

Effects of iTAX System on Compliance of VAT Payments by SMEs in Kenya: A Case Study of Wote Town in Makueni County, Kenya

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Abstract: The Kenya Revenue Authority (KRA) recently made changes from the integrated tax system to the iTAX system aimed at encouraging use of the internet to file taxes so as to boost tax compliance and revenue collection. The objective of this study was to determine the effects of iTAX on VAT Compliance on SMEs in Wote town, Makueni County, Kenya. The specific objectives of the study were, To determine how registration of VAT taxpayers using itax affect VAT compliance, and whether ICT knowledge on Wote town taxpayer has effect on VAT compliance. The target population of this study composed of 581 SMEs taxpayers from Wote Town of Makueni County. The researcher used Radom sampling method to pick a sample of 120 VAT taxpayers the response rate was 87. Both primary and secondary data was used. The data collected was analyzed using ordinary linear regression model. The study found out that majority of the respondents had registered as taxpayers with most of them having registered for VAT and income tax. Majority of the respondents had registered as taxpayers since 2014 with a higher percentage in 2016. Non registered respondents cited lack of information on when and where to register, too lengthy registration process and KRA offices being located far from Wote town. Registered respondents of Itax and integrated tax system cited less cost, simplicity and time required as benefits of filling VAT returns online and that the respondents had minimal ICT knowledge. The study concluded that registration of VAT taxpayers using Itax enhances revenue collection by KRA. It also enhances the SMEs level of understanding on KRA tax systems. This enhances tax compliance among taxpayers and reduces possible avenues for tax evasion. The study recommends that KRA should address the complexities of annual tax returns, periodic variations in the tax laws, and levels of penalties and fines. It also recommends that the Government should ensure provision of high speed internet facilities in the rural towns to facilitate the filling or online tax returns.

Keywords: Kenya Revenue Authority (KRA), ICT knowledge, VAT.

1. INTRODUCTION

1.1 Background:

One of the responsibilities of any Government is to finance public services. Therefore the taxation system in place must yield enough revenue collection. Tax is the main source of revenue to any Government with the common types of taxes being Income tax, VAT, Customs and Excise duties. Income tax yields the highest Kenya's revenue, VAT being the second most widely based tax as it covers all Vatable goods and services in Kenya (Osambo, 2009). According to Marina and Kilis (2002) taxation is the known practical sources of public finance in many economies, besides other sources like non-tax revenue such as user-fees and licenses charged for services rendered by government departments and agencies and foreign aid.

I -Tax is a web-based system developed to simplify revenue collection by allowing taxpayers to simply update their tax registration details, file tax returns using Microsoft Excel or Open Office, register all tax payments and make status enquiries with real-time monitoring of their ledger/account. In Kenya the system was established to help simplify

taxpayers' registration and as well enable them to file returns from wherever they are. iTax aims to end the reliance on the old web-based system which was tedious to use and still had manual processes for taxpayers to follow up unlike this automatic iTax system (<http://techmoran.com/kenya-revenue-authority-launches-its-itax-system-countrywide-to-simplify-tax-collection>). According to Karingi (2005). The non-compliance of VAT payment is caused by; lack of integrated registration system that can capture all the VAT tax payer, lack of a verification system of VAT tax liabilities as per the registered VAT tax payers database on real time processing and Lack of a system that undertakes real time audits on the filed returns and the identification of the unfilled returns.

According to Simiyu (1999) a good taxation system should be fair, efficient, economical, and transparent. Further the tax systems should create a virtuous circle of improving fiscal performance, good governance, fair distribution of public goods and services, and ultimately strengthens state legitimacy. All over the world, taxation is one of the government policy instruments used to achieve equity and efficiency in the economy (Jackson & Mckee, 1992). Treasury gave KRA a target of Sh817.5 billion for the year 2012/2013 but halfway through the period, the taxman had not even managed to collect 50 per cent of that amount (2012/2013 budget report). A modern, efficient, and transparent tax administration is one of the keys to overall state performance. A tax system should be based on the principles of equity, progressivity, simplicity and efficiency. Efficient internal revenue collection is a major step towards self-sufficiency and independence. To realize this goal, Developing Countries (DC) have a difficult starting position. Kenya is ranked among low compliance countries with hard task of ensuring efficient and effective tax administration. KRA performs monthly taxpayer education to all newly registered taxpayers in a bid to improve tax compliance. Over time, Kenya has moved from being a low tax burden country to a high tax burden country, yet the country faces the obvious need for more tax revenues to maintain public services. It's in the light of low revenue collections even with reforms of tax systems through introduction of Electronic Tax Register (ETR), Electronic Signature Devices, Personal Identification Number (PIN), Integrated Tax Management System (ITMS), Integrated Tax Administration System, electronic Online Tax Filing Returns as well as others, improvements yet to fully achieve Vat tax compliance system is a challenges. To solve this problem the Kanya Government adopted the itax system. (Kenya Revenue Authority Reforms and modernization programs, 2005)

The tax system should promote compliance with tax, trade, and border legislation and regulation by promoting the standards set out in the Taxpayers Charter and responsible enforcement by highly motivated and professional staff thereby maximizing revenue collection at the least possible cost for the socio-economic well being of Kenyans (KRA Annual Report, 2012). Non-compliance is the intentional failure by citizens to declare their taxable activities. It takes several forms such as concealing taxable activities, filling false returns and generally failing to adhere to the laid regulations concerning declaration and submission of returns. (Myles, 1995), but can be reduced by audits (KRA Annual Report, 2014/2015). Non-compliance among business firms is critical and therefore the greatest challenge towards realization of revenue collection targets by government. The tax legislation in Kenya is quite punitive with regards to issues of non-compliance. A case in point is that of installment taxes. Non-payment or underpayment of installment taxes attracts a penalty of 20% .If the penalty as well as the principal is not settled by the fourth month following the financial year end of the company, then an additional 2% accrues on a monthly basis on the amount of tax that was due (Cap 470 sec 72).

The role of itax is to encourage use of the internet to file taxes so as to boost tax compliance and revenue collection. The key change is that now all taxpayers will be required to only use their PIN numbers when submitting returns for PAYE, Excise and VAT. Further the system allows taxpayers to authenticate information such as Personal Identification Number (PIN) or Tax Compliance Certificate (TCC) hence distinguishing fake information from what is genuine. Lastly itax system allows users to apply for their KRA TAX PIN and to apply for a tax compliance certificate or file VAT, Income Tax, PAYE and Standards levy for Kenya bureau of standard (KBS) (KRA public notice on itax system 24th February, 2014).

The Kenya Revenue Authority (KRA) recently made changes from the integrated tax system to the iTax system aimed at encouraging use of the internet to file taxes so as to boost tax compliance and revenue collection. The key change is that now all taxpayers will be required to only use their PIN numbers when submitting returns for PAYE, Excise and VAT. KRA realized that Kenyans are notorious for avoiding paying taxes and decided to leverage on technology to make it easier for people to be tax compliant. Since itax allows the tax payer use PIN numbers this makes the tax payer more compliant. The system allows taxpayers to authenticate information such as Personal Identification Number (PIN) or Tax Compliance Certificate (TCC) hence distinguishing fake information from what is genuine. The iTax system is used to collect taxes on three types of income-employment income, business income and rental income. iTax allows users to apply for their KRA TAX PIN, check certificate, generate e-slip, file their returns electronically, view tax payers ledger,

check status and as well apply for a tax compliance certificate or file VAT, Income Tax, PAYE and Standards levy for Kenya bureau of standard (KBS) (KRA public notice on itax system, 24th February 2014). IMF Working Paper Managing Income Tax Compliance by Okello (2013) says “Experience shows that voluntary compliance is best achieved through a system of self-assessment”. Therefore itax system allows self assessment hence leading to tax compliance.

According to the World Bank(2007), SMEs includes those enterprise they are either a formally registered business, with an annual turnover of between Kenya shillings eight to one hundred millions at an asset base of at least 4 million are employ between five and one fifty employees. While in Kenya session paper number three of 2004, defines SMES as an enterprise with between one to fifty employees, the SME bill 2011 defines SME based on the number of people and employees and the company’s annual turnover. Like any other profit generating enterprises, SMEs are also expected to pay their taxes, but however their concern is how much tax should they be levied. SMEs are volatile establishments that need special treatment. Most of them remain in the informal sector because they feel the cost of compliance. This means that a good number of SMEs get away with not paying their taxes. This therefore is a situation that needs to be corrected given that their overall tax revenue contribution hardly goes beyond five percent of total tax collection (Mutua, 2011).

The SMEs in Kenya are characterized by the ease of entry and exit, the small scale nature of activities, self-employment with a high proportion of family workers and apprentices, the little amount of capital and equipment, their labor intensive technology, the low level of skills, the low level of organization with little access to organized markets, the unregulated and competitive markets, the limited access to formal credit, the low levels of education and training and the limited access to services and amenities (Waweru, 2007). It is expected that by the year 2030, Kenya would have been transformed into a newly industrialized nation. If the country has to make this leap, then the small enterprises are expected to play a key role in this transformation. To play this role, the small enterprises must succeed and the failure rate characterizing the sector be minimized if not abolished (Wanjiku, 2009).

Despite the increasing importance of the SMEs in every sector of the Kenyan economy, Waweru (2007) points out that the current taxation policy towards the SMEs that involves advance tax on Passenger Service and Commercial Vehicles, The Unified Tax System (UTS) which caters for licensing fees and tax liabilities that a business entity is required to pay periodically, usually one year and the Turnover Tax (TOT) have not yielded much as the revenues are poor and decreasing with time. Kenya’s tax system has performed better than average for Africa in the past three decades. In 1989/90, Kenya’s tax revenue collection was 23.3% of GDP. Revenue collection peaked in 1995/96 at 30.4% of GDP, and thereafter, declined to 20.5% of GDP in 2002/03, before increasing to 22.0% in 2007/08 (IMF, 2008).

Empirical analysis by Muriithi and Moyi (2003) suggest that tax reforms in Kenya under the Tax Modernization Program have led to improved productivity of direct taxes. In particular, administrative reforms aimed at eliminating avenues for tax evasion and corruption. However, Kenya’s performance effectiveness indicators suggest that whilst the tax effort is high, there is potential to increase tax revenue collection as a percentage of GDP by reducing the tax gap. A new tax was designed to bring over 52,000 of the total 66,000 who were exempted by the VAT into the tax net. The 52,000 were those having turnovers falling below Kshs.5 million. The Finance Act of 2007 named the tax as turnover tax (Waweru, 2007).

1.2 Statement of the problem:

Itax is a new concept in the tax administration in Kenya; this was introduced by an amendment of the manual payment procedure to the itax system through the KRA Quarterly communications paper Dated 11th November 2013. The paper introduced itax system of filling the tax returns. Being a new tax filing system there are scanty research on itax systems in Kenya relevant to this study. For example study on Challenges affecting collection of turnover tax by Simiyu (2010), found that the SMEs most strongly felt that the mode of payment of the turnover tax was time consuming and tedious and that they encountered problems when filing turnover tax returns. However, the frequency of filing tax returns was not viewed as having an effect on turnover tax collection. The SMEs indicated that they did not understand their obligations and the tax office did not value feedback about the way the tax system was which greatly affected turnover tax collection. This therefore creates a research gap in the tax arena. Further tax evasion and avoidance as well as low compliance remains high, in Kenya with a tax gap of about 35% and 33.1% in 2000/1 and 2001/2 respectively (KIPPRA, 2004a). The tax code is still complex and cumbersome, characterized by uneven and unfair taxes, a narrow tax base with very high tax rates and rates dispersions with respect to trade, and low compliance (KIPPRA, 2004b).

Many empirical studies indicate the nature of the challenges posed by non-compliance, and the search for simple tax regimes suitable for small enterprises, differs substantially across countries. Kringi, Wanjala, Nyamunga, Okello, Pambah, & Nyakang’o, (2005) acknowledge that like many other developing countries, Kenya faces challenges in taxing

income derived from agriculture and the informal sector. However, an empirical study by Muriithi and Moyi (2003) suggested that tax reforms in Kenya under the Tax Modernization Program have led to improved productivity of direct taxes. The findings by Waweru (2007) showed that whereas tax revenues in Kenya were on the rise, the revenues from turnover tax were getting slimmer. A research gap exists here for whereas Kiringi et al (2005) agree there are challenges facing tax collection in developing countries, Muriithi and Moyi (2003) agree that the Kenyan government has come up with reforms to address the challenges resulting in a general increase in tax incomes. However, according to Waweru (2007) the turnover tax is not raking in the expected increment in collection.

The question that arises is whether the introduction of itax system in the VAT tax filling and collection are addressing the real challenges on the ground that leads to non-compliance? Therefore this study answered the question: what are the roles of itax on the compliance of Vat in Kenya. The problem arising is that the itax system in Kenya is a new phenomena where scanty researches have been done hence there is a research gap, further the scholars, Tax administrators lack relevant research materials to make them be informed in this field.

1.3 Objectives of the Study:

The general objective of this study was to investigate on the effects of itax on VAT Compliance in Kenya.

1.3.1 The specific objectives:

To determine how registration of VAT taxpayers using itax affect VAT compliance.

To determine the effect of using itax in tracking VAT defaulters and tax enforcement on VAT compliance.

1.4 Research Questions:

Does use of itax on registration of VAT taxpayers affect VAT compliance?

Does itax tracking on VAT defaulters and tax enforcement affect VAT compliance?

1.5 Scope of the Study:

This study was conducted to determine the role of itax system on VAT Compliance in Kenya. The aspects to be looked into includes: registration, Filling vat online, Tracking VAT tax defaulters. The study was carried out in Wote town, Makueni county Kenya. The target population was 581 tax payers and a sample of 120 was taken. The study covered a scope 2 years returns from January 2014 to December 2015.

2. LITERATURE REVIEW

2.1 Theoretical Review:

The theoretical findings of this study includes:-Tax Compliance Theory, Theory of Crime, the Benefit Theory of Taxation and Theory of tax collection simplification.

2.2 Tax Compliance Theory:

James and Alley, (1999) "Tax compliance is a complex subject with broad implications." There are two main approaches the economic and the behavioral, used to encourage taxpayers to comply with the taxation system. The economic approach, usually confined to penalties, may be necessary to enforce compliance by those taxpayers who would otherwise refuse to discharge their obligations as citizens.

2.2.1 The Benefit Theory of Taxation:

According to (Dodge, 2005) on Benefit Theory of taxation, the state should levy taxes on individuals according to the benefit conferred on them. The more benefits a person reaps from the activities of the state, the more the tax the person should pay to the government. This principle has been criticized because, first, if the state maintains a certain connection between the benefits conferred and the benefits derived, it will be against the basic principle of the tax. A tax is basically a compulsory contribution made to the public authorities to meet the expenses of the government and the provisions of general benefit to all citizens (Dodge, 2005). Secondly, most of the expenditure incurred by the state is for the general benefit of its citizens, it is not possible to estimate the benefit enjoyed by a particular individual every year for it to be decided how much tax this individual should be charged. Further, if we apply this principle in practice, then the poor will have to pay the heaviest taxes, because they benefit more from the services of the state. If we get more from the poor by way of taxes, it will be against the principle of justice. According to this theory there should be some benefit to those who pay VAT (Dodge, 2005).

2.2.2 Theory of Crime:

Working on theory of crime Becker (1968) argued that authorities needed to and appropriately balances between detection of non-compliers and sanctions to the point where non-compliance becomes irrational. In the early 1970s, Allingham and Sandmo (1972) extended Becker's work on the economics of crime to the taxation context. They examined taxpayer's decision to evade taxes when they were filling out their tax returns and examined the relationship between penalty rate for tax evasion at the time, the probability of detection, and degree of tax evasion engaged in. What they found was that there was a relationship between these variables; with a higher penalty rate and probability of detection deterring individuals from evading their taxes.

2.2.3 Theory of tax collection simplification:

Tax policy experts on the theory of tax simplification pointed out the need to simplify the tax structure so that compliance costs for small taxpayers may decline. In the case of the United States, Steuerle, (1999), recommended that complexity has to be reduced. In no instance do the authors recommend the actual separation of small from large taxpayers. Rather, the emphasis is on overall simplification of the tax statute. Steuerle criticizes the tax administration, the Internal Revenue Service (IRS), strongly: "Many people do not mind paying their fair share of the cost of government, but they highly resent it when they see needless waste—including waste of their time in filling out an unreasonable number of forms." (p.1) "...I believe there is a fundamental failure in IRS administrative structure that leads to the Treasury complaints about inadequate information. Indirectly it also leads to some of IRS' internal problems in managing itself. That defect is the failure of IRS to partially organize itself on a programmatic basis. IRS organizes itself by tax return category, not by the programs under its administration."(p. 11).The study done in Australia by Bardsley (1995) suggests, "Tax simplification should...lead to an expansion at the smaller end of the small business sector and a relative contraction at the larger end."

2.3 Empirical Review:

According to Goodwin (2005), empirical review is an examination of the empirical research findings. Empirical research means a way of gaining knowledge by means of direct and indirect observation or experience. A study on assessment of the VAT system applied in the European Union, Kaulina (2007) found that the legislation lamely supported the VAT system in the country. Insufficient legislation that existed in that country resulted in failure to introduce and implement VAT grouping. Another issue identified by the study was inflexible administrative procedures of tax application and formal non-compliance which was a weakness of VAT administration. The study generally recommended for strengthening the VAT legislation and simplification of tax administration. The findings of the study suggested that VAT administration played a pivotal role in expansion of VAT. Although the study provided supporting information to this study by showing that tax administration is the key factor in VAT collection, it failed to highlight the factors which would actually influence the VAT collection performance. Much of the emphasis was on legislation leaving out very crucial information on how to implement the legislation in VAT administration.

The study carried out by Kayaga (2007), to review the pros and cons of changes made to the tax system. The motivation to conduct the study was the increasing tax policy challenges facing developing countries when they attempted to establish efficient tax systems despite the overwhelmingly taxation reforms worldwide. The study used Uganda as the mirror of the tax system in other Sub-Saharan Africa countries, in terms of the types of taxes and rates. It found out that even after various reforms, growth in domestic revenue mobilization was not significantly improved (which was indicated by the increase in overall budget deficits). The persistence of budget deficits indicated that tax policies urgently need to be reviewed to increase tax revenues. The study blamed this stagnation of domestic revenue on the domestic social phenomena like the HIV/AIDS epidemic, the ongoing civil war in Northern Uganda, the expanding informal sector, and barriers to effective tax administration. The study then recommended that policy solutions should address these systemic problems to avoid further erosion of tax

Muriithi and Moyi (2003) carried out a study to analyze the productivity of Kenya's tax structure in the context of the tax reforms. The findings suggest that tax reforms had a positive impact on the overall tax structure and on the individual tax handles, even though the impact of the reforms was not always uniform. The reforms had a bigger impact on direct taxes than on indirect taxes like VAT, suggesting that revenue leakage is still a major problem for indirect taxes. The better responsiveness of direct taxes can be attributed to the relative effectiveness of the reforms in direct taxes, which not only made the tax system simpler but also reduced avenues for evasion and corruption. Such reforms include the introduction

of PIN, lower rates, reduction of exemptions, a shift away from multiple rates across many categories and modernization like automating filling of returns.

According to (Organization for Economic Co-operation and Development) OECD (2006). There exists some anecdotal evidence about the implementation of tax reforms to enhance tax compliance, especially in African countries. Generally tax reform deals with welfare improvement by making marginal changes in tax design and structure in fact there has been a growing concern over mobility of capital across international frontiers, Europe countries. For example Scandinavian countries such as Norway have operated a dual tax system in which all personal and corporate income is taxed at 28%. Tax payers who are mistakenly accused to cheat on their taxes may perceive the intervention by the tax office to be controlling. Therefore their tax morale decreases or even erases. Similarly, increasing monitoring and penalties for noncompliance, individuals notice that extrinsic motivation has increased, which on the other hand crowds out intrinsic motivation to comply with taxes.

A study on filing of personal income tax in Taiwan as an example of e-government services (Jen & Cheng, 2005), indicated that taxpayers tend to concentrate on the usefulness of a tax-filing method and may be fairly pragmatic in developing general attitudes towards using the method. Interestingly, the effects of perceived ease of use, subjective norms, and self-efficacy on behavioral intention were different for manual and electronic tax-filers. Researches such as Hoffman (1995), Alba (1997) and Peterson (1997) have discussed several benefits of online activities to the consumers. Among them are that the Internet allows consumers to conduct transactions within a few mouse clicks. This convenience can serve as a key driver of e-filing adoption. E-filing provides many aspects of 'convenience' to taxpayers (that is time to file, place to conduct the filing, ease-of-use, information searching and online transactions) at a degree that is not available through traditional channels. E-filing also offers flexibility of time and reduces calculation error on the tax return form to the taxpayers.

The study done by Ling and Nawawi (2010) in Malaysia, on Integrating ICT in tax education, aimed at establishing the necessary skills required by taxpayers to fully utilize a tax online system found that three skills are needed by a taxpayer to interact well with technology based tax system namely, spread sheet software, word-processing software and e-mail. Failure to consider such skills may make the intention of the itax system not to be realized as confirmed by Maede (2002). He confirmed that despite the heavy investment that the Malaysian tax authority put in new online system, only 20% of the targeted taxpayers were able to use it after three years of implementation. This was mainly attributed to lack of necessary user skills like computer literacy. In Kenya, the study done by Muturi (2015) on the subject of technology and tax compliance found that online filling has an effect on tax compliance.

2.4 Summary of Literature Review and Research Gap:

The aim of this study was to assess the effects of use of iTax on vat tax compliance among SMEs taxpayers. Revenue collection is an important exercise in any country for it to meet the financial obligations. Few studies have been done on Small Micro Enterprises VAT tax compliance. The study carried out by Kayaga (2007), to review the pros and cons of changes made to the tax system. Muriithi and Moyi (2003) carried out a study to analyze the productivity of Kenya's tax structure in the context of the tax reforms. The study on behavior of tax compliance by Nicoleta (2011) on SMEs, focuses on the determinants of tax compliance, on economic and non-economic factors identify that tax non-compliance is an area of concern for all government and tax authorities, and it continues to be an important issue that must be addressed. The study done by Ling and Nawawi (2010) in Malaysia, on Integrating ICT in tax education, aimed at establishing the necessary skills required by taxpayers to fully utilize a tax online system found that three skills are needed by a taxpayer to interact well with technology based tax system namely, spread sheet software, word-processing software and e-mail.

According to Benefit Theory of taxation; the taxpayer belief that the more they register and pay tax the more they benefit this motivates them to register as taxpayers. Further the theory of crime on taxation it sees non-compliance as a crime and that non-registering of tax leads to a penalty thus encouraging tax compliance. Minimal empirical literature exists on the effects of itax system on compliance of vat payments by SMEs and those existing are scanty. There is no study ever conducted on the role of itax on VAT Compliance in Kenya and specifically of the SMEs in Wote town.

2.5 Conceptual Framework:

The focus of this study is to determine the relationship between the itax system and VAT compliance. The conceptual framework shows the independent variables which is itax system and the dependent variable which is VAT compliance.

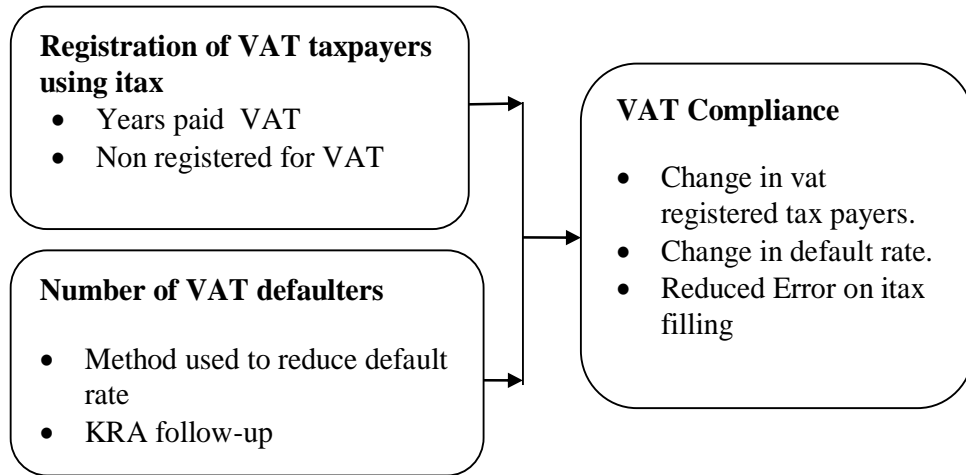


Figure 2.1: Conceptual Framework

3. RESEARCH DESIGN AND METHODOLOGY

The study employed both descriptive and diagnostic research design. a descriptive research is good in soliciting information on determining the role of itax on registration of VAT tax payers, filling of return and tracking of defaulters. In diagnostic research the researcher is interested to determining the root cause of the problem. Both research designs were used since they provide insights into the research problem by describing the variables of interest. The target population was 581 SMEs in Wote Town (Makueni County revenue office Financial Year Report, 2015).

Table 3.1: Target population

| Street in Wote Town | SAMPLED TYPES OF BUSINESS | | | | | TOTAL |
|---------------------|---------------------------|------------|-------------------------------|------------|-------------|------------|
| | General Retail shops | whole sale | Timber & woodwork fabrication | services | supermarket | |
| Shimo | 45 | 2 | 18 | 37 | 5 | 107 |
| Westlands | 42 | 4 | 16 | 32 | 4 | 98 |
| Kasarani | 46 | 4 | 15 | 43 | 4 | 112 |
| Malawi | 30 | 3 | 14 | 38 | 3 | 88 |
| Kunda kindu Street | 37 | 2 | 8 | 42 | 3 | 91 |
| Punda Street | 34 | 3 | 11 | 33 | 4 | 85 |
| TOTAL | 234 | 18 | 82 | 225 | 23 | 581 |

Source: (Makueni County revenue office Financial Year Report 2015)

The researcher adopted both stratified and random sampling to select a sample of 120 respondents out of a population of 581 towns. The target respondent is 120 (i.e. 20.6% of 581) consisting of tax payers of SMEs in Wote the proprietors of each of the 120 SMEs. Mugenda and Mugenda (2003) indicate that a sample size of 10% - 30% of the population is a good representation of the population.

Table 3.2: Target sample

| Street in Wote Town | TYPE OF BUSINESS | | | | | TOTAL |
|---------------------|----------------------|------------|-------------------------------|-----------|-------------|------------|
| | General Retail shops | whole sale | Timber & woodwork fabrication | Services | supermarket | |
| Shimo | 8 | 2 | 6 | 6 | 1 | 23 |
| Westlands | 7 | 1 | 6 | 5 | 1 | 20 |
| Kasarani | 8 | 3 | 5 | 6 | 2 | 24 |
| Malawi | 6 | 0 | 4 | 7 | 1 | 18 |
| Kunda kindu Street | 7 | 1 | 3 | 6 | 2 | 19 |
| Punda Street | 6 | 1 | 2 | 7 | 0 | 16 |
| TOTAL | 42 | 8 | 26 | 37 | 7 | 120 |

This study utilized both primary and secondary data. Primary data was collected using a well-structured questionnaire involving both Dichotomous and non Dichotomous questions. The questionnaire for this study was structured into four sections i.e. Section, general background, location of the business and type, Role of itax on VAT compliance, VAT tax compliance and ICT knowledge on taxpayers. Each section comprised of open ended and closed questions.

The data captured was coded and analyzed using statistical measures such as percentages, totals, mean and standard deviations. The mean, for instance, were used to measure the general response to a question by the respondents. The standard deviation was used to measure the variability in the responses to a question. The percentages were used to measure the shares of respondent in a given category. The results were presented using tables, charts and graphs. Linear regression model was used to establish the relationship;

$$Y = a + \beta_1X_1 + \beta_2X_2 + \varepsilon$$

Where Y = VAT compliance

a = Constant term

β_n = Represents $\beta_1, \beta_2, \beta_3$ and β_4 Beta Coefficients

X_1 = Number of registered VAT tax payers.

X_2 = Number of Vat tax defaulters.

ε = Error term

4. RESEARCH FINDINGS AND DISCUSSION

4.1 Business Turnover Per Year

The respondents were asked to indicate their business turnover per year. The finding is shown in Table 4.1.

Table 4.1: Business Turnover per Year

| | Frequency | Percent |
|---------------------------|-----------|--------------|
| Less than Sh. 2,000,000 | 13 | 14.9 |
| Sh. 2,000,000 – 3,000,000 | 17 | 19.5 |
| Sh. 3,000,000 – 4,000,000 | 14 | 16.1 |
| Sh. 4,000,000 – 5,000,000 | 16 | 18.4 |
| Sh. 5,000,000-6000000 | 15 | 17.2 |
| Over sh. 6,000,000 | 12 | 13.8 |
| Total | 87 | 100.0 |

From the responses, 14.9% of the respondents indicated less than Sh. 2,000,000 business turnover per year, 19.5% indicated between Sh. 2,000,000 – 3,000,000, 16.1% indicated between Sh. 3,000,000 – 4,000,000, 18.4% indicated Sh. 4,000,000 – 5,000,000, 17.2% indicated between Sh. 5,000,000-6,000,000 and 13.8% indicated over sh. 6,000,000

4.2. Type of Business:

The respondents were asked to indicate the type of business they own. The finding is shown in Table 4.2.

Table 4.2: Type of Business

| | Frequency | Percent |
|-----------------------|-----------|--------------|
| Kiosk/ general Retail | 26 | 29.9 |
| Wholesale | 8 | 9.2 |
| Supermarket | 7 | 8.0 |
| Wood and timber | 22 | 25.3 |
| Services | 24 | 27.6 |
| Total | 87 | 100.0 |

As shown in Table 4.2, 29.9% of the businesses were Kiosk/ general Retail, 9.2% were Wholesalers, 8% were supermarkets, 25.3% were wood and timber and 27.6% were services.

4.3 Registration of VAT Taxpayers Using Itax:

The respondents were asked to indicate whether they are registered as taxpayers. The finding is shown in Table 4.3.

Table 4.3: Registered Taxpayers

| | Frequency | Percent |
|--------------|-----------|--------------|
| Yes | 58 | 67 |
| No | 29 | 33 |
| Total | 87 | 100.0 |

From the responses, 67% of the respondents were registered as taxpayers and 33% were not registered.

Table 4.4: The Type of Tax

| | Frequency | Percent |
|--------------|-----------|--------------|
| VAT | 38 | 43.7 |
| Income | 33 | 37.9 |
| Custom duty | 11 | 12.6 |
| Others | 5 | 5.7 |
| Total | 87 | 100.0 |

From the finding, 43.7% of the taxpayers had registered VAT tax, 37.9% had income tax, 12.6% custom tax and 5.7% had registered other tax. The high numbers of those registered for Vat could be the fact that it is payable every month, Use of itax system and faster registration process.

Table 4.5: Years Paid VAT

| | Frequency | Percent |
|--------------|-----------|--------------|
| 2013 | 12 | 13.8 |
| 2014 | 9 | 10.3 |
| 2015 | 13 | 14.9 |
| 2016 | 52 | 59.7 |
| Total | 87 | 100.0 |

From the finding, 13.8% had paid tax in 2013, 10.3% had paid in 2014, 14.9% had paid in 2015 and 59.7% had paid in 2016. This shows that there was increase in a number of taxpayers over the 3 years when itax was introduced.

Table 4.6: Reasons for non-registering for VAT

| | Frequency | Percent |
|---|-----------|--------------|
| Lack of information on when and where to register | 32 | 36.8 |
| Too lengthy registration process | 33 | 37.9 |
| KRA offices being located far from Wote town | 14 | 16.1 |
| Other reasons | 8 | 9.2 |
| Total | 87 | 100.0 |

As shown in Table 4.7, 36.8% of the respondents indicated lack of information on when and where to register, 37.9% indicated too lengthy registration process, 16.1% indicated KRA offices being located far from Wote town and 9.2% indicated other reasons. In my opinion this could be true as there are minimal awareness of tax matters in the rural towns in Kenya.

Table 4.7: Reasons for non-payment of VAT

| | Frequency | Percent |
|--|-----------|--------------|
| Lack of information on when and where to pay | 20 | 22.9 |
| Length of the VAT payment process | 17 | 19.5 |
| KRA offices being located far from Wote town | 16 | 18.3 |
| Unable to calculate VAT payable | 28 | 32.5 |
| Other reasons | 6 | 6.8 |
| Total | 87 | 100.0 |

From the finding, 22.9% of the respondents indicated lack of information on when and where to pay as a reason for non-payment of VAT, 19.5% indicated length of the VAT payment process, 18.3% indicated KRA offices being located far from Wote town, 32.5% indicated unable to calculate VAT payable and 6.8% indicated other reasons.

4.4 Filling of VAT Returns Online:

The respondents were asked to specify the filling system they use. The finding is shown in Table 4.8.

Table 4.8: Filling System Use

| | Frequency | Percent |
|-----------------------|------------------|----------------|
| Itax | 62 | 71.3 |
| Integrated tax system | 25 | 28.7 |
| Total | 87 | 100.0 |

As shown in Table 4.8, 71.3% of the respondents indicated that they use Itax system while 28.7% indicated integrated tax system. This could be associated to KRA making it mandatory to file returns using itax system.

Table 4.9: Benefit of Filling of VAT Returns Online

| | Frequency | Percent |
|---------------|------------------|----------------|
| Cost | 30 | 34.5 |
| Simplicity | 39 | 44.8 |
| Time required | 18 | 20.7 |
| Total | 87 | 100.0 |

From the finding, 34.5% indicated cost as the benefit of filling of VAT returns online, 44.8% indicated simplicity and 20.7% indicated time required.

Table 4.1: Challenges Encountered while Filling VAT Online

| | Frequency | Percent |
|--|------------------|----------------|
| Lack of internet services | 8 | 9.2 |
| high cost of internet | 16 | 18.4 |
| Low internet speed | 22 | 25.3 |
| lack of knowledge on how to use internet | 41 | 47.1 |
| Total | 87 | 100.0 |

As shown in Table 4.10, 9.2% indicated lack of internet services as a challenge encountered while filling VAT online, 18.4% indicated high cost of internet, 25.3% indicated low internet speed and 47.1% indicated lack of knowledge on how to use internet. The other challenges cited by the respondents includes lack of free internet services, and the commercially available internet services are too slow. This is a common occurrence in most of the rural towns in Kenya.

4.5 Tracking VAT Tax Defaulters:

The respondents were asked to indicate whether the VAT paid by traders is properly assessed by KRA. The finding is shown in Table 4.11.

Table 4.11: VAT Paid by Traders

| | Frequency | Percent |
|--------------|------------------|----------------|
| Yes | 57 | 65.5 |
| No | 30 | 34.5 |
| Total | 87 | 100.0 |

From the responses, 65.5% of the respondents indicated that the VAT paid by traders is properly assessed by KRA while 34.5% indicated no. This is due to use of embedded integrated software for tracking purposes in the itax system.

4.6 Tax Compliance:

The respondents were required to rate the benefits of introducing itax in the tax administration in Kenya. A Likert scale of 1-5 was used where (5) Strongly Agree, (4) Agree, (3) Neutral, (2) Disagree, (1) Strongly Disagree. From the responses mean and standard deviation were calculated for ease of interpretation and generalization of finding. The finding is shown in Table 4.12.

Table 4.12: Tax Compliance

| | Mean | Std. Dev |
|---|------|----------|
| Simplified tax management to KRA | 4.00 | 1.200 |
| itax is cost effective | 4.10 | 1.110 |
| It can handle large case numbers | 3.85 | 1.136 |
| itax is a modular system and can easily be extended to cover newly arising needs and to offer new functionalities | 3.82 | 1.153 |
| It speeds up tax assessment and service delivery | 3.95 | 1.066 |
| It makes a country's tax administration more effective, leading to significant increases of tax revenues | 3.97 | 1.010 |

From the finding, simplified tax management to KRA had a mean of 4.00 with a standard deviation of 1.2, itax is cost effective had a mean of 4.10 with a standard deviation of 1.110, it can handle large case numbers had a mean of 3.85 with a standard deviation of 1.136, itax is a modular system and can easily be extended to cover newly arising needs and to offer new functionalities had a mean of 3.82 with a standard deviation of 1.153, It speeds up tax assessment and service delivery had a mean of 3.95 with a standard deviation of 1.066 and it makes a country's tax administration more effective, leading to significant increases of tax revenues had a mean of 3.97 with a standard deviation of 1.010. This is a clear indicator that use of itax system in filling of vat return has increased the compliance levels.

Regression Analysis:

The researcher further conducted multiple regression analysis to investigate on the effects of itax on VAT Compliance in Kenya. Multiple regression analysis was done to find the effect of the independent variables on the dependent variable. The findings are summarized in subsequent Tables.

Table 4.2: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------------------|----------|-------------------|----------------------------|
| 1 | .704 ^a | .497 | .478 | 0.0042 |

From the Model Summary above, the value of R is 0.704, R square is 0.497 and adjusted R square is 0.478. This means that the combined effect of the role of itax explains 49.7% of the variations on VAT Compliance in Kenya.

Table 4.3: ANOVA

| Model | Sum of Squares | Df | Mean Square | F | Sig. |
|--------------|----------------|-----------|-------------|-------|-------------------|
| Regression | 442.507 | 4 | 110.627 | 20.33 | .000 ^b |
| Residual | 446.114 | 82 | 5.44 | | |
| Total | 888.621 | 86 | | | |

The analysis of variance table shows how the independent variables are statistically significant in predicting the dependent variable. This is in view of the p-value of 0.000 hence, the model overall is a good fit. The f-ratio tests whether the regression model is fit for the data. The ANOVA findings reveal that F calculated is 20.33 while F critical (from F table) is 2.48. Since the value of F calculated is greater than F critical (20.33 > 2.48) this implies that the overall regression model was significant.

Table 4.4: Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|--------------------------------|-----------------------------|------------|---------------------------|-------|------|
| | B | Std. Error | Beta | | |
| (Constant) | 1.299 | 1.136 | | 1.143 | .002 |
| Registrations of VAT | .315 | .133 | .239 | 2.361 | .021 |
| Tracking of VAT Tax Defaulters | .427 | .614 | .068 | -.695 | .048 |

The equation becomes:

$$Y = 1.299 + 0.315X_1 + 0.427X_2 + \epsilon$$

Where; Y = Tax compliance; X₁ = Registrations of VAT Taxpayers; X₂ = Tracking of VAT Tax Defaulters

ε = Error term.

This implies that when all the factors are held constant, tax compliance would be at 1.299, a unit increase in registrations of VAT taxpayers holding other variables constant would increase tax compliance by 0.315, and a unit increase in tracking of VAT tax defaulters would increase tax compliance by 0.427. The p values for all the variables (registration of VAT taxpayers using Itax system, and tracking VAT tax defaulters) were less than 0.05 therefore all of them were statistically significant.

5. SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of the Findings:

Findings from the study reveal that all the identified factors have a direct influence on the tax compliance among SMEs. The tax compliance factors examined included registration of VAT taxpayers using Itax, filling of VAT returns online, tracking VAT tax defaulters and ICT knowledge.

5.1.1 Registration of VAT Taxpayers Using Itax

The study found out that majority of the respondents had registered as taxpayers with most of them registering VAT and income. Majority of the respondents had registered as taxpayers since 2013 with a higher percentage in 2016. Those who had not registered cited lack of information on when and where to register, too lengthy registration process and KRA offices being located far from Wote town. The findings above concurs with Kaulina (2007) who indicated that inflexible administrative procedures of tax application and formal non-compliance which was a weakness of VAT administration.

5.1.2 Tracking VAT Tax Defaulters:

The study also established that majority of the respondents believed that the VAT paid by traders is properly assessed by KRA and that use of Itax reduces default rate. This can be attributed to use of the embedded software that eliminates the unallowable deductions for VAT. The filling for the subsequent month is not possible if the previous month is skipped. These findings are consistent with Muriithi and Moyi (2003) who held that the main organizational change aimed at strengthening administrative capacity was the incorporation of the Kenya Revenue Authority in 1995. The KRA centralized and automated tax collection activities which had previously been undertaken by departments in the Ministry of Finance.

5.1.3 Tax Compliance:

From the findings of the regression analysis, the value of R is 0.704, R square is 0.497 and adjusted R square is 0.478. This means that the combined effect of the role of itax explains 49.7% of the variations on VAT Compliance in Kenya. The ANOVA findings reveal that F calculated is 20.33 while F critical (from F table) is 2.48. Since the value of F calculated is greater than F critical ($20.33 > 2.48$) this implies that the overall regression model was significant. All the p values were less than 0.05 and therefore all the variables were statistically significant.

5.2 Conclusions:

The study concluded that registration of VAT taxpayers using Itax system has led to increased number of tax payers being registered. It also enhances revenue collection by KRA as the amounts of Vat collected increased with the introduction of the system. It also enhances the SMEs level of understanding on various taxes at KRA. This enhances tax compliance among non-cooperative taxpayers and reduces possible avenues for tax evasion as it has made it easy and convenient for taxpayers to file their periodic tax returns.

This study also concludes that the use of iTax has contributed to high levels of compliance by SMEs taxpayers as they can handle their tax affairs themselves indicating that the iTax system has made compliance easier and taxpayers can file their returns anywhere any time.

5.3 Recommendations:

The study recommends that KRA should address the complexities of annual tax returns, periodic variations in the tax laws, and levels of penalties and fines. They should pass this information regularly to SMEs via various channels like tax Seminars, Booklets and Media Channels and this will greatly improve the SMEs level of compliance as the great complexity associated with tax matters.

The study also recommends that SMEs should be encouraged to automate their bookkeeping and accounting systems so that are compatible to the Itax system by government offering incentives like giving such packages. The government should also engage the small holders in sensitization forums on how to reduce the cost associated with tax compliance.

The government should offer free internet services and ensure high speed internet services are available in the rural towns like Wote.

The authority should strive to give taxpayers high quality services as stipulated in the corporate plan. Officers should endeavor to adhere to the taxpayers' charter in terms of service provision to taxpayers. Customer care counters manned by technical and knowledgeable staff should be introduced and enhanced throughout the authority's offices to bring services closer to the taxpayers. This will also improve communication between the taxpayers and the authority.

5.4 Suggested areas for Further Study:

This study focused on the role of itax on VAT Compliance in Kenya a case of Wote town. Therefore other researchers could conduct research on factors affecting income tax compliance among SMEs in other regions of Kenya. Further study can also be conducted on factors that motivate SMEs to be tax compliant.

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