

Influence of Government Spending on Tax Compliance in the Informal Sector in Kenya: Survey of Nyeri Town**Elizabeth Ndichu Gitonga¹, Dr. Teresiah Kyalo², Dr. Lucy Maina³**¹Student, School of business, Karatina University, Kenya²Lecturer, School of Business Karatina University, Kenya³Lecturer, School of Business cooperative University, Kenya***Corresponding author***Elizabeth Ndichu Gitonga***Article History***Received: 14.10.2017**Accepted: 23.10.2017**Published: 30.10.2017***DOI:**

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Abstract: Tax non-compliance reduces tax collection and the tax performance within a country. The Kenyan government has implemented various strategies to bring businesses in the informal sector into the tax bracket. However, available data shows that tax collections from the informal sector are above average but on a declining trend. The purpose of this study was to identify predictors of tax compliance in the informal sector in Nyeri Town. Specifically the study aimed to assess how tax rates, attitudes towards government spending, complexity of tax returns and tax enforcement strategies influence tax compliance. The study adopted a cross-sectional survey design and targeted 715 informal businesses in Nyeri Town. Stratified random sampling technique was used to select 143 informal businesses to participate. Researcher-administered questionnaires were used to collect data from the respondents. Descriptive methods such as frequency distribution, percentages, mean, were used to summarize and organize data. Chi-square tests and correlation analysis were employed to establish relationships between study variables. Findings were presented using tables of frequencies and percentages. Majority (66%) agreed that there was too much corruption in the government. Attitudes towards government spending ($p=0.001$) had a significant relationship with tax compliance at 95% confidence level. The study concluded that, attitudes towards government spending, is important predictor of tax compliance in the informal sector. It was recommended that the government should seek to end corruption in all sectors to enhance tax compliance.

Keywords: Informal Sector, Tax Avoidance, Tax Compliance and Tax Evasion:

BACKGROUND TO THE STUDY

Taxation as elucidated by Boucher, [1] is a compulsory levy on individuals and organizations by governments for revenues provision as a means of financing expenditure on public goods and services and control volumes of private expenditure in mainstream economies. Tax compliance is deemed as the measure of willingness by individuals and related taxable entities to comply with the provisions of tax statutes and administration without coercion [2]. The informal sector is diverse and entails small-scaled members and larger organized enterprises. Saad [3] opined the informal economies as also entailing garment workers working from their homes and informally employed personnel of formal enterprises. In Kenya the informal sector is large and estimated at 34.3% of the population. The sector accounts for 77% of employment nationally. Majority of persons working in the informal sector are youth estimated at 60% of the total sector population [4]. Nyeri County has the situation of the informal sector members for 60% of total employment. The study takes cognizance of the challenges bedeviling the sector as pertains to being within the tax bracket and sought to find out predictors of tax compliance in the informal sector in Nyeri Town.

STATEMENT OF THE PROBLEM

The U.S. Treasury and the United Kingdom lose \$100 billion and £35 billion annually in form of taxes respectively due to non-compliance [5]. Kenya rates lowly as pertains to tax compliance and ensuring efficient and effective tax administration [6]. The government introduced Turn over Tax (TOT) in January 2008, through Finance act 2006, 12c of the income tax cap 470 as measure of enforcing compliance by the informal sector. Despite the statutory provisions, tax compliance in the Kenyan informal sector is still low [6, 7]. In 2012/13, TOT generated a total of Kshs. 136 Million which was 31% of the projected revenues against a set target of Kshs. 442 Million [4]. This reflected a big gap in tax compliance, reduced collection and tax performance in the country. It is against this backdrop that the study sought to identify the influence of government spending on tax compliance in the informal sector in Nyeri Town.

OBJECTIVE OF THE STUDY

To evaluate the influence of government spending on tax compliance among businesses in the informal sector in Nyeri Town

HYPOTHESIS

Attitudes towards government spending have no significant relationship with tax compliance among businesses in the informal sector in Nyeri Town

SIGNIFICANCE OF THE STUDY

The findings of the study may be used by tax collection agencies to understand pitfalls in tax compliance in the informal sector. Policy makers in the Ministry of Finance and Kenya Revenue Authority (KRA) in particular may use the findings in coming up with relevant strategies to promote tax compliance in the informal sector. Researchers may use the findings of this study as reference material.

SCOPE OF THE STUDY

The study focused on tax compliance in the informal sector. Strategies specifically the study aimed to assess how attitudes towards government spending, influence tax compliance. The study took place in Nyeri town, Nyeri County. Business owners and managers in the informal sector served as the study respondents. Questionnaires were used to collect data from 143 business owners in the informal sector. The study took place between March and August of 2015.

LIMITATIONS OF THE STUDY

Some respondents feared participating in the study based on the perception that the study was undertaking a tax compliance evaluation for the relevant government agency.

The current study was limited to the influence of attitude towards government spending, despite the presence of other motivating factors that affect compliance.

THEORETICAL REVIEW

The theory of planned behaviour (TPB) as postulated by Fishbein and Ajzen [8] was used to predict determinants of tax compliance in the informal sector. The theory clarifies the complexity of tax compliance decision making and also importantly is utilized for the development of broad population compliance strategies. The theory is a modification of reasoned action and it was based on the assumption that human beings are usually quite rational and make systematic use of the information available to them [9]. According to the theory of planned behavior, intention, devoid of unforeseen circumstances that limit individual control, will help predict future behavior. The variance in intention is composed of three global constructs: attitudes toward the behavior, subjective norms, and control [3]. The theory related well to the citizenry attitude on the ways government spends its taxation monies as a factor motivating compliance to the tax provisions.

Perceptions towards Government Spending

Taxpayers' willingness to pay taxes differs widely across the world [5]. Empirical research indicates that taxpayers throughout the world pay more taxes than can be explained by even the highest feasible levels of auditing, penalties and risk aversion [10]. High levels of tax compliance result from the tax morale of society that fosters self-enforcement of tax compliance [3]. The willingness to pay of the taxpayer is influenced by the following factors: In general, citizens expect some kind of service or benefit in return for the taxes paid. If the government fails to provide basic public goods and services or provides them insufficiently, citizens may not be willing to pay taxes and tax evasion and avoidance will be the consequence [2].

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. This, in turn, increases the willingness to evade taxes. Alm *et al.* [10] contend that if due to high levels of corruption, citizens cannot be certain whether their paid taxes are used to finance public goods and services their willingness to pay suffers and it becomes more likely that they evade their tax liabilities. A taxpayer might consider evading taxes if the cost of bribing a tax auditor is lower than the potential benefit from tax evasion hence poor attitudes towards government spending may negatively affect tax compliance.

Boucher [1] observes that the lack of rule of law and corruption are hindrances to transparency of public action and cultivates a culture of distrust among citizens. As a result, citizens may not be willing to pay their taxes or comply with all requirements. Good government spending therefore may encourage traders in the informal sector to improve on tax compliance. Empirical evidence of this in Kenya is scarce. This study therefore sought to evaluate the influence of perceptions of government spending on tax compliance among businesses in the informal sector in Nyeri Town.

METHODOLOGY

The researcher adopted a positivist research philosophy. Positivists believe that reality is stable and can be observed and described from an objective viewpoint [11]. The researcher aimed to describe factors influencing tax compliance in the informal sector in Nyeri Town from an objective viewpoint. The study adopted a cross-sectional survey design. The study was carried out in Nyeri Town. Nyeri town is the administrative headquarters of Nyeri County. It is the largest town in Nyeri County in terms of size and population. As at 2010, the town had a population of 125,357. The town was chosen by the researcher because it has a lot of small and medium businesses and which are growing to meet the needs of the population growth. The target population consisted of all the informal businesses in Nyeri Town. Data from the Nyeri County office showed that by the end of 2013, there were 715 registered informal businesses in the town. Stratified random sampling technique was used to select the informal businesses to participate in the study since it provided greater precision than a simple random sample of the same size. In this study, the informal businesses were stratified according to the type of business. Hall, 2013, advises that a share of 10% - 30% is applicable in stratified random sampling. The study used 20% of the informal enterprises to give a sample size of 143. The research instruments in the study comprised of a researcher-administered questionnaire and focus group discussion questions guide. A pilot study was carried out to test the validity and reliability of the data collection instrument. The study tested the internal consistency of the instruments by computing Cronbach's alpha from the data collected from the pilot study to determine the reliability of the instrument. The researcher visited the businesses premises to administer the questionnaires to the participants upon prior confirmation. Data was analyzed by use of quantitative and qualitative methods. Quantitative methods entailed descriptive and inferential statistics while qualitative methods entailed content analysis of the data.

DISCUSSION OF FINDINGS

The study found that respondents had a negative perception of government spending in that they perceived the government officials as corrupt. The respondents also felt that the monies they paid as tax were not used in beneficial service delivery for their good. Attitudes towards government spending had a significant relationship ($p=0.001$) with tax compliance at 95% confidence level. Attitudes towards government have a strong positive ($r=0.635$) correlation with tax compliance implying that perceptions of government funding is an important determinant of tax compliance. The findings are therefore in agreement with Saad [3] who found that in general, citizens expect some kind of service or benefit in return for the taxes paid.

CONCLUSION

Attitude toward government spending is another important determinant of tax compliance in the informal sector. Majority of the business owners in the informal sector felt that the money they paid to the government did not come back to their aid in form of service delivery. Majority of the participants indicated that this was due to rampant corruption in the government.

RECOMMENDATIONS

Government should seek to end corruption in all sectors and commit monies into Community developing activities to enhance tax compliance.

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