



## **FACTORS AFFECTING TAX REMITTANCE BY SME'S IN KENYA**

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### **Abstract**

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*This research focus on how tax knowledge and tax remission laws affected tax remittance behaviour of SMEs where the sample was selected from Uasin Gishu County in Kenya. The main objectives of the study were to investigate how the unique business conditions of SMEs, the perceptions of SME operators towards taxation, levels of tax knowledge and tax remission laws affect tax remittance of SME taxpayers. The study adopted a chiefly qualitative research design. Methodological triangulation was employed, utilizing the interview method and a questionnaire survey to collect primary data from SMEs in Uasin Gishu County. The findings were analyzed through summative content analysis and questionnaire responses were analyzed using SPSS software. The results indicated that SMEs face different business conditions from large companies which cause them to bear high tax remission burdens. The results also indicated that the perceptions of SME operators about tax fairness, tax service quality and government spending priorities greatly affect their tax remission decisions. Tax knowledge was discovered to have no correlation with tax administration practices but weak negative correlations with tax collection procedure. Tax laws were discovered to have negative correlations with tax remittance. The study recommended that the current tax law should be amended to incorporate provisions that grant special tax incentives to SMEs in order to improve voluntary tax remittance by SME taxpayers.*

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**Keywords:** Tax education, Tax law, Tax compliance processes and Tax administration

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## **1. Introduction**

Tax is the means by which the government finances the expenditure by imposing charges on citizens and corporate entities. The government uses taxation to encourage or discourage certain economic decisions. Taxation in Kenya was introduced through tax modernization program in 1986 with the hope that this world among other things enhances revenue collection, improve tax administration and reduce compliance and collection costs. Despite tax modernization, there are concerns that the challenges that confront the Kenya revenue authority today are different from the challenges that faced these revenue authorities before. There are also concerns that tax competitiveness in Kenya is low and the country remains among the tax unfriendly economies in the world (Kimenyi, 2001).

Taxes play an important role in the budget of any economy and one of the main reasons why the government imposes taxes is to generate income to manage the economy and redistribute resources. Over the years, the Kenyan government has undertaken various revenue administration reforms aimed at enhancing revenue collection. Taxation is a major tool of raising sufficient revenue to fund public spending without recourse to excessive public sector borrowing, it is also used to mobilize revenue in ways that are equitable and that minimize its disincentive effects on economic activities (Nyakango, 2005). Even though the system has continually changed, the challenges that confront the tax authorities today are not much different from the pre-reform challenges. Tax evasion remains high with a gap above 35 % (KIPRA, 2004). The tax code is still complex and cumbersome characterized by uneven and unfair taxes, narrow tax base with very high tax rates and rates dispersions with respect to trade and low compliance (Glanday, 2002).

Kenya like many other developing countries, seeks to apply the tax weapon, so as to meet the objectives of raising enough revenue and ensuring that revenue is raised in ways that are equitable and that are minimize the disincentive effects of taxation. The taxation system has mainly concentrated on taxing individual income, profits and goods and services. However tax on land has not yet been well developed in Kenya. The main challenges facing the taxation of factors of production in Kenya includes; structure of the economy, administration, tax data and politics (Ndungu, 2001).

## **2. Statement of the problem**

Tax revenues have for quite some time, remained low relative to the number of both registered and non-registered firms and individuals who are legally qualify to pay tax. Continued low revenue collection levels for government is detrimental to economic development of this nation. Fortunately, the large registered firms usually pay their taxes. In contrast, a large segment of the informal sector, especially the SMEs in Uasin-Gishu exhibit low tax compliance levels. They found out that that the tax compliance costs exceeding over 7% of gross added value are relatively high. Value-added tax, labor taxes, and corporate taxes are the main components of tax compliance costs. The above researches made great contributions on some of the factors that affect compliance of tax payment, such compliance for SMEs in Uasin-Gishu has not been adequately dealt with.

### 3. Objectives of the study

The general objective of the study was to investigate the factors affecting proper tax remittance by SME's in Kenya. The Specific objectives were;

- i. To determine if tax education affects proper tax remittance procedure by SME's in Kenya.
- ii. To determine if compliance to tax processes will affect proper tax remittance procedures by SME's in Kenya
- iii. To determine if compliance to tax administration will favor tax remittance procedures by SME's in Kenya
- iv. To determine if compliance to tax law will affect proper tax remittance procedures by SME's in Kenya

### Conceptual framework

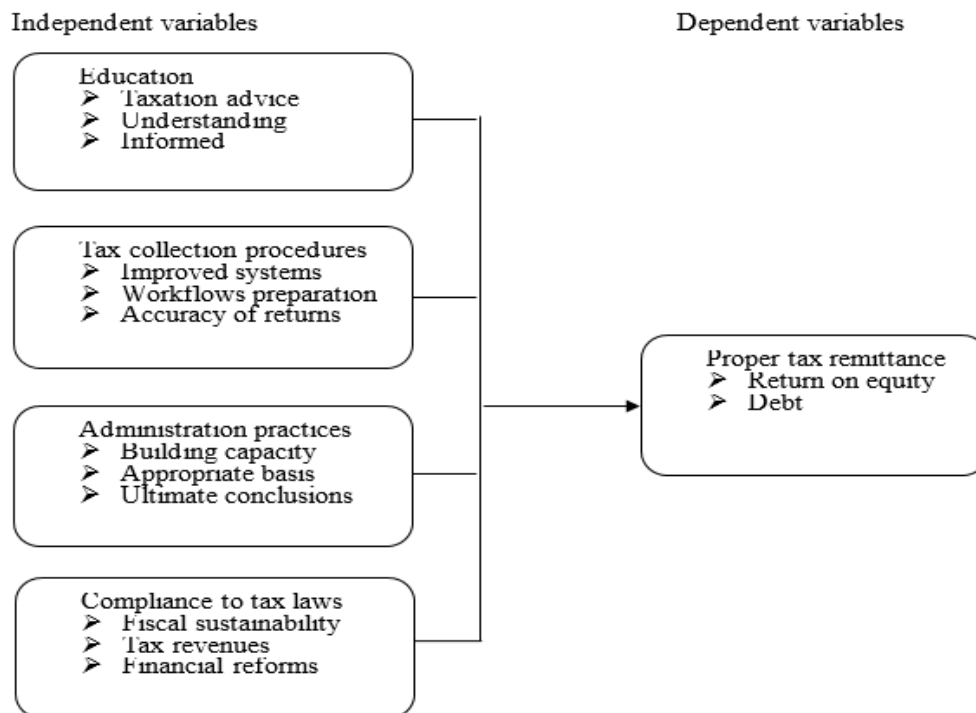


Figure 2.1: Conceptual framework

#### 4. Methodology

A descriptive research design was applied for this study. A total of 250 SMEs in Uasin-Gishu County were targeted for this study. The sample for this study was drawn from all the SMEs in Uasin-Gishu County. Primary data was collected by use of both structured and unstructured questions in the questionnaire. Every fifth firm in every cluster was selected and information gathered on the same firms. The study therefore had 138 companies which formed the sample frame. Purposeful sampling was used to select the respondents to the questionnaire. A total of 53 finance managers, 1 manager each from each of the firms were selected purposely to provide adequate responses to causes of low tax remission.

#### Research findings and Discussion

##### Determinants of Tax Remittance

The respondents were asked whether they thought tax remittance was influenced by any factors and the majority 39 or 85% agreed that there were several factors that can be attributed to tax remittance among SMEs in Uasin-Gishu County. This is as opposed to 7 or 15% of the respondents who thought that tax compliance was not influenced by any factors whatsoever.

#### 5. Tax education

**Table 1 whether tax education enhances efficiency for SME's tax compliance.**

Response	No of respondents	Percentage response
Strongly agree	9	30
Agree	9	30
Undecided	1	3.3
Strongly disagree	7	23.3
Disagree	4	13.3
Totals	30	100

Table 1 Shows that tax education enhances efficiency for SME's tax compliance, these was indicated by had following results. 30% strongly agreed, 30% agreed, 9% were neutral, 13.3% disagreed and 23.3% strongly 3.30% of the respondents were undecided; this may be due to the influence of the level of education.

#### 6. Tax collection process

**Table 2 whether tax collection process favorable for the SME's**

Response	No of respondents	Percentage response
Strongly agree	6	20
Agree	5	16.7
Undecided	4	13.3
Strongly disagree	8	26.7
Disagree	7	23.3
Totals	30	100

Table 2 Indicating that tax collection process is not favorable for the SME's. This was indicated by a cumulative of 50 % Of the respondents who disagreed and strongly disagreed respectively. Some of the respondents were undecided and this could have been an influence of both lack of tax education and the level of education respectively, these respondents were represented by 13.3% of the respondents.

## 7. Tax administration practices

**Table 3 whether tax Administration practices favor SME's**

Response	No of respondents	Percentage response
Strongly agree	4	13.3
Agree	7	23.3
Strongly disagree	9	30
Disagree	10	33.3
Totals	30	100

Table 3 It indicates that tax administration practices do not favor SME's, this was indicated by a cumulative of 63.3% of the respondents who both strongly disagreed and disagreed to the fact that tax administration practices favor SME's.

## 8. Compliant to tax laws

**Table 4 whether SME's are compliant to tax laws**

Response	No of respondents	Percentage response
Strongly agree	8	26.7
Agree	10	33.3
Strongly disagree	7	23.3
Disagree	5	16.7
Totals	30	100

Table 4 Shows that SME's are compliant to tax laws, this was indicated by a cumulative 60% of the respondents who strongly agreed and those that agreed to the fact that the SME's comply with tax laws.

## Extent of Influence of Determinants on Tax Remittance

The findings indicate that the most respondents feel that the extent of tax payers` attitude and behaviour on tax remittance is greater at 25 respondents in number; low remittance culture has the greatest influence on tax remittance at 30 respondents while bureaucracy and corruption influences tax remittance to most to a greater extent at 28 respondents. On the other hand the size of the SMEs has the least influence on tax remittance at 25 respondents, the use of family and unpaid labour has least influence on tax remittance while lack of transparency and accountability has the greatest influence on tax remission. The table 5 best illustrates these facts.

Table 5: Extent of Influence of Determinants on Tax Remittance

<b>Factor/Determinant</b>	<b>No effect</b>	<b>Least extent</b>	<b>Great extent</b>	<b>Greater extent</b>	<b>Greatest extent</b>
Tax payers` attitude and behaviour	5	15	24	25	16
Low remission culture	10	10	20	25	30
Bureaucracy and corruption	9	17	36	28	14
Size of the SMEs	11	25	10	8	9
Use of family and unpaid labour	12	30	19	9	12
Lack of transparency and accountability	2	8	14	19	32

The study findings indicate that lack of transparency and accountability has the greatest influence on tax remittance followed by low remittance culture and tax payer’s attitude and behaviour in the third spot.

### Summary of Statistics of the Factors Determining Tax Remittance

The following table 6 below is the summary of statistics.

**Table 6: Summary of Statistics**

Variable	Mean	Std	Mode	Median	Skewness	Kurtosis
Tax payers` attitude and behavior	3.10	1.424	2	3.00	1.073	-0.868
Low remission culture	1.49	0.390	1	1.00	1.312	1.072
Bureaucracy and corruption by tax administrators	2.56	1.367	2	2.00	-0.514	-1.661
Size of the SMEs informal sector	2.71	1.204	3	3.00	-0.564	-0.513
Use of family and unpaid	2.26	1.153	2	2.00	0.433	-1.033

labour						
Lack of transparency and accountability	2.14	1.052	1	1.00	1.321	1.161

## Hypotheses Test Results

**Table 7 Testing of hypotheses**

	Model	Sum Squares	of	df	Mean Square	F	Sig.
1	Regression	4.987	1		4.987	96.874	.000 <sup>b</sup>
	Residual	1.699	33		.051		
	Total	6.686	34				
2	Regression	5.332	2		2.666	63.001	.000 <sup>c</sup>
	Residual	1.354	32		.042		
	Total	6.686	34				
3	Regression	5.565	3		1.855	51.302	.000 <sup>d</sup>
	Residual	1.121	31		.036		
	Total	6.686	34				
4	Regression	5.743	4		1.436	45.694	.000 <sup>e</sup>
	Residual	.943	30		.031		
	Total	6.686	34				

The research hypothesis were,  $H_1$  Size of SMEs has no significant influence on tax remittance,  $H_2$  Low compliance culture has no significant influence on tax remittance  $H_3$ , Tax payers attitude and behaviour has no significant influence on tax remittance,  $H_4$  Bureaucracy and corruption has no significant influence on tax remittance.

Table 7 presents the results of hypotheses testing for each of the independent variables. As observed, the overall model remains statistically significant despite increasing the number of variables in the model. The results therefore shows that each of the variables included in the model contribute to the overall significance. All the F-values of the models were found to be statistically significant. The interpretation was that the stated null hypothesis were individually rejected.

The regression model was

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \text{ where;}$$

Y = DEBT TO EQUITY: (Measure of tax remittance)

$\beta_0$  = is the constant term / intercept

$\beta_i$  = beta coefficient of the independent variables,

X1= tax education, X2= tax collection process

X3=administration practices, X4= compliance to tax laws

$\varepsilon$  = error term

**Table 8 Regression Results**

Variable	Coefficient	Standard error	t-statistic	p-value
<b>Tax Education</b>	-0.341	0.052	-6.550	0.000
<b>Tax collection process</b>	-0.182	0.054	-3.374	0.002
<b>Administration practices</b>	-0.056	0.024	-2.382	0.024
<b>Tax laws</b>	0.140	0.053	2.640	0.012
<b>Intercept</b>	1.451	0.120	12.111	0.000
<b>F-statistic =&gt;45.694</b>				
<b>Probability &gt;F =&gt;0.0000</b>		<b>R-squared=0.8592</b>		<b>Adjusted R-squared=0.84</b>

**Regression model**

$$DEBTTTOEQUITY = 1.451 - 0.341X1 + 0.182X2 - 0.056X3$$

Standard error	0.120	0.052	0.054	0.024
t-statistic	12.11	-6.550	-3.37	-2.382
P-value	0.000	0.000	0.002	0.024
				$-0.14X4 + \varepsilon$

SE 0.053

t-statistic -2.664

P-value 0.012

The findings show that the coefficients` R-values are given in the parenthesis. In all the estimated model coefficients, the R-values were less than .05 (i.e. 0.5>R) the implication of this is that the variables or the determinants tested significantly in this study influence tax remittance of SMEs



in Uasin-Gishu County at 5% significance level. Also, the findings indicate that the coefficient for tax payers' education ( $x_1$ ),

Tax collection process ( $x_2$ ) and the compliance to the tax law ( $x_4$ ) are positive, this means that tax payers' attitude and behavior, low remission culture and the size of the SMEs informal sector positively relates to tax remittance for example the higher the ( $x_1$ ), ( $x_2$ ) and ( $x_4$ ), the lower the tax remittance rate among the SMEs in Uasin-Gishu County and vice versa. The fitted model was diagnosed and found that the regression was statistically significant at 5% significance level (regression  $R$ -value = .05 > .073414). The tax payers' attitude and behavior to pay tax influences the extent to which a firm complies with tax payment requirements. SMEs must be willing to pay tax and their attitudes and behaviour must be positive if they have to pay taxes whenever the obligation falls due. In this study period a unit change in tax payers' attitude and behaviour of a firm increased the chances of a tax payment or compliant by 3.0026445 or 30.02 %.

Low remission culture is another determinant that positively influences tax remittance levels among the SMEs. Taxpayers who are culturally homogeneous in terms of discharging their tax remittance obligations will be more likely to be tax compliant unlike those who lack the remittance culture. The study findings indicate that the chances of SMEs being culturally tax compliant are at 0.4270961 or 42.71%.

All together the influences of explanatory variables captured in the model are significant, and these findings are informative, as they intrigue significant questions regarding determinants of tax remittance in Uasin-Gishu County. With regards to perceptions of bureaucracy and corruption by tax administrators and government spending, those who engage in tax evasion often justify such behavior by suggesting that the government wastes tax revenue and spends unwisely; such arguments can decrease voluntary remittance in the long run (Braithwaite *et. al.* 2009). It is expected that if the government spends taxpayers' money wisely, for example on basic facilities like education, health and safety and public transportation, it is assumed that voluntary compliance will increase. In contrast, if taxpayers perceive that the government spends too much on something else, taxpayers might feel betrayed and attempt to evade. In judging their own behaviour, people tend to believe the cause is due to external attributes and cannot be tax compliant. Therefore the government should spend taxpayers' money wisely so that tax compliance will increase, thus the tax collection will also increase.

With regard to the influence of the referent group, Allingham and Sandmo (1972) found that influence from family and friends significantly affect tax compliance although the extent of influence was not clearly stated. The influence of referent groups tends to be important in tax remittances, as taxpayers are keen to refer their tax matters to their immediate family members or friends rather than tax experts, in order to minimize their remittance costs.

If a taxpayer refers to a compliant taxpayer, then the tendency to commit tax evasion is lower, but if a taxpayer refers to a non-compliant taxpayer, they might become a non-compliant taxpayer as well. Therefore, cultivating personal awareness of remittance is important so that they are less influenced by these factors for example friends and family members'. The regression output showed R-square value of 72.624%. This implies that there could be other factors that contribute to the remaining 27.4% in explaining the variation in tax remittance in Uasin-Gishu County.

## **9. Summary of the findings**

The objective of the study was to investigate on the causes of low tax compliance among small and medium enterprises (SMEs) in Uasin-Gishu. Majority of the respondents 39 or 85% agreed that there were several factors that can be attributed to tax compliance among SMEs in Uasin-Gishu County. This is as opposed to 7 or 15% of the respondents who thought that tax compliance was not influenced by any factors whatsoever. Those who agreed that tax compliance was influenced by some factors they stated the following as the factors they thought influenced tax compliance. First there was the issue of taxpayers' behavior towards tax system; the tax payers have a negative attitude towards the payment of taxes. Secondly, there was the issue of hostility between the taxpayers and tax collectors. Other factors were outward resistance from taxpayers for example the protest by taxpayers over implementation of Electronic Tax Registers, taxpayers' willingness to pay taxes, the tax morale of society that fosters self-enforcement of tax compliance which did not exist among SMEs.

On the other hand factors such as lack of transparency and accountability in the use of public funds contributes to public distrust both with respect to the tax system as well as the government, shortfalls in tax collection procedures as well as weak capacities of tax administrations to detect and prosecute tax violators are both factors that contribute to a low enforcement of tax legislation which leads to low tax compliance rates. Lack of a well-functioning body of tax investigation which is essential for the detection and prosecution of cases of tax fraud is another determinant of tax compliance.

In addition to the above the findings also indicate that perception on government spending by the tax payers was seen to influence tax compliance, organizational financial constraints was also seen to influence tax compliance. Equally, simplicity of tax return forms and awareness on offences and penalty on those that do not comply with tax payment were to blame for non-compliance of tax. Lack of transparency and accountability has the greatest influence on tax compliance followed by low compliance culture and tax payers' attitude and behaviour in the third spot. The determinant with the least influence is the size of the SMEs followed by the use of family and unpaid labour. The factors for tax non-compliance among the tax payers were found to be: the inability to understand tax laws i.e. rates of tax, filing and paying dates etc.

It is expected that if the government spends taxpayers' money wisely, for example on basic facilities like education, health and safety and public transportation, it is assumed that voluntary compliance will increase. In contrast, if taxpayers perceive that the government spends too much

on something else, taxpayers might feel betrayed and attempt to evade. In judging their own behaviour, people tend to believe the cause is due to external attributes and cannot be tax compliant. Therefore, the government should spend taxpayers' money wisely so that tax compliance will increase, thus the tax collection will also increase.

## **10. Conclusion**

Business proprietors are a significant part of the economy of most developing. They are arguably the most growing business segment hence their characteristics and remission of taxes vary considerably. Educating the consumers on the values created by remittance is vital. Tax education provides information to combat the consumer's perception that price is the only factor in relation to tax remitting. There is also a need for amendments in the tax systems to enhance favorable patterns to tax remittances of income from the taxpayer.

Small taxpayers under the regular system of taxation are discriminated against, since the compliance requirements, cost of compliance and tax rate are the same for both small and large enterprises. Reducing the compliance costs and tax rate increases the small enterprises profit margin. It also increases the Government's tax revenue, since the simplified provisions for small and medium enterprises reduce the size of the informal economy and the number of non-complying registered taxpayers. SMEs usually have to operate in an overbearing regulatory environment with the plethora of regulatory agencies, multiple taxes, cumbersome importation procedure and high port charges that constantly exert serious burden on their operations. Hence, SMEs are deprived of the benefits that arise if the government had enough tax revenue to embark on some development projects provision of amenities such as electricity and good roads which are tools that create an enabling environment for SMEs to thrive.

## **11. Recommendation**

For effective tax remission, the government through KRA should be able to educate and offer advice to tax payers on how to access their tax situation and benefit from using tax professionals. The taxpayers should also ensure compliance to the legislations about tax assessments to ensure the availability of public utilities by the government and stable economic development. The regulatory body should amend the tax system to enhance favorable patterns to tax remittances of income from the taxpayer. The tax policies should be designed in such a way that they do not only directly affect SMEs but also indirectly push for voluntary compliance and their growth. Special tax regimes for SMEs may be appropriate policy instruments for minimizing the cost of collection. Because awareness of the dangers of inadequate taxation of SMEs has grown because of the potential of uneven tax enforcement to cause distortions of competition, voluntary compliance by larger enterprises and by wage earners, government intervention should help maintain balance while ensuring that countries exploit the social benefits from greater competition and entrepreneurship. Pro-business and (Pro-SME) Tax regimes and enforcement should be simple, consistent and predictable should to lower compliance and administrative

costs, and hence reduce uncertainty faced by taxpayers as well as improve the levels of voluntary compliance.

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