

**Influence of Complexity of Tax Returns on Tax Compliance in the Informal Sector in Kenya: Survey of Nyeri Town****Elizabeth Ndichu Gitonga<sup>1</sup>, Dr. Teresiah Kyalo<sup>2</sup>, Dr. Lucy Maina<sup>3</sup>**<sup>1</sup>Student, School of business, Karatina University, Kenya<sup>2</sup>Lecturer, School of Business Karatina University, Kenya<sup>3</sup>Lecturer, School of Business cooperative University, Kenya**\*Corresponding author***Elizabeth Ndichu Gitonga***Article History***Received: 14.10.2017**Accepted: 27.10.2017**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 the influence of complexity of tax returns on tax compliance in the informal sector in Nyeri Town. 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 (71%) of the participants indicated that they could not calculate their tax returns on their own. The study found that complexity of tax returns had a significant relationship ( $p=0.001$ ) with tax compliance at 95% confidence level. The researcher therefore concludes that there is a significant relationship between complexity of tax returns and tax compliance. It was recommended that the government should commit monies to eservice delivery to enhance tax compliance.

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

**BACKGROUND TO THE STUDY**

Taxation was premised by Boucher, [1] as 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 the influence of complexity of tax returns on tax compliance in the informal sector in Nyeri Town.

**STATEMENT OF THE PROBLEM**

Losses amounting to \$100 billion and £35 billion annually in form of taxes were made in The U.S. Treasury and the United Kingdom respectively due to non-compliance [5]. Kenya rates also has the undoing of low rating as pertains to tax compliance, efficient and effective tax administration structures [6]. Introduction of the Turn over Tax (TOT) in January 2008, through Finance act 2006, 12c of the income tax cap 470 was a measure of enforcing tax 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 realized Kshs. 136 Million reflecting a paltry 31% of the set target of Kshs. 442 Million [4]. This was an apt indicator of depressed tax compliance, reduced collection and tax performance in the country. It is against this backdrop that the study sought to identify influence of complexity of tax returns on tax compliance in the informal sector in Nyeri Town.

## **OBJECTIVE OF THE STUDY**

To assess the influence of complexity of tax returns on tax compliance among businesses in the informal sector in Nyeri Town

## **HYPOTHESIS**

There is no significant relationship between complexity of tax returns and 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. 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 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 were of the view that the study was carrying out a tax compliance evaluation for the relevant government agency thus feared participating.

The study was limited to the influence of tax rates, tax payer attitudes, complexity of tax returns and tax enforcement strategies regardless of the fact that other determinants other than the four alone motivate tax compliance.

## **THEORETICAL REVIEW**

The study was hinged on the theory of planned behaviour (TPB) as postulated by Fishbein and Ajzen [8]. The theory has determinants of tax compliance in the informal sector correlated with complexity of tax compliance in decision making. The theory looked at the development of broad population tax compliance strategies and is a modification of reasoned action. It is based on the assumption that human beings are rational enough to make systematic use of the information available to them [9]. In the event of complex tax returns procedures the only rational thing would thus be to decline from undertaking in the procedures thus non compliance to the stipulated provisions. The theory thus relates well to the essence of ensuring that the provisions for the tax compliance are simplified as a measure of ensuring compliance to the expected standards and ideals.

### **Complexity of Tax Returns**

The ability of tax payer to understand tax laws as premised by Devos [10] calls for a tax system which is simple enough to enable the payer to compute his own liability and avoid administrative difficulties associated with determining the taxable income and the tax liability. A simple tax per head for all organizations would for example comply with this criterion [11]. Kopcuk [12] opines that complexity permits additional ways to shield income from tax consequently increasing the overall cost of taxation. Fjeldstad and Moore [13] observed that complexity increased the likelihood of taxpayers making inadvertent mistakes while calculating their tax liabilities thus negating the essence of penalties as a measure of enforcement and increasing the cost of non compliance detection.

Generally, income return forms are complex to complete and hence calls for one to be fairly educated to enable one peruse the return and complete it appropriately. In a Ghanaian study, Ofori [14] found that about sixty percent of the informal sector entrepreneurs were unlettered. Associated with this problem was the problem of filing out of income returns, preparation of accounts and in general the lack of voluntary compliance. Again, the income return form does not come in the local languages that the illiterates can easily understand, hence the non-declaration of income form of tax evasion [4]. Reviewed studies indicated that complexity of tax returns opened the door for tax evasion and tax non-compliance. This may be through deliberate acts or mistakes during the process. Studies in Kenya assessing the complexity of tax returns are scarce. This study therefore sought to assess the influence of complexity of tax returns 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 [15]. 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 the respondents found the tax returns systems to be complex; few could use the online tax payment systems. This was attributed to lack of training from the tax agencies and low education of majority of the business owners in the study. The study found that complexity of tax returns had a significant relationship ( $p=0.001$ ) with tax compliance at 95% confidence level. In addition, the study also found that complexity of tax returns had a weak positive correlation ( $r=0.404$ ) with tax compliance. The findings showed that, though not as important as tax rates and attitudes towards government spending, complexity of tax returns were important in predicting tax compliance. The findings were in agreement with Kopczuk [12] who found that complexity permits additional ways to shield income from tax and, consequently, complexity increases the overall cost of taxation.

## CONCLUSION

The study concluded that complexity of tax returns negatively influenced tax compliance. The respondents indicated that they did not know and they had never been provided with training on how to make tax returns.

## RECOMMENDATIONS

The ministry of trade and the Kenya Revenue Authority should organize trainings for business owners in the informal sector to train them on tax issues such as how taxes are calculated and how to use the online tax system with a view of easing the filling process to ensure greater compliance.

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