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An assessment of challenges of administering turnover tax collection: a case study of Kenya Revenue Authority

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AN ASSESSMENT OF CHALLENGES OF ADMINISTERING TURNOVER TAX COLLECTION: A CASE STUDY OF KENYA REVENUE AUTHORITY

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MPPM/29762/13

A research dissertation submitted in partial fulfilment of the requirements for the award of
Master of Public Policy and Management (MPPM) of Strathmore University

June 2018

DECLARATION

This research dissertation is my original work and has not been presented towards any award of degree in any other University. In instances where I have used the contribution from others, every effort is made to indicate this clearly with references to the literature and acknowledgment of discussions. I have done this work under the guidance and supervision of Dr. Thomas N. Kibua of Strathmore Business School.

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ABSTRACT

Turnover Tax (TOT) was introduced in Kenya in the 2006 Finance Act, and rolled out in January 2007. TOT was designed as a presumptive tax or estimate charge computed at 3% of the sales turnover of businesses making Kshs. 5 million or less. This step was designed as a revenue measure to broaden the tax base by bringing the largely untapped informal sector into the tax base. More than 10 years on the tax gap from the informal sector indicates the collections at a meagre 0.15% of the true tax potential. This study is focused on challenges faced by Kenya Revenue Authority, the single collector of national government revenue, in administering the TOT. The objectives of the study were; to assess the perceptions by KRA officers of application of trust and facilitation measures in collection of TOT in Nairobi Kenya; assess the perceptions by KRA officers of extent of application of enforcement measures in collection of turnover taxation of the informal sector; and based on the responses to identify priority areas for policy, legal and KRA administrative reform in collection of tax from the informal sector. The study identified the independent variables for this research to be trust and facilitation (simplification and education/advice) and enforcement (powers and procedures, detection capabilities and punishment). A target population of 235 KRA staff was selected and a total sample size of 147 was selected as representative, to be the focus of this study. A descriptive survey design was used. Stratified sampling technique was used to create a sampling frame ensuring that all Nairobi Domestic Tax Department (DTD) offices were included in the survey. Data was collected using self–administered questionnaires and direct interviews. Statistical Package for Social Scientist software (SPSS version 20) was used to perform descriptive and inferential analysis on the collected data, and findings presented using tables. The principal findings were that KRA has been hampered in its efforts to implement the policy on informal taxation largely due to lack of adequate resources, a poorly implemented strategy of taxpayer facilitation and lax enforcement among the informal sector largely leading to lower than expected tax gains from TOT. The study could not establish positive effects of the KRA radical shift towards trust and facilitation on the TOT collections since the launch of the 6th Corporate Plan in 2015. The study finds that a more focused investment by KRA in reviewing powers and procedures, detection of non-compliant taxpayers and punishing of those who wilfully comply has the potential of increasing the TOT revenue base.

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ABBREVIATIONS

AfDB	-	African Development Bank
CRM	-	Customer Relationship Management
DFID	-	Department for International Development
DTD	-	Domestic Taxes Department
ETR	-	Electronic Tax Register
GDP	-	Gross domestic product
GoK	-	Government of Kenya
IFC	-	International Finance Corporation
ILO	-	International Labour Organization
IMF	-	International Monetary Fund
KIPPRA	-	Kenya Institute for Public Policy Research and Analysis
KNBS	-	Kenya National Bureau of Statistics
KRA	-	Kenya Revenue Authority
MSE	-	Micro and Small Enterprise
MST	-	Medium and Small Taxpayers Department
OECD	-	Organisation for Economic Co-operation and Development
PAYE	-	Pay As You Earn
PBO	-	Parliamentary Budget Office
PFM	-	Public Finance Management Act
PIT	-	Presumptive income tax
TOT	-	Turnover Tax
UNDP	-	United Nations Development Programme
VAT	-	Value Added Tax
ZIMRA	-	Zimbabwe Revenue Authority

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I am also grateful to my immediate family who have been patient with me as I spent many hours away attending the MPPM course and particularly to my dear wife, Lucy Kairu, without whose special privileges and endearing support, my completion of the MPPM course would not have been possible. Finally, I am thankful to my father and siblings for the encouragement and support towards life in general.
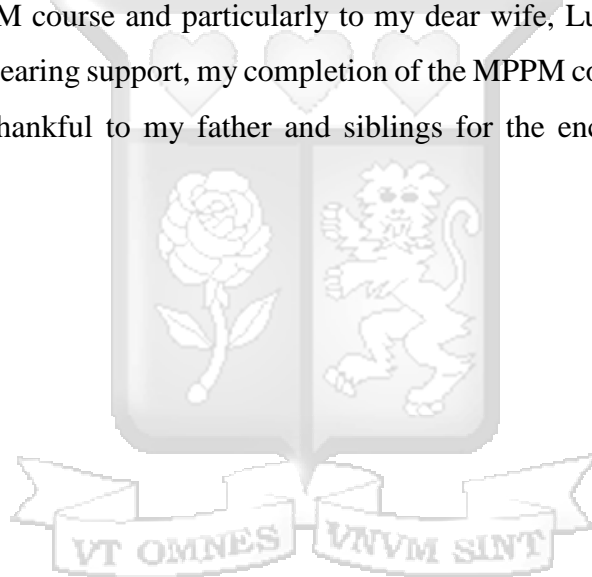
DEDICATION

I dedicate this dissertation to the memory of my late mother-Margaret Wangui Karanja.
You left fingerprints of grace on our lives that shall never be forgotten.

CHAPTER ONE:
INTROUCTION TO THE STUDY

1.1   Introduction

This study is organised into five chapters. Chapter 1 gives a background of the problem of informality and analyses the challenges faced by governments and tax administrations globally as well as by Kenya Revenue Authority (KRA) in taxing the informal sector. It identifies the research problem and concludes with the research objectives and questions as well as the significance of the study and explains the key terms. Chapter II provides a review of the literature from various authors on specific administrative challenges in taxation of the informal sector. It concludes by highlighting the specific research gap that forms the core research topic in this thesis. Chapter III presents the conceptual and analytical framework and provides the methodology applied in conducting the research.

For purposes of this study the following terms shall apply the meanings ascribed hereinbelow:

Informal sector- also described as the 'jua kali' sector (meaning 'exposed to the hot sun') refers to employment outside of formal labour markets; small and micro enterprises outside the purview of government regulation and taxation, and mainly in the subsistence economy. Firms in the informal sector exist because they contravene – or are not subject to – some of a variety of rules and regulations, including labour laws, environmental laws, registration, and taxation (De Soto, 1989). Informal economy is those economic activities and the income derived from them that circumvent or otherwise evade government regulation, taxation or observation" Edgar Geige (1998)

Micro-enterprise is defined in the Micro and Small Enterprises Act 2012 as a firm, trade, service, industry or a business activity whose annual turnover does not exceed five hundred thousand Kenya shillings. Other criteria include employing less than ten people; whose total assets and financial investment do not exceed Kshs 10 million in the manufacturing sector or Kshs 5 million in the service and farming sector. The MSE Act defines 'small enterprises' as a firm, trade, service, industry or a business activity whose annual turnover ranges between Kenya shillings 500,000 and

5,000,000; employing between 10 and 50 people; and whose total assets and financial investment are between ten million and fifty million shillings in the manufacturing sector and between Kshs 5 million and 20 million in the service sector and farming enterprises (GoK, 2012a).

Presumptive tax is a tax based on some measure of economic activity in lieu of taxable income, rather than on taxable income itself.

Turnover Tax is a type of tax, which is calculated against the turnover of a business, as opposed to a percentage of taxable profit (i.e. income less business expenses). This difference reduces the administration burden on business owners as there's less of a need to keep a detailed record of expenses and understand which are deductible for tax purposes. Turnover Tax was introduced by the Finance Act 2007 through the provision of the Income Tax Act, Cap 470, under section 12c.

1.2 Background of the Study

Through the Finance Act No 10 of 2006, the Kenya Government through the National Treasury introduced turnover tax, a form of presumptive tax as a measure geared towards broadening the tax base. The tax that was to take effect from 1st January 2007 was payable by all resident taxpayers whose income is derived from business or accrued in Kenya and does not exceed five million Kenya shillings. The objective of introducing Turnover tax (TOT) in Kenya was geared towards bringing the informal sector into the tax net and to simplify processes for the small and microenterprises by simplifying tax procedures, simplifying tax computation and by simplifying record keeping. The tax was also touted as less expensive for the KRA to administer and would reduce the burden to taxpayers, improve compliance and ensure that taxation of small enterprises conforms to international best practices (National Assembly Hansard, 2006)

According to Mr. Michael Waweru, then Commissioner General, this policy was introduced based on recommendation from the IMF to the Kenya Government. At the time of introduction of the tax, Mr Waweru confirms that no feasibility was undertaken to establish the cost of collection of the new tax or what new implementation structures would be required to implement the new tax effectively (M.G. Waweru, personal communication, May 17, 2015).

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By April 2009, a total of 8,608 TOT taxpayers had been recruited and **Kshs. 127 million** realised (KRA, 2011). The trends in collections since then have not met expectations. The trend also points to a dipping in targets set possibly arising from the low performance of the tax in previous years with a marginal tax revenue growth.
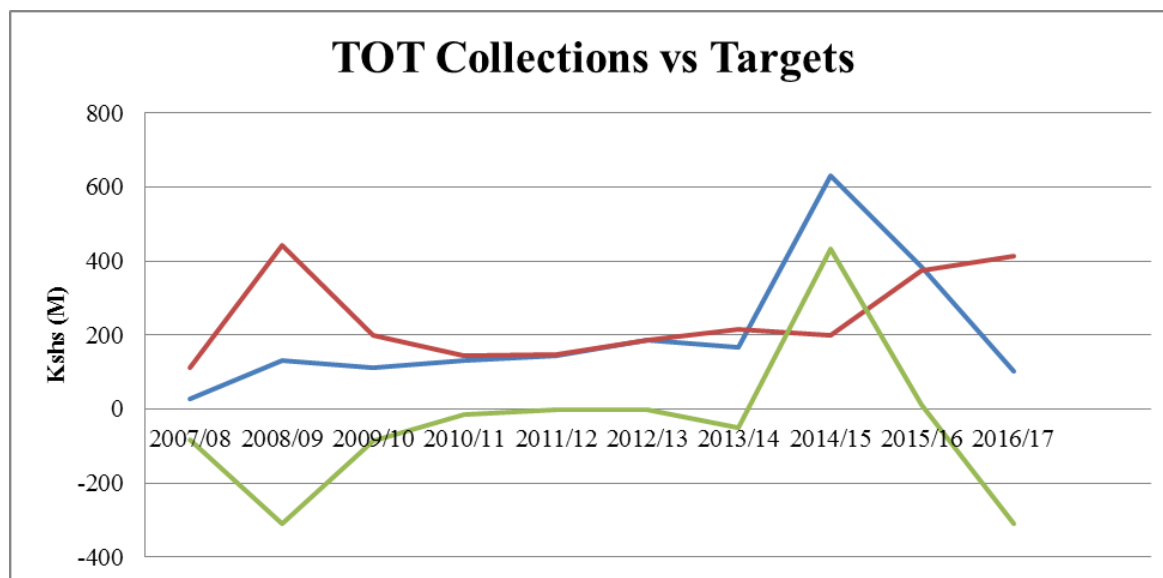
Figure 1.1: Turnover tax since inception in the 2007-08 financial year (Source: KRA)

The targets over time show a negative correlation implying a declining expectation in the collectable tax as more experience is gained in administering the tax.
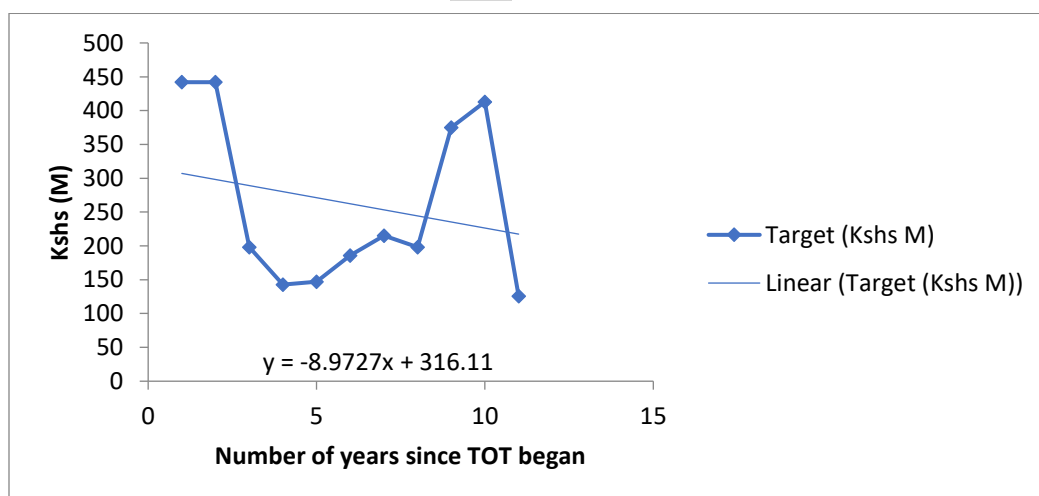
Figure 1.2: KRA TOT collection targets since 2007 to date (Source KRA data)

The TOT collections over the years have not been stable, potentially indicative of varying degree of efforts. However, the trend indicates a positive correlation implying that the tax has potential to grow if properly managed.
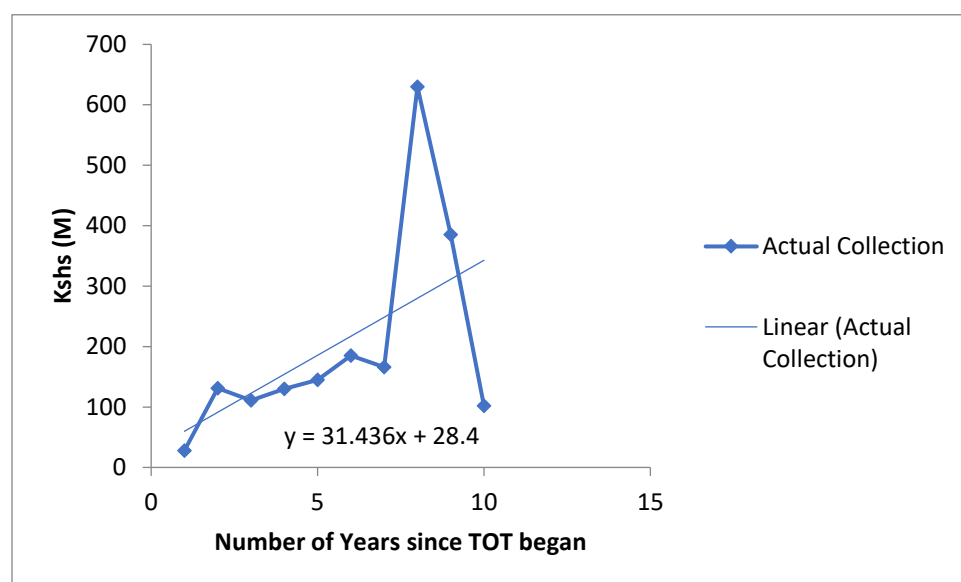
Figure 1.3: TOT collections since TOT was launched in 2007(Source KRA data)

The unstable trends in targets and tax collected from the TOT regime raises public policy design and implementation issues. It is instructive that the targets set for KRA are not based on a known tax gap analysis. Estimates of the tax gap by the Parliamentary Budget Office (PBO) points to underperformance in collection of a meagre 0.15% against estimated potential of Kshs 79.3 Billion. The PBO report titled *'Budget Options for 2013/14 and the Medium Term,'* acknowledges that the revenue administration reform agenda commenced in 1995 appears to have reached a plateau in 2011. The report stresses the need for a deliberate policy shift towards investing resources in areas that are likely to bring new sources of tax from the informal economy (Parliamentary Budget Office, 2013). Further, the report argues that the introduction of turnover tax in 1998 failed in its policy objective of bringing the underground economy into the tax net.

A review of subsequent PBO reports (Parliamentary Budget office, 2018) is instructive. The PBO report 2014/15 calls for measures to be taken to bring in more people into the tax net including robust SMEs that have not complied with TOT. The report acknowledges that workers in the

formal sectors disproportionately account for most income tax collections. The 2015/16 PBO report acknowledges that the rebasing of the GDP demonstrated a lower than expected tax effort of tax to GDP ratio of 18% compared to the 22% prior to rebasing. The report calls for a critical review of tax incidence and burden to determine flexibility and opportunities for expanding the tax base without changing the tax rates. By 2016/17 the PBO report altogether drops the focus on SMEs and TOT. The 2017/18 report recognises the significance of income tax at 44% of total revenues but decries the decline in performance of the tax relative to growth in nominal GDP. Further, the PBO attributes the decline associated with tax avoidance (transfer pricing issues), tax evasion and weak performance of major companies again with no reference to SMEs.

In the past, Kenya has made efforts to implement presumptive income regimes on farmers engaged in the agricultural production of tea and coffee. Farmers were required to have Presumptive Income Tax (PIT) deducted from gross payments at 2% as a final tax or to make an election to submit a year-end self-assessment with farming accounts. The Coffee Board of Kenya and Kenya Tea Development Authority were required to withhold the tax at source before sending payments to the farmers. This PIT was however suspended by Finance Act 2001 following protests from members of Parliament that the tax was discriminatory and punishing farmers earning meagre incomes in the face of many challenges including drought (National Assembly Hansard, 2000).The law bringing into force the turnover tax regime also empowered the Minister by notice in the Gazette, to prescribe rules for the better carrying out of the provisions of turnover taxation. To date however, there are no regulations in force to address the issue.

In May 2018, the National Treasury published a draft Income Tax Bill (Treasury, 2018) for public consultation, which proposed to abolish the turnover tax and replace it with a presumptive tax collected from businesses whose turnover does not exceed Kshs 5 million collected by County Governments alongside the single business permit. The policy choice of presumptive tax, premised on the underperformance of TOT, presents a number of challenges that are discussed in Chapter 5 of this paper. However, questions arise as to whether sufficient review has been done of the implementation challenges that may have led to the underperformance of the TOT.

This study focuses on identifying the underlying challenges that the Kenya Revenue Administration faces in administering the turnover tax among the informal sectors in Nairobi Kenya. The study delves into the identification of the legal, administrative and institutional challenges facing the Kenya Revenue Authority (KRA) as it seeks to implement turnover tax as a means to reach the untaxed informal sector.

Vision 2030 zeroes in on the main sectors of the economy, including, for example, the wholesale and retail sector in Kenya. These sectors provide the link between production and consumption, and accounts for 10% of the GDP. It concludes that this particular sector is predominantly informal and characterised by many informal players. These include a large number of medium scale retailers and a few supermarket chains located mainly in urban areas. The players are segmented into three broad categories. One, formal wholesalers and retailers who are very visible in every major metropolitan area and control only about 5% of the retail sector business. Two, millions of informal micro and small enterprises operating in markets or makeshift kiosks; and finally, hawkers constituting millions of individuals who sell the same goods on the streets, with highly negotiable prices resulting in very low profits.

Vision 2030 acknowledges that the pervasive informality problem in Kenya results in several kinds of market distortions particularly those relating to taxation, labour employment and produce marketing. The informal sector accounts for the bulk of employment in Kenya which when unregulated comes with environmental and social costs such as environmental degradation, non-enforcement of health and labour regulations and standards as well as infringement of copyright laws all of which dampen Kenya's international competitiveness. Inequality in payment of taxes is said to allow informal and less productive players to gain abnormal market share due to cost advantages and discourage investment from large operators.

The situation in Kenya according to data from Kenya National Bureau of Statistics Economic Survey 2015 is well documented. The informal sector employed 11.8 million individuals in 2014 up from 2.4 million individuals in the informal sector reported in the 1999 National Baseline survey of micro and small enterprises. The informal sector, therefore, constitutes a disproportional share of employment in Kenya accounting for 82.7 percent of the total jobs in Kenya. Further, the

survey reports that the sector popularly referred to as the 'jua kali' sector plays a major role in the labor market as it provides jobs to complement the formal sector. In 2014 of the reported 799,700 jobs created, 693,400 of those were said to be in the informal sector, majority of them being small businesses such as retailers, hawkers, motor cycle transport operators and other service providers. this however excludes drug trafficking and any other illegal activity (KNBS, 2015).

According to a Kenya Economic Report (KIPPRA, 2017) published in 2017, the Micro and Small Enterprise (MSE) sector in Kenya is a major and fast-growing sector accounting for 85% of new employment opportunities created. A 2013 version of the KIPPRA report highlights the fact that MSEs dominate in the majority of the sectors, including agriculture, business services, community and social services, construction, hotels, insurance, real estate, wholesale and retail trade, restaurants, manufacturing, transport and communication (KIPRA, 2013).

This uneven playing field and undue expansion of the informal sector is likely to be perpetuated by radar for fear of losing the competitive edge offered by the informal sector. The net result of this is that despite an increase in economic activity, the government is unable to muster sufficient tax revenue to finance public services and facilities that are used and needed greatly by this sector to thrive (GoK, 2012b).

The informal sector is characterised by, among other factors, lack of registration and regulation, highly competitive markets, family ownership of enterprises with few barriers to entry, undertaken in small-scale of operation, labour-intensive and adapted technology based on heavy reliance on indigenous resources and skills acquisition outside the formal school sector. Most informal sector businesses are also characterised by the keeping poor accounting records. They also display a history of very low compliance in filing and paying taxes on income (Anuradha, Prichard & Heady, 2014). Muchiri and Audi (2007) consider the informal sector as comprising those activities, which are undertaken with the primary objective of generation of employment and incomes. They are mostly unregistered and unrecorded in official statistics. They also operate in small-scale and mostly have very low level of capital, productivity, and income with little or no access to an organised market, credit institutions, modern technology, and formal education. Lastly, they are

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carried out by briefcase or mobile operators or in places difficult to reach places such as small shops, stalls in informal markets or home-based operations.

1.3   The Statement of the Problem

Kommer and Waris (2011) argue that for tax reforms to be successful there is a necessary precondition that the National Treasury, responsible for tax law and policy formulation, must have a strong link, understanding, and coordination with the tax administration from day one of the tax reform measures such as the introduction of turnover tax. Following introduction of TOT in 2007, it appears that no clear link was made between the formulation of the policy, clear assessment of feasibility and the means and resources through which the KRA was to implement it.

The KRA Sixth Corporate Plan 2015-2018 focused on enhancing revenue mobilisation by broadening the revenue base as a strategic priority. The plan introduced a major shift in its compliance approach towards customer facilitation rather than the traditional enforcement. This strategy was premised on building trust relationships internally (amongst staff) and externally (with citizens) as a means to sustain tax compliance enhancement in the long term.

This study fills in the gap in literature by demonstrating why the policy measure to broaden the tax base through introduction of TOT by KRA was unsuccessful from a KRA implementation perspective. The study helps establish the extent of application of the main approaches by KRA to collection; namely facilitation and deterrence and constraints in the application of each in boosting TOT compliance.

1.4   Objectives of this Study

1.4.1 Main objective

The main objective of this study is to contribute to improvement of the administration of TOT as a policy measure geared towards broadening the tax base among the informal sector in Kenya.

1.4.2 Specific objectives

  i.   To assess the extent of application of trust and facilitation measures by KRA officers in collection of turnover taxes in Nairobi Kenya;

  ii. To assess extent of KRA enforcement measures in collection of turnover taxation of the informal sector;

 iii. To identify priority areas for policy, legal and administrative reform in collection of tax from the informal sector.

1.4.3 Research questions

  i.   To what extent has KRA applied trust and facilitation measures in supporting informal sector taxpayers to pay in their turnover taxes?

  ii. To what extent has KRA applied enforcement measures in collection of turnover taxation among the informal sector?

 iii. What are the priority areas for reform in collection of tax from the informal sector?

1.5   Significance of the study

The academic importance of this study is to enhance understanding of the role tax administrations plays in ensuring the effectiveness in the taxation of the informal sector. Scholars have written extensively on the importance of tax administration reform among the major reforms in ensuring effective tapping into the informal sector. This study is unique in its contribution towards enhancing the knowledge gap in existing literature by evaluating the challenges including specific resource constraints KRA staff encounters in efforts towards implementing TOT among the informal sector.

The output of the study is intended to guide the KRA and the National Treasury on an optimal linkage between tax policy formulation and tax administration to ensure sustainability and equity of taxation in line with the requirements of Article 201 of the Kenya Constitution 2010. Policy makers in this sector will gain from the study through enhanced understanding of the specific reform areas in KRA necessary for tapping into the informal sector taxation potential. Policy makers will also gain insights into challenges bedevilling the KRA in the taxation of the MSE

sector; enhancing the credibility of the tax system and embedding tax equity; create dis-incentives for the formal sector to sub-divide into smaller business entities below tax thresholds.

CHAPTER TWO:
LITERATURE REVIEW

2.1   Introduction

This chapter presents a review of theories and empirical studies on implementation of informal sector taxation in Kenya and other parts of the world. It highlights the challenges and opportunities of the hard to tax informal sector, which is documented extensively in the normative literature. This literature review distils the issues arising from administrative challenges of taxation of this sector of the economy and identifies the gap in research.

2.2   Review of Theoretical Literature

2.2.1 Informality and Taxation

According to the International Labour Organisation (ILO, 2016), most developing countries are said to face the challenge of a growing shadow or informal economy. Informality is rooted in the inability of states to cope with the rapid population growth, and high levels of rural-urban migration, which consequently lead to an insufficient number of formal jobs to absorb all those who want to work. This results in the pursuit of alternatives in the informal sector. According to the ILO study, informal sector, also termed as vulnerable employment, accounts for 1.5 billion people, or over 46 percent of total employment. In both Southern Asia and sub-Saharan Africa, over 70 percent of workers are in vulnerable employment with Kenya ranging in the category between 31-60%.

In addition to having limited access to contributory social protection schemes, workers in vulnerable employment suffer from low productivity and weak and highly volatile earnings. The ILO report affirms an earlier IMF paper titled 'Revenue Mobilisation in Developing Countries' (2011) which report estimates that informality' constitutes 40 percent of GDP on average, and up to 60 percent in many countries. The report highlights the 'hard-to-tax' sectors to include small businesses, small farmers, and professionals (IMF, 2011).

Despite the prevalence of literature on developing countries informality problem, it does appear that challenges are not unique to developing countries only. According to an informality ranking

of 25 high-income OECD countries, the average rate of informality between 1999 and 2007 varies from 8.5% in Switzerland and 30% in Mexico (Schneider, Buehn, & Montenegro, 2010) indicative of an inverse relationship between levels of revenue income and informality. The United States is said to be facing insufficient revenue collection, which threatens the country's long-term financial outlook mainly due to low compliance rates among self-employed individuals engaged in cash businesses, who are estimated to report a staggeringly low 19% of their income. The reasons given for the non-compliance is that these earnings are not subject to withholding (an employer subtracting taxes from a paycheck) and is subject to little information reporting (Thomas, 2013).

One study shows that on the average, Kenya, Namibia, Ghana and Nigeria lose 19%, 10.5%, 15% and 28% of tax revenue as a percentage of official GDP respectively, due to the presence of underground economic activities (Nchor & Adamec, 2015). The same study found out that the average level of underground economies in Kenya, Namibia, Ghana and Nigeria as 33.7%, 29.1%, 36%% and 47% respectively. This is comparable with the averages derived by (Schneider et al., 2010) for the years 1999- 2006 as 34.5%, 30.5%, 42.3% and 56.2%, respectively. The Schneider Montenegro study ranks 98 developing countries according to the size of the shadow economy and finds China and Singapore with the lowest 12.8% and 13% respectively while Tanzania, Peru, Panama, and Bolivia with 56.8%, 58.7%, 63.5%, and 66.6% respectively.
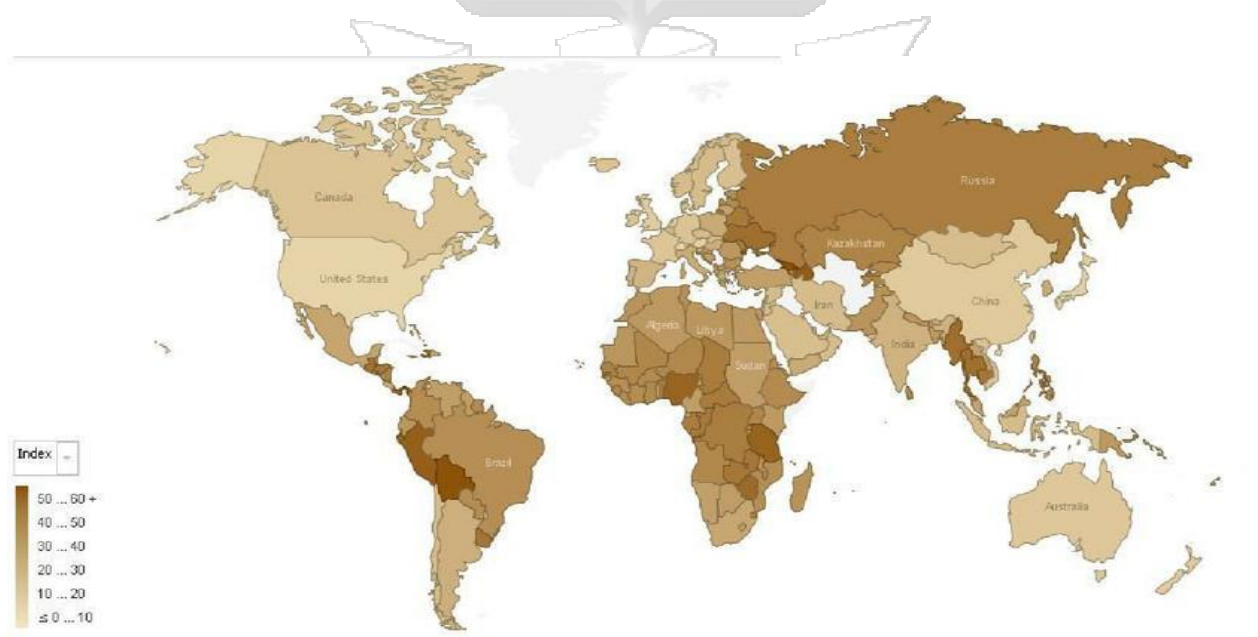
Figure 2.1: World View of Informality (Schneider & Montenegro, 2010)

Tanzi and Zee (2000) point to several challenges faced by emerging economies in financing the necessary level of public spending, in ways that are equitable without recourse to excessive public borrowing, minimising the disincentive effects on economic activity, while doing so in ways that do not deviate substantially from internationally accepted best practices. Of particular concern are formidable challenges in the establishment of effective and efficient tax systems accounting for differences in tax yield as compared to developed countries.

The structure of the economy makes it difficult to impose and collect certain taxes. Secondly, the limited capacity of the tax administration and thirdly is the paucity, or the poor quality, of basic data (Tadesse & Taube, 1996; Tanzi & Zee, 2000). The two publications argue that the political set up in many developing countries is less amenable to rational tax policy making than in advanced countries and agree that for this reason, it is difficult to combine all the ingredients that make up for a modern and efficient tax administration. The weaknesses identified include education and training levels of the staff in the tax administration, inadequate resources to hire adequate staff and pay good wages and buy necessary equipment that is critical for office operations including vehicles and office equipment (such as computers and printers). The informal structure of the majority of the businesses also poses a major challenge to the under-resourced tax administration officials, who according to Tanzi and Zee (2000) have difficulties in generating reliable and detailed statistics.

In addition to the weak revenue administrations and low taxpayer morale, numerous recent studies cited by Attila (2011) demonstrated that poor governance, and corruption cases are strongly associated with low revenue on account of the negative impact on public tax morale. Attila concludes that reducing corruption results in better good governance and greater transparency in public finance management and hence increases public resources.

Several approaches to target informal sector have failed to achieve the intended objectives mainly due to the invisibility of the informal sector and scarce empirical work to understand tax-relevant information from this sector. If the Government does not know about the income received by farmers, farm workers, and small-scale entrepreneurs, it can have no prospects of taxing it.

IMF (2011) reiterates that despite the substantial need for additional revenue in many developing countries, improving revenue mobilisation should not take the route of increasing revenue by further taxing readily compliant taxpayers, which can worsen distortions and perceived inequities. Broadening the tax base is a very critical consideration that the tax system must be sufficiently broadened to ensure that untapped tax potential of key sectors of the economy particularly in agriculture and other sectors of the informal economy preferably are harnessed using techniques such as those that make PAYE such a successful tax in Kenya.

Extensive literature denotes great attention given to how policymakers may promote enhanced tax compliance through tax process simplification. Often, the process of paying taxes entails imposing enormous efficiency costs and compliance burdens on taxpayers, which deter voluntary participation in the tax system. Complexities involving tax laws themselves as well as interactions with the tax system can also be incredibly tedious and burdensome (World Bank Group, 2009; Thomas, 2015). Thomas argues that complying with one's tax obligations may prove onerous even where the taxpayer understands the rules of accounting and the entering of information on returns, sifting through pages of instructions, or keeping records of numerous expenses. Many taxpayers are said to resist the task of fully complying with their tax obligations because of the perception that this constitutes too much mental work. All these aspects must be considered in the study evaluating to what extent the KRA addresses these key concerns in its compliance management.

Some scholars have argued that a major shortcoming of Kenya's tax structure since independence has been its over-reliance on a small number of sources of tax revenue, namely import/export taxes, sales tax/VAT and income taxes. The literature points to very narrow tax base particularly on the income taxes largely as a result of non-inclusion of the informal sector. Cheeseman and Griffiths (2005), Mawia and Nzomoi (2013), and Taube and Tadesse (1996) concurred that one of the most prominent challenges to reforms is the presence of high levels of revenue leakage from a largely untaxed informal sector and see the goal of broadening the tax base as important to tax policy reform in sub-Saharan Africa. At the same time, the potential for raising more revenue through the application of presumptive taxation methods to bring hard-to-tax groups into the tax net has yet to be fully exploited in these countries (Thuronyi & Vanistendael, 1996).

Joshi et al. (2014), quotes extensively from several scholars who argue that taxation of the informal sector is likely to produce substantial benefits regarding long-term revenue collection, economic growth, and the quality of governance. Joshi is, however, sceptical that evidence of these connections is limited though he remains hopeful that taxing informal sector operators can build tax morale and a culture of tax compliance while enhancing the growth of SMEs through formalisation. Joshi concludes by citing the need for evidence that more precisely captures the impact of tax reform and formalisation on attitudes toward compliance and overall tax morale.

Torgier and Schneider (2007) defined tax morale as a moral obligation to pay taxes, a belief in contributing to society by paying taxes. Feige (1990) takes an alternative view on the effect of the underground economies. He argues that underground economies being sizable contribute to the overall economic efficiency of their respective systems by the fact that they circumvent the inefficiencies introduced by taxation and restriction of market mechanisms. He, however, posits that the achievement of these gains come at the cost of undesired redistributions of income and degradation of information systems leading to a destabilising effect on the economy. These effects are especially important for policymakers, as a large and growing segment of the economic activity may escape the elaborate measurement system that government agencies have established to monitor economic activity.

The receipts-based presumptive tax is also said to give rise to enforcement problems and result in unevenness of application since it is dependent on taxpayers' willingness to accurately declare their gross receipts. Accordingly, it is not appropriate for sectors whose gross receipts are difficult to ascertain, such as independent professionals, and is more likely to impinge on those taxpayers who cannot hide their gross receipts (Thuronyi, 1996)

Bodin and Koukpaizan (2008) suggested five key factors to consider in the preparation of a tax regime for small enterprises, taking into account the enormous number of taxpayers subject to the system and the low level of revenues expected from this segment. These are; simplicity-the regime needs to be easily understood by small-business owners; equivalence-the tax due should be roughly equivalent to the tax that would apply under the regular regime; ease of administration- the regime should allow effective administration at a reasonable cost; transition- the tax regime applicable to

small businesses must not discourage their growth and not influence the behaviour of small entrepreneurs by facilitating improper practices; and consistency- special regimes must be consistent with and well-integrated into, the tax system.

The aim of a tax authority in a presumptive system is to estimate through appropriate bases the taxable income of the whole economic activity of each business and charge an appropriate rate of tax upon it. Presumptive Income Tax (PIT) is based on some measure of economic activity instead of taxable income, rather than on taxable income itself. Thuronyi (1996), Yitzhaki (2007) and Jaramillo (2003) on the other hand described PIT as referring to the use of simplified and cost-effective techniques to tax businesses and individuals frequently escaping taxation either by nonreporting or underreporting of actual incomes. The literature from various scholars points to mixed reactions as to the efficacy of presumptive taxes in realising increased revenue from the small and medium sector over the most focused implementation of the standard tax system among larger businesses.

Yitzhaki (2007) argued that the need for presumptive taxes arises from information asymmetry as well as high costs associated with the transaction, compliance and administration, which would render the use of the actual tax base impractical. Memon (2012) however disagreed with this, while arguing that the choice of the economic base has an impact on every tax and as such the success of PIT in the major informal economies will be primarily determined by the selection of proxy base or production indicator. Jaramillo (2003) agreed with Memon on the viability of presumptive taxes are based on the selection of the tax base and gives instances of how the economic activity may be assessed either by a firm's inventory of output, of some input of the production process or gross sales over a period.

Thuronyi (1996) raised several valid criticisms against turnover taxation. He argued that turnover taxes are a type of minimum tax that bears no close correlation between a particular year's income and turnover. In this scenario he claimed that net income represents widely varying percentages of gross receipts depending on the industry concerned, the degree of integration of the particular enterprise, and the type of product or service provided. He further argued that the turnover tax as a gross receipts tax is defective as not being a tax on income but rather a sales tax, which involves

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substantial cascading. The cascading effect means the imposition of tax on tax as the cost of the tax is passed on to others. He concluded that using the same percentage for all businesses, as is the case in Kenya, will be inaccurate as a means of approximating net income.The latter scholars, therefore, are confident that the issue of the high transaction and administration costs can be managed through effective design.

The most common presumptive tax methods are categorised by Tadesse and Taube (1996) as standard assessments, estimated assessments, and presumptive minimum taxes. Standard assessments involve the use of a fixed lump sum tax levied on taxpayers by occupation or business activity. Thuronyi (1996) on the other hand contrasted presumptive methods into rebuttable or irrebuttable presumptions.

Rebuttable methods include administrative approaches to reconstructing the taxpayer's income, which may or may not be specifically described in the statute law by which the tax authority uses indirect methods to determine the taxpayer's income, based perhaps on arbitrary criteria or on the best information available. These rebuttable presumptive assessments tend to be discretionary and form as a universal feature of tax assessment procedure, required to deal with cases where taxpayers either do not fully disclose their financial situations on their returns or fail to file a return. In such instances, the taxpayer can prove that his or her actual income, calculated under the standard tax accounting rules, was less than that calculated under the presumptive method.

By contrast, irrebuttable presumptive assessments are specified in the statute or delegated legislation are legally binding and defined precisely. They tend to be very mechanical, allowing no discretion, for example, methods based on a percentage of gross receipts or of a firm's assets. Thuronyi (1996) went ahead to classify irrebuttable presumptions into two types: minimum tax, where tax liability is no less than that determined under the presumptive rules, and exclusive, where tax liability is determined under the presumption alone, even if the regular rules might lead to a higher liability. The legislation in Kenya provides for turnover tax, a minimum tax type of presumption, whereby the taxable income of a business can be no less than a specified percentage of the gross receipts of the business.

Presumptive assessments rely on the estimation of a taxpayer's income aided by the use of certain indicators of business activity such as the number of employees, the amount of machinery and the volume of inventory based on studies of the correlation between indicators and incomes. Finally, presumptive minimum taxes, which involve the levying of lump sum taxes by gross turnover of a firm irrespective of its level of income in a given year.

PIT is appropriate for hard-to-tax groups, whose income is not easily observable; multinationals with complex transfer-pricing possibilities; small businesses with high compliance costs; and as pointers of likely tax evaders (Jaramillo, 2003). Presumptive taxes are known to reduce the opportunity to evade by removing the element of self-assessment although they do not eliminate the opportunity because taxpayers may alter their behaviour to reduce their presumptive tax liability.

Bodin (2009) SMEs' highlighted the need to conclude taxpayer segmentation specific effective tax compliance strategy for small and medium-sized enterprises leads to an effective income tax administration regime for micro and small businesses. Bodin and Koukpaizan (2008) in contrast argued that introduction of a special tax regime or improvement of an existing regime requires momentous tax administration efforts by the tax administration towards modernising its organisation and procedures. They further argued that modernisation reforms are required to manage better this sector including implementation of agencies to administer the tax obligations of small and micro enterprises. Such agencies facilitate a better understanding of the needs of small and micro taxpayers and develop and deliver appropriate services and education programmes; promotes a better knowledge of the compliance risks (failure to register, report and pay the tax due) and therefore, the development of specific enforcement programs to cope with these risks.

Kommer and Waris (2011) argued that for tax reforms to be successful, a necessary precondition that the National Treasury, which is responsible for tax law and policy formulation must have, is a strong link, understanding, and coordination with the tax administration from day one of the tax reform measures such as the introduction of turnover tax. This will ensure that all reform initiatives are properly backed by clear assessment of feasibility and adequacy of resources required to implement the policy change.

2.2.2 Theories of Tax Compliance

a) Deterrence Theory of Tax Compliance

The standard model of deterrence has its roots in the utilitarian theory first proposed by Jeremy Bentham (Bentham, 1778). Allingham and Sandmo (1972), based on Becker (1974) model of the economics of crime. The model rests on an assumption that taxpayers are rational decision makers whose aim is to maximise expected utility. As such, regulatory authorities should respond by deterring them from acts of non-compliance by ensuring the benefits to be obtained through non-compliance are lower than those achieved through compliance. Becker (1974) argued that this could be achieved in one of two ways: firstly, by increasing the chances of detecting non-compliers, and secondly, by increasing sanctions to the point where non-compliance becomes irrational. Becker (1968, p. 208) argued that authorities needed to find an appropriate balance between these two measures to make compliance behaviour the rational choice.

This model has been widely criticised by several scholars mainly because taxpayers are more compliant than the model predicts. The odds of detection and penalties are so low that according to the model it would be rational to cheat, yet most people tend to pay their taxes (Braithwaite, 2003). Thomas (2015) has termed these strategies as increasing the "monetary cost" to taxpayers of tax evasion. However, she notes that severe budgetary limitations and political hurdles have made these policies difficult to employ. Thomas, therefore, argued that this model is only appropriately suited to a small category of taxpayers she terms as 'determined cheaters' with a strong emotional aversion to the tax system that will always cheat out of principal or the firmly held belief that taxes are inherently unfair. Braithwaite (2003) described deterrence as a double-edged sword. Deterrence can strengthen the moral obligation to pay tax because it points out what is the right thing to do. However, he argued further that deterrence can also create resistance from the taxpayer by feelings of oppression affirming prior findings that a punitive deterrence-based enforcement strategy has a weighty downside on subsequent taxpayer reactions and behaviours.

Murphy (2008) argued that the deterrence model has tended to dominate policy-making and implementation approaches in taxation but based on an empirical study carried out discounts the use of this model as the means of increasing support for the law and lower the rate of subsequent re-offending and nurturing long-term compliance with the law. She points to a long-standing

debate in the regulatory literature between those who think that individuals comply with rules and regulations only when faced with harsh sanctions and penalties, and those who consider gentle persuasion and cooperation as the best means of securing compliance. The latter is called 'facilitative' models of regulation.

b) *Facilitative Theory of Taxation*

Various studies have been undertaken that indicate that the extent to which citizens perceive the tax administration to have treated them respectfully, impartially and courteously determines the degree to which they engage in compliant tax behaviour. In a dynamic perspective, educating taxpayers, correcting unintentional filing errors and providing service are strategies that increase trust and contribute to a motivational gesture of commitment. For taxpayers with motivational attitudes of capitulation or resistance, the education and a well-dosed use of power are strategies that keep up compliance and could prevent a move towards a posture of disengagement. At the same time, communicating such plans contributes to trust among committed taxpayers (Erich Kirchler, Hoelzl, & Wahl, 2008).

Several scholars have argued that citizen' attitudes toward paying taxes or tax morale may explain the high degree of tax compliance. Torgler (2001) established that tax morale plays a major role in determining the size of the shadow economy. Friedrich and Bettina (2007) find that unemployment and taxation to be the main factors driving the shadow economy in Columbia. In his treatise Alm (2013) suggested that that the compliance puzzle is explainable, in part, by incorporating the manner in which group motivations shape individual decisions. He challenged Allingham and Sandro's standard economic model of tax evasion in which audit, penalty, and tax rates shape financial incentives and the standard neoclassical paradigm that individuals always behave as the selfish, rational, self-interested individuals. Alm points to growing evidence that other group motivating factors have as their main foundation some aspects of social norms, morality, altruism, and fairness.

2.3 Empirical Literature Review

There exists an extensive body of relevant empirical research on the challenges of different approaches to enhancing compliance in the payment of taxes by the informal sector. In one Kenyan study Kenya', (Simiyu, 2013) sought to determine the factors affecting the collection of turnover tax revenues in Nairobi and identify possible remedies to the challenges identified The study, which was conducted using a sample of entities in East of Nairobi region, analysed the effect of mode of payment, taxpayer education, prohibitive rates, corruption and collusion, government policy formulation as well as quality of service on taxpayer compliance. .

Findings by Simiyu (2013) point to main challenges faced by SMEs in payment of turnover tax being the mode of payment of the turnover tax was time consuming and tedious and problems encountered when filing turnover tax returns, lack of understanding of their obligations and the tax office did not value feedback about the way the tax system was which greatly affected turnover tax collection. The study also found out that the SMEs reviewed considered the turnover tax rate to be prohibitive and higher than profit and that KRA officers accepted bribes when offered to reduce tax liability or demanded for bribes when they visited. The study concluded that effective remedies for turnover tax collection included: 'putting in place tough laws to check evaders, frequent taxpayer education and sensitisation, putting in place mechanisms to address public misconceptions or inaccuracies and providing information in a customer-focused way to reduce error.'

In a case study developed by Utaumire, Mashiri, and Mazhindu (2013) the researchers sought to evaluate the effectiveness of the PIT system in broadening the tax base in one region in Zimbabwe. The authors analysed the implementation of the tax head, setting of tax rates, collection of revenue and the views of various stakeholders. The study, which involved survey of 100 ZIMRA (Zimbabwe Revenue Authority) staff members, 180 informal traders and 20 local authority staff members, established that presumptive tax had not been fully implemented and administered having only 3% contribution to revenue compared to the contribution of 60% to the gross domestic product. The study also established that many players in the informal sector are oblivious to the existence and objective of the presumptive tax and that the absence of concerned stakeholders input in determining tax rates had resulted in spirited resistance. The study also revealed that the

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tax administration ZIMRA had its shortcomings, which included lack of follow-ups and inadequate awareness campaigns and that effective implementation and administration of the tax head had the potential of increasing the revenue base.

In another relevant study, Thairu and Jagongo (2014) studied on the factors affecting adoption of turnover tax in Kenya. The particular study questioned whether tax administration practices, turnover tax training, and tax environment policy influenced adoption of turnover tax by SMEs in Gikomba Market in Nairobi, Kenya. The target population of the study was 1405 SMEs at Gikomba market with stratified random sampling technique used to identify the respondents. Results revealed that most Gikomba traders did not understand the turnover tax process well and saw the tax computation as very tedious and complicated. Tax payment was not collected promptly, and that enforcement powers of the staff were applied injudiciously.

The study concluded that Kenya Revenue Authority needed to fully utilise the established channels to educate the traders on the importance of proper accounting systems and tax compliance (Thairu & Jagongo, 2014). Simplifying registration of businesses would enable the majority of the small enterprise operators to comply with tax payment making it easy for the adoption of turnover tax. The study results also concluded that there was a strong correlation between the independent variables and the dependent variable (R= 0.8087, p= 0.49) which is statistically significant at 5%. With an adjusted R -squared of 0.56, it means that tax administration practices; TOT training and Tax environment policy explain 56% of the variations in adoption of TOT for SMEs.

In another related study, Muchiri (2014) sought to answer the question on to what extent the rapid expansion of the informal sector influenced tax revenue performance. This study filled the gap in the country-specific literature on tax losses implied by the growth of the informal sector as well as the level of significance. The study used statistical methodology and employed time series data from secondary sources, including past research papers, Kenya Economic Surveys, World Bank and IMF Publications, Working Papers, Journals, web sources and textbooks. The empirical analysis used the Ordinary Least Squares regression method with the accompanying statistical tests. The results showed that an increase in the size of the informal sector leads to a decrease in revenue performance and vice versa, and concluded that the correlation was statistically

significant. The study recommends a need to formulate policies aimed at including the informal sector in the tax bracket by fostering voluntary compliance and reducing costs of tax collection (Muchiri, 2014).

2.4   Summary and Research Gap

The current literature points to mixed results in the efficacy in implementing presumptive tax systems among tax administrations, particularly in developing countries mainly due to weaknesses in tax administration. The key challenge is around the need for enhanced facilitation of taxpayers through education and simplification as a way of boosting turnover tax collection among the informal sector and challenges around injudicious enforcement. Further, the literature suggests that involvement of the citizens in providing feedback and input into TOT policy design may have a major impact on tax paying morale.

The Simiyu (2013) study is similar to this study in its efforts to diagnose the nature of the challenges that affect collection of turnover tax in Nairobi and provide possible approaches to the way of overcoming the identified challenges. However, his study is based on taxpayer interviews and studies a very limited number of independent variables mainly on facilitation. Further, the study does not address itself to the resources, tools and strategies applied by the KRA staff implementing turnover tax and their impact on the turnover tax collection, which are the focus of this study. Though both focused on the Nairobi region, the unit of study is the KRA and the extent of facilitative and enforcement measures adopted to boost compliance for turnover tax in Kenya. Normative theory points to the need for thoughtful TOT compliance strategy design by the KRA of a differentiated application of building trust and facilitation of those willing to pay their taxes, and demonstrating power in the ability to detect and punish those who wilfully evade their obligations among the target group.

2.5   Conceptual Framework

Miles and Huberman (1994) defined a conceptual framework as a visual or written product, one that "explains, either graphically or in narrative form, the main things to be studied—the key factors, concepts, or variables and the presumed relationships among them." The conceptual

framework of a study entails the system of ideas, assumptions, expectations, beliefs, and theories that support and informs a research study and constitutes an essential part of a research design.
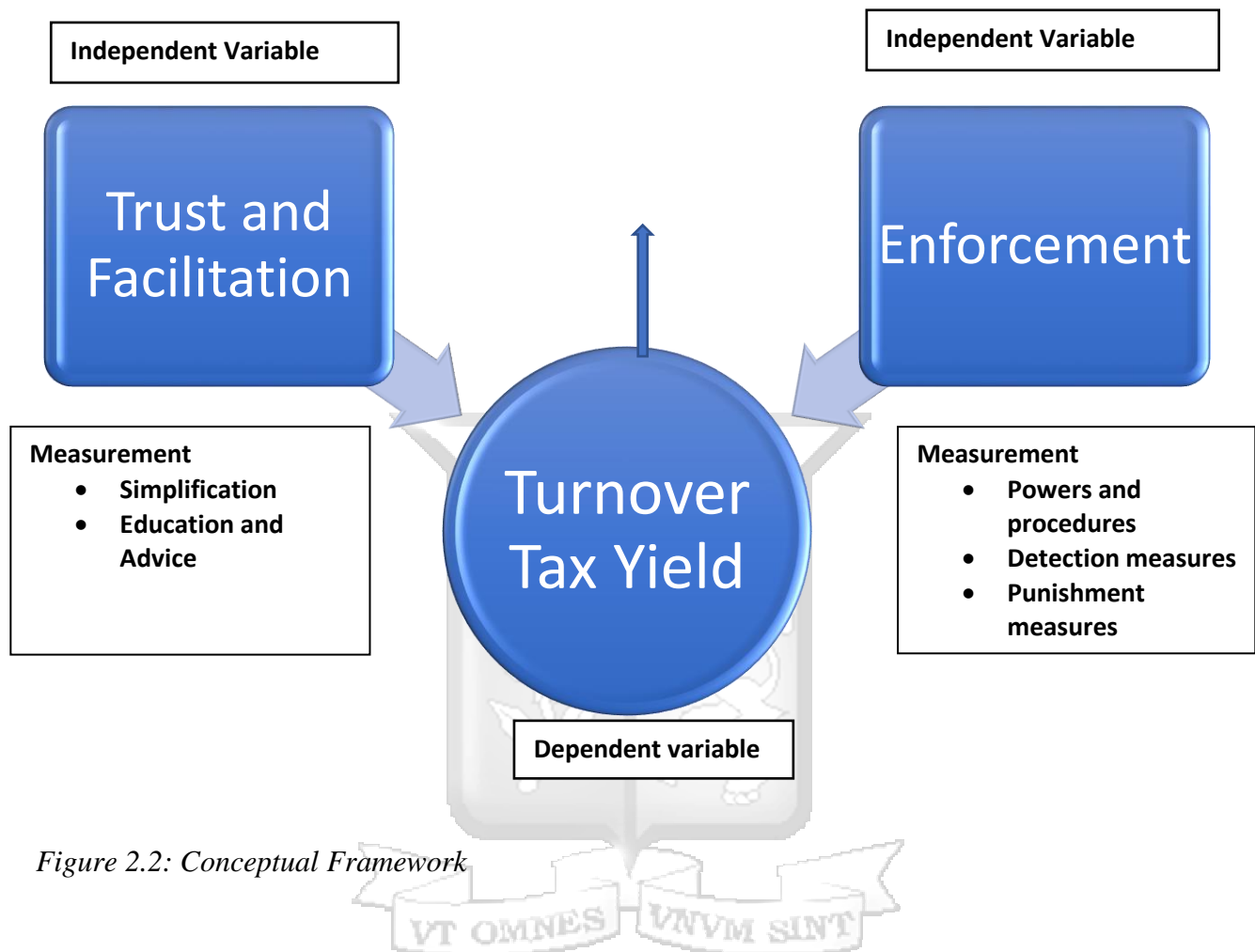
Figure 2.2: Conceptual Framework

The above framework provides means to measure tax effectiveness based on Kirchler's Slippery Slope model (Kirchler et al., 2008). The Kirchler framework is hinged along two major dimensions: the power of tax authorities and the trust in tax authorities both of which can be influenced by the actions of KRA. Effectiveness of tax compliance is affected by the interaction of these two dimensions according to the model.

A dependent variable is a variable whose value depends on independent variables. The dependent variable in this study is the revenue yield measured in an experiment or evaluated in a mathematical equation. The dependent variable is sometimes called "the outcome variable."

2.6 Explanation of the Variables

Table 2.1: Study Variables

Trust and Facilitation

	Variable	Operalisation of variable	Measurement
1	Simplification	Provision of simplified procedures for record keeping, filing and payments	1. Simple registration and filing 2. Simplified accounting procedures 3. Simplified forms and language applied. 4. Simplified payment including Third Party/withholding systems.
2	Education and Advice	Effective communication and support to taxpayers	1. Satellite offices and help lines 2. Broadcasts and seminars 3. Billboards, guides, and bulletins

Enforcement/deterrence

	Variable	Operalisation of variable	Measurement
1	Powers and Procedures	Established actions in place to deal with non-compliance	1. Resources available to conduct field visits 2. Existence of strong inter-agency co-operation e.g., Counties 3. Strong risk management framework to target high-risk sectors 4. Availability of adequate supplies of explanatory and information pamphlets, guides, return forms, applications for registration, and other materials are available in public access offices
2	Detection capabilities	Means to enhance fear of detection through regular surveillance of compliance. Based on mistrust of taxpayers	1. Number of officers assigned to field recruitment, compliance checks, and audits. 2. Number of field visits undertaken 3. Availability of tools to flag non-filers
3	Punishments	Capacity to mete out severe fines and	1. Number of fines imposed

prosecutions for non-compliance

2. No of taxpayers prosecuted or compounded

3. Seizures and forfeitures

2.7 Relationship between the Variables

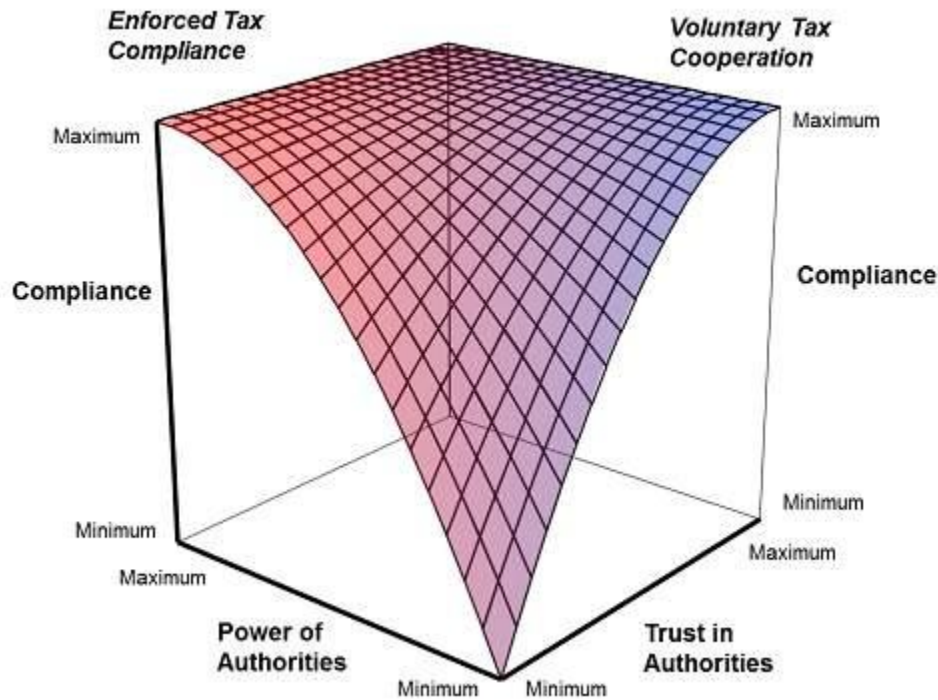The relationship between the variables is best described by the Kirchler Slippery Slope diagram.

Figure 2.3: The Kirschler Slippery slope framework (Source: E. Kirchler, Hoelzl, & Wahl, 2008: P212)

The Kirschler model in figure 2.3 best outlines the relationships between the variables.

Table 2.2: Kirschler Slippery slope framework variables explained(Source: E. Kirchler, Hoelzl, & Wahl, 2008: P212)

Scenario 1	In conditions where trust (facilitation) in authorities is low, and the power of authorities (deterrence) is weak, it is likely that citizens seek to maximise their individual outcomes by evading taxes, bringing compliance to a minimum.
Scenario 2	Under conditions of low trust, compliance increases with the power of the authorities to raise audit and detection probabilities and to inflict severe fines. Taxpayers have less and fewer incentives to evade because the expected outcome of non-compliance falls below the expected outcome of compliance. Increasing the power of the authorities is likely to result in enforced compliance with diminishing returns. Similar increases in compliance can be gained only by increasingly high investments in power.
Scenario 3	Under conditions of low power, compliance increases with the degree of trust. Increasing trust is likely to result in voluntary compliance.
Scenario 4	High compliance can result both under conditions of strong power of the authorities as well as under conditions of strong trust in the authorities.

According to (Kirchler et al., 2008), the power and trust dimensions moderate each other. Variations in trust matter most when power is low; however, when power is at its maximum, variations in trust are irrelevant because authorities can enforce maximum compliance. Conversely, variations in power matter most when trust is low; however, when trust is at its maximum, variations in power do not matter because citizens contribute their share regardless.

The ''slippery slope'' framework suggests that the position the authorities adopt towards taxpayers is important for compliance. In an antagonistic tax climate, when tax authorities communicate a ''cops and robbers'' – attitude, taxpayers will try to maximise their individual expected utility and only comply when forced to do so. In a synergistic climate, when authorities communicate a ''service and clients'' – attitude, taxpayers will act by the perceived fairness of the system and comply voluntarily.

The New Public Management ''service and client'' approach is what KRA has adopted in its new Trust and Facilitation approach as a means to enhance the synergistic climate with taxpayers. The

approach is defined by the idea that tax authorities perform a service for the community, and are a part of the same community to which individual taxpayers belong.

The Braithwaite compliance pyramid is often applied by tax administrations as a means of treatment of taxpayers based on their compliance behaviour. The pyramid is also useful in this study to delineate the application of the two approaches either facilitative or deterrent or a combination of both. The tax compliance pyramid is illustrative and helpful in guiding this study on identifying the challenges of resources applied by the tax administration depending on which strategy the bulk of resources are allocated. For the minority hardened citizens who are unwilling to comply, they will require a vast amount of resources of the tax administration to apply effective deterrence. It is counterproductive to apply the deterrence approach to the vast majority of potential taxpayers in the bottom two portions of the pyramid who are willing to do the right thing for whom a facilitative approach is required. The cost to the tax administration of ensuring compliance of this lower category is not high, and hence, the facilitative approach will provide better results at far lower costs.
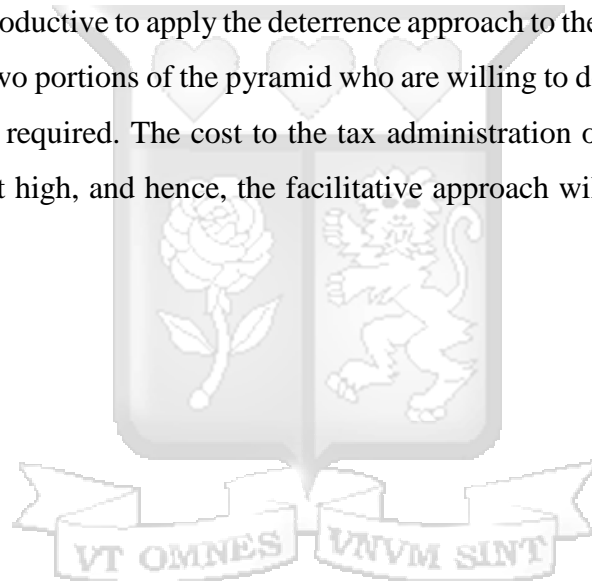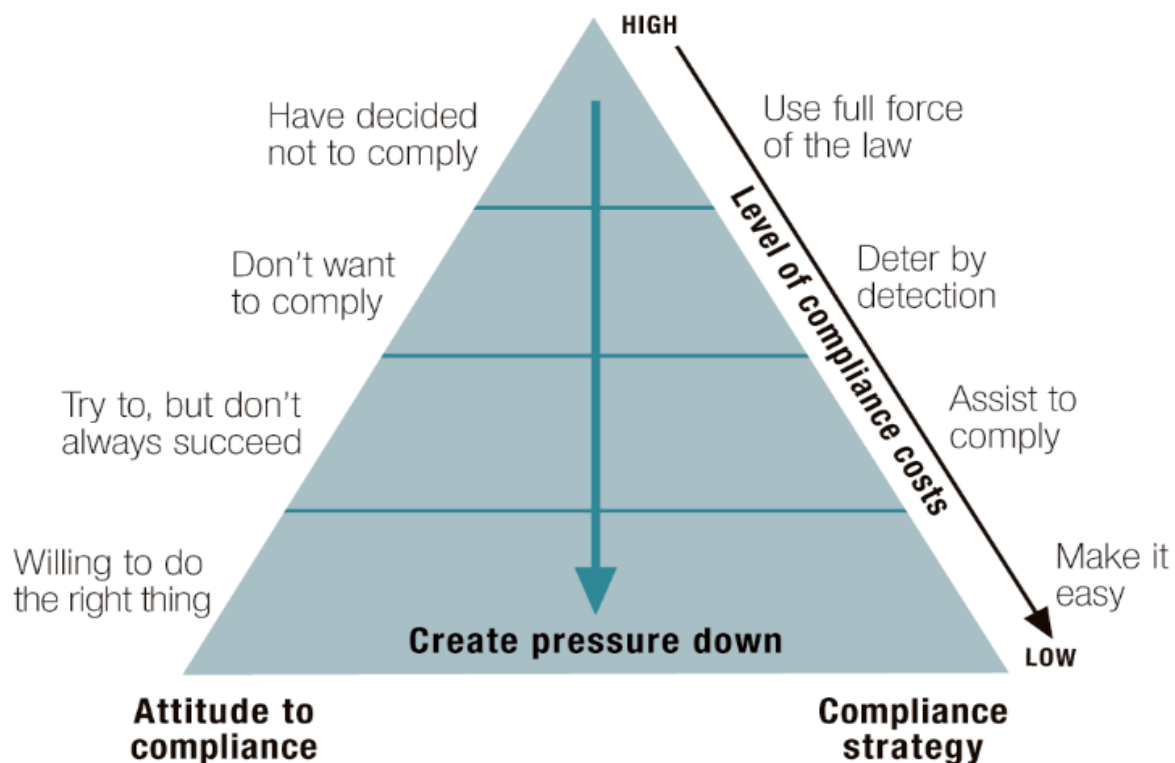
Figure 2.4: The Braithwaite Tax Compliance Pyramid (Source: Kerr & Sharon Smulders, Madeleing Stiglingh, (2012))

The framework will assist in meeting the specific objectives of this study, which include identification of the constraints faced by KRA staff in implementing Kenya's tax policy on taxation of the informal sector, establishing the efficacy of the facilitative and deterrent approaches to compliance in the taxation of the informal sector.

CHAPTER THREE:
RESEARCH DESIGN AND METHODOLOGY

3.1   Introduction

This chapter discusses the research design and method of research used, the respondents of the study, the data collection technique, the instrument used, the validation of the instrument, the administration of the instrument and the statistical treatment of the data gathered.

3.2   Research Design

This study design selected was a descriptive study, which involved gathering data that describes events and then organises, tabulates, depicts and describes the data using patterns that emerge. This was considered appropriate, as the intention of the study was to gain insights into the observed issues that may be affecting KRA field staff in collection of TOT in Nairobi, which are largely unknown. The study applied triangulation, searching converging findings from multiple units of analysis so as to increase construct validity within the KRA context.

3.3   Population Frame

The study chose KRA staff in the Domestic Taxes Department Small Taxpayers offices across Nairobi as the main unit of analysis. Numerous studies have dwelt on taxpayer interviews and not the staff tasked with implementation of the TOT collections. The KRA staff was selected based on their extensive and direct involvement in efforts to implement TOT and their in-depth practical understanding of the challenges faced in implementing the TOT policy in Kenya. The sampling frame was 235 technical KRA staff in Domestic Taxes Department in the Nairobi region as follows: South of Nairobi (54); West of Nairobi (59); North of Nairobi (54); East of Nairobi (58); and Eastleigh (10).

3.4   Target Population

The target population is the set of units to provide the required information and estimates. In this research, the target population was the staff working in KRA Domestic Taxes Small and Medium Taxpayers Department in Nairobi who are most implicated in the implementation of TOT at the KRA on a day to day basis in various parts of Nairobi region. Their insights on implementation

issues they face was critical to understanding where issues arise affecting TOT collection among the informal sector.

3.5   Sampling

Using the Krejcie and Morgan table, which also shared the same formula with Cochran (1967), the sample size for 235 staff around Nairobi was 147, allowing a margin of error of 5% and with a confidence level of 95%. The questionnaires were distributed proportionately according to the people per station, with each station as strata. Questionnaires were distributed to staff within Domestic Taxes Department region in Nairobi county.

3.6   Data Collection.

The study relied on primary data obtained from administering questionnaires to the identified respondents (KRA DTD-MST staff based in Nairobi region and TOT eligible business people in Nairobi, unstructured interviews as well as secondary quantitative and qualitative data obtained from KRA, National Treasury and the Kenya National Bureau of Statistics.

The study used a structured questionnaire for data collection using both closed and open-ended questions. One questionnaire was used for the KRA DTD officers. For secondary data, this included quantitative and qualitative data gathered from archives, libraries and face to face interviews with officials from KRA, National Treasury and National Assembly. The secondary data collected included statistics on KRA collections of turnover. Primary data is descriptive in nature and was collected as per the attached questionnaire.

The targeted KRA staff all received the relevant written questionnaire by hand. The questionnaires were delivered to respondents in KRA Nairobi offices. The staff survey elicited an impressive response rate of over 98%.

3.7   Validity and reliability

Pre-testing, or pilot testing, formed an important part of the research process. The questionnaires were pre-tested to ensure that the questions were not ambiguous, that they made sense, and the instrument captured the required information. A sample of 10 questionnaires was distributed to

some KRA staff in Times Tower and only 4 questionnaires were returned with comments indicating that the questionnaire was too long for most. The respondents could not be relied on to assess their own fairness and responsiveness to taxpayer issues, which was part of the original independent variables to be measured by the questionnaire which was later removed. An additional section H question was added to measure the dependent variable and enable the data to be subjected to a regression analysis. The outcome of this was evident during the main data collection when a higher response rate of over 98% was achieved.

Table 3.1: Results of Reliability tests (Source: own study)

	Cronbach's Alpha	N of Items
Simplification	.763	7
Education and Advice	.754	7
Powers and procedures	.811	8
Detection Capabilities	.824	7
Punishment	.846	6

Cronbach's alpha is the most common measure of internal consistency ("reliability"). It is most commonly used when you have multiple Likert questions in a survey/questionnaire that form a scale and one wishes to determine if the scale is reliable. Cronbach's alpha reliability coefficient normally ranges between 0 and 1. The closer the coefficient is to 1.0, the greater is the internal consistency of the items (variables) in the scale. The test shows reliability per the Cronbach co-efficient.

3.8   Data Analysis

The data collected through the questionnaires was coded and captured electronically. SPSS version 20 was used to perform descriptive and inferential analysis. SPSS was selected over other software due to its ability to electronically store questionnaire data in a spreadsheet-like table similar to that of Microsoft Excel and generating routine descriptive statistical data for question responses, such as frequency counts of closed questions, distribution of multiple-choice question responses. It also is useful for creating graphical presentations of questionnaire data for reporting, presentations or publications that support presentation of this descriptive research study. SPSS is also helpful for

exploring relationships between responses to different questions and collating open question responses that were a part of the questionnaire.

3.9   Assumptions Made

This study made assumptions that ineffective tax administration was the major hindrance to turnover tax collection. It thus ignored the impact of corruption, tax morale and other external factors such as the economic environment and political factors, all of which may impact on collections.

CHAPTER 4:

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1   Introduction

This chapter presents the data analysis, presentation and interpretation of findings on the data collected from KRA respondents. The study focused on significance of five dependent variables under two main categories of trust/facilitation and enforcement in influencing the effectiveness of Kenya Revenue Authority Domestic Taxes Department in efforts to improve turnover tax collection. The study was focused on the Nairobi County, both the commercial capital and seat of government of Kenya. The main objective of the study was to evaluate extent to which taxpayer facilitation and enforcement factors influence tax compliance levels. The study sampled one hundred and fifty respondents (150) KRA Domestic Taxes (Medium and Small taxpayer staff respondents within Nairobi County) and the data interpreted as per the research questions.

4.2   Demographics
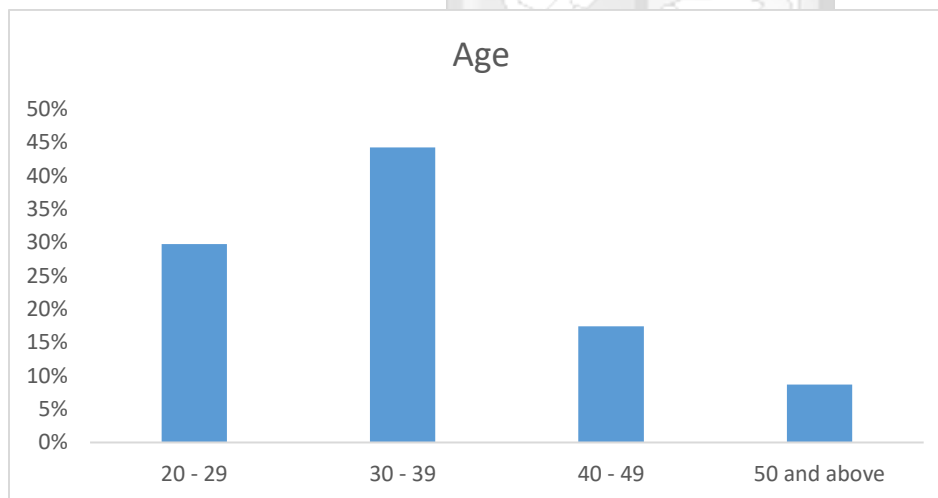
Figure 4.1: Age spread of KRA respondents (Source Own study)
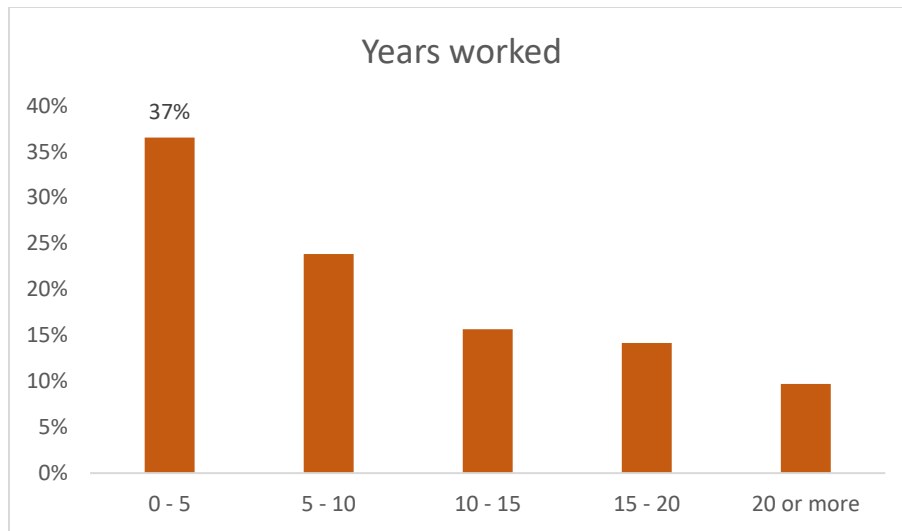
Figure 4.2: Number of years worked in KRA (Source Own study)
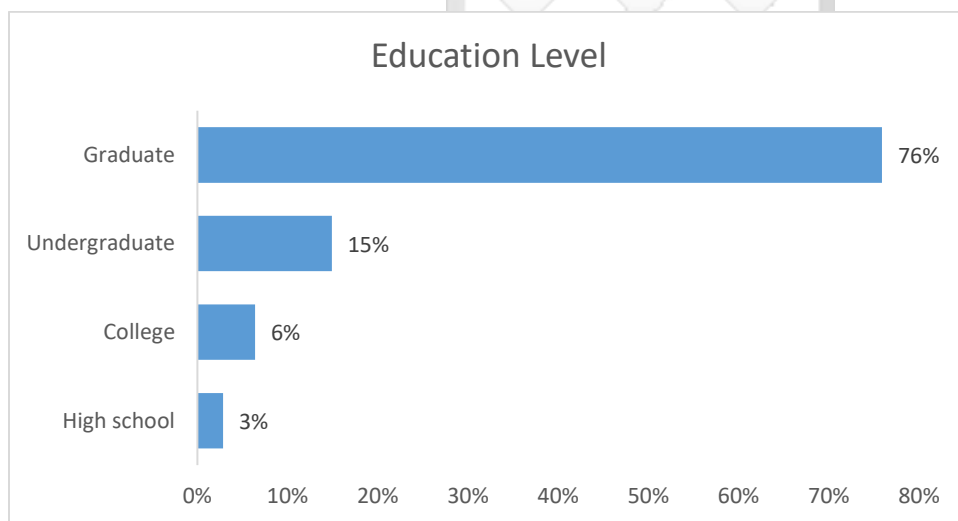
Figure 4.3: Level of education of KRA respondents (Source: Own study)

Figure 4.1 depicts that a majority of the respondents are less than 40 years of age (74%) and have worked between 0-10 years (61%) (Figure 4.2). A remarkable number of respondents possess undergraduate or advanced degrees (91%) with the majority of these respondents having attained a graduate degree (74%) (Figure 4.3). The implication of this is that the survey responses by the respondents are fairly reliable representation of the situation pertaining to turnover tax collection at the KRA.

The KRA DTD staff responded to a questionnaire, which sought to measure their personal perceptions on the various issues raised on turnover tax collection. The questionnaire provided a Likert scale of 1-5 for most questions from strongly disagree at 1 to strongly agree at 5.

4.3   Trust & Facilitation

4.3.1 Simplification
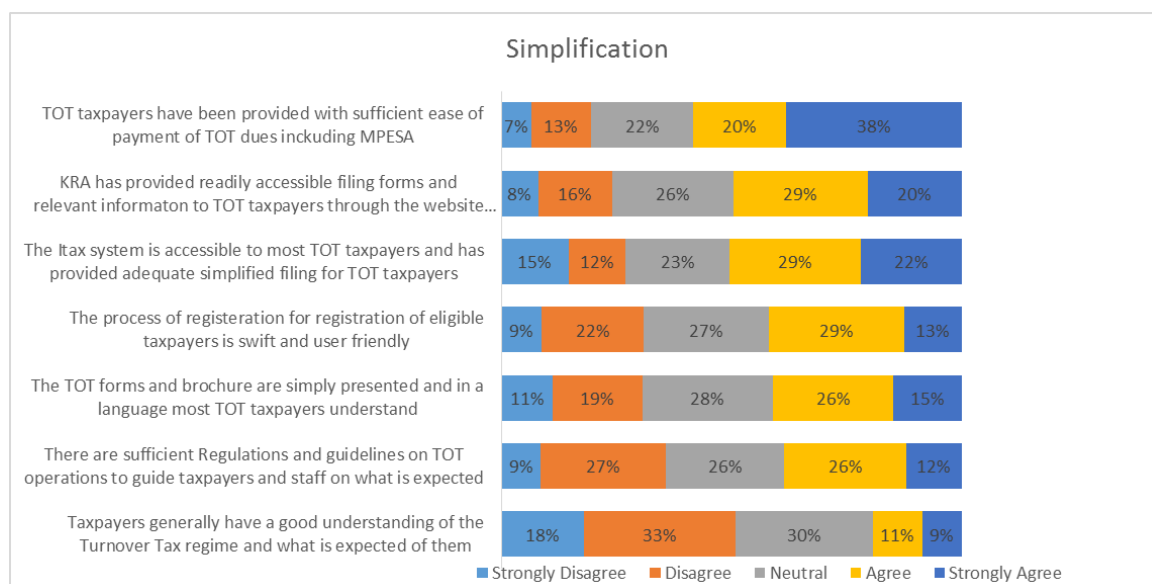
Figure 4.4: Simplification (Source: Own study)

Figure 4.4 provides analysis of the factor of simplification applied by KRA staff to facilitate ease of payments by KRA. A majority of the respondents (58%) agree that TOT taxpayers have been provided with sufficient ease of payment of TOT dues including through MPESA. Half of the respondents agreed that KRA has provided readily accessible filing forms and relevant information to TOT taxpayers through the website and other public areas including access to the *Itax system* for simplified filing.

A minority of respondents thought that the process of registration of eligible taxpayers is swift and user friendly (42%) and that TOT forms and brochures are simply presented and in a language most TOT taxpayers understand (41%). On the question of whether there are sufficient Regulations and guidelines on TOT operations to guide taxpayers and staff on what is expected, the respondents were split almost evenly between those who agree (39%) and those who disagree (36%). A

majority of respondents (51%) however disagree with the statement that taxpayers generally have a good understanding of the TOT regime and what is expected of them.

4.3.2 Education and Advice
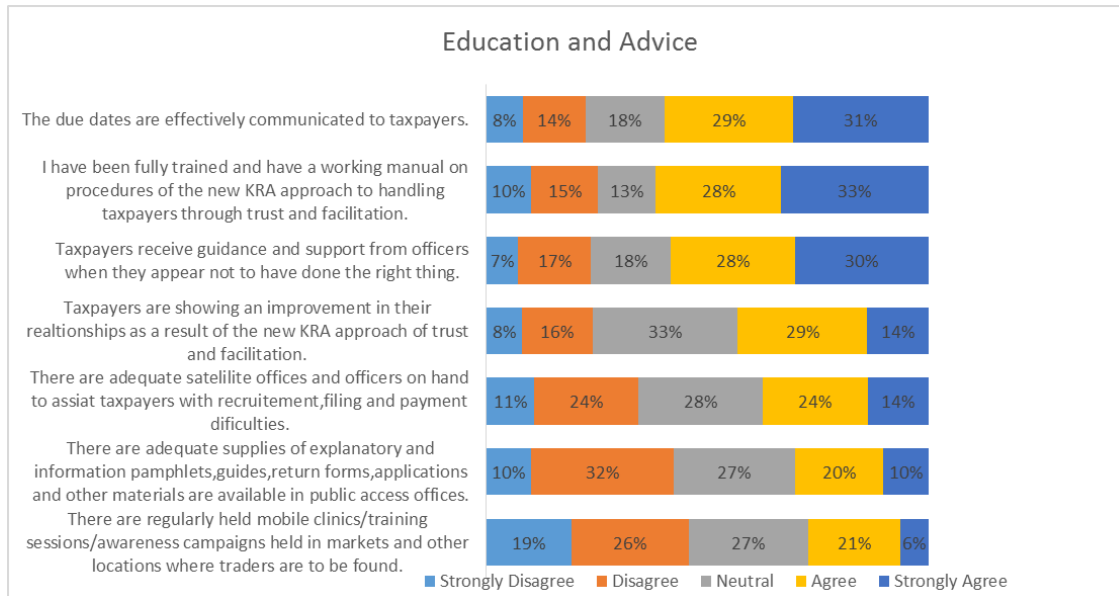
Figure 4.5: Education & Advice (Source, Own study)

Figure 4.5 provides an analysis of the findings from KRA respondents regarding the factor of education and advice. A majority of the respondents (60%) agree with the statement that due dates are effectively communicated to taxpayers while a minority (22%) disagree. A majority (62%) agree that they have been fully trained and have a working manual on procedures of the new KRA approach to handling taxpayers through trust and facilitation while a minority (25%) disagree. 58% of the respondents agree that taxpayers receive guidance and support from officers when they appear not to have done the right thing, while 24% disagree.

When asked whether taxpayers are showing an improvement in their relationships as a result of the new KRA approach of trust and facilitation, only 43% of the respondents agreed while 24% disagreed. The respondents were almost split evenly between those who agreed that there are adequate satellite offices and officers on hand to assist taxpayers with recruitment, filing and payment difficulties (37%) and those who disagreed (35%). A large number of respondents (43%) disagreed that there are adequate supplies of explanatory and information pamphlets, guides, return

forms, applications for registration and other materials are available in public access offices while only 30% agreed. Similarly, a large number (46%) disagreed that there are regularly held mobile clinics/training sessions/awareness campaigns held in markets and other locations where traders are to be found while a small minority (27%) agreed.

Respondents comments to the open-ended questions 'What more should be done to enable staff effectively reach out to potential taxpayers and those already in the TOT system to encourage compliance', yielded a number of suggestions. The key themes in the responses included identifying more regular taxpayer education at the grassroots level including media outreach on TV and radio stations targeting those in the TOT sector. Improving KRA accessibility to taxpayers through enhanced recruitment and training of surveillance teams, establishing satellite offices in market places and other populated commercial centres and increased means of transport to remote areas were also listed.

4.4   Enforcement

4.4.1 Powers & Procedures
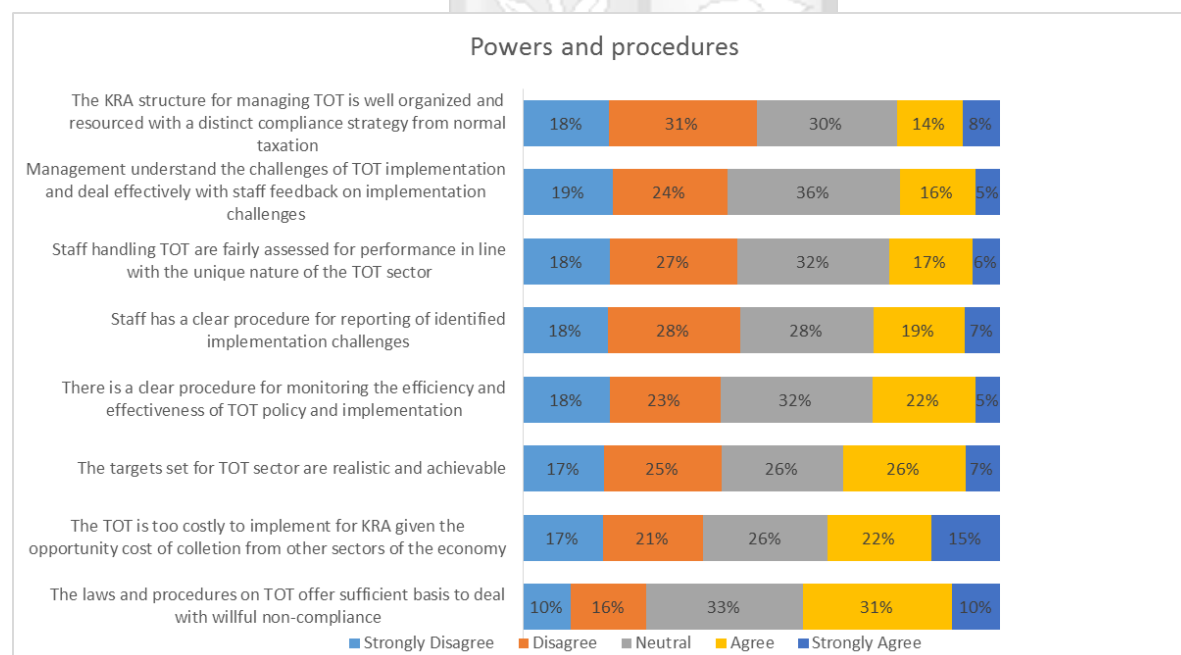
Figure 4.6: Powers and Procedures

Figure 4.6 reports analysis of the findings on the issue of powers and procedures. A large number of respondents (41%) agreed that laws and procedures on TOT offer sufficient basis to deal with wilful non-compliance while 26% disagreed. The respondents are almost split evenly between those who disagreed (38%) and those who agreed (36%) with the statement that TOT is too costly to implement for KRA given the opportunity cost of collection from other sectors of the economy. 42% of the respondents disagreed that targets set for TOT sector are realistic and achievable while 33% agreed.

A large number of respondents disagreed (41%) that there is a clear procedure for monitoring the efficiency and effectiveness of TOT policy and implementation. A larger number of respondents disagreed (46%) that they have a clear procedure for reporting of identified implementation challenges compared to those who agree (27%). A large percentage of respondents (45%) disagreed that staff handling TOT are fairly assessed for performance in line with the unique nature of the TOT sector and further disagreed (43%) that management understands the challenges of TOT implementation and deal effectively with staff feedback on implementation challenges. There is substantial disagreement (49%) with the statement that the KRA structure for managing TOT is well organised and resourced with a distinct compliance strategy from normal taxation.

In response to the open-ended question 'what are areas of improvement to powers and internal procedures that can enhance the outcome of TOT?', responses point to lack of a defined strategy for TOT implementation including monitoring the efficiency and effectiveness of TOT policy and implementation. Many respondents felt that management was not serious about the tax and unwilling to engage staff about difficulties encountered in the field. Such knowledge would be key to the retraining, strategizing and enhanced resources for more effective outreach.

Improvements were proposed on improving the organizational structure to have a dedicated unit focused on TOT with adequate staff and resources with improved monitoring ability. Many respondents advocated for more powers for staff to undertake forceful registrations, verification of declarations, and agency notices for collection of taxes due. Some respondents opined that putting in place a withholding system where they pay tax in advance would be more helpful than the current system of voluntary payments by taxpayers quarterly or monthly as one chooses. Some

respondents emphasised the importance of developing clear policies that guide TOT operations especially about other government institutions transacting with TOT payers. This includes counties, which could be enjoined to require a compliance certificate before issuance of a business license to prevent businesses operating without compliance.

4.4.2 Detection capabilities
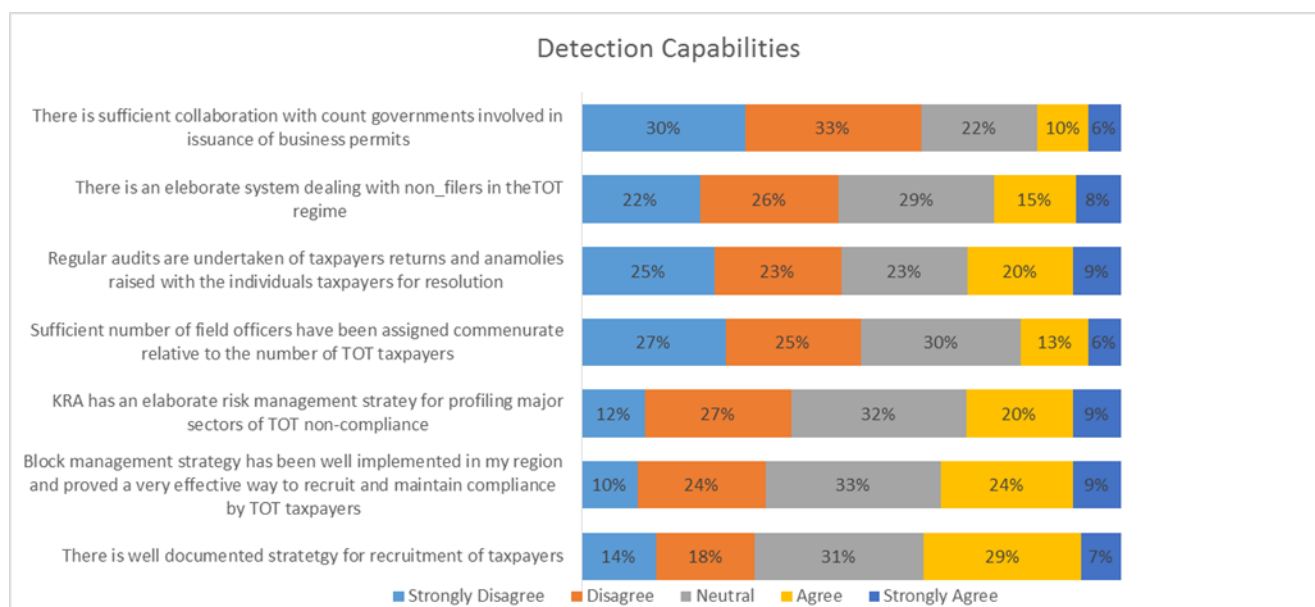
Figure 4.7: Detection capabilities (Source: own study)

Figure 4.7 presents findings from respondents on detection capabilities presented in order of significance. A majority of respondents (63%) disagreed that there is sufficient collaboration with the county governments involved in issuance of business permits. A majority of the respondents disagreed that there is in place an elaborate system for dealing with non-filers in the TOT regime. There is a strong disagreement among respondents (48%) that regular audits are undertaken of taxpayers returns and anomalies raised with the individuals' taxpayers for resolution. Similarly, a majority of the respondents (52%) disagreed that there are a sufficient number of field officers assigned to commensurate to the numbers of TOT taxpayers.

The respondents are almost evenly split between those who disagreed that there is a well-documented strategy for recruitment of taxpayers (37%) and those who agree (33%). Similarly, there is no remarkable distinction between those who disagree that block management strategy has

been well implemented and proved a very effective way to recruit and maintain compliance by TOT taxpayers (34%) and those who agree (33%). A large number of respondents (39%) disagree that KRA has an elaborate risk management strategy for profiling major sectors of TOT non-compliance compared to those who agree (29%).

On the open-ended question, 'What more can be done to enhance detection capability of non-compliant taxpayers?', respondents called for strategic monitoring of the taxpayers' declarations through *Itax module* and flash out defaulters who would be regularly contacted and reminded of their operations. Respondents suggested increased resources towards staff field monitoring and audit activities and strong linkages with county licensing process as a way of catching those who do not comply.

4.4.3 Punishment
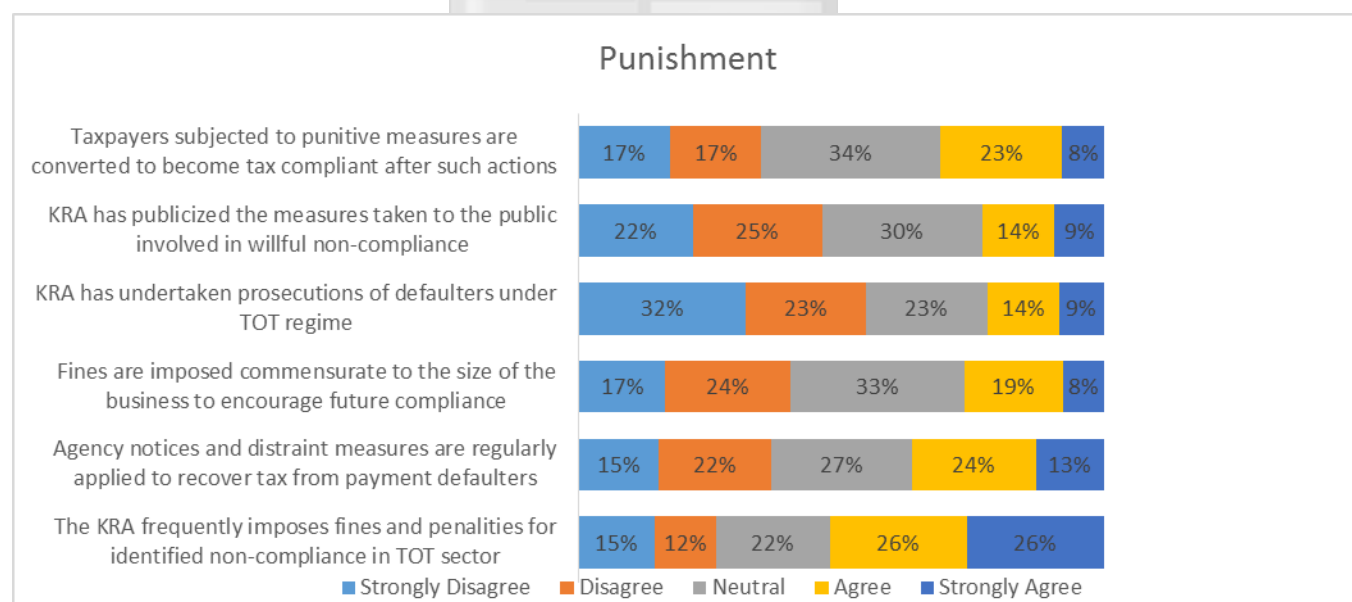
Figure 4: Punishment (Source: Own study)

Figure 4.8 is an analysis on findings on the factor of punishment on TOT tax compliance. Although a majority of respondents (52%) agreed that KRA frequently imposes fines and penalties for identified non-compliance in TOT sector, they largely disagreed (47%) that these measures have been publicised. A majority of respondents disagreed or are unaware (78%) of any prosecutions undertaken on TOT defaulters. A large number of respondents (41%) disagreed that fines are

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imposed commensurate to the size of the business to encourage future compliance. A similar number agreed and disagreed (37%) on whether agency notices and distraint measures are regularly applied to recover tax from payment defaulters. In response to the question 'Should KRA step up or tone down its punitive measures towards TOT taxpayers? If so, in which areas?', majority of the respondents called for increased penalties, compounding of offences and prosecutions, denial of business licences for failure to comply with TOT and publication of information about enforcement efforts. Those respondents who argue for toning down punitive measures advocate more taxpayer education and compliance monitoring.

4.5   Overall Effectiveness of TOT implementation measures

A question was designed to measure the dependent variable, perceptions of effectiveness of collection of TOT among KRA staff working in the Domestic Tax Department. The question reads, 'Looking at the measures that KRA has undertaken to increase the tax turnover yield, to what extent has it succeeded?'. The responses to the question are provided in Figure 4.9
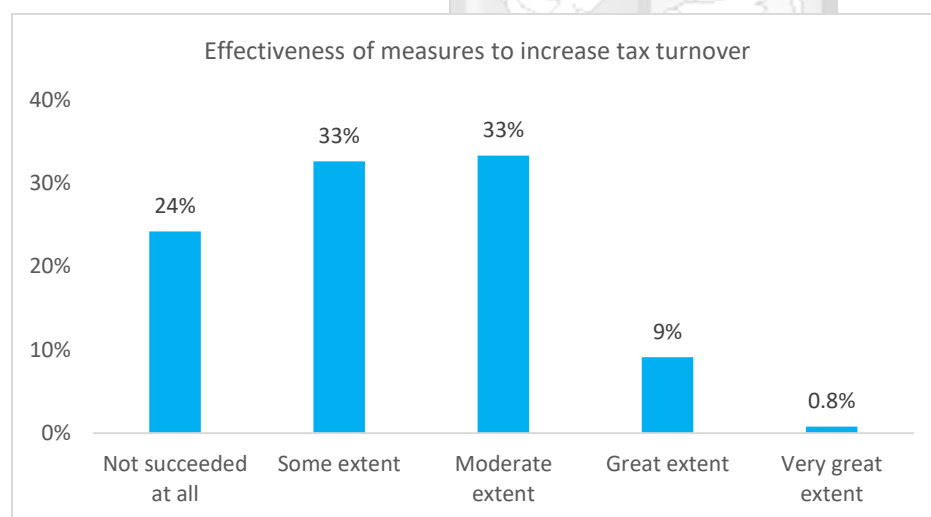
Figure 4.9: Overall effectiveness of the TOT regime (Source: Own study)

24% of the respondents considered that TOT had not succeeded at all while an equal number (33%) suggesting that TOT had either succeeded to some or to a moderate extent. Less than 10% of the KRA respondents agreed that the measures to increase TOT collection had succeeded to a great extent (9%) or very great extent (0.8%).

In response to the question on the three biggest challenges faced in dealing with collection of TOT from cash economy respondents, challenges identified included access and follow up of TOT taxpayers due to lack of sufficient manpower and resources, implying a disproportionately high cost of collection, mobility of businesses, informal settlements, and staff security concerns. Other concerns revolved around taxpayers namely illiteracy, lack of awareness about their obligations, dishonesty, costs of compliance and low tax morale arising from highly reported corruption scandals.

4.7 Regression Analysis

The choice of the type of regression to use is determined by the type of measurement of the dependent variable. In this case the dependent variable is ordinal hence the choice of ordinal regression. Ordinal regression is preferred to linear regression as it is more stable and most suitable for the data.

Table 4.1: Model fitting information (Source: own study)

Model Fitting Information				
Model	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	348.884			
Final	283.732	65.152	5	.000

A test was undertaken to determine whether the model improves our ability to predict the outcome. We do this by comparing a model without any explanatory variables (the baseline or "Intercept Only" model) against the model with all the explanatory variables (the "Final" model - this would normally have several independent variables). The significant chi-square statistic (p<0.0001) indicates that the final model gives a significant improvement over the baseline intercept-only mode.

Table 4.2: R-Square (Source: own study)

Pseudo R-Square

Nagelkerke	.421

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R squared (the coefficient of determination) summarises the proportion of variance in the dependent that can be accounted for by the independent variables. Pseudo R 2 values (Nagelkerke = 42.1%) indicates that the 5 independent variables explain 42% proportion of the variation in the measures KRA has undertaken to increase the tax turnover yield.

Table 4.3: Estimates of regression (Source: Own study)

Estimates

		Coefficients	Std.Error	Wald	df	p_value
Dependent	Question H-Not at all	73.657	0.919	21.885	1	0.000
	[QH = 2]-Some extent	564.168	1.009	39.41	1	0.000
	[QH = 3]-moderate extent	6967.463	1.146	59.651	1	0.000
	[QH = 4]-great extent	140123.385	1.531	59.947	1	0.000
Independents	Simplification	0.772	0.233	1.235	1	0.266
	Education and Advice	1.216	0.284	0.474	1	0.491
	Power and Procedures	1.917	0.305	4.565	1	0.033
	Detection Capabilities	2.374	0.294	8.644	1	0.003
	Punishment	2.091	0.255	8.384	1	0.004

4.8   Interpretation

From Figure 4.7 estimates above three measures (power & procedures, detection capabilities and punishment) were identified as significant in influencing the effectiveness of the measures applied by KRA to increase tax turnover. An agreement with power and procedures was associated with an increase in the odds of success with a ratio of 1.917 and a p-value < .033. Agreement with detection capabilities was associated with an increase in the odds of success with a ratio of 2.374 and a p-value < .003, and agreement with punishment associated with an increase in odds of success by 2.091 and a p-value < .004.

Simplification of procedures and tax education each has a positive relationship with the TOT turnover, but the study findings indicate that the relationship is not significant; the p value is higher than 0.05.

CHAPTER FIVE:
DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1   Introduction

This chapter presents the summary and discussion of findings, conclusions and recommendations.

5.2   Summary of findings

The study focused on significance of five dependent variables under two main categories of trust/facilitation and enforcement in influencing the effectiveness of Kenya Revenue Authority Domestic Taxes Department in efforts to improve turnover tax collection. The study was focused on the Nairobi County, both the commercial capital and seat of government of Kenya. The study objectives were to assess the extent of application of trust and facilitation measures by KRA officers in collection of turnover taxes in Nairobi Kenya; to assess extent of KRA enforcement measures in collection of turnover taxation of the informal sector and to identify priority areas for policy, legal and administrative reform in collection of tax from the informal sector.

The principal findings were that KRA has been hampered in its efforts to implement the policy on informal taxation largely due to lack of adequate resources, a poorly implemented strategy of taxpayer facilitation and lax enforcement among the informal sector largely leading to lower than expected tax gains from TOT. The study could not establish positive effects of the KRA radical shift towards trust and facilitation on the TOT collections since the launch of the 6th Corporate Plan in 2015 with a lot to be desired in ensuring simplification and taxpayer education. Respondents point to major gaps in resources to ensure a broad enough effort to educate a wider pool of eligible taxpayers on their TOT obligations in simple language across multiple communication channels. The study identified the need to further simplify the process of registration of eligible taxpayers to make it more accessible, swift and user friendly and the need to provide more access to taxpayers to undertake their TOT obligations. Further, respondents consider necessity for more regularly held mobile clinics/training sessions/awareness campaigns held in markets and other locations where traders are to be found.

On enforcement, the study found out that there was limited detection capability, sanctions and punishment for failure to comply. The analysis indicates a more focused investment by KRA in reviewing powers and procedures, detection of non-compliant taxpayers and punishing of those who wilfully comply has the potential of increasing the TOT revenue base.

5.3   Discussion of the Findings

The study has demonstrated that the TOT regime has largely suffered from under-resourcing leading to a very thin effort in structures, strategies and implementation and monitoring of TOT with more focus on other taxpayers in the formal economy. Major challenges have arisen from marginal gains from increasing cost of revenue mobilisation from informal sector amidst diminishing budget allocations to KRA. The situation has not been helped by increasing pressure from Treasury to further reduce the cost of collection and attain 1% cost of collection (down from 2% in 2012) which has had an adverse effect on service delivery particularly in the low yield sectors.

The Kenya government, under pressure to tame the ever-increasing national debt due to funding shortfalls cannot shy away from taxing the informal economy on account of higher costs. However, government must be prepared to bear a greater burden for the hard to tax informal sectors if only as an investment in nurturing the taxpayer of tomorrow. It is incumbent upon the Treasury to allocate adequate resources to nurture the informal sector towards a taxpaying culture as it represents the largest growing sector of the economy unhindered by massive regulation.

KRA has in the past three years adopted a more taxpayer friendly approach focused on improving trust relationships with the taxpayers. However, this shift in focus has often come at the cost of distancing itself from enhancing enforcement measures, which has greatly eroded public perceptions of the power of KRA to implement the TOT law. This study places weak tax administration as the primary obstacle to successful tax collection from the informal sector. The main problems stem from practically non-existent enforcement mechanisms; incomplete or dated tax base information; and lack of political will as evidenced from the inability of Parliament to demand greater accountability by KRA for their shortcomings in TOT collection. The study findings support the Kirchler et al. (2008) theory that the variations in trust matter most when

power is low; however, when power is at its maximum, variations in trust are irrelevant because authorities can enforce maximum compliance. In this instance the KRA choice to emphasise building trust over enhancing power was not effective as the effort was insufficient to ensure that sufficient trust was built to optimise TOT collections.

On application of enforcement measures in collection of turnover taxation among the informal sector, the findings point to inexistent/unclear structure and strategy for monitoring of TOT policy and implementation, poor detection and low punishment efforts. TOT has not received adequate management attention as the limited staff and management have been focused on the easier to collect taxes from the formal sector. As a result, lack of clear strategy and inadequate resources have been invested in TOT enforcement or collaboration with other government agencies including county governments that could help boost compliance.

The findings give credence to the deterrence theory posited by Allingham and Sandro (1972) that stated that regulatory authorities should respond to non-compliance by ensuring the benefits to be obtained through non-compliance are lower than those achieved through compliance. The extremely ineffective use of enforcement measures including, according to Becker (1974) increasing the chances of detecting non-compliers, and secondly by increasing sanctions to the point where non-compliance becomes irrational has contributed to low TOT yields for KRA. More is required on publicity on enforcement efforts and more systematic detection efforts to increase the chance of detection of non-compliance by KRA.

On the priority areas for reform in collection of turnover tax, it is clear that increasing both trust and enforcement capability is central to the improvement of the performance of TOT in Kenya. These findings are consistent with the Kirschler 'slippery slope' framework, which suggests that the position the authorities adopt towards taxpayers is important for compliance (Kirschler et al., 2012). The choice to build trust or power is only optimal if fully exercised to its limit, failure to which compliance fails. The study findings indicate that shortfall in trust can be enhanced by building up on enforcement measures increases tax compliant attitude. Deterrence through enhanced detection and use of appropriate sanctions can thus strengthen the moral obligation to pay tax among those who wilfully chose not to comply. This finding is supported by Merrima,

Fjelstad and Sjursen (2013) who observed that the perception of increased enforcement (i.e. tax evasion is more difficult) has a positive impact on compliance.

Some thought in the design by KRA of an effective non-compliance detection system that would support the targeting of a small category of 'determined cheaters' with a strong emotional aversion to the tax system that would always cheat out of principal or the firmly held belief that taxes are inherently unfair. This is consistent with the Braithwaite and Thomas (2015) arguments that deterrence is a double-edged sword with huge cost implications as well as create resistance from the taxpayers requiring a profiling of taxpayers to be subjected to different treatments depending on their profile.

The Kirschler Slippery slope framework advocates maintaining a balance between power through enforced tax compliance and voluntary tax co-operation through building trust through facilitation in order to build a high compliance culture. This study of KRA implementation of the TOT regime clearly demonstrates that the KRA efforts to build a culture of trust and facilitation approach has had very limited success in increasing compliance among the informal sector. The impact of this approach is telling in the declining collections and compliance levels from TOT since 2015 when the 6th Corporate Plan was put into place. The result of the decline is evident in the current proposal to scrap TOT in favour of presumptive tax to be collected by county governments alongside business licences. This study attributes a large portion of the blame not to design of the TOT policy but challenges in implementation at the tax administration level many of which can be remedied by improved administration.

Treasury must avert the weaknesses of an ill-considered implementation strategy in any new policy measure on the informal sector particularly on presumptive taxation to avoid undergoing the same fate as TOT. The government is currently considering replacing TOT in favour of a 15% presumptive tax charged on the county business licences for those earning Kshs. 5 million or less to be collected by county governments. This recent proposal, contained in the new draft Income Tax Bill presents a number of challenges, which should be taken into account when considering the policy choices available to KRA. Government intention to scrap and replace TOT with a

presumptive tax not based on income but on a varied business licence fee set by the counties is misconceived.

In this author's view, the 15% of business licence fee proposal is a regressive form of tax with no known relationship with the business income. Reverting to the Bodin and Koukpaizan (2008) factors to consider in design of a tax regime of simplicity, equivalence, ease of administration, transition and consistency, it is evident that the current proposal fails on three counts. These are; equivalence- the failure of the tax due should be roughly equivalent to the tax that would apply under the regular regime; transition- the proposed regime discourages growth of small businesses and influences the behaviour of small entrepreneurs to opt to use improper practices to stay away from the regular regime; and consistency- the county presumptive regime proposed is not consistent with and well-integrated into, the national tax system for ease of monitoring and follow up by KRA. On equivalence, it is difficult to justify how a person earning Kshs 5,000,001 should be treated so differently for taxation purposes than one earning Kshs. 4,999,999 and how difficult it will be for the tax administration to distinguish and graduate those who transition to the regular regime.

5.4   Conclusions

In seeking to improve taxation of the informal sector, the Kenyan Government must take into account reasons why the TOT introduced in 2007 has so far failed to make an impact. This study raises issues of weak tax administration brought about partly by poorly resourced operations, competing priorities for a very lean staff, which render TOT not a priority and poor strategy to focus away from enforcement. Remedying these shortcomings in a significant way will not only rebuild the credibility of the KRA but also safeguard the integrity of the tax system preventing widespread perception of lack of power in the revenue authority.

The need to tax the MSE sector is critical for building a legitimate tax system that stems the free rider problem while establishing tax equity with the informal sector carrying its fair share of the fiscal burden. A credible SME tax system must go beyond a review of just the immediate cost benefit analysis to nudge the huge informal sector towards transparency and accountability for tax payment. It is clear that government must broaden the tax base to increase revenue to meet its

growing demand for public services. Equally important is the need to pursue equity of participation across businesses of different size. The failure to tax small enterprise creates incentives for firms to remain small to avoid or evade government regulation including paying of taxes.

Fox and Murray (2013) argued that if the choice is taken to 'tax small enterprises, the absence of a strong and credible will to tax, along with administrative inefficiencies and corruption, can compromise the tax enforcement climate, diminish revenue productivity further and harm the perceived fiscal exchange between taxpayers and the state. It may be better to not tax at all than to tax poorly.' This statement rings true in the Kenya context where taxpayers in the informal sector do not consider that KRA is capable of effective detection and punishment for wilful non-compliance. A decision to collect taxes from the informal sector must be designed and implemented with serious thought given to simplicity and ease of collection with proper incentives to motivate compliance.

Taxpayers cannot comply if they are not aware, and do not understand the tax laws and procedures; so continuous education is a critical component of such a programme. Therefore, constant efforts must be made to simplify the law and procedures to make it easier and less expensive for taxpayers to comply with their obligations. However, as this study demonstrates, facilitation measures not accompanied by requisite measures that enhance high probability of detection and punishment of wilful offenders will invariably have no impact on the increase in collection.

Poor administration of tax does more damage than good since it takes resources away from other more formal sector taxpayers. However, to ignore the informal sector denies government the opportunity to nurse its fast-growing business community through incentives to formalise the business operations and contribute to the national economy including through payment of taxes.

The new presumptive tax proposal also presents some structural challenges. Firstly, it creates opportunities for conflicts between the constitutional and legislative mandates of both national and county governments including power to collect and appropriate taxes and fees. The Public Finance Management Act for instance provides that the Kenya Revenue Authority shall be the collector of national government revenue, which includes income tax. Secondly, lumping presumptive tax on this licence fee will infringe on fiscal decentralisation principles.

County governments are empowered to levy property and entertainment taxes as well as any other tax authorised by law. The thrust of taxation by the county is based more on the concept of fiscal decentralisation where the taxes or fees are as closely related to the services provided. Business licences are by their very nature not a tax but a regulatory fee for services rendered to the business operating in the particular county. Thirdly, the Controller of Budget annual reports indicate that a large number of counties are still operating well below capacity with limited administrative capacity to efficiently collect taxes. Front loading the licence fees with additional national government tax will likely create more inefficiencies in accounting and administering the informal sector tax, while enhancing resistance to county fee collections.

Licence fees have a very low correlation with business income and create further difficulty in transitioning the taxpayers into the national tax system. The proposal also makes it more difficult for KRA to monitor those paying presumptive tax to determine if they are already above the threshold. Fourthly, the proposal would introduce significant administrative burden on KRA to collect and account for the revenue collected by counties and monitoring those taxpayers eligible to transition to the regular regime.

Further, it is not clear what happens where a county elects not to collect business licences from a particular category of businesses for political reasons. Thuronyi (1996) rightly argued against the potential cascading effect of turnover tax as a gross receipts tax whose effect is to impose tax on tax as the cost of the tax is passed on to others. The government should pay heed to Thuronyi's prescription that any system of presumptive taxation should take into account the widely varying percentages of gross receipts depending on the industry concerned, the degree of integration of the particular enterprise, and the type of product or service provided and applying different percentages depending on the nature of business as a more accurate measure of the net taxable income.

5.5   Recommendations

5.5.1 Policy level

Treasury must take time to study successful models of assigned presumptive income tax rate system such as the Tachsiv system in Isreal and the French Forfait, which are applied to different

sectors whose gross receipts are below certain amounts. According to Jaramillo (2003), the tax collector in these two systems uses developed indicators of gross profit margins and other relevant characteristics of each trade to assign a tax liability to the taxpayer, who can accept or contest it. If accepted, the tax payment remains fixed for two years.

Stepping up implementation of Kenya's Vision 2030 is key to addressing the informality problem through a number of interventions focused on formalisation and amalgamating together of small enterprises through different initiatives such as implementation of the MSE Act, 2012. The Micro and Small Enterprises Authority established under the MSE Act has a mandate to register small business associations through which the micro and small enterprises can be incentivised towards formalisation through access to cheap loans in the MSE Fund. Government should prioritise funding of the MSE fund set up under the MSE Act aimed at financing the promotion and development of MSEs, provide affordable and accessible credit to MSEs and financing research, development, innovation and transfer of technology. The government should rationalise proliferation of funding through other initiatives such as the Youth Fund.

The government must step up its focus on improvement of the inefficient supply chain and promotion of formal associations of primary producers so as to integrate small farmers while creating possibilities of economies of scale. The implementation of these proposals must be considered alongside measures to improve the business climate through the creation of small operator retail markets, better infrastructure and reducing the number of unregistered informal market intermediaries. Increasing opportunities for reduced dependence on disproportionately high cash transactions through incentives for use of MPESA is likely to enhance opportunities for third-party verification of income and availability of basic accounting ledgers. Automation of payments in the largely informal transport sector such as the BebaPay Initiative in the transport sector will go a long way in providing for identification of income earners and tracing of records on incomes.

5.5.2 At a tax administration level

KRA must continue to enhance interactions with market traders of tangible goods who may be in the tax bracket and co-opt county governments and other national government officials such as the

County Commissioners and up to the chiefs in the villages in educating taxpayers on tax. Implementation of Itax, the new management information system at the KRA, must encompass the informal sector so that its risk-based system verification programs are used to enhance detection of blatant non-compliers. Further, more satellite offices and officers on hand should be availed to assist taxpayers with recruitment, filing and payment difficulties, provision of adequate supplies of explanatory and information pamphlets, guides, return forms, applications for registration and other materials are available in public access offices.

KRA must design a taxpayer compliance programme for the micro and small businesses that allows incorporation of all salient aspects of implementation. The program should elaborate on the number of taxpayers, nature of entities, total tax contribution, number of persons employed. The program should also identify the specific risks on a sector by sector basis and describe how KRA intends to respond to these issues and risks. The program should provide establish effective monitoring and other feedback mechanisms that ensures that the planned activities are carried out. This would complete the implementation cycle as it provides opportunities to shift strategy towards improving collection of TOT where problems are identified. Strategies on implementation on TOT must take into consideration those in the informal sector earning wages above the minimum threshold and bring them into the tax net by requiring their employers to submit Pay As You Earn (PAYE) taxes.

All taxpayers must be encouraged to file a return whether or not their tax payment is final. This is an essential part of the data collection, that also ensures uniform treatment for all citizens gainfully employed or conducting business in the formal or informal sector. This measure will aid transition to the regular system and allow for monitoring and verification by KRA.

Well-directed and publicised enforcement actions by KRA can go a long way towards promoting a culture of compliance and sense of fairness and equity among all citizens. Failure by a growing number of small businesses on the other hand is likely to breed resentment among the taxpaying public and further drive down wilful non-compliance. A well-designed system must align as far as possible the TOT system, which promotes to the regular tax system to facilitate transition and

incentivise businesses that want to expand and make use of the opportunities presented in the formal sector.

Attempts to broaden the tax base should build on insights into how citizens experience and perceive the tax administration and enforcement, and whether and how their tax behaviour is co-related with their perceptions. KRA must invest in providing a stronger link between taxes and government expenditures and gather more systematic and coherent information on taxpayer attitudes towards tax policy design and implementation for better-informed tax policy design.

5.6   Areas for further study

More studies should be carried out on the magnitude of tax gap, optimal tax yield and levels of noncompliance for small and micro enterprises in Kenya. These studies would enable government and KRA to know the income received by small-scale entrepreneurs and small businesses in order to step up prospects of taxing it. It is also critical that more attention is paid to gaining an insight into the tax potential of those employed in the informal economy who are not subject to TOT as they are not the owners of the businesses.

Numerous studies suggest that there is more to the compliance game than simply administrative enforcement of taxes imposed on the unwilling. In various empirical studies, tax morale is shown to be a crucial determinant of taxpaying behaviour. More research should be undertaken on tax morale among Kenya's informal sector to understand their motivations and reactions to perception of the behaviour of the state and other taxpayers. Research suggests an inverse relationship between tax morale and belief about extent of tax evasion. A growing body of knowledge is emerging on nudging or behavioural psychology that is focused on influencing mass compliance behaviour from a social perspective.

5.7   Limitations of this Study

Tax collection is affected by many factors outside the control of KRA such as political factors, socio-economic characteristics, and public perceptions about government expenditure and corruption, which are seldom well controlled for when evaluating impact of various measures. Hence, the use of tax efficiency measures based only on controllable outputs and inputs may distort the observed performance of KRA and lead to unreliable results.

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APPENDICES

Appendix A: Introduction Letter

11 April 2016

To whom it may concern

FACILITATION OF RESEARCH – JAMES KARANJA

This is to introduce James Karanja, who is an MPPM student at Strathmore Business School. As part of our Masters Programme, James is expected to do applied research and to undertake a project. This is in partial fulfilment of the requirements of the Master in Public Policy and Management. The outcome would be of immediate benefit to the organisations he is researching on. To this effect, he would like to request for appropriate data from your organisation.

James is undertaking a research paper on **assessment of challenges of administering turnover tax: A case study of Kenya Revenue Authority**. The information obtained from your organisation shall be treated confidentially and shall be used for academic purposes only.

Our MPPM seeks to establish links with industry, and one of these ways is by directing our research to areas that would be of direct usefulness to industry. We would be glad to share our findings with you after the research, and we trust that you will find them of great interest, if not of practical value to your organisation.
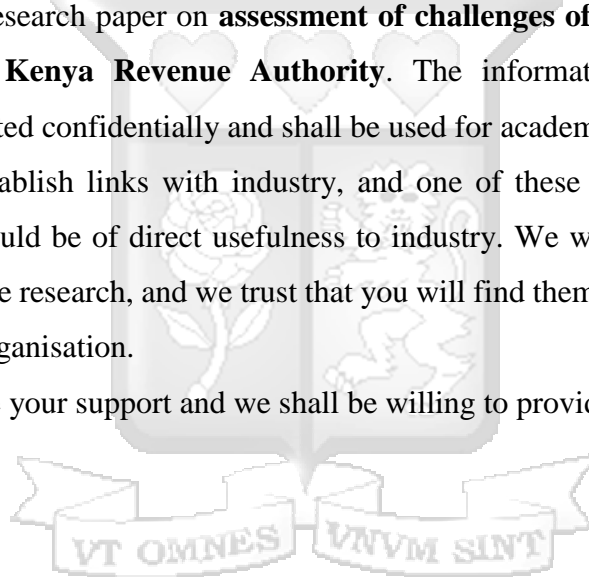
We very much appreciate your support and we shall be willing to provide any further information if required.

Yours sincerely,

Bildad Nyongesa

Manager - Master in Public Policy and Management

Strathmore Business School

Appendix B: Research Questionnaire

KRA STAFF QUESTIONNAIRE ON CHALLENGES AFFECTING IMPLEMENTATION OF TURNOVER TAX

Dear Respondent,

Thank you for taking time to fill in this questionnaire and offer honest feedback on your experiences in implementing turnover tax.

This questionnaire forms part of an academic study to be submitted in partial fulfillment of the requirements for the award of Master of Public Policy & Management Strathmore University (Business School). The study focus is on the use and effectiveness of two different approaches to enhancing TOT taxpayer compliance namely 'facilitation' and 'enforcement'. The objective of the study is to identify the foremost challenges facing KRA in enforcing collection of turnover taxation and identify priority areas for reform.

Survey Scope and respondents: The survey covers all DTD MST staff in Nairobi who are serving or have served in different aspects of management of turnover tax implementation.

Survey Date: **January/February 2018**

Section A: Personal Information

1. Age: ☐ 20-29 ☐ 30-39 ☐ 40-49 ☐ 50 and above (tick the relevant category)

2. **Number of years worked in KRA** ☐ 0-5 ☐ 5-10 ☐ 10-15 ☐ 15-20 ☐ 20 or more

3. **Position**_____

4. **Level of education**

    ☐ High School

☐ College

☐ Undergraduate

☐ Graduate

(Please add additional sheet incase more space required)

Section B: Simplification	Responses
Questions- Select from 1-5 with 1 being strongly disagree and 5 being strongly agree	**Circle one response**

1. Taxpayers generally have a good understanding of the Turnover Tax regime and what is expected of them.

      1 2 3 4 5

2. There are sufficient Regulations and guidelines on TOT operations to guide taxpayers and staff on what is expected.

      1 2 3 4 5

3. The TOT forms and brochures are simply presented and in a language most TOT taxpayers understand.

4. TOT taxpayers have been provided with sufficient ease of payment of TOT dues including MPESA.

      1 2 3 4 5

5. The Itax system is accessible to most TOT taxpayers and has provided adequate simplified filing for TOT taxpayers.

6. The process of registration for registration of eligible taxpayers is swift and user friendly.

      1 2 3 4 5

7. KRA has provided readily accessible filing forms and relevant information to TOT taxpayers through the website and other public areas.

      1 2 3 4 5

      1 2 3 4 5

Given challenges you are familiar with regarding efforts by taxpayers to comply, what more should be done to simplify the process of TOT taxpayer registration, filing and payment?

Section C: Education and Advice

Questions- Select from 1-5 with 1 being strongly disagree and 5 being strongly agree	**Please circle one response**
1. There are adequate supplies of explanatory and information pamphlets, guides, return forms, applications for registration, and other materials are available in public access offices	1 2 3 4 5
2. There are regularly held mobile clinics/training sessions/Awareness campaigns held in markets and other locations where traders are to be found.	1 2 3 4 5
3. There are adequate satellite offices and officers on hand to assist taxpayers with recruitment, filing and payment difficulties.	1 2 3 4 5
4. I have been fully trained and have a working manual on procedures of the new KRA approach to handling taxpayers through trust and facilitation	1 2 3 4 5
5. Taxpayers are showing an improvement in their relationships as a result of the new KRA approach of trust and facilitation.	
6. Taxpayers receive guidance and support from officers when they appear not to have done the right thing.	1 2 3 4 5
7. The due dates are effectively communicated to taxpayers.	
	1 2 3 4 5
	1 2 3 4 5

What more should be done to enable KRA officers effectively reach out to potential taxpayers and those already in the TOT system to encourage compliance?

Section D: Powers and Procedures

Questions- Select from 1-5 with 1 being strongly disagree and 5 being strongly agree	Please circle one response
1. The laws and procedures on TOT offer sufficient basis to deal with wilful non-compliance.	1 2 3 4 5
2. There is a clear procedure for monitoring the efficiency and effectiveness of TOT policy and implementation	1 2 3 4 5
3. The KRA structure for managing TOT is well organised and resourced with a distinct compliance strategy from normal taxation.	1 2 3 4 5
4. Staff has a clear procedure for reporting of identified implementation challenges.	
5. Management understand the challenges of TOT implementation and deal effectively with staff feedback on implementation challenges.	1 2 3 4 5
6. The targets set for TOT sector are realistic and achievable.	1 2 3 4 5
7. The TOT is too costly to implement for KRA given the opportunity cost of collection from other sectors of the economy.	1 2 3 4 5
8. Staff handling TOT are fairly assessed for performance in line with the unique nature of the TOT sector.	1 2 3 4 5

In your view what are areas of improvement to powers and internal procedures that can enhance the outcome of TOT?

Section E: Detection capabilities

Questions- Select from 1-5 with 1 being strongly disagree and 5 being strongly agree	Please circle one response
1. There is in place a well-documented strategy for recruitment of taxpayers	1 2 3 4 5

2. Block management strategy has been well implemented in my region and proved a very effective way to recruit and maintain compliance by TOT taxpayers.

1 2 3 4 5

3. KRA has an elaborate risk management strategy for profiling major sectors of TOT non-compliance.

1 2 3 4 5

4. Sufficient number of field officers have been assigned commensurate to the number of TOT taxpayers.

5. Regular audits are undertaken of taxpayer returns and anomalies raised with the individual taxpayers for resolution.

1 2 3 4 5

6. There is an elaborate system dealing with non-filers in the TOT regime.

1 2 3 4 5

7. There is sufficient collaboration with county governments involved in issuance of business permits.

1 2 3 4 5

1 2 3 4 5

Do you have additional comments on the current situation on detection capability of non-compliant taxpayers and what can be done to improve the situation?

Section F: Punishments

Select from 1-5 with 1 being strongly disagree and 5 being strongly agree	**Please circle one response**
1. The KRA frequently imposes fines and penalties for identified non- compliance in TOT sector.	1 2 3 4 5
2. Agency notices and distraint measures are regularly applied to recover taxes from payment defaulters.	1 2 3 4 5
3. Fines are imposed commensurate to the size of the business to encourage future compliance.	1 2 3 4 5
4. KRA has undertaken prosecutions of defaulters under the TOT regime.	
5. KRA has publicised the measures taken to the public involved in willful non-compliance.	1 2 3 4 5

6. Taxpayers subjected to punitive measures are converted to   1   2   3   4   5

   become tax compliance after such actions.

                                                 1   2   3   4   5

In your view, should KRA step up or tone down its punitive measures towards TOT taxpayers? If so, in which areas?

The informal economy has been mostly identified as a cash economy. What are the three biggest challenges you face while implementing turnover tax collection in such an environment?
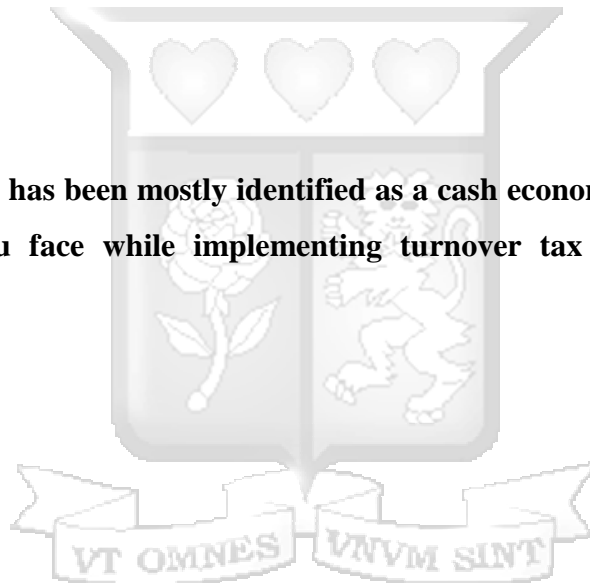
Section H: Tax Turnover Yield

Looking at the measures that KRA has undertaken to increase the tax turnover yield, to what extent has it succeeded? (Tick one of the 5 boxes)

☐

Not succeeded at all

☐ Some extent

☐ Moderate extent

☐ Great extent

☐ Very Great extent

Thank you very much for your participation!