
Average SD	0.86			

Source: Author (2015)

Under the attribute of the cost of non-compliance and tax compliance, the first item assessed how the possibility of being audited influenced their decisions on compliance. Particularly, the statement alluded that when the possibility of being audited was too low, then the probability of their compliance would decline. Based on the results, the mean value is 3.33 which matches with the response, agree. The implication is that the whenever the possibility of being audited is low, the respondent taxpayers were likely to understate their taxable income. However, a standard deviation of 0.86 indicates that the participants are dispersed relatively away from the mean implying that some of the respondents would not understate their income even when the chances of being audited were low.

The level of taxation was also viewed as a contributing factor to the willingness of taxpayers to comply with their tax obligations. As a result, respondents were asked to indicate whether, the high rates made them feel it was not cheating when remitting less tax. Based on the results, the mean score is 3.4 while the standard deviation is 0.81. The implication is that the tax payers were more likely to default on their tax obligations because they felt that the rates were high. However, the high value of the standard deviation also demonstrates that a wide variation exists among the taxpayers.

When the issue of remitting taxes to avoid penalties was put before the respondents, their responses averaged 2.55 while the standard deviation was 0.94. The implication is that over fifty per cent of the respondents paid their taxes because they were avoiding being fined. The high value of the standard deviation confirms a considerable variation in their behaviour.

The final element that was interrogated on the issue of the cost of non-compliance was the possibility of detection. Under the attribute, respondents were required to rate whether they would pay taxes because the possibility of detection was high. Based on the results, the mean value is 2.23 while the standard deviation is 0.81.When 2.23 is rounded to the nearest whole number it becomes 2.In the rating scale, 2 represents uncertain and therefore implying that the respondents are uncertain with the statement. However the high value of the standard deviation demonstrates high levels of deviations among the respondents.

Understanding the overall implication of the cost of tax non-compliance requires a calculation of the mean values of the various statements that were under investigation. Overall, the cost of non-compliance variable is rated at 2.88 based on the mean and 0.86 based on the standard deviation. Rounded off to the nearest ones, the value of 2.88 is 3. Based on the rating scale used, 3 signal agreement. The first attribute shows a statement in support of the low probability of auditing, the second shows that taxes are high, the third demonstrates that taxes are remitted to avoid fines and lastly the fourth focuses on the possibility of detection. Based on the framing of the statements, it is concluded that taxpayers pay their taxes because of the high cost attached to non-compliance. The high value of the standard deviation however shows that the respondents had widely varied views on the issue.

Calculating t

$$t = \frac{\overline{x} - \mu_0}{s/\sqrt{n}}$$

Sample – 55

Alpha 0.05

Mean- 2.88

SD- 0.86

n- 55

μ_0- 0.05

(2.88-0.05)/ (0.86/7.4)

2.83/0.12 = 23.59

Result

t-value = 23.59

Degrees of freedom – 54

Two-tailed p-value <0.0001

95% confidence intervals

Upper - 2.39

Lower – 1.91

The calculated t value

The calculated t value (= 23.59) is greater than the critical t (1.9 – 2.3). The implication is that the null hypothesis, which is H0: There is no relationship between the cost of non-compliance and taxpayers' income tax compliance is not accepted. As an alternative, the alternative hypothesis which is, H1: There is a relationship between the cost of non-compliance and taxpayers' income tax compliance, is not rejected. Thus, the study finds that a relationship exists between the cost of non-compliance and taxpayers' income tax compliance.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter entails the summary of the findings, conclusion of the study, recommendations are made to the Kenya Revenue Authority and implication for future research. Thus, it tracks the paper from the introduction to the study findings.

5.1 A Summary of Findings and Conclusion

As indicated in the paper, the current study sought to assess factors that influence income tax compliance. It was also established that despite adopting a number of measures, tax compliance has remained a controversial issue since a number of taxpayers seem reluctant to comply with their tax obligations.

Based on the introduction to the study, tax compliance has various meanings. As McBarnett (2003) observed, three forms of compliance (committed compliance, creative compliance and capitulative) exist. Committed compliance captures the free will to discharge tax obligations by a taxpayer. However, creative compliance refers acts by a taxpayer to reduce taxes by altering income and deductible expenditure without breaking the provisions of the law. In contrast, capitulative compliance demonstrates the observance of tax obligations to avoid penalties.

As Moyi and Muriithi, (2003) found, in Kenya, the tax burden has continued to rise leading to a considerable number of citizens seeming unhappy about such developments. Thus, it is not surprising that the taxpaying culture in Kenya remains discouraging. For instance, individuals who wield political and economic power refuse to cooperate on tax matters, as they do not approve of taxation activities. On the other hand, the vast majority of Kenyans lack both the political and the economic power. The latter category of citizens feel the tax burden more leading to an unwillingness to remit their taxes as indicated by (Lumumba, Wanjohi, Magutu and Mokoro, 2010).

Resentment on the part of taxpayers shows that, taxpayers would not remit their taxes were the conditions facilitative. Thus, understanding the behaviour of taxpayers regarding the factors that influence taxpayers' compliance decisions was deemed a basic step towards understanding the controversy. For that reason, the study sought to understand the factors that influence income tax compliance. It is also noted that despite a presence of many studies on income tax compliance, the Kenyan scene has a limited number of such studies. Of the studies, the most notable ones were done by(Lumumba et *al.*, 2010 and Simiyu, 2003). Hence, it became necessary to delve into the topic.

Upon the introduction, the study focused on reviewing relevant literature on the topic. Under the first issue, taxation in Kenya was considered. Reference to (KRA, 2013) and (CIAT, 2006) demonstrates the significance of taxation and the need to improve tax compliance. It emerged that integrity and fairness (which are attributes of quality of governance) are major factors that influence tax compliance. Having realised low compliance levels, the KRA has initiated different measures such as the Personal Identification Number (PIN) and Tax Compliance Certificate (TCC). Rolling various services onto an online platform is also testament of the efforts to improve tax compliance.

The issue of quality of public governance was found to be a contributing factor to the levels of tax compliance. For instance, (Besancon, 2003; Everest-Phillip and Sandall, 2009; Levi 1988 and Lassen, 2003) are some of the researchers who found that the quality of governance was a factor in tax compliance among taxpayers. In particular, the researchers found that taxpayers based their willingness to pay their taxes on the services delivered by authorities. According to (Alm, McClelland & Schulze, 1992) and (Lassen, 2003) the extension of services as expected by taxpayers improved compliance while a deviation from expectations attracted non-compliance.

The study was grounded on theories drawn from psychology and economics. It emerged that, psychology theories on tax compliance show that ethical and moral reasons are instrumental on influencing compliance. Hence, under the psychological theories, taxpayers would pay their taxes even in the absence of fines or punishment. However, economic theories do not perceive tax compliance as based on morality or ethics. Based on economic theory, taxpayers are rational individuals who base their decisions on economic outcomes. Thus, taxpayers assess the advantages and disadvantages of tax compliance before complying or not. In this regard, a taxpayer might avoid paying taxes in instances that they feel that they can do so undetected.

The current study employed a cross-sectional research design which is based on the selection of study subjects relying on existing or prevailing differences. In collecting the data, the purposive approach was employed. Since the study focused on the factors influencing income tax compliance within the context of micro and small enterprises, the population for the study was MSE owners. The area of study is Kasarani constituency of Nairobi. For that reason, MSE leaders in Kasarani constituency formed the study population. Data collection involved the administration of questionnaires to business leaders or owners. The collected data was presented using tables.

Attitudes, quality of governance and cost of non-compliance are all important factors in income tax compliance. They affect income tax compliance both positively and negatively. The area of study for this research was Kasarani Constituency. This is one constituency in Nairobi County. The data collected from this constituency may not be an exact representation of the other constituencies. That notwithstanding, the findings of the study are presented.

The average data on the attitude of taxpayers was analysed leading to the finding that the taxpayers' attitudes were not supportive of a taxpaying culture since the mean was 3.24. However, the standard deviation of 0.89 indicated that a considerable proportion of respondents held a taxpaying attitude. The hypothesis test that, taxpayers attitude influenced income tax compliance resulted in the finding that there was a relationship between taxpayers' attitude and income tax compliance.

The results of the current study confirm the literature findings that there is a relationship between the quality of public governance and tax compliance. The position is held in reference to the realisation that the overall mean of 2.15 showed that the quality of public governance did not support the culture of compliance among taxpayers. However, a standard deviation of 0.88 indicated a considerable dispersion in the way people perceive their obligations.

As stated by Hypothesis 3 that the cost of non-compliance has a significant effect on income tax compliance, research findings show consistency with the hypothesis hence, the cost of non-compliance relates to tax compliance level. High non-compliance costs have been found to diminish the competitiveness of the country in terms of taxation attractiveness thus tax authorities are interested in making the tax legislations simpler in order to avoid this situation.

The current study centres on the three hypotheses that the qualities of governance, taxpayer attitudes and cost of non-compliance influence income tax compliance. Based on the study findings, the hypothesis that, there is a relationship between taxpayers' attitude and income tax compliance was considered. Based on the study findings, a relationship exists between the taxpayers' attitude and income tax compliance. The findings support the position that attitudes are a major factor in the issue of tax compliance.

Secondly, the hypothesis that a relationship exists between the quality of governance and taxpayers' compliance to income tax requirements, is not rejected. Thus, the study concludes that a relationship exists between the quality of public governance and income tax compliance. The findings are in line with the literature which affirms the same position. Similarly, the findings support what seems to happen in practice, since taxpayers are keen on what governments do concerning the use of taxes in the extension of public services. Whenever, taxpayers feel that the government is not doing enough, there is a tendency not to comply and vice versa.

Thirdly, the hypothesis that there is a relationship between the cost of non-compliance and income tax compliance was also considered. Based on the study findings, there is a relationship between cost of non-compliance and income tax compliance.

In light of the above findings, the government and KRA need to examine the issue of governance and taxpayers' attitudes with a view to ensuring that service delivery is excellent besides focusing on improving the image of taxation in order to promote positive attitudes among the taxpayers.

5.2 Recommendations

Due to the existence of a sizeable underground economy, the Kenya Revenue Authority (KRA) has room to expand the tax base and increase revenue collection. Even though the turnover tax regime was geared towards netting in the informal sector, there are some implementation and capacity constraints bedevilling the KRA. The Authority has been forced to rationalise staff by putting more effort in areas where it can maximize revenue due to the high cost of collection. There is need to segregate these category of taxpayers and give them necessary attention instead of lumping the Turnover Tax regime amongst the general Domestic Revenue.

Due to the complexity of the sector KRA needs to consider "One stop shop where the small and micro entities pay their fair share of taxes at the point of licensing. An example will be to harmonize the registration system of the Nairobi City Council (NCC) and KRA database.
This will ensure they take their fair share of fiscal responsibility and formalize the underground activities. To allow for further analysis of the characteristic of the underground economy, there is also need to improve data capture and have a reliable data base (Ouma, 2007) .

The bookkeeping among the micro and small enterprises should be improved by offering incentives for example applying for a lower presumptive tax rate for small businesses meeting certain record keeping standards. The small holders should also be engaged in sensitization forums by the government.

To demonstrate to people that non-compliance can be detected and is punishable, the government should enhance voluntary compliance by establishing a strong enforcement presence. The capacity of the informal sector will be enhanced by offering facilities like business counselling, training, and reducing the cost of registration. This will spur growth in the sector hence driving economic growth and revenue.

To educate the small traders on the importance of adopting the turnover tax through channels like seminars, door to door, mobile tax clinics to be enforced in a thorough manner, KRA should make more frequent friendly visits'

The tax system should provide clear and simple guidelines on how to file tax returns and also enhance taxpayer education services to enable the taxpayers understand their rights and obligations as taxpayers.

5.3 Implications for Future Research

The study has focused on a complex subject by interrogating quality of public governance, attitudes and cost of compliance as factors influencing income tax compliance focusing on selected MSEs from the Kasarani constituency. The study demonstrates that the quality of public governance, attitudes and economic factors influence tax compliance.

The study was confined within a single constituency. Thus, it may not be reflective of the entire Kenyan system. Consequently, future researchers should consider carrying out studies spread out geographically in order to enhance the issue of representativeness.

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APPENDIX 1

(QUESTIONNAIRE PART 1)

My name is Phelister Machogu, LLM student at the University of Nairobi. I am conducting a study on the determinants of income tax compliance amongst small and micro enterprise (MSEs) for my project paper. I kindly request you to be as honest as possible to help me collect data. The information you give will be kept confidential. The questionnaire forms shall not have anybody's name.

a) *Preliminary questions*

1. What is the name of your business organisation?

2. What is your position/designation?

Owner

Employee

3. How many employees does your business organisation have?

Please go through the following prompts and mark a description that fits your profile

4. Age (years)

Below 35

36–45

46–55

Above 55

5. Ethnic Composition

Kikuyu

Luo

Kamba

In case of other, please specify

6. Gender

Male

Female

7. Marital status

Single

Married

PART 2 Questionnaires on Attitude of Taxpayers

Under the section, please indicate the extent to which you agree or disagree with the statements.

The rating is based on a scale: Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

1. If paid in cash, then I will not report that in the tax returns

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

2. Omitting or understating my taxable income is not wrong

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

3. It is obvious for law-abiding citizens to occasionally understate their income

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

4. It is not wrong to understate income since it does not really hurt anyone

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

5. It is not wrong to declare less taxable income because the government uses taxpayers money extravagantly

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

6. Since several businessmen do not pay income taxes at all, there is no big issue if I understate my income

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

PART 3

Questionnaire on Quality of Public Governance and Income Tax Compliance

1. I easily understand tax laws for example on rates of tax, filing and payment dates etc.

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

2. I feel that the tax system is just hence I pay my fair share of tax

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

3. I believe that my neighbours are reporting and paying taxes honestly

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

4. I pay taxes because I feel that tax is an obligation

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

5. I remit my taxes because the government portrays a positive image i.e. government is fighting corruption and is achieving tax objectives

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

PART 4 **Questionnaire on Cost of non-compliance and income tax compliance**

1. The possibility of being audited is so low such that it is sensible to make a slight understatement on my taxable income.

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

2. Income tax rates are too high, such that it is not really cheating when I look for ways to pay less than I am supposed to.

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

3. I remit my taxes to avoid paying fines and penalties.

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

4. I pay taxes because there is a high possibility of being detected for non-compliance.

Strongly disagree = (0); Disagree = (1); Uncertain (2); Agree = (3); Strongly Agree = (4).

Thank you for your participation.

Appendix 2

Table 2 - Attitude of Taxpayers and Income Tax Compliance

Statement	1	2	3	4	5	6
Respondent						
31	4	2	4	3	2	4
32	4	4	4	4	4	3
33	4	3	4	3	3	4
34	2	2	1	2	3	4
35	4	2	3	2	3	4
36	2	1	2	1	1	3
37	4	4	4	4	4	4
38	4	3	4	3	4	4
39	3	3	2	4	1	3
40	4	4	4	3	4	3
41	4	3	4	4	4	4
42	3	4	2	3	4	4
43	3	4	4	1	3	2
44	4	4	4	4	4	4
45	4	2	3	2	4	3
46	3	3	2	4	1	3
47	4	4	4	3	4	3
48	4	3	4	4	4	4
49	4	3	4	3	4	4

50	4	4	3	3	4	3
51	4	3	2	4	3	4
52	3	4	3	4	4	3
53	3	4	4	1	3	2
54	4	4	4	4	4	4
55	4	2	3	2	4	3
Mean	3.47	2.8	3.13	2.97	3.4	3.4
SD	0.73	1.16	0.97	0.96	0.89	0.77
Overall mean	3.24	0.90				

Source: Author (2015)

Table 3 - Public Governance and Income Tax Compliance

Statement	1	2	3	4	5
Respondent					
31	1	2	1	3	2
32	2	2	2	3	1
33	3	3	2	2	0
34	2	2	3	1	0
35	3	2	3	2	3
36	2	1	1	3	1
37	2	2	2	1	1
38	1	3	2	2	2
39	2	2	3	1	1
40	0	1	3	1	2
41	2	1	2	2	1
42	2	2	1	3	1
43	3	1	2	1	3
44	0	2	2	2	1
45	2	1	3	2	1
46	3	1	3	2	2
47	1	2	3	3	1
48	2	1	2	2	2
49	2	1	1	3	1
50	1	2	1	3	1
51	3	2	2	2	3

52	3	3	1	2	1
53	3	2	2	1	0
54	0	3	4	2	1
55	1	2	3	2	2
Mean	2	2.04	2.51	2.05	1.64
SD	0.97	0.94	0.88	0.78	0.87
Overall mean n SD	2.15	0.88			

Source: Author (2015)

TABLE 4 Costs of Non-Compliance and Income Tax Compliance

Statement	1	2	3	4
Respondent				
21	3	4	3	4
22	4	2	1	2
23	4	4	3	2
24	3	4	2	1
25	2	4	4	1
26	4	3	2	4
27	4	3	3	2
28	3	4	4	1
29	4	4	3	2
30	3	2	3	2
31	1	4	2	2
32	4	4	1	1
33	4	2	3	2
34	3	4	0	2
35	3	4	1	4
36	1	2	3	1
37	4	4	2	2
38	4	4	2	2
39	3	4	3	3
40	3	4	3	1
41	4	2	3	2

42	4	4	1	1
43	2	4	3	1
44	4	4	2	2
45	3	4	2	2
46	3	4	2	1
47	3	4	3	3
48	4	2	2	3
49	4	4	3	2
50	4	4	3	1
51	4	2	2	1
52	3	2	1	2
53	2	4	3	2
54	4	4	2	3
55	3	4	4	1
Mean	3.33	3.4	2.55	2.23
SD	0.88	0.81	0.94	0.81
Average mean	2.88			
Average SD	0.86			

Source: Author (2015)