

Influence of Enforcement Strategies on Tax Compliance in the Informal Sector in Kenya: Survey of Nyeri TownElizabeth Ndichu Gitonga¹, Dr. Teresiah Kyalo², Dr. Lucy Maina³¹Student, 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: 15.10.2017**Accepted: 20.10.2017**Published: 30.30.2017***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 though available data shows declines in the collected taxes. 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 statistics entailing frequency distribution, percentages, mean, were used to summarize and organize data. Inferential statistics entailing Chi-square tests and correlation analysis were employed to establish relationships between study variables. Findings were presented using tables of frequencies and percentages. A significant number (83%) indicated that they'd be more willing to pay taxes if the tax enforcement strategies were improved. The study found that tax enforcement strategies had no significant relationship ($p=0.068$) with tax compliance at 95% confidence level. The study also found that tax enforcement strategies had a weak positive correlation ($r=0.364$) with tax compliance. The study concluded although to a small extent, tax enforcement strategies predicted tax compliance in the informal sector. It was recommended that the tax enforcement strategies could be improved by bringing the services closer to their businesses, to enhance tax compliance.

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

BACKGROUND TO THE STUDY

Taxation is a medium of revenue generation by way of compulsory levies by government to the citizens as a means of financing expenditure on public goods and services appropriation in mainstream economies Boucher [1]. Tax compliance entails willingness by individuals and related taxable entities to play by the rules as pertains to meeting their obligations as pertains to the provisions of tax statutes and administration without coercion [2]. The informal sector is fluid owing to the diversity in the membership and the inability to effectively ensure the registration of enterprises with membership in the sector as premised by Saad [3]. He equally opined that the informal economies also include persons working from their homes. The informal sector is big and constitutes of 34.3% of the population in Kenya accounting for 77% of employment nationally. The youth constitutes the bulk of the informal sector and it's estimated at 60% of the total sector population [4]. In Nyeri County, the informal sector contributes to 60% of the total employment. The study appreciates the challenges affecting the informal sector. This is in relation to ensuring that the membership of the sector is within the tax bracket. The study envisaged to find out influence of enforcement strategies on 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 every financial year attributed to non-compliance [5]. Kenya as a country has not effectively ensured compliance to the statutory provisions enforcing tax payments especially so in the informal sector [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 compliance by the informal sector. Tax compliance in the Kenyan informal sector has still been low despite the existing statutory provisions enforcing adherence [6, 7]. In 2012/13, TOT realized collections amounting to Kshs. 136 Million way below par of the envisaged targets taking into account it was a paltry 31% of the projected revenues targeted at Kshs. 442 Million [4]. The foregoing was a

reflection of reduced collections and tax performance not in line with the expected situation which are an indication of growth in the informal sector. The prevailing situation necessitated the study which sought to identify influence of enforcement strategies on tax compliance in the informal sector in Nyeri Town.

OBJECTIVE OF THE STUDY

To determine the influence of tax enforcement strategies on tax compliance among businesses in the informal sector in Nyeri Town

HYPOTHESIS

Tax enforcement strategies 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. Specifically the study aimed to assess how 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 had the perception that the study was undertaking a tax compliance evaluation thus avoided participating in the study.

Tax compliance is motivated by many diverse factors but the current study was limited to the influence of tax enforcement strategies only.

THEORETICAL REVIEW

The study was hinged on the theory of planned behaviour (TPB) as premised by Fishbein and Ajzen [8] which predicts factors motivating tax compliance in the informal sector. The theory was in tandem with the study attributed to the essence of provisions for enforcement as a measure of tax compliance. The theory is premised on the fact that despite human beings being rational and making systematic use of the information available to them they have to be forced to obey the provisions in place requiring them to dutifully pay taxes [9]. According to the theory of planned behavior, intention, devoid of unforeseen circumstances that limit individual control, will help predict future behavior. In the same vein, the need to force the citizenry to pay the requisite taxes with a view of having them compliant borrows from the theory of planned behavior. This is because it is human nature to resist what the populace deems as overbearing tendencies from the government thus non compliance with the tax provisions and in the event of the same it calls for enforcement.

Tax Enforcement Strategies

Tax administration reforms are a crucial part of any effective strategy to strengthen enforcement at the national level [2, 10]. According to Bird and Vazquez-Caro [11] measures in this area include different approaches of organizational reforms such like the creation of semiautonomous revenue authorities, setting-up of Large Taxpayer Units as well as capacity development such as trainings and courses on selected topics, e.g. specialized courses in the area of detecting illegitimate profit shifting activities or tax fraud, but also restructuring of the wage schedule to offer sufficient incentives in order to attract and recruit capable staffs and to minimize the risk of corruptive behavior.

An inefficient tax administration weakens the willingness of the tax payers to comply and creates room for political manipulation and in the process the government losses revenue [12]. According to Saad [3] the basis for efficient tax administration to enhance tax compliance lies in the choice of appropriate technology and clear administrative procedures, good methods of conducting tax payer registration and assessment and the provision of public goods. Studies assessing tax enforcement strategies and how it affects tax compliance are lacking in Kenya. It is against this backdrop that the study sought to establish determine the influence of tax enforcement strategies 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 [13]. 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 perceived KRA officials to be polite and consistent in tax collection. The study found that tax enforcement strategies had no significant relationship ($p=0.068$) with tax compliance at 95% confidence level. The study also found that tax enforcement strategies had a weak positive correlation ($r=0.364$) with tax compliance. The findings therefore showed that tax enforcement strategies predicted tax compliance to a small extent. The findings were in agreement with Johnson, Masclet and Montmarquette [12] who found that an inefficient tax administration weakens the willingness of the tax payers to comply and creates room for political manipulation and in the process the government loses revenue.

CONCLUSION

Although to a small extent, tax enforcement strategies predicted tax compliance in the informal sector. The respondents felt that the tax enforcement strategies could be improved by bringing the services closer to their businesses.

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 the respondents felt that the tax enforcement strategies could be improved by bringing the services closer to their businesses.

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