Influence of tax regulations enforcement on tax compliance by agri-business small and micro enterprises in Nyeri county Kenya

Maina Leonard Ngatia¹, Kiragu David N¹
¹Dedan Kimathi University of Technology, Kenya

*Corresponding Author:
Maina Leonard Ngatia
Email: ngatiamaina15@gmail.com

Abstract: Governments all over the world collect taxes so as to finance public services. Taxpayers in Kenya display varying levels in compliance to tax. The objective of this study was to investigate the influence of tax regulations enforcement on tax compliance by Agri-business SMEs in Nyeri County, Kenya. The theory of Economic deterrence anchored the study and the study did empirical review regarding related literature. Target population in the study was owners of Agri-business SMEs in Nyeri and Karatina Towns. Sample size was of 208 SMEs owners. Descriptive survey research method was used. Stratified systematic sampling method was adopted. Proportional method of allocation was used in allocating sample size. Semi-structured questionnaire was used to collect primary data. The questionnaire’s reliability was tested through Cronbach’s Coefficient Alpha computation. Instrument’s validity test was conducted using two expert groups. Data analysis was done through Statistical Package for Social Sciences (SPSS) software. Descriptive statistics and also inferential statistics were generated. Bivariate as well as multivariate linear regression analysis generated ANOVA, correlation coefficients and Model fitness $R^2$. Findings presentation was through graphs and tables. At 95% confidence level, the regression results generated a correlation coefficient, $R=0.629$ indicating a moderate positive relationship between tax regulations enforcement and tax compliance by Agri-business SMEs in Nyeri County, Kenya. Coefficient of determination, $R^2$, was found to be 0.395 showing that 39.5% of variation in tax compliance was explained by tax regulations enforcement. The study thus concluded that tax regulations enforcement affected tax compliance among SMEs in Nyeri County. The study recommends more inspections and stiffer penalties for non-compliance. Findings of this study will be used by stakeholders including owners and employees of SMEs, government, scholars and other researchers.

Keywords: Tax compliance, Influence, Tax Regulations Enforcement and Small and Micro Enterprises.

INTRODUCTION

Tax can be defined as an obligatory payment by natural and legal persons to the government so as to enable government finance its activities, which are, funding public services. Every patriotic citizen should primarily desire to uplift his/her society [1]. Paying tax demonstrates such a desire as taxation is the primary practical method of resources collection by the government so as to finance its expenditure on consumption of goods and services by the citizen [2]. Tax forms vital element on the way government affects its citizens’ lives, and thus it is important that citizens understand taxation. On the other hand taxation bears very heavily upon the well-being of the citizens, both in private and also in the economic enterprise [2]. Economic units assigned the tax burden do not entirely intend to bear the real tax burden as governance and integrity are still major challenges affecting organizations [3].

Smes can be defined as any activity that generates income and profits on small scale basis, by means of simple skills, vibrant and not subjected to directives of its activities [4]. In Kenya, SME’s control over 34% of the country’s economy [5]. This implies that SME’s play a very essential role in economic growth in Kenya. SME’s also account for 77% of the country’s total employment [5]. This implies that SME’s play a key role in creation of employment in this country. Most SME’S do not maintain accurate financial statements making it challenging for tax authorities to levy taxes on them [6].

Kenya ranks among countries with low tax compliance and hard task to ensure effective and efficient tax administration and enforcement is required [7]. In particular, tax compliance among Smes in Kenya is highly wanting with Parliamentary Budget Office [26] study showing that in the year 2008, the government would have increased its tax base by nearly Kshs.79.3 billion had tax enforcement by SMEs been addressed. Similarly, according to KRA annual report there was a massive tax revenue loss in year 2012 amounting to Ksh 108 billion and which is directly attributable to the SMEs [8]. The economic pillar of vision 2030 aims at creating a globally competitive
prosperous country by transforming Kenya into newly a industrializing, middle-income country [9]. However Smes non-compliance to taxation will impede the country’s realization of vision 2030. This study sought to find out and establish the influence of tax regulations enforcement on tax compliance by Agri-business SMEs in Nyeri County.

Objective of the Study
The objective of this study was to determine the influence of tax regulations enforcement on tax compliance by Agri-business SMEs in Nyeri County.

Research Hypothesis
H0: Tax regulations enforcement does not have a significant influence on tax compliance by Agri-business SMEs in Nyeri County

Theoretical Framework
Economic Deterrence Theory
The theory affirms that the behavior of taxpayers in evading tax depends on the benefits of evasion, that is, money not paid to tax authorities and the costs of evasion, that is, detection probability and penalties for non-compliance [1]. The implication of this theory is that where the probabilities of detection are high and the penalties for tax evasion are severe, not many people would evade taxes. By contrast, where there is a low detection probability and penalties are also low, the expected tax evasion would be high. The model can thus explain why tax non-compliance among SMEs in Kenya is high as this could be as a result of poor audits and penalties.

The model has faced criticism for focusing absolutely on the coercive side of compliance and ignoring the consensual side [10]. Despite this criticism, there exists evidence in support of the deterrence theory in addressing tax evasion [11]. Detection fear, or the possibility of being detected, has in several contexts been seen to be one of the effective strategies in inducing truthful behavior [12]. In summary it is expected that individuals perceiving tax evasion to be difficult will more likely comply with tax payment [13]. From the perspective of personal consequence, tax compliance is analyzed as a decision to maximizing income by balancing the gain of under reporting against the additional risk of being detected and facing penalties [14].

Empirical Literature
The empirical literature for this study consists of literature pertaining to tax regulations enforcement and the relationship of this variable to tax compliance.

Tax Regulations enforcement and Tax Compliance
Thiga and muturi [15] investigated the factors influencing tax compliance among Smes in Kenya. They found out that fines and penalties had a positive influence on tax compliance though not greatly, that is, their influence to tax compliance is partial.

Ali, Fjeldstad and Sjursen [1] carried out a study on the factors that affect attitude in tax compliance in Africa. Their focus was on Kenya, Uganda, Tanzania and South Africa. They found out that in Kenya and South Africa, respondents were more likely to comply with tax if they perceived tax enforcement made evasion more complicated. These findings thus support the economic deterrence theory. Other studies done on the probability of audit have found out a positive relationship between audit or detection and tax compliance [1, 16-18].

However some studies have differed and argued that audit decreases tax compliance [19, 20]. Additionally, Slemrod, et al. [21] do not give the relationship between audit and tax compliance.

The above studies provide mixed findings on the influence of detection, audit and penalties on tax compliance. Additionally, the studies seem to concentrate on whether audits and penalties are related to tax compliance leaving out an important question which is how audits and penalties impacts tax compliance. From the above studies, it was therefore hypothesized that tax regulations enforcement has no significant influence on tax compliance by Agri-business SMEs in Nyeri County.

RESEARCH METHODOLOGY
Descriptive research design was found appropriate in this study as this study was concerned with description of characteristics of taxpayers in terms of tax compliance. Research strategy for this study was a survey research strategy as the study involved data collection from a significant population of taxpayers and aimed to determine status of those taxpayers in terms of tax compliance. Survey research strategy can be used to explore and describe the existing status of variables, in collection of original data in order to describe a large population and also in measurement of large populations’ characteristics [22]. The study area was Nyeri County. Nyeri County’s choice was informed by its diversity in agri-business activities as Nyeri County boasts of cash crop including tea and coffee, Horticultural farming like cabbages and French beans as well as Dairy farming activities within its vicinity. The study’s target population was the owners of Agri-business SMEs in Nyeri and Karatina Towns. Nyeri town has a total of 281 businesses dealing with Agri-business related products whereas Karatina town has 152. These products are farm input and farm products.

The study’s sample size was 208 out of the 433 agri-business Smes in Nyeri and Karatina Towns. A systematic stratified sampling method was used to select the sample. This resulted in 135 SMEs in Nyeri Town and 73 in Karatina Town
For this study, primary data was collected using questionnaires. Questionnaire provides a competent way of collecting responses from a large group of respondents by asking each respondent to answer the same set of questions [23]. This study employed closed and open-ended questionnaires. This choice was informed by the fact that close-ended questionnaires are economical in usage both in terms of money and time, are easily analyzed as they are in immediate usable structure and are also easy to administer as alternative answers follow each item [24]. On the other hand, open-ended questionnaires permit higher depth of response and stimulate a respondent to think of his motives and feelings [25].

This study used self-administered questionnaires because when the respondents complete questionnaires themselves, they are known to be free from respondent’s subjectivity and bias in answering of the questions [23]. These questionnaires were delivered to respondents through hand delivery and the respondents were allowed a week’s time before collecting back the questionnaires. Hand delivery was used as it enhances the participation of respondent [25].

To ensure reliability of the research instrument, this study conducted a pilot test. Pilot testing is a small-scale study on a group which is parallel to the sample population [24]. The pilot study aimed at refining the research instrument to minimize the chances of respondents experiencing difficulties in answering questions and also to minimize the problems in data recording.

Pilot test was done on taxpayers that did not participate in the main study. Hand delivery of self-administered questionnaires was done to the owners of agri-business Smes and the response time given was one week. Where not effective, the research instrument was refined either by reviewing or deleting items therein. This study used the internal consistency method to evaluate the instrument’s reliability. Internal consistency method involves the administration of a single test to a sample of subject and then correlating a score from one item with the scores from the other items [22]. In this study, a single test was administered to the owners of Agri-business Smes, scores from the items correlated and Cronbach’s Coefficient Alpha of 0.82 was obtained.

For this study, content validity test was used for measuring validity of data collection instrument. Content validity is the degree to which the measurement device offers adequate coverage of questions being investigated [24]. This study evaluated content validity by use of two professional experts groups. The first group comprised members of ICPAK. This group established whether the sets of items in the data collection instrument correctly represented the taxation compliance. The other group was made up of practicing Accountants. They evaluated the concept which the research instrument was measuring.

For data analysis, Statistical Package for Social Sciences software was used. Descriptive statistics were generated through univariate analysis of each variable. Descriptive statistics comprised the measures of central tendency, which includes arithmetic mean, median and mode as well as measures of dispersion encompassing variance and standard deviation. Hypotheses testing inferential statistic was p-value. The test was for hypothesis testing at 5% level of significance. The computed value was compared with table value and if computed value was less than table value, the null hypothesis was rejected, otherwise it was accepted.

For determination of the magnitude and direction of the variable’s relationship, Pearson’s product moment correlation coefficient (R) was generated at 0.05 significance level. Correlation coefficient of above 0.7 was interpreted as a strong association, 0.5 to 0.7 as moderate and below 0.5 as low association between the variables. Coefficient of determination (R²) was also generated at significance level of 0.05. This was in order to indicate the variation in dependent variable that was explained by independent variable. Presentation of findings was by use of tables and graphs.

**RESEARCH FINDINGS**

The study also sought to determine how tax regulations enforcement influences tax compliance by agri-business SMEs in Nyeri County. The study found out that the level of tax regulations enforcement was low as a sixty four percent of respondents indicated that frequency of inspections were not done to a great extent. Further, fifty four percent of the respondents indicated that the probability of detection was to a small extent. Similarly, severity of penalties was found to be of small or moderate extent according to eighty nine percent of the respondents. The findings therefore reveal that adherence was not greatly emphasized by the regulators.

These findings therefore imply that there was little tax regulations enforcement within agri-business SMEs in Nyeri County as the regulators subjected agri-business SMEs owners to low levels of frequency of inspections, detection probability and severity of penalties. This highly explains why the tax compliance within agri-business SMEs in Nyeri County was very low. The findings are in agreement with Thiga and muturi [14] who investigated the factors influencing tax compliance among agri-business Smes in Kenya and found out that fines and penalties had a positive influence on tax compliance. The findings are also in agreement with Ali, Fjeldstad and Sjursen [15] who carried out a study on the factors that affect attitude in tax compliance in Africa and found out that in Kenya...
and South Africa, respondents were more likely to comply with tax if they perceived tax enforcement made evasion more complicated. Additionally the findings are in agreement with other studies done on the probability of audit which have found out a positive relationship between audit or detection and tax compliance [1, 16-18].

CONCLUSION
The study concluded that tax regulations enforcement moderately influences tax compliance among SMEs in Nyeri County. Regressing tax compliance on tax regulations enforcement yielded a p-value statistic of 0.000 which is less than 0.05. This test was also done by use of SPSS software, the confidence level being 95%. Further, regression results generated a coefficient of correlation (R) = 0.629 signifying a moderate and positive relationship between tax regulations enforcement and tax compliance. Coefficient of determination (R^2) was 0.395 indicating that 39.5% of variation in tax compliance was explained by tax regulations enforcement.

Recommendations
The findings revealed that tax regulations enforcement had a moderate influence on tax compliance. Therefore, the study recommends that:
- Kenya Revenue Authority should subject SMEs to more frequent inspections.
- Kenya Revenue Authority should also impose more strict fines and penalties on non-complying SMEs.
- Kenya Revenue Authority should also consider upgrading its compliance officers’ efficiency for example through additional training.

REFERENCES
4. The Budget Focus. A Publication of the IEA Budget Information Programme (2012) issue 29

International Journal of Recent Research in Commerce Economics and Management (IJRCEM), 1(3), 60-75


Available Online: http://scholarsbulletin.com/