**SOCIO ECONOMIC FACTORS AFFECTING VALUE ADDED TAX COMPLIANCE AMONG SMALL AND MEDIUM ENTERPRISES IN NAIROBI NORTH TAX STATION, KENYA**

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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF DEGREE OF MASTERS IN TAX AND CUSTOMS ADMINISTRATION, SCHOOL OF BUSINESS AND ECONOMICS**

**MOI UNIVERSITY**

**2023**

# DECLARATION

**Declaration by the Student:**

I, the undersigned, declare that this research project is my original work and has not been submitted to any other university for academic merit.

Signed: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Date: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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This research project has been submitted for examination with my approval as a university supervisor.

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**Dr. John Tarus**

# ABSTRACT

Taxation is an important source of income for both the national and county government for its a vital stream of income for government's improvement ventures. Be that as it may, tax compliance among SMEs is poor. The purpose of the study was to determine the effect of socio-economic factors affecting value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya. The specific objectives were to: determine the effect of taxpayer’s education level, taxpayer’s income level, cost of compliance, taxpayer’s tax knowledge on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya and investigate the moderating effect of tax complexity on the relationship between socio economic factors and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya. The study adopted explanatory research design. The population of the study comprised of 1700 VAT registered SMEs operating business in North of Nairobi tax station. The specific respondents were managers of the SMEs. Therefore, the sample size was 324 managers of SMEs in Nairobi North tax station, Kenya. Stratified random sampling was used to sample the respondents. Primary data was used in this study. Collection of primary data was aided by the use of questionnaires. The drop and pick later method was used in the study. Quantitative data analysis was done using both descriptive statistics and inferential statistics. Descriptive statistics included mean, standard deviation, percentages, and frequencies. Inferential statistics that were used to show the relationship between variables included regression analysis and correlation analy(β=0.215, p=0.000). The coefficient for the interaction term for cost of compliance and tax complexity (X3M) had a p value of 0.01 which means that tax complexity had a statistically significant moderating effect on the relationship between cost of compliance and VAT compliance. The study concluded that taxpayer’s education level, income level and tax knowledge have a positive and statistically significant effect on VAT compliance among SME taxpayers but cost of compliance has a negative but statistically significant effect on VAT compliance. The study recommends that Kenya Revenue Authority should consider adopting strategies that will lead to more education programs on VAT tax and obligations to SMEs. The management of KRA should come up with strategies that will address the balance on VAT among low-income businesses and high-income ones so that there is be fairness. Management of KRA should consider revising the costs of compliance to VAT in order

to bring them to a level that the SME taxpayers will be in a position to incur.sis. The results were presented using charts and tables. Results showed that taxpayer’s education level had a positive and significant effect on VAT compliance (β=0.448, p=0.000). Taxpayer’s education level had a positive and significant effect on VAT compliance (β=0.215, p=0.000). In addition, cost of compliance had a negative and significant effect on VAT compliance (β=-0.261, p=0.000). Further results showed that taxpayer’s tax knowledge had a positive and significant effect on VAT compliance

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# ABBREVIATIONS AND ACRONYMS

**ANOVA** Analysis of variance

**GDP**  Gross Domestic Products

**KRA** Kenya Revenue Authority

**PLS**  Partial Least Square

**SAS** Self-Assessment System

**SMEs** Small Medium Enterprises

**VAT** Value Added Tax

# OPERATIONAL DEFINITION OF TERMS

**Medium enterprise**: are defined as enterprises with annual turnover of Ksh 5,000,000 to Ksh 800,000,000 with a staff capacity of between 50 to 99

**Small enterprise:** are defined as enterprises with annual turnover that falls between Ksh 500,000 to Ksh 5,000,000 and have a staff capacity between 10 to 49

**SME**: is a small business with annual sales lower than Ksh. 1 million

**Tax complexity:** is a multidimensional concept defined by different people from different viewpoint.

**Tax compliance:** is defined as the art of filing returns within the stipulated time and pay tax due as required by the relevant laws

**Taxation:** is the economic obligation imposed by governments on natural and legal persons and entities to cover the expenditure outlays of their programs with no specific return to the taxpayers

**Taxpayer education:** refers to a method of educating individuals about the entire taxation process and why they should pay taxes

**Taxpayer knowledge**: is concerned with the taxpayers’ ability in understanding tax laws, the  
willingness to comply and the role of taxes in national development

**Value Added Tax:** is a multi-stage consumption tax charged on the sale of goods and services at all stage of production and distribution chain

# CHAPTER ONE

# INTRODUCTION

## 1.0 Overview of the Chapter

The chapter outlines the background of the study. Statement of the problem as well as the objectives of the study were also discussed in this chapter. The chapter has also outlined the research hypothesis, significance of the study as well as the scope of the study.

## 1.1 Background of the Study

Taxation is an economic obligation that governments impose on individuals and companies to cover the costs of their programs without providing specific rewards to taxpayers. According to Naomi (2022), tax revenues play a large role in the country's economic growth. The primary purpose of taxation is to increase state revenues, redistribute the wealth resulting from such collections, and direct these revenues toward economic growth and development. Even though taxes are income for the government, they are a burden for taxpayers. As a result, people want to reduce expenses and increase income, while the government wants to increase tax compliance to increase income (Kamau, 2020).

Direct and indirect taxes often make up the tax structure. In contrast to indirect taxes, which are paid by households, families, and businesses that consume taxable commodities, direct taxes assume that only the sources of income are taxed (Adhiambo, 2019). Corporate income tax, withholding tax, rental income tax, bank interest tax, and notional income tax are examples of direct taxes. VAT is an illustration of an indirect tax (Ngachah, 2019).

According to Gangl et al. (2018), the government uses a self-assessment approach in paying VAT, because the business world determines the VAT owed itself by calculating VAT on purchases and VAT on sales. Naomi (2022) claims that VAT is a layered consumption tax imposed on the sale of products and services at every point in the chain of production and distribution. Both the delivery of taxable goods or services and their import are subject to taxation. The tax burden is transferred to consumers through higher pricing even though it is collected from registered traders and paid to the Kenya Revenue Authority. Kenyan law mandates the collection of VAT under Section 476 of the VAT Act. According to Ngachah (2019), tax compliance is the process by which taxpayers adhere to the rules established by the appropriate tax authorities, such as paying the tax due and reporting SPT.

Small enterprises, in particular, are a major source of tax revenue for the government, especially when compared to payroll taxpayers who are solely liable to income tax, which is withheld from net taxes by the majority of taxpayers. Small enterprises (SMEs) also significantly contribute to the unofficial economy, which is unregulated and untaxed. SME growth is frequently noted as being the quickest in economies that are still in the nascent stage (Ngachah, 2019). Tax compliance by these companies varies from country to country. In some cases, owners choose to comply voluntarily, while in other cases, compliance occurs through authorities enforcing compliance. However, due to factors including the complexity of challenging compliance procedures and the desire to have a competitive advantage over non-compliance procedures, many small firms decide to enter the informal economic sector (Nasaye, 2021).

In the world, taxes are a government's primary source of income and a crucial component of its fiscal plan (Mwaura, 2019). In Europe, tax non-compliance costs governments around 8% of their GDP. Tax violations cost North and South American economies 10% and 2% of GDP respectively (Muthinji, 2022). In the United States, for example, forty percent of Americans working in the informal sector do not comply with VAT. The reasons for non-compliance are clear. For example, the taxpayer lacks the necessary knowledge of tax laws, the taxpayer interprets the laws differently than the Internal Revenue Service in the U.S., the taxpayer lacks the ability to maintain adequate records to meet Internal Revenue Service requirements, and the payer taxes lead to calculation errors or relying on taxes. on professional tax return preparers to make mistakes (Gogo, 2018).

In Vietnam, SMEs help local communities in generating employment opportunities. The growth of SMEs has been recognized and given priority by the Vietnamese government as one of its strategic goals (Gherghina et al., 2020). Notwithstanding how crucial these firms are to the nation and its areas, they still confront numerous difficulties. Ensuring tax compliance is one of the most difficult and time-consuming problems. Preparing, filing, and paying taxes on time is known as tax compliance (Naicker & Rajaram, 2019; Nguyen, 2019).

Since they run in informal settings, small firms in Ghana often evade taxes while going unnoticed (Okpeyo, Musah, & Gakpetor, 2019). This shows that tax collection is not easy for small businesses because they are characterized by poor accounting and deliberate tax avoidance. Without traceable source documents and accounting records, the taxation of these companies becomes difficult to understand. Similar feelings may be seen in Nigeria, where low VAT compliance would unavoidably persist among taxpayers of this category until small business owners choose to pay taxes willingly through facilitation (Michael, 2018). Vincent (2021) further points out that Nigeria has generated significant revenues from voluntary VAT compliance, however these revenues are considered underutilized due to high levels of tax evasion, poor accounting by companies, use of unqualified FIRS personnel, and low levels of VAT education in between VAT organizations. and the public. It was also shown that, contrary to expectations, these organizations saw VAT as a burden.

Tax non-compliance in East African countries was high relative to GDP in 2018. Uganda recorded the lowest tax evasion compared to other East African countries, losing $856 million, Tanzania $1.9 billion; Kenya lost more than $2 billion. 4 (Mutinji, 2022). According to a case study of SMEs in Tanzania, tax rates and tax compliance have a strong and positive link, and tax compliance has a positive but insignificant impact on tax compliance (Baba, 2022).

In Kenya's corporate sector, the majority of taxpayers are SMEs. The National Economic Survey (2022) states that SMEs make up 98% of all firms in Kenya and generate 30% of all jobs each year. Viffa (2018) estimates that there are 7.4 million internally displaced people in Kenya. Of the 7.4 million SMEs, 1.5 million have received permits from 47 local governments, and an estimated 5.9 million do not, which shows that there are a lot of unregistered businesses operating clandestinely in Kenya. If all SMEs can improve tax compliance, then KRA will be able to generate more income thereby contributing to KRA's income target (Orwa, 2019).

### 1.1.1 Socio Economic Factors

The desire of taxpayers to abide by tax laws in response to their actions and social setting is referred to as tax compliance factors from a social and economic perspective. This also includes actions pertaining to the expenses and advantages of carrying out certain actions (Etim et al., 2020). According to Torgler (2019), taxpayers are likely to be economically logical avoiders who understand the risks and rewards of noncompliance. They will make an effort to reduce their tax obligations, such as by purposefully underestimating their income, and will benefit from tax breaks if the tax authorities are unaware of them.

Social and economic determinants which affect taxpayer’s behavior are crucial to be considered while making policies because they have also an effect on the rate of tax collection. Therefore, taxes are considered one of the most common relationships between citizens and the state, because everyone is obliged to pay taxes (Mugler, 2018). Tax and expenditure policies formulated with taking into consideration cultural, legal, economic, political and social factors which reflect the society will affect tax compliance because it will be easier to attain social acceptance. This may bring success to the policies and practices implemented by the government (Erul, 2020). Some of the social economic factors that will be considered in the study will include; tax payer education level, taxpayer income level, cost of compliance and taxpayer tax knowledge.

### 1.1.2 Value Added Tax Compliance

The sale of products and services at all points along the manufacturing and distribution chain are subject to the VAT, a multi-stage consumption tax. Both the delivery of taxable products or services to Kenya and their importation into Kenya are subject to tax. The tax burden is transferred to consumers through higher pricing even though it is collected from registered traders and paid to the Kenya Revenue Authority. Kenyan law mandates the collection of VAT under Section 476 of the VAT Act. According to Ngachah (2019), tax compliance is the process by which taxpayers adhere to the rules established by the appropriate tax authorities, such as paying the tax due and reporting SPT.

According to the VAT Act of 2013, the VAT rate in Kenya is 16% on general value purchases and sales and 12% on gasoline. Other shipments, such as B. Exports are subject to zero tax rate, others are tax free. VAT collection is carried out as part of the self-assessment procedure, where the taxpayer pays the VAT on the invoice via the electronic tax register and pays the balance no later than the 20th of the month following the expenditure or receipt of income. VAT must be recorded on the day of payment or invoice, whichever comes first (Belyon, 2019).

The degree to which a taxpayer makes an effort to abide by the requirements of the applicable tax laws of a nation is referred to as tax compliance. Tax compliance is assessed using a variety of metrics. King'Oina (2018) states that there are four ways to gauge tax compliance: registration, submission, computation, and payment. The percentage of registered taxpayers who are in compliance with their tax duties is known as registration compliance. Compliance is the percentage of SPT submissions that are received on time. The percentage of correctly computed and submitted tax liabilities is referred to as calculation compliance. Tax compliance is the percentage of predicted tax liabilities that are paid on the due dates specified in tax regulations (King'Oina, 2018). Nyangau (2018) measures tax compliance as the percentage of VAT to total sales.

Gitaru (2018) evaluates tax compliance by the rise in the number of taxpayers who are employed and registered, the rise in the quantity and quality of tax returns filed, the timely filing of returns, and the rise in tax income from tax payments. Kamau (2020) measures tax compliance by registering new taxpayers, reporting taxes on time, and paying taxes on time. Wanjiru (2020) measured tax compliance through prompt return filing, accurate declarations, and timely payment; an improvement in these indicators leads to better tax compliance, which in turn leads to an increase in tax revenue. Compliance with registration, filing, computation, and payment requirements will be measured in this study as a measure of value added tax compliance.

### 1.1.3 Small and Medium Enterprises

Small and Medium Enterprises comprises over 95% of organizations in Kenya, and they are the driving force in the country economy with contributions through jobs creation, exports and imports, contributions of the GDP, stimulating competition, innovation and technical support provision to large organizations among others. The Economic Survey (2017) indicated that over 80% of jobs created in Kenya were in the SMEs Sector. In Kenya SMEs are defined by Micro and Small Enterprise Act 2012. Micro enterprises are defined as enterprises with annual turnover not exceeding Ksh 500,000 and have employees not more than 10; Small enterprise are defined as enterprises with annual turnover that falls between Ksh 500,000 to Ksh 5,000,000 and have a staff capacity between 10 to 49 while medium enterprise are defined as enterprises with annual turnover of Ksh 5,000,000 to Ksh 800,000,000 with a staff capacity of between 50 to 99 (Aondo, 2019).

In general, the SME sector includes manufacturing and trade activities that have an impact on the country's economy as a whole. Most importantly, to ensure voluntary compliance and economic growth, ideal tax policies must be implemented. One of the primary sources of funding for development initiatives and the delivery of public goods and services is tax money. Due to their volatility, small and medium-sized businesses that contribute to the economy must pay taxes. Therefore, most SMEs continue to operate in industries where formalities are lacking and compliance costs have also proven to be too high (Naomi, 2022). There are 1,700 VAT paying SMEs operating in Nairobi North (Nairobi County Report 2023).

## 1.2 Statement of the Problem

Taxation is an important source of income for both the national and county government for its a vital stream of income for government's improvement ventures. Be that as it may, tax compliance among SMEs is poor (Adhiambo, 2019). Specifically, the level of VAT compliance is still low, providing only 23% to total revenue, despite numerous administrative measures made to raise tax compliance. In 2018, KRA plans to increase the VAT to total sales ratio to 35% and attain 65% compliance with the VAT (Gai, 2020). VAT compliance was only 55%, according to the KRA report (2020), while filing was 65%.

A total of 52,198 VAT-registered taxpayers filed no SPT or no SPT at all in April 2018, and 23,948 of these were UKM8 (KRA 2020). This is in contrast to the KRA iTax report, which demonstrates that numerous SMEs conducted business with withholding agents over the same time period (Ngachah, 2019). The issue of non-compliance caused KRA to establish a unit at each KRA station to deal with zero-declarers and non-declarers, the majority of whom are contractors and SMEs. More than 30% of the registered businesses in Kisii town did not file their taxes in the year 2021 (Naomi, 2022).

Little is known about how socioeconomic factors affect VAT compliance among small and medium-sized businesses in Nairobi North Tax Office, Kenya, notwithstanding prior study that has been done in this area. Erul (2020) did a study on the OECD and the European Union that focuses on socioeconomic factors and tax compliance within the context of financial sociology. This study highlights that social, political, cultural and economic structures influence the taxation system. This study focuses on the European Union and OECD thereby highlighting contextual gaps. This research was conducted in Kenya. Naomi (2022) focuses on the elements affecting Kenya's VAT compliance. According to the study's findings, there is a considerable relationship between the cost of tax compliance, one's level of tax education, how one feels about paying taxes, and the imposition of penalties and interest. There is a conceptual gap in this work because moderators were not included. Ngachah (2019) focuses on the Central Business Development, Nairobi, issues that affect VAT on small and medium-sized businesses. In KRA, Kenya, this study discovers that tax compliance expenses, tax expertise, and tax rates all significantly affect revenue outcomes. This study has methodological flaws because it is based on a descriptive research approach. The current study therefore sought to answer the question; what is the effect of socio-economic factors affecting value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya.

## 1.3 Objectives of the Study

The purpose of the study was to determine the effect of socio-economic factors affecting value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya.

### 1.3.1 Specific objectives

The specific objectives were to:

1. Determine the effect of taxpayer’s education level on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
2. Examine the effect of taxpayer’s income level on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
3. Establish the effect of tax payer’s cost of compliance on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
4. Determine the effect of taxpayer’s tax knowledge on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
5. Investigate the moderating effect of tax complexity on the relationship between tax payers’ education level, tax payers’ income level, tax payers cost compliance and taxpayers tax knowledge on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

## 1.4 Research Hypotheses

1. H01: Taxpayer’s education level does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
2. H02: Taxpayer’s income level does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
3. H03: Cost of Compliance does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
4. H04: Taxpayer’s tax knowledge does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
5. H05: Tax complexity does not have a significant moderating effect on the relationship between:
6. H05a: Taxpayer’s education level and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
7. H05b: Taxpayer’s income level and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

(c) H05c: Cost of Compliance and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

(d) H05d: Taxpayer’s tax knowledge and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

## 1.5 Significance of the Study

The investigation will benefit KRA. The results of this survey will be input for the formulation and implementation of future policies regarding VAT administration issues in this country.

The results of this research will also help the Kenyan government compile statistics on compliance levels and how these can be improved to increase tax compliance.

Focusing on the impact of socio-economic factors on VAT compliance among small and medium enterprises in Nairobi North Tax Office, Kenya, will expand the literature on VAT compliance. The results of this research will expand the scope of knowledge, which over time can also be used by academics to research and carry out further studies to analyze the impact of socio-economic factors that influence VAT compliance on small and medium businesses in Northern Tax. Influence Station in Nairobi, Kenya.

## 1.6 Scope of the Study

This study examines the impact of socio-economic factors on VAT compliance among small and medium enterprises at the Nairobi North Tax Office in Kenya. This research investigation was limited to five objectives; To determine the impact of taxpayer education level on VAT compliance in small and medium enterprises at the Nairobi North Tax Office, Kenya. To examine the impact of taxpayer income level on VAT compliance among small and medium enterprises in the tax district of Nairobi North Station, Kenya, to determine the impact of compliance costs on VAT compliance among small and medium enterprises in Nairobi North. Tax Station, Kenya, to determine the impact of taxpayers' tax knowledge on VAT compliance among SMEs in Nairobi North Tax Station, Kenya, and to determine the moderating effect of tax complexity on the relationship between socio-economic factors and VAT compliance among SMEs in Nairobi North Tax Station, Kenya. A total of 1,700 VAT registered SMEs (KRA, 2022) operating in Nairobi North were selected for this research. The population of the study comprised of 1700 VAT registered SMEs operating business in North of Nairobi tax station. The specific respondents were managers of the SMEs. Therefore, the sample size was 324 managers of SMEs in Nairobi North tax station, Kenya. The managers were selected since they have the information concerning the SMEs. This research adopts an explanatory research design. Primary data was collected using a structured questionnaire. The research was conducted during July-December 2023.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Introduction

This chapter provides a discussion of theories related to the study concepts. The chapter also provides a review of the study concepts based in their definitions and conceptualization. Further an empirical review of related literature is provided where studies conducted in relation to the study objectives are reviewed. A critique and summary of the studies is also provided and finally the conceptual framework for the study.

## 2.2 Review of Study Concepts

The following study concepts were reviewed in this sub section; value added tax compliance**,** tax payer’s education level, taxpayer income level, cost of compliance, taxpayer tax knowledge and tax complexity.

### 2.2.1 Value Added Tax Compliance

In Kenya, the sales tax that had been in force since 1973 was replaced in 1990 with a VAT on consumer expenditure. It was put forth as a method to boost tax collection by enlarging the tax base. Consumption of taxable goods and services imported or supplied into Kenya is subject to a value-added tax (VAT). VAT is collected by registered individuals on behalf of the Kenyan government at predetermined sites, and they then turn it in to the Kenya Revenue Authority (KRA) (Naomi, 2022).

Tax compliance refers to the extent to which taxpayers comply with their tax obligations and obligations. Tax compliance includes calculating taxes correctly and paying them in accordance with tax regulations (Aondo, 2019). Banu Khalid and others. (2022) further stated that tax compliance includes submitting tax reports on time, reporting all income and claiming the correct deductions, as well as making tax payments on time when the tax is due (Bani-Khalid et al., 2022). Tax compliance requires two forms of compliance, which are different and can be accounted for by the company. Technical or administrative compliance make up this category. The first category refers to fulfilling all administrative requirements, including those related to tax payment and accommodation. Reporting compliance is another name for this type of administrative compliance. The term "technical compliance" refers to following the rules of tax law in a technical sense, such as when calculating taxes or comprehending the rules when paying one's fair share of taxes (Kenimak, 2019).

### 2.2.2 Taxpayer’s Education Level

The term "tax education" is a strategy for informing individuals about the overall taxation system and the justifications for why they must pay taxes (Gitaru, 2018). This aids taxpayers in meeting their duties regarding state taxes. This demonstrates that motivating voluntary taxpayer compliance is the primary objective of taxpayer education. According to Margaret (2022), the three major goals of tax education are to increase tax collection through voluntary compliance, change taxpayer attitudes toward taxes, and provide information about tax laws and their enforcement.

The tax authorities use four dimensions to give people knowledge and information. The first is a stakeholder education forum, which involves educating taxpayers about taxes through workshops, seminars, and cultural activities. The second is fundamental media education, which entails educating taxpayers about taxes via radio and television. The third kind of education is through print media, namely educating taxpayers about taxes through periodicals, newspapers, and pamphlets (Gitaru, 2017). The broadcast of tax education to taxpayers through Facebook, Twitter, Instagram, and other social media applications is included in the fourth category of education (Koumpias & Martnez-Vázquez, 2019). Therefore, the current study measured tax payer’s education in terms of stakeholders’ education, stream media education, print media education and awareness of tax risks.

### 2.2.3 Taxpayer’s Income Level

The amount of tax payable is decided by the level of the revenue generated during the period considered. Therefore, among many factors, income level is also one of the main determining factors in taxpayer compliance behavior (Mohammed & Dabor, 2018). The government applies different approaches when imposing taxes to determine how much people should pay according to their earnings. Low-income earners tend to submit incorrect reports and evade tax. Contrary, Dissanayake and Premaratna (2020) found that a high level of business income encourages the business community to pay more taxes to the state.

Tax payments decrease disposable income, which hurts low-income individuals particularly and can encourage risk-taking behavior. As a result, it is assumed that low-income groups comply with taxes less than high-income groups. Contrarily, it is believed that those with higher earnings are more prone than those with lower incomes to evade taxes. Mohamed and Dabor (2018) presumptively believe that low compliance is correlated with high income. As a result of paying higher absolute and relative tax rates than low-income individuals and running a higher risk of fines for open tax evasion, high-income individuals should be more risk-averse (Dissanayake & Premaratna, 2020).

### 2.2.4 Cost of Compliance

According to Omondi and Theuri (2019), there are social costs and taxpayer compliance costs associated with tax compliance. Administrative costs are those expended by the state in the process of tax collection and refund. Efficiency costs, often known as weight loss costs, and administrative expenses are social costs. Operational compliance costs are the total of administrative and social costs. According to Dabla-Norris et al. (2018), the complexity of the tax system and the numerous technological developments are to blame for the fact that compliance expenses are an issue for researchers. In accordance with Abdul and Wang (2018), net compliance costs are calculated as the difference between the benefits of compliance and gross compliance. Tax reduction, improved cash flow, and improved management are all advantages of compliance.

There are many factors to take into account when investigating this subject because OECD 2001 says that compliance costs are a serious risk. This is due to the fact that spending depletes private enterprises' resources. occur from taxpayers in complying with these laws and regulations and in meeting their commitments, according to Dabla-Norris et al. (2018). Abdul and Wangâ (2018) found that most organizations do not cooperate when they receive high ratings that come with high fines and penalties.

### 2.2.5 Taxpayer’s Tax Knowledge

Tax knowledge and training is considered an important part of attitudes towards tax compliance (Fauziati et al., 2020). It discusses the ability of tax payers to comprehend VAT regulations, their desire to abide by them, and the function of taxes in a country's development. Based on formal education and tax avoidance expertise, this knowledge is divided into different categories. Understanding and following tax laws and regulations are directly correlated with tax literacy on the part of the taxpayer. While delivering services to taxpayers, taxpayer education works to promote voluntary compliance (King'Oina, 2018).

Kirchler et al. (2018) postulate that tax knowledge is very important because if someone knows what to do at all times, then he or she will always comply. According to Zhang and Qiu-Sheng (2018)taxation knowledge helps to raise public understanding with regard with withholding VAT taxation guidelines, the function of tax in state growth and particularly to elucidate how and where the revenue gathered is utilized by the administration. Measures of tax knowledge included; availability of information, tax systems, technical details, availability of professional trainers.

### 2.2.6 Tax Complexity

Tax complexity is a multidimensional concept defined by different people from different perspectives. Tax complexity has been explained by Abdul and McFie (2020) as one of the main drivers of tax compliance behavior, the underlying assumption is that taxpayers can evaluate various complex decisions by appropriately assessing the available information so that they can make decisions with the best results. (Alsqour & Alshirah, 2020). Therefore, tax complexity mainly includes calculations, ambiguities, changes, excessive details, forms and recording (Mat et al., 2021). In this research, tax complexity is defined as a measure related to the problems faced by SMEs in VAT regulations. This includes frequent changes, excessive detail, repetitive calculations, and detailed and specific record keeping.

Tax complexity is defined in three different ways: by tax consultants, by tax attorneys, and by taxpayers. Tax complexity, in the context of a tax advisor, refers to the amount of time required to prepare income tax returns, including tax planning, or to provide tax advice and counsel. The difficulty of reading, comprehending, and interpreting tax regulations so that they can be applied in compliance with tax laws and regulations might be characterized by a tax lawyer as tax complexity. Tax complexity is considered for taxpayers in terms of the time and expense required to comply with applicable tax legislation (Alsqour & Alshirah, 2020). Therefore, in line with the opinions of tax professionals and taxpayers, this study analyzes the complexity of taxes based on the amount of time taxpayers spend complying with applicable tax rules. Long recognized as one of the determining variables for tax compliance in the tax system/structure, tax system complexity is still an important consideration today. According to additional research (Mat et al., 2021) tax complexity can have an impact on tax compliance.

## 2.3 Theoretical Review

The study was anchored on three theories that is;ability to pay theory, vroom’s expectancy theory and economic deterrence theory.

### 2.3.1 Ability to Pay Theory

This 16th century scientific theory was put forward by Swiss philosopher Jean-Jacques Rousseau (1712-1778). This theory holds that a person's income or ability to pay determines how much tax should be imposed on that person. As a result, progressive taxes are based on this, and as taxable income rises, so do tax rates (Jones & Rhoades, 2011). In the case of SMEs as the taxable income level rises, then the amount of taxes they are supposed to pay rises. So the theory states that people who have higher income or wealth and are actually able to pay taxes should be taxed at a higher rate than people with lower incomes, thus resulting in a fair tax system. This disease is widespread in developed countries with unequal income distribution.

However, this theory does not have a strong method for measuring victim justice, because it has been proven that justice can be measured absolutely, proportionally and, to some extent, within boundary conditions. Therefore, the importance of this theory also extends to taxes and the taxation system, which in turn contributes to increasing government revenue. This theory also has social implications related to economic impacts. The accepted criteria for tax selection, as well as the level of implementation, have led to a preference for one set of economic impacts over others, giving rise to different social consequences arising from different economic impacts. It should be emphasized, however, that this theory does not accurately reflect VAT, as each individual is subject to the same VAT on the specific things they purchase, despite the fact that they all make wildly different amounts of money and, consequently, have diverse skill sets. Therefore, even though a person's income is increasing, the VAT only covers a small percentage of it, according to Jones and Rhoades' (2011) argument.

This theory was adopted in this study to address both the dependent (value added tax compliance) and independent variable which is (social economic factors). According to this theory the VAT charged on the SMEs should be in relation to their ability to pay. SMEs with equal ability to pay should be taxed equally while those with unequal ability to pay should receive unequal taxation on their income.

### 2.3.2 Vroom’s Expectancy Theory

Vroom (1964) created this hypothesis. He believed that decisions are made consciously between options with the intention of maximizing pleasure and limiting misery. According to Vroom, an employee's success is influenced by personal traits like temperament, skills, experience, expertise, and talent. This idea is about the inner purpose of desire or decision. It outlines the procedure a business follows while making decisions. According to Vroom, motivation is a mechanism that controls an individual's ability to choose between several forms of voluntary activity. People make decisions based on assessments of how closely the anticipated outcomes of a course of action match or finally lead to the intended conclusion. Participants are motivated when they believe that their efforts will be rewarded with the anticipated outcomes (Hester & Adams, 2014).

The importance of this idea in this study is that it suggests that SMEs taxpayers are motivated to pay taxes when they believe that doing so will satisfy one or more of their most pressing demands. It is the duty of the government to educate construction companies about taxes through seminars, workshops, the media, and stakeholder awareness. Tax education gives the SMEs tax payers tax information and can help establish a compliance attitude since it boosts or stimulates people to pay taxes, which promotes economic growth and raises people's standards of living (Murga & Böhm, 2015).

This theory therefore informed one of the independent variables which is tax payers’ education. The theory shows the need to equip the tax payers with knowledge which motivate them to pay taxes. As a result, the expectancies theory proposed by Vroom anticipates a clear connection between taxpayer education and SMEs' compliance with the VAT.

### 2.3.3 Economic Deterrence Theory

This theory was proposed by Becker in 1968. This hypothesis is predicated on the idea that if the costs associated with committing a specific crime outweigh the gains from the crime, the person will not do the crime. Economics' precautionary principle is founded on the supposition that everyone can quickly tell what is right and wrong, as well as the effects of doing something wrong.

Supporters of this idea belong to a school of thinking that makes the assumption that individuals weigh the benefits and drawbacks of their activities before deciding whether or not to abide by the law. By creating an economic deterrence model that posits a taxpayer is most likely to evade taxes when he or she believes there are economic gains coming from noncompliance, Allingham and Sandmo (1972) attempted to merge economic deterrence with taxation theories. with tax laws outweighing the expenses of registering.

Participants in training programs can assist taxpayers in this case the SMEs who pay taxes because they believe doing so will have a positive economic impact in realizing that such benefits are not a guarantee of taxation. No government in the world, according to Yusoff, Ling, and Wah (2014), guarantees its citizens immediate advantages in exchange for tax payments. Taxes help to redistribute wealth in the economy so that people who are less fortunate might gain. Taxpayers will become more compliant in paying taxes thanks to education campaigns like these, but not always because of the benefits they might get. The economic precautionary principle is significant in this study because it emphasizes the importance of taxpayer awareness of the repercussions of noncompliance. According to this argument, taxes are not meant to directly benefit people who pay them; rather, they are meant to redistribute wealth. This idea has also been applied in other relevant studies on taxpayer education, such as those by Misra (2004) and Gitaru (2017).

## 2.4 Empirical Review

This section reviewed past studies on tax payer education level, tax payer income level cost of compliance, taxpayer tax knowledge and tax complexity.

### 2.4.1 Taxpayer’s Education Level and Value Added Tax Compliance

Gitaru (2018) investigated how taxpayer education affected Kenyan tax compliance. A case study research design is used in this investigation. According to the study's findings, stakeholder involvement, electronic taxpayer training, and print media taxpayer training all have an impact on SMEs in Nairobi's central business district when it comes to tax compliance. Furthermore, the research results show that stakeholder sensitivity is positively related to taxpayer education regarding correct tax compliance calculations. This research is based on a case study design and thus demonstrates a methodology. This research adopts an explanatory research design.

In Nairobi County, Margaret (2022) focuses on the effect of taxpayer education on VAT compliance for bottled water. A cross-sectional quantitative design was used in this study. According to this study, social media education significantly and favorably impacted Nairobi County's water bottlers' compliance with the VAT. The taxpayer awareness program, according to the report, significantly and favorably impacted Nairobi County's water bottling industries' compliance with the VAT. The study also discovered that water bottling enterprises in Nairobi County are significantly and positively impacted by electronic/print media on VAT compliance. According to the study's findings, taxpayer education significantly affects VAT compliance. This study is based on a quantitative cross-sectional design and thus suggests a methodological gap.

Kurniawan (2020) focused on how college-level tax education affects tax knowledge and how it affects individual tax compliance. Descriptive research methodology is used in this study. The findings of the study demonstrate that tax education significantly affects taxpayer compliance. Consequently, tax knowledge's indirect impact on tax education has a big impact on taxpayer compliance. The outcomes of interviews with two students, two tax instructors, and a representative of the Directorate General of Taxes provide additional support for the findings of the quantitative study. According to this study's findings, tax education can improve tax knowledge and affect taxpayer compliance behavior. This study only focuses on one socioeconomic factor, indicating a conceptual gap.

Tan et al. (2021) focuses on the moderating influence of the education level of individual taxpayers on ethical perceptions and tax compliance behavior in Peninsular Malaysia. This research examines how individual taxpayers' ethical perceptions can be influenced by their level of education, thereby influencing their tax compliance behavior. Data are gathered using a cross-sectional approach by researchers at predetermined points in time. The findings of the study demonstrate that ethical attitudes significantly and favorably affect tax compliance behavior. Depending on the amount of education, the results also demonstrate a substantial positive association between ethical attitudes and tax compliance behavior. This indicates that an increase in education raises taxpayers' ethical awareness and makes them more obedient. There exist contextual gaps, according to studies carried out in Malaysia. This research was conducted in Kenya.

### 2.4.2 Taxpayer’s Income Level and Value Added Tax Compliance

Kenimak (2019) concentrated on the influence of demographic traits on tax compliance among small- and medium-sized company owners. Descriptive research methodology is used in this study. The study's findings demonstrate how age, education, and economic status all have an impact on SME owners along Jalan Ronal Ngala in terms of their tax compliance. Therefore, based on demographic information, KRA and the government can make adjustments that can dramatically increase taxpayer compliance. The ultimate effect is higher tax revenues for the government, allowing them to offer taxpayers and the government as a whole high-quality services and expanding and improving public services. While this study employs an explanatory research design, this study employs a descriptive research design.

Dissanayake and Premaratna's (2020) study on Sri Lanka focuses on the impact of income on tax compliance using empirical data from the country's small and medium taxpayers. The purpose of this study is to investigate, using a slippery slope approach, how taxpayer income levels affect compliance behavior. The Kendall Tau b and Spearman correlation coefficients are used to assess how closely two variables are related. According to the study's findings, forced compliance has a negative association with a taxpayer's income level, whereas voluntary compliance has a positive relationship. The findings of the study further demonstrate the significance of income level in determining tax compliance. In addition, tax authorities should take appropriate steps to review the strategies developed to implement tax policies. Studies conducted in Sri Lanka indicate the existence of contextual gaps. This research was conducted in Kenya.

Mannan (2020) focuses on the socioeconomic factors influencing tax compliance in Bangladesh, using an empirical study of individual taxpayers in the Dhaka region. Individual taxpayers in Dhaka's fifteen zones are the study's target audience. This study has a descriptive focus. According to the ordered logistic regression model's findings, compliance has a positive and substantial association with fairness, tax penalties, and their relationship to taxpayers' evaluations of government expenditure. Examined is the effect of recommender compliance judgments on other compliance decisions. The findings reveal a weak but not statistically significant correlation between the two, suggesting that each taxpayer makes their compliance decisions independently of those of others. The study's analysis of the effect of tax compliance costs on compliance levels reveals a negative link between the two, demonstrating that higher compliance costs are associated with lower compliance levels. There exist contextual gaps, according to studies carried out in Bangladesh. This research was conducted in Kenya.

Kipkoech and Joel's (2018) study of limited liability businesses in Eldoret City focuses on the influence of economic factors on tax compliance in Kenya. This study's specific goal is to identify the factors that affect tax compliance with tax laws, including tax rates, tax audits, actual income, fines, and fine amounts. This study uses a survey-based methodology. The survey's findings indicate that, after tax rates, fines, and penalties, tax audits have the greatest positive effect on tax compliance. The two factors that have the least favorable impact on tax compliance are tax incentives and actual income levels. This study shows a conceptual gap because it only considers economic issues and tax compliance. The current study focuses on the impact of socio-economic factors and VAT compliance.

### 2.4.3 Cost of Compliance and Value Added Tax Compliance

In their study, Dabla-Norris et al. (2018) looked at how the quality of tax administration affects company performance in a large sample of businesses in emerging and developing nations. They found that better tax administration reduces the productivity gap between small and young businesses and large and old businesses, and that countries can gain growth and productivity gains through improvements in tax administration that lower compliance costs for businesses.

The impact of tax compliance costs and taxpayer knowledge on small business owners in Nakuru City, Kenya, was the main emphasis of Omondi and Theuri's (2019) study. Descriptive research methodology is used in this study. A structured questionnaire was used to gather the information. Tables and diagrams are then used to summarize the data. The findings of the study demonstrate that tax awareness and education have a favorable and significant impact on tax compliance, and that the cost of compliance has a considerable impact on the degree of compliance. Descriptive research was employed in this study to identify methodological inadequacies. The purpose of this study is exploratory.

Abdul and Wang (2018) concentrate on Kenya's tax expenditure and tax compliance practices. This study looks at how tax compliance policies affect Kenyan taxpayers who work for medium-sized and large businesses. The findings demonstrate that tax compliance in Kenya considerably declines as tax compliance costs rise, particularly in relation to comprehending complicated tax laws, alterations in tax rules, and overall compliance costs and regulatory requirements. This research focuses on only one socio-economic factor that influences tax compliance, namely tax expenditure. This survey examines the taxpayer's education level, income level, and taxpayer's level of knowledge.

The study by Mahangila (2018) focuses on how tax compliance expenses affect tax compliance behavior. 75 small and medium-sized business owners with offices in Tanzania's capital city of Dar es Salaam participated in the tax context experiment. Overall, the study's findings indicate that when the cost of tax compliance rises, so do tax infractions. The results of this study imply that tax compliance expenses may be to blame for SME taxpayers' subpar tax compliance, despite the fact that the study only included a small sample of SME taxpayers and the results may not be generalizable. While this study was carried out in Kenya, this study was carried out in Tanzania.

The socio-economic traits and tax compliance of individual taxpayers in Kenya are the main topics of discussion in Muturi and Abdul (2021). Additionally, this study intends to ascertain the moderating impact of tax punishments on the association between socioeconomic traits and individual taxpayers' tax compliance in Kenya. Primary data was gathered by people responding to questionnaires by researchers. Multiple regression and descriptive statistics were used to analyze the acquired data. The study's findings demonstrate that tax knowledge significantly affects individual taxpayers' compliance with tax laws in Kenya. The study also discovered that tax complexity significantly affects individual taxpayers' tax compliance in Kenya. Additionally, the characteristics of individual taxpayers have a big impact on their tax compliance in Kenya. The study also discovered that tax penalties significantly moderate the association between a taxpayer's socioeconomic status and their tax compliance in Kenya. The poll revealed that while filing tax returns, taxpayers seek the advice of a tax professional. Additionally, this survey discovered that taxpayers are unaware of the Income Tax Law CAP 470 and do not keep up with changes to tax rules and regulations. This research is descriptive while this research is explanatory.

### 2.4.4 Taxpayer’s Tax Knowledge and Value Added Tax Compliance

Amin et al. (2022) examine the effect of tax knowledge on boosting taxpayer compliance in Malaysia by implementing tax education in universities. Through questionnaires, this study employs a quantitative methodology. The findings of the study demonstrate that tax knowledge is a factor that affects a nation's level of tax compliance. While this study was carried out in Kenya, the other study was carried out in Malaysia.

Twum et al. (2020) focused on the tax compliance and awareness of SMEs in Ghana. An approach called structural equation modeling was used to analyze the data. The findings of the study demonstrate a significant and positive association between taxpayer compliance and understanding of tax rights and obligations, employment income, and sanctions. Statistics show that understanding business income has little relation to paying taxes. According to the study's findings, understanding one's tax obligations and rights as well as being aware of potential penalties are what have the biggest effects on taxpayer compliance in the SME sector. Despite the lack of significance, the association between tax compliance and business income knowledge is still crucial for this study's self-evaluation of SME behavior. Self-assessment levels should be targeted to encourage SMEs to pay their taxes. The research only focuses on one socio-economic factor that influences tax compliance, namely tax knowledge. This research also examines the taxpayer's education level, income level, and compliance costs.

Abd Hamid et al.'s (2019) study on Malaysian SMEs in the e-commerce industry concentrated on the variables affecting tax compliance. Interviews with six owners of small and medium-sized businesses engaged in e-commerce were used to gather data. The findings demonstrate that tax rates have a significant impact on how Malaysian online enterprises comply with tax laws. Additionally, respondents think that Malaysia's tax laws are too difficult to comprehend and that the country's present corporate tax rates are onerous and excessively high. While one study focuses on SMEs in Nairobi, Kenya, another study focuses on SMEs in Malaysia.

The effect of tax knowledge on tax compliance among small and medium-sized firms in developing countries was the main topic of a study by Newman (2018). The purpose of this literature review is to evaluate how tax knowledge affects small and medium-sized businesses (SMEs) in developing nations' tax compliance. According to this report, SMEs in these developing nations do not adhere to tax regulations. They do not have a thorough comprehension of tax-related subjects and only have a basic concept of taxation. Additionally, it was discovered that improving SME tax compliance behavior did not result from simply raising tax knowledge in isolation from issues like high tax rates and corruption. This study adopted a desktop research design, indicating the methodology. This research adopts an explanatory research design

### 2.4.5 Social Economic Factors, Tax Complexity and Tax Compliance

The study by Mat Jusoh et al. (2021) focuses on how tax knowledge, tax complexity, and tax morale affect employee groups' tax compliance behavior in Malaysia. Employees in Malaysia's private and public sectors were given a standardized questionnaire. Data analysis of 152 complete replies reveals that tax expertise, complexity, and passion significantly affect employee groups' tax compliance behavior. The findings of this research not only contribute to the literature on the determinants that encourage taxpayers' voluntary compliance with the Self-Assessment System (SAS) in Malaysia, but also provide insights for government agencies and tax authorities regarding the need to improve current tax policies and develop measures strategic to increase taxpayers' tax literacy. This research was conducted in Malaysia while this research was conducted in Kenya.

In their study of large and medium-sized taxpayers in Kenya, Abdul and McFie (2020) put special emphasis on the complexity of taxation and their compliance practices. Examination was also done on the effect of perceived behavioral control. A sample of 142 companies were employed in the study using a partial least squares (PLS) methodology. The study's findings demonstrate that, despite the fact that there are many different dimensions to fairness views, only exchange fairness has an impact on taxpayer compliance behavior, whereas other aspects of fairness are influenced by complexity. A strong detrimental effect of perceived behavioral control on compliance behavior has been discovered. The results suggest that tax authorities in Kenya and similar tax jurisdictions should strive to achieve fair exchanges and reduce instances where taxpayers may have uncontrolled control over their business relationships to improve tax compliance. In this research, tax complexity is used as an independent variable, while in this research tax complexity is used as a moderating variable.

Gambo et al. (2018) concentrated on tax compliance and complexity in African self-assessment environments. This study investigates how tax complexity affects tax compliance in an African self-assessment setting. The population of the study spans the entirety of Africa. Descriptive research methodology is used in this study. The findings indicate that tax complexity has a considerable negative impact on tax compliance in Africa, with taxpayers spending an extra day (19 hours) in a self-assessment setting over the regional norm. While this study employs an explanatory research design, this study employs a descriptive research design.

Focusing on the effect of tax complexity on VAT compliance among Jordanian SMEs is Alsqour and Alshirah's (2020) primary concern. An online survey was used for this study. According to the findings, tax complexity has a big impact on how much VAT is collected. This study recommends conducting future research on VAT compliance in the SME context to gain deeper insight into the driving factors. This research focuses on SMEs in Jordan, while this research was conducted in Kenya.

## 2.5 Critique of Literature Review

The concept of social economic factors and its impact on value added tax compliance is very important. However, only few studies focused on social economic factors on value added tax compliance. Erul (2020) focuses on socio-economic variables and tax compliance within the framework of financial sociology. Muturi and Abdul (2021) focus on the socio-economic characteristics and tax compliance of individual taxpayers in Kenya. These studies however left out the aspect of the SMEs. The studies also did not include any moderator.

The numerous results presented have been used in prior studies. (2018) Abdul and Wangâ concentrate on Kenyan tax expenditure and tax compliance behavior. The findings indicate that when tax compliance expenses rise, tax compliance in Kenya considerably declines. Similar research was undertaken by Mahangila (2018), but the findings revealed that tax non-compliance rose sharply as tax compliance expenses increased.

## 2.6 Summary of Previous Studies and Research Gaps

The summary of previous studies and research gaps will be presented in Table 2.1.

#### Table 2.1: Summary of Empirical Review and Research Gaps

| **Author &Year** | **The focus of the study** | **Research Gap** | **Focus on the current study** |
| --- | --- | --- | --- |
| Gitaru (2018) | effect of taxpayer education on tax compliance in Kenya. | The study adopted a case study research design thus showing a methodological gap | The current study adopted an explanatory research design |
| Margaret (2022) | effect of educating taxpayers on value added tax compliance of water bottlers in Nairobi County. | The study adopted a quantitative cross-sectional study design thus showing a methodological gap | The current study adopted an explanatory research design |
| Kurniawan (2020) | influence of tax education during higher education on tax knowledge and its effect on personal tax compliance | The study focused on personal tax compliance thus showing a contextual gap thus showing a methodological gap | The current study focused on value added tax compliance |
| Tan et al. (2021) | moderating effect of individual taxpayers’ education level on ethical perception and tax compliance behaviour in Peninsular Malaysia. | The study was done in Malaysia thus showing a contextual gap | The current study was done in Kenya |
| Kenimak (2019) | effects of demographic characteristics on tax compliance among small and medium enterprise owners along Ronald Ngala street, Nairobi | The study adopted a descriptive research design thus showing a methodological gap | The current study adopted an explanatory research design |
| Dissanayake and Premaratna (2020) | impact of income on tax compliance | The study focused on only one social economic variable thus showing a contextual gap | The current study focused on four social economic variable |
| Mannan (2020) | socio-economic factors of tax compliance: An empirical study of individual taxpayers in the Dhaka zones | The study adopted a desktop research design thus showing a methodological gap | The current study used an explanatory research design |
| Kipkoech and Joel (2018) | Effect of economic factors on tax compliance in Kenya | The study focused on economic factors and tax compliance thus showing a conceptual gap. | The current study focused on effect of social economic factors on value added tax compliance. |
| Dabla-Norris et al. (2018) | the quality of tax administration affects firm performance for a large sample of firms in emerging market and developing economies. | The study however left out the aspect of value added tax compliance thus showing a conceptual gap. | The current study focused on value added tax compliance |
| Omondi and Theuri (2019) | effect of taxpayer awareness and compliance costs on tax compliance among small scale traders in Nakuru town, Kenya' | The study used descriptive research design thus showing a methodological gap. | The current study was explanatory |
| Abdul and Wangâ (2018) | tax costs and tax compliance behaviour in Kenya. | The study focused on only one social economic factor that affects tax compliance which was tax costs thus showing a conceptual gap. | The current study looked at tax payer education level, taxpayer income level and tax payers knowledge |
| Amin et al. (2022) | exploring the influence of tax knowledge in increasing tax compliance by introducing tax education at Tertiary Level Institutions | The study focused on tertiary level institutions thus showing contextual gap | The current study focused on SMEs |
| Twum et al. (2020) | tax knowledge and tax compliance of small and medium enterprises in Ghana | The study was done in Ghana | The current study was done in Kenya |
| Abd Hamid et al. (2019) | factors affecting tax compliance among Malaysian SMEs in e-commerce business. | The study focused on Malaysia SMEs | The current study focused on SMEs in Nairobi |
| Newman (2018) | impact of tax knowledge on tax compliance among small medium enterprises in a developing country | The study adopted a desktop research design thus showing a methodological gap | The current study adopted an explanatory research design |
| Mat Jusoh et al. (2021) | effects of tax knowledge, tax complexity and tax morale towards tax compliance behavior among salaried group in Malaysia | The study was done in Malaysia thus showing a contextual gap | The current study was done in Kenya |
| Abdul and McFie (2020) | tax complexity and compliance behaviour of large and medium sized business tax payers in Kenya | The study used tax complexity as an independent variable thus showing a conceptual gap | The current study used tax complexity as a moderating variable. |
| Gambo et al. (2018) | tax complexity and tax compliance in African self-assessment environment. | The study used a descriptive research design thus showing a methodological gap. | The current study used an explanatory research design. |
| Alsqour and Alshirah (2020) | influence of tax complexity on sales tax compliance among Jordanian SMEs. | The study focused on Jordanian SMEs thus showing a contextual gap | The current study focused on SMEs in Nairobi, Kenya |

## 2.7 Conceptual Framework

A conceptual framework is a strategy that shows the relationship between the independent and dependent variables in a study (Kazandzhieva & Santana, 2019). The independent variables in this study were tax payer education level, tax payer income level cost of compliance, taxpayer tax knowledge, the moderating variable will be tax complexity whereas the dependent variable is value added tax compliance. The conceptual framework of this study was presented in Figure 2.1.















Taxpayer’s Tax Knowledge

**Independent variable Moderating variable Dependent variable**

##### Figure 2.1: Conceptual Framework

**Source: Researcher (2023)**

# CHAPTER THREE

# RESEARCH METHODOLGY

## 3.1 Introduction

The research design, target audience, data collecting, and data collection techniques are the sections that make up this chapter. This chapter also includes a pilot study that examines the validity and reliability of the research instrument. This chapter also discusses data presentation and analysis, diagnostic testing, operationalization and measurement of variables, and ethical issues.

## 3.2 Research Design

Research design is a plan for collecting, evaluating and analyzing data, Kothari (2009). An explanatory research design was chosen for this study. This design was used since is the most relevant design since it is concerned about finding out the relationship that exist between the independent and dependent variables by collecting quantifiable data (Akhtar, 2016). Therefore, this design is relevant to determine the socio-economic factors influencing VAT compliance among small and medium enterprises in Nairobi North Tax Office, Kenya.

## 3.3 Target Population

A study population, in the opinion of Kothari and Garg (2015), is made up of a number of pickable components. The research population has a total of these options for a particular trait of interest. In this study, the population consisted of 1,700 VAT registered SMEs conducting business in the northern Nairobi Tax Authority (Nairobi County Report). The Nairobi County report also showed that there were 1100 small enterprises while medium enterprises were 600. The specific respondents were SME managers/owners.

#### Table 3.1: Target Population

| **Category** | **Total** |
| --- | --- |
| Small enterprises | 1100 |
| Medium enterprises | 600 |
| **Total** | **1700** |

## 3.4 Sample Size and Sampling Technique

The following sample calculation formula by to Yamane (1967) was used to determine the sample size:

n = 

In the equation, n stands for the sample size, N for the entire population that the researcher is attempting to reach, and e for the margin of error or significance. A conservative significance level of 5% was selected to strike a balance between Type I and Type II errors. To ensure fairly accurate sample results, a significance level of 5% was used.

n = 1700/ [1+ (1700x 0.0025)]

= 323.8

n = 324

#### Table 3.2: Sample Size

| **Category** | **Total** | **Percentage** | **Sample** |
| --- | --- | --- | --- |
| Small enterprises | 1100 | 64.71% | 210 |
| Medium enterprises | 600 | 35.29% | 114 |
| **Total** | **1700** | **100%** | **324** |

Therefore, the sample size was 324 managers/owners of SMEs in Nairobi North tax station, Kenya. Stratified random sampling was used to sample the respondents. The population was divided into two strata which were small enterprises and medium enterprises.

## 3.5 Data Collection Instrument

Primary data are used in this study. Questionnaires are used to facilitate primary data collecting. First, a letter outlining the goals of the research is sent to the sample participants before asking the appropriate agency for permission to collect data is requested. A systematic questionnaire comprising open-ended and closed-ended questions was employed to make it simpler for researchers to gather quantitative data. Sekaran and Bougie (2013) claim that questionnaires are a crucial instrument for gathering data since they make it clear what is required and how to measure the numerous variables of interest, as well as because they're simple to administer and evaluate.

## 3.6 Data Collection Procedure

Two researchers assisted in the distribution of surveys. 324 questionnaires had to be completed, and they were given to SME owners in North Nairobi. Data collectors explained to respondents that the instruments provided were for research purposes only and their responses would be kept confidential. Before data collection, researchers also received an introductory letter from the university. This research uses the “play later and choose” method.

## 3.7 Pilot Study

The data collection tool was improved through the use of a pilot research (Hazzi & Maldaon, 2015). Malhotra, Nunan, and Birks (2017) claim that testing questionnaires aims to observe respondents' responses and fix questions that frequently have confusing answers. 32 people made up the sample, which is thought to constitute 10% of all SME owners in Nairobi, Northern Kenya. These SME proprietors were excluded from the final survey. 10% of the sample, as a general rule, is adequate for a study (Wandera, 2018). Suitable for evaluating the viability of research plans, data gathering methods, and analysis approaches (Blumberg et al., 2014).

### 3.7.1 Reliability of the Instrument

Reliability, according to Creswell (2014), refers to the consistency of outcomes after repeated measurements. This study therefore presupposes that. Cronbach's alpha coefficient measures how similar the components under investigation are internally. Price, Jhangiani, and Chiang (2015) found that the chance of internal dependability increases as the coefficient becomes closer to 1. Items were excluded from consideration for this study if their Cronbach alpha was less than 0.7 because they were deemed to have insufficient internal consistency. The reliability results are shown in Table 3.3; all variables have Cronbach's alpha values over 0.7.

#### Table 3.3: Reliability Results

| **Variable** | **Cronbach's Alpha** |
| --- | --- |
| Taxpayers’ education level | 0.775 |
| Taxpayers’ income level | 0.75 |
| Cost of compliance | 0.79 |
| Taxpayers tax knowledge | 0.704 |
| Tax Complexity | 0.992 |
| VAT Compliance | 0.779 |

**Source: Research Data (2023)**

### 3.7.2 Validity of the Research Instrument

The degree to which a research tool measures what it is meant to measure is referred to as validity. As a result, it refers to the measuring device's accuracy, namely, whether the instrument accurately measures the intended quantity and whether random errors occur (Kothari, 2015). Construct validity and content validity were used in this study. The questionnaire was separated into sections for construct validity to guarantee that each segment assessed data for a particular purpose and that the data was closely related to the conceptual framework of this study (Locke, 2012). Two tax administration supervisors thoroughly reviewed the questionnaire to guarantee the legitimacy of its contents. Based on the supervisor's suggestions, the questionnaire was modified.

## 3.8 Data Analysis and Presentation

Heeringa et al. (2017) defined data analysis as the process of looking over the gathered data and coming to conclusions. This entails revealing the underlying framework, isolating key variables, looking for anomalies, and putting fundamental hypotheses to the test. Additionally, it entails thoroughly analyzing the pertinent data and making judgments.

Descriptive and inferential statistics were used in the quantitative data analysis. Means, standard deviations, percentages, and frequencies are examples of descriptive statistics. Regression analysis and correlation analysis are two inferential statistics that are used to demonstrate relationships between variables. Analysis of variance (ANOVA) is also employed in this study to determine whether the regression analysis model utilized is accurate or whether the association between the variables is the result of chance. The research findings were calculated and analyzed using SPSS Version 22 (Statistical Package for Social Sciences). The accuracy of estimations is improved by using several linear regression models to examine if independent variables predict a certain dependent variable. Helps to better comprehend how the usual value of the dependent variable varies when one of the independent factors changes while the other independent variables are regarded as constant or stable, according to Zikmund et al. (2010). Diagrams and tables are used to display the results.

### 3.8.1 Data Analysis Model

The study adopted multiple regression model as follows.

Y= 0 +β1X1 + β2X2 + β3X3 + + β4X4 + e……………………………..Eq 1

Where:

Y= value added Tax Compliance

β0= Constant

βi = Is the coefficient for Xi which is (i= 1,2,3,4)

X1= tax payers education level

X2= tax payers income level

X3= cost of compliance

X4= tax payers tax knowledge

e= Error term

The following Hierarchical Regression models was used in assessing the moderating role of tax complexity on the relationship between socio economic factors and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya:

Model 1: Y=β0+β1X1+β2X2+β3X3+β4X4+ε

Model 2: Y=β0+β1X1+β2X2+β3X3+β4X4+β5M5+ε

Model 3: Y=β0+β1X1+β2X2+β3X3+β4X4+β5M5+β6X1\*M+ ε

Model 4: Y=β0+β1X1+β2X2+β3X3+β4X4+β5M5+β6X1\*M+β7X2\*M+ ε

Model 5: Y= β0+β1X1+β2X2+β3X3+β4X4+β5M5+β6X1\*M+β7X2\*M+β8X3\*M+ ε

Model 6: Y= β0+β1X1+β2X2+β3X3+β4X4+β5M5+β6X1\*M+β7X2\*M+β8X3\*M+β9X4\*M+ ε

Where:

Y = Dependent variable (value added Tax Compliance)

β0 = Y intercept

β1- β4=coefficients of independent variables

X1-X4- Independent variables

M –moderating variable (tax complexity)

M\*X= Interaction terms (independent variable\*moderator)

Independent variables = (tax payers education, level tax payers income level, cost of compliance, tax payers tax knowledge)

Moderating variable =tax complexity

## 3.9 Diagnostic Analysis

This analysis was done before running a regression model, it involves conducting pre-estimation and post estimation tests. The diagnostic tests included normality tests, multicollinearity tests as well as linearity tests. They also included heteroscedasticity and autocorrelation.

### 3.9.1 Normality

The normality test is used to assess the likelihood that the random variables underlying a data collection are regularly distributed as well as if the data set has the necessary model for a normal distribution. The skewness and kurtosis tests used in this study are used to determine whether or not the data is regularly distributed. If the skewness and kurtosis values fall within the ranges of -2 and +2, as well as -7 and +7, respectively, the null hypothesis of a normal distribution is accepted.

### 3.9.2 Multicollinearity

Multicollinearity is characterized by a strong degree of connection between independent variables. The degree of multicollinearity is assessed using the inflation variance factor (VIF). When the independent and dependent variables are correlated, the factor inflation variance (VIF) is used to calculate the variance of the estimated coefficient. In the absence of multicollinearity, there is just one-factor inflation variance (VIF). There is a moderate connection between the independent variables if the VIF value is more than 1. A multicollinearity issue is indicated by VIF values between 5 and 10 (Myres, 1990).

### 3.9.3 Linearity Test

Before beginning a regression analysis, scatter plots are used to assess for linearity to determine whether a linear relationship exists between two continuous variables. Prior to the use of the regression model, it is anticipated that the relationships between the variables will be largely linear (Jain et al., 2017).

### 3.9.4 Heteroscedasticity

Since the statistics for this investigation is cross sectional, there emanates distresses about the heteroscedasticity presence. The homoscedasticity of the error term is assumed by CLRM. Heteroscedasticity is present in the data set if the error variance is continuous (Long & Ervin, 2000). Heteroscedasticity in the study was evaluated using the Breusch-Pagan test. P value higher than 0.05 indicates that the null hypothesis of no heteroskedasticity is accepted.

### 3.9.5 Autocorrelation

Cameron (2015) described auto-correlation as a relationship between members of a series of observations ordered in time or space. The research used Durbin Watson statistics to test for auto correlation. The Durbin Watson statistics, according to Cameron (2015), range from 0 to 4. Non-auto correlation is indicated with a value almost 2. A value closer to 0 is positive, whereas a value closer to four is negative autocorrelation. Durbin Watson value ranging between 1.5 and 2.5 imply no autocorrelation.

## 3.10 Operationalization and Measurement of Variables

Table 3.4 indicates the operationalization and measurement of variables.

#### Table 3.4: Operationalization & Measurement of Variables

| **Variable** | **Type of variable** | **Indicators** | **Type of Questions** | **Tool of Analysis** |
| --- | --- | --- | --- | --- |
| **Tax payers education level** | Independent variable | * Electronic taxpayer education * Print media tax payer education * Awareness of tax risks | Questionnaire-Likert scale | Descriptive, Correlation, regression Analysis. |
| **Tax income level** | Independent variable | * High level income * Middle level income * Low level income | Questionnaire-Likert scale | Descriptive, Correlation, regression Analysis. |
| **Cost of compliance** | Independent variable | * Training costs * Professional consultancy costs * Personnel expenses | Questionnaire-Likert scale | Descriptive, Correlation, regression Analysis. |
| **Taxpayer tax knowledge** | Independent variable | * Availability of information * Tax systems * Technical details | Questionnaire-Likert scale | Descriptive, Correlation, regression Analysis. |
| **Tax complexity** | Moderating variable | * Tax obligation * Legal actions * Category of tax payers | Questionnaire-Likert scale | Descriptive, Correlation, regression Analysis. |
| **Value added Tax Compliance** | Dependent variable | * registration * filing * computation * payment compliance | Questionnaire-Likert scale | Descriptive |
|  |  |  |  |  |

## 3.11 Ethical Considerations

Respondents were asked to provide consent while maintaining the anonymity and confidentiality of information collected during and after the research. Research approval was obtained from the Graduate School of Moi University and the National Commission for Science, Technology and Innovation (NACOSTI). Ethical approval was obtained from the Moi University Ethical Review Board.

# CHAPTER FOUR

# DATA ANALYSIS AND DISCUSSION OF FINDINGS

## 4.1 Introduction

This chapter provides the presentation of the study results and the discussion thereof. The chapter begins with presentation of the response rate and then the demographic characteristics results. The study further goes on to present the results for the diagnostic tests and then proceeds to descriptive analysis results. The correlation analysis results, multiple linear regression analysis results and the hierarchical regression analysis results are also presented in the chapter. Finally, the study provides a summary of the hypothesis testing and the discussion of key findings.

## 4.2 Response Rate

Figure 4.1 shows the response rate for the study.

##### Figure 4.1: Response Rate

**Source: Research Data (2023)**

The researcher administered 324 questionnaires to respondents who were managers of SMEs operating business in North of Nairobi tax station. Out of these total administered, those that were completely filled and returned numbered 274 translating to a response rate of 85%. This is a good response rate as Holtom et al. (2022), argues that a response rate of 50% and above is excellent in a survey.

## 4.3 Demographic Characteristics

The demographic characteristics that the study analyzed were gender, highest level of education and the duration of firm existence. The results are presented in this section.

### 4.3.1 Gender

The results in Figure 4.2 are for the gender representation of the respondents.

##### Figure 4.2: Gender Representation

**Source: Research Data (2023)**

The results showed that majority of the respondents were male representing 68% while only 32% were female indicating that the SME sector managerial position is dominated by male.

### 4.3.2 Education Level

Figure 4.3 further presents the results for the analysis of the highest education level attained by the respondents.

##### Figure 4.3: Highest Education Level attained

**Source: Research Data (2023)**

The results showed that most of the respondents had acquired a diploma representing 41.2%. This was followed by those who had a certificate at 31.8% and then those with a degree who represented 17.2%. Only 8.8% and 1.1% had a masters and a PhD respectively. Nevertheless, it can be deduced that the respondents had acquired the basic education required to manage a business. They were also able to read and write and hence the responses they provided were considered trustworthy since they were able to read and interpret the questionnaire.

### 4.3.3 Duration Firm Existed

The results for the length of time that the SMEs in the study had existed were as presented in Figure 4.4.

##### Figure 4.4: Duration Firm Existed

**Source: Research Data (2023)**

The results revealed that almost half of the SMEs representing 43.8% had been operational for 15-20 years. This was followed by those that had operated for 10-15 years with a 28.1% representation and then those that had been operating for over 20 years at 16.8%. Only 6.6% and 4.7% of the SMEs had operated for 5-10 years and below 5 years respectively. This was an indication that the SMEs had been in existence long enough for the researcher to draw results on the effect of social economic factors on value added tax compliance.

## 4.4 Diagnostics Tests

Diagnostic tests were assessed which included the normality test, test for multicollinearity, linearity test, heteroskedasticity and autocorrelation tests. The findings are presented and interpreted herein.

### 4.4.1 Normality

Table 4.1 shows the results for the normality test which was assessed using skewness and kurtosis statistics. Hair et al. (2010) and Bryne (2013) argued that data is considered to be normal if skewness is between ‐2 to +2 and kurtosis is between ‐7 to +7.

#### Table 4.1: Skewness and Kurtosis Test for Normality

|  | **N** | **Skewness** | | **Kurtosis** |  |
| --- | --- | --- | --- | --- | --- |
| **Variable** | **Statistic** | **Statistic** | **Std. Error** | **Statistic** | **Std. Error** |
| Taxpayers Education Level | 274 | -1.247 | 0.147 | 1.773 | 0.293 |
| Taxpayers Income Level | 274 | -1.617 | 0.147 | 2.488 | 0.293 |
| Compliance Cost | 274 | 1.33 | 0.147 | 3.389 | 0.293 |
| Taxpayers Tax Knowledge | 274 | -0.848 | 0.147 | 1.717 | 0.293 |
| Tax Complexity | 274 | 0.374 | 0.147 | -0.218 | 0.293 |
| VAT Compliance | 274 | -2.577 | 0.147 | 6.894 | 0.293 |

**Source: Research Data (2023)**

The results in Table 4.1 showed that the skewness statistic for the study variables were all in the range -2 to +2 and the kurtosis values were also in the range of -7 to +7. The data was therefore considered to be normally distributed.

### 4.4.2 Multicollinearity

Multicollinearity was assessed using the VIF test and the findings were as in Table 4.2.

#### Table 4.2: VIF Test for Multicollinearity

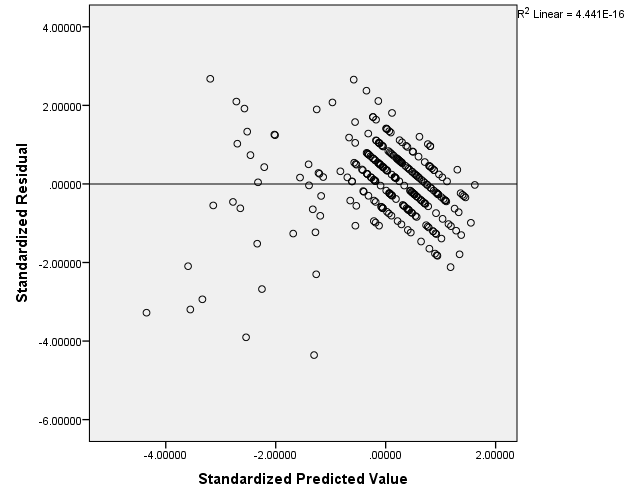
|  | **Collinearity Statistics** | |
| --- | --- | --- |
|  | **Tolerance** | **VIF** |
| Taxpayers Education Level | 0.729 | 1.372 |
| Taxpayers Income Level | 0.767 | 1.304 |
| Taxpayers Tax Knowledge | 0.928 | 1.078 |
| Compliance Cost | 0.882 | 1.133 |

**Source: Research Data (2023)**

The results showed that the VIF values for all the study variables were less than 10 and tolerance values were all more than 0.2. Therefore, as Myres (1990) argues that VIF less than 10 indicate lack of multicollinearity, the data for the study did not suffer multicollinearity. The absence of multicollinearity was further supported by Tolerance values greater than 0.1.

### 4.4.3 Linearity

Linearity test was assessed using the scatterplot and the results were as in Figure 4.5.



##### Figure 4.5: Linearity Test

**Source: Research Data (2023)**

The scatter plots showed that the residual data points were equally distributed along the predictor values. This was an indication of linearity.

### 4.4.4 Heteroscedasticity

To test for heteroskedasticity, the study adopted the Breusch pagan test and the findings were as in Table 4.3.

#### Table 4.3: Bresuch-pagan test for Heteroskedasticity

|  | **Sum of Squares** | **df** | **Mean Square** | **F** | **Sig.** |
| --- | --- | --- | --- | --- | --- |
| Regression | 5.992 | 4 | 1.498 | 21.879 | 0.090 |
| Residual | 18.417 | 269 | 0.068 |  |  |
| Total | 24.408 | 273 |  |  |  |

**Source: Research Data (2023)**

The results showed that the p value was 0.090 greater than 0.05. Therefore, the null hypothesis of no heteroskedasticity was accepted. Hence, the data was homoscedastic.

### 4.4.5 Autocorrelation

Autocorrelation was tested using the Durbin Watson test and the results were as in Table 4.4.

#### Table 4.4: Durbin Watson Test for Autocorrelation

| **Model** | **R** | **R Square** | **Adjusted R Square** | **Std. Error of the Estimate** | **Durbin-Watson** |
| --- | --- | --- | --- | --- | --- |
| 1 | .775a | 0.601 | 0.595 | 0.380168 | 2.082 |

**Source: Research Data (2023)**

The Durbin Watson value was 2.082 which was in the acceptable range of 1.5 and 2.5. Therefore, there was no presence of autocorrelation.

## 4.5 Descriptive Analysis

Descriptive analysis was conducted on all study variables where the percentages, the mean and the standard deviation were reported.

### 4.5.1 Taxpayer’s Education Level

The first independent variable was education level of the taxpayer. Figure 4.6 shows the responses provided on whether the respondent was aware of their tax obligation.

##### Figure 4.6: Awareness of Business Tax Obligation

**Source: Research Data (2023)**

From the results, it was revealed that more than half (60%) of the respondents were aware of the tax obligation of their business while 40% were not aware. The two tax obligations stated by the respondents were the Turnover tax and the VAT tax.

Table 4.5 shows the descriptive statistics results for the variable taxpayer’s education level.

#### Table 4.5: Descriptive Statistics for Taxpayer’s Education Level

| **Statement** | **Strongly disagree** | **Disagree** | **Neutral** | **Agree** | **Strongly Agree** | **Mean** | **Std. Dev.** |
| --- | --- | --- | --- | --- | --- | --- | --- |
| I get tax education through social media | 15.30% | 14.20% | 17.20% | 21.90% | 31.40% | 3.4 | 1.44 |
| Print media education on tax has been very helpful | 10.90% | 13.10% | 17.90% | 25.50% | 32.50% | 3.55 | 1.35 |
| Workshops are more detailed and provide ample time for the public to conceptualize ideas | 8.80% | 10.60% | 13.10% | 37.60% | 29.90% | 3.69 | 1.25 |
| I am aware of the possible tax risks in my area of operation | 8.40% | 9.10% | 17.20% | 34.70% | 30.70% | 3.7 | 1.23 |
| I can comfortably engage in various tax calculations without assistance | 7.70% | 9.90% | 7.70% | 36.50% | 38.30% | 3.88 | 1.24 |

**Source: Research Data (2023)**

From the results, it was revealed that majority of the respondents agreed that they get tax education through social media (mean=3.4, standard deviation=1.44). This infers that most SMEs were able to use social media to get tax education. It was also shown that majority of the respondents affirmed that print media education on tax has been very helpful (Mean =3.55, standard deviation=1.35). This infers that most SMEs were able to use print media to get tax education. The majority of respondents also agreed that the workshop was more detailed and provided sufficient time for the community to conceptualize their ideas (mean = 3.69, standard deviation = 1.25). This infers that most SMEs managers were able to attend the tax workshops which help then to understand more on taxation. It turned out that the majority of respondents also stated that they were aware of possible tax risks in their area of ​​activity (mean =3.7, standard deviation =1.23). This infers that most SMEs were already aware of the possible tax risks in their firm. Finally, the research results show that the majority of respondents agree that they can easily handle various tax calculations without help (mean = 3.88, standard deviation = 1.24). This infers that most SMEs had knowledge on how to handle tax calculations without errors.

### 4.5.2 Taxpayer’s Income Level

The descriptive statistics for the second independent variable taxpayer’s income level are presented and discussed herein. Figure 4.7 shows the monthly income levels for the respondents SMEs.

##### Figure 4.7: Monthly Income Level

**Source: Research Data (2023)**

From the results, it was shown that almost half (48%) of the businesses provide and income of less than 100, 000 monthly while 28% have an income level of 100,000-500,000 and 24% above 500,000. This is an indication that the monthly income turnover for SMEs operating in North of Nairobi tax station is not so high. The respondents also revealed that income level affect their tax compliance to a great extent since they struggle to pay tax as their income is way too small. Table 4.6 shows the descriptive statistics for taxpayer’s income level.

#### Table 4.6: Descriptive Statistics for Taxpayer’s Income Level

| **Statement** | **Strongly disagree** | **Disagree** | **Neutral** | **Agree** | **Strongly Agree** | **Mean** | **Std. Dev.** |
| --- | --- | --- | --- | --- | --- | --- | --- |
| I am not able to pay my taxes due to my low income | 10.20% | 8.00% | 1.80% | 43.10% | 36.90% | 3.88 | 1.27 |
| The taxes are too high as compared to my business earnings | 9.90% | 7.30% | 2.90% | 34.30% | 45.60% | 3.99 | 1.29 |
| The penalty rates for non-compliances are too high | 10.60% | 8.00% | 3.30% | 43.80% | 34.30% | 3.83 | 1.28 |
| The filing status determines the rate at which income is taxed | 8.40% | 4.00% | 3.60% | 43.10% | 40.90% | 4.04 | 1.17 |

**Source: Research Data (2023)**

The results show that majority of the respondents agreed that they are not able to pay their taxes due to their low income (mean=3.88, standard deviation=1.27). This infers that most SMEs had low income and thus wee not able to pay taxes. It was also shown that majority of the respondents affirmed that the taxes are too high as compared to their business earnings (Mean =3.99, standard deviation=1.29). This infers that the taxes imposed to SMEs in Kenya are too much higher compared to their earning. Similarly, majority of the respondents agreed that the penalty rates for non-compliances are too high (Mean =3.83, standard deviation=1.28). This infers that the penalty rates to the SMEs in Kenya when they fail to comply is high. Finally, it was revealed from the results that majority of the respondents agreed that the filing status determines the rate at which income was taxed (mean =4.04, standard deviation =1.17). This infers that filling status was the major determinant of income taxed in Kenya.

### 4.5.3 Compliance Cost

The third independent variable for the study was compliance cost. Figure 4.8 shows the results for the responses provided on whether the respondents are comfortable with the cost of compliance.

##### Figure 4.8: Whether respondents are comfortable with the cost of compliance

**Source: Research Data (2023)**

It was revealed that majority (65%) were not comfortable with the cost of tax compliance and only 35% were comfortable. They cited the costs of buying the software needed and administrative costs as some of the tax compliance costs they are not comfortable with.

Table 4.7 shows the results for the descriptive statistics for cost of tax compliance.

#### Table 4.7: Descriptive Statistics for Cost of Tax Compliance

| **Statement** | **Strongly disagree** | **Disagree** | **Neutral** | **Agree** | **Strongly Agree** | **Mean** | **Std. Dev.** |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Personnel expenses in Preparation and filing of returns are high | 28.50% | 29.20% | 33.20% | 3.30% | 5.80% | 2.29 | 1.09 |
| Training costs on taxes are high | 30.30% | 29.90% | 29.20% | 5.50% | 5.10% | 2.25 | 1.10 |
| Professional consultancy costs are high | 28.80% | 29.90% | 30.70% | 5.10% | 5.50% | 2.28 | 1.10 |
| The level of compliance cost determined the level of tax compliance | 33.90% | 28.50% | 26.30% | 4.40% | 6.90% | 2.22 | 1.17 |

**Source: Research Data (2023)**

According to the results presented it was evident that majority of the respondents disagreed that personnel expenses in preparation and filing of returns are high (mean=2.29, standard deviation=1.09). This infers that that personal expenses for filing returns were low and manageable for the SMEs. It was also shown that majority of the respondents disagreed that training costs on taxes are high (Mean =2.25, standard deviation=1.10). This infers that taxations trainings are not expensive and thus SMEs managers can afford the trainings. Similarly, majority of the respondents disagreed that professional consultancy costs are high (Mean =2.28, standard deviation=1.10). This infers that professional consultancy are not expensive and thus SMEs managers can afford the professional consultancy. Finally, it was revealed from the results that majority of the respondents disagreed that the level of compliance cost determined the level of tax compliance (mean =2.22, standard deviation =1.17). This infers that compliance was not a hinderance to tax compliance level.

### 4.5.4. Taxpayer’s Tax Knowledge

The taxpayer’s tax knowledge was the fourth independent variable of the study. The results for the descriptive statistics for the variable were presented in Table 4.8.

#### Table 4.8: Descriptive Statistics for Taxpayer’s Tax Knowledge

| **Statement** | **Strongly disagree** | **Disagree** | **Neutral** | **Agree** | **Strongly Agree** | **Mean** | **Std. Dev.** |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Conflicting information on withholding VAT from different sources hinder tax compliance | 3.30% | 3.60% | 2.90% | 43.8% | 46.40% | 4.26 | 0.93 |
| Tax system for construction firms is easy to understand | 2.90% | 4.70% | 2.90% | 54.7% | 34.70% | 4.14 | 0.90 |
| Technical details on brochures and tax Acts slows down tax compliance | 4.40% | 3.30% | 5.10% | 40.5% | 46.70% | 4.22 | 1.00 |
| Required information on tax is always available | 3.60% | 3.60% | 2.90% | 45.3% | 44.50% | 4.23 | 0.95 |
| Our firm always receives tax knowledge from professionals | 2.90% | 6.60% | 1.80% | 43.8% | 44.90% | 4.21 | 0.98 |

**Source: Research Data (2023)**

The results shown revealed that majority of the respondents agreed that conflicting information on withholding VAT from different sources hinder tax compliance (mean=4.26, standard deviation=0.93). This infers that getting conflicting information on withholding VAT as a major for SMEs tax compliance. It was also shown that majority of the respondents affirmed that tax system for SMEs firms is easy to understand (Mean =4.14, standard deviation=0.90). This infers that the SMEs were able to understand their tax systems. Similarly, majority of the respondents agreed that technical details on brochures and tax Acts slows down tax compliance (Mean =4.22, standard deviation=1.00). This infers that SMEs found the details on brochures and tax Acts difficult which made them hard to comply with tax compliance. Further, it was revealed that majority of respondents affirmed that required information on tax was always available (mean =4.23, standard deviation=0.95). This infers that information on taxation was available to the SMEs. Finally, it was revealed from the results that majority of the respondents agreed that their firm always receives tax knowledge from professionals (mean =4.21, standard deviation =0.98). This infers that SMEs were able to get tax knowledge from their professionals.

### 4.5.5 Tax Complexity

Tax complexity was the moderating variable for the study. The descriptive statistics for the variable were as presented in Table 4.9.

#### Table 4.9: Descriptive Statistics for Tax Complexity

| **Statement** | **Strongly disagree** | **Disagree** | **Neutral** | **Agree** | **Strongly Agree** | **Mean** | **Std. Dev.** |
| --- | --- | --- | --- | --- | --- | --- | --- |
| I understand my tax obligation as set out in various tax law | 34.30% | 31.00% | 27.0% | 3.60% | 4.00% | 2.12 | 1.05 |
| I understand the likely legal actions against noncompliance | 31.80% | 28.80% | 31.8% | 5.50% | 2.20% | 2.18 | 1.01 |
| I understand the category of tax payers that I fall under | 31.80% | 31.00% | 29.9% | 4.70% | 2.60% | 2.15 | 1.01 |
| I can comfortably engage in filing tax returns as required by law | 29.60% | 32.10% | 31.0% | 2.90% | 4.40% | 2.2 | 1.04 |

**Source: Research Data (2023)**

The results revealed that majority of the respondents disagreed that they understand their tax obligation as set out in various tax law (mean=2.12, standard deviation=1.05). This infer that tax obligations of the SMEs had not been made clear to them. It was also shown that majority of the respondents disagreed that they understand the likely legal actions against noncompliance (Mean =2.18, standard deviation=1.01). This infers that most SMEs did not understand the legal action for noncompliance. Similarly, majority of the respondents disagreed that they understand the category of tax payers that they fall under (Mean =2.15, standard deviation=1.01). this infers that most SMEs don’t understand the category of tax payers they fell under. Finally, it was revealed from the results that majority of the respondents disagreed that they can comfortably engage in filing tax returns as required by law (mean =2.2, standard deviation =1.04). This infers that most SMEs cannot comfortable engage in filing tax returns.

### 4.5.6 VAT Compliance

The dependent variable for the study was VAT compliance and the descriptive statistics for the variable were presented in Table 4.10.

#### Table 4.10: Descriptive Statistics for VAT Compliance

| **Statement** | **Strongly disagree** | **Disagree** | **Neutral** | **Agree** | **Strongly Agree** | **Mean** | **Std. Dev.** |
| --- | --- | --- | --- | --- | --- | --- | --- |
| My business file returns on time | 3.30% | 2.20% | 1.50% | 42.7% | 50.40% | 4.35 | 0.89 |
| My business committed to paying taxes | 4.40% | 3.30% | 4.40% | 41.6% | 46.40% | 4.22 | 0.99 |
| My business accurately calculates tax dues | 3.60% | 3.60% | 2.90% | 44.9% | 44.90% | 4.24 | 0.95 |
| I am always willing to be deducted the withholding VAT | 1.10% | 1.50% | 1.10% | 46.0% | 50.40% | 4.43 | 0.70 |
| My business do not indulge in any tax evasion activity | 1.50% | 1.10% | 1.50% | 46.0% | 50.00% | 4.42 | 0.72 |

**Source: Research Data (2023)**

The results showed that majority of the respondents agreed that their business file returns on time (mean=4.35, standard deviation=0.89). This infer that most SMEs In Nairobi County are able to file their returns on time. It was also shown that majority of the respondents affirmed that their business committed to paying taxes (Mean =4.22, standard deviation=0.99). This infer most SMEs managers were committed to pay taxes for their businesses. Similarly, majority of the respondents agreed that their business accurately calculate tax dues (Mean =4.24, standard deviation=0.95). This infers that most SMEs were able to do accurately their tax dues. Further, it was revealed that majority of respondents affirmed that they were always willing to deduct the withholding VAT (mean =4.43, standard deviation=0.70). This infers that most SMEs in Nairobi were always willing to do the deductions of the withholding VAT. Finally, it was revealed from the results that majority of the respondents agreed that their business do not indulge in any tax evasion activity (mean =4.42, standard deviation =0.72). This infers that most SMEs do not evade taxes.

## 4.6 Correlation Analysis

Correlation analysis was carried out to see how the variables associated with the dependent variable that is the strength and the direction of the association between the variables. The results for the correlation were presented in Table 4.11.

#### Table 4.11: Correlation Matrix

|  | **VAT Compliance** | **Taxpayers Education Level** | | **Taxpayers Income Level** | | **Compliance Cost** | **Taxpayers Tax Knowledge** | | **Tax Complexity** | |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| VAT Compliance | 1 |  | |  | |  |  | |  | |
|  |  | |  |  |  | | |  | |
| Taxpayers Education Level | .669\*\* | 1 | |  | |  |  | |  | |
|  | 0.000 |  | |  | |  |  | |  | |
| Taxpayers Income Level | .516\*\* | -.205\*\* | | 1 | |  |  | |  | |
|  | 0.000 | 0.000 | |  | |  |  | |  | |
| Compliance Cost | -.478\*\* | -.236\*\* | | .198\*\* | | 1 |  | |  | |
|  | 0.000 | 0.000 | | 0.001 | |  |  | |  | |
| Taxpayers Tax Knowledge | .357\*\* | .216\*\* | | .243\*\* | | -.332\*\* | 1 | |  | |
|  | 0.000 | 0.001 | | 0.000 | | 0.027 |  | |  | |
| Tax Complexity | -.332\*\* | -0.017 | | -.134\* | | -.204\*\* | .455\*\* | | 1 | |
|  | 0.000 | 0.000 | | 0.000 | | 0.000 | 0.000 | |  | |
|  | 274 | 274 | | 274 | | 274 | 274 | | 274 | |

**Source: Research Data (2023)**

The findings revealed a positive and significant above average correlation between taxpayer’s education level and VAT compliance (r=0.669, p=0.000). This infers that taxpayer’s education level had a moderately positive association with VAT compliance. The findings also revealed that taxpayer’s income level and VAT compliance have a positive and significant correlation that is above average (r=0.516, p=0.000). This infers that taxpayer’s income level had a moderately positive association with VAT compliance. However, the correlation between compliance cost and VAT compliance was found to be negative but significant and below average (r=-0.478, p=0.000). This infers that taxpayer’s compliance costs had lowly negative association with VAT compliance. A weak positive and significant correlation was also established between taxpayer’s tax knowledge and VAT compliance (r=0.357, p=0.000). This infers that taxpayer’s knowledge had a weak positive association with VAT compliance. The correlation between tax complexity and VAT compliance was however found to be weakly negative but significant (r=-332, p=0.000). This infers that tax complexity had a lowly negative association with VAT compliance.

## 4.7 Linear Regression Analysis

A multiple linear regression analysis was performed in order to determine the relationship between the independent variables and the dependent variable. Table 4.12 shows the model fitness estimates.

#### Table 4.12: Model of Fitness

| **R** | **R Square** | **Adjusted R Square** | **Std. Error of the Estimate** |
| --- | --- | --- | --- |
| .775a | 0.601 | 0.595 | 0.380168 |

**Source: Research Data (2023)**

From the results shown, the R square for the model was 0.601. This revealed that the variables adopted in the study that is taxpayers education level, taxpayers income level, cost of compliance and taxpayer’s tax knowledge explain 60.1% of the variations in VAT compliance among SMEs operating business in North of Nairobi tax station. The remaining variation of 39.9% may be explained by other factors that were not in the present study’s scope.

#### Table 4.13: ANOVA

|  | **Sum of Squares** | **df** | **Mean Square** | **F** | **Sig.** |
| --- | --- | --- | --- | --- | --- |
| Regression | 58.444 | 4 | 14.611 | 101.096 | 0.000 |
| Residual | 38.878 | 269 | 0.145 |  |  |
| Total | 97.322 | 273 |  |  |  |

**Source: Research Data (2023)**

Table 4.13 shows the ANOVA findings. It was revealed from the results that the whole model used to relate the socioeconomic factors and VAT compliance was significant (p=0.000).

#### Table 4.14: Regression Coefficients

|  | **Unstandardized Coefficients** | | **Standardized Coefficients** | **t** | **Sig.** |
| --- | --- | --- | --- | --- | --- |
|  | **B** | **Std. Error** | **Beta** |  |  |
| (Constant) | 1.931 | 0.273 |  | 7.072 | 0.000 |
| Taxpayers Education Level | 0.321 | 0.032 | 0.448 | 9.929 | 0.000 |
| Taxpayers Income Level | 0.148 | 0.03 | 0.215 | 4.882 | 0.000 |
| Compliance Cost | -0.223 | 0.035 | -0.261 | -6.37 | 0.000 |
| Taxpayers Tax Knowledge | 0.257 | 0.057 | 0.182 | 4.539 | 0.000 |

**Source: Research Data (2023)**

The model for the analysis was confirmed as

Y=1.931+0.448X1+0.215X2-0.261X3+0.182X4

Where;

Y= value added Tax Compliance

X1= tax payers education level

X2= tax payers income level

X3= cost of compliance

X4= tax payers tax knowledge

The coefficients of regression results were presented in Table 4.14. The results showed that the coefficient for the variable taxpayer’s education level was 0.448 and the p value was 0.000<0.05. Therefore, the relationship between taxpayer’s education level and VAT compliance was positive and significant revealing that increasing taxpayer’s education level by one unit would translate to 0.448 units increase in VAT compliance.

The results also showed that the coefficient for the variable taxpayer’s income level was 0.215 and the p value was 0.000. This therefore means that the relationship between taxpayer’s income level and VAT compliance is positive and significance, hence if taxpayers income level goes up by one unit, VAT compliance would also go up by 0.215 units.

In contrast, the coefficient for the variable cost of compliance was -0.261 and p value was 0.000. This revealed that cost of compliance and VAT compliance are negatively but significantly related revealing that increasing the cost of compliance by one unit would lead to a decrease in VAT compliance by 0.261 units.

Further, the coefficient for taxpayer’s tax knowledge was 0.182 and the p value was 0.000. This indicated that taxpayer’s tax knowledge and VAT compliance were positively and significantly linked together. Therefore, if taxpayer’s tax knowledge was increased by one unit, VAT compliance would also increase by 0.182 units.

## 4.8 Hierarchical Regression Analysis

In order to assess the moderating effect of tax complexity on the relationship between socioeconomic factors and VAT compliance a hierarchical regression analysis was performed. Table 4.15 shows the model fitness for the moderating effect.

#### Table 4.15: Model Fitness for Moderating Effect

| **R** | **R Square** | **Adjusted R Square** | **Std. Error of the Estimate** | **Change Statistics** | |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **R Square Change** | **F Change** | **df1** | **df2** | **Sig. F Change** |
| .775a | 0.601 | 0.595 | 0.380168 | 0.601 | 101.09 | 4 | 269 | 0.000 |
| .787b | 0.619 | 0.612 | 0.371914 | 0.019 | 13.072 | 1 | 268 | 0.000 |
| .798c | 0.637 | 0.628 | 0.363984 | 0.017 | 12.804 | 1 | 267 | 0.000 |
| .799d | 0.639 | 0.629 | 0.363615 | 0.002 | 1.543 | 1 | 266 | 0.215 |
| .805e | 0.647 | 0.637 | 0.359811 | 0.009 | 6.654 | 1 | 265 | 0.01 |
| .806f | 0.649 | 0.637 | 0.359793 | 0.001 | 1.026 | 1 | 264 | 0.312 |

**Source: Research Data (2023)**

From the results, it was shown that when the variable tax complexity was added to the model, the R square change was 0.019 which was also significant. It was also revealed that the change in R square when the interaction term for taxpayers education level and tax complexity was added was 0.017, the R square change when the interaction term for taxpayers level of income and tax complexity was added to the model was 0.002, the R square change when the interaction term for cost of compliance and tax complexity was added was 0.009 and the R square change when the interaction term for taxpayers tax knowledge and tax complexity was added was 0.001. This was an indication that the introduction of the variable tax complexity in the model led to a change in R square hence the model was fit in explaining the moderating effect for the variable tax complexity. Table 4.16 shows the ANOVA results.

#### Table 4.16: ANOVA for Moderating Effect of Tax Complexity

|  | **Sum of Squares** | **df** | **Mean Square** | **F** | **Sig.** |
| --- | --- | --- | --- | --- | --- |
| Regression | 58.444 | 4 | 14.611 | 101.096 | .000b |
| Residual | 38.878 | 269 | 0.145 |  |  |
| Total | 97.322 | 273 |  |  |  |
| Regression | 60.252 | 5 | 12.05 | 87.121 | .000c |
| Residual | 37.07 | 268 | 0.138 |  |  |
| Total | 97.322 | 273 |  |  |  |
| Regression | 61.949 | 6 | 10.325 | 77.932 | .000d |
| Residual | 35.373 | 267 | 0.132 |  |  |
| Total | 97.322 | 273 |  |  |  |
| Regression | 62.153 | 7 | 8.879 | 67.155 | .000e |
| Residual | 35.169 | 266 | 0.132 |  |  |
| Total | 97.322 | 273 |  |  |  |
| Regression | 63.014 | 8 | 7.877 | 60.842 | .000f |
| Residual | 34.308 | 265 | 0.129 |  |  |
| Total | 97.322 | 273 |  |  |  |
| Regression | 63.147 | 9 | 7.016 | 54.201 | .000g |
| Residual | 34.175 | 264 | 0.129 |  |  |
| Total | 97.322 | 273 |  |  |  |

**Source: Research Data (2023)**

According to the presented results, all the models had a p value of 0.000 which was less than 0.05. This means that all the models were significant in explaining the moderating effect of tax complexity on the relationship between socioeconomic factors and VAT compliance.

Table 4.17 results showed the regression coefficients for the interaction terms for each of the independent variables with the moderating variable.

#### Table 4.17: Coefficients of Regression for Moderating Effect of Tax Complexity

|  | **Unstandardized Coefficients** | | **Standardized Coefficients** | **t** | **Sig.** |
| --- | --- | --- | --- | --- | --- |
|  | **B** | **Std. Error** | **Beta** |  |  |
| (Constant) | 1.931 | 0.273 |  | 7.072 | 0.000 |
| Taxpayers Education Level | 0.321 | 0.032 | 0.448 | 9.929 | 0.000 |
| Taxpayers Income Level | 0.148 | 0.03 | 0.215 | 4.882 | 0.000 |
| Compliance Cost | -0.223 | 0.035 | -0.261 | -6.37 | 0.000 |
| Taxpayers Tax Knowledge | 0.257 | 0.057 | 0.182 | 4.539 | 0.000 |
| (Constant) | 2.238 | 0.28 |  | 7.984 | 0.000 |
| Taxpayers Education Level | 0.312 | 0.032 | 0.437 | 9.859 | 0.000 |
| Taxpayers Income Level | 0.13 | 0.03 | 0.189 | 4.324 | 0.000 |
| Compliance Cost | -0.203 | 0.035 | -0.238 | -5.866 | 0.000 |
| Taxpayers Tax Knowledge | 0.27 | 0.055 | 0.191 | 4.868 | 0.000 |
| Tax Complexity | -0.14 | 0.039 | -0.143 | -3.616 | 0.000 |
| (Constant) | 3.535 | 0.455 |  | 7.776 | 0.000 |
| Taxpayers Education Level | -0.052 | 0.106 | -0.072 | -0.485 | 0.628 |
| Taxpayers Income Level | 0.126 | 0.029 | 0.183 | 4.287 | 0.000 |
| Compliance Cost | -0.176 | 0.035 | -0.206 | -5.042 | 0.000 |
| Taxpayers Tax Knowledge | 0.269 | 0.054 | 0.19 | 4.954 | 0.000 |
| Tax Complexity | -0.69 | 0.158 | -0.705 | -4.359 | 0.000 |
| X1M | 0.151 | 0.042 | 0.693 | 3.578 | 0.000 |
| (Constant) | 3.258 | 0.506 |  | 6.436 | 0.000 |
| Taxpayers Education Level | -0.1 | 0.113 | -0.139 | -0.882 | 0.379 |
| Taxpayers Income Level | 0.24 | 0.096 | 0.349 | 2.493 | 0.013 |
| Compliance Cost | -0.174 | 0.035 | -0.204 | -4.993 | 0.000 |
| Taxpayers Tax Knowledge | 0.273 | 0.054 | 0.193 | 5.03 | 0.000 |
| Tax Complexity | -0.583 | 0.18 | -0.595 | -3.229 | 0.001 |
| X1M | 0.172 | 0.046 | 0.79 | 3.786 | 0.000 |
| X2M | -0.049 | 0.04 | -0.227 | -1.242 | 0.215 |
| (Constant) | 2.253 | 0.635 |  | 3.551 | 0.000 |
| Taxpayers Education Level | -0.034 | 0.115 | -0.048 | -0.3 | 0.764 |
| Taxpayers Income Level | 0.245 | 0.095 | 0.356 | 2.57 | 0.011 |
| Compliance Cost | 0.156 | 0.132 | 0.183 | 1.179 | 0.240 |
| Taxpayers Tax Knowledge | 0.279 | 0.054 | 0.197 | 5.187 | 0.000 |
| Tax Complexity | -0.144 | 0.246 | -0.148 | -0.586 | 0.558 |
| X1M | 0.138 | 0.047 | 0.631 | 2.929 | 0.004 |
| X2M | -0.051 | 0.039 | -0.235 | -1.303 | 0.194 |
| X3M | -0.137 | 0.053 | -0.571 | -2.58 | 0.01 |
| (Constant) | 3.037 | 1.001 |  | 3.034 | 0.003 |
| Taxpayers Education Level | -0.032 | 0.115 | -0.044 | -0.276 | 0.783 |
| Taxpayers Income Level | 0.262 | 0.097 | 0.381 | 2.709 | 0.007 |
| Compliance Cost | 0.125 | 0.136 | 0.147 | 0.923 | 0.357 |
| Taxpayers Tax Knowledge | 0.088 | 0.196 | 0.062 | 0.45 | 0.653 |
| Tax Complexity | -0.505 | 0.433 | -0.515 | -1.167 | 0.244 |
| X1M | 0.137 | 0.047 | 0.627 | 2.91 | 0.004 |
| X2M | -0.06 | 0.04 | -0.275 | -1.488 | 0.138 |
| X3M | -0.125 | 0.055 | -0.519 | -2.286 | 0.023 |
| X4M | 0.089 | 0.088 | 0.398 | 1.013 | 0.312 |

**Source: Research Data (2023)**

As per the findings, tax complexity had a negative and significant effect on VAT compliance (β=-0.14, p=0.000). This implies that tax complexity increases VAT non-compliance.

Further, the coefficient for the interaction term between taxpayer’s education levels (X1M) was 0.151 and the p value was 0.000. This means that there was a statistically significant moderating effect of tax complexity on the relationship between taxpayer’s education level and VAT compliance. The results however revealed that there is no statistically significant moderating effect of tax complexity on the relationship between taxpayers’ income level and VAT complexity as the p value for the interaction terms for taxpayers’ income level and tax complexity (X2M) was p=0.215>0.05.

The coefficient for the interaction term for cost of compliance and tax complexity (X3M) had a p value of 0.01 which means that tax complexity had a statistically significant moderating effect on the relationship between cost of compliance and VAT compliance. The p value for the interaction term for taxpayers’ tax knowledge and tax complexity (X4M) was 0.312>0.05 hence indicating that tax complexity has no statistically significant moderating effect on the relationship between taxpayers’ tax knowledge and VAT compliance.

## 4.9 Hypotheses Testing

H01: Taxpayer’s education level does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

H02: Taxpayer’s income level does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

H03: Cost of Compliance does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

H04: Taxpayer’s tax knowledge does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

H05: Tax complexity does not have a significant effect on the relationship between:

1. H05a: Taxpayer’s education level and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
2. H05b: Taxpayer’s income level and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
3. H05c: Cost of Compliance and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya
4. H05d: Taxpayer’s tax knowledge and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya

#### Table 4.18: Hypotheses testing summary

| **No:** | **Hypothesis** | **P-Value** | **Verdict** |
| --- | --- | --- | --- |
| **H01**  **H02**  **H03** | Taxpayer’s education level does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya  Taxpayer’s income level does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya  Cost of Compliance does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya | 0.000<0.05  0.000<0.05  0.000<0.05 | Rejected  Rejected  Rejected |
| **H04** | Taxpayer’s tax knowledge does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya | 0.000<0.05 | Rejected |
| **H05a** | Tax complexity does not have a significant effect on the relationship between taxpayer’s education level and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya | 0.000<0.05 | rejected |
| **H05b** | Tax complexity does not have a significant effect on the relationship between taxpayer’s income level and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya | 0.215>0.05 | Not rejected |
| **H05c** | Tax complexity does not have a significant effect on the relationship between cost of compliance and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya | 0.01<0.05 | rejected |
| **H05d** | Tax complexity does not have a significant effect on the relationship between taxpayer’s tax knowledge and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya | 0.312>0.05 | Not rejected |
|  | **Source: Research Data (2023)** |  |  |

## 4.10 Discussion of the Key Findings

### 4.10.1 Taxpayer’s Education Level and Value Added Tax Compliance

The results of the study revealed that majority of the respondents had acquired tax education through print media, social media and workshops. In doing so, they had a good understanding of the tax risks and were able to do tax calculations without assistance. The results further revealed a positive correlation between taxpayer’s education level and VAT compliance. This implied that if taxpayer’s education level went up, VAT compliance would also go up. Further, according to the regression analysis, there is a positive and significant relationship between taxpayer education level and VAT compliance (β=0.448, P=0.000). This infers that an improvement in education level by one unit would lead to enhancement in VAT compliance by 0.448 units. This implies that if the education level for the SME taxpayers is increased, then their VAT compliance would also increase. Therefore, increasing the education level of SME taxpayers through the various platforms such as the social media, print media and through workshops would lead to taxpayers being more compliant to their VAT obligation. This is achieved since the taxpayer is able to do their VAT tax calculations on their own and also understand the risks associated with the tax noncompliance.

These findings are consistent with research by Gitaru (2018), which discovered that stakeholder involvement, taxpayer education in print media, and electronic taxpayer education have an impact on tax compliance among SMEs in the Nairobi CBD region. These findings concur with those of Margaret (2022), who discovered that taxpayer education significantly influenced the level of VAT compliance among water bottlers in Nairobi County. Kurniawan (2020) observed that tax education can raise tax knowledge and influence taxpayers' compliance behavior, and additional research supported these conclusions.

### 4.10.2 Taxpayer’s Income Level and Value Added Tax Compliance

The study findings revealed that the taxpayer’s level of income has a positive and significant correlation with VAT compliance. Therefore, if taxpayer’s level of income goes up, then the VAT compliance of the taxpayer would also go up. More so, the study findings revealed that the relationship between taxpayers level of income and VAT compliance is positive and significant (β=0.215, P=0.000). This infers that an improvement in tax payers level of income by one unit would lead to enhancement in VAT compliance by 0.215 units. Therefore, it was deduced that where the taxpayer’s level of income is increased, their VAT compliance would also increase.

These findings are consistent with study by Kenimak (2019), which examined SME owners along Jalan Ronal Ngala and discovered that income status had an impact on tax compliance. The findings of this study concur with those of Dissanayake and Premaratna (2020), who surveyed small and medium-sized taxpayers in Sri Lanka and discovered that income level was a significant determinant of tax compliance. Last but not least, these outcomes are in line with those of Joel (2018), who studied limited liability businesses in Eldoret City and discovered that actual income had a favorable influence on tax compliance.

### 4.10.3 Cost of Compliance and Value Added Tax Compliance

The study findings on the relationship between cost of compliance and VAT compliance established a negative correlation. Regression analysis also revealed a negative but significant relationship between cost of compliance and VAT compliance (β=-0.261, P=0.000). This infers that a decline in cost of compliance by one unit would lead to enhancement in VAT compliance by 0.261 units. This indicated that an increase on the cost of tax compliance is related with a decrease in the VAT compliance among SME taxpayers. Therefore, increasing the compliance costs will lead to a decrease in the compliance.

These outcomes are consistent with those of Omondi and Theuri (2019), who discovered that the level of tax compliance among small business owners in Nakuru City, Kenya, is significantly impacted by compliance costs. Similar findings were made by Abdul and Wangâ (2018), who focused on tax costs and tax compliance behavior in Kenya. Their research revealed that tax compliance considerably declined in Kenya as tax compliance costs rose. The results of this study concur with those of Mahangila (2018), who discovered that the cost of tax compliance has grown along with an increase in tax non-compliance among small and medium-sized businesses in Dar es Salaam.

### 4.10.4 Taxpayer’s Tax Knowledge and Value Added Tax Compliance

The findings revealed a positive and significant association between taxpayer’s tax knowledge and VAT compliance. The regression results also revealed a positive and significant relationship between taxpayer’s tax knowledge and VAT compliance (β=0.182, P=0.000). This infers that an improvement in taxpayers tax knowledge by one unit would lead to enhancement in VAT compliance by 0.182 units. This was an indication that increasing the taxpayer’s tax knowledge is a prerequisite for increased VAT compliance. If taxpayers are provided with the required tax knowledge by professionals making the information on tax always available and easy to understand, the taxpayers will be more tax complaint.

The findings of Amin et al. (2022) who discovered that tax awareness is demonstrated to be one of the elements that determines a country's level of tax compliance are consistent with these findings. The findings concur with those of Twum et al. (2020), who discovered a positive and substantial association between knowledge of tax rights and obligations, knowledge of employment income, and awareness of fines, and tax compliance of SMEs in Ghana.

### 4.10.5 Social Economic Factors, Tax Complexity and Tax Compliance

According to the study findings, the introduction of the interaction terms for the variables taxpayer’s education level, taxpayer’s income level, cost of compliance, taxpayers tax knowledge and tax complexity led to a change in R square. The models were also found to be significant. However, the p values for the individual coefficients for the models revealed a significant value for the model with taxpayer’s education level and costs of compliance (p<0.05) but were insignificant for the models with taxpayer’s income level and taxpayers tax knowledge (p>0.05). This implied that although the variable tax complexity has a moderating effect on the relationship between all the socioeconomic factors combined and VAT compliance, it fails to moderate the relationship between some individual socioeconomic factors and VAT compliance.

The results are in accordance with the results of Mat Jusoh et al. (2021) who found that complexity has a significant impact on the tax compliance behavior of employee groups in Malaysia. The findings of this study are also consistent with research by Alsqour and Alshirah (2020), which discovered that tax complexity significantly influences Jordanian SMEs' compliance with the VAT law. The findings, however, disagree with those of Gambo et al. (2018), who discovered a notable detrimental impact of tax complexity on tax compliance in Africa.

# CHAPTER FIVE

# SUMMARY, CONCLUSION AND RECOMMENDATIONS

## 5.1 Introduction

The contents of this chapter are the summary, conclusions, recommendations for practice and management, for theory and policy implications and also recommendations for further research.

## 5.2 Summary

### 5.2.1 Taxpayer’s Education Level and Value Added Tax Compliance

The study found that taxpayer’s education level has a positive and significant correlation with VAT compliance. The results of regression analysis also revealed a positive and significant relationship between taxpayer’s education level and VAT compliance (β=0.448, P=0.000). The responses from the respondents revealed that they are aware of their tax obligation and have received education on tax through various platforms which include the print media, social media and also through workshops. The tax education enabled the respondents to calculate their tax with ease and also understand the risk of noncompliance. The null hypothesis that taxpayer’s education level does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya was rejected and the alternative hypothesis adopted.

### 5.2.2 Taxpayer’s Income Level and Value Added Tax Compliance

The study findings revealed that taxpayer’s income level has a positive and significant correlation with VAT compliance. Similarly, the relationship between taxpayer’s income level was found to be positive and significant (β=0.215, P=0.000). According to the responses provided by the respondents, it was observed that the low income among majority of the SME taxpayers makes them unable to pay their taxes as their tax obligation is higher compared to their earnings. This makes the taxpayers not to be complaint on their VAT obligation. The null hypothesis that taxpayer’s income level does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya was rejected and the alternative hypothesis adopted

### 5.2.3 Cost of Compliance and Value Added Tax Compliance

The results for correlation analysis revealed a negative but significant correlation between cost of compliance and VAT compliance. Similar findings were obtained from the regression analysis that produced a negative coefficient which was however significant indicating that the relationship between cost of compliance and VAT compliance is negative but significant (β=0.261, P=0.000). As per the responses form the respondents, it was deduced that the taxpayers did not see the cost of preparing and filing tax as being high. Further, the respondents indicated that training costs as well as professional consultancy costs are not high. They further indicated that the level of the cost of compliance did not determine the level of compliance. This showed the SME taxpayers are able to comply with VAT tax since the cost of compliance is not high. The null hypothesis that cost of compliance does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya was rejected and the alternative hypothesis adopted

### 5.2.4 Taxpayer’s Tax Knowledge and Value Added Tax Compliance

The results for the correlation between taxpayer’s tax knowledge and VAT compliance produced a correlation coefficient that was positive indicating that there is a positive and significant correlation between taxpayer’s tax knowledge and VAT compliance. The results for regression also produced a positive coefficient with a significant p value (β=0.182, P=0.000). This revealed that there is a positive and significant relationship between taxpayer’s tax knowledge and VAT compliance. As per the responses from the respondents, it was revealed that conflicting information on withholding VAT from different sources hinder tax compliance. It was also revealed that tax system for construction firms is easy to understand and that the required information on tax is always available as the firms always received tax knowledge from professionals. However, they revealed that technical details on brochures and tax Acts slows down tax compliance. The null hypothesis that taxpayer’s tax knowledge does not have a significant effect on value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya was rejected and the alternative hypothesis adopted

### 5.2.5 Social Economic Factors, Tax Complexity and Tax Compliance

From the hierarchical regression analysis, it was deduced that that introduction of tax complexity into the model leads to a change in R square meaning that tax complexity has a significant effect on the model. The models were also found to be significant whenever the tax complexity variable interacted with the individual independent variables. However, interaction terms for taxpayer’s education level and compliance costs p values were significant (p<0.05) while the interaction terms for taxpayer’s income level and taxpayer’s tax knowledge were not significant (p>0.05). The null hypothesis that tax complexity does not have a significant effect on the relationship between socio economic factors and value added tax compliance among small and medium enterprises in Nairobi North tax station, Kenya was rejected and the alternative hypothesis adopted.

## 5.3 Conclusion

Based on the findings form the analysis on the data on taxpayer’s education level and VAT compliance, the study made conclusion that taxpayer’s education level as a socioeconomic factor has a positive and statistically significant effect on VAT compliance among SME taxpayers. This is deduced from the fact that the taxpayers who receive tax education are able to know their tax obligation, compute their tax and also understand the risks associated with failure to comply with the tax obligation. The taxpayers are therefore able to correctly calculate their VAT, file their returns on time while avoiding the penalties of failing to comply.

The analysis of the data on taxpayer’s level of income and VAT compliance also led to the conclusion that taxpayer’s income level as a socioeconomic factor has a positive as well as a statistically significant effect on VAT compliance among SME taxpayers. The study concluded that if the income level of an SME business is low compared to the tax obligation, the taxpayer will opt not to pay the tax. The income level of the business also determines the filing status of the SME. A high-income level on its part will lead to compliance since the taxpayer will have some good amount of earnings left after paying the tax.

The study analysis on the data for cost of compliance and VAT compliance led to the conclusion that cost of compliance has a negative but statistically significant effect on VAT compliance. If the cost of complying with a VAT is high, the taxpayer will opt not to pay the tax in order to avoid the high cost which may eat up a huge amount of their earnings. However, if the compliance cost is low, the taxpayer will be able to cater for the cost and hence comply with the obligation. High cost of compliance personnel expenses in Preparation and filing of returns, training and professional consultancy therefore lead to low VAT compliance.

The study further concluded that taxpayers tax knowledge as a socioeconomic factor has a positive and also statistically significant effect on VAT compliance among SME taxpayers. Taxpayers to whom tax information is always made available and who receive tax knowledge from professionals are able to understand the tax obligation. This leads to high chances of such a taxpayer paying their taxes on time and making the right calculations leading to high VAT compliance. In contrast, if the tax information provided to a taxpayer is conflicting or is technical, the taxpayer will have difficulty understanding the VAT obligation hence leading to the taxpayer failing to file return son time and or making the wrong calculations. This leads to low VAT compliance.

Finally, on the moderating effect of tax complexity, the analysis of data led to the conclusion that tax complexity has a statistically significant moderating effect on the relationship between socioeconomic factors and VAT compliance. This was based on the change in R square that was also significant. On one hand, if a taxpayer understands the tax obligations set out in various tax laws, understand the likely legal actions against noncompliance and the category of tax payers that they fall under, they will more likely comply with VAT obligation regardless of their education level, income level, tax knowledge or cost of compliance. On the other hand, failure to understand the above dimensions of tax laws may lead to failure to comply regardless of the socioeconomic status of the taxpayer in terms of education level, income level, tax knowledge and cost of compliance.

## 5.4 Recommendations

### 5.4.1 Recommendations on Study Results

Based on the above conclusions, the study makes recommendations to the management of the Kenya Revenue Authority to consider adopting strategies that will lead to more education programs on VAT tax and obligations to SMEs. They should identify existing gaps in existing programs and fill them up in order to ensure that every SME owner receives the needed education on VAT tax. For SMEs to improve their tax compliances, those involved in their tax matters need knowledge and skills to interpret the various tax laws and regulations. Tax compliance procedures should be simplified because in most cases they are found to be very complicated by SMEs, especially for those who do not keep proper books of account and sometimes do not understand the tax laws in order to reduce the compliance costs in terms of money and time.

The management of KRA should also come up with strategies that will address the balance on VAT among low-income businesses and high-income ones so that there is fairness. The study further recommends that KRA should adjust the penalty rates for the non compliance especially for the small firms. KRA should also consider the level of income when coming up with the tax schedules.

Further, the management of KRA should consider revising the costs of compliance to VAT in order to bring them to a level that the SME taxpayers will be in a position to incur. They can do so by offering a helping hand with some of the costs such as offering the consultancy for free and doing the filing for the SMEs. In addition, Kenyan tax authorities should come up with policies to reduce tax compliance cost to ensure that they do not affect the growth of SMEs and encourages SMEs to comply with taxes.

The study recommends that tax payers learning ought to be emphasized since tax data, tax learning tends to advance tax compliance than tax organization. Thus legislature ought to through its organizations instruct the potential taxpayers on taxation laws and controls by coordinate free symposia and courses. Furthermore, the management of KRA is recommended to consider exposing all the needed information to the SME taxpayers in order to ensure that they fully understand their VAT obligation and the category they fall under as this will make it easier for the taxpayers to comply with the VAT obligation.

### 5.4.2 Implication to theory

The study findings have supported the propositions of the existing theories on the effect of socioeconomic factors on VAT compliance. For instance, the Ability to Pay Theory contends that an individual's income or capacity to make payments dictates the appropriate level of taxation to impose on them. The study's findings also showed that a taxpayer's income level influences their tax compliance, validating the idea and adding to the body of knowledge on the subject. The study's findings also offer evidence in support of the Economic Deterrence Theory, which holds that it is simple for all people to discriminate between good and wrong, as well as the repercussions of wrongdoing, and that this makes tax education and enhanced tax understanding necessary.

### 5.4.3 Policy implication

The government's decision-makers in the field of taxation may apply the study's findings in order to create appealing policies that will increase tax compliance among SME taxpayers. The policy makers should make policies that provide more platforms to taxpayers to be educated on matters relating to their tax obligations and making the required information available to them. The policies should also be focused on reducing the complexity of the tax obligations of the taxpayers and also reducing the costs related to complying with the tax obligation. Further, the policy makers are recommended to consider coming up with policies that will ensure fairness in tax system such that those SMEs with higher income are taxed more than those with lower income.

## 5.5 Recommendations for Further Research

The study was focused on determining the effect of socioeconomic factors specifically taxpayer’s education level, income level, tax knowledge and cost of compliance on VAT compliance and the moderating effect of tax complexity. In doing so, the study was not exhaustive on the socioeconomic factors as hence future studies may consider evaluating other factors such as perceived fairness, attitude, social influence and ethics. There are also other factors that can be assessed as moderators such as moral standing and culture. Furthermore, since the study only focused on SMEs operating business on the north tax station, future studies may consider other locations as well as other sectors such as large enterprise.

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# APPENDICES

## Appendix I: Questionnaire

**SECTION A: GENERAL INFORMATION**

1. Kindly indicate your gender

Male ( ) Female ( )

1. Kindly indicate your highest level of education.

Certificate ( ) Diploma ( ) Degree ( ) Masters ( ) PhD ( )

Any other………………..

1. For how long have this construction firm been in existence?

Below 5 years 5- 10 years 10-15 years 15-20 years over 20 years

**SECTION B: Taxpayers Education Level and Value added Tax Compliance**

1. Are you aware of your tax obligation?

Yes ( ) No ( )

1. If yes kindly state your obligation?

.........................................................................................................................................................

1. The statements are meant to obtain your views on tax education value added tax compliance by ticking in the appropriate.

**KEY**: **1**-Strongly disagree **2** –Disagree **3** -Neutral **4** –Agree **5** –Strongly Agree

| **Statement** | **1** | **2** | **3** | **4** | **5** |
| --- | --- | --- | --- | --- | --- |
| I get tax education through social media |  |  |  |  |  |
| Print media education on tax has been very helpful |  |  |  |  |  |
| Workshops are more detailed and provide ample time for the public to conceptualize ideas |  |  |  |  |  |
| I am aware of the possible tax risks in my area of operation |  |  |  |  |  |
| I can comfortably engage in various tax calculations without assistance |  |  |  |  |  |

**SECTION C: Taxpayers Income Level and Value added Tax Compliance**

1. What is your income level from your business monthly

Less than 100,000 ( ) 100,000 – 500,000 ( ) Above 500,000( )

1. To what extent does your income level affect your level of tax compliance

………………………………………………………………………………………………………………………………………………………………………………………………………………

1. The statements are meant to obtain your views on tax payer income level on value added tax compliance by ticking in the appropriate.

**KEY**: **1**-Strongly disagree **2** –Disagree **3** -Neutral **4** –Agree **5** –Strongly Agree

| **Statement** | **1** | **2** | **3** | **4** | **5** |
| --- | --- | --- | --- | --- | --- |
| I am not able to pay my taxes due to my low income |  |  |  |  |  |
| The taxes are too high as compared to my business earnings |  |  |  |  |  |
| The penalty rates for non-compliances are too high |  |  |  |  |  |
| The filing status determines the rate at which income is taxed |  |  |  |  |  |

**SECTION D: Cost of Compliance and Value added Tax Compliance**

1. Are you comfortable with the costs of tax compliances?

Yes ( ) No ( )

1. If no, what are some of the compliance costs that you are uncomfortable with?

…………………………………………………………………………………………………………………………………………………………………………………………………………

1. The statements are meant to obtain your views on tax payer income level on value added tax compliance by ticking in the appropriate.

**KEY**: **1**-Strongly disagree **2** –Disagree **3** -Neutral **4** –Agree **5** –Strongly Agree

| **Statement** | **1** | **2** | **3** | **4** | **5** |
| --- | --- | --- | --- | --- | --- |
| Personnel expenses in Preparation and filing of returns are high |  |  |  |  |  |
| Training costs on taxes are high |  |  |  |  |  |
| Professional consultancy costs are high |  |  |  |  |  |
| The level of compliance cost determined the level of tax compliance |  |  |  |  |  |

**SECTION E: Taxpayers Tax Knowledge and Value added Tax Compliance**

1. Have you ever attended a tax training?

Yes ( ) No ( )

1. If yes who had organized the training?

.........................................................................................................................................................

1. The statements are meant to obtain your views on tax payer income level on value added tax compliance by ticking in the appropriate.

**KEY**: **1**-Strongly disagree **2** –Disagree **3** -Neutral **4** –Agree **5** –Strongly Agree

| **Statement** | **1** | **2** | **3** | **4** | **5** |
| --- | --- | --- | --- | --- | --- |
| Conflicting information on withholding VAT from different sources hinder tax compliance |  |  |  |  |  |
| Tax system for construction firms is easy to understand |  |  |  |  |  |
| Technical details on brochures and tax Acts slows down tax compliance |  |  |  |  |  |
| Required information on tax is always available |  |  |  |  |  |
| Our firm always receives tax knowledge from professionals |  |  |  |  |  |

**SECTION F: Social economic factors, Tax Complexity and Value added Tax Compliance**

1. The statements are meant to obtain your views on tax payer income level on value added tax compliance by ticking in the appropriate.

**KEY**: **1**-Strongly disagree **2** –Disagree **3** -Neutral **4** –Agree **5** –Strongly Agree

| **Statement** | **1** | **2** | **3** | **4** | **5** |
| --- | --- | --- | --- | --- | --- |
| I understand my tax obligation as set out in various tax law |  |  |  |  |  |
| I understand the likely legal actions against noncompliance |  |  |  |  |  |
| I understand the category of tax payers that I fall under |  |  |  |  |  |
| I can comfortably engage in filing tax returns as required by law |  |  |  |  |  |

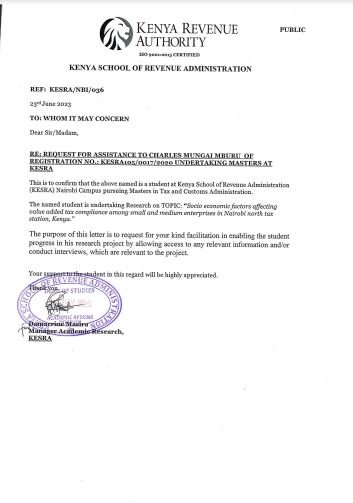
**SECTION G: Value added Tax Compliance**

1. The statements are meant to obtain your views on value added tax compliance by ticking in the appropriate.

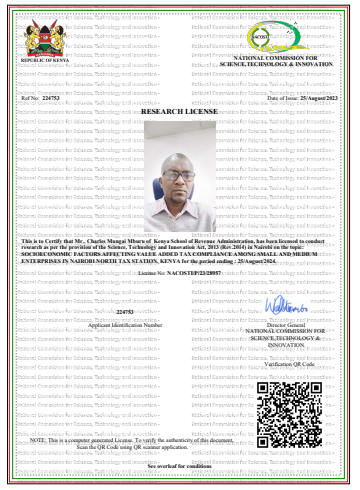
**KEY**: **1**-Strongly disagree **2** –Disagree **3** -Neutral **4** –Agree **5** –Strongly Agree

| **Statement** | **1** | **2** | **3** | **4** | **5** |
| --- | --- | --- | --- | --- | --- |
| My business file returns on time |  |  |  |  |  |
| My business committed to paying taxes |  |  |  |  |  |
| My business accurately calculate tax dues |  |  |  |  |  |
| I am always willing to be deducted the withholding VAT |  |  |  |  |  |
| My business do not indulge in any tax evasion activity |  |  |  |  |  |

## Appendix II: Authorization Letter from Moi University



## Appendix III: Research Permit



## Appendix IV: Plagiarism Certificate

