INFLUENCE OF I-TAX ON PERFORMANCE OF TAX RETURN COMPLIANCE AMONG SMALL AND MEDIUM ENTERPRISES, CASE OF NAKURU CITY CENTRAL BUSINESS DISTRICT, KENYA

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ABSTRACT

The purpose of the study was to establish the influence of the ITax system on performance of tax return compliance among taxpayers of Nakuru city CBD, Kenya. The objective of the study was to establish the influence of fines and penalties on performance of tax compliance in Nakuru city CBD. The study was anchored economic based deterrence theory. This study will be of great significance to the taxpayers and the tax authority as it will give information relevant for formulation of tax policy and tax reforms implementation as well as tax administration. The study was carried out in Nakuru city since it has a large number of businesses approximately above 1426 who are also eligible taxpayers. The study adopted descriptive research design. Data collection was done by use of structured questionnaires. Stratified sampling was used to sample individuals registered on I-Tax. Piloting was done in Naivasha town among employees working in the flower farms. Validity test was carried out through triangulation. Reliability test was carried through the test-retest method. The data was analyzed using SPSS to produce both descriptive and inferential statistics. Informed consent was issued to the respondents to ensure voluntary participation and ethical consideration was observed. From the findings the study concluded that there exists a positive and significant relationship between tax fines and penalties on tax compliance performance in Nakuru city CBD, Kenya with (r=0.607, p=0.000). The study recommends that Kenya Revenue Authority should make improvements to the iTax platform to make it more use friendly. This can be enhanced by carrying out I tax training to the tax payers through seminars, door to door and workshops to enable taxpayers understand the importance of tax compliance and what antecedents determine their compliance as well as Tax is an important source of revenue for the government and every administration.

INTRODUCTION

Background to the Study

Tax systems have been evolving over a period of years, due to the need of governments to meet the demands of its citizen. Governments require all persons in the respective jurisdiction have the obligation to pay taxes as set out in the Tax laws of every country (Glatfelter,2015). It is the duty of persons to be tax compliant in order for them tobe considered as being tax compliant by the authorities mandated to enforce given tax laws. Persons who donot declare their taxable activities and end up failing to pay the requisite taxes are considered non- compliant and therefore every jurisdiction has set out ways of dealing with such persons.

Global perspective on I tax compliance

In developing countries, the income tax compliance has been constrained by the significant number of changes to the tax laws, that are now so complex and only a handful of tax experts can understand them.This creates additional problems for compliance by taxpayers who do not have access to sophisticated tax specialists (Braithwaite, 2019). Moreover, enforcement of these laws cannot reduce non- compliance among taxpayers because some tax measures put small and medium taxpayers under severe liquidity pressure, forcing many to fold in the informal sector (Azmi, 2019).

Regional perspective of I tax compliance

According to (Elizabeth & Gilbert 2015) in Uganda the URA has boosted its revenue by running an online tax administration system referred to as E-tax. This system offers benefits to the taxpayer as well as the tax authority by offering 24-hour service to taxpayers. It has aided the filing of tax returns that can now be done in minutes contrary to the manual system that would take hours. However, the system is still facing challenges due to lack of connectivity most of the times, and as suchonly large companies are effectively using it. Small and medium sized companies and individual taxpayers are still experiencing challenges. E-tax faces continuous system failure and has little backup support for customers.

Local perspective of I tax compliance

In Kenya, the iTax system came into operations from the year 2011 to replace the ITMS system which was previously being used by KRA. This failed to automate taxation causing serious customer dissatisfaction. ITAX is a one stop shop for various domestic taxes functions such as PIN registration,Filing of tax returns, processing of claims and refunds and status inquiries with real time monitoring of accounts. This iTax platform therefore makes it possible for taxpayers to easily register their personal details and also file their respective returns, make payment while also monitoring their ledgers and accounts at any given time and from the comfort of their homes or office without necessarily having to make regular visits to KRA offices whenever their tax obligations fall due. With ITAX, taxpayers are able to register, file returns, make payments and enquire about their status, while monitoring their accounts in real time 24 hours a day, from the comfort of their homes or offices. (Elizabeth,2017)

The iTax platform alsomakes it possible for taxpayers to ascertain if their money has been remitted to KRA given that the platform has been developed in such a way that it can be generate payment slips to show that indeed thetaxpayer has paid for that the sums of money required of him or her. The iTax platform has also made itpossible for employees to confirm if employer has remitted the amounts that are deducted every month as pay as you earn tax to KRA. (Gekonge et.al 2016)

Tax compliance

Tax compliance has various definitions. It can be described as a combination of a number of proceduresnot limited to payment filing and reporting, (Marti 2020) defines it as a fulfillment of obligations in relation to taxation voluntarily as required by the law. It is also determined by the power of authorities and taxpayers' trust in the authority (Groenland, 2017). In its article on tax compliance, Organization of Economic Cooperation and Development (2016), categorizes compliance in two namely; administrativecompliance and technical compliance. Tax compliance is defined as the full payment of all taxes due (Alm 2018).Tax noncompliance is referred to as any difference between the actual amount of taxes paid and the amount of taxes due. This difference occurs because of overstating and understating income,expenses, and deductions. Non-compliance comprises both intentional evasion and unintentional non- compliance, which is due to calculation errors and an inadequate understanding of tax laws (David, 2017). Tax compliance behaviours of a taxpayer usually differ from the compliance behaviours estimated in economics models. Taxpayers are greatly influenced by other taxpayers.

Statement of the problem

Despite the introduction of iTax, KRA still continues to post revenues short of the treasury targets. In the financial year 2017/2018 the authority collected exchequer revenue of Kshs. 1022 billion against the treasury target of Kshs. 1,065.8 billion (KRA, 2019). Tax compliance among SMEs is critical in assuring the government's ability toincrease tax income in order to manage the country's development plans (Groenland, 2017). While these studies make an attempt to identify what factors influence tax compliance, Kenyan SMEs have over the years demonstrated low compliance rates in Kenya (Ernst& Young, 2016). Currently, the seventh KRA corporateplan report (2020) indicated that compliance rate is 59% which is below the target rate of 65%. Most of them don't willingly register unless forced. Additionally, they mostly don't comply to the existing tax laws while also not keeping records for easy tax audits (KRA, 2016). Therefore, there is low tax compliance rates among SMEs therefore a need to look at iTax and its influence on performance of tax compliance among small and medium scale traders in Nakuru city CBD, Kenya.

Purpose of the study

The purpose of the study was to establish the influence of the ITax system on performance of tax return compliance among taxpayers of Nakuru city CBD, Kenya.

Objectives of the study

To establish the influence of ITax fines and penalties on performance of taxcompliance among taxpayers of Nakuru city CBD, Kenya.

LITERATURE REVIEW

Introduction

This chapter covers various sections, the theoretical literature, and empirical literature. The conceptual framework and recap of literature review. This study adopted economic based deterrence theory.

Economic based deterrence theory

This model was developed by Backer in 1968 and was later developed in 1972 by Allingham and Sandom and the model of tax compliance come into lame light. This model indicates that tax payer is always assumed to have an income and must decide on the part of the income to submit to the tax agency (Fishbein, 2015). The core idea behind the theory is that people choose to engage in activities thatmaximize their rewards while minimizing their costs (Gekonge et.al, 2016). The act will not beundertaken if the risks are high enough and the expenses are high enough to outweigh the benefits. Manysorts of criminal conduct, including tax evasion, have been studied using deterrence theory as a foundation.

Empirical Literature review

Andreoni (2018) argued that legal enforcement measures such as fines and penalties can be perceived as retaliation against a conduct that affects the community in an antagonistic climate. Eriksen (2016) added that legal enforcement measures has a double-edged effect whereby while it can spur compliance, it can also discourage the same especially when the legal enforcement measures are too harsh. The effect of legal enforcement measures on tax compliance is thus conflicting and contradictory across the world that motivates this study.

The study of penalties is important given that it is also one of the factors, which are within the control of tax authorities. An emphasis in the study was placed on how taxpayers‟ felt penalties impacted as a deterrent measure and the appropriate use of penalties by the revenue authorities. Allowing for some expected inbuilt bias given the cohort of taxpayers being investigated, the study will nevertheless shed some light on the views of tax evaders regarding penalties and enforcement measures by analyzing originaltax evader data. Some researchers have found that taxpayers are more sensitive to the magnitude of the penalty than to the probability of detection when the probability is very low 4% or less) (Kirchle, 2017).

Conceptual framework

The conceptual framework in Figure 1 shows the relationship between the independent variable I Taxfines and penalties and performance of tax return compliance by small and medium scale enterprises in Nakuru city CBD, Kenya.

I Tax fines and penalties on performance of tax compliance

Independent variables **Dependent Variables**

Tax fines and penalties

- Reasonable tax rates
- Amount of fines and penalties

Tax compliance

- Timely filing of taxes

RESEARCH METHODOLOGY

Introduction

The research methodology that was employed to attain the research objectives is be presented in this chapter. The research design, target population, sample size determination procedure, data collection research instrument and procedures as well as data analysis techniques is discussed in this chapter.

Research design

The study design adopted in this research was descriptive design. It uses multiple units to describe the current situation and problem (Khan, 2018). The researcher does not manipulate the variables; he only reports what will happen or what is happening. It was relevant to this research becauseit supports collection of primary data to describe and answer the research objectives. It clearly defines from where the data was sourced from and guides on how the questions were answered. Descriptive research studies are those studies, which are concerned with describing the characteristics of a particular individual, or of a group (Fischer, 2016).

Target Population

According to the Micro Small and Medium Enterprises Authority (MSEA) (2020), The target populationfor this study were all the 1416 small scale traders licensed by the registrar of trade (County licensing department in Nakuru) city, Kenya.

Table.1: Target Population

Business sector(small and medium)	Total
Manufacturing	156
Service industry	325
Commercial	278
Others(e.g boda boda operators)	657
Total	1416

Source: County Licensing Department Nakuru, 2022

Sampling Procedure and technique

A sample is a part or representative element of the total population. The sample size was be established through stratification using a formula. The sample was selected from the population of 1416 by stratified random sampling to ensure equal participation of the subjects according to the coding done by the county government of Nakuru. The sample size consisted of traders licensed by the Nakuru county licensing department. Sampling Strategy and sample size.

Table 2: Sample Size

Business sector(small and medium)	Total	Rep sample Y= 302/1416*x
Manufacturing		33
Service industry		70
Commercial		59
Others(e.g boda bodaoperators)		140
Total		302

Source: County Licensing Department Nakuru, 2022

Pilot testing

Pilot testing was carried out in Naivasha town to 30 small and medium scale enterprises, which represented 10% of the sample respondents. Naivasha town was picked because of its physical location and its distanceto the research area, and hence it was expected that the factors under observation would reflect those of Nakuru city on I tax compliance. The following regression equation was be adopted in the analysis.

$Y = \alpha + \beta 1X_1 + \varepsilon$

Where: Y=Tax Compliance

X1 =Tax penalties and fines

RESEARCH FINDINGS AND DISCUSSIONS

Introduction

This chapter provides a detailed descriptive analysis of the research data obtained the interpretation and discussion of the findings of the study. The chapter first presents the response rate, presents the respondents' profile and the findings of the study variables. The findings are presented in tables and discussed in this chapter in respect of the specific study objectives.

Response Rate

According to Schwarz (2013), a response rate refers to the number of units in the net sample used in the study expressed as a percentage of the units in the gross sample. In this study, 302 questionnaires were administered out of which 272 questionnaires were duly returned and found to be properly filled and thus used in the study representing a response rate of 90%. (2012) noted that response rate of 70% and above is sufficient for a research study. Therefore, 90% was good for the current study.

Test of Linearity

Linearity tests were undertaken to establish the linear relation between fines and penalties, taxpayer's attitude, cost of compliance, taxpayer training and tax compliance.
Results are presented in Tables 3

Table 3: Linearity between fines and penalties and tax compliance

			Sum of Squares	df	Mean Square	F	Sig.
Tax compliance * fines and penalties	Between Groups	(Combined)	3.668	10	.367	3.471	.015
		Linearity	2.042	1	2.042	19.326	.001
		Deviation from Linearity	1.626	9	.181	1.710	.172
	Within Groups		1.585	163	.106		
	Total		5.252	272			

Influence of I tax fines and penalties on performance of tax

The study objective sought to establish the reasons that influence of ITax fines and penalties on performance of taxcompliance by taxpayers of Nakuru city CBD. Table 4 shows the statistical results in details.

Table 4 Descriptive Statistics on I Tax fines and penalties

I Tax fines and penalties	N	Min	Max	Mean	Std. Dev.	CV (%)
Non filling of returns	272	2	5	3.27	.813	25.09
Agency notices to file tax returns	272	2	5	3.34	.770	24.29
Filing returns after due date	272	2	5	4.13	.837	22.25
Under declaration of income	272	1	5	3.46	.756	28.66
Claiming expenses not for business	272	2	5	3.14	.767	30.93
Revocation of licenses as a result of late tax payments	272	2	5	3.41	.870	26.64
Prosecutions related to taxes	272	1	5	3.25	.803	31.93
Arrests as a result of tax crimes	272	1	5	3.55	.789	26.10
Valid N (listwise)	272					

(Source, field data ,2024)

Correlation Analysis for fines, penalties, and tax compliance performance

This section outlines the results of correlation analysis between fines and penalties on performance on taxcompliance by taxpayers in Nakuru city CBD as shown in table 5. The findings were interpreted and discussed accordingly.

Table 5: Correlations between fines and penalties and tax compliance performance

		Fines and Penalties	Tax compliance Performance
Fines and penalties	Pearson Correlation	1	.607**
	Sig. (2-tailed)		.000
	N	272	272

**. Correlation is significant at the 0.01 level (2-tailed).

The correlation analysis results in Table 5 revealed that there was a positive and a strong significant association between fine and penalties on tax compliance performance of as supported by (r=0.607, p=0.000). This implied that both fines and penalties and tax compliance performance change in the same direction.

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

This chapter provides a detailed summary of the major findings of the actual study; it then draws conclusions and discusses implications emanating from these findings. Finally, it makes some recommendations and suggestions on areas of further study. The main aim of this study was to establish the influence of the ITax system on performance of itax return compliance of the taxpayers of Nakuru city CBD, Kenya.

Summary of Findings

The study sought to determine the summary of key major findings of the study objective.

Influence of I tax fines and penalties on tax compliance performance

From the analysis the study findings revealed that non filling of returns; agency notices to file tax returns; Filing returns after due date; under declaration of income; claiming expenses not for business; revocation of licenses as a result of late tax payments; prosecutions related to taxes; arrests as a result of tax crimes and departure prohibition orders from KRA were the major reasons for paying fines and penalties. The study revealed that I tax fines and penalties had a positive influence on performance of tax compliance in Nakuru city CBD, Kenya.

Conclusion

The study concludes the following based on the summaries.

Influence of I tax fines and penalties on tax compliance performance

From the findings the study concluded that there exists a positive and significant relationship between tax fines and penalties on tax compliance performance in Nakuru city CBD, Kenya with ($r=0.607$, $p=0.000$). Therefore, the findings imply that tax fines and penalties have an influence on tax compliance performance in Nakuru city CBD, Kenya.In the light of the foregoing findings, the study recommends that; From the conclusion the study recommended that, KRA should make improvements to the iTax platform to make it more use friendly. This can be enhanced by carrying out I tax training to the tax payers through seminars, door to door and workshops to enable taxpayers understand the importance of tax compliance and what antecedents determine their compliance as well as the fines and penalties in relation to noncompliance.

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