TAX STRUCTURE, TAX SERVICE QUALITY AND VALUE ADDED TAX COMPLIANCE AMONG SMALL AND MEDIUM ENTERPRISES IN WESTLANDS SUBCOUNTY, NAIROBI, KENYA

BY

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DECLARATION

Declaration by student

I declare that this research project is my original work and has not been submitted for the award of a degree in any other University

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Approval by supervisors

This research project has been submitted with my approval as the University appointed supervisor

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DEDICATION

I dedicate this research project to my dad Yohakim, mum Theresa, brothers Dennis and Dismas and sister Patricia including my classmates for the support they accorded me.

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I acknowledge God sufficiency of His Grace, which enabled me to complete this research project. I thank my supervisors Dr. Nderitu Githaiga and Dr. Robert Odunga, for being there for me to complete this research project.

ABSTRACT

Value added tax compliance has remained a challenge, especially when it comes to SMEs operating in Kenya. The high level of informality of this sector provides an incentive for most of the SMEs to evade payment of VAT, situation that has constrained the amount of tax revenues available to finance fiscal budget. For instance, in the financial year 2022/2023, the shortfall between actual and targeted VAT collected stood at Kshs. 24 billion. It is hoped that strengthening of VAT compliance among SMEs in Kenya including those in Westlands would be critical in countering the aforementioned VAT shortfalls between actual and targeted collections. The link between tax structure and value-added tax compliance among small and medium-sized businesses in Westlands Sub County, Nairobi, Kenya, was shown to be moderated by tax service quality, according to this study. More precisely, the goal of this study was to determine how tax service quality affected the relationships between small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County and the probability of detection, tax complexity, tax penalty and sanctions, costs compliance, and value-added tax compliance. The deterrence theory, planned behavior theory, responsive regulatory theory, fiscal exchange theory, and service quality theory served as the study's pillars. Explanatory design was used. A representative sample was selected from each of the four categories based on the type of business activity undertaken by the 261 owners of the aforementioned SMEs, from whom data was collected. The data was gathered via a questionnaire. The outcomes of the data analysis, which included multiple regression analysis and descriptive statistics like means and standard deviations, were shown in tables and figures. Regression of coefficients showed that probability of detection had a positive and significant effect on VAT compliance of SMEs (β=0.358, p=0.000), tax complexities had a negative and significant effect on VAT compliance of SMEs (β=-0.131, p=0.001), tax penalties had a positive and significant effect on VAT compliance of SMEs (β=0.500, p=0.000) and that costs of compliance had a negative and significant effect on VAT compliance of SMEs (β=-0.134, p=0.005). Further, the findings revealed that tax service quality had an enhancing moderation effect on its relationships with probability of detection (β= 0.086, $\rho<0.05$) and tax penalties and sanctions (β= 0.094, $\rho<0.05$), and had a buffering moderation effect on its relationships with tax complexity (β= -0.078, $\rho>0.05$), cost of compliance (β= -0.052, $\rho>0.05$) and value added tax compliance. These results demonstrate the significant relationship that exists between value-added tax compliance, tax service quality, and tax structure. The study provided specific policy, managerial, and practice suggestions in light of these findings. To improve VAT compliance among SMEs, policymakers should develop new audit detection technologies that would raise the probability of detection. The research further argues that as the government depends on revenue to carry out its economic and development goals, taxpayers should not be burdened with the responsibility of complying with applicable tax laws and regulations, as this could lead to an increase in non-compliance.

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OPERATIONAL DEFINITION OF TERMS

Cost of compliance: includes all costs incurred by individuals and businesses to comply with tax laws, but does not include actual tax payments. Complying with tax laws entails paying significant resources, such as buying specialized software to file tax returns and manage administrative costs related to taxes (Musimenta, 2020).

Penalties and sanctions: refers to financial penalties levied as a result of a crime or infraction; these are usually imposed by a government entity. A comparable interpretation is employed in the study (Mustapha et al., 2021).

Probability of Detection: It refers to the likelihood that an event or object will be identified or noticed within a given context or system (Ojo and Adesina, 2023).

Small and Medium Enterprises: a small company with 10–99 workers and a yearly revenue of under 50 million Kenyan Shillings. (MSME Act, 2012)

Tax complexity: Tax administration and legislation involve various complications, such as determining tax responsibilities, filing tax returns, and interpreting tax rules. The country's ease of doing business is impacted by these complications.

Tax service quality: It is made up of reliability, responsiveness as well as assurance as indicators (Amoh & Ali-Nakyea, 2019)

Tax Structure: It refers to the organization and arrangement of taxes within a specific jurisdiction, outlining the types of taxes imposed, their rates, and the way they are collected, which can include income taxes, sales taxes, property taxes, and others. (Chesire, 2023)

Value added tax compliance: It is defined as the ability of the taxpayers to be registered, file, compute and pay accurate amount of the determined tax revenues (Pham, Le, Truong & Tran, 2020)

ABBREVIATIONS

KESRA	Kenya School of Revenue Administration
KMO	Kaiser-Meyer-Olkin
KRA	Kenya Revenue Authority
OECD	Organization for Economic Co-operation and Development
PAYE	Pay As You Earn
PBC	Perceived behavioral control
PLS	Partial Least Square
POD	Probability of detection
SMEs	Small and Medium Enterprises
SPSS	Statistical Package for Social Sciences
TC	Tax Complexity
TPS	Tax penalties and sanctions
TSQ	Tax service quality
VAT	Value Added Tax

CHAPTER ONE

INTRODUCTION

This chapter covers the background to the study, statement of problem, research objectives, hypotheses, significance and scope of the study.

1.1 Background of the Study

Value added tax (VAT) has been acknowledged as one of the most significant tax head that can be harnessed by developed and developing countries to grow and develop their economies. In developed countries like Japan, Switzerland and the United States, statistics from Organization for Economic Co-operation and Development (OECD) indicate that VAT account for over 20% of the total amount of tax collected in the entire economy on average (OECD, 2022). In most developing countries especially in Africa, OECD reports that an average of 51.9% of the total tax revenue collection is attributed to VAT (OECD, 2022). Against this background, literature on efforts to drive VAT compliance has gathered momentum across the world.

The term VAT compliance has been defined differently by scholars including the ability of the taxpayer to closely abide by the tax laws of a jurisdiction (Cahyonowati, Ratmono & Juliarto, 2023). Defining VAT compliance in administrative term, it involves registration, timely payment and filling of returns to the tax authority. It also entails efforts taken by the taxpayer to notify the tax authority in respect to the status of a taxpayer (Erul, 2020). In this study, VAT compliance was defined as the ability of eligible taxpayers to get registered, make accurate assessment and payment of their tax obligations and file tax returns within established timeframes by a tax collection agency on behalf of the government.

VAT compliance has received considerable attention among scholars and researchers. In Bangladesh for instance, Mannan (2020) aimed at determining key social and economic factors that influence VAT compliance. In Nigeria, Etim, Umoffong and Bassey (2020) also determined the socio-economic factors affecting VAT compliance. In Kenya, Muturi and Abdul (2021) focused on VAT compliance and determined whether it is influenced by social factors while Kipkoech and Joel (2016) determined if it is influenced by economic factors. From the foregoing discussion, it is evident that VAT compliance has attracted significant scholarly attention and the same debate was covered by this study by uniquely combing both social and economic factors, which combine to form the tax structure.

The literature on tax compliance in both rich and developing nations worldwide has extensively demonstrated the role of social and economic determinants (Erul, 2020). In emerging economies like Bangladesh, it has been discovered that social and economic factors such as fairness, tax complexity, tax fines and sanctions, tax compliance costs, and views of government spending have a substantial impact on tax compliance (Mannan, 2020). In Nigeria, Etim, Umoffong and Bassey (2020) identified level of awareness of existing tax penalties and tax rates as critical social economic factors influencing tax compliance behavior in general. Evidence from Ghana indicate that tax equity, attitude, education and culture are important social factors that drive tax compliance by taxpayers (Mbilla, 2023). Ethiopia's tax system's fairness, tax rate, fines, views of government spending, and compliance costs are among the economic and social elements influencing tax compliance (Tilahun, 2018). According to Pemstein, Seim and Siwale (2019), the key social dimensions that have affected tax compliance in Zambia include social norms.

In Kenya, VAT contributed to 32% of the total tax collection in the country in 2021 (OECD, 2022) which mirrors unfavorably to the average contribution in developing countries in Africa at above 50%. This trend has resulted into rigorous efforts by the government through the Kenya Revenue Authority (KRA) to have in place right strategies of driving VAT compliance. Existing scholars including Majiwa (2016), Muturi, and Abdul (2021) have strongly argued that determinants of VAT compliance can be of social and economic nature. According to Hadiwibowo, Jufri and Lusiyana (2023), over-emphasizing the factors that drive VAT compliance without a critique of the tax service quality cannot yield expected tax collections.

In Kenya, tax knowledge, tax complexity, tax penalties and individual attributes of the taxpayers have been key tax structure factors hindering tax compliance (Muturi & Abdul, 2021). According to Kipkoech and Joel (2016), the low level of tax compliance in Eldoret was attributed to economic factors like tax rates, tax audits, level of actual income as well as existing fines and penalties. According to Kevin (2019), there has been low level of revenue collection in Siaya County signifying compliance issues attributed to socio-economic factors like enforcement, automation and political goodwill.

Parasuraman, Zeithaml and Berry (1988) provides a model (SERVQUAL) that provides the basis of assessing and evaluating tax system quality. The five characteristics of service quality that are listed in this paradigm are: physical evidence (tangibles), recognizing difficulties and providing attention (empathy), assurance, responsiveness, and reliability (Parasuraman et al., 1988). Both objective and subjective perspectives can be used to analyze and evaluate the quality of a service (Al-Ttaff, & Abdul-Jabbar, 2016). The amount of research on the quality of tax services is likewise expanding quickly. As noted by Kuryana, Sumani, and Farisi (2022), tangible, dependability, assurance, responsiveness, and empathy are important measures of the quality of tax services.

Mustapha and Obid (2015) indicated that for tax authorities having complicated tax systems, perceived ease of use could mediate their tax service quality. Dharmayanti (2023) asserts that the quality of tax services has a substantial impact on taxpayers' tax compliance behavior. According to Sugiyarti, Larasati, Suwitri, and Ngatno (2021), the professionalism of tax officials in responding to taxpayer requests is a key factor in the quality of tax services. Maqsudi, Ratnawati, and Riyadi (2021) claim that the quality of tax services positively influences taxpayers' tax compliance behavior. The view of Maqsudi et al. (2021) were corroborated by Alabede, Zainal-Affrin and Md-Idris (2011) as well as Hadiwibowo, Jufri and Lusiyana (2023).

1.1.1 Small and Medium Enterprises

The term SMEs has several definitions, most of which are dependent on asset bases, sales revenues, and employee counts (Berisha & Pula, 2015). In this study, SMEs were defined based on the number of employees. According to the European Commission (2005), a micro enterprise is one that employs less than ten people, a small enterprise employs fewer than fifty people, and a medium enterprise employs more than one hundred people. As per the World Bank Standards ascertained by an Independent Evaluation Group in 2008, an enterprise classified as micro has less than 10 employees, a small enterprise has between 10 and 50 people, and a medium enterprise has between 50 and 300 staff. A company or organization with fewer than 250 employees and an annual revenue of less than €50 million is classified as a SME by AGICAP.

In most countries including Kenya, SMEs are obliged to pay taxes one of it being VAT. These are the largest businesses that when fully exploited can increase the amount of

VAT collected for the growth of the economy. However, the key challenge encountered is that most of these enterprises operate in the informal sector increasing their tax evasion opportunities. An estimated 45% of SMEs in Kenya have faced challenges of noncompliance of their various tax heads including VAT that they are obliged to pay to the government (Woodward & Tan 2015). Media reports have recently pointed out alarming rate of an increase in VAT investigations particularly for SMEs operating in Westlands Subcounty in Nairobi. According to Muturi and Abdul (2021), a tax agency can only initiate a VAT investigation on susception of non-compliance.

1.2 Statement of the Problem

Value added tax (VAT) has been acknowledged as one of the most significant tax heads that can be harnessed by developed and developing countries to grow and develop their economies. In developed countries, statistics indicate that VAT accounts for over 20% of the total amount of tax collected in the entire economy on average (OECD, 2022). In most developing countries especially in Africa, OECD reports that an average of 51.9% of the total tax revenue collection is attributed to VAT (OECD, 2022).

Compliance with value-added tax has continued to be difficult, particularly for SMEs doing business in Kenya (KRA, 2022). The high level of informality of this sector provides an incentive for most of the SMEs to evade payment of VAT, situation that has constrained the amount of tax revenues available to finance fiscal budget. For instance, VAT contributed to 32% of the total tax collection in the country in 2021 (OECD, 2022) which mirrors unfavorably to the average contribution in developing countries in Africa at above 50%. In the financial year 2022/2023, the shortfall between actual and targeted VAT collected stood at Kshs. 24 billion (KRA, 2023). It is hoped that strengthening of VAT compliance among SMEs in Kenya including those in

Westlands would be critical in countering the aforementioned VAT shortfalls between actual and targeted collections.

Tilahun's (2018) investigation of the social and economic factors impacting Ethiopia's voluntary tax compliance is one of the studies that is currently accessible. The study found that the following factors—tax system fairness, tax rate, penalty, taxpayer perceptions of government spending, and compliance costs—have a significant impact on taxpayers' voluntary compliance. An examination into the features of tax structures that affect individual taxpayers' tax compliance in Kenya was carried out by Muturi and Abdul in 2021. Research has shown that each individual taxpayer's knowledge, complexity, and traits have an impact on their level of tax compliance. Fairness, tax penalties, and the relationship between taxpayer perceptions of government expenditure and tax structure were identified by Mannan (2020) as factors affecting tax compliance in Bangladesh. A favorable correlation between these variables was found in the analysis of the impact of tax service quality on taxpayer compliance conducted in Indonesia by Sugiyarti et al. (2021).

From the aforementioned studies, it is evident that while some like Sugiyarti et al. (2021) were conducted in different countries like Indonesia other than Kenya, others like Muturi and Abdul (2021) were conducted focusing in general tax compliance other than VAT. This creates gaps which the proposed study sought to fill by analyzing the moderating role of tax service quality on the relationship between tax structure and value added tax compliance among small and medium enterprises in Westlands Subcounty, Nairobi, Kenya;

1.3 Research Objectives

This study was guided by the following general and specific objectives:

1.3.1 General Objectives

The general objective of this study was to establish the moderating role of tax service quality on the relationship between tax structure and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya

1.3.2 Specific Objectives

This study was guided by the following specific objectives:

i. To establish the effect of probability of detection on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
ii. To determine the effect of tax complexity on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
iii. To analyze the effect of tax penalty and sanctions on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
iv. To analyze the effect of costs of compliance on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
v. To examine the moderating effect of tax service quality on the relationship between:
    a) probability of detection and value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
    b) tax complexity and value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
    c) tax penalty and sanctions and value added tax compliance among SME in Westlands Sub County, Nairobi, Kenya
    d) cost of compliance and value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya

1.4 Research Hypothesis

The study sought to test the following hypotheses:

$H_0$1: probability of detection has no statistically significant effect on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya

$H_0$2: tax complexity has no statistically significant effect on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya

$H_0$3: tax penalty and sanctions have no statistically significant effect on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya

$H_0$4: cost of compliance has no statistically significant effect on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya

$H_0$5: tax service quality does not moderate the effect on the relationship between:

a) probability of detection and value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
b) tax complexity and value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
c) tax penalty and sanctions and value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya
d) cost of compliance and value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya

1.5 Significance of the study

This study might be important to owners and managers of SMEs operating in Nairobi and Kenya at large in understanding how the existing tax structure influences their compliance with VAT. Through this study, KRA might understand and develop relevant strategies concerning the tax structure aimed at driving VAT compliance appropriately. The study might guide policy makers at National Treasury and County Governments to apply the established tax structure that may potentially inform policy direction to drive revenue collection in their respective contexts. This study might provide review existing theoretical, conceptual and empirical literature linking the tax structure and general tax compliance that expounded on the knowledge available. Future researchers working on relevant topics may be able to review this study's literature.

1.6 Scope of the Study

The scope of a study refers to the boundaries or limits of the research project, including the specific objectives, research questions, variables, population, and geographical or temporal boundaries. This study was to determine how tax service quality as a moderator variable affects the relationship between the tax structure and VAT compliance. Geographically, the study was conducted in Westlands Subcounty. The unit of analysis was registered SMEs operating in Westlands Sub County. The reason for focusing on Westlands is due to the diverse nature of businesses in the area. The target population was 751 registered SMEs in Westlands Sub County. The study focused on tax compliance reports during the financial year 2022/2023.

CHAPTER TWO

LITERATURE REVIEW

2.1 Overview

This section contained the review of concepts including VAT compliance, relevant theories, past empirical studies and conceptual framework as well as summary of literature and knowledge gaps.

2.1.1 Value Added Tax Compliance

Value added tax compliance is a broad term that covers the ability of the taxpayer to be registered, file and pay accurate amount of assessed tax. It is the degree to which a taxpayer attains his/her obligations and duties as established in the provisions of law (Li & Wang, 2020). It entails accurate assessment and determination of the actual amount of taxes that should be paid by the taxpayer, accurate declaration of related incomes as well as expenses and ensure that the determined tax liabilities are settled timely. There are four broad ways of measuring tax compliance, which include being registered, filing, computation and payment of taxes to a revenue collection agency (Pham, Le, Truong & Tran, 2020).

Tax compliance can further be defined as timely and voluntary registration of the tax obligation, ensuring that the tax returns submitted are accurate and ensuring the determined tax obligation is as accurate as possible. OECD (2008) defines VAT compliance as the ability of the taxpayers to be registered for the purpose of taxes, legal submission of tax returns, disclosure of all taxable incomes and ensuring claims for deduction is made accurately as well as payment of the determined taxes within established timeframe (date).

2.1.2 Probability of Detection

Probability of detection is a tax metric that has attracted significant level of attention among scholars. According to Allingham and Sandmo (1972), if there is a good chance of being caught, taxpayers are motivated to honestly report their income. Probability of detection influences and determines taxpayers' reporting habits. This is because taxpayers will always have an incentive of ensuring everything has been declared if they believe they will fall victim of tax audit anytime. Probability of detection can broadly be defined as the likelihood that a tax authority was able to discover noncompliance behavior of the taxpayer and rectify. Taxpayers will only declare their tax returns in line with the established tax laws if they have information and knowledge that they may be audited at the end of a given year (Biru, 2020).

2.1.3 Tax Complexity

Tax complexity is a set of actions that are undertaken aimed at addressing issues that face a business concerning VAT laws. It can be used in to complexity of the established laws and regulations guiding taxes in a given country (Zwick, 2021). Existence of complicated tax laws, methods and systems of payment of taxes and filling of returns may be a strong incentive for tax noncompliance behavior of the taxpayers. Tax complexity can be used in reference to computation, law, readability and administrative procedures. Existence of a complex system of tax can be an incentive for taxpayers not to comply with their tax obligations. Existence of complex tax systems may increase the costs incurred by taxpayers to comply. Tax complexity is a key problem for the growth of the economy (Armstrong & Glaeser, 2023).

2.1.4 Tax Penalty and Sanctions

Tax penalty and sanctions determine the compliance attitude of the taxpayers in a given country. Penalizing evaders of tax can compel other people to know their actions in regard to tax compliance are right and well informed. Penalties to tax evaders when caught encourage other taxpayers to ensure that their true incomes have been recorded accurately (Mohdali, Isa & Yusoff, 2014). Taxation sanctions is a guarantee that the provisions established in a given legislation was obeyed by the taxpayers. Tax sanctions are deterrent in nature aimed at ensuring taxpayers do not violate established tax provisions. Generally, there exists two forms of sanctions in law: administrative and criminal. Administrative sanctions include interests and fines. Criminal sanctions include fines of criminal nature as well as imprisonment (Mohd Yusof, Lai & Yap, 2014).

2.1.5 Cost of Compliance

The willingness of the taxpayers to pay their tax obligation is shaped and determined by the costs they incur to comply with tax obligations (D'andria & Heinemann, 2023). An increase in of compliance can lead into tax avoidance, tax related fraud and this negatively affects the flow of investments to the county. According to Eragbhe and Modugu (2015), the costs of compliance can be internal, external and psychological in nature. The study by OECD (2014) noted that costs of compliance do increase the tax heads that a taxpayer is subjected to pay, complexity of the existing rules guiding tax issues, the frequency of submission of tax returns among other issues. Evans and Tran-Nam (2014) were of the view that two key costs of compliance are incurred by taxpayers: psychological as well as gross monetary costs.

2.1.6 Tax Service Quality

According to Amoh and Ali-Nakyea (2019), service quality refers to the efforts made to accurately fulfill the wants and aspirations of consumers while maintaining a balance with their expectations. Quality, in the opinion of Parasuraman et al. (1988), dictates how a service's overall evaluation is determined. Accordingly, the delivery of all dependable and superior services to the delight of the taxpayers can be considered the definition of tax service quality. The existing literature indicate various measures of tax service quality including Khudri and Sultana (2015) who established five measures of the same including problem solving, personal interaction, appearance and reliability as well as policy. Parasuraman et al. (1988) contribute to the literature of tax service quality by highlighting its five key measures which include tangibles, reliability, responsiveness, assurance, and empathy.

2.2 Theoretical Review

This study was guided by economic deterrence theory, planned behavior theory, responsive regulation theory, fiscal exchange theory and the service quality theory. Discussions on each of these theories was as set out below:

2.2.1 Economic deterrence theory

This theory, which was first presented by Becker in 1968 and then expanded upon by Allingman and Sandmo in 1972, emphasizes how a variety of circumstances, including tax rates and fines, can affect the behavior of taxpayers. People were less inclined to avoid paying their taxes when tax audits and penalties were more severe. On the other hand, existence of less strength in tax audits and penalties can increase noncompliance behavior of the taxpayers. As per Becker et al. (1968), authorities must strike a suitable balance between identifying non-compliers and taking steps that don't allow non-compliance to become unreasonable (OECD, 2010).

According to the argument, taxpayers are logical people who make most of their decisions on computations derived from economic calculations. This theory was useful in anchoring the first independent variable being probability of detection and how it influences VAT compliance. It is expected and hypothesized under this theory that existence of periodic tax audits can increase probability of detection of noncompliance behaviour of the taxpayers (Bun, Kelaher, Sarafidis& Weatherburn, 2020). In turn, this is likely to increase the compliance behaviour and attitude of the taxpayers.

2.2.2 Theory of planned behaviour

This hypothesis was advanced by Ajzen and Fishbein (1991), and it adds to the body of tax literature by explaining taxpayers' attitudes and behaviors related to tax compliance. The primary claim of this theory is that a variety of elements that emerge in a planned fashion shape and govern how individuals behave in communities. According to the idea, a person's intentions to engage in a target activity are largely determined by their perceived behavioral control (PBC), which also has an impact on how the action is carried out (Ajzen, 1991).

According to this study, a taxpayer is more likely to evade paying taxes if they think they can do so without getting detected by a tax audit. This indicates that the taxpayer has a high perceived behavioral control. Saad (2010) employed two components of PBC: the perceived ease or difficulty of understating income as a motivator or hindrance to the taxpayer, and the control factor (knowledge, ability, and resources). In terms of the behavioral intention to adhere to the self-assessment system, PBC was discovered to be significant. Mohammed (2016) claims that there is a statistically significant negative correlation between PBC and tax compliance. It was discovered that when there are more options for tax non-compliance and fewer barriers to compliance, taxpayers are less likely to comply with import tax payments. This theory was useful in anchoring the second objective variable which is tax complexity and its implication in VAT compliance.

2.2.3 Responsive Regulation Theory

This theory, which was put forth by Ayres and Braithwaite (1992), is based largely on the idea that different factors influence people's actions, and that a regulatory agency must have a variety of enforcement tools at its disposal in order to effectively deal with people who are motivated by various factors. For example, a system based on self-regulation or persuasion could efficiently govern businesspeople who are driven by a sense of social duty. However, a punishment-based system would only be necessary to control individuals who are motivated exclusively by financial gain. The main goal of this strategy is to reduce the "psychology of resentment," which is the potential for organizations and people to grow suspicious of compliance goals and enforcement personnel when confronted with strict guidelines and harsh consequences.

Using the compliance pyramid, the theory selects an enforcement strategy based on the taxpayers' actions. According to the theory, regulators can successfully implement regulation if they use the right strategy, have access to a hierarchical range of sanctions, and the severity of the most severe sanctions is high enough. Ayres and Braithwaite (1992) state that the fundamental tenet of the theory is to modify the level of regulator participation in accordance with the capacity and propensity of the regulated to comply. This suggests that whenever new regulations are created by the regulators, the public interest has to be considered. This idea emphasizes how crucial it is to have both punishing and persuasive components in order to improve compliance behavior, which is what this study shows. The variability of tax fines and sanctions and its impact on VAT compliance were supported by this argument.

2.2.4 Fiscal exchange theory

Alm (1995) proposed the hypothesis that items that people want can be more efficiently and readily provided, leading to a rise in tax compliance (Cowell and Gordon, 1988). People thus recognize that their taxes play a crucial role in funding government operations and pay them because they value the goods and services that the government provides (Fjeldstad & Semboja, 2001). Therefore, the likelihood of voluntary tax compliance may rise given the presence of public services. It follows that it makes sense to infer that the degree of pleasure taxpayers have with their terms of trade with the government or tax authority influences their behavior. This theory holds that by providing individuals with more effective and efficient access to goods and services, the government can boost tax compliance (Moore 2004). It also acts as a reliable conduit between the taxpayers and the government (Moore 2004). Therefore, it is more logical to assume that taxpayers' conduct is influenced by their level of satisfaction or dissatisfaction with the provision of public goods and services.

This theory's empirical findings are contradictory. According to Das et al. (2014), India's annual tax burden associated with the shortage of elementary teachers is $1.55 billion. The degree of education provided by the state seems to be a significant factor in determining tax behavior. The tax loss was decreased by increasing the number of inspectors assigned to oversee teachers. According to Cowell and Gordon (1988), tax evasion diminishes when public goods are adequately provided, even in a dynamic tax analysis where an increase in tax rates causes an underground economy. According to Bodea and LeBas (2014), taxes are paid by individuals in relation to the provision of public goods. Timmons (2005) and Alm et al. (1992) discovered empirical support for this idea. The cost of compliance variable was well-anchored by the theory.

2.2.5 Service Quality Theory

This theory, developed by Parasuraman, ZeithamI, and Berry (1985), highlights the five dimensions of tax service quality: tangibles, reliability, responsiveness, assurance (combining communication, credibility, security, competence, and courtesy), and empathy (combining understanding and knowing the customer with accessibility). It enhanced the suggested study as well. Reliability demonstrates the ability to provide services with accuracy, timeliness, and credibility (Parasuman, Zeithaml & Berry, 1985). This calls for upholding consistency in the services rendered and keeping promises given to customers. Reactivity is defined as the capacity to address client complaints effectively, resolve difficulties quickly, and show a willingness to help clients and meet their demands (Parasuman, 1988). Put another way, responsiveness is the degree to which banks fulfill customer requests.

According to Parasuman, Zeithaml, and Berry (1985), images of the bank's facilities, equipment, staff attitudes, supplies, guidelines, and information systems are regarded as tangibles. Put another way, tangibles are the effects that actual buildings, equipment, personnel, and promotional materials have on customers (Sureshchandar, Rajendran, and Kamalanabhan, 2001). The environment, sometimes referred to as the "service-scape," has a direct impact on workers and customers in the areas of physiology, psychology, sociology, cognition, and emotion (Sureshchandar, 2001). When a company gives its clients confidence, such confidence is derived from professional services, exceptional technical expertise, a polite demeanor, and strong communication abilities. Empathy is the finest way to demonstrate customers that you value their company and are ready to meet their demands, as well as to make them feel like "guests" at all times. Human factors play a major role in this achievement; the more care the bank takes for its customers, the better informed those customers become. The tax service quality variable was well-anchored by the theory.

2.3 Empirical Review

The subsequent sections detail a review of empirical studies in regard to

2.3.1 Value Added Tax Compliance

A study on value added tax compliance incentives was conducted by Alshira'h (2024). This study looked experimentally at tax compliance expenses and public faith in the government. An online survey is used to gather the study's data, and 189 responses from Jordan's retail industry are used to validate the research model. The data collected to examine the effects of government trust and the cost of VAT compliance were evaluated using partial least squares structural equation modeling. The results showed that, although there was a statistically significant positive correlation between VAT compliance and faith in the government, there was no significant relationship between VAT compliance and the costs associated with it.

Trifan, Szentesi, Cuc, and Pantea (2023) assessed the tax compliance behavior of Romanian taxpayers through an empirical case study.The research hypotheses were tested on a sample of 402 individual taxpayers, and the quantitative data was analyzed using partial least squares structural equation modeling. The results showed that seven major factors—tax system fairness, faith in the government and tax authorities, tax law knowledge, personal financial constraints, coercive measures, moral standards, and simplicity of tax legislation—significantly increase the likelihood of tax compliance among individual taxpayers.

Ojo and Shittu (2023) examined value-added tax compliance and small and medium-sized enterprises (SMEs) in Nigeria, emphasizing crucial factors. Based on primary and secondary data, the research population consisted of all Nigerian SMEs that were registered. The research was conducted using a sample of 3,600 SMEs from the study. Furthermore, using the financial records of SMEs, a panel data set of 3,600 SMEs covering the years 2018 to 2022 was chosen, out of a total of 18,000 observations. The findings show that VAT compliance is influenced by TPA, OC, TCC, and VIE. The study also found that revenue influences VAT compliance in a positive but insignificant way. Furthermore, SMEs' compliance with VAT laws is positively and significantly impacted by the size and degree of profit they earn. However, the compliance of SMEs with regard to VAT is not significantly impacted by the number of employees and consumers.

2.3.2 Probability of Detection and Value Added Tax Compliance

Sinnasamy and Bidin (2019) examined the moderating effect that chance of detection has on the variables influencing non-compliance with Malaysian excise duties. The surveys were distributed using a proportionate stratified simple random sample technique. Five hundred valid surveys were collected for analysis. Partial least squares analysis was performed on the data. Peer influence, tax expertise, and tax audit have a high positive correlation, according to a study of data from all throughout Malaysia. Additionally, there is a moderating effect, with a substantial negative correlation and a sizable positive link between tax expertise and tax audit. The study's conclusions offered guidance to the tax administration on how to maximize tax revenues and promote taxpayer compliance.

Ortega and Sanguinetti (2013) used experimental data from Venezuela to investigate how reciprocity and deterrent affected tax compliance. Over 6,000 businesses in a large Caracas municipality were the subject of the study, which involved tracking their local business tax compliance. The local tax administrator sent letters to the businesses in five treatment arms with different messages linked to tax compliance; the businesses were also randomly assigned to a control group that did not receive any stimulus. An enforcement message was found to have the greatest compliance effect (raising the perceived probability of detection); a message highlighting the public goods and services that the local government provides and that have a direct impact on businesses was found to have the second-largest effect; the effects of other messages on compliance were found to be much smaller. Furthermore, it appears that the message of reciprocity has a longer-lasting effect than the message of enforcement.

A review of the disincentives affecting value-added tax compliance in Kisumu County, Kenya, was conducted by Korongo and Kilonzi (2023). The particular goals were on tax audits, tax rates, and compliance evaluations and how these affect Kisumu County, Kenya's value-added tax compliance. The investigation was anchored by the fiscal and social psychology theories as well as the economic deterrence theory. A descriptive strategy was used, focusing on 430 Kisumu town establishments. The results of the analysis were presented using tables and figures. It has been determined that compliance inspections significantly contribute the most to VAT compliance. The study comes to the conclusion that VAT is significantly influenced by deterrent factors.

2.3.3 Tax Complexity and Value Added Tax Compliance

Octavia and Wangdra (2024) reviewed the impact of financial health, tax penalties, and tax complexity on taxpayer compliance. The results demonstrate that while financial conditions and tax sanctions have a favorable and considerable impact on taxpayer compliance, complexity has no influence on taxpayer compliance in terms of taxes. In addition, individual taxpayer compliance in KPP Pratama Batam Selatan is significantly impacted by tax complexity, financial circumstances, and tax sanctions.

Using data from several nations, Hoppe, Schanz, Sturm, Sureth-Sloane, and Voget (2020) determined the association between tax complexity and foreign direct investments. For a sample of 15,607 new foreign subsidiaries, we find no relationship between site likelihood and total tax complexity (TCI). Analyzing the TCI in terms of tax code complexity and tax framework complexity reveals connections that are incompatible. While tax code complexity has a positive link with location likely, tax framework complexity has a negative relationship with location likelihood. These relationships are influenced, for instance, by the intricacy of the tax code's loss offset and transfer pricing rules as well as the dimensions of the tax framework's filing, payments, audits, and guidance. Further examination revealed that the relationships were dependent on a number of factors, including firm- and country-specific features. For instance, when tax rates are high, the favorable tax code link becomes less pronounced.

Musimenta (2020) discussed the need for understanding, the complexity of taxes, the expense of compliance, and tax compliance in Uganda. Withholding agents registered with the VAT department were used in a cross-sectional and correlational study design. The findings of this study imply that there is no meaningful correlation between knowledge requirements and compliance expenses. When attempting to communicate the internal costs of compliance, knowledge needs work better than external costs. The results indicated that taxpayers knew enough about taxes to be able to pay them, but that doesn't mean they won't have to pay the accompanying costs too. The more complex the tax system is; the more expensive compliance becomes. To ensure compliance with the complex tax systems, taxpayers need to obtain further training and external legal advice. As a result, tax complexity has an effect on tax compliance both directly and indirectly (via compliance expenses).

Abdul and McFie (2020) looked at how tax complexity affected Kenyan large- and medium-sized business taxpayers' compliance procedures. The Partial Least Square (PLS) approach is used in the study to sample 142 firms. The findings indicate that although there are many different perspectives on fairness, only exchange fairness has an impact on corporate tax payers' tax compliance behavior; complexity has an impact on the other dimensions of fairness. It was shown that perceived behavioral control had a substantial detrimental influence on compliance behavior. The findings suggest that tax authorities in Kenya and other tax jurisdictions should strive for exchange fairness and reduce circumstances in which taxpayers may have unrestricted control over their commercial operations in order to increase tax compliance.

2.3.4 Tax Penalty and Sanctions and Value Added Tax Compliance

Bt-Yunus and Bt-Ramli (2017) looked at the effect of tax fines on small and medium-sized enterprises' (SMEs') tax compliance. The relationship between tax fines and each aspect of tax compliance behavior is examined in this study. In this study, a sample of small- and medium-sized businesses (SMEs) in Malaysia were surveyed using a quantitative research methodology. The result shows that there is a significant effect of tax penalties on taxpayer compliance. According to study findings, there is a substantial correlation between tax penalty factors such as rate and punishment, tax penalty education and understanding, and the psychological characteristics of taxpayers who engage in tax compliance behavior. Thus, this study explained to the tax administrator how tax penalties contribute to a rise in tax compliance behavior in Malaysia.

Darmayanti (2019) evaluated the effects on taxpayer compliance of tax amnesty, fiscal assistance, tax awareness, and tax sanctions. The research population consisted of taxpayers who work as civil servants in the Sumberrejo sub-district of the Bojonegoro district. A total of 38 respondents were selected for the samples using quota sampling.

The following findings were obtained using multiple linear regression analysis: (1) tax levy sanctions have no effect on taxpayer compliance; (2) tax knowledge variables have no effect on taxpayer compliance; (3) fiscal service has a significant impact on taxpayer compliance; and (4) tax amnesty has no significant impact on taxpayer compliance.

The impact of tax fines on SME tax compliance was ascertained by Swistak (2016). The study talks about how tax penalties help small firms comply with tax laws and how effective they are at doing so. It makes the case that while tax penalties are essential for enforcing tax laws, they might not be the best option for guaranteeing tax compliance. The formalization of business is significantly hampered by an unduly punitive tax system, and increasing tax penalties has the opposite effect of what is intended. Instead than using harsh methods to suppress taxpayers, tax penalties should encourage and discourage them.

2.3.5 Costs of Compliance and Value Added Tax Compliance

Pope (2002) calculated the expenses of foreign taxation in terms of administration and compliance. It was discovered that the private sector bears a number of costs as a result of taxation, including "hidden costs" associated with the levying and collection process. The term "hidden costs" refers to these expenses associated with tax compliance. Compliance expenses and the administration costs incurred by the tax authority make up tax operating costs. From an international viewpoint, the conceptual, analytical, and methodological challenges surrounding administrative and compliance expenses are the main emphasis of this work. When possible, the costs of tax compliance are assessed within the framework of policy. Emphasis is placed on their expanding number of research papers and public and political acknowledgment in numerous nations across the globe.

Abdul and Wang'ombe (2018) demonstrated a link between tax costs and tax compliance behavior in Kenya. The study used structural equation modeling, or SEM, to identify the primary cost drivers while taking significant tax system elements and firm characteristics into consideration. SEM was first used to survey data. The findings show that tax compliance in Kenya dramatically decreases as tax compliance costs rise, especially those associated with comprehending the intricate tax laws that are already in place, modifications to tax regulations, and overall expenses associated with complying with regulatory obligations. Approximately 40% of the differences in Kenyan tax compliance behavior can be explained by the model constructs, which is more than the empirically recommended threshold for preliminary research.

Lazos et al. (2022) computed the cost of tax compliance for firms and its primary variables based on data from Greek enterprises. In terms of methodology, a sample of businesses representative of the Greek economy was used in the study. Factor analysis was employed in conjunction with a questionnaire to handle the data that was gathered. The results of the poll indicated that the two main factors influencing the cost of tax compliance are the extent to which the tax administration provides electronic tax services and the complexity of the tax code. In actuality, the identification and evaluation of these variables significantly lowered operating expenses for enterprises. Maintaining sustainability and achieving appropriate growth rates are crucial for firms to remain competitive in the contemporary economic landscape.

2.3.6 Tax structure, Tax Service Quality and Value Added Tax Compliance

Mannan (2020) conducted an empirical study of individual taxpayers in the Bangladeshi Dhaka zones, focusing on tax structure aspects of tax compliance. The ordered logistic regression model's findings show that there are positive and substantial correlations between compliance and fairness, tax penalties, and taxpayer perceptions of government spending. It also looks at how referrals' compliance decisions affect other judgments about compliance. The results indicate a weak but negative correlation between them, suggesting that individual income taxpayers decide whether to comply without considering the opinions of others. Ultimately, the study assessed the impact of tax law compliance costs on tax compliance and found a negative correlation, suggesting that higher compliance costs resulted in lower compliance levels.

Alshira'h, Alsqour, Lutfi, Alsyouf, and Alshirah (2020) examined the socio-economic model of sales tax compliance in Jordan after putting in place a number of fiscal measures to increase compliance on the domestic front over the preceding several decades. Annual statistics, however, indicate that the country's net public debt and fiscal imbalance are still rising significantly, and this trend may be traced back to the increased tax non-compliance rate. This is particularly valid in relation to Jordan's sales tax. To make matters worse, not enough study has been done on what influences sales tax compliance and other variables that result in non-compliance. Moreover, an all-encompassing tax compliance model that can satisfactorily explain the issue remains elusive. Thus, this study expanded on Fischer's tax compliance model by presenting the direct influence of tax service quality and the moderating effect of tax knowledge. It also suggested the drivers of sales tax compliance within the framework of Jordanian small and medium-sized enterprises (SMEs). In order to shed light on Jordanian SMEs' sales tax compliance, this study provided a model that included social, psychological, and economic components.

Susuawu, Ofori-Boateng, and Amoh (2020) used Ghana as a case study to examine if service quality affected SMEs' tax compliance behavior. Five hypotheses were tested by the study using the survey and regression, correlation, and frequency tables. Reliability, responsiveness, assurance, and empathy were revealed to have statistically significant positive effects on SMEs' tax compliance behavior. Second, the main metrics for assessing the quality of tax services have differing positive associations. Because of its impact on tax revenue collection for economic growth and development, the research has a number of policy implications for taxation authorities and policy makers.

Purnomolastu (2021) examined taxpayer satisfaction, word-of-mouth activity, and the quality of tax services. The quantitative approach is the research methodology employed. Using the accidental sampling technique, 70 taxpayers in Surabaya served as the study's sample. Partial Least Square analysis is the method used for analysis in this paper. The findings demonstrated that: (1) taxpayer satisfaction influences service quality; (2) loyalty influences service quality; (3) taxpayer satisfaction influences loyalty; (4) loyalty influences word-of-mouth; and (5) service quality significantly influences loyalty through taxpayer satisfaction.

Osei-Darko (2012) examined customer service and how it affects the caliber of services provided by Ghanaian tax authorities. Survey techniques are among the procedures and methods used to conduct this investigation. In order to gather information from the taxpayers as well as the manager of the VAT office, an interview schedule was also employed. For the study, a sample of 100 taxpayers was used. The study design utilized was descriptive. To improve understanding, data were explained using tables, figures, averages, aggregates, and percentages. According to the report, the VAT service is decentralizing its operations to increase customer access to its offerings. It also revealed that workers believe the tax system is equitable. However, it was revealed that not every Ghanaian district has an office for the VAT service.

Mustapha and Obid (2015) focused on the quality of tax services offered as well as the perceived usability of Nigeria's online tax system as a mediating factor. This study examines the relationship between the online tax system's perceived ease of use and the caliber of tax services. The total of 206 survey data points were examined using structural equation modeling. The results show that there is a substantial mediating relationship between perceived ease of use and tax service quality, and that the relationship between the two is positively correlated with online tax systems.

Ali, Asmi, Rahman, Malik, and Ahmad (2017) evaluated the quality of e-services based on customer satisfaction. In this work, exploratory factor analysis (EFA) was used to assess the validity and reliability of the measurement model. A statistical method called regression modeling has been used to assess the significance of the relationship between various variables in the study model. According to statistical results from recent study, customer happiness is substantially correlated with the service quality characteristics of responsiveness, reliability, and trust, but not with empathy.

2.4 Summary of Literature and Research gaps

Alshira'h (2024) did an experimental examination of trust in government and tax compliance costs. Trifan, Szentesi, Cuc and Pantea (2023) did an assessment among Romanian taxpayers. Ojo and Shittu (2023) did a review with emphasis on influential factors in Nigeria. Sinnasamy and Bidin (2019) focused on the moderating role that chance of detection has on the factors driving Malaysian excise duty non-compliance. Wangdra (2024) and Octavia conducted a review on taxpayer compliance. Musimenta (2020) discussed the need for understanding, the complexity of taxes, the expense of compliance, and tax compliance in Uganda. The emphasis of Abdul and McFie (2020) was Kenyan large- and medium-sized corporate taxpayers' compliance behavior. The impact of tax penalties on the tax compliance of SMEs in Malaysia was examined by

Bt-Yunus and Bt-Ramli (2017). Pope (2002) calculated the expenses of foreign taxation in terms of administration and compliance. In order to determine the primary cost drivers based on survey data, Abdul and Wang'ombe (2018) employed the SEM technique. Lazos, Pazarskis, Karagiorgos, and Koutoupis (2022) took evidence from Greek Businesses. Empirical research of individual taxpayers in Bangladesh's Dhaka zones was conducted by Mannan (2020). In 2020, Alshira'h, Alsqour, Lutfi, Alsyouf, and Alshirah reviewed the socioeconomic model of Jordanian sales tax compliance. Using Ghana as a case study, Susuawu, Ofori-Boateng, and Amoh (2020) examined the tax compliance behavior of SMEs.

2.5 Conceptual Framework

Figure 2.1 below is the conceptual framework that guided the proposed study:

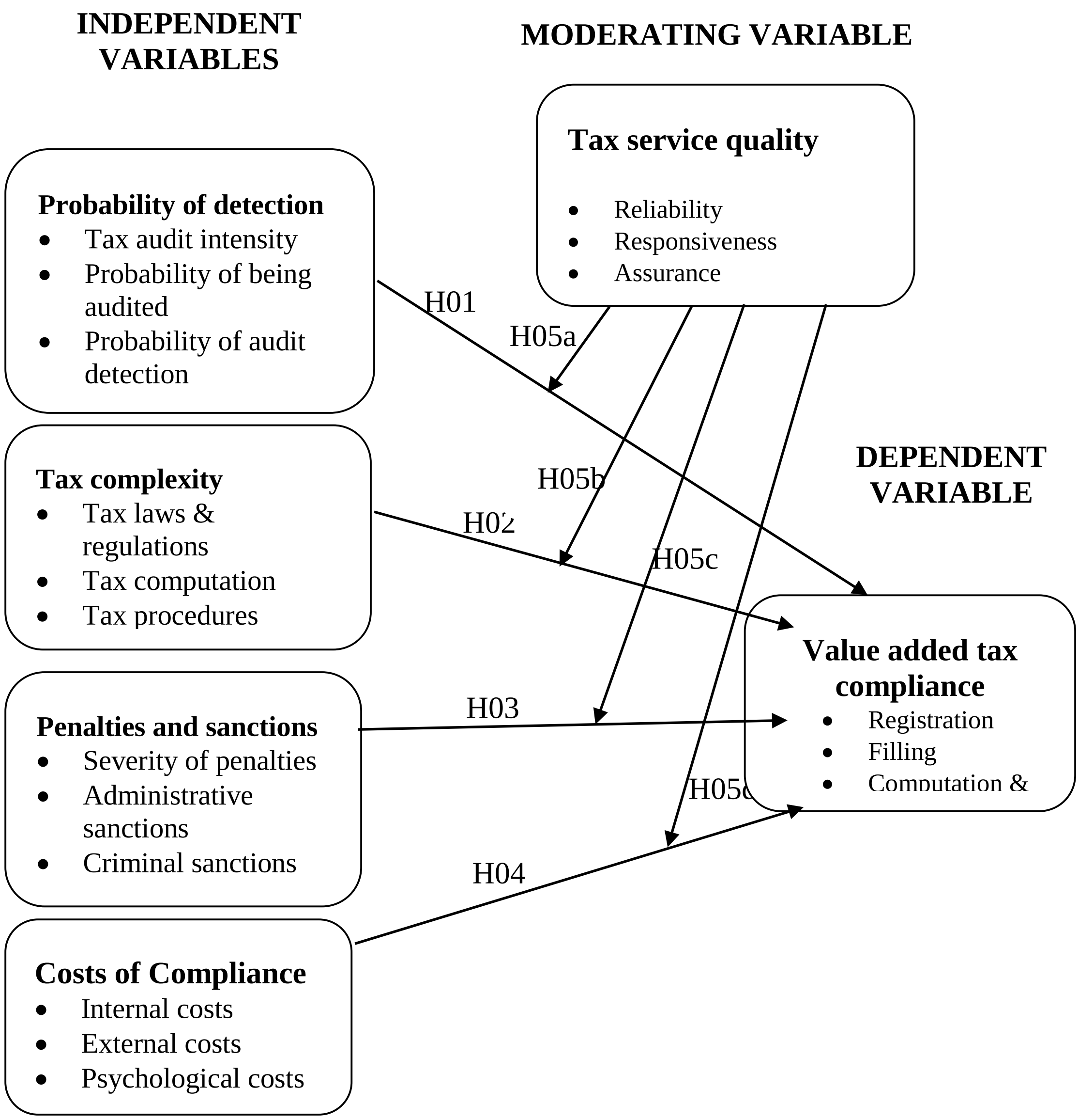

Figure 2.1: Conceptual Framework

Source: Researcher (2024)

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter covered the research methodology, target population, sampling frame, sampling method, sample size and related technique as well as data collection. The chapter also covered details on pilot testing including how reliability and validity was determined, relevant diagnostic tests as well as data analysis, operationalization of variables and ethical issues that were considered.

3.1 Research Design

A research design, according to Creswell (2014), is the framework, approach, and plan of inquiry developed to find solutions to research problems or questions. Creswell also maintained that a study's research design is essential to its success since it offers a road map for ensuring that the study is properly organized, planned, and carried out. This minimizes risk of bias, increases the validity and reliability of findings, and draw more accurate and meaningful conclusions. A research design, according to Creswell (2014), is the framework, approach, and plan of inquiry developed to find solutions to research problems or questions. This study employed a cross-sectional approach using a explanatory research design to allow the researcher to gather information, summaries, present, and interpret for clarification (Polkinghorne, 2005)

3.2 Target Population

Population is a set items including people and all things in the universe that have common features (Eden & Nielsen, 2020). According to Kara (2020), the target population is a particular group of individuals, goals, and objects that share observable characteristics and that the study is trying to learn more about. The target population of the study was 751 SMEs operating in Westlands Subcounty, Nairobi, Kenya as registered by Nairobi City County. The unit of analysis was Small and Medium Enterprises operating in Westlands sub county, Nairobi Kenya. A breakdown of these SMEs was as provided in Table 3.1 below:

Table 3.1: Target Population

Category of SME	Target Population	Sample Proportion
Eateries	190	25.3%
Hardwares	174	23.1%
ICT and digital related businesses	187	24.9%
Other service-oriented businesses	200	26.7%
Total	**751**	**100.0**

Source: Nairobi City County (2023)

3.3 Sampling Frame

A sampling frame is an inventory of the entire population that serves as the foundation for choosing the study's sample (Thanem & Knights, 2019). The list of SMEs in Nairobi City County's Westlands Subcounty served as the study's sample frame.

3.4 Sample Size

Sample size is a small representative unit that is drawn from the entire target population and its essence is to allow for generalization of the findings to the rest of the population (Rose, McKinley & Baffoe-Djan, 2019). The study determined the sample size from the following formula by Yamane (1967):

$$\mathbf{n = N / (1 + Ne^2)}$$

n = is the desired sample size

N = is the target population

e = is the acceptable margin of error estimated at 0.05 (at 95% confidence interval)

Therefore, sample size (n) = 751÷ (1+751(0.0025))

= 751÷ (1+1.875)

= 751÷2.875

n= 261 respondents

3.5 Sampling Method

The process of choosing participants for a study by selecting them from the target population is known as sampling. It makes it possible to extrapolate the study's conclusions to the full population (Fellows & Liu, 2021). Stratified random sampling was used in the investigation. According to Kothari (2004), this technique preserves statistical regularity and guarantees that the sample chosen represents the population's composition and characteristics in a comparable way, making it suitable for classification as a representative sample. In this regard, the owners of the SMEs stratified was into four categories based on the nature of undertaking of their business and representative sample from each of these categories was drawn. This was as represented in Table 3.2 below:

Table 3.2: Sampling Method

Category of SME	Target Population	Sample Proportion	Sample size
Eateries	190	25.3%	25.3%*261=66
Hardwares	174	23.2%	23.2%*261=61
ICT and digital related businesses	187	24.9%	24.9%*261=65
Other service-oriented businesses	200	26.6%	26.6%*261=69
Total	**751**	**100.0**	**261**

Source: Nairobi City County (2023)

3.6 Data Collection

Data collection is a process that is conducted to gather information from respondents in response to the established research questions (Nielsen, Eden & Verbeke, 2020). The questionnaire helped this study collect primary data. McKinley and Rose (2019) define a questionnaire as a tool consisting of a series of questions given to respondents with the aim of eliciting appropriate replies that align with the predetermined study objectives. Lo, Rey-Martí, and Botella-Carrubi (2020) list the ease of administration and capacity to collect a substantial amount of data from participants even in the face of time constraints as benefits of employing questionnaires for information gathering.

The questionnaire was structured covering items that was designed on a 5-point Likert scale where 1-strongly disagree and 5-strongly agree. There were a total of seven sections within the questionnaire covering general information in A, VAT compliance in B, probability of detection in C, tax complexity in D, tax penalties and sanctions in E, costs of compliance in F and tax service quality in G respectively. Structuring of the questionnaire in such way to provide an opportunity for respondents to provide responses that was standardized thus easing the process of analysis.

3.7 Pilot Test

A pilot study is a min-inquiry conducted with the aim of validating as well as establishing reliability of the study tool. One to ten percent of the study sample size can be used for a pilot study, according to Thomas, Martin, Etnier, and Silverman (2022). As a result, 26 SMEs from Nakuru City were specifically chosen to be a part of the pilot study, making up 10% of the study sample size. The reason for selecting upon Nakuru City for the purpose of pilot testing is for the avoidance of biasness since the actual study is to be done in Westlands.

3.7.1 Validity Test

The degree to which a study questionnaire measures an item that it is intended to test is known as its validity (Privitera, 2022). After several iterations, a valid tool continues to measure the item it is intended to measure. With the assistance of the supervisor and two specialists chosen from the field of taxation, this study assessed for construct validity as well as content. They reviewed all the details on the questionnaire against the theories and operational constructs of each variable to ensure there is an alignment. The study also used factor analysis to measure the construct validity of the questionnaire.

3.7.2 Reliability Test

Reliability of an item in a study is determined by its consistency. An internal consistency score called Cronbach Alpha was used in this study to evaluate the questionnaire's reliability. In this sense, Cronbach Alpha values were determined using the duly completed questionnaires from the pilot study. According to Adams and McGuire (2022), a study's tool is considered credible if its Cronbach Alpha score is greater than 0.7.

3.8 Diagnostic Tests

Diagnostic tests are preliminarily conducted before regression analysis as one of the inferential statistic. Their essence is to validate the assumptions of regression analysis model adopted in a study. In this study, normality, linearity and multicollinearity tests was conducted and they were as discussed below:

3.8.1 Normality Test

For the findings of regression analysis to be legitimate, the data set must be regularly distributed. To confirm this, a normality test is performed. In this study, normality was evaluated using the Shapiro-Wilk test. P-values in the Shapiro-Wilk test larger than 0.05, according to Dawson (2019), indicate that the data under investigation has characteristics of a normal distribution.

3.8.2 Linearity Test

The assumption of regression analysis is that the independent and dependent variables have a linear relationship. A linearity test is necessary to verify this assumption. Scatter plots were employed in this study to investigate the association between the variables. Testing for linearity—a regression analysis assumption—helped ascertain whether the connection between the variables could be properly captured by a linear model.

3.8.3 Multicollinearity Test

When any or all of the independent variables have a correlation with one another, this is a highly serious breach of the regression analysis assumption. This should not be the case and such may create multicollinearity problem. To test for this assumption, values of Variance of Inflation Factors (VIFs) was computed and as pointed out by Sardinha and Pinto (2019), when such values are in the range of 1-10, an implication is that there is absence of multicollinearity in the sample data of the study.

3.8.4 Heteroscedasticity Test

To find out if the variance of the residuals in the model is not constant across all levels of the independent variables, do the heteroscedasticity test. One popular technique for determining heteroscedasticity is to run a White or Breusch-Pagan test. Both tests compare the residuals to the fitted values and calculate a test statistic. A significant test statistic indicates the presence of heteroscedasticity (Kleinbaum et al., 2013).

3.9 Data Analysis

Data analysis describes the steps that are undertaken to process raw facts into insights for supporting decision making. Once gathered from the field, the questionnaires was inspected and sorted before being keyed into excel. From there, it was exported to spss (version 26) in readiness for analysis. The analysis took form of percentages and means as descriptive statistics as well as regression analysis as inferential statistic. Two regression models were adopted; one for testing effect of tax structure on VAT compliance (direct regression model) and the other one for determining the moderating effect of tax service quality in the above relationship (moderated regression model). These were specified below:

3.9.1 Direct Regression Model

The following model was used to test for the effect of tax structure factors on VAT compliance:

Model 1. Testing the effect of the independent variables on VAT compliance.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where Y = value added tax compliance

β_0 = Constant

β_1, β_2, β_3 and β_4 are Coefficients

ε = error term

X_1= Probability of detection

X_2= Tax complexity

X_3= Tax penalty and sanctions

X_4= Costs of compliance

3.9.2 Moderated Regression Model

To capture the moderating effect of tax service quality in the link between tax structure factors and VAT compliance, the following moderated regression models was adopted as adapted from Baron and Kemmy (1986).

Model 2 Testing the effect of the moderator on tax compliance.

$$Y_{it} = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \varepsilon$$

Model 3. Introducing the first interaction term between X_1 and X_5

$$Y_{it} = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_1{*}X_5 + \varepsilon$$

Model 4. Introducing the second interaction term between X_2 and X_5

$$Y_{it} = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_1{*}X_5 + \beta_7X_2{*}X_5 + \varepsilon$$

Model 5. Introducing the third interaction term between X_3 and X_5

$$Y_{it} = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_1{*}X_5 + \beta_7X_2{*}X_5 + \beta_8X_3{*}X_5 + \varepsilon$$

Model 6. Introducing the fourth interaction term between X_4 and X_5

$$Y_{it} = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_1{*}X_5 + \beta_7X_2{*}X_5 + \beta_8X_3{*}X_5 + \beta_9X_4{*}X_5 + \varepsilon$$

Where Y_{it} = value added tax compliance

β_0 = Constant

β_1, β_2, β_3, β_4, β_5, β_6, β_7, β_8, β_9 are Coefficients

ε = error term

X_1= Probability of detection

X_2= Tax complexity

X_3= Tax penalty and sanctions

X_4= Costs of compliance

X_5= Tax service quality

$\beta_6X_1*X_5$, $\beta_7X_2*X_5$, $\beta_8X_3*X_5$ and $\beta_9X_4*X_5$ are Interaction terms

3.10 Operationalization and Measurement of Variables

Table 3.3 is an overview of how the study operationalized the variables:

Table 3.3: Operationalization and Measurement of Variables

Variable	Indicator	Source	Measurement
Probability of detection	Tax audit intensity Probability of being audited Probability of audit detection	Carnes, G. A., & Englebrecht, T. D. (1995).	5-point Likert ordinal scale
Tax complexity	Tax laws & regulations iTax system Tax procedures	Saad, N. (2014).	5-point Likert ordinal scale
Penalties and sanctions	Severity of penalties Administrative sanctions Criminal sanctions	Bt Yunus, N., & Bt Ramli, R. (2017).	5-point Likert ordinal scale
Costs of compliance	Internal costs External costs Psychological costs	Kimungu, I., & Kileva, L. (2007).	5-point Likert ordinal scale
Tax service quality	Reliability Responsiveness Assurance	Susuawu, D., Ofori-Boateng, K., & Amoh, J. K. (2020).	5-point Likert ordinal scale
VAT compliance	Registration Filling Computation & payment	KRA (2023)	5-point Likert ordinal scale

3.11 Ethical Considerations

Ethics is viewed as the prescribed code of how the research study is conducted. Completion of this study required adherence to a number of ethical issues. This study placed significant emphasis on ethical considerations, especially since it involved human participants who could be at risk of harm or exploitation. It was crucial to safeguard their rights, well-being, and dignity throughout the research. Consequently, informed consent was obtained from all participants prior to their involvement. The researcher also ensured the confidentiality and anonymity of participants, minimized any potential risks, and provided debriefing and support services as needed.

A letter of introduction from Moi University was used to request permission to carry out the study. The National Commission for Science, Technology, and Innovation then issued a research permit. Given the sensitive nature of the data collected, which included information on taxation, income, and property ownership, the researcher maintained strict confidentiality and privacy standards. The data was securely stored and anonymized, and it was used solely for the study's intended purposes, with no unauthorized sharing or use without participant consent. Additionally, clear and detailed information regarding the study’s objectives, procedures, risks, and benefits was communicated to participants. The findings were presented objectively and without bias, avoiding any misrepresentation of the data.

CHAPTER FOUR

FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter included findings and discussion. Along with narrative explanations, the results are displayed in tables, charts, and diagrams. The data analysis was organized into themes that corresponded with the goals of the study.

4.2 Response Rate from the Questionnaire

The number of questionnaires that were administered to the owners of the SMEs in Westlands Subcounty, Nairobi, Kenya were 261.

Table 4.1: Response Rate

Response	Frequency	Percentage
Returned	219	83.91%%
Unreturned	42	16.09%
Total	**261**	**100%**

Source: Research Data (2024)

In total 219 questionnaires were answered and returned. Table 4.1 displays an overall response rate of 83.91%. Consequently, 83.91% was the overall response rate, indicating a successful response rate. A rate higher than 70% is considered excellent for the study, according to Babbie (2004).

4.3 Reliability Analysis

The purpose of the reliability test results was to evaluate the internal consistency of the variables as determined by the five-point Likert scale. Every Likert scaled item's dependability coefficient was calculated, and the findings are shown in Table 4.2.

Table 4.2: Reliability Assessment

Variable	Cronbach's Alpha	Number of items	Comment
Probability of detection	0.798	4	Reliability
Tax complexity	0.720	4	Reliability
Tax penalty	0.865	4	Reliability
Cost of compliance	0.721	4	Reliability
Tax service quality	0.703	4	Reliability
VAT compliance	0.745	4	Reliability

Source: Research Data (2024)

The result shown in Table 4.2 indicates that all scaled items were higher than the 0.7 cutoff. This means that all of the variables were appropriate for this study because they all satisfied the reliability threshold of 0.7 and above. This construct measure reliability level is significantly higher than the cutoff points established by Bryman (2012) and Cooper and Schindler (2011).

4.4 Factor Analysis

Factor analysis was also conducted on tax service quality, tax structure and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. They helped assess how well each variable was represented by the identified factors. They guided the refinement of the factor model and provided insights into the relevance of each variable. Communalities indicated relationships between variables and factors. The results were presented in the subsections 4.4.1 and 4.4.2.

4.4.1 Test for Sampling Adequacy

In order to check if the statements used to measure service quality, tax structure and value added were correlated or factorable, test of sampling adequacy was done and the findings are displayed in Table 4.3.

Table 4.3: Sampling Adequacy

KMO and Bartlett's Test		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0.764
Bartlett's Test of Sphericity	Approx. Chi-Square	1153.92
	Df	120
	Sig.	**0.000**

Source: Research Data (2024)

The findings in Table 4.3 show that the KMO value was 0.764 which was way above the recommended minimum threshold of 0.5. This statistic implies that the statements used to measure tax structure and tax service quality were adequate for factorability.

Additionally, the findings demonstrate that a Chi-square statistic of 1026.95 with 120 degrees of freedom and a p-value of 0.000 is obtained using the Bartlett's Test of Sphericity. According to this data, the statements assessing tax structure and service quality are significantly related and, as a result, fit into point 1153.92 of the Principle Component Analysis. This study verified that additional factor analysis on the predictor variable may be carried out based on the factorability test results.

4.4.2 Communalities

Communalities were done to determine the factor loading of the statements. Results were shown in Table 4.4.

Table 4.4: Communalities

		Initial	Extraction
Probability of detection	I believe there is a significant risk of VAT non-compliance being detected	1	0.687
	I am confident in the systems for monitoring VAT compliance and detecting non-compliance.	1	0.618
	I believe the likelihood of being detected encourages taxpayers to comply with VAT laws	1	0.722
	The likelihood of being caught for tax evasion is high	1	0.59
Tax complexities	VAT law and regulation is overly complex	1	0.668
	It is difficult to compute the amount of VAT payable	1	0.733
	VAT law and regulation changes frequently	1	0.563
	VAT forms e.g returns are easy to fill	1	0.643
Tax penalty	The penalties for nonpayment of VAT are very severe for this enterprise	1	0.826
	Late payment of VAT can attract severe penalties	1	0.644
	The likelihood of being caught for tax evasion is small	1	0.64
	The likelihood of penalties and sanctions encourage me to comply with the VAT law.	1	0.647
Cost of compliance	Cost of hiring professionals tax agents is expensive to the firm	1	0.502
	Record keeping for 5 years is expensive to maintain	1	0.6
	The burden of compliance costs discourages the owners to fulfill VAT obligations	1	0.611
	Reasonable compliance costs would increase voluntary compliance among SMEs	1	0.64
Tax service quality	Tax officials approach their job with professionalism and dedication	1	0.767
	Tax service is delivered quickly and timely	1	0.543
	Tax staffs have a polite, friendly, proper communication attitude and respect for businesses	1	0.666
	The problems related to the tax support application system of the tax authority are regularly overcome in time	1	0.632
VAT compliance	I am registered for VAT purposes	1	0.736
	I submit my VAT returns on time	1	0.798
	I pay my VAT taxes on time	1	0.729
	I have been charged late payment penalties and interests in the past	1	0.625

Source: Research Data (2024)

The findings in Table 4.4 show that, all variables had a factor loading above 0.4 and thus were all retained for further analysis.

4.5 Descriptive Statistics Analysis

Descriptive analysis was done for all the independent, moderating and dependent variables as shown below. In order to interpret the study results objectively, where 5= Strongly Agree 4= Agree 3= Undecided 2= Disagree 1=Strongly Disagree.

4.5.1 Descriptive Analysis for Probability of detection

Descriptive analysis results for probability of detection were presented in Table 4.5.

Table 4.5: Descriptive Analysis for Probability of Detection

Statement	SD	D	N	A	SA	Mean	Std. Dev
I believe there is a significant risk of VAT non-compliance being detected	10.00%	3.70%	24.20 %	26.00 %	36.10%	3.74	1.26
I am confident in the systems for monitoring VAT compliance and detecting non-compliance.	10.50%	13.70%	15.50 %	32.40 %	27.90%	3.53	1.31
I believe the likelihood of being detected encourages taxpayers to comply with VAT laws	9.10%	4.60%	13.20 %	37.90 %	35.20%	3.85	1.21
The likelihood of being caught for tax evasion is high	11.00%	0.90%	11.40 %	26.90 %	49.80%	4.04	1.28

Source: Research Data (2024)

The majority of respondents, or 62.1%, agreed with the assertion that there was a substantial danger of discovering VAT non-compliance, according to the results (mean =3.74, std.dev=1.26). This suggests that owners of SMEs believed there would be consequences if they did not comply with VAT. The majority of respondents, or 60.3%, to the study agreed with the statement that they have faith in the processes in place to monitor VAT compliance and identify non-compliance (mean =3.53, std.dev= 1.31). This shows that the mechanisms for tracking VAT compliance and identifying non-compliance were regarded with confidence by the owners of SMEs. Additionally, the majority of respondents, or 73.1%, agreed with the statement that they think taxpayers are more likely to comply with VAT regulations because of the possibility of being identified (mean =3.85, std.dev=1.21). This implied that there was a potential for detection in the event of tax nonpayment. The majority of respondents, or 73.1%, agreed with the statement that there is a high chance of getting discovered evading taxes, according to the results (mean = 4.04, std.dev = 1.28). This suggests that in the event of tax avoidance, SMEs stood a chance of being discovered.

4.5.2 Descriptive Analysis for Tax Complexity

Descriptive analysis results for tax complexity were presented in Table 4.6.

Table 4.6: Descriptive Analysis for Tax complexity

Statement	SD	D	N	A	SA	Mean	Std. Dev
VAT law and regulation is overly complex	10.50%	11.90%	16.90%	38.40%	22.40%	3.50	1.25
It is difficult to compute the amount of VAT payable	5.50%	7.30%	3.70%	36.50%	47.00%	4.12	1.13
VAT law and regulation changes frequently	9.10%	11.00%	3.70%	33.30%	42.90%	3.90	1.31
VAT forms e.g returns are easy to fill	5.50%	5.90%	6.40%	39.30%	42.90%	4.08	1.11

Source: Research Data (2024)

The findings demonstrated that the majority of respondents, or 60.8%, agreed that the complexity of VAT law and regulation is excessive (mean=3.50, std.dev=1.25). It was evident that SMEs considered the VAT legislation to be intricate. The majority of respondents, or 83.5%, agreed with the statement that it is challenging to calculate the amount of VAT owed, according to the results (mean=4.12, std.dev=1.13). This suggests that the SMEs had trouble figuring out the taxes.

The majority of respondents, or 76.2%, agreed with the assertion that VAT law and regulation changes frequently, according to the results (mean=3.90, std.dev=1.31). This indicates that VAT legislation and regulations have changed frequently. Additional results showed that 82.2% of respondents agreed with the assertion that it is simple to fill out VAT forms, for example, returns (mean = 4.08, standard deviation = 1.11). This infers that the SMEs found easy to fill returns.

4.5.3 Descriptive Analysis for Tax Penalty

Descriptive analysis results for tax penalty were presented in Table 4.7.

Table 4.7: Descriptive Analysis for Tax Penalty

Statement	SD	D	N	A	SA	Mean	Std. Dev
The penalties for nonpayment of VAT are very severe for this enterprise	7.80%	5.00%	10.50 %	21.90 %	54.80%	4.11	1.24
Late payment of VAT can attract severe penalties	8.70%	3.70%	5.90%	19.20 %	62.60%	4.23	1.25
The likelihood of being caught for tax evasion is small	11.00%	1.80%	8.20%	25.60 %	53.40%	4.09	1.29
The likelihood of penalties and sanctions encourage me to comply with the VAT law.	9.10%	0.00%	6.40%	29.70 %	54.80%	4.21	1.18

Source: Research Data (2024)

The majority of respondents,76.7%, agreed that this firm faces very severe penalties for failing to pay VAT (mean=4.11, std.dev=1.24). This suggests that the SMEs faced extremely harsh penalties for failing to pay VAT. The findings also revealed that the majority of respondents, or 81.1%, agreed with the statement that there can be serious consequences for paying VAT beyond the deadline (mean=4.23, std.dev=1.25). This indicates that the SMEs that failed to pay their VAT were subject to exceptionally harsh penalties.

Additional findings revealed that 79.0% of respondents agreed with the assertion that there is little chance of being detected evading taxes (mean=4.09, std.dev= 1.29). It was evident that tax cheating by the SMEs was being discovered. Furthermore, the majority of respondents, or 79.0%, agreed with the statement that the possibility of fines and penalties motivates them to abide by the VAT law (mean=4.21, std.dev=1.18). This indicates that the SMEs comply with VAT laws in order to stay out of trouble.

4.5.4 Descriptive Analysis for Costs of Compliance

Descriptive analysis results for costs of compliance were presented in Table 4.8.

Table 4.8: Descriptive Analysis for Costs of Compliance

Statement	SD	D	N	A	SA	Mean	Std. Dev
Cost of hiring professionals tax agents is expensive to the firm	10.00%	8.70%	5.50%	40.60%	35.20%	3.82	1.28
Record keeping for 5 years is expensive to maintain	6.40%	8.70%	18.30%	29.70%	37.00%	3.82	1.20
The burden of compliance costs discourages the owners to fulfill VAT obligations	5.90%	12.30%	13.20%	51.60%	16.90%	3.61	1.09
Reasonable compliance costs would increase voluntary compliance among SMEs	1.80%	4.10%	12.80%	38.40%	42.90%	4.16	0.93

Source: Research Data (2024)

The majority of respondents, or 75.8%, agreed with the assertion that hiring tax agents with experience is costly for the company (mean=3.82, std.dev=1.28), according to the data. This indicates that engaging tax agents came at a substantial expense for SMEs. The results clearly showed that the majority of respondents, or 66.7%, agreed that maintaining records for five years is expensive (mean=3.82, std.dev=1.20). This suggests that record keeping cost the SMEs a great deal of money.

Additional findings revealed that the majority of respondents, or 68.5%, agreed with the assertion that owners are discouraged from fulfilling their VAT requirements by the weight of compliance costs (mean=3.61, std.dev=1.09). This indicated that tax compliance was adversely impacted by compliance costs. Furthermore, the majority of respondents, or 81.3%, agreed with the assertion that SMEs would comply voluntarily more often if the costs of compliance were reasonable (mean=4.16, std.dev=0.93). This indicated that tax compliance was positively impacted by reduced compliance costs.

4.5.5 Descriptive Analysis for Tax Service Quality

Descriptive analysis results for tax service quality were presented in Table 4.9.

Table 4.9: Descriptive Analysis for Tax Service Quality

Statement	SD	D	N	A	SA	Mean	Std. Dev
Tax officials approach their job with professionalism and dedication	7.80%	4.10%	9.60%	22.80%	55.70%	4.15	1.23
Tax service is delivered quickly and timely	8.70%	2.70%	29.20%	35.60%	23.70%	3.63	1.14
Tax staffs have a polite, friendly, proper communication attitude and respect for businesses	4.60%	10.50%	2.70%	43.80%	38.40%	4.01	1.12
The problems related to the tax support application system of the tax authority are regularly overcome in time	2.70%	6.40%	8.70%	43.80%	38.40%	4.09	0.98

Source: Research Data (2024)

As per the findings, 78.5% of the participants agreed, on average, that tax officials approach their work with professionalism and dedication (mean=4.15, std.dev=1.23). This suggests that the SMEs felt at ease with the tax inspectors' professionalism. The results also indicated that the majority of respondents, or 59.3%, agreed with the statement that tax services are provided in a timely and efficient manner (mean=3.63, standard deviation= 1.14). This indicated that KRA provided prompt and efficient tax services. The majority of respondents, or 82.2%, agreed with the assertion that tax staff members have a courteous, friendly, appropriate communication style and respect for businesses, according to the data (mean=4.01, std.dev=1.12). This suggests that the SMEs were at ease with the tax staff's demeanor and regard for their company. Furthermore, the majority of respondents (82.2%) agreed with the assertion that issues with the tax authority's application system for tax support are routinely resolved promptly (mean=4.09, std.dev= 0.98). This indicates that the tax authority's application system for tax support is consistently overcome on schedule.

4.5.6 Descriptive Analysis for Value Added Tax Compliance

Descriptive analysis results for value added tax compliance were presented in Table 4.10.

Table 4.10: Descriptive Analysis for Value Added Tax Compliance

Statement	SD	D	N	A	SA	Mean	Std. Dev
I am registered for VAT purposes	8.20%	8.20%	12.80 %	26.50%	44.30%	3.90	1.28
I submit my VAT returns on time	9.10%	10.00 %	16.00 %	22.80%	42.00%	3.79	1.33
I pay my VAT taxes on time	6.40%	6.80%	17.80 %	22.80%	46.10%	3.95	1.22
I have been charged late payment penalties and interests in the past	15.10%	15.10 %	25.10 %	16.90%	27.90%	3.27	1.40

Source: Research Data (2024)

The majority of respondents, or 70.8%, agreed, on average (mean=3.90, std.dev=1.28), with the assertion that they are registered for VAT purposes. It follows that the majority of SMEs have VATA registrations. The majority of respondents, or 64.8%, agreed with the assertion that they file their VAT returns on time, according to the data (mean=3.79 std.dev=1.33). This indicates that Westlands Subcounty's SMEs file their returns on schedule.

Additional findings revealed that 68.9% of respondents agreed with the assertion that they should pay their VAT taxes on time (mean=3.95, std.dev= 1.22). The majority of SMEs, therefore, pay their taxes on time. The findings also revealed that 44.8% of respondents, or the majority, agreed with the assertion that they had previously been assessed interest and late payment penalties (mean=3.27 std.dev=1.40). This implied that certain SMEs had made late tax payments.

4.6 Regression Assumptions

4.6.1 Normality

To confirm whether the error term is normal or not, this study employed the Shapiro-Wilk test. Results are presented in table 4.11.

Table 4.11: Normality Test

	Shapiro-Wilk		
	Statistic	**Df**	**Sig.**
Probability of detection	0.878	219	0.066
Tax complexity	0.781	219	0.068
Tax penalty	0.809	219	0.077
Cost of compliance	0.879	219	0.081
Tax service quality	0.789	219	0.567
Value added tax compliance	0.809	219	0.098

Source: Research Data (2024)

The findings demonstrated a normal distribution for the following variables: value added tax compliance, tax complexity, tax penalty, cost of compliance, and probability of detection. Their p values were greater than 0.05.

4.6.2 Multicollinearity Test

According to the multicollinearity assumption, there shouldn't be much correlation between independent variables. The variance inflation factor was used in the study to test for multicollinearity. The outcomes were displayed in Table 4.12.

Table 4.12: Multicolinearity Test

	Tolerance	VIF
Probability of detection	0.497	2.013
Tax complexity	0.494	2.023
Tax penalties	0.463	2.162
cost of compliance	0.872	1.147
Tax service Quality	0.493	2.022
Mean		1.873

Source: Research Data (2024)

VIF values ranged from 1.147 (cost of compliance) and 2.162 (Tax penalties). The mean of the VIF was 1.873. This implied that there was no multicollinearity amongst the variables.

4.6.3 Linearity tests

Linearity test was done using scatter plots. Linearity test for probability of detection and value added tax compliance was presented in Figure 4.3.

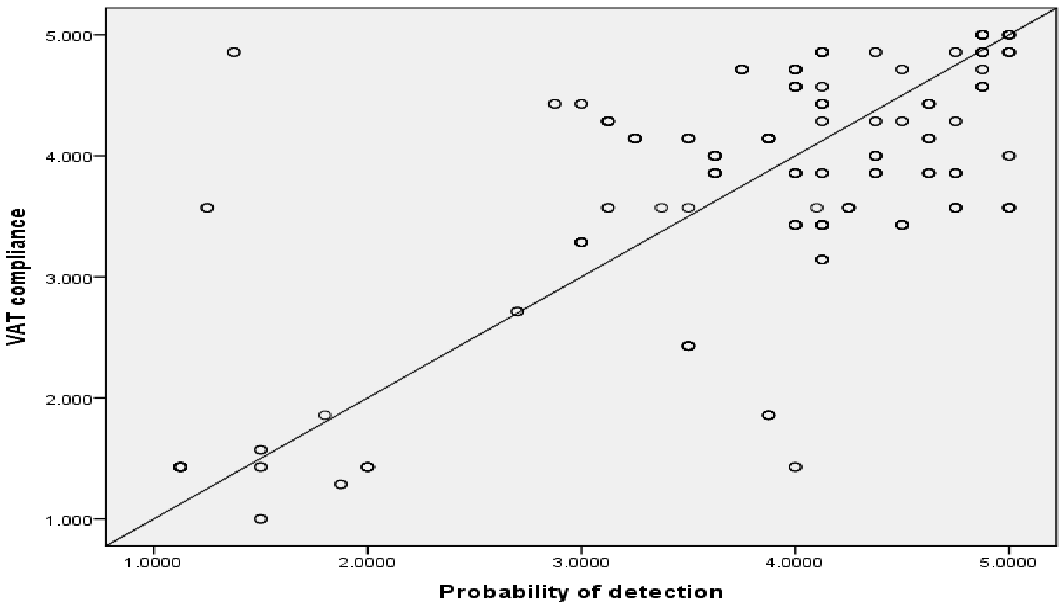

Figure 4.3: Probability of Detection and VAT compliance

Source: Research Data (2024)

Results showed that there was a positive linear relationship between probability of detection and VAT compliance of SMEs.

Linearity test for probability of detection and VAT compliance of SMEs was presented in Figure 4.4.

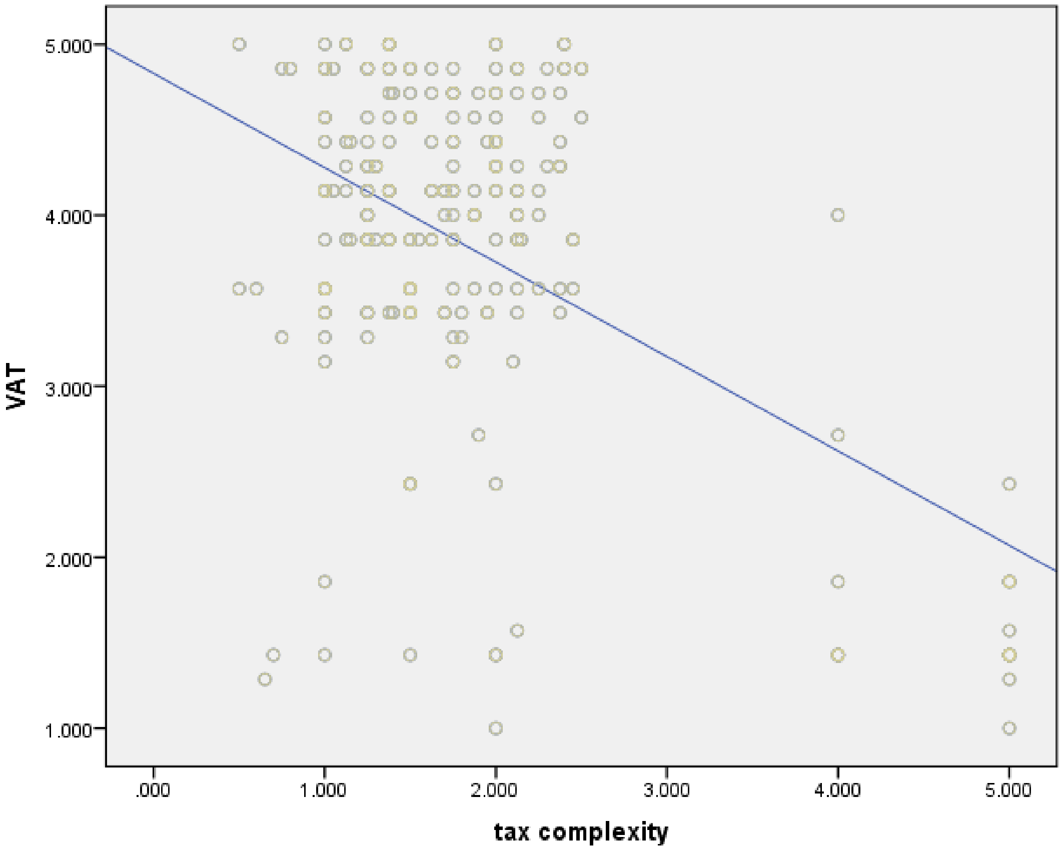

Figure 4.4: Tax Complexity and VAT compliance

Source: Research Data (2024)

Results showed that there was a negative linear relationship between tax complexity and VAT compliance of SMEs.

Linearity test for tax penalties and VAT compliance of SMEs was presented in Figure 4.5.

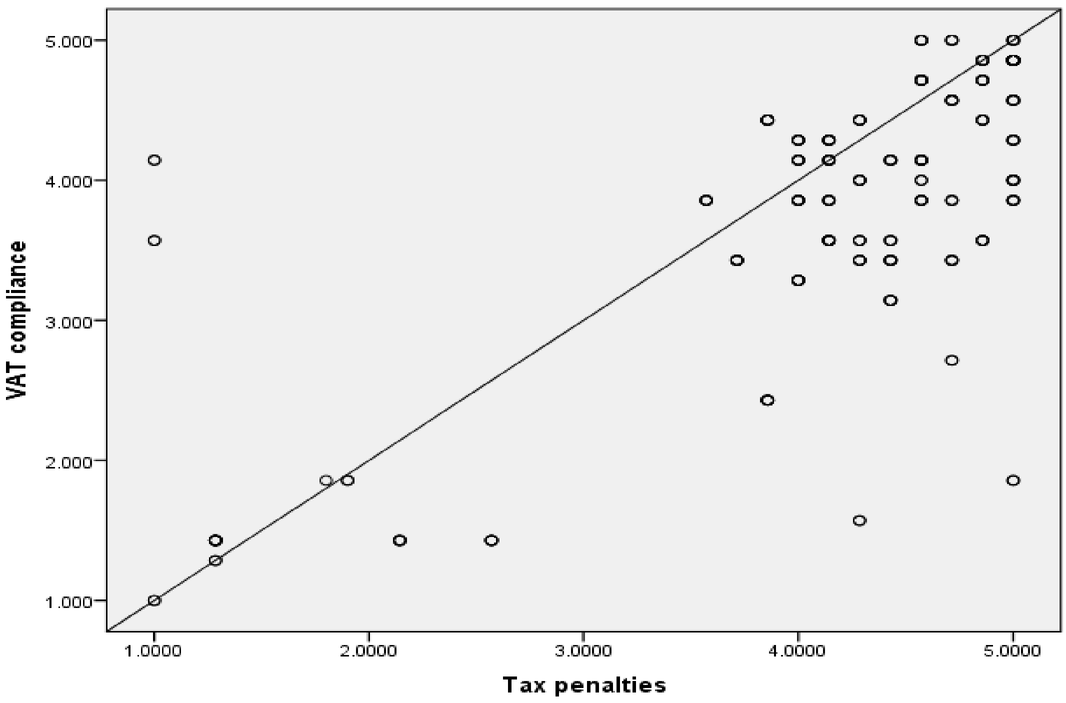

Figure 4.5: Tax Penalties and VAT compliance

Source: Research Data (2024)

Results showed that there was a positive linear relationship between tax penalties and VAT compliance of SMEs.

Linearity test for cost of compliance and VAT compliance of SMEs was presented in Figure 4.6.

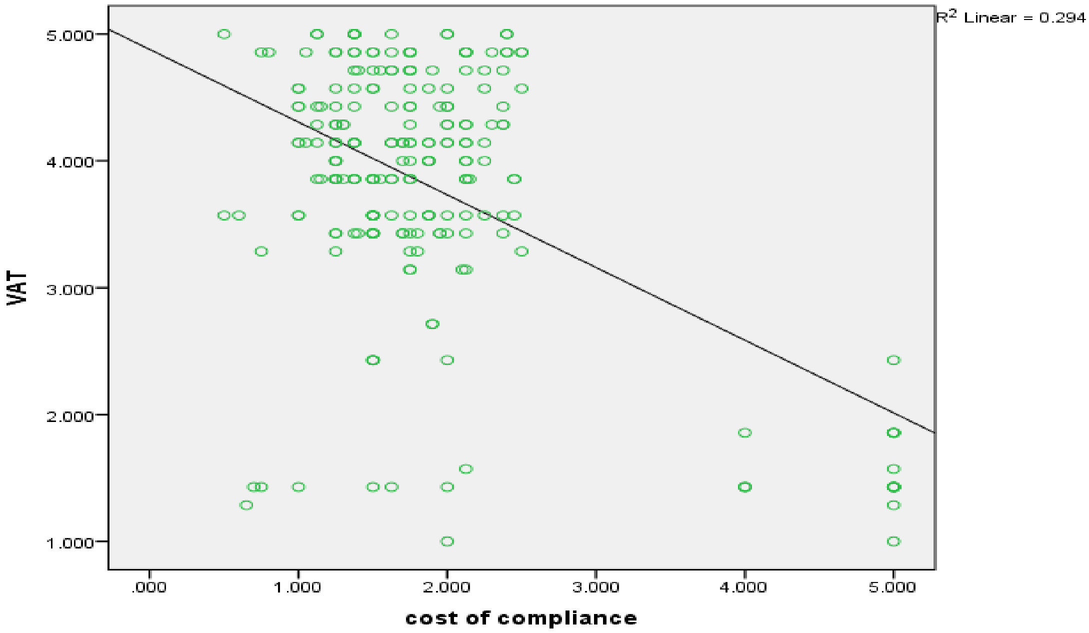

Figure 4.6: Cost of Compliance and VAT compliance

Source: Research Data (2024)

Results showed that there was a negative linear relationship between cost of compliance and VAT compliance of SMEs.

4.6.4 Heteroscedasticity Test

This study used the Breusch-Pagan test to ensure that all observations have a constant variation of residuals when the null hypothesis is tested. The results were presented in Table 4.13.

Table 4.13: Breusch-Pagan test of Heteroscedasticity

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity Ho: Constant variance Variables: fitted values of VAT Compliance
chi2(1) = 0.34 Prob > chi2 = 0.5577

Source: Research data, 2024

The probability value was 0.5577 above 0.05, thus implying that the data did not have heteroskedasticity problem.

4.7 Regression Analysis

4.7.1 Direct Effect tax structure and value added tax compliance

Regression analysis was one of the inferential statistics used to show the relationship between variables. It showed the relationship between tax structure and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. Regression results were presented in Table 4.13.

Table 4.13: Model Fitness

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.787a	0.619	0.612	0.63883

Source: Research Data (2024)

The R value was found to be 0.787. This suggests that in Westlands Sub County, Nairobi, Kenya, small and medium-sized businesses' compliance with value-added tax was strongly correlated with the tax structure. Furthermore, the R-square value was 0.619. This suggests that 61.9% of the differences in the dependent variable—value added tax compliance among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County—can be explained by changes in tax structure.

Table 4.14: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	141.822	4	35.455	86.879	.000b
Residual	87.334	214	0.408		
Total	229.155	218			

Source: Research Data (2024)

With a reported p value of 0.000, less than the standard probability of 0.05 significance level, and a F statistic of 86.879, Table 4.14 demonstrated that tax structure was a strong predictor of value added tax compliance. This suggests that, at a 95% confidence level, the tax structure has a statistically significant impact on VAT compliance.

Table 4.15: Regression of Coefficient

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.615	0.352		4.594	0
Probability of detection	0.366	0.057	0.358	6.409	0.000
Tax complexity	-0.222	0.072	-0.131	-3.081	0.002
Tax penalties	0.501	0.056	0.500	9.005	0.000
cost of compliance	-0.134	0.047	-0.121	-2.846	0.005

Source: Research Data (2024)

The null hypothesis (H_{01}) was that there is no significance effect of probability of detection on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. The likelihood of discovery had a positive and significant impact on SMEs' VAT compliance, according to a regression analysis of coefficients (β=0.358, p=0.000). The study indicated that there was a statistically significant association between the probability of detection and value added tax compliance among small and medium firms in Westlands Sub County, Nairobi, Kenya, and that the null hypothesis was rejected as a result. The results of the study corroborated those of Ortega and Sanguinetti (2013), who discovered that the biggest impact on compliance is achieved by an enforcement message that raises the perceived likelihood of detection. However, the results did not coincide with Sinnasamy and Bidin's (2017) finding that Malaysian excise duty non-compliance is significantly influenced by the probability of discovery.

The null hypothesis (H_{02}) was that there is no significance effect of tax complexity on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. Additional findings indicated that SMEs' VAT compliance was significantly impacted negatively by tax complexity (β=-0.131, p=0.001). As a result, the study's null hypothesis was rejected, and it was determined that tax complexity and value added tax compliance among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, were statistically significantly correlated. The results of the study corroborated those of Musimenta (2020), who discovered that tax complexity significantly affects tax compliance in Uganda. The study's conclusions disagreed with those of Octavia and Wangdra (2024), who discovered that taxpayer compliance is unaffected by complexity.

The null hypothesis (H_{03}) was that there is no significance effect of tax penalties on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. Furthermore, the findings indicated that tax penalties had a noteworthy and favorable impact on SMEs' VAT compliance ($\beta=0.500$, $p=0.000$). The study indicated that there was a statistically significant association between tax fines and value added tax compliance among small and medium firms in Westlands Sub County, Nairobi, Kenya, and that the null hypothesis was rejected as a result. The study's conclusions concurred with those of Bt-Yunus and Bt-Ramli (2017), who discovered that tax fines do, in fact, have a major impact on taxpayer compliance behavior. The study's conclusions ran counter to those of Swistak (2016), who contended that while tax penalties are essential for enforcing tax laws, they might not be the best option for guaranteeing tax compliance.

The null hypothesis (H_{04}) was that there is no significance effect of cost of compliance on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. Subsequent findings indicated that SMEs' VAT compliance was significantly impacted negatively by compliance expenses ($\beta=-0.134$, $p=0.005$). The study found that among small and medium-sized businesses in Westlands Sub County, Nairobi, Kenya, there was a statistically significant correlation between value added tax compliance and cost of compliance; hence, the null hypothesis was rejected.

The study's findings were in line with those of Abdul and Wang'ombe (2018), who discovered that increased costs associated with tax compliance significantly lower tax compliance in Kenya.

Optimal Model

$$\mathbf{Y = 0.358X_1 - 0.131X_2 + 0.500X_3 - 0.121X_4}$$

Where;

Y represents VAT compliance

$\mathbf{X_1}$ represents probability of detection

$\mathbf{X_2}$ represents tax complexity

$\mathbf{X_3}$ represents tax penalties

$\mathbf{X_4}$ cost of compliance

4.7.2 Moderating effect of Tax Service Quality

The moderating role of tax service quality on the relationship between tax structure and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya was presented in this model.

Table 4.16: Moderating Effect of Tax Service Quality

R	R Square	Adjusted R Square	Std. Error of the Estimate		
.827a	0.683	0.676	0.58369		
	Sum of Squares	**df**	**Mean Square**	**F**	**Sig.**
Regression	156.588	5	31.318	91.923	.000b
Residual	72.568	213	0.341		
Total	229.155	218			
	Unstandardized Coefficients		**Standardized Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	1.276	0.325		3.923	0.000
probability of detection	0.286	0.054	0.279	5.332	0.000
tax complexity	-0.19	0.066	-0.112	-2.877	0.004
tax penalties	0.392	0.053	0.392	7.343	0.000
cost of compliance	-0.188	0.044	-0.17	-4.292	0.000
tax service quality	0.332	0.05	0.312	6.583	0.000

Source: Research Data (2024)

The R^2 of the model improved from 61.9% to 68.3%, therefore indicating a 6.4% ΔR^2 and that the beta co-efficient of was (β= 0.332, ρ<0.05) indicating that there was positive statistically significant effect of tax service quality and VAT compliance. The results of the study corroborated those of Susuawu, Ofori-Boateng, and Amoh (2020), who discovered statistically significant positive effects of assurance, empathy, responsiveness, and reliability on SMEs' tax compliance behavior.

4.7.3 Moderating role of tax service quality on the relationship between tax structure and value added tax compliance

The null hypothesis (H_{05a}) *tax service quality does not moderate the effect on the relationship between probability of detection and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya*. The moderating effect was determined from model 6 where interactive term was introduced between probability of detection and tax service quality. The beta coefficient for the interactive term was (β= 0.086, ρ<0.05). This suggested that the null hypothesis was rejected, and the study came to the conclusion that among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, tax service quality moderates the association between the likelihood of detection and value-added tax compliance. This suggested that improving tax service quality will improve VAT compliance. Figure 4.7 shows that VAT compliance is high with high probability of detection and high tax service quality.

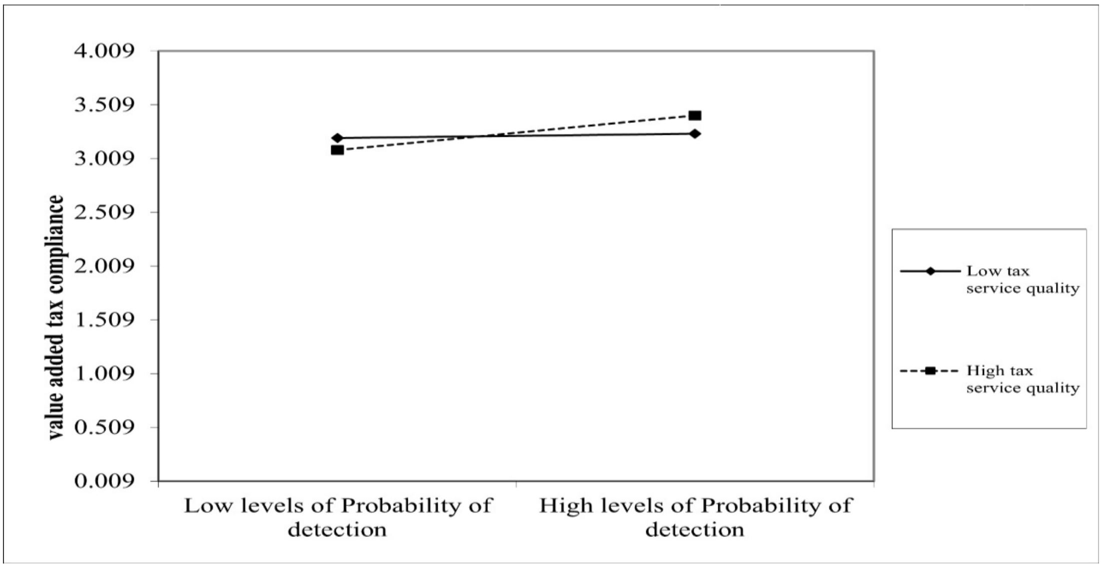

Figure 4.7: Modgraph for tax service quality on probability of detection value added tax compliance

Source: Research Data (2024)

The null hypothesis (H_{05b}) *tax service quality does not moderate the effect on the relationship between tax complexity and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya*. The moderating effect was determined from model 6 where interactive term was introduced between tax complexity and tax service quality. The beta coefficient for the interactive term was (β= 0.078, ρ>0.05). This suggested that the null hypothesis was rejected, and the study came to the conclusion that among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, tax service quality moderates the association between the likelihood of detection and value-added tax compliance. This suggested that improving tax service quality will improve VAT compliance. This therefore indicated that tax service quality would not have any effect on VAT compliance in cases of tax complexity. Figure 4.8 shows that VAT compliance is low with high tax complexity and low tax service quality.

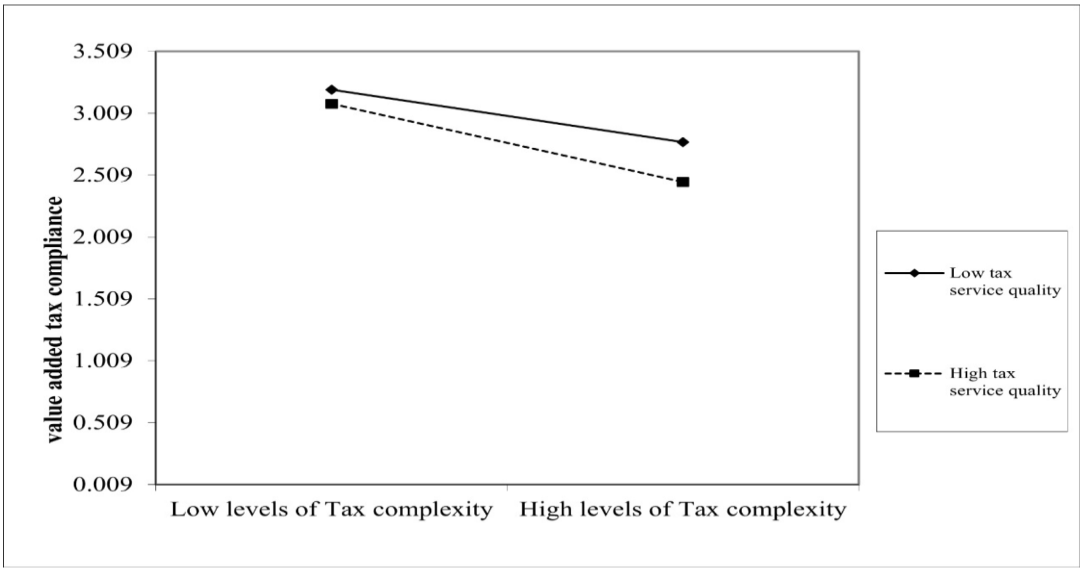

Figure 4.8: Modgraph for tax service quality on tax complexity and value added tax compliance

Source: Research Data (2024)

The null hypothesis (H_{05c}) *tax service quality does not moderate the effect on the relationship between tax penalties and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya*. The moderating effect was determined from model 6 where interactive term was introduced between tax penalties and tax service quality. The beta coefficient for the interactive term was (β= 0.094, ρ<0.05). This suggested that the null hypothesis was rejected, and the study came to the conclusion that tax service quality moderates the association between tax fines and compliance with value-added tax among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County. This therefore indicated that tax service quality would enhance VAT compliance. Figure 4.9 shows that VAT compliance is high with high tax penalties and high tax service quality.

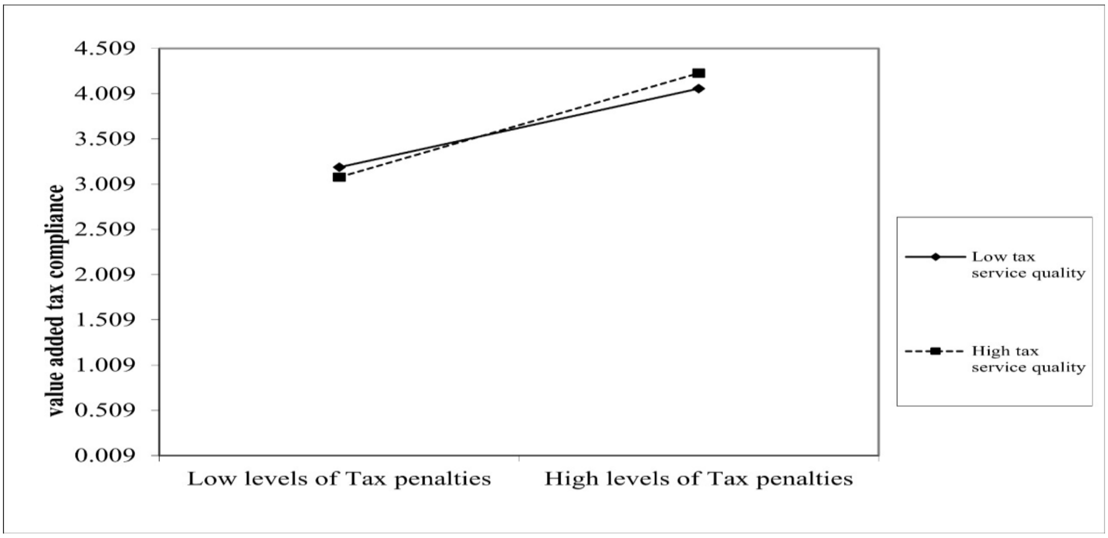

Figure 4.9: Modgraph for tax service quality on tax penalties and value added tax compliance

Source: Research Data (2024)

The null hypothesis (H_{05d}) *tax service quality does not moderate the effect on the relationship between cost of compliance and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya*. The moderating effect was determined from model 6 where interactive term was introduced between cost of compliance and tax service quality. The beta coefficient for the interactive term was (β= -0.052, ρ>0.05). This indicated that the study did not reject the null hypothesis and the study concluded that tax service quality does not moderate the relationship between cost of compliance and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. This therefore indicated that tax service quality would not have any effect on VAT compliance in cases of high cost of compliance. Figure 4.10 shows that VAT compliance is low with high cost of compliance and low tax service quality.

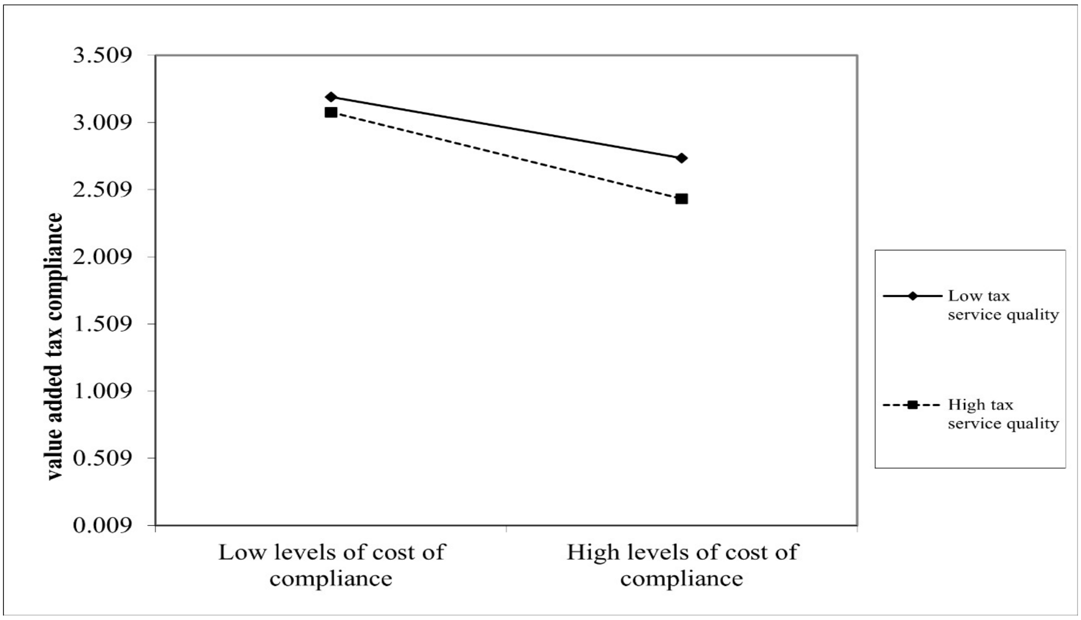

Figure 4.10: Modgraph for tax service quality on cost of compliance and value added tax compliance

Source: Research Data (2024)

Table 4.17: Summary hierarchical regression results

	Model1	**Model 2**	**Model 3**	**Model 4**	**Model 5**	**Model 6**
	Coef	**Coef**	**Coef**	**Coef**	**Coef**	**Coef**
(Constant)	1.615(0.352) **	1.276 (0.325) **	1.582(0.332) **	3.346(1.097) **	3.406(1.024) **	3.142 (1.034) **
Probability of detection	0.366(0.057) **	0.286(0.054) **	0.21(0.057) **	0.223(0.058) **	0.112(0.057)	0.093(0.058)
Tax complexity	-0.222 (0.072) **	-0.19 (0.066) **	-0.18 (0.065) **	-0.638 (0.279) **	-0.394 (0.264)	-0.445 (0.265)
Tax penalties	0.501 (0.056) **	0.392(0.053) **	0.378(0.052) **	0.374(0.052) **	0.362(0.049) **	0.505(0.101) **
cost of compliance	-0.134 (0.047) * *	-0.188 (0.044) **	-0.195 (0.043) **	-0.198 (0.043) **	-0.301 (0.043) **	-0.303 (0.044) **
Tax service quality		0.332(0.05) **	0.194(0.065) **	-0.303 (0.302)	-0.503 (0.284)	-0.373 (0.294)
Tax service quality *Probability			0.044(0.014) **	0.042(0.014) **	0.081(0.014) **	0.086 (0.015) **
Tax service quality *complexity				0.129(0.076)	0.063(0.072)	-0.078 (0.073)
Tax service quality *penalty					0.092(0.016) **	0.094(0.016) **
Tax service quality *cost						-0.052 (0.032)
R Square	0.619	0.683	0.698	0.702	0.742	0.745
F statistics	86.879	91.923	81.778	71.113	75.354	67.782
P value	0.000	0.000	0.000	0.000	0.000	0.000

( ) standard error; ** Significance level (0.05)

Source: Research Data (2024)

4.8 Discussion of Findings

This study determined the moderating role of tax service quality on the relationship between tax structure and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. The exact objective of this study was to ascertain the impact of tax service quality on the associations between small and medium-sized enterprises in the Westlands Sub County of Nairobi, Kenya, as well as the likelihood of detection, tax complexity, tax penalties and sanctions, costs compliance, and value-added tax compliance.

The first objective was to determine the effect of probability of detection on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya. The findings demonstrated a statistically significant correlation between small and medium-sized businesses' probability of detection and compliance with value-added tax laws in Nairobi, Kenya's Westlands Sub County. This suggests that improving the likelihood of detection will improve SMEs' compliance with VAT. This is explained by the fact that if there is a significant chance of discovery, taxpayers are incentivized to honestly report their income. The likelihood of detection influences and determines how taxpayers report. The results of the study corroborated those of Ortega and Sanguinetti (2013), who discovered that the biggest impact on compliance is achieved by an enforcement message that raises the perceived likelihood of detection. However, the results did not coincide with Sinnasamy and Bidin's (2017) finding that Malaysian excise duty non-compliance is significantly influenced by the probability of discovery.

The second objective was to determine the effect of tax complexity on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya. The findings demonstrated a statistically significant correlation between value added tax compliance and tax complexity for small and medium-sized businesses in Nairobi, Kenya's

Westlands Sub County. The complexity of the tax code may make it more expensive for taxpayers to comply. As a result, there may be less VAT compliance. This suggests that SMEs' VAT compliance would improve if tax complexity were reduced. The results of the study corroborated those of Musimenta (2020), who discovered that tax complexity significantly affects tax compliance in Uganda. The study's conclusions disagreed with those of Octavia and Wangdra (2024), who discovered that taxpayer compliance is unaffected by complexity.

The third objective was to examine the effect of tax penalties on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya. The findings demonstrated a statistically significant correlation between tax fines and SMEs ' compliance with value-added tax in Nairobi, Kenya's Westlands Sub County. This suggests that a higher tax penalty would result in SMEs complying with VAT regulations more effectively. Penalizing tax evaders can make others realize that their tax compliance measures are appropriate and well-informed. Tax evaders who are found face penalties, which incentivize other taxpayers to make sure their actual income is appropriately reported. The study's conclusions concurred with those of Bt-Yunus and Bt-Ramli (2017), who discovered that tax fines do, in fact, have a major impact on taxpayer compliance behavior. The study's conclusions ran counter to those of Swistak (2016), who contended that while tax penalties are essential for enforcing tax laws, they might not be the best option for guaranteeing tax compliance.

The fourth objective was to establish the effect of cost of compliance on value added tax compliance among SMEs in Westlands Sub County, Nairobi, Kenya. The findings demonstrated a statistically significant correlation between SMEs in Nairobi, Kenya's Westlands Sub County and their cost of compliance with regard to value added tax compliance. The high cost of compliance in Kenya, which raises the cost of doing business and has a negative effect on VAT compliance, may be the cause of the negative correlation between the cost of compliance and VAT compliance. The study's conclusions concurred with those of Abdul and Wang'ombe (2018), who found that rising tax compliance expenses considerably reduces tax compliance in Kenya.

The fifth objective was to assess whether tax service quality moderate the relationship between probability of detection and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. The research findings indicate that the quality of tax services provided to small and medium-sized enterprises in Westlands Sub County, Nairobi, Kenya, influenced the relationship between value-added tax compliance punishments, tax penalties, and the likelihood of detection. The quality of tax services had no moderating effect on the relationship between the cost of compliance and tax problems and value-added tax compliance in small and medium-sized firms in Westlands Sub County, Nairobi, Kenya. The study's findings supported those of Susuawu, Ofori-Boateng, and Amoh (2020), who found that assurance, empathy, responsiveness, and reliability had statistically significant positive effects on SMEs' tax compliance behavior.

Table 4.18: Summary of Hypotheses Testing

Hypothesis	P-Value	Decision
H_{01}: probability of detection has no statistically significant effect on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya	0.000	Reject
H_{02}: tax complexity has no statistically significant effect on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya	0.002	Reject
H_{03}: tax penalty has no statistically significant effect on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya	0.000	Reject
H_{04}: cost of compliance has no statistically significant effect on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya.	0.005	Reject
H_{05a}: probability of detection and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya	0.000	Reject
H_{05b}: tax complexity and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya	0.286	Reject
H_{05c}: tax penalty and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya	0.000	Reject
H_{05d}: cost of compliance and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya	0.108	Reject

Source: Field Data, 2024

CHAPTER FIVE

SUMMARY, CONCLUSION, AND RECOMMENDATIONS

5.1 Introduction

The study main objective was to examine the moderating role of tax service quality on the relationship between tax structure and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. More specifically, this study sought to establish the effect of probability of detection, tax complexity, tax penalty and sanctions, costs compliance and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya.

5.2 Summary of Study

This section contained the summary of the study findings. This was done per objectives

5.2.1 Probability of Detection and VAT compliance

The first objective was to determine the effect of probability of detection on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. According to the findings, the majority of respondents thought there was a good chance that VAT non-compliance would be discovered ($\beta=0.358$, $p=0.000$). The majority of respondents to the study expressed confidence in the procedures in place to monitor VAT compliance and identify non-compliance, according to the study's findings. The majority of respondents, as indicated by the results, also believed that taxpayers are encouraged to comply with VAT regulations because of the possibility of being identified. The majority of respondents concurred, according to the data, that there is a high chance of getting discovered evading taxes.

According to regression analysis, SMEs' VAT compliance was positively and significantly impacted by the likelihood of discovery ($\beta=0.358$, $p=0.000$). The hypothesis results additionally demonstrated that among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, there was a statistically significant association between the chance of detection and value-added tax compliance.

5.2.2 Tax Complexity and VAT compliance

The second objective was to determine the effect of tax complexity on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. The majority of respondents, according to the results, agreed that VAT law and regulation are unduly complicated. The majority of respondents agreed, according to the results, that figuring out how much VAT is owed is challenging. The majority of respondents, according to the results, also agreed that changes in VAT law and regulation occur regularly. Additional results showed that most respondents agreed that it is simple to fill out VAT documents, such as returns.

According to regression analysis, SMEs' VAT compliance was significantly and negatively impacted by tax complexity ($\beta=-0.131$, $p=0.001$). The hypothesis results additionally demonstrated that among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, there was a statistically significant association between tax complexity and value-added tax compliance.

5.2.3 Tax Penalties and Sanctions and VAT compliance

The third objective was to determine the effect of tax penalty and sanctions on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. The majority of respondents, according to the results, agreed that this business faces very harsh penalties for failing to pay VAT. The majority of respondents agreed, according to the results, that late VAT payments can result in harsh penalties.

Additional findings revealed that most respondents thought there was little chance of being discovered evading taxes. Furthermore, the majority of respondents believed, according to the results, that the possibility of fines and penalties motivates them to abide by the VAT law.

The findings of the regression analysis indicated that tax penalties had a substantial and favorable impact on SMEs' compliance with VAT (β=0.500, p=0.000). The hypothesis results additionally demonstrated that among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, there was a statistically significant association between tax fines and value-added tax compliance.

5.2.4 Costs of Compliance and VAT compliance

The fourth objective was to determine the effect of costs of compliance on value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. The majority of respondents, according to the results, agreed that the expense of engaging qualified tax agents is high for the company. The results also made it evident that most respondents thought it was costly to store records for five years. Subsequent findings revealed that most respondents felt that the owners are deterred from meeting their VAT duties by the cost of compliance. Furthermore, the majority of respondents agreed, according to the results, that SMEs would comply voluntarily if the costs of compliance were fair.

The findings of the regression analysis indicated that SMEs' VAT compliance was significantly and negatively impacted by their compliance costs (β=-0.134, p=0.005). The hypothesis results additionally demonstrated that among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, there was a statistically significant association between tax fines and value-added tax compliance.

5.2.5 Tax structure, Tax Service Quality and Value Added Tax Compliance

The results showed that majority of the respondents agreed that tax officials approach their job with professionalism and dedication. The results also indicated that most respondents agreed that timely and efficient tax services are provided. The majority of respondents, according to the results, felt that tax staff members are kind, kind, and have a respect for businesses. Furthermore, the majority of respondents stated, according to the results, that the tax authority's tax assistance application system's issues are routinely resolved on time.

The study's findings also demonstrated a favorable and significant relationship between SMEs' VAT compliance and the quality of their tax services. Furthermore, among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, the relationship between the likelihood of discovery ($\beta = 0.086$, $\rho < 0.05$) and the tax penalty and sanctions ($\beta = 0.094$, $\rho < 0.05$) on value-added tax compliance is moderated by the quality of tax services. In Westlands Sub County, Nairobi, Kenya, small and medium-sized businesses, the relationship between the cost of compliance ($\beta = -0.078$, $\rho > 0.05$) and tax complexity ($\beta = -0.052$, $\rho > 0.05$) and value-added tax compliance is not mitigated by the quality of tax services.

5.3 Conclusions

The study came to the conclusion that SMEs' VAT compliance was positively and significantly impacted by probability of detection. When it comes to VAT compliance, the likelihood of discovery is important because taxpayers will appropriately report their taxes if they believe they will be inspected in a given year. Additionally, tax payer compliance rises when they have faith in the procedures in place to track VAT compliance and identify non-compliance.

The study also found that SMEs' VAT compliance was significantly and negatively impacted by tax complexity. As a result, a simpler and less complicated tax self-assessment system increases the acceptable level of tax compliance among taxpayers. The majority of small and medium-sized business taxpayers have a mediocre comprehension of their tax responsibilities, especially when it comes to completing tax returns and doing various tax computations on their own without help.

Furthermore, the study found that tax penalties had a favorable and noteworthy impact on SMEs' compliance with VAT. As tax penalties do incentivize small business owners to pay taxes on time, they may provide a remedy for taxpayers who break tax laws. Owners of SMEs are more inclined to abide by VAT laws and regulations if they are aware that paying VAT after the deadline will result in harsh penalties.

The study found that SMEs' VAT compliance was significantly and negatively impacted by the cost of compliance. In the Wetlands sub county, it was discovered that compliance expenses were a significant factor in small- and medium-sized businesses' VAT compliance. The research concludes that having a straightforward and affordable system for VAT compliance increases VAT compliance automatically because it incentivizes traders to comply with tax body requirements. This is because taxpayers are naturally inclined to invest time and employ professional skills to meet their VAT compliance obligations.

Furthermore, the study found that among small and medium-sized businesses in Nairobi, Kenya's Westlands Sub County, tax service quality moderated the relationship between the likelihood of detection, the tax penalty, and the sanctions on value-added tax compliance. The quality of tax services had no moderating effect on the relationship between the cost of compliance and tax problems and value-added tax compliance in small and medium-sized firms in Westlands Sub County, Nairobi, Kenya. When promises in the areas of equality, equity, loyalty, and accountability are upheld for balance, the quality of tax services will be more effective and efficient, which will motivate SMEs to achieve VAT compliance.

5.4 Recommendations

5.4.1 Theoretical recommendations

According to the notion of economic deterrence, the goal of all government initiatives, including fines, penalties, automation of systems, and other deterrent measures, is to increase compliance. Automation must, however, be easy to use, straightforward, and capable of doing its intended task with the least amount of work. For these reasons, the study suggests that in order to increase compliance, tax authorities should deliberately work to guarantee that automated solutions for compliance are reasonably priced, easy to use, and understand.

According to the theory of planned behavior, a person's intentions and behavior should work together to establish the appropriate ways for them to participate in an activity or not. It emphasizes how societal pressures and a logic of control, in addition to specific transgressions, shape people's behaviors. SMEs in the Westlands subcounty may have opinions that are influenced by how fair they think the tax system is, how much they feel like they have control over their tax-paying behavior, and what they think their significant others expect of them in terms of tax compliance. Reducing the administrative load and uncertainty related to taxes is something that high-quality institutions can do, which will have a good effect on SMEs' intentions and real compliance.

5.4.2 Policy recommendations

The study first recommends simplification of the tax structure as the study highlighted the significant positive effect of tax complexity on Value Added Tax compliance. Therefore, policymakers should strive to simplify the tax structure, making it more transparent and easily understandable for SMEs. Clear and straightforward tax regulations will help reduce confusion and enhance compliance among taxpayers. Simplification measures may include providing clear guidelines, streamlining tax forms and procedures, and minimizing unnecessary complexities in the tax system

In order to improve compliance among SMEs, tax authorities should develop new audit detection technologies that will raise the rate probability of audit detection. To encourage tax payers to comply with VAT, the tax authorities ought to raise the audit rate and the likelihood of audit discovery.

Medium-level taxpayers must comprehend why they pay or should pay taxes in order to deal with voluntary tax payment compliance. Taxpayers should be made aware of the value of filing their taxes by the government. Furthermore, in order to prevent taxpayers from feeling as though their money is being misappropriated, it is advised that the government maintain openness on the use of tax funds.

The penalties must be applied carefully and sensibly even though they are required to force taxpayers to pay their taxes on time. particularly with regard to small companies that are already making an effort to act morally. Policies that facilitate compliance for small business owners and awareness, training, and instructional programs must be implemented in addition to these sanctions.

The research further argues that as the government depends on revenue to carry out its economic and development goals, taxpayers should not be burdened with the responsibility of complying with applicable tax laws and regulations, as this could lead to an increase in non-compliance. As a result, the tax authority has to make sure that taxpayers incur the fewest possible expenses for compliance.

As explicitly mentioned in the corporate strategy, the government should work to offer SME owners in Nairobi's Westlands Sub County high-quality services, such as those at the tax stations, to lessen the need to pay for the services of qualified individuals like tax consultants. VAT compliance would increase as a result.

In addition, the tax authority should invest more on tax service quality to increase compliance levels of SMEs as well as taxpayers dwelling in other tax regions with similar features as SMEs. Both tax authorities and taxpayers must steadfastly uphold this obligation. Tax officers are required to uphold their code of ethics in the service of taxpayers.

5.4.3 Managerial recommendations

SMEs in this area ought to spend money on tax education and streamlining compliance processes. Since perceived tax complexity can affect compliance, small and medium-sized enterprises (SMEs) should teach their finance staff or hire tax professionals to assist them in managing the complexities of the tax system. Additionally, the seeming complexity can be lessened by increasing transparency and efficient communication with tax authorities, as well as by clarifying tax regulations and procedures. Additionally, the government should keep working with business associations to streamline the tax code in order to significantly lower its complexity.

In view of the fines and penalties associated with taxes, SMEs should emphasize the need of adhering to internal controls and monitoring systems. Putting in place strong internal auditing procedures can assist in locating and resolving such non-compliance problems before they become more serious. SMEs should also keep thorough and precise financial records, as this might help them avoid penalties down the road. A more effective deterrent to non-compliance can be achieved by SMEs by making sure that deterrence measures are applied consistently and equitably.

5.5 Limitations of the Study

While this study sheds light on the influence of tax structure on Value Added Tax compliance, it's crucial to acknowledge its limitations, which may arise from the study's approach and the broad generalizations it makes. Since the research concentrated solely on SMEs in Westlands sub-county, its findings might not be easily generalized to the rest of the country. The SMEs in this specific region might be shaped by unique cultural, informational, and infrastructural factors that differ from those in other areas.

Moreover, the study's reliance on self-reported data collected via questionnaires presents a risk of response bias, as respondents may provide socially desirable answers or inaccurately reflect their behavior. Despite efforts to ensure the questionnaires were valid and reliable, the potential for measurement errors or bias remains, potentially affecting the outcomes. Future research might benefit from incorporating different data collection methods, such as interviews or observations, to complement self-reported data and improve the validity of the findings.

Additionally, the study focused largely on how tax structure affects Value Added Tax compliance, without thoroughly considering other factors that might influence taxpayer behavior. Numerous variables, including tax rates, perceived fairness, enforcement tactics, and the involvement of tax officials, could play a significant role in determining taxpayers' willingness and ability to comply with tax laws.

5.6 Suggestions for Further Studies

The study focused on moderating role of tax service quality on the relationship between tax structure and value added tax compliance among small and medium enterprises in Westlands Sub County, Nairobi, Kenya. The study therefore only focused on tax service quality as a moderator. There is a need to study other factors as moderators to value added tax compliance. Additionally, it only focused on probability of detection, tax complexity, tax penalties and sanctions and costs of compliance as variables of the tax structure. More studies need to be done on other variables of the tax structure such as tax rates, taxpayer education and tax procedures. Also, the study focused on Value Added Tax compliance. There is the need for studies on other tax heads such as PAYE, Rental taxes and turnover tax. Finally, the study was done in Westlands Sub County, Nairobi, Kenya and thus the need for a study in other parts of Nairobi such as Kamukunji, Mathare and Kasarani for purposes of making comparison with the current study.

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APPENDICES

Appendix I: Letter of Introduction

Dear Respondent,

REF: REQUEST TO PARTICIPATE IN DATA COLLECTION

My name is Davies Kipkosgei Kirwa, I am currently undertaking a research study entitled **TAX STRUCTURE, TAX SERVICE QUALITY AND VALUE ADDED TAX COMPLIANCE AMONG SMALL AND MEDIUM ENTERPRISES IN WESTLANDS SUBCOUNTY, NAIROBI, KENYA,** as a minimum requirement for the award of a Masters Degree in Tax and Customs Administration at Moi University. Kindly take around 15-20 minutes to fill in this questionnaire and any information you will provide will only be used for academic purpose. Thank you.

Regards,

Davies Kipkosgei Kirwa

Appendix II: Questionnaire

TAX STRUCTURE, TAX SERVICE QUALITY AND VALUE ADDED TAX COMPLIANCE AMONG SMALL AND MEDIUM ENTERPRISES IN WESTLANDS SUBCOUNTY, NAIROBI, KENYA

Instructions:

Kindly take a few minutes and provide relevant response to the following questions:

SECTION A: GENERAL INFORMATION

1. What is your gender?

Male ( ) Female ( )

2. How long has this enterprise been in operations?

Less than 5 years ( ) 6-10 years ( ) 11-15 years ( ) more than 16 years ( )

SECTION B: PROBABILITY OF DETECTION

3. Kindly indicate the extent of your agreement with each of these statements relating to probability of detection (PoD). Use a scale of 1 to 5, where 1-strongly disagree, 2-disagree, 3-neutral, 4-agree and 5-strongly agree.

Code	Statements of probability of detection (PoD)	1	2	3	4	5
PoD 1	I believe there is a significant risk of VAT non-compliance being detected	1	2	3	4	5

PoD 2	I am confident in the systems for monitoring VAT compliance and detecting non-compliance.	1	2	3	4	5
PoD 3	I believe the likelihood of being detected encourages taxpayers to comply with VAT laws	1	2	3	4	5
PoD 4	The likelihood of being caught for tax evasion is high	1	2	3	4	5

SECTION C: TAX COMPLEXITY

5. Kindly indicate the extent of your agreement with each of these statements relating to tax complexity (TC). Use a scale of 1 to 5, where 1-strongly disagree, 2-disagree, 3-neutral, 4-agree and 5-strongly agree.

Code	**Statements of tax complexity (TC)**	**1**	**2**	**3**	**4**	**5**
TC 1	VAT law and regulation is overly complex	1	2	3	4	5
TC 2	It is difficult to compute the amount of VAT payable	1	2	3	4	5
TC 3	VAT law and regulation changes frequently	1	2	3	4	5
TC 4	VAT forms e.g returns are easy to fill	1	2	3	4	5

SECTION D: TAX PENALTIES AND SANCTIONS

6. Kindly indicate the extent of your agreement with each of these statements relating to tax penalties and sanctions (TPS). Use a scale of 1 to 5, where 1-strongly disagree, 2-disagree, 3-neutral, 4-agree and 5-strongly agree.

Code	Statements on penalties and sanctions	**1**	**2**	**3**	**4**	**5**
TPS 1	The penalties for nonpayment of VAT are very severe for this enterprise	1	2	3	4	5
TPS 2	Late payment of VAT can attract severe penalties	1	2	3	4	5
TPS 3	The likelihood of being caught for tax evasion is small	1	2	3	4	5
TPS 4	The likelihood of penalties and sanctions encourage me to comply with the VAT law.	1	2	3	4	5

SECTION E: COST OF COMPLIANCE

7. Kindly indicate the extent of your agreement with each of these statements relating to cost of compliance (CoC). Use a scale of 1 to 5, where 1-strongly disagree, 2-disagree, 3-neutral, 4-agree and 5-strongly agree.

Code	Statements on cost of compliance (CoC)	**1**	**2**	**3**	**4**	**5**
CoC 1	Cost of hiring professionals tax agents is expensive to the firm	1	2	3	4	5

CoC 2	Record keeping for 5 years is expensive to maintain	1	2	3	4	5
CoC 3	The burden of compliance costs discourages the owners to fulfil VAT obligations	1	2	3	4	5
CoC 4	Reasonable compliance costs would increase voluntary compliance among SMEs	1	2	3	4	5

SECTION F: TAX SERVICE QUALITY

8. Kindly indicate the extent of your agreement with each of these statements relating to tax service quality (TSQ). Use a scale of 1 to 5, where 1-strongly disagree, 2-disagree, 3-neutral, 4-agree and 5-strongly agree.

Code	**Statements on tax service quality (TSQ)**	**1**	**2**	**3**	**4**	**5**
TSQ 1	Tax officials approach their job with professionalism and dedication	1	2	3	4	5
TSQ 2	Tax service is delivered quickly and timely	1	2	3	4	5
TSQ 3	Tax staffs have a polite, friendly, proper communication attitude and respect for businesses	1	2	3	4	5
TSQ 4	The problems related to the tax support application system of the tax authority are regularly overcome in time	1	2	3	4	5

SECTION G: VALUE ADDED TAX COMPLIANCE

9. Kindly indicate the extent of your agreement with each of these statements relating to value added tax compliance (VATC). Use a scale of 1 to 5, where 1-strongly disagree, 2-disagree, 3-neutral, 4-agree and 5-strongly agree.

	Statements on value added tax compliance (VATC)	**1**	**2**	**3**	**4**	**5**
VATC 1	I am registered for VAT purposes	1	2	3	4	5
VATC 2	I submit my VAT returns on time	1	2	3	4	5
VATC 3	I pay my VAT taxes on time	1	2	3	4	5
VATC 4	I have been charged late payment penalties and interests in the past	1	2	3	4	5

THANK YOU

Appendix III: SPSS output

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	141.822	4	35.455	86.879	.000[b]
	Residual	87.334	214	.408		
	Total	229.155	218			

a. Dependent Variable: Average_VAT

b. Predictors: (Constant), Average_cost_of_compliance, Average_Tax_penalties, Average_Tax_complexity, Average_Probability_of_detection

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.615	.352		4.594	.000
	Average_Probability_of_detection	.366	.057	.358	6.409	.000
	Average_Tax_complexity	-.222	.072	-.131	-3.081	.002
	Average_Tax_penalties	.501	.056	.500	9.005	.000
	Average_cost_of_compliance	-.134	.047	-.121	-2.846	.005

a. Dependent Variable: Average_VAT

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	156.588	5	31.318	91.923	.000[b]
	Residual	72.568	213	.341		
	Total	229.155	218			

a. Dependent Variable: Average_VAT

b. Predictors: (Constant), Average_TSQ, Average_Tax_complexity, Average_cost_of_compliance, Average_Probability_of_detection, Average_Tax_penalties

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.276	.325		3.923	.000
	Average_Probability_of_detection	.286	.054	.279	5.332	.000
	Average_Tax_complexity	-.190	.066	-.112	-2.877	.004
	Average_Tax_penalties	.392	.053	.392	7.343	.000
	Average_cost_of_compliance	-.188	.044	-.170	-4.292	.000
	Average_TSQ	.332	.050	.312	6.583	.000

a. Dependent Variable: Average_VAT

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	156.588	5	31.318	91.923	.000[b]
	Residual	72.568	213	.341		
	Total	229.155	218			

a. Dependent Variable: Average_VAT

b. Predictors: (Constant), Average_TSQ, Average_Tax_complexity, Average_cost_of_compliance, Average_Probability_of_detection, Average_Tax_penalties

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.276	.325		3.923	.000
	Average_Probability_of_detection	.286	.054	.279	5.332	.000
	Average_Tax_complexity	-.190	.066	-.112	-2.877	.004
	Average_Tax_penalties	.392	.053	.392	7.343	.000
	Average_cost_of_compliance	-.188	.044	-.170	-4.292	.000
	Average_TSQ	.332	.050	.312	6.583	.000

a. Dependent Variable: Average_VAT

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	Average_TSQ, Average_Tax_complexity, Average_cost_of_compliance, Average_Probability_of_detection, Average_Tax_penalties[b]	.	Enter
2	TSQ*1, TSQ*3, TSQ*4, TSQ*2[b]	.	Enter

a. Dependent Variable: Average_VAT

b. All requested variables entered.

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	156.588	5	31.318	91.923	.000[b]
	Residual	72.568	213	.341		
	Total	229.155	218			
2	Regression	170.680	9	18.964	67.782	.000[c]
	Residual	58.476	209	.280		
	Total	229.155	218			

a. Dependent Variable: Average_VAT

b. Predictors: (Constant), Average_TSQ, Average_Tax_complexity, Average_cost_of_compliance, Average_Probability_of_detection, Average_Tax_penalties

c. Predictors: (Constant), Average_TSQ, Average_Tax_complexity, Average_cost_of_compliance, Average_Probability_of_detection, Average_Tax_penalties, TSQ*1, TSQ*3, TSQ*4, TSQ*2

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.276	.325		3.923	.000
	Average_Probability_of_detection	.286	.054	.279	5.332	.000
	Average_Tax_complexity	-.190	.066	-.112	-2.877	.004
	Average_Tax_penalties	.392	.053	.392	7.343	.000
	Average_cost_of_compliance	-.188	.044	-.170	-4.292	.000
	Average_TSQ	.332	.050	.312	6.583	.000
2	(Constant)	3.142	1.034		3.040	.003
	Average_Probability_of_detection	.093	.058	.091	1.592	.113
	Average_Tax_complexity	-.445	.265	-.264	-1.682	.094
	Average_Tax_penalties	.505	.101	.504	4.989	.000
	Average_cost_of_compliance	-.303	.044	-.275	-6.931	.000
	Average_TSQ	-.373	.294	-.350	-1.266	.207
	TSQ*1	.086	.015	.438	5.839	.000
	TSQ*2	.078	.073	.327	1.071	.286
	TSQ*3	.094	.016	.438	5.758	.000
	TSQ*4	-.052	.032	-.298	-1.613	.108

a. Dependent Variable: Average_VAT

Appendix IV: KESRA Introduction letter

KENYA REVENUE AUTHORITY

PUBLIC

ISO 9001:2015 CERTIFIED

KENYA SCHOOL OF REVENUE ADMINISTRATION

REF: KESRA/NBI/036

9th August 2024

TO: WHOM IT MAY CONCERN

Dear Sir/Madam,

RE: REQUEST FOR ASSISTANCE TO DAVIES KIRWA OF REGISTRATION NO.: KESRA105/0077/2020 UNDERTAKING MASTERS AT KESRA

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

The named student is undertaking Research on TOPIC: **"Tax structure, tax service quality and value added tax compliance among small and medium enterprises in Westlands sub county, Nairobi, Kenya."**

The purpose of this letter is to request for your kind facilitation in enabling the student progress in his research project by allowing access to any relevant information and/or conduct interviews, which are relevant to the project.

Your support to the student in this regard will be highly appreciated.

Thank you

KENYA SCHOOL OF REVENUE ADMINISTRATION
DEAN OF STUDIES
09 AUG 2024

Dr. Marion Nekesa
For: Manager Academic Research

Tulipe Ushuru, Tujitegemee!

Appendix V: NACOSTI License

REPUBLIC OF KENYA

NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION

Ref No: **554190**

Date of Issue: **12/August/2024**

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This is to Certify that Mr.. Davies Kipkosgei Kirwa of Moi University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Nairobi on the topic: TAX STRUCTURE, TAX SERVICE QUALITY AND VALUE ADDED TAX COMPLIANCE AMONG SMALL AND MEDIUM EMTERPRISES IN WESTLANDS SUBCOUNTY, NAIROBI, KENYA for the period ending : 12/August/2025.

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Appendix VI: Plagiarism Awareness Certificate

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THESIS WRITING COURSE

PLAGIARISM AWARENESS CERTIFICATE

This certificate is awarded to

DAVIES KIPKOSGEI KIRWA

KESRA105/0077/2020

In recognition for passing the University's plagiarism

Awareness test for Thesis **entitled: TAX STRUCTURE, TAX SERVICE QUALITY AND VALUE ADDED TAX COMPLIANCE AMONG SMALL AND MEDIUM ENTERPRISES IN WESTLANDS SUBCOUNTY, NAIROBI, KENYA** similarity index of 9% and striving to maintain academic integrity.

Word count:20032

Awarded by

Prof. Anne Syomwene Kisilu

CERM-ESA Project Leader Date: 20/09//2024