

**FACTORS AFFECTING TAX COMPLIANCE AMONG SMALL AND MEDIUM  
ENTERPRISES IN NAIROBI'S CENTRAL BUSINESS DISTRICT, KENYA**

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**A Research Project**

**Submitted in partial fulfilment of the requirements for the Degree of**

**Bachelor of Commerce at Strathmore University**

**Strathmore Business School**

**Strathmore University**

**Nairobi, Kenya**

**August, 2024**

**DECLARATION**

I declare that this work has not been previously submitted and approved for any award of a degree by this or any other University. To the best of my knowledge this research project does not contain any material previously published by any other person exception being made for due references made for the research project conducted.

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Date: .....

## **DEDICATION**

I dedicate this project to my loving mother and sister who have taught me the importance of hard work and resilience is all one does and the never-ending motivation and support they have extended to me not only in this project but throughout my life.

## **ACKNOWLEDGEMENT**

I am greatly indebted to my supervisor, Mr. Josphat Manani who imparted invaluable knowledge and great guidance to me throughout the research process and always made time to guide me despite his busy schedule. I would also like to thank the organizations that openly answered the questionnaires enabling me to complete this research project successfully. I would also like to thank my friends and extended family for the encouragement and support they have offered me throughout this study period.

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## **ABBREVIATIONS**

GoK-Government of Kenya

SMEs –Small and Medium Enterprises

CBD- Central Business District

VAT-Value Added Tax

OECD-Organization for Economic Cooperation and Development

## **ABSTRACT**

Tax is an important stream of revenue for government's development projects and therefore all efforts must be made by governments to ensure that it is accurately and efficiently collected so as to facilitate the government's operations. In an effort to maximize collection of revenue and efficiency in tax administration, key changes to tax policy evolving around ensuring equity, further widening the tax base, promoting increased investment and in doing so, reducing the tax compliance burden, have in the recent past been made by the Kenyan government. This study sought to identify the factors that influence tax compliance in Kenya, specifically focusing on SME's operating within Nairobi's Central Business District. The researcher outlined a detailed literature review and identified the variables for this research. The dependent variable being tax compliance, the independent variables being tax rates, tax literacy, compliance costs and tax attitude. The tax rate included those of Corporate Tax and Value Added Tax. The research was a descriptive survey. Given the large population of registered SMEs in Nairobi, a sample size of 194. The research was conducted using questionnaires which were distributed out with the help of two assistants and the results were out the data was analyzed by coding according to variables in the study for efficiency so as to reduce replies given by respondents to a small number of classes. The study found that tax literacy, compliance costs, tax rates, and taxpayer attitudes significantly influenced tax compliance among SMEs in Nairobi's CBD. Tax literacy was the most impactful factor, with SMEs that understood tax processes showing higher compliance. High tax rates and prohibitive compliance costs discouraged many businesses from adhering fully to tax regulations. Mixed attitudes towards tax payments were observed, influenced by perceived inefficiencies in government expenditure. The conclusions emphasized the need for improved tax education, simplified filing processes, and reduced compliance costs to enhance voluntary compliance. Recommendations included progressive tax rate adjustments, subsidized professional support for SMEs, and initiatives to rebuild trust in government spending through increased transparency.

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## **CHAPTER ONE: INTRODUCTION**

### **1.1 Background to the Study**

Tax Compliance refers to adhering to tax laws and regulations by correctly reporting income, expenses and other financial details to the relevant tax authorities. It involves timely filing of tax returns and paying the correct amount of taxes. Maintaining tax compliance is crucial for individuals and businesses to avoid legal consequences and penalties. It requires staying informed about tax laws and regulations which often change (TopSource Worldwide, 2024). A great number of individuals and businesses fail to comply, which is a great problem in both developed and undeveloped countries, as taxes are the main source of government's financing (Anthony.M, 2016). The collection of taxes is a key development priority. It is essential for financial investments in human capital, infrastructure and the provision of services for citizens and businesses, as well as to set the right price incentives for suitable private-sector investment. Technically the role of taxation is achieving budgetary objectives of a country (World Bank, 2024). The average tax to GDP ratio for the 33 African countries remains unchanged over the period of time of 2020-2024 at 15.6 %, this call for increase in revenue in tax collection (Business Daily, 2024). The loss from tax irregularities is estimated at 3.2 % of GDP in OECD countries (Buehn & Schneider, 2016). Countries are losing \$480 billion in tax evasion to global tax abuse. (Tax Justice Network, 2023). Kenya loses over Ksh 600 billion every year to tax evasion (GoK, 2020). On average, Kenya's informal sector accounts for about 32% of the GDP. The tax burden in Kenya is high, standing at about 30-40%. If the Kenya government is to increase its social expenditure, then it needs to reduce tax evasion in the informal economy.

Taxpayers' behavior towards the tax system has evoked great attention among many Revenue Authorities in the World, especially in Developed Countries. However, it is debatable on what has been done towards the study of taxpayers' behavior towards tax system in developing countries as they concentrate more in studies which would increase their budgets bottom-line in terms of huge revenue collection and enforcement efforts at the expense of studies on taxpayers' behavior which would make increase in this tax revenue to be realized and enforcement efforts work. Perhaps the less developed countries are not to blame as they run on budget deficits, hence scarce resources to see through such studies which are perceived as adding no direct value to revenue collection.

Empirical evidence on the ground shows there has been hostility between the taxpayers and tax collectors on issue relating to tax compliance (Porcano, 2021).

In 2014, the government introduced a new tax bracket of 30% for individuals with income above KES 1,000,000 per year. This was aimed at capturing higher-income individuals who were previously not paying their fair share of taxes. In 2018, the government increased the standard rate of VAT from 16% to 18%. This was part of a broader effort to simplify and modernize the tax system in Kenya. In 2019, the government introduced a new excise tax on certain goods and services, such as bottled water, soda, and beer. This was aimed at raising additional tax revenue and discouraging the consumption of certain goods. In 2020, the government increased income tax rates for individuals and businesses in certain income brackets. For example, the top marginal tax rate increased from 35% to 37% for individuals with income above KES 5,000,000 per year. These tax rate increases have helped to widen the tax base and increase tax revenue in Kenya. (GoK, 2022).

The National Tax Policy aims to improve the predictability and transparency of Kenya's tax system, addressing longstanding challenges and laying the groundwork for tax reforms and legislation updates. This policy supports the Fourth Medium-Term Plan (2023-2027) of Kenya Vision 2030, which focuses on economic recovery through the Bottom-Up Economic Transformation Agenda (BETA). BETA seeks to lower living costs, boost employment, encourage investment, ensure fair income distribution, enhance social security, expand the tax base, and increase foreign exchange earnings. The policy is crafted in response to fiscal pressures from drought-related costs, external shocks, and financing constraints, alongside a declining revenue share of GDP. This decline is due to factors like increased tax incentives, low compliance, the aftermath of COVID-19, growth in the informal sector, and challenges in taxing modern business models. To address these issues, the policy proposes guidelines for expanding the tax base to improve fairness, adopting international best practices in tax administration, ensuring tax rate and base stability, boosting tax compliance, encouraging investment, and reducing tax expenditures to avoid market distortions and minimize refund pressures. It also aims to reform tax incentives by establishing a framework to make them time-bound and growth-focused.

## 1.2 Problem Statement

Tax plays an important role in the growth of any economy so non-tax compliance is harmful to the economy. Non-tax compliance hampers government revenue collection thus inefficiency in Government spending because it diminishes the capacity of the state to mobilize domestic revenues that cater for various public services, such as education, healthcare, infrastructure development and defense. (GoK,2024). Non-tax compliance also damages the country's growth capacity by discouraging both local and foreign investors. The high tax rate and burden in Kenya, is the leading disincentive to business activity (Mwangi, 2021). In Kenya the informal economy, which is characterized by Small and Medium Enterprises (SMEs), is the biggest employer accounting for over 90% of the labor force and contributing about 32% of Kenya GDP (Republic of Kenya, 2023).

The increasing trend of disparity between the levels of submitted annual income tax returns, reported tax assessments and voluntarily paid tax liabilities, among SMEs, on the one hand, and the trend of business birth and growth, on the other hand, has been a cause of worry to the government of Kenya. This resulted in the government offer of an olive branch to taxpayers through the tax amnesty announced by the Minister for Finance in Kenya in 2024 (GOK, 2024). A study by, Parliamentary Budget Office (2020) shows that in 2020 the government could have increased the tax base by approximately Kshs. 192 billion if the non- tax compliance among SMEs was addressed. According to the KRA annual report for year ended 2020, the amount lost inform of taxes was Ksh 600 billion which can be directly attributed to the informal sectors and SMEs. (K.R.A, Annual Tax Report, 2020). The SMEs are continuously expanding and have the potential to increase the revenue flows, but which have been otherwise left out of the tax bracket.

Generally, if the informal sector remains untaxed, and as more people transition into the sector, the government is likely to continue losing billions of shillings. Such a scenario will impact on the government's ability to achieve its revenue targets and consequently its development agenda. The question as to why some people pay tax while others do not has raised a lot of concern. Tax revenues have, for quite some time, remained low relative to the number of both registered and non-registered firms and individuals who are legally qualified to pay tax. Continued low revenue collection levels for government is detrimental to economic development of this nation. (Mwangi, 2021). A large segment of the informal sector, especially the SMEs in the Central Business District which accounts for about 7092 out of the 30252 registered SMEs in Nairobi exhibit low tax

compliance levels (GoK,2021). This is a great loss of revenues meant for public expenditure. It is for this reason that research needs to be undertaken to identify the causes for low tax compliance among small and medium enterprises in the Central Business District. It is also instructive to note that there is little research that has been done in this area. In this context SMEs in Nairobi's Central Business District exhibit low tax compliance levels and this requires an understanding on the determinants of tax compliance to enable the government to improve on its tax collection among the SMEs in Nairobi's Central Business District (Elizabeth. W, 2017)

### **1.3 Research objectives**

#### **1.3.1 General research objective**

The main objective is to assess the factors that affect tax compliance among SMEs in Nairobi's Central Business District.

#### **1.3.2 Specific research objectives**

1. To assess the extent to which tax rates explain tax compliance among Small and Medium Enterprises in Nairobi's Central Business District.
2. To assess the extent to which levels of tax literacy influence tax compliance among Small and Medium Enterprises in Nairobi's Central Business District.
3. To assess the extent to which compliance costs incurred by small and medium enterprises in Nairobi's Central Business District influence their level of tax compliance.
4. To assess how Small and Medium Enterprises in Nairobi's Central Business District attitude about tax, influence tax compliance.

### **1.4 Research Questions**

This research was guided by the following research questions:

1. To what extent do tax rates in Kenya explain tax compliance among Small and Medium Enterprises in Nairobi's Central Business District?
2. How does the level of tax literacy influence tax compliance among Small and Medium Enterprises in Nairobi's Central Business District?
3. To what extent does the cost of tax compliance explain tax compliance among Small and Medium Enterprises in Nairobi's Central Business District?

4. How does the attitude of Small and Medium Enterprises in Nairobi's Central Business District about tax influence tax compliance?

### **1.5 Significance of the Study**

The government is not able to collect the required taxes from the targeted taxpayers. From the SME point of view, tax evasion is driven generally by a perception that the tax burden is too high. This poses several problems to tax systems, raising difficult questions over how tax policies and tax administration may influence tax compliance incentives and behavior. The compliance tax burden on the Informal Sector may be high relative to that of large companies (higher unit cost in relation to turnover). Further, the cost of complying with a given set of tax rules and regulations is generally high.

This study focused on how social, cultural and personal factors influence tax compliance. It is anticipated that the results of this study will provide concepts and grounds on which to develop a framework. The knowledge accruing from this study could benefit the Government of Kenya and its revenue collection body Kenya Revenue authority in its effort to design suitable tax policies for SMEs. This study has provided concepts which to develop a framework to explore tax compliance behavior among SMEs. It has opened the underlying factors that promote tax compliance. The research will be useful to the business community and organization's management teams for purposes of knowing the tax compliance environmental factors and how the conditions can be improved or dealt with. Finally, the research will be of interest to scholars and researchers who may require developing and/or advancing their knowledge in the field of tax compliance and administration.

### **1.6 Scope and Limitation of the Study**

This is research carried out by a student completing their undergraduate. The significance of this research is to solve the issue of non-compliance that is affecting the government revenue collection process. It is going to major with SMEs in Nairobi's Central Business District.

Time constraint was a limiting factor because the study is to be concluded within a short time.

Availability of funds was also a limiting factor to the study since the researcher is self-sponsored.

There was no assurance that the respondents will return all the questionnaires duly completed, neither was there a guarantee that those who will be interviewed would respond to all the questions put forward to them comprehensively for fear that it would expose their noncompliance to K.R.A.

To counter these limitations, the researcher used all their free time from classes to make time to interview the respondents and also sought funding from relatives. The SMEs fear of participation was overcome by explaining to them the intent of the study and issuing the transmittal letter as well as the supervisors contact for verification purposes.

### **1.7 Operational Definition of Terms**

**Tax:** A compulsory financial contribution imposed by a government to raise revenue, levied on the income or property of persons or organizations, on the production costs or sales prices of goods and services, etc.

**Tax Compliance:** The Degree to which a taxpayer complies (or fails to comply) with the tax rules of his country, for example by declaring income, filing a return, and paying the tax due in a timely manner.

**Tax Evasion:** It refers to the conscious or unconscious action and behavior of a person who is liable to pay tax but who fails to fulfill this duty by either under reporting his tax liability or failing to account for his income generating activities altogether. Tax evasion also refers to the reduction or minimization of tax liability by illegal methods.

**Tax Rate:** The tax rate is the tax imposed by the federal government based on an individual's taxable income or a corporation's earnings. Kenya uses a progressive tax rate system, where the percentage of tax increases as taxable income. It can also be defined as the percent of income paid as tax.

**Tax Information:** The knowledge or facts provided about taxes.

**Tax Obligation:** Responsibilities pertaining to tax payment and declaring of tax returns which a person duly registered and having a PIN is required to observe.

**Tax Compliance cost:** It refers to the expenditure of time or money in conforming with government requirements such as legislation or regulation.

Tax Attitude: The way of thinking or feeling about taxes.

Tax Administration: It refers to the procedures attached to tax compliance including registration and filing of returns.

Small and Medium Enterprises: Those entities with full-time employees not exceeding 100 or annual sales turnover not exceeding Ksh 150 million.

Value Added Tax: It is a type of tax imposed on the value added to goods and services at each stage of production and distribution.

Corporate Tax: This is a type of tax imposed on the profits of a business.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter aims to introduce and discuss areas the researcher seeks to examine in the process, especially for post studies. It includes the theoretical review, empirical literature review gap analysis, framework, Operationalization and measurement of variable and finally the summary of the chapter.

### **2.2 Theoretical Review**

This study is grounded on the Benefit theory, The Tax Morale and the Theory of Crime as discussed as follows.

#### **2.2.1 The Tax Morale Theory**

The tax morale theory was first advanced by German scholars centered son Gunter Schmolders known as Cologne school of tax psychology. Tax morale refers to the individual factors that drive a person to fulfill their tax obligations. As a significant determinant of tax behavior, tax morale aims to clarify how a taxpayer's sense of morality influences their tax compliance. Numerous

studies have indicated that tax evasion can be linked to levels of tax morale (Mocetti, 2014). Taxpayers are more likely to evade taxes when they perceive that their local community disapproves of such actions. Additionally, individuals are more inclined to comply with tax obligations if their friends, family, and acquaintances also meet these requirements. Conversely, if taxpayers observe others evading taxes without consequences, they may be encouraged to do the same. In essence, a society that tolerates tax evasion fosters an environment that promotes it (Waweru, 2014).

Religious beliefs also play a role in tax compliance, with studies indicating that taxpayers who hold strong religious convictions are more likely to comply with tax regulations, even when faced with high tax rates (Gee, 2016). However, some taxpayers may feel morally justified in evading taxes if they believe that the tax system is unfair or unsatisfactory. Conversely, in environments where taxpayers perceive the tax system as equitable, rates of tax evasion tend to be lower.

Taxpayers are also more likely to meet their obligations if they view their government as honest, democratic, and participatory, and if they feel they have a meaningful role in governance (Mwangi, 2014). Therefore, the principles of equity serve as crucial predictors of tax evasion. This study aims to examine the principles of tax equity and their impact on tax compliance among SMEs in the Nairobi County, Central Business District.

### **2.2.2 The Allingham and Sandmo Theory (AS Theory)**

The Allingham and Sandmo (AS) Theory, introduced by Allingham and Sandmo (1972), remains a foundational framework in understanding tax evasion. This theory posits that taxpayers may choose to evade taxes if they perceive the likelihood of detection and the associated penalties to be low, while also considering the cost of compliance. Specifically, taxpayers are likely to evade taxes when the perceived cost of evasion is lower than the cost of compliance, or when they believe that the likelihood of being audited is minimal. Additionally, cumbersome tax systems and high compliance costs can further encourage evasion.

Recent developments in the theory have built on and refined these foundational ideas. For example, modern studies have continued to explore the interaction between tax rates, penalties, and compliance behavior. Research from the past decade suggests that the relationship between tax rates and compliance remains complex. A notable contribution in this area is the work by Slemrod and Weber (2014), who emphasize the importance of both the probability of detection and the severity of penalties in shaping taxpayer behavior. Their findings suggest that while higher tax rates can potentially increase the temptation to evade, effective enforcement and significant penalties can mitigate this tendency.

Yitzhaki's (2002) refinement of the AS Theory remains influential. His work demonstrated that when penalties are proportionate to the amount of evaded taxes, the substitution effect—where higher tax rates might increase evasion—disappears. Instead, the remaining income effect tends to promote better compliance, as higher tax rates make taxpayers feel worse-off and less inclined to engage in risky behavior.

Further advancements in the theory are reflected in recent research by Kleven et al. (2020), who argue that increasing the visibility and probability of detection can significantly improve tax compliance. Their studies emphasize the role of technology and data analytics in enhancing audit capabilities and thus reducing evasion.

Additionally, the issue of tax compliance among small and medium-sized enterprises (SMEs) has been highlighted in recent literature. Studies by Alm and Torgler (2018) reveal that SMEs often face greater challenges in complying with tax regulations due to limited resources and complex requirements. This environment can increase the likelihood of tax evasion among these businesses.

Overall, the evolution of the AS Theory over recent years underscores the importance of balancing tax rates, enforcement strategies, and compliance costs to effectively manage and reduce tax evasion.

### **2.3 Empirical literature review**

Makokha, Nambuswa and Namusonge, (2017) did a study to investigate the determinants of tax compliance among SMEs in Bungoma county. The study was guided by the following objective; to determine the effect of cost on tax compliance among SMEs in Bungoma County. The study applied a descriptive survey design of all the SMEs in Bungoma County. The population of the study consisted of all the SMEs in Bungoma County. A total of 170 SMEs in Bungoma County were targeted for the study, with a sample of size of 227 respondents. Closed-ended questionnaires covered all the issues relating to the causes of low tax compliance among SMEs in Bungoma County were personally administered the questionnaires to the respondents 227 managers, 1 from each of the sampled organizations in sectors. Pilot test was done to verify the reliability and validity of the research instrument. The data collected was analyzed using descriptive statistics, correlations, and linear regression analysis.

Results showed that there was a significant influence of cost on tax compliance in Bungoma County. From study findings and earlier discussion, it was noted that cost influence tax compliance negatively and significantly contributing 9.6% variability to tax compliance by SMEs when other factors are held constant. The Kenya Revenue Authority should consider revising the cost of tax product downwards. Additionally, Kenya Revenue Authority should make the tax filing process convenient, easy and costless. Similarly, Kenya revenue authority should not impose penalties on late filing of taxes. The tax computation should be as easy as possible to enhance eligible tax payers' compliance

Musau, (2015) examined factors affecting compliance with tax laws and regulations among income earners majoring on SME's in Nairobi County, Kenya. The exploration utilized a quantitative research plan. Given the extensive populace of enrolled SMEs as taxpayers in Nairobi County, an example size of 398 was picked as delegate, to be the focal point of this investigation out of which 120 of them were returned and dissected.

To guarantee that different various classifications of taxpayers and business substances were incorporated into the overview, stratified examining system was embraced. Information was gathered utilizing self-regulated polls.

The gathered information was thus investigated utilizing Statistical Package for Social Scientist programming and afterward exchanged to STATA for encourage examination. The examination discoveries uncovered that an expansion in the impression of people about the trouble of dodging

taxes is found to improve the probability of being tax compliant among SMEs in Nairobi County. The discoveries likewise uncovered that people who are happier with open administration arrangement; have enough tax data; trust government authorities in taking care of their taxes; and have the observation that tax documenting strategies are less intricate will probably be tax compliant.

Mwangi, (2014) examined the factors influencing tax compliance among small and medium enterprises in Nairobi's Industrial Area, Kenya. The research was a descriptive survey. Given the large population of registered taxpayers in Nairobi, a sample size of 150 was picked as representative, to be the focus of this study. The findings of the study revealed that with regard to tax rate as a factor influencing SMEs compliance, the majority view that Kenya has high tax rates with several different tax heads and this consequently hinders their level of compliance. The SMEs view that if more information would be availed to them in form of tax seminars and literature, this would demystify the complex concept of tax and greatly motivate them to be compliant. Lastly the study recommended that, by gaining an understanding of these underlying factors, KRA and the government will be able to make changes that will greatly improve taxpayers' tax compliance level, with the end result being increased government revenues, allowing the tax authority to give quality service to taxpayers and the government as a whole providing more and improved utilities to the public.

Wasao, (2014) did a study on the effect of online tax system on tax compliance among small taxpayers In East of Nairobi Tax District. The study adopted quantitative and descriptive methods as a research designs. Data was collected using structured questionnaire, which covered all the variables of the study from 160 sampled taxpayers based in East of Nairobi tax District. Data obtained was subjected to quantitative methods of data analysis using SPSS (version 20). Results obtained were presented using tables and graphs for ease of understanding and interpretation. In addition, both correlation and regression analyses were done and summaries presented. The findings of the study were that online system do affect tax compliance level among small taxpayers in East of Nairobi as far as registration, filing and payments were concerned. The study recommends that a further study should be done to establish how other factors of tax compliance affect compliance in other tax districts of small taxpayers which are considered more/less advanced than East of Nairobi tax District and also in that region.

## **2.4 Summary of literature and research gaps**

Makokha, Nambuswa and Namusonge, (2017) did a study to investigate the determinants of tax compliance among SMEs in Bungoma county. The study broadly addresses cost but does not dissect which specific cost elements e.g., filing fees, compliance costs, administrative burden, have the most significant impact on tax compliance. Further research could explore which particular costs are most burdensome. The study is focused on Bungoma County. Further research could expand to compare how the influence of costs on tax compliance varies across different regions or counties with different economic conditions and tax administration practices. The study relies on quantitative methods to analyze the impact of costs. Incorporating qualitative research could provide deeper insights into how SMEs experience and perceive the costs associated with tax compliance.

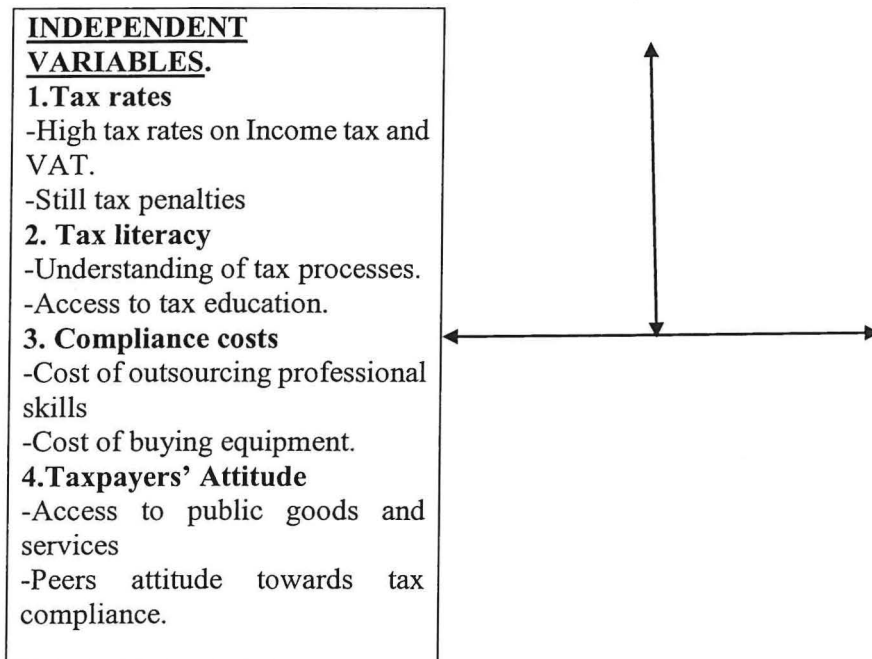
Musau, (2015) examined factors affecting compliance with tax laws and regulations among income earners majoring on SMEs in Nairobi County, Kenya. The sample size used was too little to cover the whole of Nairobi to collect reliable and accurate data as 120 SMEs cannot accurately represent over 30252 SMEs. The study also concentrated on tax laws and regulations and not the rest of the factors such as taxpayer's attitude, tax literacy, tax rates etc. The study does not consider how cultural or social factors might influence tax compliance beyond perceptions of complexity and trust. Research could further explore how local cultural attitudes and social norms impact tax compliance behaviors.

Mwangi, (2014) examined the factors influencing tax compliance among small and medium enterprises in Nairobi's Industrial Area, Kenya. The study notes that high tax rates hinder compliance but does not specify which tax rates e.g., corporate tax, VAT or income tax has the most significant impact. Further research could explore how different types of tax rates affect tax compliance. The study primarily focuses on external factors like tax rates and information availability but does not explore psychological and behavioral factors that might affect tax compliance, such as attitudes towards taxation, perceived fairness, or social norms.

Wasao, (2014) did a study on the effect of online tax system on tax compliance among small taxpayers in East of Nairobi Tax District. The study does not identify specific barriers or challenges faced by small taxpayers in using online tax systems. Research could explore issues such as technological access, digital literacy, or internet connectivity that might affect the effectiveness of online systems. The study focuses on the impact of online systems on registration, filing, and payments. Future research could assess how online systems affect other aspects of tax compliance, such as record-keeping, audits, and interaction with tax authorities. Addressing these gaps could provide a more comprehensive understanding of the factors influencing tax compliance among SMEs and help develop targeted strategies to improve compliance and revenue collection.

## 2.5 Conceptual Framework

This study assumes that the factors under discussion have a direct influence on tax compliance among SMEs in Kenya. The relationship between the dependent and the independent variables is illustrated in the conceptual framework presented in figure below:



<b>MODERATING VARIABLE</b>		<b>DEPENDENT VARIABLE</b>
Government Regulations.	Policies	<b>Tax Compliance</b> -Increased revenue collection. -Timely payment of taxes.

**Figure 2. 1 Conceptual Framework**

## 2.6 Operationalization and measurement of variables

Table 2.1: Operationalization of variables

Objective	Variable	Indicator	Measurement scale	Tools of analysis	Type of analysis
To assess how tax compliance is affected by all the stated factors.	Dependent	Amount of revenue collected. Timely payment of taxes.	Nominal	Mean percentages Frequencies	Descriptive statistics
To ascertain the extent to which tax rate explains tax compliance behavior	Independent	The high tax rate. Stiff tax penalties Several tax heads	Nominal	Mean percentages	Descriptive statistics
To establish the relationship between tax literacy and tax compliance by SMEs in Nairobi's Central	Independent	Level of access to knowledge and understanding of the process of filing of taxes by SMEs in Nairobi's Central	Nominal	Mean Percentages Frequencies	Descriptive statistics Inferential statistics

Business District.		Business District.			
To determine the extent to which tax compliance costs explain tax compliance.	Independent	Outsourcing costs. Equipment costs. Penalties when paying for complying with previous pending taxes.	Ordinal	Mean Percentages	Descriptive statistics
To determine how attitude of SMEs in Nairobi's Central Business District about tax influence tax compliance.	Independent	Access to public goods and services. Peer attitude and motivation associated with tax compliance.	Ordinal	Positive Negative	Descriptive statistics.
Government Policies and Regulations.	Moderating	Guidelines for registration for tax and tax declaration provided in the law.	Ordinal	Scale	Descriptive statistics

Table 2. 1 Operationalization of variables

The literature review indicates that there has been ongoing research examining the factors that influence tax compliance among Small and Medium Enterprises in Nairobi's Central Business District. The primary objective of this study is to identify these factors impacting tax compliance within SMEs in Nairobi's Central Business District. The research specifically focuses on tax rates, tax literacy, compliance costs, and the attitudes of taxpayers. This paper aims to address issues related to the tax gap caused by non-filing, underreporting, and underpayment. The specific goal of the research is to gain insights into the elements affecting tax compliance among SMEs in Nairobi's Central Business District. The findings are anticipated to assist policymakers and, specifically, the Kenya Revenue Authority (K.R.A) in developing a better understanding of SMEs, thereby enabling them to plan and design services more effectively.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

The forthcoming section delves deeply into the research methodology to be employed for this study. This chapter provides an extensive examination of several key components, including the research design, the study's target population, the chosen data collection instrument and methodology, the steps for data analysis, and lastly, a comprehensive exploration of the ethical considerations guiding this research endeavor.

### **3.2 Research Design**

A descriptive survey design was adopted for this study. A descriptive survey design was best for this study as it describes characteristics associated with the subject population, and in particular factors that make them behave the way they do. According to Cooper and Schindler (Cooper,2023) descriptive design discovers and measures the cause and effect of relationships between variables. Mugenda and Mugenda (Mugenda, 2024) state that a descriptive research determines and reports the way things are and attempts to describe possible behavior, attitude, values and characteristics of such things. The study used a descriptive design because it enables the researcher to collect a large quantity of in-depth information about the population being studied.

A survey design was appropriate as the data required for analysis needed to be collected from a large population of SMEs operating in Nairobi's Central Business District.

### **3.3 Population and sampling**

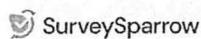
The research targeted SMEs operating their business in Nairobi's Central Business District. The unit of analysis for the study in any SMEs registered by the Kenya Revenue Authority. The researcher was interested in examining the tax behavior of these SMEs in Nairobi's Central Business District. The total population was 7092.

The researcher ensured a high degree of correspondence between the sampling frame and the sample population as the accuracy of the sample depends mostly on the sampling frame.

The sample size is an important feature of any empirical study in which the goal is to make inferences about a population from a sample. In practice, the sample size used in a study is

determined based on the expense of data collection, and the need to have sufficient statistical power. Sample size is important primarily because of its effect on statistical power.

For the population of 7092 taxpayers of SMEs in Nairobi Central Business District, a sample size of 194 is manually calculated. When it comes to this research the convenience sampling technique will be used which is a type of non-probability technique where the subjects are chosen depending on the ease of the research accessing them. (Etikan 2016)



### Sample Size - Slovin's Formula

$$n = \frac{N}{(1+N*e^2)}$$

n is the sample size

N is the population size

e is the desired margin of error

### 3.4 Data Collection Methods

The study utilized primary data collection through a self-administered questionnaire that included both structured open-ended and closed questions, facilitating an in-depth exploration of the factors influencing tax compliance among SMEs. The questionnaires will ask questions testing on how tax rates such as Income Tax and VAT, tax literacy, tax attitude and compliance costs influence tax compliance among SMEs in Nairobi's Central Business District. The research instruments comprised of detailed questionnaires. Data collection procedures began upon approval of the proposal after its defense. An introduction letter was issued to the sampled entities for consent to collect data from the respondents. The questionnaires were administered to the respondents directly by the researcher with the help of two research assistants in order to save on time. For

those respondents who were not available for a sit-in filling of the questionnaire, it was e-mailed to them.

### **3.5 Data Analysis**

The data collected for this study was analyzed using Microsoft Excel which facilitated the organization, calculation, and summarization of the metrics to meet the research objectives. Descriptive analysis was carried out to summarize and interpret the characteristics of the respondents and their responses. The study used tables of frequencies, percentages, means, and standard deviations were used to describe the data. Demographic information including the roles of respondents, years of business operation, and monthly turnover was analyzed to provide context to the study.

Inferential analysis involved applying multiple regression analysis to establish the relationship between the independent variables and the dependent variable, tax compliance. The regression analysis followed the model:

$$Y = B_0 + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4 + \epsilon$$

Where:

Y = tax compliance

B<sub>0</sub> = constant

X<sub>1</sub> = tax rates

X<sub>2</sub> = tax literacy

X<sub>3</sub> = compliance costs

X<sub>4</sub> = taxpayer's attitude

ε = error term

B<sub>1</sub>, B<sub>2</sub>, B<sub>3</sub>, B<sub>4</sub> = regression coefficients

### **3.6 Research Quality**

This section dives into the reliability and validity test.

#### **3.6.1 Validity**

Validity is the degree to which an instrument measures what it is supposed to measure. (Kothari, 2023) Therefore, the term refers to the extent to which an instrument asks the right questions in terms of accuracy. The content validity of the research instrument for this study was determined through piloting, where the responses of the subjects were checked against the research objectives. For a research instrument to be considered valid, the contents selected and included in the questionnaire must be relevant to the variables being investigated. The researcher performed the pilot test with a randomly selected sample of fifteen SMEs in Nairobi's Central Business District. Content validity of the instrument was also tested using a research expert's opinion, who was the research supervisor. The research supervisor independently judged the validity of the items in the questionnaire in relation to the research objectives.

### **3.6.2 Reliability**

Reliability of an instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trials (Cooper, 2023). To test the reliability of the questionnaire as a research instrument, a test-retest technique was employed in which questionnaires were administered to a group of SMEs with similar characteristics as the actual sample size but not included in the final study. The test was repeated after two weeks. This was to establish the extent to which the questionnaire elicited the same responses every time it is administered. The findings were found to be consistent and therefore the questionnaire proved to be a reliable research instrument.

### **3.6.3 Objectivity**

Objectivity in research refers to the ability to present findings in a way that is unbiased, impartial, and free from personal opinions or emotions. It involves gathering data and analyzing it in a way that is consistent and reliable, without allowing any preconceived notions or biases to influence the results. Maintaining objectivity during the research methodology process involves clearly defining the research question this helps to focus the research and ensure that it remains on track and unbiased. Secondly, using a systematic and structured approach to data collection and analysis: This helps to ensure that the data is gathered and analyzed in a consistent and reliable manner, without any personal biases or opinions influencing the results. Minimizing the impact of personal

biases and preconceived notions: This can be achieved by using objective language when describing the findings, and by avoiding any language or terminology that may be subjective or biased. Ensuring that the research is peer-reviewed and critiqued by others this helps to identify and address any potential biases or limitations in the research, and ensures that the findings are presented in an objective and reliable manner.

### **3.7 Ethical Consideration**

This research endeavored to obtain informed consent from the respondents before undertaking to collect data from the field. Objectives of the research were explained and made known to the respondents to solicit their informed consent. High level of confidentiality on the information provided by respondents through interview or questionnaires was maintained.

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## **CHAPTER FOUR: RESEARCH FINDINGS AND PRESENTATION**

### **4.1 Introduction**

This chapter presents the results of the study, which include the response rate, demographic characteristics of the respondents, descriptive analysis of the data, multiple regression analysis, and a summary of the findings. The presentation follows the sequence of these elements to address the research objectives.

### **4.2 Sample representation**

The study targeted a sample size of 194 respondents from Small and Medium Enterprises (SMEs) in Nairobi's Central Business District. Out of this, 172 responses were successfully collected,

representing an 88.7% response rate. This high response rate is deemed sufficient for the analysis and ensures reliable and valid results.

Table 4. 1 Response Rate

Category	Frequency	Percentage (%)
Targeted Respondents	194	100
Responses Collected	172	88.7
Non-Responses	22	11.3

### 4.3 Demographic information of respondents

This section analyzes the demographic characteristics of the respondents, including their position in the organization, years of business operation, nature of business activity, monthly turnover, and the number of employees.

#### 4.3.1 Position of Respondents in the Organization

The majority of respondents were business owners (45.3%), followed by finance managers (25.6%), accountants (18.6%), and managing directors (10.5%). This indicates that most respondents had firsthand knowledge of their organization's financial and tax matters.

Table 4. 2 Position of Respondents

Position	Frequency	Percentage (%)
Business Owner	78	45.3
Finance Manager	44	25.6
Accountant	32	18.6
Managing Director	18	10.5

### 4.3.2 Years of Business Operation

The findings revealed that 40.1% of SMEs had been in operation for 1–5 years, 35.5% for 6–10 years, and 16.9% for over 10 years, while only 7.5% had operated for less than a year. This indicates a broad representation of SMEs at various stages of growth.

Table 4. 3 Years of Business Operation

Years of Operation	Frequency	Percentage (%)
Less than 1 year	13	7.5
1–5 years	69	40.1
6–10 years	61	35.5
Over 10 years	29	16.9

### 4.3.3 Nature of Business Activity

Most SMEs were in the service industry (52.9%), followed by commercial enterprises (35.5%) and manufacturing (11.6%). This reflects the dominant role of the service and trade sectors within Nairobi's CBD.

Table 4. 4 Nature of Business

Nature of Business	Frequency	Percentage (%)
Manufacturing	20	11.6
Service	91	52.9
Commercial	61	35.5

### 4.3.4 Monthly Turnover

Analysis of monthly turnover showed that 48.8% of SMEs earned between Ksh 500,001 and Ksh 1 million, while 27.9% earned below Ksh 500,000. SMEs earning between Ksh 1 million and Ksh 2 million made up 15.1%, while those earning over Ksh 2 million accounted for 8.1%.

Table 4. 5 Monthly Turnover

Monthly Turnover (Ksh)	Frequency	Percentage (%)
Below 500,000	48	27.9
500,001–1,000,000	84	48.8
1,000,001–2,000,000	26	15.1
Over 2,000,000	14	8.1

#### 4.3.5 Number of Employees

A significant portion of SMEs employed fewer than 50 employees (63.4%), while 24.4% had 51–100 employees. SMEs with over 100 employees accounted for 12.2%. This highlights the small-scale nature of most businesses in the CBD.

Table 4. 6 Number of Employees

Number of Employees	Frequency	Percentage (%)
Below 50	109	63.4
51–100	42	24.4
Over 100	21	12.2

#### 4.4 Descriptive Analysis

This section presents an analysis of the factors influencing tax compliance among SMEs in Nairobi’s Central Business District. The results are presented using both frequency distributions and descriptive statistics, including means and standard deviations for rating scale questions.

##### 4.4.1 Tax Rates

The findings highlight the perception of tax rates and their influence on compliance among SMEs in Kenya. A majority of respondents (68.6%) believe that VAT rates are high, with 31.4% indicating otherwise. Corporate tax rates are perceived as high by 73.3% of the respondents, while 26.7% disagreed. These perceptions suggest that tax rates, both VAT and corporate, are considered significant burdens for SMEs. 81.4% of respondents reported that the amount of taxes payable significantly influences their compliance, reflecting the financial strain imposed by tax liabilities. 18.6% indicated that the amount payable does not affect their compliance behavior.

The data shows that high tax rates and substantial tax obligations are viewed as major challenges for SMEs by impacting their willingness and ability to comply with tax requirements.

Table 4. 7 Tax Rates

Category	Response	Frequency	Percentage (%)
Perception of VAT Rates	Yes	118	68.6
	No	54	31.4
Perception of Corporate Tax Rates	Yes	126	73.3
	No	46	26.7
Influence of Tax Amounts on Compliance	Yes	140	81.4
	No	32	18.6

#### 4.4.2 Tax Literacy

A substantial majority of respondents (85.5%) agreed that knowledge about taxes is readily available, indicating that tax-related information is generally accessible to most SMEs. There were 14.5% who disagreed, suggesting there are still gaps in awareness or accessibility for some businesses.

When it comes to the ability to correctly calculate tax amounts payable, 72.1% of respondents expressed confidence in their ability to do so. However, 10.5% indicated that they could not accurately calculate their taxes, and 17.4% were unsure about their capability.

Table 4. 8 Tax Literacy

Category	Response	Frequency	Percentage (%)
Knowledge About Taxes in Kenya	Yes	147	85.5
	No	25	14.5
Ability to Correctly Calculate Tax Payable	Yes	124	72.1
	No	18	10.5
	Not Sure	30	17.4

The effect of lacking tax knowledge on compliance was rated using a scale of 1 (Not at all) to 5 (Very great extent). The mean rating was 4.12, indicating that respondents perceive a significant

impact of inadequate tax knowledge on compliance. The standard deviation was 0.87, reflecting moderate variability in opinions.

Table 4. 9 tax knowledge on compliance

Statistic	Mean	Standard Deviation
Lack of Tax Knowledge	4.12	0.87

#### 4.4.3 Tax Compliance Cost

The majority of SMEs (62.8%) spend between Ksh 10,001 and Ksh 50,000 per month to remain tax compliant. Other notable percentages include 22.1% spending below Ksh 10,000, and 11.6% spending between Ksh 50,001 and Ksh 100,000. Only 3.5% reported spending over Ksh 100,000 monthly.

Table 4. 10 Monthly Tax Compliance Costs

Cost (Ksh)	Frequency	Percentage (%)
Below 10,000	38	22.1
10,001–50,000	108	62.8
50,001–100,000	20	11.6
Over 100,000	6	3.5

Respondents rated the effect of compliance costs on tax compliance on a scale of 1 (Not at all) to 5 (Very great extent). The mean rating was 3.87, indicating that compliance costs have a moderate effect on tax compliance. The standard deviation was 0.78, suggesting relatively low variability in responses.

Table 4. 11 Compliance Costs on Tax Compliance

Statistic	Mean	Standard Deviation
Effect of Compliance Costs	3.87	0.78

The majority of SMEs (56.4%) identified the cost of outsourcing professional staff as the highest expense in maintaining tax compliance. Equipment costs (29.1%) and software and internet costs (14.5%) were the other significant contributors.

Table 4. 12 Highest Tax Compliance Cost

Expense Type	Frequency	Percentage (%)
Outsourcing Professional Staff	97	56.4
Equipment Costs	50	29.1
Software and Internet Costs	25	14.5

#### 4.4.4 Attitude towards tax

The responses indicate that SMEs moderately feel they receive access to public utilities and services funded by taxes, with a mean of 3.45. They strongly value the payment of taxes, as reflected by a higher mean of 4.01. On the other hand, the perception of how much other SMEs value tax payments is somewhat moderate, with a mean score of 3.65. The standard deviations are relatively low, suggesting that there is a general consensus on these attitudes, though some variability exists.

Table 4. 13 Attitude towards tax

Question	Mean	Standard Deviation
Access to Public Utilities and Services Funded by Taxes	3.45	0.92
Value of Tax Payment to the Kenyan Government	4.01	0.76

Perception of Other SMEs in CBD Regarding Tax Payment	3.65	0.84
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**4.5 Multiple regression analysis**

To determine the impact of tax rates, tax literacy, compliance costs, and taxpayers' attitude on tax compliance, a multiple regression analysis was conducted. The regression model used is:

$$Y = B_0 + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4 + \epsilon$$

Where:

Y = Tax Compliance

X1 = Tax Rates

X2 = Tax Literacy

X3 = Compliance Costs

X4 = Taxpayer's Attitude

B<sub>0</sub> = Constant

B<sub>1</sub>, B<sub>2</sub>, B<sub>3</sub>, B<sub>4</sub> = Regression Coefficients

ε = Error Term

Table 4. 14 regression analysis

Variable	Unstandardized Coefficients (B)	Standard Error (SE)	Standardized Coefficients (Beta)	t-value	Sig.
Constant (B <sub>0</sub> )	1.201	0.323	-	3.72	0
Tax Rates (X1)	0.332	0.105	0.312	3.16	0.002
Tax Literacy (X2)	0.487	0.101	0.421	4.82	0

Compliance Costs (X3)	0.275	0.095	0.279	2.89	0.004
Taxpayer's Attitude (X4)	0.265	0.097	0.236	2.73	0.007

The constant value of 1.201 indicates the baseline level of tax compliance when all independent variables (tax rates, tax literacy, compliance costs, and taxpayer's attitude) are equal to zero. The constant is statistically significant (p-value = 0.000).

The coefficient for tax rates (0.332) suggests that for each one-unit increase in the perception of tax rates, tax compliance increases by 0.332 units. This relationship is statistically significant at a 5% significance level (p-value = 0.002), indicating that tax rates do influence tax compliance.

The coefficient for tax literacy (0.487) is the highest among the variables, meaning that for each one-unit increase in tax literacy, tax compliance increases by 0.487 units. This relationship is highly significant (p-value = 0.000), demonstrating that higher levels of tax literacy significantly promote better tax compliance.

The coefficient for compliance costs (0.275) shows that as compliance costs increase by one unit, tax compliance increases by 0.275 units. This variable is statistically significant (p-value = 0.004), meaning that reducing compliance costs can positively affect tax compliance.

The coefficient for taxpayer's attitude (0.265) indicates that a positive attitude toward tax payment leads to a 0.265 increase in tax compliance. The relationship is statistically significant (p-value = 0.007), implying that a positive attitude towards tax payments plays a significant role in ensuring compliance.

#### 4.6 Discussion of results

The study revealed that tax rates significantly influence tax compliance among SMEs in Nairobi's Central Business District. Most respondents perceived VAT and corporate tax rates as high, with these rates being described as burdensome to business operations. The financial strain created by these high rates discourages compliance, as many SMEs struggle to meet their tax obligations

while maintaining profitability. The findings suggest a pressing need for more progressive tax policies to alleviate this burden and improve compliance levels.

Tax literacy was identified as the most critical factor affecting tax compliance. A majority of SMEs with sufficient knowledge of tax laws and processes demonstrated higher compliance rates. Conversely, businesses with limited tax knowledge were more prone to errors, delays, and reliance on external assistance. This highlights the need to enhance access to tax-related information through training, workshops and simplified filing processes to bridge knowledge gaps and encourage voluntary compliance.

The study also showed that compliance costs and taxpayer attitudes play substantial roles in determining tax compliance. High compliance costs in hiring professionals, were a significant financial challenge for many SMEs. Mixed attitudes toward taxation were noted, with businesses expressing skepticism about the effective utilization of tax revenues. Improving government transparency and accountability in resource allocation could improve trust, positively influencing attitudes and compliance behaviors.

## **CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 Introduction**

This chapter provides a summary of the key findings, conclusions drawn from the study, and recommendations for improving tax compliance among SMEs in Nairobi's Central Business District.

### **5.2 Summary**

#### **5.2.1 Tax Rates**

The feedback collected regarding tax rates revealed that a significant number of SMEs in Nairobi's Central Business District perceive tax rates, particularly VAT and corporate tax, as high and burdensome. Many respondents highlighted that the current tax structure places a strain on their businesses, especially in light of the rising operational costs. This has led to a general sense of frustration, as businesses feel that the high tax rates are discouraging their growth and profitability. Some recognized the necessity of taxes for public services but the overwhelming sentiment was that the rates should be more aligned with the realities of running a small or medium-sized business. In many cases, this has resulted in efforts to minimize tax liabilities, sometimes leading to non-compliance or underreporting of earnings.

#### **5.2.2 Tax Literacy**

Tax literacy was a key factor influencing tax compliance, with many respondents indicating that a lack of understanding about tax processes and requirements significantly affected their ability to comply. The majority of respondents who felt confident in their knowledge of taxes were more likely to meet their obligations. This suggests that a strong understanding of the tax system empowers SMEs to properly calculate their liabilities, file their returns on time, and avoid mistakes that could lead to penalties. On the other hand, those with limited tax knowledge expressed uncertainty about their responsibilities and often relied on external help to navigate the system.

#### **5.2.3 Tax Compliance Cost**

The cost of tax compliance was another major issue raised by the SMEs. Respondents shared concerns about the significant financial and time investment required to ensure they remain compliant with tax laws. Many reported spending considerable sums on professional services, such as accountants and tax advisors, to assist with filing returns and managing tax-related issues. For

some, these costs were seen as disproportionately high compared to their business size and revenue. These expenses often created a barrier to full compliance, as businesses with tighter budgets were less able to afford the necessary services. There were calls for the government and relevant authorities to explore ways to reduce these costs, perhaps by simplifying the tax filing process or offering more accessible resources for small businesses. Reducing these costs could encourage greater compliance and reduce the burden on businesses already struggling with other operational expenses.

#### **5.2.4 Attitude towards tax**

The attitude towards tax payments among SMEs varied, but overall, most respondents recognized the importance of paying taxes and contributing to the development of public services. There was a noticeable lack of trust in how tax revenues are utilized, with some business owners expressing skepticism about the transparency and effectiveness of government spending. This sentiment was particularly evident among those who felt that the public services they receive do not reflect the taxes they pay. Businesses that viewed tax payments positively were more inclined to comply, indicating that fostering a culture of respect for tax obligations is crucial. Encouraging a more positive attitude toward tax payments could be key to improving compliance rates.

#### **5.3 Conclusions**

The findings of this study confirm that tax rates are a significant factor in explaining tax compliance among SMEs in Nairobi's Central Business District. High tax rates, specifically VAT and corporate tax, were consistently identified as barriers to full tax compliance. SMEs perceive these taxes as too burdensome, which leads to a reluctance to pay taxes on time or fully report earnings. SMEs acknowledge the necessity of taxes for public goods and that the rates do not reflect the financial capabilities of small businesses. This conclusion aligns with the work of Mwangi (2014), who found that high tax rates discourage compliance and contribute to the underreporting of income. The findings of this study support the argument made by Musau (2015) that excessive tax rates may lead SMEs to engage in tax avoidance practices. Thus, reducing the tax burden on SMEs could increase compliance if the government considers implementing more progressive tax policies.

Tax literacy emerged as one of the most significant determinants of tax compliance in this study. The findings indicate that SMEs with higher levels of understanding of the tax system, including knowledge of tax laws, regulations, and filing processes, are more likely to comply with tax obligations. Musau (2015) noted that a lack of tax knowledge among SMEs leads to errors in filing, late payments, and avoidance of tax responsibilities. In contrast, when SMEs possess a solid understanding of tax requirements, they are better equipped to manage their tax affairs efficiently, leading to increased compliance. This outlines the importance of tax education and simplified communication from tax authorities. Initiatives in tax workshops, training programs, and clear, accessible guidelines could improve tax literacy and, in turn, boost compliance.

The cost of tax compliance was identified as another key factor affecting tax compliance. The study found that the financial burden of hiring professionals, such as accountants and tax consultants, to help with tax filing and management is significant for many SMEs. These costs can become prohibitively high, especially for smaller businesses with limited resources, creating a barrier to compliance. This finding aligns with Makokha et al. (2017), who also emphasized that the high cost of compliance discourages SMEs from fulfilling their tax obligations. The cost of tax compliance, including the administrative burden of understanding and following complex tax procedures leads to delayed filings, underreporting, or complete avoidance of taxes.

The attitude toward tax payments was another important factor influencing compliance. The study found that SMEs with a positive attitude towards tax payments seeing them as a civic duty and a contribution to public development were more likely to comply. Waweru (2014) argued that social norms and perceptions of fairness play a key role in shaping taxpayers' behavior. There were also instances where SMEs expressed distrust towards the tax system, particularly regarding how the government utilizes tax revenues. This mistrust can discourage compliance, as some business owners feel that their tax payments do not result in visible improvements to public services. SMEs with a more favorable view of tax payments tend to engage more fully with the tax system, filing returns on time and paying the correct amounts.

#### **5.4 Recommendations**

A simplified tax system would make it easier for businesses to understand their obligations and reduce the administrative burden they face. The government should streamline tax forms, create

user-friendly online platforms, and provide clearer instructions. This could reduce the time and financial cost of compliance, making it more accessible for SMEs. Simplifying these processes would likely increase compliance and enhance tax collection efficiency (Mwangi, 2014).

A focused effort on increasing tax literacy is crucial. Many SMEs lack a proper understanding of tax laws and processes, which contributes to errors in filing and delays in payments. To address this, the government should provide more accessible training and resources through workshops, seminars and online guides tailored for SMEs. The government can help SMEs comply more effectively and reduce the likelihood of tax evasion due to ignorance (Musau, 2015). This would also cultivate a long-term culture of responsibility among SMEs.

The costs associated with tax compliance, including hiring professional services, are prohibitive for SMEs. The government should consider providing subsidies or tax breaks for businesses that comply with tax regulations. Simplifying the filing process to reduce dependence on professional services would also lower these costs. Reducing the financial strain would make it easier for SMEs to meet their tax obligations, increasing compliance rates and encouraging more businesses to participate fully in the tax system (Makokha, Nambuswa, & Namusonge, 2017).

Improving the perception of the tax system is essential for increasing compliance. Many SMEs are skeptical about how their taxes are used and do not see the direct benefits of paying taxes. The government should improve transparency and clearly communicate how tax revenues are allocated to public goods and services. When SMEs can see the tangible benefits of paying taxes, they are more likely to comply willingly. This positive attitude requires consistent communication, accountability and visible outcomes from tax-funded initiatives (Waweru, 2014).

### **5.5 Limitations of the study**

The study was confined to SMEs operating within Nairobi's Central Business District (CBD), which restricts the ability to generalize the findings to all SMEs in Kenya. The economic conditions, tax policies, and challenges faced by businesses in the CBD might differ from those in other parts of the country. SMEs in rural or less urbanized areas may experience different levels of tax awareness, tax burdens, or access to resources for tax compliance.

Due to the limited time available for data collection and analysis, the study was not able to explore certain aspects of tax compliance in as much detail as would have been ideal. The study could have included more in-depth interviews or focus groups with SME owners, which might have provided details into the factors influencing tax compliance. A longer period for data collection could have allowed the researcher to survey a larger sample size, which would have improved the reliability and representativeness of the findings.

The reliance on data via questionnaires poses a limitation to the study. Respondents may have provided socially desirable answers or underreported their tax compliance issues in tax evasion or non-compliance, due to the sensitive nature of the subject. This could lead to response bias, affecting the accuracy and reliability of the data. In addition, some respondents might have misinterpreted the questions or lacked the necessary understanding to answer them accurately.

### **5.6 Suggestion areas of research**

A potential area could be to explore how recent changes in tax policies affect tax compliance among SMEs. The effects of policy adjustments in tax rate changes or the introduction of new tax incentives, on SMEs would look into how businesses adapt to shifting tax environments. This could also include studying the effectiveness of specific tax reforms designed to encourage compliance and reduce the burden on small businesses.

Given the increasing role of technology in business operations, it would be useful to investigate how digital tools and online platforms can improve tax compliance for SMEs. Exploring how tax filing systems, mobile apps, or digital accounting software could simplify the process of managing taxes for small businesses might lead to recommendations for improving efficiency and compliance. This could also cover the challenges SMEs face in adopting such technologies and how they can be overcome.

Another area for discussion could focus on how government support and initiatives can help SMEs meet their tax obligations. This might include looking into the availability and effectiveness of government resources through tax education programs, advisory services, or financial assistance for SMEs struggling with compliance costs. Researching how well these support programs are reaching SMEs and how they can be improved could provide valuable recommendations for policy development.



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## **APPENDICES**

### **APPENDIX I: LETTER OF INTRODUCTION**

Peris Momanyi

P.O Box 59857-00200

Nairobi, Kenya.

[peris.masese@strathmore.edu](mailto:peris.masese@strathmore.edu)

Dear Respondent,

I am a student at Strathmore University pursuing a Bachelor in Commerce. I am conducting an academic research on the factors promoting tax compliance among SME's in Nairobi's Central Business District. I'm writing to invite you to participate in the research by filling in the questionnaire.

My research project focuses on tax rate, tax literacy, tax compliance costs and taxpayers' attitude. The questionnaire should take about 15 minutes to complete. Your participation is entirely voluntary and the questionnaire is completely anonymous.

I assure you that the information you will provide will be treated with utmost confidentiality. Your ability to answer all the questions comprehensively and to the best of your knowledge will be highly appreciated.

I look forward to your support.

Thank you.

Yours Sincerely,

Peris Momanyi

Tel: 0115-244-143

**APPENDIX II: QUESTIONNAIRE**

**Instructions**

This questionnaire is designed to collect information on the factors affecting tax compliance in SMEs in Nairobi's Central Business District, Kenya. The information obtained will only be used for academic purposes and shall be treated in utmost confidence. You are requested to complete this questionnaire as honestly and objectively as possible.

Please cross the answer you find the most appropriate and where elaborate answers are needed feel free to fill in the space provided.

**SECTION A: GENERAL INFORMATION**

1.Name of SME (Optional).....

2.Position of respondent in the organization.

- A. Business Owner
- B. Finance Manager
- C.Managing Director
- D.Accountant
- E.Other(Specify).....

3. How long has the organisation been in existence?

- A.Less than One year
- B.1-5 Years
- C.6-10 Years
- D.More than 10 Years

4. What is your main business activity?

.....

5. What is the Nature of your Business?

A. Manufacturing

B. Service

C. Commercial

D. Others( Specify).....

6. On average, what is your business monthly turnover?

A. Below 500,000

B. Between 500,001 and 1 million

C. Between 1 million and 2 million

D. Between 2,000,001 and 3 million

E. Over 3 million

7. Number of Employees at the SME

A. Below 50

B. Between 51 and 100

C. Between 101 and 150

D. Over 150

## **SECTION B: FACTORS INFLUENCING TAX COMPLIANCE AMONG SMEs IN CBD**

### **Tax Rates**

8. Do you think the Kenyan tax rate on VAT is high?

A. Yes B. No

9. Do you think the Kenyan tax rate on Corporate tax is high?

A. Yes B. No

10. Is the amount payable in terms of taxes influence your tax compliance?  
A. Yes B.No

### **Tax Literacy**

Tick or circle where appropriate) {Note: [1] = Not at all, [2] = Less extent, [3] = Some extent, [4] = Great extent, [5] = Very Great extent;

11. Is knowledge about taxes in Kenya readily available?  
A. Yes B. No

12. How does the lack of tax knowledge affect your company's tax compliance?  
[1] [2] [3] [4] [5]

13. As an organization we are able to correctly calculate the tax amount payable based on available knowledge.  
A. Yes B. No C. Not sure

### **Tax Compliance Cost**

Tick or circle where appropriate) {Note: [1] = Not at all, [2] = Less extent, [3] = Some extent, [4] = Great extent, [5] = Very Great extent;

14. On average how much do you spend in a month in order to be tax compliant?  
A. Below Ksh 10,000  
B. Between Ksh 10,001 and Ksh 50,000  
C. Between 50,001 and Ksh 100,000  
D. Over 100,000

15. How much does the cost of compliance affect your company's tax compliance?  
(1) (2) [3] [4] [5]

16. Which of the following expenses constitute the highest tax compliance cost?  
55

A. Cost of outsourcing professional staff

B. Equipment costs

C. Software and Internet

**Attitude towards tax**

**Tick or circle where appropriate) (Note: [1] = Not at all, [2] = Less extent, [3] = Some extent, [4] = Great extent, [5] = Very Great extent;**

17. To what extent does your company receive access to public utilities and services funded by the taxes collected for the government by the KRA?

[1] [2] [3] [4] [5]

18. To what extent, in your opinion, does your company value the payment of taxes to the Kenyan government?

[1] [2] [3] [4] [5]

19. To what extent do you view other SMEs in CBD value the payment of taxes?

[1] [2] [3] [4] [5]

## PERIS PROJECT.docx

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