

**DETERMINANTS OF VALUE ADDED TAX COMPLIANCE WITHIN
CLASSIFIED HOTELS IN NAIROBI COUNTY, KENYA**

BY

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DEDICATION

To Sussie Karanja, my best friend and Kyrie Karanja, our son.

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ABSTRACT

Taxation is the main instrument through which governments raise finances required to provide public goods. Kenya Revenue Authority does not collect as much revenue from tax as it should as a result of low compliance. Value Added Taxpayers in particular have the potential of generating a lot of revenue for the government but this is not the case. Unfortunately, Kenya, like other governments, struggles to achieve its set revenue targets. In relation to its VAT collection, KRA notes a compliance gap as high as 45%. The question of how to narrow the compliance gap is therefore timely. The hotel industry forms an integral constitution of the larger tourism sector, regarded as one of the main economic pillars of the country, with a contribution of 8.2% to Kenya's GDP and over 1.1 million employment opportunities. This study seeks to determine the determinants of the Value Added Tax compliance among the classified hotels within Nairobi County. The objectives of the study were to determine tax compliance costs, tax knowledge, taxpayer perception and tax audit on value added tax compliance among the classified hotels within Nairobi County. The study was supported by four theories namely; The rational choice theory, The Information Asymmetry Theory, The Fiscal Exchange Theory and The Lending Credibility Theory. The study adopted explanatory research design where the target population was 60 classified hotels within Nairobi County. The study had 2 respondents each from the 60 different Hotels thus making a total of 120 respondents. Primary data was used to collect the data using questionnaires. Regression and Correlation analysis was used to determine the significance and relationship of the variables. The data was analyzed using descriptive and inferential statistics. Regression analysis was conducted; the findings revealed that, tax compliance costs had $\beta_1 -0.226 = p$ value of 0.000 which is less than 0.05. Tax knowledge $\beta_2 0.218 = p$ value of 0.000 which is less than 0.05. Taxpayer perception $\beta_3 0.302 = p$ value of 0.002 which is less than 0.05. Tax Audit $\beta_4 0.340 = p$ value of 0.003 which is less than 0.05. significantly affect classified hotels within Nairobi County. The study concluded that indeed tax knowledge, taxpayer perception and tax audit enhance value added tax compliance among the classified hotels within Nairobi County. However, compliance cost affects value added tax compliance negatively. The study recommends that, KRA should step up trainings to sensitize hotel operators on taxation matters, including required documentation and deadlines, train and carry out public awareness campaigns targeted at the hospitality sector on matters relating to taxation as well as conduct record keeping trainings to hotel operators. Further research may be done to examine the effect of tax incentives on tax compliance in the hospitality industry.

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DEFINITION OF TERMS

- Classified hotels -** These are hospitality facilities which have met the criteria set out by the tourism regulatory authority in terms of size, location, star and degree of service offered (Tourism Regulatory Authority 2020)
- Tax Audit:** A tax audit is an investigation of an organization's or person's tax return to authenticate that they are appropriately conveying their fiscal informational. Alm *et al.*, (2017)
- Tax Compliance Costs** – This refers to all the costs borne by businesses and individuals for complying with tax regulation, excluding the costs of the taxes themselves. To comply with tax provisions, both businesses and individuals bear tax substantive costs (e.g. they might need to purchase specific software to fill in tax returns (Sandford, 2009).
- Tax Education:** Is the level of awareness on taxation processes and other tax-related Information (Hasseldine, Holland & Rijt, 2009).
- Taxpayers' perceptions:** Personal psychological and social attributes which influences the level of compliance (Cheeseman, 2015).
- VAT-** Is a general consumption tax assessed on the value of goods and services, and applies to all commercial activities involving production/distribution of goods/services,ICPAK, (2015)

ABBREVIATIONS

| | | |
|-------------|---|--|
| GDP | - | Gross Domestic Product |
| IMF | - | International Monetary Fund |
| KRA | - | Kenya Revenue Authority |
| OECD | - | Organization for Economic Co-operation and Development |
| VAT | - | Value Added Tax |

CHAPTER ONE

INTRODUCTION

This chapter discusses the background of the study. It also sets out the problem statement, the objectives of the study and the hypotheses focusing on the dependent variable which is VAT compliance as affected by the independent variables being compliance costs taxpayers' knowledge taxpayers' perception and tax audit. The chapter also outlines the significance of the study and the scope of the study.

1.1 Background of the Study

Taxation is the instrument used by governments to raise the revenue required for the provision of public goods (Avi-Yonah, 2006). In many instances, governments are faced with the challenge of fiscal constraints arising from increasing expenditures and less revenue (OECD, 2014). Since the ability to collect taxes has a very direct bearing on how a given country caters for its social services that include education, health and security, studies abound on the possible methodologies to improve tax compliance (Akitoby, 2018). The idea of VAT is credited to Wilhelm Von Siemens, a German businessman, who is thought to have developed the same around the 1920s.

Because of the strong backing given by IMF, VAT has since been widely implemented in many countries around the world (Ebrill, Michael, Bodin, & Summers, 2001). Lejeune, (2011) notes that this form of tax now accounts for a quarter of the global tax revenue. VAT is an indirect tax aimed at taxing the final consumer of goods and services (OECD, 2014). VAT was introduced in Kenya in the year 1990 as a key instrument of widening the tax base of the Kenyan government (Onduru & Olweny, 2019). A central feature of VAT is the staged remittance by the taxpayers in the value chain of the proportion of tax corresponding to their margins within a particular tax period (OECD, 2014).

Article 209 of the Kenyan Constitution donates power to the national government to impose taxes in Kenya (Government of Kenya, 2010). This is done through the statutes as assented by the president after being debated and enacted by parliament. Article 94 & 95 of the constitution of Kenya establishes the National assembly and gives it power to legislate. The main piece of legislation governing VAT in Kenya is the VAT Act (Government of Kenya, No. 35 of 2013). VAT accounted for 481.6 billion in the 2020/2021 financial year, comprising 29% of Kenya's revenue (Kenya National Bureau of Statistics, 2021). In line with its constitutional mandate to assess, collect, administer and enforce laws relating to revenue (Government of Kenya, No.2 of 1995), KRA has in its corporate plans always aimed at achieving higher levels of tax compliance (Kenya Revenue Authority, 2020). In order to realize the revenue targets set Kenya Revenue Authority has clustered the economy into different sectors and set various targets for each cluster.

According to Andreoni, Erard and Feinstein, (1998). Tax compliance has been referred to as the taxpayer's desire to follow the laws of taxation in a country in order to enhance economic equilibrium. James & Alley, (2009) state tax compliance to be the level to which the citizens of a given country obey tax law. The elements of tax compliance have been held to include the following: a correct detailing of tax bases; the tax liability arithmetic and payment of tax liabilities in time (Ahmed & Kedir, 2015). James & Alley, (2009) suggest that the measure of non-compliance ought to be the tax gap existing between total collected revenue and the sum that would be collected if there was full tax compliance. The VAT compliance gap in Kenya stood at 43% for both the 2020 and 2021 financial years, against the targeted 35% VAT compliance gap (Kenya Revenue Authority, 2020).

In 2019, the tourism sector contributed about US \$8.8 Trillion to the global GDP and is credited with creating 10% of the employment opportunities around the world (World Travel and Tourism Council, 2019). In Africa, the sector accounts for 8.5% of the GDP, amounting to US \$ 194.2 Billion (Africa Travel and Tourism Association, 2019). The Kenyan tourism industry is considered to be among the major economic pillars of the country, with a contribution of 11% to Kenya's GDP and over 1.1 million employment opportunities (The World Bank, 2017). Within the Sub-Saharan region, Kenya's tourism sector ranks third after South Africa and Nigeria (The World Bank, 2017). Hotel establishments are the major key attractions within the Kenyan tourism industry, alongside fascinating geographical sceneries, wildlife and culture that the country has (Kenya Tourism Board, 2016).

The 2018 Tourism Sector Report identified the hotel industry as one of the key drivers of tourism, and highlighted Nairobi's ranking as 3rd on the African continent in the hotel pipeline report (Tourism Research Institute, 2018). The authority has an obligation to sell the brand of the country to the outside world. This happens by ensuring that the facilities that the visitors reside in when in the country meets certain criteria that are internationally recognized. The Tourism Regulatory Authority is mandated under the (Tourism Act, No. 28 of 2011) with various regulatory functions within the tourism sector, including the classification of hotels and according to them star ratings. Hotel star ratings are used universally to indicate the capacity, facilities, amenities, staff numbers, location and other hotel features (Martin-Fuentes, 2016). Star ratings range from 1 star to 5 stars, having higher ratings pointing to better standards, additional amenities and a larger business enterprise (Abrate, Capriello, & Graquelli, 2011).

The Tourism Regulatory Authority has developed parameters that hotel must meet and uses the parameters to assess the suitability of hotels. A hotel that is positively assessed is added to the list of classified hotels and the list uploaded in the regulators website for the tourist to choose from. For a hotel to be classified, it must meet the standards developed by the authority, including obtaining the necessary operational licenses, attaining the requisite facility standards, meeting specified room and bed capacities and complying with the stipulated staff and management requirements. According to this classification, Nairobi County has the highest number of classified hotels (Tourism Regulatory Authority, 2020). The classified hotels have elaborated organizational structures that made the study findings more reliable. Given the centrality of the hotel industry to the greater tourism industry and the unique classification nature, the study found them fit to evaluate the determinants of VAT compliance and try to answer the question of VAT compliance gap.

1.2 Statement of the Problem

Governments in developing countries have been observed to collect much lower tax revenue in proportion to their GDPs than their counterparts in OECD countries (Mills, 2017). Countries in the sub-Saharan region are recorded to collect revenues amounting to 15% of GDP, while countries in developed economies collect revenues of up to 30% of their GDP (Mills, 2017). The Kenya Revenue Authority has perpetually faced difficulty in meeting the set revenue targets (Kenya Revenue Authority, 2020). While the set projection for the 2018/2019 financial year was Ksh. 1,643.2 billion, the annual performance recorded 1,580.1 billion, representing a 63.1 shortfall (Kenya Revenue Authority, 2020).

The shortfall is made more significant by the fact that the target was already revised downwards from an initial 1,809.9 billion target (Kenya Revenue Authority, 2018).

One of the key initiatives identified in the 7th KRA Corporate Plan 2018/2019-2020/2021 (Kenya Revenue Authority, 2018) was the implementation of a data driven compliance strategy aimed at reducing the existent 45% VAT compliance gap. The targets set in the 7th Corporate plan aimed at reducing the VAT compliance gap to 40% for the financial year 2019/2020 and then to 35% for the year 2020/2021 (Kenya Revenue Authority, 2018). Hotel industry VAT administration received a major blow because of the COVID-19 pandemic.

Reference to the 8th Corporate Plan 2021/2022-2023/2024 (Kenya Revenue Authority, 2020) demonstrates that the targets set in the 7th Corporate Plan with respect to the narrowing of the VAT compliance gap have not yet been realized. The VAT compliance gap stood at 43% for both the 2020 and 2021 financial years, against the targeted 35% VAT compliance gap (Kenya Revenue Authority, 2020).

KRA set targets for various sectors in the economy to try and raise the required revenue through improved efficiency. The hotel industry was allocated the VAT target of ksh355,208 billion and only raised ksh284,167 billion representing 20% loss on target (Kenya Revenue Authority, 2020). According to the statistics provided, it is evident that there is indeed a widening VAT compliance gap in Kenya, requiring to be addressed. Stiff competition characterizes the hospitality industry within the sub-Saharan region, with each country looking to package itself as the most attractive destination (World Bank Group, 2010).

Kenya is documented as the costliest travel destination among its Eastern African peers, partly on account of the 16% VAT rate, which is higher than that of its neighbors (Mwangi, 2018). Hotel owners in Kenya are therefore perpetually faced with the concern of bringing costs down, in a bid to compete successfully with

establishments in neighboring countries (World Bank Group, 2010). As a result, tax avoidance and evasion has colored some of the hotel activities and contributed to instances of VAT non-compliance (World Bank Group, 2010). This non-compliance in turn contributes to the ever-widening VAT compliance gap in Kenya.

Many studies have been carried out on this field, (Mogeni 2014; Chebusit, Namusonge, Oteki and Kipkoech 2014; King’oina 2016; Gitaru 2017; Kuria and Omboi 2016; maelo 2020). Nevertheless, most studies have been done on sectors different from the hospitality industry. So, in order to bridge this existing gap, the present survey looked into the determinants of the VAT compliance among the classified hotels within Nairobi County.

1.3 Research Objectives

1.3.1 General objective

The general objective of the study was to investigate the determinants of the Value Added Tax compliance among the classified hotels within Nairobi County.

1.3.2 Specific objectives

The proposed survey had specific objectives as follows:

- i) To establish the effect of tax compliance costs on Value Added Tax compliance among the classified hotels within Nairobi County.
- ii) To determine the effect of tax knowledge on Value Added Tax compliance among the classified hotels within Nairobi County.
- iii) To establish the effect of taxpayer perception on Value Added Tax compliance among the classified hotels within Nairobi County.
- iv) To determine the effect of tax audit on Value Added Tax compliance among the classified hotels within Nairobi County.

1.4 Hypotheses

- H₀₁:** Tax compliance cost does not have a significant effect on Value Added Tax compliance among the classified hotels within Nairobi County.
- H₀₂:** Tax knowledge does not have a significant effect on Value Added Tax compliance among the classified hotels within Nairobi County.
- H₀₃:** Taxpayer perception does not have a significant effect on Value Added Tax compliance among the classified hotels within Nairobi County.
- H₀₄:** Tax Audit does not have a significant effect on Value Added Tax compliance among the classified hotels within Nairobi County.

1.5 Significance of the Study

The outcome of this research will help tax policy makers, regulators and academic researchers. While previous studies have evaluated tax compliance within the hotel industry generally, this study is the first of its kind to deal with VAT compliance within the new segment of hotels classified by the Tourism Regulatory Authority. The study also makes a worthwhile contribution to the body of tax knowledge in evaluating the effect of hotel star rating as a control variable to the determinants of VAT tax compliance.

This survey's findings together with policy recommendations of this study will be much useful to the Kenya Revenue Authority's department of domestic taxes in establishing strategies aimed at bridging the VAT compliance gap. The study's results will also be useful to classified hotel managers in improving their level of VAT compliance and in providing a basis for engaging the Kenya Revenue Authority in discussions on the various compliance challenges encountered. Other stakeholders like the Tourism Regulatory Authority will be sensitized on VAT tax compliance,

providing a platform for interaction with Kenya Revenue Authority on tax training for registered members.

1.6 Scope of the Study

The survey focused on investigating the determinants of VAT compliance among the classified hotels within Nairobi County. The hotel industry is a major constituent of the greater tourism industry, a major tax income earner within Kenya's economy. Classified hotels are selected on the basis of their homogeneity in meeting the basic hotel regulatory requirements and on their possession of a star rating awarded by the Tourism Regulatory Authority. This target population was 60 classified hotels within Nairobi County and aimed to seek answers from 2 individual per hotel thereby distributing 120 questionnaires. The study embraced an explanatory research design. The study focused on 2020/2021 financial years.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter presents the review of literature, review of concepts, theoretical framework, empirical review, and research gaps and conceptual framework.

2.1 Review of Concepts

This section contains review of concepts studies related to the variable of the study

2.1.1 Value Added Tax Compliance

The idea of VAT is credited to Wilhelm Von Siemens, a German businessman, who developed the idea around the 1920s. Following a strong backing by the IMF, many countries have quite adopted VAT all around the world (Ebrill, Michael, Bodin, & Summers, 2001). (Lejeune, 2011) notes that this form of tax now accounts for a quarter of the global tax revenue. VAT can be said to be an indirect tax aimed at taxing the final consumer of goods and services (OECD, 2014). VAT was introduced in Kenya in the year 1990 with the aim of increasing the tax base of the national government (Onduru & Olweny, 2019). A central feature of VAT is the staged remittance by the taxpayers in the value chain of the proportion of tax corresponding to their margins within a particular tax period (OECD, 2014).

Article 209 of the Kenyan Constitution donates power to the national government to impose taxes in Kenya (Government of Kenya, 2010). The main piece of legislation governing VAT in Kenya is the VAT Act (Government of Kenya, No. 35 of 2013). VAT accounted for 481.6 billion in the 2020/2021 financial year, comprising 29% of Kenya's revenue (Kenya National Bureau of Statistics, 2021). In line with its constitutional mandate to assess, collect, administer and enforce laws relating to

revenue (Government of Kenya, No.2 of 1995), KRA has in its corporate plans always aimed at achieving higher levels of tax compliance (Kenya Revenue Authority, 2020).

According to Andreoni, Erard and Feinstein, (1998) tax compliance has been described to be the taxpayer's desire to follow tax laws to protect the economic stability of a state. (James & Alley, 2009) state tax compliance to be the extent to which citizens of a given country follow tax laws. The elements of tax compliance have been held to include the following: an accurate disclosure of tax bases; the truthful calculation of tax liability and payment of outstanding tax debts on time (Ahmed & Kedir, 2015). (James & Alley, 2009) suggest that the measure of non-compliance ought to be the tax gap separating the existing income received and the actual income that would be received if there was full tax compliance. The VAT compliance gap in Kenya stood at 43% for both the 2020 and 2021 financial years, against the targeted 35% VAT compliance gap (Kenya Revenue Authority, 2020).

2.1.2 Compliance cost

Compliance costs associated with taxation are major impediments to prompt compliance behaviour of taxpayers (Muturi and Thiga, 2015). Compliance costs, monetary and in terms of time and effort, can create barriers for tax compliance. High-level of tax rates and complex tax legislations can result to various tax crises like tax evasion and tax fraud. A research by (Luigi, 1998) concluded that companies will create a kind of resentment against authorities who impose too high levies and too complex tax systems which accelerates tax avoiding systems.

He also argued that due to the complexity of tax systems, most companies rely on external tax professionals who by means of advanced tax avoidance engineering will

minimize tax payments (Luigi, 1998). Some elements of costs of tax compliance may include audit costs, travelling, administrative costs and others. Administrative costs are the costs that exist besides the occurrence of compliance costs that are borne by the companies. Compliance costs can also be divided into three components time spent, cash expenses and psychological costs. The nature of these costs is in a way that the taxpayer must consider in order to ensure compliance. Tax laws keep changing every financial year with the introduction of a finance bill. It therefore requires that a taxpayer keep track of the changes. This could only happen with employing proper resources like regular trainings and tax consultants whose costs eat on the profits of the organization.

2.1.3 Tax knowledge

Tax knowledge is an essential element in a voluntary tax compliance system (Kasipillai, 2014). Tax knowledge as one of the factors influencing tax compliance is related to the taxpayers' ability to understand taxation laws, especially regarding tax registration, filing requirements and their willingness to comply (Abdu & Wondimu, 2019). Therefore, understanding taxpayers' knowledge and compliance behaviour is an important issue for any government and tax collecting authority particularly in a self-assessment environment. Commonly Citizens have limited knowledge on government true expenditures and the cost of public services provided by the government. Therefore, taxpayers without tax knowledge are compelled to solicit the service of tax professionals. Tax knowledge can be learnt by self-learning, taking formal education, and taking the informal ones. The government also takes many actions to socialize tax rules and policies where taxpayers can learn from. Unfortunately, not all people give their best attention to acknowledge the rules, some of them assume that tax is a burden that should be denied (Hastuti, 2014).

Studies conducted by different researchers such as (Ahmed & Kedir, 2015), (Palil, 2010), (Abdu & Wondimu, 2019) showed that tax knowledge has a positive and significant impact on tax compliance. However, a study of (Engida and Baisa, 2014) indicated that tax knowledge was not significantly correlated with tax compliance.

2.1.4 Taxpayer Perception

Perception towards tax and its general compliance levels among SSEs has been identified as one of the major factors that influence compliance (Redae & Sekhon, 2016). Savitri and Musfialdy (2016) opine that tax evasion is a universal phenomenon that takes place in all societies and economic systems including both developed and developing countries and it is influenced by many factors among them attitudes and perceptions. According to Junpath, Kharwa and Stainbank (2016), the growing dissatisfaction with the fairness of tax system is the major causes for increasing tax noncompliance. This is in contrasting between the benefits received for the tax given and the equity of the taxpayer's burden in reference to that of other individuals. It has thus seen that taxpayers who believe that the tax system is unfair are more likely to commit tax noncompliance behavior. Perception towards corruption dents compliance behavior among taxpayers. This perception erodes the willingness of taxpayers in contributing just shares of revenue (according to Jahnke as reviewed by Melgar et al, 2010) and nurtures beliefs of doubt in taxpayers in the associated government authority (Melgar and others, 2010). (Arifin, Chris & Binh, 2017) noted that corruption perceptions and tax noncompliance behavior presents major problems in the success of developing countries. Tax compliance should therefore be sustained, for instance, by a strong cooperative interaction between the government and the citizens who are taxpayers. This is believed that it will eventually lead to improved voluntary compliance.

Because taxes constitute payment for government services, taxpayers' perception on government's utilization of revenue becomes a strong tax morale indicator (Torgler, 2011). In a 2013 study conducted in Kenya, Uganda and South Africa, Kenyan taxpayers who were content with government's services provision of electricity and roads reported a 10% more likelihood at tax compliance than those who were not (Ali, Fjeldstad, & Sjørusen, 2013). Where a tax system is transparent and accountable, taxpayer's confidence and trust in the government leads to improved rates of tax compliance (Global Initiative for Fiscal Transparency, 2021).

2.1.5 Tax Audit

There is a positive association existing voluntary compliance and the audit (Niu, 2010). The findings as per the survey by Niu (2010) state that audit productivity is often underestimated especially in many works of literature. The study tells us that consideration of the audit work productivity should involve audit impact on voluntary tax compliance in addition to direct audit collections. Because of this, the finding from this survey provides tax authorities and professionals with incentives that work to promote their audit poer and organization structure that aid in generating more income to the country.

Jimenez & Iyer, (2016) assessed individual compliance responses to some degree of audit likelihood. They found that taxpayers' compliance rate rises when they learn they will be audited. The compliance rate decreases when they are aware that the tax audit will not take place. Kircher (2018) referred tax audit to be the inspection of the tax reports of an individual taxpayer or an organization by the official tax authorities for them to know whether the taxpayer complies with a country's taxation laws and regulations. Additionally, he put forward that tax audit is the exercise in which the

revenue service looks into the numbers you have established to be your tax return and determine the legibility.

2.2 Theoretical Framework

This research borrowed from existing theories and knowledge database on VAT compliance. It discussed four theories that sought to explain more on the relevance of the studied independent variables. The theories discussed are the Rational Choice Theory, The Information Asymmetry Theory, the Fiscal Exchange Theory, and the Lending Credibility Theory.

2.2.1 Rational Choice Theory

The rational choice theory is thought to first have been developed by Adam Smith in his fourth maxim for taxes in 1776 (Smith, 1904). The maxim, appreciating the effect that operating costs have on the tax system, denounced a tax system that exposed taxpayers to unnecessary trouble and vexation over and above that which was beneficial to the sovereign (Smith, 1904). Although developed in the context of free market economies, the theory has found useful application in the area of modern economic theory and thus provides a useful theoretical underpinning to the proposed study (Ulen, 1999). The theory generally posits that rational individuals will comply with norms where the utility of such compliance outweighs non-compliance. In his seminal work, 'Crime and Punishment: An Economic Approach' (Becker, 1968) is credited with extending the application of the rational choice theory to tax behavior, specifically tax evasion. It was his argument that tax evasion can be considered as a rational choice in which the taxpayer assesses the benefits obtainable from declaration vis-a-vis those accruing from concealment (Becker, 1968).

On the matter of tax compliance behavior, this theory proposes that business decisions will almost always follow a rational path of action, aimed at profit maximization (Ulen, 1999). Following this rational thread, the theory suggests that enterprises will often seek out cost minimization strategies, so that high compliance costs are likely to discourage overall tax compliance (Ulen, 1999). Tax compliance costs are generally regarded as additional financial burdens imposed on taxpayers over and above the actual tax imposed, in a bid to conform to their tax obligations (Sandford, Michael, & Peter, 1981).

From a rational choice perspective, compliance costs are nothing more than dead weight losses, merely increasing the effectiveness of the tax burden without a corresponding increase in tax revenue (Eichfelder & Vaillancourt, 2014). Various criticisms have been levelled against the rational choice theory and its relation to tax compliance, the chief of which is that not all enterprises will automatically elect the same choice as being the most rational in a given situation (Hedstrom, 2005). In response, proponents of the theory ascribe the deviations to market failures such as information asymmetry or monopoly as hindrances to optimal decision making (Elster, 2007). In light of the rational choice theory, high VAT compliance costs are likely to be met with low incidences of VAT payment.

2.2.2 The Information Asymmetry Theory

A second theory underpinning the study is the information asymmetry theory first propounded by George Akerlof in 1970 (Akerlof, 1970). The theory defines information asymmetry as a situation in which one side in the association possesses either more information or better details than the other side which eventually leads to market (Akerlof, 1970). Although developed in the context of economics based on the imperfect information between a buyer and a seller, the theory has been extended

to numerous subfields including human resource management (Gomez-Mejia & Balkin, 2017) and organization theory (Paruchuri & Misangyi, 2014).

The information asymmetry theory has already been employed in studying the effects of tax compliance in Indonesia (Kristiaji, 2013) and in evaluating income shifting in relation to patents in the US (Amberger & Osswald, 2019). Kristiaji, (2013) in his study found an imbalance of tax knowledge between the regulator and the taxpayer, which asymmetry contributed to tax non-compliance. The information asymmetry in tax matters is characterized by the complex nature and large volume of tax laws, and the fact that these laws are ever changing (Kristiaji, 2013). Taxpayers are therefore deterred from seeking to acknowledge the existent laws of taxation and where they are unable to hire tax experts to enable them comply, remain largely non-compliant (Yaniv, 1999).

On the other hand, (Dodwell, 2020) notes that the taxpayer has a monopoly of knowledge relating to his gains and profits. Where the taxpayer withholds this information from the tax authority, whether willingly or because they are unaware of their disclosure obligations, the government will perpetually get less revenue than it ought (Dodwell, 2020). Given the self-assessment nature of Kenya's tax system, information asymmetry as expounded in the theory has a direct influence to VAT compliance.

2.2.3 The Fiscal Exchange Theory

The Fiscal Exchange Theory, coined by Robert Bates and Da-Hsiang Lien in 1985 (Bates & Lien, 1985) suggests that the provision of public goods perceived by the taxpayer as being valuable dictates the degree of compliance. (Fjeldstad, Schulz-Herzenberg, & Sjursten, 2012) argue that under this theory, the taxpayer exchanges

their compliance expecting government services in turn. This exchange is often operational and efficient with quality performance from the government. Based on this theory then, the greater the taxpayer satisfaction with the government services, the greater the level of compliance (Bates & Lien, 1985). On the other hand, compliance will be reduced when the taxpayer is not content with the quality of government services provided or even the way in which the remitted taxes are utilized (Spicer & Lundstedt, 1976). From the foregoing, taxpayer perception affects tax compliance.

2.2.4 The Lending Credibility Theory

The lending credibility theory is the theory of inspired confidence. The lending credibility theory states that the main aim of audit is to compliment financial statements of a firm. Because of this, an auditor must enhance credibility to win clients. Having financial statements that are audited increases a user's confidence and trust in the financial numbers provided by a firm. According to Limperg (1932), this theory that is also referred to as the theory of rational expectations directs demand and supply of all audit services.

The demand for these audit services arises as a requirement imposed by the involved stakeholders to enhance the accountability of the company and promote confidence for them to invest. The agency theory determines the relationship between the auditor and stakeholders (Arrow, 1985). From this, it is clear that an auditor is chosen to enhance assurance between the third parties and the management of a company (Watts and Zimmerman, 1979). The end of an auditor's professional task is marked by delivering his judgment in reports that he prepares. In the early 20th century, it was assumed that the role of an auditor is searching, identifying and preventing financial fraud in a company which his client is part of. Overtime, this role has integrated to

providing assurance, enhancing fairness and verifying the truth displayed in financial statements which is done through fraud detection.

This theory of auditing states that the chief role of auditing is to promote credibility to financial statements. According to Akinbuli (2010), audited financial statements work to promote faith and trust in management by the stakeholders with the reasoning that an independent party is the best person to go through the financial statements, ensure they are correct and produce a report. Often, shareholders and stakeholders trust the reports of auditors and it enhances their feeling of security and thus they can freely invest. The theory was a result of the modification carried out on the initial one by Hayes et al (1999) that specifically said that revenue authorities use financial statements to determine the amount they should collect as revenue. This enhanced credibility in the theory of auditing.

2.3 Empirical Review

The ensuing portion discusses the literature surrounding the study's independent variables.

2.3.1 The effect of tax compliance costs on VAT compliance

According to Sandford (1995) defines compliance costs as those expenses incurred by firms over and above the actual payment of tax, towards meeting the firms' taxation obligations. Tran-Nam, Evans, Walpole, & Ritchie, (2000) on the other hand, define compliance costs as the value spent by taxpayers on resources used to meet their tax requirement or responsibility. For a long time, these costs were thought to be incapable of ascertainment, first because they were considered largely insignificant, secondly because there was no formal model developed towards their assessment and

lastly because of the dearth of data collected from firms on the subject (Tran-Nam, Evans, Walpole, & Ritchie, 2000).

Several studies in the recent past have however disabused these traditionally held perceptions. A survey done to investigate compliance and administrative costs within the context of the UK by (Sandford, Godwin, & Hardwick, 1989) is thought to have been the earliest attempt at measuring compliance costs. The study concluded that a combination of these costs make up to about 4% of the total tax revenue due to the country, with smaller firms shouldering a heavier portion of the burden (Sandford, Godwin, & Hardwick, 1989). (Sandford & Hasseldine, 1992) study of compliance costs in New Zealand highlighted their significance, their cumulative impact and found that they had a disproportionate effect on smaller enterprises.

Studies on VAT compliance costs in Algeria (Mansor, Tayib, & Ferdjani, 2016), Botswana (Makara & Pope, 2013) and South Africa (Smulders, Stiglingh, Franzsen, & Fletcher, 2012) conclude that the compliance costs are high and in most instances regressive. A study undertaken by (Wang'ombe & Farida, 2018) on how tax compliance costs affect tax compliance behavior in Kenya found that heightened compliance costs in Kenya were mainly connected with complex and often changing tax laws. An increasing awareness of how compliance costs influence tax compliance generally has shifted the discussion merely from academic platforms to government policy platforms (Charron, Chow, & Halbesma, 2008).

The Australian, UK and New Zealand governments have for example brought forward a strategy that ensures that all new tax regulations are accompanied with a statement on cost compliance impact (Tran-Nam, Evans, Walpole, & Ritchie, 2000). The study notes an existent gap in studies relating to VAT compliance costs in Kenya,

specifically within the hotel industry. A review of the literature above also demonstrates that developed economies have been able to calculate the amount of these compliance costs expressed as percentage of its suitable revenue. The studies done on the African continent do not seem to have statistical support for tax compliance costs.

There is ongoing debate on the specific costs to be comprised as tax compliance costs (Killian, Karlinsky, Payne, & Arendse, 2007). Literature on compliance costs generally include the following categories: value of time spent in understanding and applying tax rules; record keeping costs; payments made to tax professionals and incidental costs for communication with tax authorities (Evans, 2006). For purposes of the present study, the compliance costs may be classified into two classes: internal tax compliance costs and external compliance costs.

Internal compliance costs entail the costs expended by the classified hotels in collecting, remitting and accounting for VAT. The attendant software and hardware costs required in the computation of tax liability are also a section of the internal compliance costs. The wages of the employees employed to collect, remit and even account for VAT tax also forms a necessary constituent of internal compliance costs. Advisory costs related to tax queries, objections and appeals as well as the cost of continuous training on emergent tax areas are some of the external compliance costs relating to VAT. These costs also include incidental expenses incurred in communicating with the tax authority.

2.3.2 The effect of tax knowledge on VAT compliance

(Memen, Adi, Hanifa, & Ikin, 2019) define tax knowledge as the amount of understanding of tax laws and other related information by taxpayers. The ability to

the taxpayer to understand tax laws and regulations influences the compliance behavior of the taxpayers to a great extent (Palil & Mustapha, 2011). Empirical studies on how tax knowledge affects compliance evidence a connection linking non-compliance and taxpayers' lack of knowledge (Fjeldstad & Heggstad, 2012). Bornman and Ramutumbu, (2019) package the relevant tax knowledge into three broad categories; general tax knowledge; legal tax knowledge and procedural tax knowledge. General tax knowledge refers to a taxpayer's awareness of their financial position and the effect of the tax system on their finances (Fjeldstad & Heggstad, 2012). (Masaku, 2019) suggests that in the case of an individual tax payer, general tax knowledge increases with the level of formal education attained.

Legal tax knowledge refers to the correct interpretation of taxation laws and regulations and the competence to apply these rules to determine the extent of tax liability (Fjeldstad & Heggstad, 2012). Acquisition of this category of tax knowledge has been found to be the most difficult, owing to the intricacy of these laws and also because tax evolves and changes frequently (Kirchler, Alm, & Muehlbacher, 2012). According to (Yaniv, 1999) tax complexity is seen to arise where there are too many tax regulations to be complied with; where the language in those regulations is difficult and where multiple forms require to be filled. Increase in complication of a tax system lowers the level of tax compliance witnessed (Yaniv, 1999).

Procedural tax knowledge refers to an awareness of the processes and responsibilities of compliance including production of supporting documentation and timely payment of tax (Fjeldstad & Heggstad, 2012). This category of tax knowledge includes awareness on the relevant tax rates as well as the level of penalties associated with non-compliance (Oladipupo & Obazee, 2016). (Tallaha, Shukor, & Hassan, 2014) in a study conducted in Malaysia, found that persons who had no legal tax knowledge

were still able to utilize the provided the e-filing system to submit their tax returns, demonstrating the distinctiveness between the two categories of tax knowledge.

From the foregoing, wholesome tax knowledge, including a general, legal, and procedural understanding affect tax compliance. Understanding the level of knowledge and the hurdles towards acquisition of that knowledge among classified hotels in Nairobi will shed light on the aspect of VAT compliance.

2.3.3 The effect of taxpayers' perception on VAT compliance

Tax morale refers to the inherent obligation to finance taxes as a form of contribution to society (Schmolders, 1970). Curiosity around the inquiry of why people finance their taxes has increasingly gained popularity especially in the context of countries with low tax evasion detection frameworks (Alm, McClelland, & Schulze, 1992). Even where there are strong audit structures and strict penalties for non-compliance, these governmental interventions on their own cannot account for all the honored tax obligations (Kirchler, 2007). (Long & Swingen, 1991) suggest that a large population of taxpayers are simply honest and are ready to bear their tax obligations.

According to (Erard & Feinstein, 1994) tax evasion for this category of taxpayers arouses feelings of guilt, anxiety and low self-worth. (Frey & Schneider, 2000) on the other hand, propose that some taxpayers are compliant simply because they do not have the know-how or resources to evade. The influence of factors such as gender (Vogel, 1974), religiosity (Anderson & Tollison, 1992) and culture (Swidler, 1986) have also been found to have a bearing on the level of tax morale. Perhaps the strongest determinant of tax morale studied to date relates to the country's political conditions (Bird, Martinez-Vazquez, & Torgler, 2006). While literature on individual determinants of tax morale abound, the study will provide useful information on the

factors that influence the tax morale of corporate taxpayers within Kenya's hotel industry.

Because taxes constitute payment for government services, taxpayers' perception of government's utilization of revenue becomes a strong tax morale indicator (Torgler, 2011). In a 2013 study conducted in Kenya, Uganda and South Africa, Kenyan taxpayers who were content with government's services provision of electricity and roads reported a 10% more likelihood at tax compliance than those who were not (Ali, Fjeldstad, & Sjurson, 2013). Where a tax system is transparent and accountable, taxpayer's confidence and trust in the government leads to improved rates of tax compliance (Global Initiative for Fiscal Transparency, 2021).

2.3.4 The effect of Tax Audit on VAT compliance

Tax audit influences the revenue collected by enhancing voluntary VAT tax compliance by the taxpayers hence increasing the overall revenue. Further, tax audit scrutinizes the accuracy stated in returns which enhances correct submission of taxes. With this audit, it is easy to declare tax liability and also point out the issues that require some changes. Tax audit also plays a key role in collecting interests and penalties accruing from taxes that in the long run increase the total revenue collected. Conducting a tax audit helps to in developing and making changes in taxation that suppress or eliminate tax evasion. Therefore, tax audit can be said to have a positive relationship with value added tax compliance.

Kircher (2018) referred tax audit to be the inspection of the tax reports of an individual taxpayer or an organization by the official tax authorities for them to know whether the taxpayer complies with a country's taxation laws and regulations. Additionally, he put forward that tax audit is the exercise in which the revenue service

looks into the numbers you have established to be your tax return and determine the legibility.

According to Ola (2011), the exercise of tax audit entails chosen tax returns for audit. There must be an established criteria for this selection. Afterwards, the records and the books kept by the taxpayer are then scrutinized to ensure they relate to the taxes filed. Tax audit has a variety of importance especially in enabling the government collect the relevant revenue that is used to finance the national budget, ensuring financial and economic stability, to guarantee that taxpayers deliver their deserved tax returns, to realize and cope with tax evasion and avoidance, to make sure that taxpayers follow tax laws diligently, and to increase the level in which taxpayers agree to voluntary tax compliance.

Rwanda. Ordinary least square regression (OLS) was utilized, this review found an important positive connection linking Rwanda's tax audit and collection of revenues. It was thus inferred that, tax audit affects revenue collection and helps to encourage voluntary taxpayer enforcement, which raises revenue significantly. Jimenez & Iyer, (2016) assessed individual compliance responses to some degree of audit likelihood. They found that taxpayers' compliance rate rises when they learn they will be audited. The compliance rate decrease when they are aware that the tax audit will not take place.

In Nigeria, Olaoye et al., (2018) examined the impact of tax audit on tax productivity in Lagos State. The survey viewed tax audit in three different categories, namely, desk auditing, back-duty audit and field auditing. Logistic regression techniques were used, and the result shows that tax auditing has a major effect on tax productivity and tax

enforcement in Lagos State. The study concluded that tax enforcement might be enhanced among taxpayers; tax audits should be performed on a routine basis.

In a related study by Olaoye & Ekundayo (2019), low tax compliance and remittance is identified as one limiting factor for government revenue generation. In this regard, they investigated how tax audit affects tax compliance and the remittances made in Ekiti State, Nigeria. The outcome of their study shows that a significant positive relationship exists between tax audit, tax compliance and tax remittances among taxpayers in Ekiti State. The study also found that audit history, including frequent audit, audit results, and small business owner's type of review has a substantial impact on record keeping and tax compliance.

2.4 Research Gaps

Previous surveys try to show the interplay between compliance costs, (Mogeni, 2014) (Chebusit, Namusonge, Oteki, & Kipkoech, 2014) (Omondi & Theuri, 2019) taxpayer awareness and education (King'oina, 2016) (Gitaru, 2017) (Masaku, 2019) (Maithya, 2020) and taxpayer perception (Magutu, Lumumba, & Migwi, 2010) (Kuria & Omboi, 2016) (Maelo, 2020) on VAT compliance in Kenya. While the variables have been studied with reference to small scale traders, businesses within the SMEs sector as well as large corporate taxpayers, VAT compliance with reference to classified hotels has not yet been undertaken.

In addition, prior research has sought to establish the connection linking the variables and VAT compliance generally. The proposed study is grounded on KRA's inability to meet the set VAT targets, specifically demonstrated through the current 43% compliance gap. The proposed study is therefore oriented at establishing the contribution made by these variables on the VAT compliance gap. In addition, the

inclusion of hotel star rating as a control variable on the question of VAT compliance has not been appreciated in prior study.

2.5 Conceptual Framework

This part gives a conceptual model, outlining the relationship between the different variables. Conceptual modelling enables the interplay between the various variables to be easily identifiable, eases understanding of the various complexities in the survey and serves like a map of the research's empirical enquiry (Briggs, 2007). The study has three variables: a dependent variable; three independent variables and one modifying variable. The conceptual framework models the impact of tax compliance costs measured by Internal costs and External costs, tax knowledge was measured by Taxpayers' obligations & rights, Tax rates and Fines and penalties. Taxpayer perception was measured by Tax morale Tax transparency & accountability. Tax audit was measured by Desk Audits and Field Audits

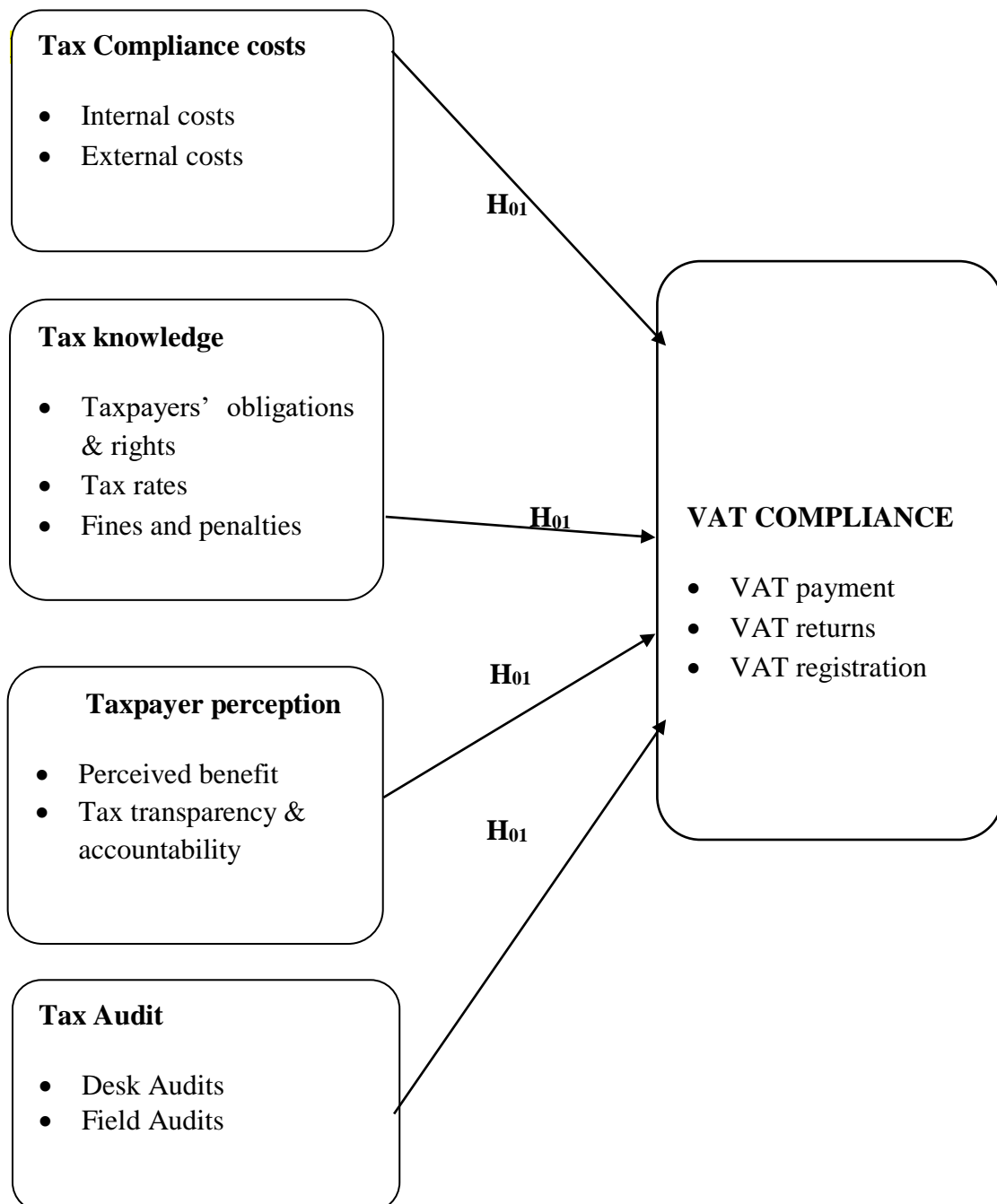
Independent Variables**Dependent Variable**

Figure 2.1: Conceptual framework

Source: Author, 2022.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The following section explains the research methodology that the researcher adopted in conducting the research. It shows a clear blueprint on the research design, target population, sampling design, data collection method, research procedures and data analysis.

3.2 Research Design

As reported by Creswell, (2014) a research design as one of the tenets of a survey approach essentially dealing with the procedure of inquiry adopted in satisfying research objectives. The exploratory research design was chosen as the most suitable for this study. The exploratory research design has been hailed as the most appropriate for seeking new insights and understanding the relationship between phenomena in a new light (Yin, 2009). The exploratory research design was adopted since the research proposed to evaluate the interplay between the dependent variable, being VAT compliance among the classified hotels in Nairobi, and the independent variables being, compliance cost, tax knowledge and perception on tax in the context of hotel star rating as a control variable.

3.3 Target Population

A target population has been referred to as the category to which inferences are made based on a sample drawn (Lavrakas, 2008). The target population for the study was 60 Tourism Regulatory Authority classified hotels within Nairobi County; particularly, targeting one representative from each hotel giving a target population of 60 (KRA 2021). The study had 2 respondents each from the 60 different Hotels. This made a unified sum of 120 respondents who included finance managers and finance assistant

because they are directly or indirectly involved in decision making that ensures that their respectively hotels are compliant. The researcher used a census survey on the population. Classified hotels were selected for this study based on their uniformity in compliance with the licensing, capacity, facility, staff, and management standards set out by the Tourism Regulatory Authority (Tourism Act, No. 28 of 2011). Based on their satisfaction of the stipulated requirements, they have obtained star ratings, making comparison across the study set tenable (Tourism Regulatory Authority, 2020).

3.4 Sampling Frame

A sampling frame that is also known as a source list is a list that constitutes all elements in a population wherefrom the sample will be obtained (Kothari, 2004). The target population is 120 comprising of 60 finance manager and 60 finance assistant, as reflected in the sampling frame in table 3.1

Table 3.1: Sampling Frame

| Population Description | Population |
|-------------------------------|-------------------|
| Finance Manager | 60 |
| Finance Assistant | 60 |
| Total | 120 |

3.5 Data Collection Instruments

This research utilized primary data in collecting required information. A structured questionnaire was administered using physical methods. The assistant in the research utilized questionnaires to be the main instrument for collecting data. The questionnaire entailed basic questions about all the respondents and additional close-ended statements

drafted to cover the research questions, objectives and study variables and in the format of a Likert-scale.

According to Cooper and Schindler (2006), the most suitable questionnaires particularly in studies like this where there is need for the respondents to have enough time to focus on their responses are self-administered questionnaires. Additionally, these questionnaires are also cost efficient and enhance a sense of anonymity to the respondents.

3.6 Data Collection Procedure

This study employed self-administered questionnaires to collect data. The structure of the questionnaire depends on the recommendation in (Suskie, 1996) in containing close ended questions to a large extent and using only a few open-ended questions for clarification and recommendations. This questionnaire structure had been used by (Kuria & Omboi, 2016) in studying how tax attitudes affect tax compliance in Kenya; (Abdul & Wang'ombe, 2018) in evaluating how compliance costs influence tax compliance behaviour in Kenya and (Adhiambo & Theuri, 2019) in studying how tax awareness affects tax compliance in Kenya. The questionnaires was distributed to the finance department of the selected hotels. This ensured that a total of at least 120 questionnaires was distributed. Where possible, in person interviews was conducted to ensure proper understanding of the exercise. The filled questionnaires were then collected after two weeks for analysis.

3.7 Pilot Study

A pilot study as a test undertaken in preparation and prior to the complete survey for the purposes of detecting any shortcomings in the collection procedure, identifying unclear questions in the questionnaires and generally testing the feasibility of the

proposed study (Teijlingen & Hundley, 2001). This test should range between 1% and 10% based on the size of the entire sample (Cooper & Schindler, 2006). Because of this, the pilot test for this study was done on 12 classified hotels located in Machakos county. Given the similar developmental standards of Machakos County in relation to Nairobi County, these gave a representation of the data collection experience within classified hotels.

3.8 Reliability of Research Instrument

Reliability is the degree up to where test scores are devoid of error in measurement (Muijs, 2011). It has also been described as the measure of stability of an instrument when employed to measure various concepts (Jackson, 2006). The questionnaire tested 10% of the population, equivalent to 12 respondents . The Chronbach's alpha test was done to establish how reliable the instrument was. The results showed coefficient of over 0.7, hence all variables were regarded reliable

3.9 Validity

An instrument's validity is measured by its ability to accurately measure any prescribed variable (Ghazali, 2016). The testing of the valifdity of the questionnaire was carried out during the piloting phase and the resultant responses were checked against the study's objectives. Further more, content validity was adopted in this study; this was to ensure that items in the data instruments reflect the content universe to which the instrument was to measure. Consequently, any useful information from the contributions of the researcher, supervisors and other appropriate academic staff was considered to come up with validity of the research instruments.

3.10 Statistical Assumptions

Statistical assumptions have been defined to be the general assumptions about statistical populations. For a researcher to make accurate and valid conclusion about real statistical tests some appropriate background assumptions need to be made. The testing of all assumptions played a key role in making sure that the analysis was valid which in addition helps prevent errors in hypotheses. The diagnostic tests that were done included; Linearity, Normality and Multi-collinearity tests.

3.10.1 Normality test

The best and powerful test to use when doing normality test is the Shapiro-Wilk (Razali & Wah, 2011). “This test was adopted for this survey to test the data. When the p value of the test is below 0.05, it is an evidence that the data has deviated by a great amount from its normal distribution. In this case, the assumption of normality made was not violated since Shapiro-wilk had p values of above 0.05 and the data was normally distributed.

3.10.2 Multicollinearity test

According to Osborne and Waters, (2014), multicollinearity makes significant variables non-significant by enlarging their standard errors. Tolerance refers to the quantity of variance in one independent variable and that is hardly elucidated by the other independent variable.

Lower levels of VIF prove to be more useful than higher levels of VIF that negatively influence results of multiple regression analyses (Bowerman & Connell, 2006). According to the authors, a VIF greater than 2.50 shows lofty levels of multicollinearity. .

3.10.3 Linearity test

Linearity test When p value of deviation from linearity test is >0.05 the assumption of linearity is not violated, if the p value is ≤ 0.05 the assumption for linearity has been violated.

3.11 Data Analysis

Data collected from the questionnaire were examined against the three research hypothesis underpinning the study. This data was analyzed to ensure completeness, consistency, and uniformity. The resultant data was then be collated into tables and analyzed using SPSS software version 21. Inferential analysis like correlation analysis and multiple linear regression test were generated in analyzing the data. The model to be used is as demonstrated below:

$$Y = \alpha + \beta X_1 + \beta X_2 + \beta X_3 + \beta X_4 + \epsilon$$

Where:

Y= Value Added Tax Compliance

α = Constant (Regressions coefficient)

X_1 = Tax Compliance costs

X_2 = Taxpayer's knowledge

X_3 = Taxpayer's perception

X_4 = Tax Audit

ϵ = error term

3.12 Measurement of Variables

Data collection in this study was done using a structured questionnaire. The Likert scale was applied as a measurement tool for the variables and a multiple regression analysis adopted to do the analysis of the study's findings. The choice of measurement variable and data analysis was informed by the following prior studies whose independent variables, dependent variable and moderating variable are similar to the ones studied. In other studies, Mogeni, (2014) used a structured questionnaire, utilizing the 5-point Likert scale in evaluating the effect of compliance costs on tax compliance of companies listed at the Nairobi Securities Exchange.

Chebusit, Namusonge, Oteki, & Kipkoech, (2014) similarly employed the methodology in the measurement of variables in their study concentrated on the effect of compliance costs on tax compliance by SMEs in Trans Nzoia. In assessing how tax knowledge affects tax compliance, King'oina, (2016), studying compliance behavior among construction firms in Kisumu County.

Gitaru, (2017) evaluating compliance behavior among listed companies within Nairobi's central business district and (Maithya, 2020) examining compliance trends among large corporates in Nairobi, used structured questionnaires to measure this variable. Kuria & Omboi, (2016) in studying how taxpayer perception influences tax compliance occurring in the top 100 SMEs as well as (Maelo, 2020) in his study on how hotels in Nakuru County comply with value added tax requirements utilized questionnaires to measure tax perception.

Table 3.2: Operationalization & Measurement of Variables

| I | Variable type | Source | Data instrument | Scale | Data analysis |
|--|----------------------|---|------------------------|----------------------|----------------------|
| Tax Compliance costs <ul style="list-style-type: none"> • Internal costs • External costs | Independent Variable | Mogeni, (2014) Chebusit, Namusonge, Oteki, & Kipkoech, (2014) Omondi & Theuri, (2019) | Questionnaire | 5-Point Likert Scale | Multiple Regression |
| Tax Knowledge <ul style="list-style-type: none"> • Taxpayers' rights and obligations • Tax rates • Fines and penalties | Independent Variable | (King'oina, (2016) (Gitaru, (2017) (Masaku, (2019) (Maithya, (2020) | Questionnaire | 5-Point Likert Scale | Multiple Regression |
| Taxpayer perception <ul style="list-style-type: none"> • Tax morale • Tax transparency and accountability | Independent Variable | Kuria & Omboi, (2016) Maelo, (2020) | Questionnaire | 5-Point Likert Scale | Multiple Regression |
| Tax Audit <ul style="list-style-type: none"> • Desk Audits • Field Audits | Independent Variable | Kircher (2018) Ola (2011) | Questionnaire | 5-Point Likert Scale | Multiple Regression |
| VAT Compliance VAT Registration VAT returns VAT payments | Dependent Variable | (Maithya, (2020) (Maelo, (2020) | Questionnaire | 5-Point Likert Scale | Multiple Regression |

Source: Author, 2022

3.13 Ethical Considerations

This survey utilized questionnaire-based survey in the collection of data. The researcher assured respondent that all the information provided was treated with utmost confidentiality and that their identity will be always protected. The researcher also adhered to all ethical issues of honesty, cultural sensitivity, informed consent, and voluntary participation. Moreover, respect for intellectual property was ensured by honoring patents, copyrights, and acknowledgment of other contributions from various parties and scholars. Permission was obtained from Moi University and NACOSTI to conduct data collection. The researcher was bound to adhere to all ethical issues of honesty, privacy, cultural sensitivity, informed consent, and voluntary participation. Ethics of the study will be ensured by protecting the rights of the respondents that is anonymity and confidentiality. This was done through informing them in advance of the importance of the study and participation will be on willing basis. Respondents will be at liberty to pull out from the study any time they feel not comfortable proceeding with the survey.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

The section outlines the results and discussion of the study findings. It begins by showing response rate and demographic information. This chapter also provides descriptive findings according to the research's objectives. It also provides correlation, regression and hypothesis testing showing the kind of relationship that exists between study variables.

4.2 Reliability Test

The testing of reliability of the questionnaire in this survey was done after pilot testing. The reliability of the instrument was established because all variables had a Cronbach's Alpha value that was higher than the threshold of 0.7. (Compliance cost $\alpha=0.893$; Tax knowledge $\alpha=0.842$; taxpayer perception $\alpha=0.911$; Tax Audit $\alpha=0.753$; Value Added Tax compliance $\alpha=0.951$).

Table 4.1: Reliability test

| Reliability Statistics | | |
|-------------------------------|-------------------------|-------------------|
| Variable | Cronbach's Alpha | N of Items |
| Tax Compliance costs | 0.893 | 6 |
| Tax knowledge | 0.842 | 5 |
| Taxpayer perception | 0.911 | 4 |
| Tax Audit | 0.753 | 4 |
| Value added tax compliance | 0.951 | 3 |

Source: (Research Data, 2022)

4.3 Validity of Instruments Test

Table 4.2 reveal factor loadings which gives values over 0.5 implying linear relationship, interval to test the construct validity of the study instrument. Kervin (2009) suggested that any factor loading below 0.4 is weak and those between 0.5 and 0.6 are moderate. While values which are below 0.3, the outcomes of the factor analysis probably will not be very practical in the research. Thus, from results of the all the questionnaire was able to meet a significant value in the research findings.

Table 4.2: Test for Construct Validity (Factor Analysis)

| | CC | TK | TP | TA |
|--|-------|-------|-------|-------|
| Tax Compliance cost | | | | |
| Cost of hiring a tax expert.... | 0.690 | | | |
| Costs of continuous professional... | 0.875 | | | |
| The cost of internet usage.... | 0.947 | | | |
| Record management systems.... | 0.585 | | | |
| The cost tax consultant.... | 0.612 | | | |
| Compliance costs have an impact.... | 0.802 | | | |
| Tax knowledge | | | | |
| Information on VAT is available... | | 0.729 | | |
| Laws on VAT are easy... | | 0.884 | | |
| Payment procedures are complex | | 0.603 | | |
| Our organization is able to calculate.... | | 0.911 | | |
| Our organization receives communication | | 0.675 | | |
| Taxpayer perception | | | | |
| Tax collected by government is utilized... | | | 0.650 | |
| There is accountability of taxes ... | | | 0.819 | |
| Our organization has access public utilities ... | | | 0.728 | |
| Taxes levied on the hotel industry are fair... | | | 0.990 | |
| Tax Audit | | | | |
| I have been once summoned by KRA officials... | | | | 0.717 |
| I have been summoned for a tax audit... | | | | 0.658 |
| Probability of being audited will enhance VAT... | | | | 0.814 |
| Field Tax audits increase VAT compliance... | | | | 0.800 |
| Our hotel have been audited by KRA... | | | | 0.934 |

**Extraction Method: Principal Component Analysis
Survey Data (2022)**

4.4 Summary of Responses

A rate of return that averaging at 60% is often good for many studies (Morton, Bandara, Robinson & Carr, 2012). In this study, the researcher distributed 120 questionnaires to respondent in the classified hotels, 89 responses were obtained, 5 of these were repudiated because of poor filling in. Hence, 84 questionnaires were obtained and taken to be diligently answered which implies a 70% rate of response. A response rate of 70% and above is very acceptable for an objective analysis (Mugenda & Mugenda, 2003).

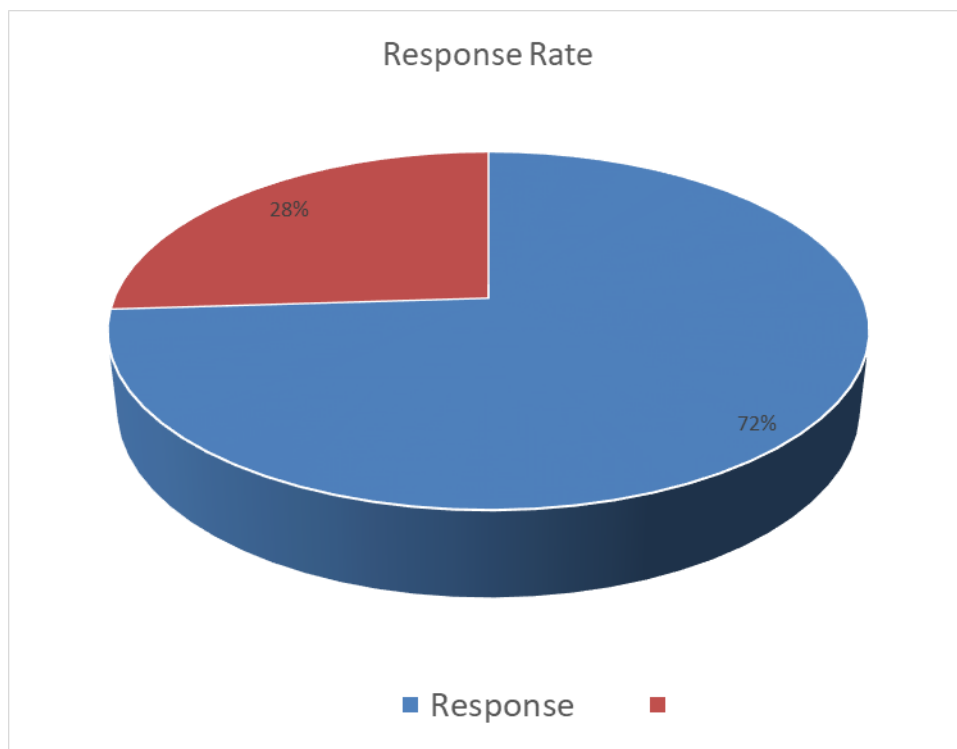


Figure 4.1: Response Rate

4.5 Demographic Information

The gender of the respondents was sought. The study found out that majority (63.1%) respondents were male while the rest (36.9%) were female. The study also implored the respondents to state their age bracket. Outcomes in table 4.3 reveal that (4.8%) were aged between 21-30 years, 45.2% were aged between 31-40 years, 30.9% were aged below 41-50 years, 19% were above 50 years. The result depicts that most of the

respondent at Nairobi Hotels are middle aged. The survey wanted to determine the duration in which the hotels involved in this study has been operating. The findings showed that 11.9% have been in existence for a duration of 5 - 10 years; 42.8% of the hotels have a duration of 10-15years, while 45.3% have been operation for more than 15 years

Table 4.3: Demographic Information

| Characteristics | | Percent (%) |
|--------------------------------------|-----------------|--------------------|
| Gender | Male | 63.1 |
| | Female | 36.9 |
| | Total | 100 |
| Age | 21-30Yrs | 4.8 |
| | 31-40yrs | 45.2 |
| | 41-50yrs | 30.9 |
| | Above 50yrs | 19 |
| | Total | 100 |
| Years hotel been in existence | Less than 5yrs | 0 |
| | 5-10yrs | 11.9 |
| | 10-15yrs | 42.8 |
| | More than 15yrs | 45.3 |
| | Total | 100 |

Survey Data (2022)

4.6 Diagnostic tests

Before running descriptive and regression analysis, the researcher did a number of diagnostic tests investigate the violation of linear regression assumptions. These tests included Linearity test, Normality test, Multicollinearity test.

4.6.1 Linearity test

In order establish that the correlation of the dependent and independent variables is linear, linearity tests were carried out. Linearity is determined by looking at the deviation of a variable from the linearity metric that has an alpha of 0.05. According to Csörgő (1985), if the p value of deviation from linearity is >0.05 the assumption of

linearity is not violated, if the p value is ≤ 0.05 the assumption for linearity has been violated.

Table 4.4: Linearity Test

| | | | Sum of | | Mean | | |
|-------------|---------|-----------------------------|---------|----|--------|-------|------|
| | | | Squares | df | Square | F | Sig. |
| Value Added | Between | (Combined) | .167 | 14 | .001 | .423 | .276 |
| Tax | Groups | Linearity | .003 | 1 | .003 | 2.345 | .516 |
| Compliance* | | Deviation from Linearity | .318 | 69 | .004 | .687 | .540 |
| | Total | | .488 | 84 | | | |

Source: Field data (2022)

This was done through a scatter plot between VAT compliance and the predictors (compliance cost, tax knowledge and taxpayers perception). The findings as shown below did not show any nonlinearity; all the scatter plots showed that the connection linking predictor variables to response variable is linear.

4.6.2 Normality test

To test for the normality in error term, this study used the Shapiro-Wilk Test; Usually when the significant value of the Shapiro-Wilk goes above 0.05, the data is said to be normal. As shown by the test results below, all the variables had their p-values above 0.05 showing that there is no problem of normality as all the p-value > 0.05 Razali and Wah (2011) argued that the best and powerful normality test is Shapiro-Wilk. This study adopted it. The findings of the tests are presented in Table 4.5. The test was used to test the data. Shapiro-Wilk test of less than 0.05 simply communicates that the data has a considerable digression from the normal distribution. Since in our case the test was above the p values, there was a normal distribution in the data, compliance cost 0.096, Tax knowledge 0.163, taxpayer perception 0.095, Tax audit 0.083 and

value added Tax compliance had 0.115. which means there was no violation in the normality assumption.

Table 4.5: Tests of Normality

| | Kolmogorov- Smirnov ^a | Shapiro-Wilk | |
|----------------------------|-------------------------------------|--------------|------|
| | Statistic | Statistic | Sig. |
| Compliance cost | .176 | .810 | .096 |
| Tax Knowledge | .180 | .771 | .163 |
| Taxpayer perception | .267 | .928 | .095 |
| Tax Audit | .218 | .980 | .083 |
| Value Added tax compliance | .195 | .922 | .115 |

a. Lilliefors Significance Correction

Source: Research Data, 2022

4.6.3 Multicollinearity test

One of the assumptions of a linear regression is the assumption of Multicollinearity. The survey applied Variance Inflation Factor to test for multicollinearity. The results shown in table 4.6 below, shows VIF values of 1.169, 1.403 1.322, and 1.057 these values were below the level of 2.5 as proposed by Allison (2009) as a multicollinearity signal; hence, the analysis had no multicollinearity problem. Therefore, the findings from the survey conveniently reached the threshold mainly because Table shows that the VIF of the study were all less than 2.

Table 4.6: Multicollinearity Test

| Model | Coefficients ^a | |
|---------------------|---------------------------|-------|
| | Collinearity Statistics | |
| | Tolerance | VIF |
| Tax compliance cost | 0.856 | 1.169 |
| Tax knowledge | 0.713 | 1.403 |
| Taxpayer perception | 0.651 | 1.322 |
| Tax audit | 0.764 | 1.057 |

a. Dependent Variable: Value added tax compliance

4.7 Determinants of VAT Compliance among the Classified Hotels in Nairobi

This study had its main objective being probing the determinants of the VAT compliance among the classified hotels within Nairobi County. The factors looked were compliance cost, tax knowledge and the perception of a taxpayer. All respondents had to rate the various statements by stating the extent to which they agreed with them. Mean scores and standard deviations were used to analyze data and set that 'strongly agree' and 'agree' show a statement concurred with and whose mean score ranges from 0 to 2.5. 'Neutral' shows a statement that the respondent neither agrees with or disagrees and it has a mean score of 2.6 to 3.4. Finally, 'disagree' and 'strongly disagree' show a statement that has not been agreed with and its mean score ranges from 3.5 to 5.

4.8 Descriptive Statistics

4.8.1 Tax Compliance Costs

The first objective of this study was to establish the effect of tax compliance costs on VAT compliance among the classified hotels within Nairobi County. There is a very high cost of employing a tax expert (mean = 4.45). Additionally, the survey showed that respondents concurred that Annual costs of continuous professional development courses for a tax accountant are expensive (mean = 3.18). The cost of internet usage per month is high (mean = 3.67). The outcomes indicated that the respondents agreed that Record management systems are expensive to install (mean = 4.29). There exists a high cost of hiring a tax consultant (mean = 4.13). Compliance costs have an impact on our tax compliance (mean = 3.23).

Table 4.7: Descriptive Statistics on Cost Compliance

5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1= Strongly Disagree

| | Mean | Std. Dev | Skewness | Kurtosis |
|--|------|----------|----------|----------|
| The cost of hiring a tax expert is high | 4.45 | 0.615 | -0.546 | 0.290 |
| Annual costs of continuous professional development courses for a tax accountant are expensive | 3.18 | 0.727 | -0.639 | -0.854 |
| The cost of internet usage per month is high | 3.67 | 0.657 | 0.203 | -1.538 |
| Record management systems are expensive to install | 4.29 | 0.590 | -1.364 | 0.026 |
| The cost of hiring a tax consultant is high | 4.13 | 0.485 | -0.387 | -0.530 |
| Compliance costs have an impact on our tax compliance | 3.23 | 0.976 | -0.132 | -0.509 |

4.8.2 Tax Knowledge

The second objective was to show how tax knowledge affects VAT compliance among the classified hotels within Nairobi County. Information on VAT in Kenya is readily available (mean =3.2). The results showed that Laws on VAT are easy to understand (mean = 4.74). From the results, respondents admitted that VAT filing and payment procedures are complex (mean = 4.29). Additionally, the respondents also admitted that our organization is capable of accurately calculating the VAT payable in accordance with the information available (mean = 3.07) While respondent almost disagreed on Our organization receives communication from KRA whenever there is a change in VAT laws with a (mean = 2.61).

Table 4.8: Descriptive Statistics on Tax Knowledge

| | Mean | Std. Dev | Skewness | Kurtosis |
|--|------|----------|----------|----------|
| Information on VAT in Kenya is readily available | 3.21 | 0.756 | -0.826 | -0.748 |
| Laws on VAT are easy to understand | 4.74 | 0.578 | -0.204 | -0.862 |
| VAT filing and payment procedures are complex | 4.29 | 0.560 | -0.920 | -0.206 |
| Our organization is able to accurately calculate the VAT payable based on the information available. | 3.07 | 0.821 | 0.572 | -0.860 |
| Our organization receives communication from KRA whenever there is a change in VAT laws. | 2.61 | 0.912 | -0.977 | 0.321 |

4.8.3 Taxpayer's perception

The third objective was to establish the effect of taxpayer perception on VAT compliance among the classified hotels within Nairobi County. As a taxpayer, we are informed on the manner in which the tax collected by the government is to be utilized (mean = 4.09). In my opinion, there is accountability in the utilization of the taxes collected by government (mean = 3.17). Respondent almost disagreed with the statement that in my opinion, our organization has access to services financed by the taxes collected from them by the state (mean =2.75). Further, the study indicated that respondents disagreed with the statement that In my opinion, the taxes levied on the hotel industry are fair (mean = 2.58)

Table 4.9: Descriptive Statistics on taxpayer perception

5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1= Strongly Disagree

| | Mean | Std. Dev | Skewness | Kurtosis |
|---|------|----------|----------|----------|
| As a taxpayer, we are informed on the manner in which the tax collected by the government is to be utilized | 4.09 | 0.517 | 0.537 | -0.991 |
| In my opinion, there is accountability in the utilization of the taxes collected by government | 3.17 | 0.737 | 0.271 | -0.542 |
| In my opinion, our organization has access to public utilities and services funded by the taxes collected by the government | 2.75 | 0.906 | -0.549 | -0.182 |
| In my opinion, the taxes levied on the hotel industry are fair | 2.58 | 0.832 | -0.136 | -0.692 |

4.8.4 Effect of Tax Audit on Value Added Tax Compliance

The fourth objective was to establish the effect of tax audit on VAT compliance among the classified hotels within Nairobi County. Making inferences from statistics presented respondent agreed that I have been once summoned by KRA officials to submit our books for audit fair (mean = 4.25) I have been summoned for a tax audit by relevant tax authorities fair (mean = 4.10). Perceiving a high probability of being audited will enhance value added tax compliance fair (mean = 3.98). Field Tax audits increase value added tax compliance fair (mean = 4.00). Our hotel have been audited by KRA fair (mean = 3.68).

Table 4.10: Descriptive statistics on Tax Audit

5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1= Strongly Disagree

| | Mean | Std. Dev | Skewness | Kurtosis |
|--|------|----------|----------|----------|
| I have been once summoned by KRA officials to submit our books for audit | 4.25 | .506 | -0.554 | 0.124 |
| I have been summoned for a tax audit by relevant tax authorities | 4.10 | .520 | -0.348 | -0.811 |
| Perceiving a high probability of being audited will enhance value added tax compliance | 3.98 | .819 | -0.1022 | -0.153 |
| Field Tax audits increase value added tax compliance | 4.00 | .628 | -0.527 | -0.774 |
| Our hotel have been audited by KRA | 3.68 | .974 | -0.076 | -0.940 |

4.8.5 VAT compliance

This research tried to show the status of VAT compliance in the classified hotels within Nairobi County. As a firm we submit the VAT returns every month (mean = 3.97). Further, the The hotel keeps proper records of purchases and sales for VAT calculations (mean = 3.34) The hotel pays VAT amount payable on time without fail (mean = 4.82).

Table 4.11: Descriptive statistics on Value Added Tax Compliance

5 = Strongly Agree 4 = Agree 3 = Neutral 2 = Disagree 1= Strongly Disagree

| | Mean | Std. Dev | Skewness | Kurtosis |
|--|------|----------|----------|----------|
| As a firm we submit the VAT returns every month | 3.97 | 0.832 | -0.295 | -0.372 |
| The hotel keeps proper records of purchases and sales for VAT calculations | 3.34 | 0.905 | -0.462 | -0.163 |
| The hotel pays VAT amount payable on time without fail | 4.82 | 0.583 | -0.315 | -0.680 |

4.9 Correlation Analysis

To determine the connection linking determinants constructs and VAT compliance in classified hotels in Nairobi City, correlation analysis was utilized. The Table 4.12 shows the outcomes of the correlation analysis. The outcomes indicate that compliance cost is negatively and remarkably related to value added tax compliance as shown $r = -0.311$ and $p = 0.000 < 0.05$). The outcomes show tax knowledge to be positively and significantly associated with value added tax compliance as shown $r = 0.326$ and $p = 0.002 < 0.05$. Additionally, results show that tax audit is positively and remarkably connected with value added tax compliance as shown $r = 0.380$ and $p = 0.000 < 0.05$),

Table 4.12: Correlation Analysis

| | | VAT | CC | TK | TP | TA |
|---------------------|---------------------|---------|--------|--------|------|----|
| VAT compliance | Pearson Correlation | 1 | | | | |
| | Sig. (2-tailed) | | | | | |
| | N | 84 | | | | |
| Tax compliance cost | Pearson Correlation | -.311** | 1 | | | |
| | Sig. (2-tailed) | .000 | | | | |
| | N | 84 | | | | |
| Tax knowledge | Pearson Correlation | .326** | .219** | 1 | | |
| | Sig. (2-tailed) | .002 | .001 | | | |
| | N | 84 | | | | |
| Taxpayer perception | Pearson Correlation | .202** | .292** | .361** | 1 | |
| | Sig. (2-tailed) | .000 | .001 | .000 | | |
| | N | 84 | | | | |
| Tax audit | Pearson Correlation | .380** | .331** | .248 | .263 | 1 |
| | Sig.(2tailed) | .000 | .000 | .001 | .003 | |
| | N | 84 | | | | |

** . Correlation is significant at the 0.05 level (2-tailed).

Source: Research Data, (2022)

4.10 Model Summary

The results are discussed under table 4.13. The study noted that R was 0.577 which shows that compliance cost, tax knowledge, tax audit and taxpayer perception are

directly correlated with VAT compliance up to 57.7%. Compliance cost, tax knowledge, tax audit and taxpayer perception caused variations in value added tax compliance by 33.2% or ($R^2 = .332$). The results additionally show that even in the case where the study adjusts the model would still account for 32.8% (Adjusted R Square, 0.328) of value added tax compliance. The remaining 66.8 % of the variation was brought about by elements that were not incorporated in the research.

Table 4.13: Effect of Compliance Cost, Tax Knowledge, Taxpayer Perception and Tax Audit on Value Added Tax Compliance

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|--------------|-------------------|-----------------|--------------------------|-----------------------------------|
| 1 | .577 ^a | .332 | .328 | .13056 |

Source: Research Data (2022)

4.10.1 Analysis of Variance

The ANOVA statistics presented in the table 4.14 was used to present the regression model significance

Table 4.14: Analysis of Variance

| Model | Sum of Squares | Df | Mean Square | F | Sig. |
|--------------|-----------------------|-----------|--------------------|----------|-------------------|
| Regression | 4.752 | 1 | 4.752 | 28.473 | .000 ^b |
| 1 Residual | 9.601 | 83 | 0.115 | | |
| Total | 14.353 | 84 | | | |

Additional ANOVA tests were performed to investigate whether the model operates well in proving the connection between variables as shown in the conceptual model. The findings in Table 4.14 show an F value of 28.473 with a significance level of 0.000 which is less than the p value of 0.05, hence establishing the model is

statistically significant. The implication is that compliance cost, tax knowledge, tax audit and taxpayer perception contribute significantly to changes in the value added tax compliance

4.10.2 Regression Coefficients

A regression analysis was done to test combined effect of the independent variables (compliance cost, tax knowledge, taxpayer perception and tax audit) to the dependent variable (VAT compliance). The results were then presented in table 4.15 below.

Table 4.15: Regression Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|---------------------|-----------------------------|------------|---------------------------|--------|------|
| | B | Std. Error | Beta | | |
| (Constant) | .417 | .073 | | 5.712 | .000 |
| Compliance cost | -.226 | .057 | .243 | -3.964 | .000 |
| Tax knowledge | .218 | .048 | .227 | 4.541 | .000 |
| Taxpayer perception | .302 | .039 | .252 | 7.743 | .002 |
| Tax audit | .340 | .063 | .315 | 5.396 | .003 |

Source: Research Data (2022)

a. Dependent Variable: VAT Compliance

Regression equation:

$$Y = 0.417 - .226X_1 + .218X_2 - .302X_3 + .340X_4$$

Where;

Y= Value Added Tax Compliance

X₁ = tax compliance costs

X₂ = tax knowledge

X₃ = taxpayer perception

X₄ = tax audit

α = constants term

$\beta_1, \beta_2, \beta_3$ and β_4 = regression coefficients of X_1, X_2, X_3 and X_4

ε = error item.

The Regression equation declares the relationship between independent and dependent variables was statistically significant compliance cost had a beta coefficient (β_1) of -0.226 which implies that a unit change in compliance cost leads to an decrease of VAT compliance by -0.226 .tax knowledge had a beta coefficient (β_2) of 0.218 which shows that a factor change in tax knowledge leads to an increase of VAT compliance by 0.218 .Taxpayer perception had a beta coefficient (β_3) of 0.302 which states that a unit change in taxpayer perception leads to an increase of VAT compliance by 0.302. “Tax audit had a beta coefficient (β_4) of 0.340 which implies that a unit change in tax audit leads to an increase of VAT compliance by 0.340.

4.10.3 Test of Hypotheses

The first hypothesis H_{o_1} stated that. Cost of compliance does not have a significant effect on value added tax compliance among the classified hotel within Nairobi County. The results in Table 4.16 show that the p value is 0.000 less than 0.05, which indicates that the relationship is statistically significant, so the hypothesis is rejected.

The second hypothesis H_{o_2} stated that tax knowledge does not have a significant effect on value added tax compliance among the classified hotel within Nairobi County. The results in Table 4.16 show that the p value is 0.000 less than 0.05, which indicates that the relationship is statistically significant, so the hypothesis is rejected.

The third hypothesis H_{o_3} stated that taxpayer perception does not have a significant effect on value added tax compliance among the classified hotel within Nairobi County. The results in Table 4.16 show that the p value is 0.002 less than 0.05, which indicates that the relationship is statistically significant, so the hypothesis is rejected.

The fourth hypothesis H_{o_4} stated that tax audit does not have a significant effect on value added tax compliance among the classified hotel within Nairobi County. The results in Table 4.16 show that the p value is 0.003 less than 0.05, which indicates that the relationship is statistically significant, so the hypothesis is rejected.

Table 4.16: Hypotheses Testing

| Hypothesis | Objective | P-Value | Verdict |
|--|--|----------------|----------|
| H_{o1} Tax compliance cost does not have a significant effect on value added tax compliance among the classified hotel within Nairobi County | To establish the effect of compliance costs on Value Added Tax compliance among the classified hotels within Nairobi County | P=0.000< 0.05 | Rejected |
| H_{o2} : Tax knowledge does not have a significant effect on value added tax compliance among the classified hotel within Nairobi County | To determine the effect of tax knowledge on Value Added Tax compliance among the classified hotels within Nairobi County | P=0.000 < 0.05 | Rejected |
| H_{o3} :Taxpayer perception does not have a significant effect on value added tax compliance among the classified hotel within Nairobi County | To establish the effect of taxpayer perception on Value Added Tax compliance among the classified hotels within Nairobi County | P=0.002 < 0.05 | Rejected |
| H_{o4} : Tax audit does not have a significant effect on value added tax compliance among the classified hotel within Nairobi County | To determine the effect of tax audit on Value Added Tax compliance among the classified hotels within Nairobi County | P=0.003 < 0.05 | Rejected |

4.11 Discussion of the Findings

This section contains a discussion of the findings of the study's several tests. The findings of each of the study's hypotheses are discussed.

4.11.1 Effect of tax compliance costs on Value Added Tax Compliance

The first objective of this study was to establish the effect of compliance costs on Value Added Tax compliance among the classified hotels within Nairobi County. The results showed that a unit change in compliance cost caused a variation of 22.6% in VAT compliance among the classified hotels within Nairobi County. The findings revealed that there was a statistically significant association between tax compliance cost and VAT compliance, with a p-value of 0.000, which is lower than the standard 0.05 probability significance level. The findings were in agreement with by (Sandford, Godwin, & Hardwick, 1989) The study concluded that tax compliance costs constituted a significant amount of the total costs of a firm especially because they form part of necessary administrative costs. This therefore is a great influencer when making the compliance decision especially for the smaller firms that are still finding their way in the market. With many other factors that affect the hotel industry like the COVID-19 pandemic, costs are a greater impediment to VAT compliance.

4.11.2 Effect of tax knowledge on Value Added Tax Compliance

The second objective of this study was to determine the effect of tax knowledge on Value Added Tax compliance among the classified hotels within Nairobi County. The findings showed that there was a statistically significant association between tax knowledge and VAT compliance, with a p-value of 0.000, which is lower than the standard 0.05 probability significance level. These results showed that a unit change in tax knowledge causes a unit in increasing the VAT compliance by 21.8% among

the classified hotels in Nairobi County. The findings concurred with study by Haber and Reichel, (2007) which concluded that taxation knowledge is a specific part of the general human potential of entrepreneurs, which increases the chances of business success. Also, Naibei and Siringi, (2011) in their study found that non-compliance arises from knowledge deficits by taxpayers; this is attributed to the complexity of reporting and returning requirements that might lead to VAT non-compliance.

4.11.3 Effect of Taxpayer perception on Value Added Tax Compliance

The third objective of this study was to establish the effect of taxpayer perception on Value Added Tax compliance among the classified hotels within Nairobi County. From the findings it was concluded that the unit change in taxpayer perception caused a variation of 30.2% in VAT compliance among the classified hotels in Nairobi County. The findings revealed that there was a statistically significant association between taxpayer perception and VAT compliance, with a p-value of 0.002, which is lower than the standard 0.05 probability significance level. These findings concurred with a South African study of tax compliance in the mining industry that disassociated perceptions about fairness, corruption and the efficiency of the tax authority from tax compliance (Netshaulu, 2016).

4.11.4 Effect of Tax Audit on Value Added Tax Compliance

The fourth objective of this study was to determine the effect of tax audit on Value Added Tax compliance among the classified hotels within Nairobi County. The study findings showed that a unit change in Tax Audit caused a variation of 34% on VAT compliance among the classified hotels in Nairobi County. The findings showed that there was a statistically significant association between tax audit and VAT compliance, with a p-value of 0.003, which is lower than the standard 0.05 probability significance level. The findings were in agreement with Olaoye et al., (2018)

examined the impact of tax audit on tax productivity in Lagos State. The study viewed tax audit in three different categories, namely, desk auditing, back-duty audit and field auditing. Logistic regression techniques were used, and the result shows that tax auditing has a major effect on tax productivity and tax enforcement in Lagos State. The study concluded that tax enforcement should be enhanced among taxpayers; tax audits should be performed on a routine basis. Tax audit should also be used as tools to educate the taxpayers on efficient ways of keeping records and taking advantage of KRA resources for education purposes.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The following chapter does a summary of the findings, makes the conclusions and even offers recommendations in accordance with the findings that the survey found.

5.2 Summary of the Findings

The main objective of the study was to investigate determinants of VAT compliance among classified hotels in Nairobi City County. The study intended to find whether compliance cost, tax knowledge, tax audit and tax perception influence VAT compliance among classified hotels in Nairobi City County. Questionnaires were used to collect data which was later analyzed using both descriptive and inferential statistics. A presentation of the findings was done on frequency tables, percentages and even inferential statistics tables and the response rate to the questionnaires was 70%.

5.2.1 Tax Compliance costs

The first objective of this study was to establish the effect of compliance costs on VAT compliance among the classified hotels within Nairobi County. Correlation analysis showed that compliance cost on VAT compliance has a negative effect and significant relationship. In addition, regression analysis showed that there is a significant positive linear relationship between compliance cost of VAT compliance among the classified hotels within Nairobi County of $p = 0.000, <0.05$.

5.2.2 Tax Knowledge

The second objective was to establish the effect of tax knowledge on VAT compliance among the classified hotels within Nairobi County. Correlation analysis

indicated tax knowledge to affect VAT compliance positively and significantly. In addition, regression analysis showed a significant positive relationship between tax knowledge of VAT compliance among the classified hotels within Nairobi County of $p = 0.000, <0.05$.

5.2.3 Taxpayer's perception

The third objective was to establish the effect of taxpayer perception on VAT compliance among the classified hotels within Nairobi County. Correlation analysis showed that taxpayer perception on VAT compliance has a positive effect and significant relationship. In addition, regression analysis showed that there is a significant positive linear relationship between taxpayer perception of VAT compliance among the classified hotels within Nairobi County of $p = 0.002, <0.05$.

5.2.4 Tax Audit

The fourth objective was to determine the effect of tax audit on Value Added Tax compliance among the classified hotels within Nairobi County. Correlation analysis showed that tax audit on VAT compliance has a positive effect and significant relationship. In addition, regression analysis showed that there is a significant positive linear relationship between tax audit of VAT compliance among the classified hotels within Nairobi County of $p = 0.003, <0.05$.

5.3 Conclusion

The Kenyan tax system is one that puts trust on the taxpayer to file returns. The system is such that the taxpayer assesses the tax payable and voluntarily makes the payment to the government through the KRA as the government agent. The study revealed that for the taxpayer to meet the obligation a lot of facilitation is required since there are many factors that influence the ability of the taxpayer to comply.

Some of the factors as discussed in the study are compliance costs tax knowledge, taxpayer perception and tax audit by KRA. Based on the first objective, the study revealed that tax compliance costs influence VAT compliance among classified hotels in Nairobi City County. Respondent agreed that the cost of hiring a tax expert is high. Record management systems that would ensure proper records are not only kept but maintained for future reference are expensive to install and maintain. It was agreed that the cost of hiring a tax consultant discourages the taxpayer from meeting the compliance requirements.

On the second objective, this study revealed that the level of tax understanding and knowledge has a significant effect on VAT compliance. This is because a better understanding of VAT laws encourages compliance. Therefore, revenue authorities are supposed to plan for trainings to inform business operators and other citizens on matters to do with taxes. KRA should formulate ways that ensures hotels owners get sufficient information on important tax related dates and keep the required documentations. They also should conduct public awareness campaigns especially on the hospitality industry on unique issues that relate to taxation in this industry. This is also aimed to change taxpayer perception and attitude towards taxation.

In relation to the third objective, it was concluded that the perception that taxpayers have on governance affects VAT compliance among the classified hotels in Nairobi. Respondent agreed that as taxpayers, they are informed on the manner in which the tax collected by the government is to be utilized and in their opinion, there was accountability in the utilization of the taxes collected by government. The fight against corruption should be upscaled and those convicted pay for their misgivings. This would go along way in improving the confidence of the taxpayer that the amount they pay inform of taxes are well utilized.

Based on the fourth objective, the study revealed that tax audit influence VAT compliance among classified hotels in Nairobi City County. Respondent agreed to a great extent that they have been once summoned by KRA officials to submit their books for audit. KRA should enhance this audit in order to catch more tax evaders. The individual involved in tax evasion distorts the competitiveness of the industry since the prices are not informed by the market forces of demand and supply. The study revealed that being summoned by KRA for an audit discouraged tax evasion. A not qualified opinion from the audit also improved the confidence of the taxpayer and this encouraged VAT compliance among the classified hotels. KRA is encouraged to make the audit more friendly and use them as training tools to ensure more compliance. The audit process should not be scary but rather should improve the relationship between the classified hotel owners and the Kenya Revenue Authority officers.

5.4 Limitation of the Study

Because of the sensitive nature of the information in this study, the respondents involved were afraid of disseminating their details to competitors. This was solved by guaranteeing the respondents that their responses were purely used for academic purposes only and utmost confidentiality assured with an introduction letter from Moi University, Post Graduate School of Economics and Business was attached to the questionnaires to affirm confidentiality. The other limitation was that the study looked at a very sensitive matter in business world. There exists fear among the taxpayer in discussing their compliance or noncompliance of their organizations with strangers. The challenge was solved by taking time to discuss the use of the findings and offering more knowledge relating to the tax laws to the managers. Again, the authority letter for the school and the ethical clearance from NACOSTI was of great help.

5.5 Recommendations

Based on findings of the study, the following recommendations were given:

5.5.1 Management and Practice

Voluntary tax compliance is enhanced by knowledge and understanding of tax systems. Thus, KRA should step up trainings to educate hotel operators on matters to do with taxes, including the deadlines they should meet and the taxation documents required. They should also conduct training and public awareness on this sector to ensure taxation laws are followed by the hotel operators.

KRA should put in place an electronic system that links the financial institutions (mostly banks) with its integrated system. This will make it easier for the KRA to monitor money flows into and out of the personal accounts. The money flow can then be compared with the tax returns filed. This exercise will go a long way to capture tax evaders/avoiders in hospitality industry.

5.5.2 Policy implication

Based on the study findings, it revealed a statistically significant relationship between compliance cost, tax knowledge, taxpayer perception and tax audit on value added tax compliance. The study recommends policy makers to formulate policies which will enhance Value added tax compliance among classified hotels. Policies could be made to ensure that the audit process conducted by KRA official is friendly and seeks not to expose the taxpayer but to guide him into compliance. KRA should also formulate policies in conjunction with the Institute of Certified Accountants (ICPAK) on training hotels owners or their employees on better understanding of tax laws. The tourism regulatory authority should also formulate ways in which they can facilitate the classified hotels through organized seminars and trainings.

5.5.3 Implication to theory and academics

This study adds to the existing empirical studies on the extent to which compliance cost, tax knowledge taxpayer's perception and tax audit influence on VAT compliance. This study is useful in academics as it gives insight and knowledge on application of compliance cost, tax knowledge and taxpayer's perceptions in improving Value Added Tax compliance by classified hotels. This study confirmed various theoretical contributions and advances support for the relationships hypothesized. The results strengthen literature by confirming the postulations of the fiscal exchange theory.

5.6 Suggestions for Further Studies

The study suggests further research on the following areas related to this study:

Research on macro and micro factors affecting VAT compliance among SMEs in other areas, these studies may aid in research finding generalization a fiscal policies formulation by the tax authority. The effect of withholding VAT compliance on the growth of revenue in hotel industry. An investigation to examine the effect of tax incentives on tax compliance in the hospitality industry.”

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APPENDICES

Appendix I: Questionnaire

INSTRUCTIONS

The purpose of this questionnaire is to collect information on determinants affecting VAT compliance among classified hotels within Nairobi County, Kenya. The information obtained will be treated with utmost confidence strictly and will strictly be used for academic purposes.

Some of the questions will require you to tick the relevant box, while others will require you to put your response in the blank spaces provided. Should you need more space than provided, kindly use the space at the back of the questionnaire to put down your response. You are requested to complete the questionnaire as truthfully and as objectively as you can.

Kindly make use of the following scale for reference to enable you tick appropriately.

(5-Strongly agree, 4-Agree, 3-Neutral, 2-Disagree, 1-Strongly disagree)

PART A: GENERAL INFORMATION

1. Gender

Male { }

Female { }

2. Age

21– 30 Years { }

31– 40 Years { }

41– 50 Years { }

Above 50 Years { }

3. Highest Level of Education

Secondary { }

Diploma { }

Degree { }

4. How long has the hotel been in existence?

- Less than 5 years
- 5-10 years
- 10-15 years
- More than 15 years

PART B: DETERMINANTS OF VAT COMPLIANCE AMONG THE CLASSIFIED HOTELS WITHIN NAIROBI COUNTY

COMPLIANCE COSTS

To what extent do you agree or disagree with the following statements on compliance cost? Put a tick (✓) where applicable. Use a scale of 1-5 where (5-Strongly agree, 4-Agree, 3-Neutral, 2-Disagree, 1-Strongly disagree)

| | 1 | 2 | 3 | 4 | 5 |
|--|---|---|---|---|---|
| The cost of hiring a tax expert is high | | | | | |
| Annual costs of continuous professional development courses for a tax accountant are expensive | | | | | |
| The cost of internet usage per month is high | | | | | |
| Record management systems are expensive to install | | | | | |
| The cost of hiring a tax consultant is high | | | | | |
| Compliance costs have an impact on our tax compliance | | | | | |

TAX KNOWLEDGE

To what extent do you agree or disagree with the following statements on tax knowledge? Put a tick (✓) where applicable. Use a scale of 1-5 where (5-Strongly agree, 4-Agree, 3-Neutral, 2-Disagree, 1-Strongly disagree)

| | 1 | 2 | 3 | 4 | 5 |
|--|---|---|---|---|---|
| Information on VAT in Kenya is readily available | | | | | |
| Laws on VAT are easy to understand | | | | | |
| VAT filing and payment procedures are complex | | | | | |
| Our organization is able to accurately calculate the VAT payable based on the information available. | | | | | |
| Our organization receives communication from KRA whenever there is a change in VAT laws. | | | | | |

TAXPAYER PERCEPTION

To what extent do you agree or disagree with the following statements on tax knowledge? Put a tick (✓) where applicable. Use a scale of 1-5 where (5-Strongly agree, 4-Agree, 3-Neutral, 2-Disagree, 1-Strongly disagree)

| | 1 | 2 | 3 | 4 | 5 |
|--|---|---|---|---|---|
| As a taxpayer, we are informed on the manner in which the tax collected by the government is to be utilized | | | | | |
| In my opinion, there is accountability in the utilization of the taxes collected by government | | | | | |
| In my opinion, our organization has access to public utilities and services funded by the taxes collected by the government? | | | | | |
| In my opinion, the taxes levied on the hotel industry are fair | | | | | |

TAX AUDITS

To what extent do you agree or disagree with the following statements on taxpayer perception? Put a tick (✓) where applicable. Use a scale of 1-5 where (5-Strongly agree, 4-Agree, 3-Neutral, 2-Disagree, 1-Strongly disagree)

| No. | Statement | 1 | 2 | 3 | 4 | 5 |
|-----|--|---|---|---|---|---|
| 1 | I have been once summoned by KRA officials to submit our books for audit | | | | | |
| 2 | I have been summoned for a tax audit by relevant tax authorities | | | | | |
| 3 | Perceiving a high probability of being audited will enhance value added tax compliance | | | | | |
| 4 | Field Tax audits increase value added tax compliance | | | | | |
| 5 | Our hotel have been audited by KRA | | | | | |

PART C: VALUE ADDED TAX COMPLIANCE

To what extent do you agree or disagree with the following statements on value added tax compliance? Put a tick (✓) where applicable. Use a scale of 1-5 where (5-Strongly agree, 4-Agree, 3-Neutral, 2-Disagree, 1-Strongly disagree)

| | 1 | 2 | 3 | 4 | 5 |
|--|---|---|---|---|---|
| As a firm we submit the VAT returns every month | | | | | |
| The hotel keeps proper records of purchases and sales for VAT calculations | | | | | |
| The hotel pays VAT amount payable on time without fail | | | | | |

THE END

Thank you for your participation! Much appreciated.

Appendix II: Research Work Plan

| | Oct | Nov | Dec | Jan | Feb | March |
|--|-----|-----|-----|-----|-----|-------|
| Research proposal topic | | | | | | |
| Research proposal development | | | | | | |
| Proposal submission | | | | | | |
| Data collection | | | | | | |
| Data analysis | | | | | | |
| Final project submission | | | | | | |
| Final project presentation | | | | | | |
| Final project corrections and approval | | | | | | |
| Submission of bound copies | | | | | | |

Appendix III: Proposed Budget

In order to ensure a higher degree of results and considering the time constrain a researcher assistant will be hired and tasked to distribute the questionnaires and also collect the filled ones.

| Item | Total (ksh) |
|---|--------------------|
| Proposal development | 10,500 |
| Travel costs | 10,000 |
| Questionnaire preparation | 3,000 |
| Distribution and collection of questionnaires | 5,000 |
| NACOSTI | 1,500 |
| Data Analysis | 20,000 |
| Preparation of final report | 3,000 |
| TOTAL | 53,000 |

Appendix IV: List of Classified Hotels within Nairobi County

| 1. GREATER NAIROBI | | | | | |
|--------------------|-----------------------------------|---------|---------------|-----|--------|
| NO | ESTABLISHMENT | COUNTY | CAPACITY | | RATING |
| | | | ROOMS BEDS | | |
| 1 | Intercontinental Nairobi | Nairobi | 326 | 372 | ***** |
| 2 | Radisson Blu Hotel Nairobi | Nairobi | 271 | 354 | ***** |
| 3 | The Sarova Stanley | Nairobi | 217 | 440 | ***** |
| 4 | Villa Rosa Kempinski | Nairobi | 200 | 216 | ***** |
| 5 | Fairmont The Norfolk | Nairobi | 170 | 200 | ***** |
| 6 | Sankara Nairobi | Nairobi | 156 | 167 | ***** |
| 7 | The Boma Nairobi | Nairobi | 148 | 178 | ***** |
| 8 | Crowne Plaza Nairobi Airport | Nairobi | 144 | 209 | ***** |
| 9 | Tribe Hotel | Nairobi | 137 | 154 | ***** |
| 10 | Dusit D2 | Nairobi | 101 | 122 | ***** |
| 11 | Hemingway's Nairobi | Nairobi | 45 | 50 | ***** |
| 12 | Hilton Nairobi Limited | Nairobi | 287 | 334 | **** |
| 13 | Crowne Plaza | Nairobi | 206 | 254 | **** |
| 14 | Hilton Garden Inn Nairobi Airport | Nairobi | 175 | 226 | **** |
| 15 | City Lodge Hotel At Two Rivers | Nairobi | 171 | 200 | **** |
| 16 | Southern Sun Mayfair Nairobi | Nairobi | 171 | 212 | **** |
| 17 | Eka Hotel | Nairobi | 167 | 220 | **** |
| 18 | Sarova Panafric Hotel | Nairobi | 162 | 324 | **** |
| 19 | Silver Springs Hotel | Nairobi | 160 | 180 | **** |
| 20 | Nairobi Safari Club | Nairobi | 146 | 186 | **** |
| 21 | The Panari Hotel, Nairobi | Nairobi | 136 | 272 | **** |
| 22 | Ole Sereni Hotel | Nairobi | 134 | 206 | **** |

| | | | | | |
|----|---|----------|-----|-----|------|
| 23 | Windsor Golf Hotel and Country Club | Nairobi | 130 | 205 | **** |
| 24 | Fairview Hotel | Nairobi | 127 | 133 | **** |
| 25 | Weston Hotel | Nairobi | 120 | 154 | **** |
| 26 | Golden Tulip Westlands | Nairobi | 94 | 188 | **** |
| 27 | Amboseli Serena Lodge | Kajiado | 92 | 184 | **** |
| 28 | Gelian Hotel | Machakos | 90 | 136 | **** |
| 29 | Pride Inn Lantana Apartments and Suites | Nairobi | 55 | 110 | **** |
| 30 | Executive Residency by Best Western. | Nairobi | 48 | 106 | **** |
| 31 | House of Waine | Nairobi | 11 | 20 | **** |
| 32 | Carnivore Restaurant | Nairobi | 0 | 0 | **** |
| 33 | Ibis Styles Nairobi Westlands | Nairobi | 277 | 331 | *** |
| 34 | Maanzoni Lodge | Machakos | 272 | 421 | *** |
| 35 | Azure Hotel | Nairobi | 165 | 231 | *** |
| 36 | Best Western Plus Meridian Hotel | Nairobi | 128 | 166 | *** |
| 37 | Ngong Hills Hotel | Nairobi | 110 | 165 | *** |
| 38 | The Heron Portico | Nairobi | 109 | 218 | *** |
| 39 | Pride Inn Raptha Nairobi, | Nairobi | 100 | 200 | *** |
| 40 | Sportsview Hotel Kasarani | Nairobi | 94 | 188 | *** |
| 41 | Kenya Comfort Suits | Nairobi | 88 | 120 | *** |
| 42 | Amboseli Sopa Lodge | Kajiado | 83 | 166 | *** |
| 43 | La Masion Royale | Nairobi | 71 | 144 | *** |
| 44 | The Clarion Hotel | Nairobi | 62 | 67 | *** |
| 45 | Kibo Safaris Camp | Kajiado | 60 | 120 | *** |
| 46 | Boma Inn Nairobi | Nairobi | 59 | 83 | *** |
| 47 | Utalii Hotel | Nairobi | 57 | 114 | *** |
| 48 | Marble Arch Hotel | Nairobi | 41 | 57 | *** |

| | | | | | |
|-------|-------------------------|---------|-------|--------|-----|
| 49 | Fahari Gardens Hotel | Nairobi | 32 | 64 | *** |
| 50 | Villa Leone Guest House | Nairobi | 51 | 54 | *** |
| 51 | Jacaranda Hotel Nairobi | Nairobi | 128 | 256 | ** |
| 52 | Town Lodge | Nairobi | 84 | 124 | ** |
| 53 | Central Park Hotel | Nairobi | 80 | 100 | ** |
| 54 | After 40 Hotel | Nairobi | 63 | 101 | ** |
| 55 | Summerdale Inn | Nairobi | 60 | 75 | ** |
| 56 | Eton Hotel | Nairobi | 58 | 116 | ** |
| 57 | Zehneria Portico | Nairobi | 56 | 65 | ** |
| 58 | Kahama Hotel | Nairobi | 47 | 51 | ** |
| 59 | West Breeze Hotel | Nairobi | 26 | 34 | ** |
| 60 | Tea Tot Hotel | Nairobi | 54 | 66 | ** |
| Total | | | 7,112 | 10,209 | 60 |

Appendix V: Research Letters



ISO 9001:2015 CERTIFIED

REF: KESRA/NBI/036

2nd December 2021

TO: WHOM IT MAY CONCERN

RE: REQUEST FOR RESEARCH DATA

JAMES KARANJA KANGURU- REG. NO.: MU/KESRA105/0009/2020

This is to confirm that the above named is a student at Kenya School of Revenue Administration (KESRA) Nairobi Campus pursuing Masters in Tax and Customs Administration.

The named student is undertaking Research on TOPIC: "DETERMINANTS OF VALUE ADDED TAX COMPLIANCE AMONG THE CLASSIFIED HOTELS WITHIN NAIROBI COUNTY KENYA"

The purpose of this letter is to request your good office to assist the above student with the information to enable him work on his project.

Your support to KESRA in this regard will be highly appreciated.

Thank you.

Dr. Marion Nekesa, PhD
Head Academic Research
KESRA



P. O. Box 48240 – 00100, Nairobi Email: kesratraining@kra.go.ke Tel: +254715877535/9

Tulipe Ushuru Tujitegemeel!

| | |
|--|---|
|  REPUBLIC OF KENYA |  |
| Ref No: 890241 | Date of Issue: 22 May 2022 |
| RESEARCH LICENSE | |
|  | |
| <p>This is to Certify that Mr. James Karanja Kangara of Kenya School of Revenue Administration, has been licensed to conduct research in Nairobi on the topic: DETERMINANTS OF THE VALUE ADDED TAX COMPLIANCE GAP IN CLASSIFIED HOTELS WITHIN NAIROBI COUNTY IN KENYA for the period ending : 22 May 2022.</p> | |
| License No: NACOSTI P/22/17589 | |
| 890241 |  |
| Applicant Identification Number | Director General NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION |
| | Verification QR Code |
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