

**FACTORS INFLUENCING VALUE ADDED TAX COMPLIANCE
AMONG THE CONSTRUCTION FIRMS IN KISUMU COUNTY, KENYA**

BY

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DECLARATION

This is my original work and has not been presented for award of a degree in any other university or any other institution of higher learning for examination.

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

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DEDICATION

I dedicate this project to my parents, Mr. King'oina Mokua and Mrs. Alice King'oina for their love and sacrifices they made in educating me. To my wife Nyamokami and children Moguche, Angel and Jeremy for their emotional & moral support and understanding during my period of study out of the busy working schedule and demanding family roles.

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ABBREVIATIONS AND ACRONYMS

GDP	: GROSS DOMESTIC PRODUCT
KeNHA	: KENYA NATIONAL HIGHWAYS AUTHORITY
KERRA	: KENYA RURAL ROADS AUTHORITY
KIPPRA	: KENYA INSTITUTE OF PUBLIC POLICY RESEARCH AND ANALYSIS
KNBS	: KENYA NATIONAL BUREAU OF STATISTICS
KRA	: KENYA REVENUE AUTHORITY
KURA	: KENYA URBAN ROADS AUTHORITY
NCA	: NATIONAL CONSTRUCTION AUTHORITY
OECD	: ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT
VAT	: VALUE ADDED TAX

ABSTRACT

Tax is an important stream of revenue for the government's development projects and therefore all efforts must be made by governments to ensure that it is accurately and efficiently collected. The main issue faced by all tax authorities is that it has never been easy to persuade all taxpayers to comply with the regulations of a tax system. Tax compliance is the degree to which the taxpaying community meets the tax obligations set out in the appropriate legal and regulatory provisions, (Maxwell, 2003).

The construction industry contributes approximately 4.2% to the Gross Domestic Product. The main objective of the study is to establish factors influencing Value Added Tax compliance among the construction firms in Kisumu County. The researcher employed a descriptive design to collect a large quantity of information about the population being studied. Descriptive approach was integrated with survey design in collecting comprehensive qualitative and quantitative data that enriched the outcome of the study. The study targeted all registered construction firms within Kisumu County. The researcher collected primary data from the sampled construction firms using self administered questionnaires. Data collected was analyzed using Statistical Package for Social Sciences and the study findings presented in the form of tables.

All the established factors have a significant influence on the Value Added Tax compliance among the construction firms. The findings revealed that tax understanding and knowledge has a significant effect on tax compliance. Better understanding of VAT laws encourages voluntary compliance. Reduced tax compliance cost is associated with high levels of tax compliance. The study findings reveal that effective imposition of fines and penalties play a vital role in improving tax compliance. The findings of the study show that taxpayer perception and attitudes has a significant effect on tax compliance. It is therefore prudent for KRA to enhance their taxpayer education activities to enable businesses have better understanding of various factors affecting tax compliance. These study findings will help KRA and the government develop interventions that will encourage voluntary tax compliance that will lead to increased revenue collection to enable the government provide goods and services to its citizens.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

In developing countries, taxation is an important element in the management of the national economy (Lyme and Oats, 2009). The purpose of taxation in Kenya is to finance government planned activities. Article 209 of the constitution of Kenya 2010 grants powers to impose taxes as revenue source by both the national and the county governments. However mobilizing sufficient tax revenue is a major challenge due to narrow tax base and cases of non-compliance among taxpayers. Tax noncompliance is a major challenge confronting tax administrations (Chau & Leung, 2009; Terkper, 2003)

There are a number of tax compliance theories that have been developed by various scholars. The economic deterrence theory is a theory under criminology that views a taxpayer as a perfectly moral, risk-neutral or risk-averse individual who seek to derive maximum satisfaction whenever the expected gain exceed the cost (Becker, 1968). The fiscal and social psychology theory proposes that taxpayers are more willing to pay taxes if they have a positive attitude towards the payment of taxes (Schmolders, 1960). The theory has been build on by various scholars overtime. The taxpayers' willingness to comply with tax authorities relates to the individuals' attitudes and perception of the tax system (Strumpel, 1966). Psychology theories examines taxpayers' attitudes and beliefs so as to understand and predict their behavior and factors affecting their tax compliance. Social psychology theories inductively examine the attitudes and beliefs of taxpayers in order to understand & predict human behaviour and factors that affect taxpayers' compliance attitudes. The ability to pay theory proposes that citizens to

contribute to the support of the government as nearly as possible, in proportion to their respective abilities in terms of revenue (Mill, 1848).

The construction sector, basically deals with goods and services that attract Value Added Tax at a rate of 16% hence most of them are eligible for VAT registration. Construction firms face numerous challenges in complying with the VAT laws. Some of the most notable challenges include; lack of proper purchase invoices for VAT in put claims, delayed payment receipts for timely VAT payments, irregular business transactions, shortage of skilled manpower and record keeping, return submission and paying VAT that requires honesty and greater degree of accuracy.

1.1.1. The Concept of Value Added Tax

Value Added Tax is a tax on the value added to the supply by the last seller, (Radhakrishanan, 2008).VAT was introduced in Kenya in 1990 as a means of increasing the government tax collections by widening the tax base.VAT is imposed by Kenya revenue Authority (KRA) as per the laws of the Value Added Tax Act 2013.The Value Added Tax is an indirect tax on consumption applicable on the sale of supplies at all levels of production and distribution.VAT registered taxpayers acts as agents in collecting and remitting collected VAT to the government. The VAT paid on inputs in turn is claimed as credit when registered taxpayers declare output VAT on their sales (VAT Act 2013 Sec 17). Suppliers of exempt goods & services (VAT Act 2013, first schedule) do not charge VAT on their supplies and cannot claim credit for VAT paid on their purchases. The VAT system also contains zero rated goods and services (VAT Act 2013, 2nd schedule). Businesses charge

VAT at a rate of 0% on their supplies and are allowed to deduct the input tax paid on the purchase of those zero rated goods and services (VAT Act 2013 Sec 17).

The government formulates policy and VAT laws, KRA oversees implementation of the laws, professionals offer services to ensure tax compliance, businesses act as agents in collecting VAT & remitting it to the government and the general public is concerned about the VAT rate which influences their spending and how the government is utilizing the VAT revenue collected. VAT contributes about 23% of the total tax revenue collection by the government (KNBS 2014).

Table 1.1: Proportion of Value Added Tax (Kshs.Millions)

Tax head/Year	2010	2011	2012	2013
VAT	171.9	176.4	198.4	236.5
Total collection	704.7	771.8	882.6	1,092.0
VAT as % of total collection	24.4%	22.9%	22.5%	21.2%

Source: KNBS 2014

1.1.2. Tax Compliance

Tax compliance is the extent to which the taxpaying community fulfils their duties and obligations as per the tax legal provisions (Maxwell, 2003). Tax compliance involves proper computation of taxes and payment as per the tax laws. Mohd *et al* (2011) defines Tax compliance is the fulfillment of tax laws, declaration of the correct income & expenses and the payment of taxes on time. From the above definitions, it can be concluded that tax compliance means complying with the tax laws, accurate declaration of income & expenses and timely settlement of tax liabilities.

Tax compliance is measured in four ways that is registration, filing, computation and payment compliance. Registration compliance relates to the portion registered taxpayers with the appropriate tax obligation. Filing compliance relates to the proportion of tax returns filed on time. Computation compliance measures the percent of the correct tax liability that is correctly computed and reported. Tax payment compliance measures the portion of the computed tax liability that is paid within the timelines of tax laws. Taxpayer facilitation involves the provision of taxpayer services giving proper guidelines, instructions, and simplified ways of filing tax returns, educating taxpayers on their rights, duties and obligations. Another definition of tax compliance is the voluntary & timely registration with the relevant tax obligation(s), submission of accurate tax returns, voluntary & timely settlement of tax and keeping accurate records as required by law.

Tax revenue plays a significant role in the economic growth of the country. Tax evasion and tax avoidance hampers revenue collection which leads to inefficiency in government operations. Tax evasion refers to the illegitimate intentional actions by taxpayers taken in order to reduce their tax liability.(Alm, 2012). Tax evasion is achieved through criminal acts of omission e.g. failure to register for VAT and acts of commission e.g. under declaration of sales, overstating expenses, claiming of personal expenses as if they are business expenses and misclassifying supplies to lower rates of tax. Also a taxpayer can reduce his VAT liability by abusing the credit and refund mechanism. Tax reduction is the legal reduction of tax liabilities by employing tactics like splitting income and postponing payment of taxes (Martinez, 2001).Tax avoidance makes full advantage of loopholes in the taxation. Even though tax avoidance is anti social and not patriotic, it remains legal unless laws are put in place to prohibit it.

1.1.3. Factors Influencing VAT Compliance

The aspect of tax understanding (knowledge of the tax system, awareness of tax obligation & availability of information) in relation to tax compliance is the understanding about tax laws and opportunity available for tax evasion. (Kasipillai, 2003). Being a key determinant in tax compliance, knowledge has a very close relationship with taxpayers' ability to understand the laws and regulations of taxation, and their ability to comply (Singh, 2003). Tax compliance costs (employee resources, professional fees & computer systems, training and time spent) are expenses incurred by taxpayers in the process of fulfilling taxation laws. (Sandford, 1989). Another factor that influences tax compliance is fine and penalty. A fine as a punishment or penalty imposed on an individual for any violation of law, (Radhakrishanan, 2008). In circumstances where a taxpayer fail to; register for the tax obligation, submit a tax return, settle the tax liability and keep proper records will be penalized. Effective application of fines and penalties can minimize cases of tax non compliance.

The taxpayer's perception of how the tax system is fair has an influence on the attitude of the taxpayer on the payment of taxes (Coskun, 2009; Alm, et al, 2011). For a taxpayer whose motive is to demonstrate his belief in a system, will evaluate the tax system with objectivity but if a taxpayer's attitude is motivated by the derived benefits then, he will regard the tax system as fair if he benefits from it. If tax collections are not properly utilized and accounted for by the government, then there will be lack taxpayers commitments to the payments of taxes. (Young et al, 2013).

Tax non compliance refers to the failure by taxpayers in fulfilling taxation laws i.e. not reporting the correct income, claiming incorrect expenses, tax relief and underpayment of taxes (Mohd *et al*, 2011). The tax gap can be used to measure the degree of non compliances in regard to reporting and payment. The difference between actual revenue collections and the expected revenue collection in case of 100% compliance is what is called the “Tax Gap” (James, 1999).

1.1.4 Construction Industry in Kenya

The construction industry approximately contributes 4.2% in the Gross Domestic product (GDP)

Table 1.2 The Construction Industry’s share of the GDP (Kshs. Millions)

Industry	2010	2011	2012	2013
Construction	109,232	125,132	142,261	166,906
Gross Domestic Product	2,570,334	3,047,392	3,403,534	3,797,988
% Contribution	4.2%	4.1%	4.2%	4.4%

Source: KNBS records

The construction industry exhibits a positive growth following the construction of roads, development of the real estate sector and other infrastructural developments being undertaken by the national and county governments as well by private developers. Construction firms like other registered taxpayers are by law required to comply with taxation laws. The National Construction Authority (NCA) is the regulator for the construction industry. Information available from KRA on sector based economies reveals that the compliance rate in the construction industry is low. KRA records and reports on VAT nil and non filers indicates that the majority are construction firms and the Small & Medium Enterprises (SME).

1.1.5. Construction Firms in Kisumu County

Contractors in Kisumu County are relatively of small and medium size focusing on murram road leveling, buildings, road repairs and maintenance, bridges on murram roads, laying culverts, construction of water pans. Their main customers include; the County government of Kisumu, Kenya Rural Roads Authority, Kenya Urban Roads Authority and Kenya national Highways Authority. With the advent of devolution there is an increase in investments in the construction industry. The County Government allocated Kshs. (millions) 347, 398 and 508 for the financial years 2014/2015, 2015/2016 and 2016/2017 respectively towards road construction (Kisumu County-Budgetary Allocations, 2016).

1.2. Research Problem

Compliance with taxation laws Tax compliance is a major concern for all tax authorities and it is not easy to have all taxpayers comply with the tax requirements (James and Alley 2004). Good compliance rates guarantees the government of the much needed revenue to finance the planned activities. Non-compliance denies the government the required revenue. Even though there have been many administrative reforms, VAT compliance level has remained low contributing only 23% of the total revenue. KRA expects to achieve VAT compliance rate of 65% and raise the ratio of VAT to total revenue to 35% by 2018, (KRA 6th Corporate Plan, 2015).

Joint studies carried out by KIPPRA, KRA and the ministry of finance, revealed that VAT payment compliance was as low as 55% while return filing was 65%(Masinde and Makau, 2010).Repercussions relating to non compliance of raising enough tax revenue by the

government to finance planned activities, has motivated researches and policy makers to put emphasis on tax non compliance.

Available information indicates that a significant percentage of registered construction firms are Nil or Non-filers, (KRA-Kisumu, 2016 reports). In the month of April 2016 report, a total of 521 VAT registered taxpayers either returned a nil return or did not file a VAT return where, Two hundred thirteen of these nil and non filers were construction firms. This contradicted KRA iTax reports which indicated that some of these firms had conducted business with withholding tax agents during the same period. These facts of non compliance has led KRA to establish a unit in every KRA station to deal with Nil and Non filers majority of them being contractors and SME. With the advent of devolution the construction sector has witnessed massive growth evidenced by the increased budgetary allocations towards infrastructure development with no corresponding growth in VAT collections from the registered construction firms.VAT in general continues to perform below expectations despite the increased taxable business transactions especially among firms in the construction industry.

Mukabi (2014) carried out a study on “factors influencing Turn over Tax compliance and concluded that, taxpayers’ perception of the tax system, level of awareness, enforcement efforts and compliance costs have an effect on compliance level. Osebe (2013) carried out a study on the analysis of factors affecting tax compliance in the real estate sector. He concluded that the established factors (compliance costs, available opportunity for tax evasion, taxpayer knowledge, fines and penalties) greatly affect the tax compliance level in the industry. The study of Mwangi (2013) on the establishment of factors affecting tax compliance among the small and medium

enterprises reached a conclusion that rates of tax, availability of information, compliance costs and taxpayer attitude towards tax payments have a direct effect on tax compliance. To fill this study gap I will carry out a study on the factors influencing VAT compliance among the construction firms in Kisumu County-Kenya. What are the factors influencing VAT compliance among the construction firms in Kisumu County, Kenya?

1.3. Objective of the Study

The study objective is the establishment of factors influencing Value Added Tax compliance among construction firms in Kisumu County.

1.4. Value of the Study

Every government collects taxes to finance planned activities of the provision of goods and services to its people. Information obtained from this study will help the government to formulate policies geared towards enhancing VAT voluntary compliance and seal tax evasion and tax avoidance loopholes. In this regard, the study will help the government to institute key changes to ensure equity, widening the tax base, promote increased investment and in so doing reduce tax burden.

Since the major concern of a revenue authority is the maximization of tax collections, it will develop policies and put in place proper mechanisms to encourage voluntary compliance. In this way revenue collection will be enhanced and non compliances cases will be minimized. This study will help KRA to establish barriers to compliance and put in place proper and adequate mechanisms to encourage voluntary compliance and minimize non compliance cases.

The study results will ascertain challenges construction firms face in complying with tax laws and propose possible alternative solutions in overcoming these challenges. Professional tax advisors help taxpayers in the interpretation of tax laws to enable them comply. The study will aid the tax professional in understanding the various challenges faced by taxpayers in complying and develop appropriate measures to ensure that their clients complies with the law. This research study will form a basis for further research in other sectors of the economy by other researchers

CHAPTER TWO: LITERATURE REVIEW

2.1. Introduction

The literature review of chapter two covers the theoretical and empirical review, factors influencing VAT compliance and the conceptual framework.

2.2 Theoretical Literature Review

This section will discuss tax compliance theories namely; the fiscal psychology theory, the economic deterrence theory, and the ability to pay theory.

2.2.1 Fiscal Psychology Theory

The fiscal and social psychology theory says that the more the taxpayer's attitude in the payment of taxes, the bigger is their motivation in paying taxes (Schmolders (1960). Taxpayers' motivation to comply with tax laws relates to the taxpayers perception and attitude of the tax system (Strumpel, 1966).The theory pays attention to psychological variables like moral values, ethical values and the fairness of the tax system. Tax compliance theories assume that psychological factors in addition to moral and ethical values are important to taxpayers.

Under the fiscal psychology theory, is the theory of planned behavior which states that the behavior of an individual is under the influence of some factors that originate from certain reasons and emerge in a planned way (Ajzen, 1991). Ones behavioral intention which is influenced by factors like attitude, subjective norms and perceived behavioral control influences the individual to behave in a particular way. The three factors fall under the influence of behavioural, normative and the control beliefs. Taxpayers may comply even where the

probability of detection is low since the theory's focus is on morals and ethics. Under the psychology theory the emphasis is on change of the taxpayers attitudes towards the tax system.

2.2.2. The Economic Deterrence Theory

The economic deterrence theory is a theory under criminology developed by Becker (1968). The theory is built on the perception that an individual will be deterred from committing a crime if the benefit of the crime is outweighed by the consequence of committing the crime. The theory is premised in the belief that all individuals are aware of the consequences associated with criminal behaviour. Taxpayers will act contrary to the law after evaluating the uncertain advantages of a successful evasion against the risk of being caught and punished. Rational taxpayers will evade taxes if the expected benefits are greater than the cost of being caught.

Deterrence can be achieved through punitive and persuasive approaches (Kendrick, 1939). Under the punitive approach, effective imposition of tougher penalties and reducing the probability of non detection will deter a taxpayer from committing activities related to tax evasion. Persuasive approaches advocate for activities relating to improved taxpayer education concerning their duties, rights & obligations, simplifying the tax system and facilitating taxpayers in filing their tax returns & making payments.

2.2.3 Ability to Pay Theory

The ability to pay theory developed by, Mill (1848) proposes that citizens contribute to the support of the government as nearly as possible, in proportion to their respective abilities in terms of revenue. Those who are better able to pay should bear the greater burden of taxation,

whether or not they benefit. Ability to pay is interpreted in terms sacrifice. It says that money for public should come from “him that hat” instead of from “him that hath not”, Kendrick (1939).Kendrick further says that, the usual and indeed the only serious justification of ability to pay is on grounds of sacrifice. The payment of tax is viewed as a deprivation to the taxpayer. He might have spent the money for his own purposes but instead must turn it over to the public treasury from which it will be expended for social ends. In surrendering his money to the government, he is said to make a sacrifice. The idea of sacrifice when linked to the concept of the declining marginal utility of money has given rise to three theories of progressive taxation: the equal, equal-proportional, and least-sacrifice theories.

The theory of equal-sacrifice suggests that, taxes should be laid in such a manner that the sacrifices of all taxpayers are equal. The concept of equal sacrifice means to impose an equal amount of sacrifice on all taxpayers, (Brown, 1929). The theory of equal-proportional sacrifice holds that the sacrifice of taxpayers should bear an equal proportion to their incomes. Thus in this view equality of sacrifice is not sufficient. The rich man's tax payment should represent a greater sacrifice than the contribution of a man of moderate means. It should, however, not be greater in relation to his income. The equality is, therefore, to be found in the proportion, not in the quantity of sacrifice, (Pigou, 1928). The theories of equal and of equal-proportional sacrifice both involve the taxation of poor as well as rich persons, (Seligan, 1928). In neither theory is there an attempt to make any income group bear all the taxes. According to the theory of least sacrifice, taxes should be laid first on the incomes of the very rich (Pigou 1928). When these incomes are reduced to the level of the rich, then the rich would be taxed. Persons of moderate means would be taxed only after the incomes of the very rich and the rich have been reduced by

taxation to their level. The theory calls for the progressive elimination of the high incomes by taxation.

2.3. Factors Influencing VAT Compliance

This section will discuss factors influencing Value Added Compliance among tax payers.

2.3.1. Tax Understanding and Taxpayer Knowledge

Lewis (1982) says that a good tax system should satisfy the four canons of taxation (ability to pay, efficiency, equity and simplicity). Simplifying that tax systems ensures that basics of taxation are easily understood by the majority of taxpayers and should be easy to operate it. The system should avoid frequent changes to the tax rates, complicated and cumbersome tax language. The language should be easily understood by ordinary taxpayers. Tax understanding encompasses tax aspects like conversant with the tax system, knowledge of the applicable tax obligations and knowing where relevant tax information is available.

Taxpayer knowledge is concerned with the taxpayers' ability in understanding tax laws, the willingness to comply and the role of taxes in national development (how tax collected by the government is utilized (Mohd, 2010). Taxpayer education activities are meant to enhance the level of taxpayer understanding of the tax systems and empower taxpayers in fulfilling their tax obligations. Non compliance opportunities may be readily available to educated taxpayers but because of their better understanding of the tax system contributes towards positive attitudes hence promoting tax compliance. Education programs creates awareness of laws, procedures, motivates taxpayers to voluntarily comply, report correct income, maintain a close relationship

between the revenue authority & the taxpayer and instill confidence in the tax system (Oyedele, 2009). Teaching tax courses should be emphasized because of their impact on compliance (Hite and Hasseldine, 2001).

Taxpayer knowledge has influence on compliance and various researches support this argument. Knowledge is categorized on the basis ordinary or official education received and knowledge towards the opportunity to evade tax (Groenland & Veldhoven 1983). Tax knowledge as one of the key factor in tax compliance has a very close relationship with the taxpayers' ability to understand the tax law & regulations, and their ability to comply (Singh, 2003). Taxpayer education exists to encourage voluntary compliance through service delivery to taxpayers. Low levels of voluntary tax compliance will compel revenue authority to use costly and coercive methods to enforce compliance (Fjeldstad and Ranker 2003). Kimumu and Kileva (2007) says that the education component will deal with compliance matters in the informal sector. This is premised on the possibility that non-compliance being unintentional due to the ignorance of the law or may be intentional due to the negative compliance attitudes. (Christina, Deboral and Gray, 2003).

2.3.2. Cost of Tax Compliance

Tax compliance expenses are incurred by taxpayers in the process of fulfilling tax requirements laid on them by tax law (Sandford, 1995). Tax compliance costs include the tax collection costs, expenses relating to paying and accounting for tax, wages & salaries of employees and professionals and the cost of acquiring knowledge, updating the system to enable it work. Taxpayers usually depend on tax professionals who through avoidance schemes minimize tax payments (Franzoni, 2000). High tax compliance costs disadvantages a country's

competitiveness interns of attractiveness, KRA has devised ways of simplifying the tax systems e.g. the iTax system in order to reduce reliance on tax professionals. This encourages voluntary compliance

Compliance expenses can be interpreted in different ways. One, the costs are divided in three in respect to time, monetary and psychological costs. Time expenses relate to hours consumed to in ensuring all aspects of tax compliance. Cash expenses relate salaries paid to internal employees and fees paid external tax professionals. The psychological costs concerns the effects upon a taxpayer in dealing with the tax matters e.g. mental stress. Psychological costs are difficult to quantify. Other compliance expenses include all expenses incurred by the taxpayer but are outside the control of the taxpayer (Hijattulah and Pope, 2008). Vaillancourt (1987) held that Value Added Tax (indirect tax) has a higher compliance cost than Income Tax (direct tax). In the study survey of the OECD countries, 8 out of 11 countries cited VAT compliance cost as forming the largest part of the total tax compliance cost (Pope, 2001). Compliance expenses entail record keeping, preparation and submission of VAT returns (Cleruox, 1992); Klun, 2004; O'Keefe & O'Hare, 2008).

2.3.3. Fines and Penalties

Empirical studies on the impact of fines on tax compliance do not provide a clear picture on the relation between fines and tax compliance (Fischer et al, 1992). Keeping constant the expected value of a tax but changing audit probabilities and fines for non-compliance, it showed that compliance increased significantly with higher fines, but not with higher audit probabilities (Friedland, Maital and Rutenberg, 1978). Punitive penalties makes tax evasion more costly for

the taxpayer hence leading to the reduction of tax evasion. Research studies show that more punitive fines and penalties can result in more tax avoidance (Kirchler,2007).Deterrence is effective when there is a combination of effective imposition of fines and frequent audits to detect cases of non compliance.

Penalties and audit probabilities have a strong impact on tax compliance (Allingham and Sandmo, 1972).The Higher the fine, penalty and higher the potential of audit probability, the greater the deterrent effect on tax evasion. Extremely punitive tax penalties have no effect if it is common knowledge that tax audits will not occur. Fines should be set at a higher level to minimize the expected the value of tax evasion and assure its deterrent effect on taxpayers. The tax system would be viewed as unjust if fines are too high individuals would exploit any available opportunity to avoid tax payment (Kirchler et al, 2007).In Kenya, the penalty for non submission or late filing of a VAT return is 5% of VAT payable or kshs.10, 000 per tax period whichever is higher. Fines and penalties commonly relate to failure to; register, submit a return on or before the due date or submitting a payment return without paying the tax due, filing incorrect tax returns, keeping inaccurate records, issue of improper tax invoice, failure to display a certificate of registration, and charging VAT when not registered among the many non compliance aspects.

2.3.4. Taxpayer Perception and Attitudes

Perception towards taxation and its general compliance levels has been identified as one of the major factors that influence compliance, even in the tax compliance theory as explained in Section 2.2.1(the fiscal and social psychology theory) of this study. Taxpayer's perception on

how fair the tax system is influences their attitudes to pay taxes (Coskun, 2009; Alm, et al, 2011). If the motive of the taxpayer is to reveal his viewpoint in a system will evaluate the fairness of the tax system with objectivity and where the taxpayer whose attitude is motivated by what to gain from the system may regard the system fair only if he is benefitting from the system (Alabede et al, 2011). In the studies of Roth (1989) and Jackson & Milliron (1986), they concluded that the taxpayers' about the fairness of the system have links with taxpayer attitudes and behavioural intentions about tax compliance. And Richardson (2006) explained that the perceived tax fairness of the system is significantly related to tax non compliance.

There exists a strong relationship between the taxpayer's attitudes and tax compliance. Taxpayers' positive attitudes encourage tax compliance. In a research conducted in Kenya (Wanjohi, 2010) explained that most taxpayers view the Kenyan tax system as unfair. This was because most respondents differed that they are paying a fair share of tax than their neighbors or friends and that their neighbours are not reporting and paying tax honestly.

Tax fairness consists of two different dimensions. The first dimension involves the equity of the trade - the benefits received for the tax given. Thorndike (2009) noted that taxpayers should comply with their tax obligations and the government to secure the security of taxpayers. The second dimension is that the tax system should ensure equity of the tax burden on all taxpayers (Jackson and Milliron, 1986). The unfairness of the tax system is reflected in the taxpayers' perception when they feel that the value of received services provided by the government is not commensurate with taxes paid or they are overpaying taxes when compared with what other

taxpayers pay. Taxpayers who believe that the tax system is unfair are prone to engage in non compliance behavior (Porcano, 1984).

2.4 .Empirical Review

Observations from existing studies reveal that tax compliance is influenced by various factors. Factors identified from the empirical studies shows that they have an influence on tax compliance. Studies were carried out to examine the influence of tax education as a proactive move toward the enhancement of voluntary tax compliance among taxpayers in Malaysia. In 2004 the official tax assessment process changed to the self assessment. Under the self assessment system, the taxpayer computes his or her own tax liability, submits the tax return and pays the taxes due to the revenue authority. Much later after the submitted tax return is accepted, the revenue body will carry out an audit with an intention of establishing the accuracy of the declared transaction in the tax return and taxes paid. The findings of the above Malaysian studies revealed that there is a significant relationship between the level of tax education and tax compliance.

Aruwa (2008) did a study on the relevance and the problems of Value Added Tax (VAT) in Nigeria. He surveyed Nigerian organizations dealing in taxable supplies, revenue staff and the public to gain insight into the administration Value Added Tax, its relevance in the revenue generation and problems hindering the efficient administration of VAT. Primary and secondary data was used. Descriptive statistics as a tool of analysis was used in analyzing the collected data. The study findings showed that the Federal Inland Revenue Service (FIRS) staff perceives that they are not adequately armed technically to handle VAT. The study findings concerning

organizations revealed that they have inadequate knowledge of the VAT mechanism due to the low VAT education. Businesses treat VAT as a cost contrary to the expected practices. Due to the lack of proper records, unqualified FIRS staff and low level of education among the taxpayers, VAT collection was below average and finally there was a perception among the citizens that there was underutilization of the VAT collected by the government.

Kakembo (2007), in his study revealed that tax compliance is positively related to revenue collection. He said that Intention to pay taxes is also significantly positively related to attitudes and tax compliance which would help to increase on domestic revenue. The taxpayers' compliance level is greatly affected by the taxpayer's attitudes and intentions. Tax compliant taxpayers always have high intentions and positive attitudes towards the payment of taxes as a way of fulfilling the requirements of taxation laws.

Gilligan et al (2005) studies on "perception of tax fairness and tax compliance in Australia and Hong Kong" concluded that there seem to be no universal relationship or pattern that exist cross culturally between the different facets of tax fairness perceptions and tax compliance behavior. Faridy (2015) studied on Value Added Compliance costs and Value Added Tax evasion of the SME sector in Bangladesh. It was concluded that analyzing tax evasion is a difficult exercise and taxpayers have a very strong incentive of concealing their tax evasion schemes.

The researcher is not aware of previous studies on factors influencing VAT compliance among the construction firms. The findings of my study will assist policy makers and the Kenya Revenue Authority in developing an efficient Value Added Tax system will enhance voluntary

compliance especially those in the construction industry. To the construction firms, the survey findings will identify factors that hinder the construction firms VAT compliance.

2.5. Summary of Literature Review

Higher levels of tax compliance lead to increased revenue collection. In this particular study, increased VAT compliance rate will significantly help the government collect more VAT and broaden the tax base. This will help the country to realize its goals and objectives. Revenue authorities need to simplify the tax system for taxpayers to have easier and better understanding of it and incur minimal cost in complying. If this is realized then voluntary compliance will be encouraged. Stopping non compliance requires effective application of fines and penalties consistently. Though, care should be taken because in some instances punitive penalties can lead to tax evasion. Regular and effective taxpayer education will encourage voluntary compliance and lead to increased revenue collections. The research will be carried out using descriptive design in soliciting for information. From all the studies reviewed, past research has tried to explore the area of tax compliance as a whole but no one has actually done the research on factors influencing VAT compliance in the construction industry. Therefore, the study will seek solutions to the research problem.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter will describe the research design, population, sampling design, data collection and analysis which will be employed to achieve the research objective of this study.

3.2. Research Design

This study adopted a descriptive research design which is best for this study as it describes characteristics associated with the subject population. According to Coopers and Schindler (2003), descriptive design discovers and measures the cause and effect of relationships between variables. The descriptive research will determine and report the way things are and provide the alternative possible behaviour, attitudes, ideals and characteristics of such things (Mugenda, 2003).

The researcher will use a descriptive research design because this enables the researcher to collect a large quantity of information about the population under study. A survey design is appropriate as the data required for analysis is to be collected from a large population that is construction firms registered within Kisumu County, Kenya. The descriptive design is appropriate in the study since it is accurate, factual and systematic. The descriptive approach will be incorporated with the survey design to enable the researcher to collect comprehensive qualitative and quantitative data that will enrich the outcome of the study. For that reason, the approach will enable the researcher to establish factors influencing Value Added Tax compliance among the construction firms in Kisumu County.

Therefore, the approach will enable the study to establish factors influencing VAT compliance among the construction firms.

3.3. Target Population

Registered contraction firms within Kisumu County during the study period makes up the target population for this study. The researcher will collect the required information from the sampled construction firms. Available information indicates that there are a total of five hundred fifty registered contractors as at January 2016 (KRA-Kisumu January 2016 reports).

3.4. Sample Size and Sampling Procedure

Sampling entails the selection of part of the population that represents the characteristics of the entire group. Sampling is advantageous in the sense that it saves on time and cost since it is easier to deal with the small group (sample) that represents an entire population than analyzing the whole group of interest. From the target population of five hundred fifty registered contractors, the Krejcer and Morgan table (t table) gives an ideal sample size of 226. The researcher will adopt a systematic sampling technique to select the respondents from the target population.

3.5. Data Collection and Sources of Data

The study used cross sectional survey. Both primary and secondary data will be used. Questionnaires will be administered to obtain primary data on the influence of; the level of tax understanding & taxpayer education, compliance costs, fines & penalties and taxpayer education

on VAT compliance. Secondary data will be obtained from reports and records of KRA, Kisumu County Government and KNBS. The researcher will personally administer the questionnaires.

3.5.1. Validity of the Research Instrument

Validity is the extent to which a research instrument measures what it ought to measure (Kothari, 2004). In this reason the term validity refers the degree to which an instrument asks the right questions in terms of accuracy. Reliability of an instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trials Mugenda (2003).The validity of the research instrument will be determined in two ways. First, the questions in the questionnaires will be discussed with the supervisor and the tax administration professionals. Secondly, the researcher conducted run a pilot test of the questionnaire to make sure it is understandable and acceptable to the intended audience. This helped redefine the emerging issues on the study instruments.

3.5.2. Data Analysis and presentations

Edition for completeness and uniformity of received questionnaires will be done. Both quantitative and qualitative data was generated. The descriptive analysis was used. Frequencies and percentages under the descriptive statistics will be used to summarize the collected data and in the presentation of the study findings.

3.6. Ethical Issues

This survey endeavored to obtain an informed consent from the respondents before undertaking the collection of data. Objective of the research was explained to the respondents so as to get

their informed consent. The level of confidentiality relating to the information received from the respondents is high this will be maintained and the same will be explained to the respondents. The information obtained will only be used for this academic study purposes and will not be shared with third parties without the consent of the respondent(s).

CHAPTER FOUR: DATA ANALYSIS, PRESENTATION, PRESENTATION AND INTEPRETATION.

4.1. Introduction

This chapter presents data analysis, presentation and interpretation of findings on the primary and secondary data collected. The main objective of the study was to evaluate the factors that influence VAT compliance levels in relation to taxpayer level of tax understanding & taxpayer education, compliance costs, fines and penalties and taxpayer perception and attitudes. The study sampled two hundred twenty six (226) construction firms within Kisumu County and the data analyzed and interpreted as the objective of the study.

4.2. Response Rate

The study targeted a total of 226 respondents on the factors influencing VAT compliance in the construction sector in Kisumu County. Out of the 226 questionnaires issued, 164 were returned giving a 72.5% response rate as shown in Table 4.1. According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% is rated very good. This implies that based on these assertions; the response rate for this study, 72.5% is very good.

Table 4.1. Response Rate

Response	Administered questionnaires	Returned questionnaires	Percentage
Total	226	164	72.5%

Source: Research findings 2016

4.3 Demographic information

The study found it important to establish the demographic information in order to evaluate the factors that influence the VAT compliance in the construction sector in Kisumu County. The respondents' demographic information includes; business age, level of education of the respondent, form of business ownership type, annual turnover, PIN registration and VAT obligation.

4.3.1. Business Age

The researcher sought to determine for how long the business has been in operation. The findings are shown in table 4.2 below.

Table 4.2.For Business age

Business Age	Frequency	Percentage
<3years	24	14.6
4-6years	65	39.6
7-10years	40	24.4
>10 years	35	21.3
Totals	164	100

Source: Research findings 2016

The study findings reveal that most businesses are 4-6 years old at 39.6%. Followed by those which are 7-10 years old at 24.4%.21.3% of the businesses are more than ten years old and the remaining 14.6% of the businesses are less than three years old. It can therefore be concluded from the findings that most of the business (85.4%) have been in operation for more than 4 years. Information obtained from KRA records agrees with the respondents responses.

4.3.2. Level of Education

The researcher sought to know the level of education of the respondents which mostly affects the taxpayers' level of tax understanding and knowledge. The findings are presented in Table 4.3 below;

Table.4.3.Education level

Education Level	Frequency	Percentage
Primary education	13	7.9
Secondary education	34	20.7
Technical education	66	39.6
Undergraduate and above	51	31.7
Totals	164	100

Source: Research findings 2016

The research results reveal that most respondents are those that possess technical level of education at 39.6% followed by those with undergraduate level and above at 31.7%. The study findings reveal that 20.7% of the respondents are educated up to secondary level and 7.9% have primary education. The study shows that most of the respondents are well educated to enable them make better decisions concerning their tax matters.

4.3.3 Annual Turnover

The researcher sought to establish the annual turnover for the sampled businesses. Turnover is a major factor in the determination for VAT registration threshold. Turnover helps to identify and compare the level of business and the amount of VAT paid. Table 4.4 below shows the results of the research findings.

Table 4.4. Annual turnover of the business

Annual Turnover(Kshs.)	Frequency	Percentage
<3million	8	4.9
3-5million	11	6.7
5-10million	71	43.3
>10million	74	45.1
Totals	164	100

Source: research findings 2016

74 of the respondents representing 45.1% have an annual turnover of at least Kshs.10million,71 of the respondents (43.3%) have a turnover of between 5-10 million.Shs.5 million of annual turnover is the minimum threshold for VAT registration.11 (6.7%) and 8 (4.9%) of the respondents had an average annual turnover of kshs.3-5million and below Kshs.3 million respectively.However,information obtained from KRA records reveal that only 10 businesses of the sampled 226 businesses have an average annual turnover of less than Kshs.5million.Though in the construction industry, it is difficult to maintain a consistent turnover ,it is noted from the study findings that some respondents did not give true information concerning their business turnover.

4.3.4 Personal Identification Number and Online Update

The researcher sought to determine whether all businesses had a KRA PIN. This was to establish whether the businesses are registered for tax purposes since the KRA PIN is a mandatory requirement for all operating businesses. The findings revealed that for all the 164 respondents, their businesses have a valid KRA PIN. This information was found to agree with KRA records data.

4.3.5. Tax Obligations Registration

The researcher sought to establish the type of tax obligation(s) the sampled businesses are registered for. The question was considered necessary since the topic of study is to establish factors influencing VAT compliance. The study findings are shown in the table below;

Table 4.5. Tax Obligations registered for

Registered Tax Obligation	Frequency	Percentage
Turnover Tax (TOT)	4	2.4
Income Tax	22	13.4
Income Tax & VAT	132	80.5
Income Tax & PAYE	1	0.6
Income Tax, PAYE & VAT	5	3.0
Totals	164	100

Source: Research findings 2016

The findings revealed that 2.4%, 13.4% and 3.0% of the construction firms were registered for TOT, Income Tax and Income Tax, PAYE & VAT respectively. Majority of the respondents 132 representing 80.5% were registered for Income Tax and VAT obligation. Only 138 of the responding businesses have a VAT obligation. From the annual turnover, 145 of the respondents have a turnover of 5 million and above. This means that seven (145-138) of the respondents qualifies for VAT registration but have not complied with the registration requirements.

4.4. Factors Influencing VAT Compliance

The objective of the study is to establish factors influencing VAT compliance among the construction firms in Kisumu County. The researcher sought the opinion of the sampled business on the factors influencing their level of VAT compliance.

4.4.1. Level of Tax Understanding and Knowledge

It is believed that if all taxpayers are knowledgeable on tax matters, then tax compliance rates will go up. The researcher sought to establish the level of tax understanding and knowledge of the respondents. Tax understanding and knowledge entail operations of VAT self assessment system, challenges faced in the process of raising tax understanding and the effect of tax understanding and knowledge on tax compliance as discussed below. The responses received are as captured below;

Under the VAT self assessment system (VAT-SAS), taxpayers assess their personal tax liabilities or credits, declare in their respective tax returns, submit the tax return and make payments where applicable. The researcher sought to know whether the respondents understood the VAT self assessment tax system, the VAT mechanism of input output and obligations and duties of a VAT registered business. Tax knowledge and understanding is significant in tax compliance. The findings of the study are presented in table 4.6 below;

Table 4.6 understanding and knowledge of the SAS-VAT

Tax understanding and knowledge	Frequency	Percentage
Knowledgeable about SAS-VAT	94	57.3
Little knowledge	41	25.0
No knowledge about the VAT-SAS	29	17.7
Total	164	100

Source: Research findings 2016

Ninety four of the construction firms representing 57.3% are knowledgeable and have a good understanding of the VAT-SAS & their duties and obligations as registered VAT businesses. Fourth one of the respondents representing 25% have little knowledge of the VAT-SAS and twenty nine of the respondents representing 17.7% have no knowledge or understanding of the VAT-SAS and their duties as VAT registered businesses. It can therefore be concluded that the

majority of the respondents (94+41=135) are knowledgeable about the SAS, hence in a better position in making prudent VAT decisions. Of the 138 VAT registered businesses (table 4.5), it can be observed that three taxpayers (138-135) who are registered for VAT have no knowledge of the VAT operations, hence impacting negatively of the VAT compliance.

The researcher sought to establish challenges businesses face while trying to comply with the VAT regulations. The study findings are as indicated in Table 4.7 below.

Table 4.7 Ratings on challenges faced while accessing information.

Challenge	1		2		3		Mean	Std Deviation
	No.	%	No.	%	No.	%		
Conflicting information from different sources	44	27	62	38	58	35	2.09	0.786
Tax system (iTax is not easy to understand)	28	17	52	32	84	51	2.34	0.755
Long queues in gaining access to KRA offices	72	44	55	34	37	22	1.79	0.789
Technical details on brochures and tax Acts that I don't understand	22	13	106	65	36	22	2.09	0.590
Delay in receiving feedback on queries raised	40	24	59	36	65	40	2.15	0.788
High fees charged by tax consultants and other professionals on services/advise	6	4	32	20	126	76	2.73	0.521
Required information not readily available	32	20	38	23	94	57	2.38	0.793

Source: Research findings 2016

From the responses, 76% of the respondents said that the high fees charged by tax consultants in raising their tax understanding is a very serious challenge while 57% who cited non availability of information sought as a very serious obstacle and 51% said that the complexity of the tax system is a also a very serious challenge. It can be observed that tax understanding is a contributing factor in raising VAT compliance level. 65% of the respondents said that the complexity of the technical details in the tax acts poses a serious challenge in raising the level of knowledge and understanding. If KRA can simplify the tax system, make readily available the

tax information give appropriate feedback to questions raised in good time and simplify the technical language used in the tax Acts, then this will positively contribute in raising the Vat understanding and knowledge. This will make it possible for the taxpayers to comply with VAT laws.

The researcher sought to know from the respondents the extent the level of tax understanding and education influences VAT compliance rate. The responses are as indicated in table 4.8 below.

Table 4.8. How tax understanding and knowledge influences VAT compliance level

Tax understanding	Frequency	Percentage
Less extent	11	6.7
Some Extent	28	17.1
Great Extent	125	76.2
TOTALS	164	100

Source: Research findings 2016

The study findings reveal that the level of tax understanding and knowledge greatly (76.2%) and to some extent (17.1%) influences the level of VAT compliance among the construction firms. The information in these study findings is very much important for KRA in devising ways of raising the level of knowledge among the contractors in order to improve the VAT compliance rates.

4.4.2. Tax Compliance Costs

Hiring of professionals to handle tax matters is a cost to businesses and in most instances taxpayers resort to handling their own tax issues even though they may not have proper

understanding of the VAT legislation. The cost of book keeping and recordkeeping is also a major expense. In this regard the researcher sought to find out how compliance costs incurred by contractors affect their VAT compliance level. Covered under this are the VAT monthly compliance costs, the various VAT compliance costs and how the compliance costs affects VAT compliance rate.

The researcher sought to establish from the respondents the awareness of the tax period. It was established that the tax period for VAT returns is monthly. The researcher sought to find out on average how much contractors spend per tax period in complying with VAT regulations. The findings are as shown in the Table 4.9 below;

Table 4.9 Monthly cost of VAT compliance

Compliance cost Kshs.	Frequency	Percentage
<10,000	23	14.0
10,000-20,000	59	36.0
20,000-30,000	30	18.3
30,000-40,000	30	18.3
>40,000	22	13.4
TOTALS	164	100

Source: Research findings 2016

22 construction firms representing 13.4% incur a monthly cost of more than Kshs.40, 000 in complying with VAT requirements, 23 of the firms representing 14% of the respondents spend less than Kshs.10, 000 in complying with the VAT legislation. Majority (59) of the respondents spend between 10,000 and 20,000 per month in complying with VAT laws. 30 of the respondents representing 18.3% spend an average of between Kshs.20, 000 and 30,000 in complying. A similar number incurs a cost of between 30,000 and 40,000 per month. The cost of compliance does not include the VAT payable in the tax period.

The researcher sought to establish what the respondents felt was the most expensive compliance cost. The research findings are as shown in the table below;

Table 4.10. Feeling on the most expensive compliance cost

Most expensive cost	Frequency	Percentage
Book keeping	20	12.2
Hiring professionals	122	74.4
Training	18	11.0
Internet connections	4	2.4

Source: Research findings 2016

From the study findings, 74.4% of the respondents said that the cost of hiring tax professionals was the most expensive compliance cost while only 2.4% of the respondents said that internet expenses was the highest compliance expense. 11% and 12.2% felt that the cost of training and book keeping were the most expensive compliance costs respectively. If KRA can effectively train the taxpayers on how to deal with their VAT obligations, then reliance on professionals will reduce hence lowering compliance expenses and this will lead to increased compliance levels.

The researcher sought to know how the monthly VAT compliance costs incurred determines their compliance level. The results are as shown in the below;

Table 4.11. How compliance costs influences VAT compliance level

Compliance costs	Frequency	Percentage
Less extent	30	18.3
Some Extent	46	28.0
Great Extent	88	53.7
TOTALS	164	100

Source: Research findings 2016

From the above observations it can be noted that 53.7% of the construction firms say that costs incurred greatly affects their VAT compliance level followed by 28.0% who agrees that costs affects their compliance level to some extent. Only 18.3% of the respondents say the costs affects compliance level to a less extent. From the study findings it can be concluded that compliance costs influences the level of VAT compliance.

4.4.3. Fines and Penalties

Fines and penalties are imposed on cases where non compliance issues are discovered by the revenue Authorities.

The researcher sought to know whether the sampled firms have ever been fined or penalized by KRA for VAT non compliance issues and additional taxes raised. The study finding is shown in the table below;

Table 4.12.Imposition of fines

	Frequency	Percentage
Penalized	152	92.7
Never penalized	12	7.3
TOTALS	164	100

Source: Research findings 2016

The study findings reveal that 92.7% of the respondents at some point have been penalized for not complying with VAT laws. 7.3% of the respondent firms have never been penalized for matters relating to VAT compliance. This is a strong indication that VAT compliance in the construction sector is low hence KRA need to develop ways of encouraging compliance.

The researcher sought to establish whether effective imposition of fines and penalties will deter VAT non compliance. The findings are as shown in the table below.

Tick as appropriate, where 1-Strongly Disagree 2.Disagree, 3- Agrees 4-Strongly agree.

Table 4.13 Imposition of fines and penalties.

Challenge	1		2		3		4		Mean	Std deviation
	No.	%	No.	%	No.	%	No.	%		
The penalty rates are very low. I can afford to pay.	65	40	51	31	33	20	15	9	1.99	0.984
I believe that the penalty is lower than my tax saving if I don't comply.	69	42	48	29	34	21	13	8	1.95	0.974
KRA will effectively impose fines if I don't comply	2	1	7	4	13	8	142	87	3.8	0.567
Penalties are punitive and the probability of detection is high, I better comply with the tax laws	10	6	4	2	92	56	58	35	3.80	0.567

Source: Research findings 2016

From the study findings, 40% of the respondents said that penalties are not low, 9% strongly agrees that the penalty is low and can afford to pay while 20% agrees that the penalty is low and can afford to pay .On tax savings in relation to tax penalties, 8% strongly agrees that they can make a saving by not complying, 21% agrees, 42% strongly disagrees and 29% disagrees on the same. On the effective imposition of fines, only 1% strongly disagrees, 4% disagrees, 8% agrees and 87% strongly agrees that KRA will effectively impose penalties for non compliance. Lastly on the detection non compliance, 6% strongly disagrees, 2% disagrees, 56% agrees and 35% strongly agrees that penalties are punitive and they better comply. Generally it can be deduced from the findings that effective imposition of the existing VAT penalty rates will greatly deter non compliance cases.

The researcher sought to know from the respondents whether effective imposition of penalties will deter VAT non compliance. The findings are as shown in table 4.12 below.

Table 4.14. The extent of effective imposition of penalties on VAT compliance

Compliance costs	Frequency	Percentage
Less extent	12	7.3
Some Extent	74	45.1
Great Extent	78	47.6
TOTALS	164	100

Source: Research findings 2016

From the above study findings it is observed that 47.6% of the respondents said that effective imposition of fines and penalties will greatly influence VAT compliance while 45.1% said that it will influence VAT compliance to some extent and the remaining 7.3% said that effective imposition will to a less extent influence VAT compliance. This finding is important for KRA to devise ways of effectively impose penalties to raise VAT compliance levels.

4.4.4 Taxpayer Perception and Attitudes

Concerning taxpayer perception and attitudes towards the tax system, the respondents were asked questions on their belief on supporting the government by paying VAT, motivation of the tax system, ease of application of VAT laws, if they believe the VAT collected was properly used and if KRA has put in place adequate tax measures to encourage VAT compliance.

Payment of taxes as everyone's duty. When asked whether the respondents thought that payment of taxes is everyone's duty, the responses were as shown in Table 4.13 below.

Table 4.15: paying taxes as a duty

Paying tax is a duty?	Frequency	Percentage
Yes	132	80.5
No	32	19.5
Total	164	100

Source: Research findings 2016

The findings reveal that 80.5% of the respondents' believed that payment of taxes is everyone's duty while 19.5% percent said that they don't think the payment of taxes is everyone's duty. KRA needs to educate the 19.5% thought otherwise. This is believed to be a small percentage that can be eliminated through tax education and training.

The researcher sought to establish the perception of respondents concerning tax payments. The respondents were expected to rate their perception using a four likert scale ranging from strongly agree to strongly disagree. The findings are shown in Table 4.16:

Table 4.16 Perception and tax payments

Question	1 SD		2 D		3 A		4 S A		n	mea	Std dev
	No	%	No	%	No	%	No	%			
I believe it's my obligation as a citizen to support the government by paying taxes	8	5	24	15	99	60	33	20	2.96	0.738	
I feel that there is a lot that can be done on our tax systems to ease the work of preparation of tax returns and payment.	2	1	26	16	56	34	80	49	3.30	0.778	
I see no point of paying tax when it is being misused by individuals in government	22	13	6	4	72	44	64	39	3.09	0.981	
I feel that I can pay my taxes in all obligations without being followed	12	7	14	9	98	60	40	24	3.01	0.791	
I value the payment of taxes to the government	11	7	21	12	98	60	34	21	2.95	0.777	
Other businesses value the payment of taxes to the government	20	12	28	17	80	49	36	22	2.80	0.919	
I do gain access to the public utilities and services funded by the taxes collected.	38	23	70	43	54	33	2	1	2.12	0.774	

Source: Research findings 2016

The study findings reveal that 80% (20% strongly agrees and 60% agrees) of the respondents believe that it's their duty to support the government by paying taxes while 20% (5% strongly disagrees and 15% disagrees) do not believe that supporting the government through payment of taxes is everyone's obligation. 83% of the respondents (49% strongly agrees and 34% agrees)

agrees that tax systems can be simplified to ease work on tax returns and payments. Another 83% (39% strongly agrees and 44% agrees) agrees that the government misuses taxes collected and see no point of paying taxes. The remaining 17% (4% disagrees and 13% strongly disagrees) said that they do not believe that the government misuses the taxes collected hence they will continue paying taxes.

On the importance of paying taxes, 81% (21% strongly agrees and 60% agrees) said that they value the payment of taxes while 19 % (12% disagrees and 7% strongly disagrees) do not value the payment of taxes. Concerning other businesses, 71% (22% strongly agrees and 49% agrees) of the respondents agrees that other businesses value payment of taxes and 29% (17% disagrees and 12% strongly disagrees) do not value payment of taxes. Finally, 84%(24%strongly agrees and 60% agrees) agrees that they can pay taxes without being followed and 16%(9% disagrees and 7% strongly disagrees) disagrees that they can pay taxes without being followed.

From the study findings it can be concluded that the respondents value the importance of supporting the government through the payment of taxes if the revenue collected is put to proper use and taxpayers can access services funded by taxes collected. This is clearly shown by the mean of 3.3 (and standard deviation 0.778) of the respondents that believed there is a lot that can be done on tax systems to ease the work of preparation of tax returns and payment. However, respondents with a mean 3.09 and standard deviation of 0.981 strongly disagreed paying taxes when it is being misused by individuals in government officers. Respondents with a mean of 2.12 disagreed with the opinion that they gain access to the public utilities and services funded by the taxes collected. This is an indication that majority of the tax payers do not understand how their taxes are spent.

The researcher further sought to establish taxpayer perceptions and attitudes on VAT compliance. The outcome of their responses is as indicated in Table 4.17 below;

Table 4.17 Influence of attitude and perceptions on VAT compliance

. Effect	Frequency	Percentage
Not Influenced	10	6.1
Less Influence	23	14.0
Some Influence	44	26.8
Greater Influence	87	53.1
TOTALS	164	100

Source: Research findings 2016

The above results indicate that 79.7% of the respondents agreed that their perceptions and attitudes have greater influence on VAT compliance that is somehow (26.7%) and greater (53.1%) influences their VAT compliance. Only 20.1% of the respondents said that their perceptions and attitudes concerning the tax system have less (14%) or no influence (6.1%) on their VAT compliance level. Generally it can be observed from the study findings that taxpayer perception and attitudes towards the tax system has greater influence on the VAT compliance level.

4.5. Ranking of factors influencing VAT compliance among construction firms.

The researcher sought to determine how the respondents rank the established factors on their effect on VAT compliance. The study findings are shown in Table 4.18 below.

Table 4.18: Ranking Factors Influencing VAT Compliance

Factors	1		2		3		4		Total
	N	%	N	%	N	%	N	%	
Tax understanding and Knowledge	68	41	52	32	38	23	6	4	164
Fines and penalties	54	33	68	41	37	23	5	3	164
Compliance costs	28	17	27	17	72	44	37	23	164
Taxpayer perception and attitudes	14	9	17	10	17	10	116	71	164
Total	164	100	164	100	164	100	164	100	

Source: Research findings 2016

The above study findings reveal that majority (41%) of the respondents rank tax understanding and knowledge in number one among the established factors influencing VAT compliance. Ranked second with 33% is fines and penalties factor followed by compliance costs factor with 17% and finally taxpayer perception and attitudes with 9%.

4.6. Discussions

From the study findings, 85% (40% 4-6yrs, 24% 7-10yrs and 21% >10yrs) of the business have been in operation for more than 4 years. Business age provides a good basis in analyzing compliance trends especially taxes paid in relation to turnover level. Concerning annual turnover, 88% (43% 5-10million and 45% > 10million) has at least an average turnover of Kshs.5 million which is the minimum turnover threshold for VAT obligation registration, hence most of the business firms under study qualified for VAT registration. 100% of the respondents have the KRA Personal Identification Number. This means that all the sampled businesses are registered with KRA for tax purposes.

The study findings revealed that 138 (Income Tax & VAT -81% and Income Tax, VAT & PAYE-4%) of the respondents representing 85% have a VAT obligation whose compliance among the construction firms is the topic of this study. 94 of the respondents representing 57% have a better tax understanding and adequate knowledge of the VAT-SAS. This means that they are well placed in understanding their obligation in relation to VAT laws and the consequences of non-compliance. The remaining 43% have little (25%) understanding or no knowledge (18%) on VAT laws and operations. This is a threat for VAT compliance therefore KRA should intensify taxpayer education activities to enable taxpayers understand; taxation laws, importance of paying taxes, and the costs of non-compliance. Simplify the tax system and language used, make readily available the tax information and give appropriate feedback to questions raised in good time. 76% of the respondents said that the level of tax understanding and knowledge greatly influences VAT compliance.

Hiring of tax professionals formed the highest expenditure in terms of compliance costs and the construction firms feel that compliance costs affect their level of VAT compliance to a great extent. Other established compliance expenses include; book keeping, trainings and expenses related with internet connectivity for online VAT return filing and payments. 54% of the respondents said that compliance costs influence VAT compliance to a great extent. Other costs cannot be quantified e.g. the psychological costs (mental stress while trying to comply). KRA can simplify the system so that taxpayers can have an easy understanding so that they can reduce reliance on the external tax professionals. Even though, the cost of hiring professionals is beyond

the control of KRA.93% of the respondents said that effective imposition of fines and penalties influences Vat compliance to some extent (48%) or to a greater extent (45%).

From the above study findings it is observed that 48% of the respondents said that effective imposition of fines and penalties will greatly influence VAT compliance while 45% said that it will influence to some extent and the remaining 7% said that effective imposition will to a less extent influence VAT compliance. This finding is important for KRA to devise ways of effectively impose penalties to raise VAT compliance levels. The study findings are consistent with the Allingham and Sandmo model who said that the tax penalty and the potential audit probability have an impact on compliance.

Study findings indicates that 80% of the respondents say that their perceptions and attitudes somehow (27%) or greatly (53) influences their VAT compliance. It can be concluded from the study findings that taxpayer perception and attitudes towards the tax system has greater influence on the VAT compliance level. The findings are in agreement with the fiscal and social psychology theories which propose that the more positive a taxpayer's attitude towards paying tax and working with the tax authorities, the greater their willingness to comply in paying taxes and the alleged fairness of the tax system is significantly related to tax non compliance.

A good percentage of the respondents feel that they do not have access to public utilities but to the contrary they value the payment of taxes in support of the government. Furthermore they also feel that their business colleagues in the construction industry do value the payment of taxes. Even though, majority belief that they can pay their taxes without being followed, a greater percentage says that there is no point of paying taxes when it is being misused, the feeling of the

majority of the respondents is that there exists an opportunity for improvement of the tax system to ease the burden and costs of compliance.

CHAPTER FIVE: SUMMARY OF THE STUDY FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

The study objective is to establish factors influencing Value Added Tax compliance among the construction firms in Kisumu County. The target population consists of registered construction businesses within the Kisumu County. In this chapter the research findings are summarized, conclusions & recommendations to the study are drawn; limitations to the study explained and research gap areas identified for future studies.

5.2. Summary of Findings

The researcher sampled 226 construction firms registered within Kisumu County, 164 of the targeted respondents returned properly filled in questionnaires giving a 72.5% response rate. Relying on the responses given by the respondents, the researcher came up with findings which were used to make conclusions and give recommendations. From the study findings, majority respondents' businesses have been in operation for more than 4 years. The findings reveal that 71% of the respondents, their level of education is that of Technical and graduate making them have better understanding of the industry business they are engaged in and able to make informed decision on VAT matters. The study findings reveal that 88% of the sampled businesses have an annual turnover of kshs.5million and above which is the minimum threshold for VAT registration. Also noted from the study findings, is that all the respondents have the KRA PIN meaning that they have a tax payment obligations. Finally the study findings reveal that 84% of the businesses are VAT registered.

5.2.1. Tax Understanding and Knowledge

It was reported from the study that 57% of the respondents agree they are knowledgeable on the SAS-VAT system which is in operation in Kenya, how the VAT mechanism operates and their duties and responsibilities in regard to VAT legislation. 25% of the remaining respondents had little knowledge on the VAT SAS and 18% of the respondents; had not understanding on the SAS-VAT system. In conclusion, it is noted that majority of the respondents are knowledgeable about the SAS-VAT and are in a position to voluntary comply.

5.2.2. Compliance Cost

The study sought to clarify issues on compliance cost, where 54% of the respondents said that compliance costs to great extent influences compliance with the VAT legislation. 28% of the respondents agreed that compliance costs influences them to comply with some extent and 18% of the respondents said compliance costs influences VAT compliance to a less extent.

5.2.3 Fines and Penalties

The findings reveal that 48% of the respondents believe that effective imposition of fines and penalties are greatly influence the level of tax compliance and this make majority of the respondents to comply with the VAT laws, 45% of the respondents were found to be influenced to some extent to comply and the remaining 7% of the respondents said that effective imposition of fines and penalties will have but to a less extent influence on VAT compliance.

5.2.4 Taxpayer Perception and Attitudes

Majority (81%) of the respondents', believe that it is everyone's obligation to pay taxes with 80% of the respondents agreeing that it's their obligation as citizens to support the government in

tax payment.84% feel that they can pay their taxes without being followed,71% of the respondents value the payment of taxes to the government and the also knows that other business value payment of taxes.66% of the respondents say they do not gain access to public utilities funded by the taxes collected and majority feel that there is room for KRA to improve on the tax systems in facilitating in tax understanding, reduce compliance costs ensure effective application of penalties and positively change taxpayer perceptions on the importance of tax payment and the general tax compliance. Taxpayer perception and attitudes towards the tax system has greater influence on the VAT compliance level.

In terms of attitude of taxpayers toward payment of taxes to the government it can be concluded that majority of the businesses had some access to the public utilities financed by taxes while at the same time valued the payment of taxes to the government of Kenya .This factor can be exploited to improve income tax compliance. Proper utilization of collected revenue by the government will motivate taxpayers to voluntary comply. If taxpayers perceive the government as corrupt or not utilizing collected revenue well, they might feel betrayed and attempt to evade.

5.3. Conclusions

This section will discuss the findings of the study as per the research objectives the study sought to achieve. The objective of the study is to establish factors influencing VAT compliance among the construction firms in Kisumu County, Kenya.

The study findings reveal that all the identified factors have a direct influence on the tax compliance among contractors. The tax compliance factors examined include tax understanding

and taxpayer education, tax compliance cost, fines & penalties and taxpayer perception and attitudes toward complying with VAT laws.

The study results inferred that the level of tax understanding and knowledge has a significant effect on tax compliance. This is because a better understanding of VAT laws encourages compliance.

The study results provide evidence indicating that Value Added Tax compliance cost is a major factor considered by taxpayers whether to comply with taxation laws. Effective imposition of fines and penalties play a vital role in improving tax compliance. Finally, the research study concludes that taxpayer perception and attitudes has a significant effect on tax compliance. It is therefore sensible for KRA to enhance their taxpayer education activities to enable taxpayers have better understanding of various factors affecting tax compliance.

5.4. Recommendations

The establishment of factors influencing VAT compliance is of great concern for the VAT registered businesses. The study findings will facilitate the management of the construction firms to effectively deal with all those factors that contributes to non compliance. Proper tax understanding and Knowledge of the tax systems encourages voluntary compliance. Better understanding of the tax systems and consequences for non compliance, will influence contractors to comply since they will keep proper records in order to avoid fines and penalties. They will reduce reliance on external professional. Tax understanding, knowledge and education have a significant effect on tax compliance.

KRA should also enhance recruitment & registration mechanisms to ensure that quality taxpayers are registered. Also it should improve on surveillance and monitoring of registered taxpayers to ascertain that they make correct tax returns, claim right credits and pay accurate taxes. Thus KRA should empower the taxpayer education service section to enable it educate taxpayers so that they can understand their rights and obligations as taxpayers. This way tax compliance levels will increase.

5.5. Limitations of the Study

The study only focused on the construction firms within Kisumu County. The findings of the study therefore may not 100% reflect the true position for the construction firms in the country.

The study focused only on the construction sector. It should be carried on other lines of businesses to obtain objective conclusions as different industries and sectors have different operational environment.

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

5.6. Suggestions for Further Research

This study proposes the following areas for further study; an investigation into how peers pressure influence VAT compliance among contractors. The effect of withholding VAT compliance on the growth of revenue in the construction sector. An investigation to examine the effect of tax incentives on tax compliance in the construction industry.

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APPENDIX I: QUESTIONNAIRE

The purpose of this survey is to study the factors influencing VAT compliance among the construction firms in Kisumu County, with an aim of enhancing tax compliance with tax laws. The information obtained will only be used for academic purposes and shall be treated in utmost confidentiality. You are kindly requested to complete this questionnaire objectively.

Instructions

Please tick in the appropriate box and also fill in the blank spaces provided for those questions where elaborate answers are required. Feel free to use the back pages if you need more space for narrative responses.

SECTION A: GENERAL INFORMATION

i) Name of business (Optional).....

ii) Kindly indicate your gender: Male Female

iii) What is your position in the business?

- | | |
|--|--|
| <input type="checkbox"/> Business Owner | <input type="checkbox"/> Managing Directors |
| <input type="checkbox"/> Finance Managers | <input type="checkbox"/> Accountant (employee) |
| <input type="checkbox"/> Tax agent/auditor | <input type="checkbox"/> others (Specify)..... |

iv) How long has the business been in operation?

- | | |
|---|---|
| <input type="checkbox"/> Less than 3years | <input type="checkbox"/> 4-6 Years |
| <input type="checkbox"/> 7-10 Years | <input type="checkbox"/> More than 10 Years |

v) What is your level of education?

- | | |
|--|--|
| <input type="checkbox"/> Primary education | <input type="checkbox"/> Secondary education |
| <input type="checkbox"/> Technical level | <input type="checkbox"/> Undergraduate and |

vi) What is the average annual turnover of the business?

Annual Turnover(Kshs.)	Tick
<3 million	
3-5 million	
>20million	

Annual Turnover(Kshs.)	Tick
5-10million	
10-20million	

vii) Does your business have a Personal Identification Number (PIN)?

Yes No

ix) If yes, what are the tax obligations is the business registered for?

Registered Tax Obligation	Tick
Turnover Tax (TOT)	
Income Tax (IT)	
IT,PAYE & VAT	

Registered Tax Obligation	Tick
Income Tax & VAT	
Income Tax & PAYE	

SECTION B: FACTORS INFLUENCING VAT COMPLIANCE AMONG THE CONSTRUCTION FIRMS

1. Levels of tax understanding and taxpayer education

i) Have you ever attended any tax training? Yes No

ii) If yes, who had organized the training?

Kenya Revenue Authority Education Institution

Professional Experts Others (specify).....

iii) If you need to obtain any information on taxation where would you go for the information?

A business colleague KRA website

A friend / relative KRA offices

Professional consultants' Other (specify).....

iv) Do you face any challenges in trying to access information on tax issues?

Yes No

v) If yes, how would you rate the challenges experienced in the process of raising your tax understanding and knowledge level?

Tick your opinion in a scale of 1-4; where 1-not serious,2-serious and 3-very serious

Challenge	1	2	3
Conflicting information from different sources			
Tax system (iTax is not easy to understand)			
Long queues in gaining access to KRA offices			
Technical details on brochures and tax Acts that I don't understand			
Delay in receiving feedback on queries raised			
High fees charged by tax consultants and other professionals on services/advise			
Required information not readily available			

2. Fines and Penalties

Have you ever been penalized for VAT non compliance related behavior?

Yes No

Tick as appropriate, where 1-Strongly Disagree 2.Disagree,3- Agree 4-Strongly agree

Question	Rate				
	1	2	3	4	
The penalty rates are very low and I can afford to pay the penalty					
Enforcement efforts by KRA are weak					
I believe that the penalty is lower than my tax saving due if not complying with VAT laws.					
KRA will impose fines if I don't comply					
Chances of being detected by KRA for non compliance are near zero					
Penalties are punitive and the probability of detection is high, I better comply with the tax laws					

To what extent do you think imposition of fines and penalties influences VAT compliance?

Less extent	<input type="checkbox"/>
Some Extent	<input type="checkbox"/>
Great Extent	<input type="checkbox"/>

3. Compliance costs

How much do you spend per month to submit VAT return and pay the tax payable?

Amount spent-internal & external (Kshs.)	Tick
<5,000	<input type="checkbox"/>
5-10,000	<input type="checkbox"/>
10,000-20,000	<input type="checkbox"/>
20,000-30,000	<input type="checkbox"/>
>30,000	<input type="checkbox"/>

What do you feel is the most expensive compliance cost?

Expense	Tick	Expense	Tick
Most expensive cost	<input type="checkbox"/>	Hiring professionals	<input type="checkbox"/>
Book keeping	<input type="checkbox"/>	Training	<input type="checkbox"/>
Others (specify).....	<input type="checkbox"/>	Internet connections	<input type="checkbox"/>

How compliance costs influences VAT compliance level. Tick in the appropriate box.

Compliance costs	Tick
Less extent	<input type="checkbox"/>
Some Extent	<input type="checkbox"/>
Great Extent	<input type="checkbox"/>

4. Taxpayer perception and attitude

i) Do you think payment of taxes is everybody’s obligation?

Yes No

ii) Please rate the following statements on a scale of 1-4, where 1-Strongly disagree, 2-

Question	Rate				
	1	2	3	4	
I believe it's my obligation as a citizen to support the government by paying taxes					
I feel that there is a lot that can be done on our tax systems to ease the work of preparation of tax returns and payment.					
I find it hard to comply with the tax laws as they are complicated					
I see no point of paying taxes when it is being misused by individuals in government					
K.R.A has put in place enough measures to ensure that taxpayers know of their obligations and reparations of noncompliance.					
The tax system in place motivates me to voluntarily comply with my tax obligations.					
feel that I can pay my taxes in all obligations without being followed					
I value the payment of taxes to the government					
Other businesses value the payment of taxes to the government					
I do gain access to the public utilities and services funded by the taxes collected.					

Disagree, 3-Agree and 4-Strongry agree

The influence of attitude and perceptions on VAT compliance. Tick in the appropriate box

Influence	Tick
Not Influenced	
Less Influence	

Influence	Tick
Some Influence	
Greater Influence	

SECTION C: RANK THE FACTORS INFLUENCE ON VAT COMPLIANCE LEVEL

Factors Influencing VAT Compliance where 1 means greater influence than other factors and 4 means least influence.

Factor	Rank
Tax understanding and Knowledge	
Compliance costs	
Fines and penalties	
Taxpayer perception and attitudes	

Below are my details

Name : Jared Onyiego Cell phone: 0722686290

Respondent's name (Optional): Cell phone:

**APPENDIX II: KREJCER AND MORGAN TABLE FOR DETERMINING
THE SAMPLE SIZE FOR A GIVEN POPULATION SIZE**

N	S	N	S	N	S	N	S	N	S
10	10	100	80	280	162	800	260	2800	338
15	14	110	86	290	165	850	265	3000	341
20	19	120	92	300	169	900	269	3500	346
25	24	130	97	320	175	950	274	4000	351
30	28	140	103	340	181	1000	278	4500	354
35	32	150	108	360	186	1100	285	5000	357
40	36	160	113	380	191	1200	291	6000	361
45	40	170	118	400	196	1300	297	7000	364
50	44	180	123	420	201	1400	302	8000	367
55	48	190	127	440	205	1500	306	9000	368
60	52	200	132	460	210	1600	310	10000	370
65	56	210	136	480	214	1700	313	15000	375
70	59	220	140	500	217	1800	317	20000	377
75	63	230	144	550	226	1900	320	30000	379
80	66	240	148	600	234	2000	322	40000	380
85	70	250	152	650	242	2200	327	50000	381
90	73	260	155	700	248	2400	331	75000	382
95	76	270	159	750	254	2600	335	100000	384

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