DETERMINANTS OF TAX COMPLIANCE AMONG THE RENTAL INCOME OWNERS WITHIN ELDORET TOWN

BY

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DECLARATION

Declaration by the Candidate

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DEDICATION

I dedicate this thesis to my family members, my Late father Philip Kogo, mother Mrs Mary Kogo, my brothers Meshack Kogo and Erick Kogo, sisters Rebecca Rirei and Phoebe Jelagat who have been an encouragement and inspiration to me throughout this academic journey. I am forever grateful to them.

ABSTRACT

The main issue faced by all tax authorities is that it has never been easy to persuade all taxpayers to comply with the regulations of a tax system. Real estate sector is one of the fastest growing sectors of the economy in Kenya yet taxes collected from this sector have continually been on decline for the last five years. The study analyzed the determinants of tax compliance among the rental income owners in Eldoret town. The objectives of the study were to analyze the factors that influence tax compliance among the rental income owners, access the; effect of perceived fairness of tax system on tax compliance, the effect of tax audit on tax compliance, determine the simplicity of the tax system and to establish the effect of level of income on tax compliance. The target population of this study comprised of 1200 individuals owning rental houses. The study adopted an explanatory design and stratified and random sampling technique was used to select a sample size of 300 individuals owning rental houses The study used frequencies and percentage to analyze demographic data, while means and standard deviations were used to give general information on perceived fairness of tax system, tax compliance and level actual income, at 0.05% level of significance. Pearson correlation was used to provide linear relationship for the variables while multiple regression model was used to test the hypothesis. This was done with aid of SPSS version 20. Data was collected through the use of questionnaires. The findings of the study showed that perceived fairness of tax incentives had positive effect on tax compliance ($\beta_1=0.317$, $\rho<0.05$). Tax audit, had highest positive effect on tax compliance ($\beta_2=0.331$, $\rho<0.05$). The level of income ($\beta_3=0.111$, $\rho<0.05$) and structure of the tax system ($\beta_4=0.194$, $\rho<0.05$) had positive effect on tax compliance. The study concludes that perceived fairness of the tax system is associated with high levels of tax compliance. Tax audit was important in improving tax compliance while simplicity in the tax system enhances tax compliance. Level of actual income determines tax compliance. It is concluded that the tax system be fair to all individuals at all income levels, tax system should provide a clear and simple guideline on how to fill tax returns so that individuals who are not well educated are able to fill their tax returns. The tax system should target individuals at all levels of income in order to avoid tax evasion and tax audits impacts highly on tax compliance. This study contributes to current global literature in this field of the relative importance of tax knowledge in affecting tax compliance, as well as exploring the factors that make people avoid tax and methods of increasing voluntary compliance.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

ABBREVIATIONS AND ACRONYMS

VIF -Variance Inflation Factor

KRA - Kenya Revenue Authority

SAS – Self Assessment System

SPSS -Statistical Package for Social Sciences

SMEs – Smalland Medium enterprises

OPERATIONAL DEFINITION OF TERMS

Tax Compliance – This is the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws and regulation. It entails filling tax returns on time, reporting all the income and claiming the right deductions and where taxes are due, making payments on time.

Rental Income Owners – This are the taxpayers whose source of income are the houses or buildings they rent to individuals or organizations at a fee.

Tax Audits – This is an investigation undertaken by Kenya revenue authority to verify the accuracy of tax returns and attempt to detect non-compliance behavior and activities.

Tax System – This refers to the process of filling returns and making payments to the Kenya Revenue Authority.

Level of Income – This is the degree to which the amount of income earned affects taxpayer's willingness to comply with tax laws.

Taxpayer's Perception – This is an individual concern or feeling about the fairness and treatment they receive from tax authorities in terms of the tax burden compared with others in the same level.

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CHAPTER ONE

INTRODUCTION

1.1 Overview

This chapter consists of background of the study, statement of the problem, research objectives, and significance of the study and the limitations of the study.

1.2 Background to the study

Tax non-compliance is an area of concern for all government and tax authorities, and will continue to be an important issue that must be addressed. It is a critical problem that transcends cultural and political boundaries (Kasipillai *et al*., 2003). The main issue faced by all tax authorities is that it has never been easy to persuade all taxpayers to comply with the regulation of a tax system.

Mohd (2010) argued that previous studies have listed 14 main factors that have influenced tax compliance. These factors are age, gender, education, income, occupation or status, peers' or other taxpayers' influence, ethics, legal sanction, complexity, relationship with taxation authority , income sources, perceived fairness of the tax system, possibility of being audited and tax rate. Various researchers have listed factors that influenced tax compliance such as demographic, income, compliance cost, and tax agents, in addition to moral or ethical factors (Singh, 2003).

The most frequent form of tax non-compliance, tax evasion, it's an extreme form of non-compliance James, *et al*(2001). It shares the basic component of other white collar crimes such as cheating, lying and theft. Richardson, (2008) tax evasion should

be distinguished from tax avoidance, which is the reduction of tax liability by taking advantage of provisions in the tax laws.

Riahi-Belkaoui (2004) attempted to compare the level of compliance in thirty countries worldwide. In his study, tax compliance in each country is measured based on four variables, namely situation of high economic freedom, importance of equity markets (the degree that each country depends on equity financing), effective competition laws (measured by the answer to survey questions) and high moral norms (violent crime rates is used as proxy), Economic freedom is measured by the 1999 summary economic freedom index from Gwartney. Economic freedom is viewed from seven areas including size of government; economic structure and use or markets; monetary policy and price stability; freedom to use alternative currencies and legal structure and security of private ownership. Riahi-Belkaoui used a regression equation to examine these tax compliance determinants.

The highest compliance rate is from developed countries like Singapore, New Zealand, Australia, the UK and Hong Kong. Surprisingly, among the lowest compliance indexes are from European countries like Italy, Sweden, Turkey, Portugal and Poland. Although the results of Riahi-Belkaoui's study are important, impressive and interesting the reliability is questionable because he was using subjective measurements and indicators which have different impacts on each country. However, it is has become a benchmark and key indicator tool in the tax compliance discipline (Riahi-Belkaoui 2004).

Kenya is ranked among low-income countries characterized with low compliance presenting hard task of ensuring efficient and effective Tax administration. In order to

ensure tax compliance, hence raising more revenue. Administration of tax in Kenya is done by Kenya Revenue Authority (KRA) established through an act of Parliament on July 1st 1995 (Cap 469). KRA is supposed to promote compliance with Kenya's tax system by ensuring responsible enforcement by highly motivated and professional staff thereby maximizing revenue collection at least possible cost for the social-economic well being of Kenyans (CIAT, 2006).

In Kenya, taxation is the single largest source of government budgetary resource. It is therefore in the interest of the government, that maximum revenue be collected where it is due from the public. The Kenya Government through its tax collection agent (KRA) has taken major steps aimed at maximizing revenue collection measures including the introduction of the self assessment system. Under the self assessment system, the taxpayer is not only required to file return by the prescribed date showing their income and tax due but also to make payments by the due date. The failure to comply with law is contributed by actions of tax payers, including ignorance, carelessness recklessness or deliberate evasion as well as weakness in the tax administration (Cobham, 2005b).

The KRA plays a central role in ensuring that taxpayers and other parties understand their tax obligations under the tax laws. The taxpayers and other parties have a role to play in meeting their obligations under the law. With the self assessment system of accessing tax liability by the taxpayers, a situation of non-compliance with the law will definitely arise not everyone will tell the truth about their tax liability.

The obligations are: registration in the tax system, timely filing/lodgments of requisite taxpayer information, payment of taxation obligations on time, reporting of complete and accurate information. Any taxpayer who fails to meet any of the above

obligations is considered to be non-compliant and a compliance certificate would only be issued to a tax payer who has met all the above conditions.

Housing activity and the residential construction associated with it are key elements of the national, state, and local economies. The housing market plays a pivotal role in the economy: depending on the incidence of house ownership, real estate usually forms an important part of household wealth, housing-related expenses are an important part of household consumption, rental prices are a component of consumer prices, housing taxation can have a profound impact on public finances, and the structure of the housing market can influence the supply side of the economy (for example, labour mobility).Moreover, housing wealth plays an important role in economic and financial cycles, as sharp fluctuations in house prices can threaten economic and financial stability (EU, 2012).

1.3 Statement of the Problem

The Government of Kenya relies on tax revenues both for its recurrent and development expenditure. In pursuit of this, KRA has been mandated to assess and account for all taxes due to the government (KRA Act Cap 469). Tax compliance level which is internal factor affecting tax revenue not only undermines tax administration infrastructure but also makes the tax base narrow and inequitable. When the level of compliance is low, government revenue collections always fall behind targets. During the 2011/2012 financial year, KRA was able to collect Shs. 707.4 billion against a target of 717 billion (KRA Fourth Quarter report 2011/2012).

According to figures from KRA, rental income declaration declined from 5 billion in 2007 to 1 billion in 2009 (GoK, 2009). This is despite the imposition of VAT on

commercial rent by the Finance Act of 2007/2008 that would have led to higher tax revenue. In the Budget speech of 2012/2013, the Finance Minister instructed KRA to intensify revenue collection in this sector. There is therefore a need to assess the level of tax consciousness, review factors causing non-compliance and capture the expectations of the taxpaying public with a view to formulating strategies aimed at enhancing tax collection in this sector. It is against this background that this study has been undertaken with the aim of analyzing the determinants of tax compliance among the rental income owners and recommend measures to be put in place by the government and KRA to enhance tax collection in this booming sector (KIPPRA 2006).

1.4 Research Objectives

1.4.1 General objective

The main objective of this study was to analyze the determinants of tax compliance among the rental income owners in Eldoret town.

1.4.2 Specific Objectives

1. To determine effect of taxpayer's perception of tax system on tax compliance.

2. To identify the effect of tax audit on tax compliance.

3. To determine the effect of the simplicity of tax system on tax compliance

4. To establish the effect of level of income on tax compliance.

1.5 Hypotheses

H_{o1}: There is no significant relationship between a taxpayer's perception of tax system and tax compliance

H_{o2}: There is no significant effect of the tax audit on tax compliance

H_{o3}: There is no significant effect of the simplicity of tax system on tax compliance

Ho_4: There is no significant effect of the level income on tax compliance.

1.6 Significance of the Study

The results from this study will add knowledge to the existing facts of tax compliance which will be of great use to the government in formulating laws and policies aimed at reducing non compliance. Knowledge stipulating the factors affecting tax compliance shall be made available that will greatly assist those in the sector lay out their tax policies. It will also assist KRA in identifying the various needs of taxpayers as far as tax payer education is concerned so as to make strategic decision aimed at maximizing revenue collection from real estate's sectors.

The government raises tax revenues to finance public security, health, education, and infrastructure. In this regard, the government has to ensure that its source of revenue is effective and efficient. Findings from this study will help the government to institute the necessary legislative and administrative measures to enhance tax compliance in cases of voluntary compliance and enforce compliance in cases of non-compliance.

CHAPTER TWO

LITERATURE REVIEW

2.1   Introduction

This chapter reviews literature including past studies and theories that have been put forward in relation to the study.

2.2   Concept of Tax Compliance

According to Brown and Mazur (2003), tax compliance is multi-faceted measure and theoretically, it can be defined by considering three distinct types of compliance such as payment compliance, filing compliance, and reporting compliance. Organization for Economic Cooperation and Development (2001), advocates for dividing compliance into two categories in considering definitions of tax compliance. These categories are administrative compliance and technical compliance where the former refers to complying with administrative rules of lodging and paying otherwise referred to as reporting compliance, the latter refer to complying with technical requirements of the tax laws in calculating taxes or provisions of the tax laws in paying the share of the tax.

Mohd (2010) defined tax compliance as the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments. Another definition of tax compliance is a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority (Singh, 2003). Furthermore, tax compliance has also been segregated into two perspectives, namely

compliance in terms of administration and compliance in terms of completing (accuracy) the tax returns (Chow, 2004).

Compliance in pure administrational terms therefore includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year (if required) and following the required payment time frames (Ming Ling,*et al* 2005). In contrast, the wider perspective of tax compliance requires a degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation (Singh and Bhupalan, 2001). In line with Singh (2003) claimed that the wider perspective of compliance becomes a major issue in a self assessment system since the total amount tax payable is highly dependent on the levels of tax compliance this perspective reveals, although it is inevitable that tax authorities will seek to 'influence' the areas taxpayers have influence over determining to reduce the risks of non-compliant behavior they face otherwise e.g through continuously conducting tax audits of different sorts and other means such as various compliance influencing activities including tax education.

James and Alley (2004) defined tax compliance as the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments. Mohd *et al*., (2011) tax compliance defined as the taxpayer's willingness to comply with tax laws, declare the correct income, claim the correct deductions, relief and rebates and pays all taxes on time.

Tax compliances is also described as an issue of reporting of actual income and that compliance behavior is influenced by a situation whereby taxpayers have to make a decision under uncertainty i.e. either taxpayers would enjoy tax savings due to under reporting income or have to pay on the undeclared amount at a penalty rate which is higher than they would have paid had the income been fully declared at the correct time. Another definition of tax compliance is a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority (Mohd *et al, .*2011). Compliance in pure administrational terms therefore includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year (if required) and following the required payment time frames. In contrast, the wider perspective of tax compliance requires a degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation (Mohd *et al,.* 2011)

Theoretically, views of the taxpayers and tax collectors are that tax compliance means adhering to the tax laws, which are different from one country to another. The goal of tax administration is to foster voluntary tax compliance and hence reduce tax gap (difference between taxes paid and owed for all taxes and all taxpayers) and "compliance gap." Tax compliance, according to Cobham (2005b), is a problem to many countries as measured by tax to GDP ratio although it has been improving for many countries. For example, its one-third of GDP in rich countries; Latin America and the Caribbean - 17% of GDP and low-income countries (in Sub Saharan Africa) showed less than 15% to GDP.

Empirical evidence shows there has been hostility between the taxpayers and tax collectors on issue relating to tax compliance. Hostility towards tax compliance dates back to the history of Taxation. "Taxes are considered a problem by everyone. Not surprising, taxation problems date back to the earliest recorded history" (OECD, 2001). According to OECD (2001), during the Roman Empire, in 60A.D, Boadecia queen of East Anglia led a revolt that can be attributed to corrupt tax. In Great Britain, the 100 years war (1337-1453) between England and France was renewed in 1369 by among other key factors, the rebellion of the nobles of Aquitaine over the oppressive tax policies of Edward, The Black Prince, and in Post-Revolution America, Tax Act of 1864 was challenged several times.

Tax compliance has traditionally been viewed as a necessary evil by many companies. Today, though, the risks of overlooking tax liabilities and the potential benefits of an active tax compliance effort have never been higher (Cobham, 2005a). For example, many lenders will not even consider providing financing to a company that cannot demonstrate compliance with applicable sales, personal property and income taxes. But some may be willing to provide a larger credit line or reduce interest rates to companies that can prove compliance. Even as the rewards for tax compliance can be great, so can the risks and costs of noncompliance. Smart prospective buyers scrutinize tax payment records, and considerably discount or even entirely avoid lease portfolios or companies with questionable compliance practices. Further, with states across the nation facing serious budget deficits, state revenue departments are becoming much more aggressive in seeking out companies that are neglecting their tax obligations.

In Kenya the tax compliance requirements according to the income tax laws relating to businesses are: keeping of up to date books of account by businessmen, acquiring of Personal Identification Numbers (PIN) by all potential taxpayers, determining the taxable income according to the stipulated rules and regulation, accurate determination of tax liability, filing of returns on income by the prescribed date, paying of tax dues by the prescribed date, payment of fines and penalties for overdue taxes and allowing of audit by tax collectors, if deemed necessary.

2.3 Theoretical Perspective of Tax Compliance

2.3.1 Economic Based Theory

Economic theories of tax compliance are also referred to as deterrence theory. According to Trivedi and Shehata (2005), economic theories suggest that taxpayers "play the audit lottery," i.e. they make calculations of the economic consequences of different compliant alternative, such as whether or not to evade tax; the probability of detection and consequences thereof, and choose the alternative which maximizes their expected after tax return/ profit (possibly after adjustment for the desired level of risk). The theories suggest that taxpayers are amoral utility maximizes hence; economic theories emphasize increased audits and penalties as a solution to compliance problems. Economic based studies suggest that taxpayers' behavior is influenced by economic motives such as profit maximization and probability of detection (Trivedi and Shehata, 2005).

There are a number of recent extensions to the early economic deterrence models which serve to demonstrate the large theoretical literature that has evolved. For example, Falkinger (1988) models the taxpayer/ government exchange relationship within an evasion setting. This was in response to perceived equity being cited as of

importance in earlier empirical work Kaplan and Reekers, (1985). This author examines how a rational tax evader is affected by the benefits from public expenditures, finding that evasion decreases when a taxpayer is aware of the benefits received in return for tax payments. However, the proportion by which evasion reduces when public benefits received increase could not be unambiguously confirmed as demand for public goods varies between individuals.

2.3.2 Psychology Theory

Psychology theories of tax compliance assume that psychological factors including moral and ethical concerns are also important to taxpayers and so taxpayers may comply even where the risk of audit is low. Psychology theories de-emphasize audits and penalties and instead focus on changing individual attitudes towards tax system. Trivedi and Shehata (2005) concluded that some taxpayers' behaviour may follow economic theories while others may follow the psychological theories and a mixture of the two is also possible.

2.4 The Link between the Determinants and Tax Compliance

This section focuses on four key issues that may affect any particular tax compliance based on what literature in this area has previously focused upon, namely perceived fairness of tax system, the simplicity of the system and tax audits and level of actual income. Each country has its own laws and regulations in implementing tax compliance. In line with information technology developments, many countries for example, the UK and Malaysia, have moved toward electronic filing which, from a tax administrators' perspective, is more user-friendly and, most importantly, could save costs.

2.4.1 Tax Audits and Tax Compliance

A tax audit is an investigation made by the tax authority in order to verify the accuracy of tax returns and attempt to detect non-compliance behavior and activities. Some studies claimed that audits have a positive impact on tax evasion (Shanmugam, 2003; Dubin, 2004). Tax audits can play an important role and their central role is to increase voluntary compliance. Audits rates and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. In contrast, taxpayers who have never been audited might be tempted to under report their actual income and claim false deductions.

Evans,*et al* (2005) studied the tax compliance of small and medium size enterprises (SMEs) in Australia. Their objective was to examine the relationship between record keeping practices of SMEs and the potential exposure to tax compliance problems. The study hypothesized that low tax compliance among SMEs might better encourage the tax authority to increase audits and investigations. The result also evidenced that the primary objective of the small business owners doing their record keeping is tax compliance related rather than part of their management of their business. Thus, as the audits investigations increase, many private firms will make more of an effort at proper record keeping. In summary, previous studies have evidenced that tax audits play an important role in increasing voluntary compliance. Audits rates and the thoroughness of the audits could potentially encourage taxpayers to be more prudent in completing their tax returns.

Badara (2012) assessed the effect of Tax audit on tax compliance in Nigeria, the methodology employed for data collection was only primary source, which involved

the use of questionnaires, in which 48 questionnaires were administered to the staff of Bauchi State Board of Internal Revenue; some selected individual tax payers and corporate bodies within Bauchi State out of which only 42 questionnaires were completed and returned. The data generated for the study were interpreted using simple percentage. The main finding of the study included among other; the Relevant Tax Authority (RTA) employed tax audit towards achieving target revenue, tax audit reduce the problems of tax evasion, tax payers do not usually cooperate with tax audit personnel during the exercise (IRD, 2007). The author recommended that the RTA, at all levels, should improve the standard of tax audit employed for effectiveness and efficiency. Tax audit should aim at reducing the level of tax evasion and RTA should provide a policy that would allow the tax payers to cooperate during the period of tax audit.

Ebimobowei and Gbalam (2013) examined the impact of tax audit on tax compliance in Nigeria. To achieve this objective, data was collected from primary and secondary sources. The secondary sources was from scholarly published and unpublished studies and the primary source from a well structured questionnaire of three sections administered to two hundred and four (204) respondents with an average reliability of 0.77 using diagnostic tests, augmented dickey-fuller, ordinary least square and granger causality. The empirical analysis provided a significant relationship between random tax audit, cut-off tax audit and conditional tax audit on tax compliance in Nigeria. On the basis of the empirical result, the author conclude that tax audit is one of the compliance strategies that can be used to achieve tax compliance because the average Nigerian is known for tax evasion and avoidance using all the available means of not paying the relevant tax to the government.

Alm and McKee (2006) investigated the application of experimental methods to examine the individual compliance responses to a "certain" probability of audit, and conclude that the compliance rate rises if an individual knows he will be audited and the rate falls if he knows he will not be audited. Slemrod,*et al* (2001) examined randomly selected taxpayers and inform them that their filling will be "closely examined' and found evidence of taxpayers' behavior changes in response to an increased probability of audit, although the responses are not uniform among different groups of taxpayers. Mittone (2006) investigated that early experience of audits in taxpayers' "tax life" is a more effective way to increase compliance than later audits. Also Kastlunger,*et al* (2009) study of experimental research suggests that although the effectiveness of audits and fines cannot be completely confirmed, early audits in taxpayers' "tax life" have a positive impact on compliance.

2.4.2 Perceptions of Equity or Fairness and Tax Compliance

In distributive justice, an individual is concerned about the fairness of their actions, and wants to be treated in relation to his merits, efforts and needs Kirchler (2007). If he feels that his tax burden is higher than other people within the same income group, his tax compliance probably decreases more widely at group levels, as taxpayers want a fair treatment of their group relative to other income groups. If a specific group perceives that their tax liability is higher than other groups, then tax evasion might occur among the group members. At a society-wide level, tax compliance is less likely if the perception is held that the tax system is unfair; wide scale tax evasion is likely to occur (Barjoyai, 1987). In contrast, if the society perceives that the tax system is equitable and fair, voluntary compliance is expected to increase.

The main elements for perceived fairness are neutrality of procedures used, trustworthiness of the tax authorities, and the polite, dignified, and respectful treatment of taxpayers as individuals or groups. Taxpayers expect that tax authorities will provide sufficient information about the tax law and regulations so that they can complete their tax return as accurately as possible. It is argued therefore that increased information about tax law and regulations can increase fairness perception and compliance. Retributive justice, unreasonable and intrusive audits and unfair penalties lead to stressful and dissatisfied taxpayers (Mohd 2010).

Unfavorable retributive justice perceptions could lead to non-compliant behavior and consequently increase tax evasion and inflate the tax gap. Spicer and Becker (1980) examined the relationship between fiscal inequity and tax evasion. In summary, the beneficiaries of income equity and what forms of inequity are likely to affect evasion behavior are still unclear and debatable based on results of prior research. The perceived fairness of the tax system also has an influence on the inclination towards tax evasion (Richardson, 2008).

Verboon and Goslinga (2007) studied the relation between fairness considerations and tax compliance attitudes and intentions. Data from a large panel survey among small business owners in the Netherlands were analyzed. Besides a number of background and control variables the questionnaire contained measures of personal norms, procedural and distributive justice, tax compliance attitudes and intentions to comply with tax rules. Results support the hypothesis that personal norms and justice concerns are related to tax compliance attitudes. Moreover, analyses confirmed the hypothesis that distributive fairness positively affects both tax compliance attitudes and intentions to comply among entrepreneurs with relatively low personal norms.

Mubiru (2009) examined the relationship between perceived fairness to tax payers and tax compliance. A cross-sectional design combined with descriptive and analytical research design was used in the study. The survey population included tax payers operating SMEs in Arua district and a sample of 375 was considered for this survey. The findings of the study revealed a strong relationship between tax fairness and tax compliance.

2.4.3 Income Level and Tax Compliance

Durhama, *et. al.* (2012) in their study employed a laboratory experiment to explore the joint effect of income source (earned versus endowed) and decision context (tax versus nontax) on tax compliance behavior. During the experiment, subjects faced various income levels and made multiple reporting decisions. The results indicated that overall compliance is not significantly affected by the interaction of income source and context. However, this joint effect influences the relationship between income level and compliance and how compliance behavior evolves over time. In both cases, the treatment group with earned income in a tax context displays behavior that is distinct from the other three groups.

Blumenthal, *et.al.*(2001) reported on the results of a controlled experiment in Minnesota. They analyzed reported income of sample of taxpayers, reported income on their previous year's returns, and reported income from the two corresponding years' returns of a control group of taxpayers that did not receive the letter and found that the treatment effect varies depending on the level of income. Low and middle income taxpayers increased reported income and tax liability relative to the control group, which is interpreted as indicating the presence of non-compliance. The effect was much stronger for those with more opportunity' to evade, as measured by their

source of income. However, the reported income of the high-income treatment group fell sharply relative to the control group.

In contrast, high income earners are likely to be more compliant rather than lower income earners, as suggested by Torgler and Schneider (2007). In a country where the income redistribution is not satisfying, higher income groups tend to evade more (Mohani, 2001) because a high income earner might feel the tax system is not treating him fairly. According to the Fischer Model, Chan *et. al.* (2000), non-compliance opportunities based on income level can be affected directly and indirectly through attitudes and perceptions. Results of Chan *et al.* (2000) suggest that income level is unrelated to compliance among US and Hong Kong taxpayers.

Despite the mixed negative and positive associations of income levels with tax compliance, there are studies that found insignificant results that should be perhaps also noted: for example, Park and Hyun (2003) in their experiment in South Korea found that income levels had no significant effect on tax compliance. Chan *et. al.* (2001) also found the same results as Park and Hyun. Therefore, while in some research, income levels are the most important determinant of compliance (Kirchler, 2008), other previous studies, have shown that the impact of income on compliance is still unclear and the relationship between the two variables needs to be investigated further and it is perhaps not linear, as many studies implicitly assume (Kirchler, 2007). Tax evaders should have an incentive to report at the top of a tax bracket rather than at the beginning or in the middle range, whereas honest taxpayers should report their income, independent of where it falls within a tax bracket (Kirchler 2007). A higher level of education, perhaps, would lead to a better income level and would

improve one's tax knowledge; consequently this might eventually change one's attitude towards compliance (Loo, 2006a).

2.4.4 Simplicity of the System and Tax Compliance

As tax systems have become increasingly complex over time in many developed countries, complexity has become an important determinant of tax compliance behavior. The main feature of SAS is self-completed tax returns which require at least a reasonable level of simplicity because taxpayers come from various backgrounds, with differing levels of education, income and most importantly levels of tax knowledge. In helping taxpayers to complete the tax returns accurately, the tax authority should have come up with a simple, but sufficient, tax return. The information required in the return must be at minimum level and be readily available from taxpayers' business and personal records (Mohd 2010).

Denmark, Canada and New Zealand are the leading countries that have introduced simplified tax returns by reducing the number of pages to facilitate and increase voluntary compliance among taxpayers (Mohani, 2001: Mohani and Sheehan, 2004). In the UK for example, the HMRC has, in recent years tried to present more simplified tax returns that ordinary people can understand better. In 2007, the tax returns was accompanied by a 35 page guide on how to complete the tax return and that did not even include the 8 extra pages of notes that also needed to be considered by some taxpayers (HMRC, 2009). The form and the accompanied guide has now been simplified to facilitate taxpayers, in particular by computerizing this process so that only context-sensitive details are needed as the taxpayers complete their returns.

This significantly simplified the range of guidance the taxpayer is exposed to, keeping it to the necessary minimum.

Mohd (2010) outlined the importance of the fact that a tax authority should have a simple tax return system from a taxpayer's point of view. A tax authority might assume its tax return is simple and easy to complete but it may not be so from the taxpayers' point of view. Therefore, before the final and actual version is delivered to taxpayers, it would be normal to put the forms through a series of 'pilot' tests to validate that the tax return is simple and easy to complete. In the UK, evidence suggests that uncomplicated tax returns play a major role in improving tax compliance

Although tax knowledge and the simplicity of tax returns have a different impact on compliance (Kirchler, 2008), it is noted that a taxpayer with low tax knowledge may be able to file the tax returns accurately provided the tax returns are simple, clearly explained and consistent.

The current year of tax returns should be the same as the previous one or at least largely the same. This can encourage taxpayers to file their tax returns correctly. Over an extended period, research focusing on complexity of a tax system in Self Assessment System has reported that there is an association between complexity and compliance, but the extent of the association remains in part uncertain. Some research has found positive association between complexity and non-compliance, whether intentional or unintentional (McKerchar, 2002)

As the tax regulations and laws in most countries are amended almost every year as part of annual budget process, the current regulations might be no longer relevant in

the future. For example, tax rates, personal allowances, deductions, rebates and taxable income are usually different each year. This situation will encourage taxpayers to make mistakes. Simplifying tax administration is important because it can facilitate efficient and enhanced administration and reduce costs (Mohani, 2001). Thus, non compliance in terms of inaccurate tax returns is not only caused by taxpayers evasive behavior (either intentional or unintentional), but may also be because of the tax authority's mistakes or weaknesses in developing and designing the systems.

It has also been argued that simplifying tax laws might encourage compliance among taxpayers as they might more easily interpret and understand the law and the tax structure, and so possibly be better able to declare their income and compute their own tax liabilities correctly (Blanthorne and Kaplan, 2008). However, Forest and Sheffrin (2002) assert that simplifying the tax system (and therefore generating simpler tax returns) implicitly might not be an effective deterrent to tax evasion because taxpayers may not necessarily consider a complex tax system to be unfair. Forest and Sheffrin were unable to identify any relationship between complexity and perception of unfairness and concluded that while simplifying the tax law would not automatically improve compliance, many taxpayers perceive that tax systems are always complex and become a burden to them (Forest and Sheffrin, 2002).

Forest and Sheffrin (2002) suggested that the impact of the simplicity of the tax systems in Self Assessment System were insignificant, the main feature of Self Assessment System is self completed tax returns which require a high degree or at least a reasonable level of simplicity because taxpayers come from various levels of backgrounds, education, income and most importantly levels of tax knowledge. In

helping taxpayers to complete their tax returns accurately, the tax authority should supply simple but sufficient tax systems.

Richardson (2008) found that out of seventeen variables tested across 45 countries (including age, gender, education, fairness, culture and religion), complexity is found to be the most important determinant of tax evasion. He therefore concluded that 'a more simple tax system and administration can reduce tax evasion.

2.5 Summary of Literature and Research Gap

Tax compliance (evasion) has been an important subject of research in a large number of developed and a number of developing countries. Since each country has its own approach to managing tax compliance levels and each has different tax laws and regulations, the factors impacting tax compliance behavior appear to vary among countries.

Although various studies have been undertaken to determine as accurately as possible the factors that impact upon tax compliance behavior, undoubtedly, the government should consider seriously the characteristics of non compliant taxpayers, review current regulations and possibly as a result, increase audit rates and penalty rates (enforcement) as well as attempting to build good relationships with taxpayers in seeking to improve general tax compliance levels

The beneficiaries of income equity and what forms of inequity are likely to affect evasion behavior are still unclear and debatable based on results of prior research. The perceived fairness of the tax system also has an influence on the inclination towards tax evasion (Richardson, 2008).Simplifying tax returns and administration potentially could help taxpayers to complete their tax returns accurately and increase compliance.

Finally, previous studies have evidenced that tax audits play an important role in increasing voluntary compliance. Audits rates and the thoroughness of the audits could potentially encourage taxpayers to be more prudent in completing their tax returns.

2.6 Conceptual framework

From a theoretical point of view, it is consequently hardly possible to integrate this existing variety of conceptual orientations, choices, and boundaries into a single conceptual framework. Therefore, it may be preferred to reposition a number of these variables and processes into a new conceptual framework, that serves as a guide to integrate theoretical perspectives that interlink these variables and process and help to explain the actual determinants that influence tax compliance in rental income owners in Kenyan Context. This study conceptualizes that the tax compliance could be affected by Perceived fairness of tax system, Tax Audit and Simplicity of tax system Level of actual Income. As such the study adopts the following conceptual framework where Perceived fairness of tax system, Tax Audit, Simplicity of tax system and Level of actual Income are independents variables, which are linked to the study dependent variable, tax compliance, (see figure 2.1).

Independent variable   **Dependent variable**

| Perceived fairness of tax system |

| Tax Audit |

| Simplicity of tax system |

| Level of Income |

| Tax Compliance |
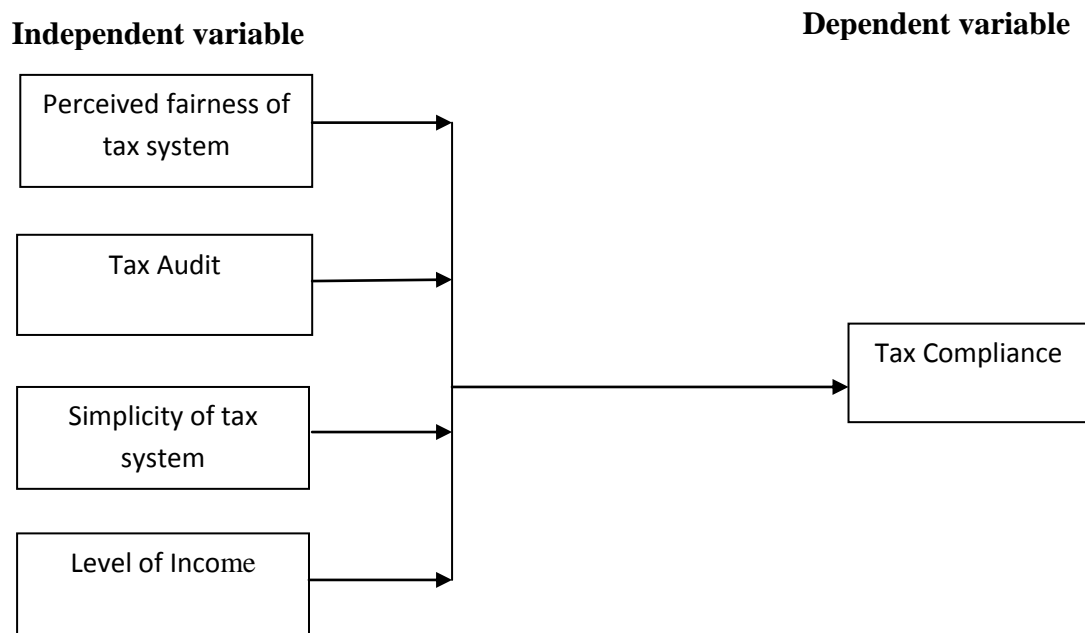
(Figure 2. 1: Conceptual Framework)

Perceived fairness of the tax system was proxy of perception of fairness of the entire income tax system, including the distributed of income across taxpayers, and fairness in provisions of the income tax law. Tax audit in the conceptual frame work is not limited to the actual conducting of the audit but incorporates the fear of tax audits and prosecutions. Clear communication of Audit Standards and Procedures are well communicated by the Tax Auditors, availing of Audit Findings on Time. Level of income was explained as disclosing the level of our income to the relevant regulatory bodies, reporting financial reporting purposes and claiming deductible allowances in arriving at the net taxable income.

CHAPTER THREE

MATERIALS AND METHODS

3.1   Introduction

This chapter covers the research design, target population, sampling procedures, description of research instruments, validity and reliability of research instruments, data collection, analysis and presentation.

3.2   Research Design

This study adopted an explanatory design. According to Cooper and Schindler (2003), an explanatory study uses theories or hypotheses to account for the forces that cause a certain phenomenon to occur. They further said that explanatory design goes beyond description and attempts to explain the reasons for the phenomenon. Orodho (2003) explained that an explanatory study analyses the cause-effect relationship between two or more variables. Explanatory research focuses on why questions and it also establishes causal relationships. Answering the 'why questions' involves developing causal explanations. Some causal explanations will be simple while others will be more complex. For example, we might argue that there is a direct factor effecting tax compliance (De Vaus, 2001).

3.3   Target Population

The target population of this study comprised of individuals owning rental houses within Eldoret town; there are 1200 individuals according to records by Department of Physical Planning, Eldoret.

3.4   Sample Size and Sampling procedure

From the target population of 1200, Yamane Taro (1973) sample size formula was used to select a sample size of 300 individuals owning rental houses within Eldoret town as shown below

$$n = \frac{N}{1 + N_{e^2}}$$

Where:

n = Sample size

N = Population size

e = the error of Sampling

This study allowed the error of sampling on 0.05. Thus, sample size was as follows:

$$n = \frac{1200}{1 + 1200(0.05)^2} = 300$$

3.4.1   Sampling procedure

This study used stratified sampling technique to select the classes where respondents were picked from. Therefore, individuals were stratified into four strata's which include, Upper class, Middle class, Lower class and Commercial buildings, the stratus were made up with references to the classification of real estate firms Department of Physical planning in Eldoret, where the sample size was distributed according to Neyman (1934), allocation formula. The purpose of the method is to maximize survey precision, given a fixed sample size. With Neyman allocation, the best sample size for stratum h would be:

$$n_h = \left[\frac{N_h}{N}\right]^n$$

Where,

nh - The sample size for stratum h,

n - Total sample size,

Nh -The population size for stratum h,

N   - The total population

Hence, distribution will be as follows;

Table 3. 1: Distribution of the target population

Classes	Population	Sample size $n_h = \left[\dfrac{N_h}{N}\right]^n$
Upper class	57	14
Middle class	414	104
Commercial buildings	66	17
Lower class	663	165
Total	**1200**	**300**

(Source; (Department of Physical Planning, Eldoret.)

The respondents were selected using simple random sampling from the list acquired by the researcher, where each name was allocated a number then picked at random.

3.5 Data type, data collection instruments and procedures

3.5.1 Type of data

This study involved both Secondary data and Primary data. Primary data was collected directly from the respondents using questionnaires which were administered to individuals owning rental houses. Secondary data was collected from government publication, journeys, published papers, survey reports among others.

3.5.2 Data collection instruments

Data collection is the process of gathering the required information for each selected unit in the survey. Survey questionnaires were administered to all the sampled

respondents. Questionnaires are preferred because they can be used to gather data quickly from a large sample population. They are also deemed appropriate as many respondents can be reached (Borg and Gall, 1983; Monette *et al*, 1986). They are economical in terms of time, effort and cost.

3.6 Data Reliability and Validity

3.6.1 Reliability

Reliability is the extent to which a questionnaire, test, observation or any measurement procedure produces the same results on repeated trials. Cronbcha alpha was used to measure the reliability of the questionnaire. The Statistical Package for the Social Sciences (SPSS) version 20 was used to calculate the value of the Pearson Product-moment Correlation Coefficient denoted by r. This ensured that data collection instruments were reliable to collect data.

3.6.2 Validity

Validity is the degree to which results obtained from the analysis of the data actually represents the phenomenon under study, Mugenda and Mugenda (1999). To determine and improve the validity of the questionnaire, pilot testing was conducted to allow the preparation of the final questionnaire.

3.6.3   Pilot test

Instrument piloting is a crucial element of a good study design. Conducting a pre-test study will not guarantee success in the main study but it does increase its chance (Madsen, 2012).The questionnaire used in this study was pre- tested through a pilot study before actual data collection. This enabled the revision of the questionnaires before actual data collection in terms of their content.

To establish reliability of research instruments a pilot study was carried out in 30 individual owners of rental houses in Eldoret town. The researcher choose respondents in Eldoret town to control the "hallow effect" and to widen the applicability of the study. The tests were done so as to find out whether the terms used resonate with rental income owners. The feedback obtained from the piloted individual helped the researcher in revising the questionnaire to ensure that they covered the objectives of the study adequately.

3.7 Data Analysis

Analysis and interpretation of data was done bearing in mind the objectives and the research hypotheses of the study. Data collected was analyzed by use of quantitative technique; quantitative data was analyzed using descriptive statistical method, the statistical tools such as frequency distribution, tables. Measures of central tendency such as mean, mode and median were used. Regression analysis was used to analyze the data collected and data was presented using tables.

The data collected was analyzed using Pearson moments of correlation and multiple regression analysis. Correlation analysis was used to measure the degree of relationship between the variables. Kothari (2004) asserts that the coefficient assumes that there is linear relationship between the two variables and that the two variables are casually related which means that one of the variables is independent and the other is dependent.

Hypotheses were tested at 0.05 level of significance (95% confidence level) from the multiple regression model which showed the relationship between the independent

variable and dependent variable. The data was analyzed using SPSS version 20 and the results presented in a tabular form.

The analysis of the data collected from the respondent followed a number of basic statistical techniques in order to identify and interpret the ratings of respondents such as means, standard deviations, t- test for independent variable.

The multiple regression model used by this study is given as;

$$y_{it} = \alpha_{it} + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \varepsilon_i$$

(Source: author, 2013)

Where,

y =tax compliance

α = constant.

$\beta_1 \ldots \beta_4$= the slope which represents the degree in which tax compliance changes as the independent variable change by one unit variable.

x_1= Perceived fairness of tax system

x_2= Tax Audit

x_3=Simplicity of tax system

$x_{4=}$ Level of actual Income

ε = error term

3.8 Ethical Considerations

The researcher sought permission from District Commissioner Eldoret west. Consent was also sought from the respondents by giving them letter of introduction to carry out research. The respondents were assured that the information they give was meant for this research only. Recorded data necessary for reports was given anonymity.

The study strived to achieve honesty and practice integrity (Shamoo and Resnik, 2009). The researcher strived to avoid biasness in experimental design, data analysis and data interpretation.

CHAPTER FOUR

RESULTS

4.1   Introduction

This chapter presents results of the study based on the formulated objectives and
hypotheses as presented in Chapter One. The chapter analyzes the variables involved
in the study and estimates the conceptual model described in Chapter Two In the first
two sections data description and analysis is presented. The model estimation and the
analysis of the results are then interpreted. Finally concluding remarks are made. Data
description involved a discussion on the sources of data and definitions of the
dependent and the independent variables. Data collected was quantitatively analyzed
and presented in tables. In the first two sections data description and analysis is
presented. The model estimation and the analysis of the results are then interpreted.
Hypotheses are also tested with the study accepting or failing to accept them
depending to the p-values and t-test value.

4.2   Social-Economic Characteristics of the Respondents

Demographic information shows the characteristics of the elements in the sample
size: it helps the researcher understand the general view of the respondents based on
the research objectives. As such the researcher sought to establish the general
information of the respondents, which forms the basis under which data
interpretations are made. The respondents were selected from individuals owning
rental houses within Eldoret town. Among the characteristics regarding respondents
themselves included; gender, age and academic qualification. The gender of the
respondents was necessary to obtain information on whether the respondents were

either male or female. Eighty one percent (81%) of the respondents were male while nineteen percent (19%) are female. The age bracket of respondents shows that five percent (5%) of the respondents were between 18 and 25 years of age. Also twelve point four percent (12.4%) are in the 26 and 35 years, thirty eight point eight percent (38.8%) are in the 36 and 45 years bracket and those above 46 years of age are forty three point eight percent (43.8%).

The educational qualifications of the respondents were necessary to know whether the respondents are educated or illiterate. Information on the academic qualifications of the respondents is statistically shown in Table 4.1. Thirty four point three percent (34.3%) of the respondents have a Certificate; Thirty one point five percent (31.5%) have a Diploma, twelve percent (12%) Degree and twenty two point two percent (22.2%) have other qualifications.

Table 4.1: **Social-Economic Characteristics of the Respondents among the Rental incomes owners in Eldoret town**

		Percent
Gender	Male	81
	Female	19
	Total	**100**
Age bracket	18-25	5
	26-35	12.4
	36-45	38.8
	46 And Above	43.8
	Total	**100**
Academic Qualification	Certificate	34.3
	Diploma	31.5
	Degree	12.0
	Others Specify	22.2
	Total	**100**

4.3   Tax characteristics

Tax characteristics were inquired from respondents. It was affirmed that majority of the respondents have a KRA pin number as revealed by ninety one point nine percent (91.9%) as compared to those who were not in possession of a KRA pin number, eight point one percent(8.1%). The use of E-filling was also inquired from the respondents, majority of the respondents were found to have never used E-filling as shown by fifty five percent(55%) while those who had used E-filling were forty five percent(45%).Respondents found to be using E-filling have been using it between 0 and 5 years are forty four point six percent (44.6%), those who have not been introduced to E-filling were sixteen point two percent (16.2%) whereas those who found use of E-filling to be tedious and very difficult to understand were fourteen point four percent (14.4%).Respondents found to have attended formal taxation course organized by KRA or university or any other were twenty six point two

percent (26.2%). In relation to being audited, majority of respondents eighty one point eight (81.8%) have never been audited while only eighteen point two percent (18.2%) have been audited. Those who have been audited, five point two percent (5.2%) have been audited twice, seven percent (7%) thrice whereas those who have been audited more than five times, nine point two percent (9.2%).

Table 4. 2: Tax Characteristics of the Respondents among the Rental incomes owners in Eldoret town

		Percent
Do you have KRA pin number?	Yes	91.9
	No	8.1
	Total	**100**
Have you ever used E-filling	Yes	45
	No	55
	Total	**100**
If yes how long have you been using E-filling to file your tax returns	0-5 years	44.6
	10-above	7.7
	Total	**52.4**
Not introduced to me	Yes	16.2
its tedious, very difficult to understand	Yes	14.4
have you ever attended any formal taxation course organized by KRA or university or any other	Yes	26.2
	No	73.8
have you ever been audited	Yes	18.2
	No	81.8
If yes how many times	2	4.2
	3	5
	5	9
	Total	**18.2**

Table 4.2 shows the degrees (levels) used to interpret the results of the five variables, perceived fairness of tax system, level of actual Income, simplicity of tax system, tax

audit and tax compliance as will be seen in the subsequent information in the research objectives 1, 2, 3 and 4.

Table 4. 3: Scale of Interpretation

Range	Weight	Interpretation
4.50 – 5.00	5	Strongly agree
3.50 – 4.49	4	Agree
2.50-3.49	3	Neutral
1.50 – 2.49	2	Disagree
1.00 – 1.49	1	Strongly disagree

4.4 Perceived Fairness of Tax System

Findings on Perceived fairness of tax system shows that real estate investors were uncertain on the fairness of tax system since mean=2.95 falls within the range of neutral response. However, they believe there is fairness in the manner tax system is distributed across taxpayers (mean= 4.08). In general, rental income owners perceive income tax to be fair (mean=3.46). More findings showed that the burden of income tax is fairly distributed as indicated by mean=3.21. It is also evident that current tax laws don't require rental income owners to pay more than their fair share of income taxes (mean=3.37). Findings also revealed that compared to other taxpayers, rental income owners pay less than the fair share of income taxes (mean=3.08). Nevertheless, KRA has special provisions in the income tax law that apply to only few people are fair (mean=3.06). This information clearly shows that there is perceived fairness of the tax system (mean=3.14).

Table 4. 4: Perceived Fairness of Tax System by the respondents among the Rental Incomes Owners in Eldoret town

	Mean	Std. Deviation
I believe that the income tax system is fair	2.95	1.343
I believe that the manner in which the income tax is distributed across taxpayers is fair	2.87	1.414
Generally, I feel the income tax is a fair tax	3.46	1.03
On the whole, the burden of income tax is fairly distributed	3.21	1.185
Current tax laws don't require me to pay more than my fair share of income taxes	3.37	1.298
Compared to other taxpayers, I don't pay less than the fair share of income taxes	3.08	1.182
Special provisions in the income tax law that apply to only a few people are fair	3.06	1.389
Perceived fairness	3.14	0.89536

4.5 Tax Audit

On findings on Tax audit in Table 4.5, comparing with the above likert scale mean 4.27 falls with the range of "agree", as such the study infers that fear of tax audits and prosecutions induce real estate investors to comply. Audit standards and procedures are well communicated by tax auditors to rental income owners (mean=2.78). It was also shown that there was uncertainty on friendliness and in formativeness of tax auditors.   However, audit findings are availed to them on time to rental income owners (mean=2.4).Finally, rental income owners fear of being sufficient to act as a restrain (mean=3.52).In general, findings on tax audit was on average found to be

(mean=3.126) and when compared with above scale the study confirmed that tax audit was perceived positively among real estate investors.

Table 4. 5: The Perception about Tax audit among the Rental Incomes Owners in Eldoret town

	Mean	Std. Deviation
Fear of tax audits and prosecution induces us to comply	4.27	0.788
Audit standards and procedure are well communicated by tax auditors	2.78	1.417
Audit findings are availed to us on time	2.4	1.362
Tax auditors are friendly and informative to us	2.74	1.317
The fear of being sufficient to act as a restrain	3.52	1.328
Tax audit	3.126	0.93536

4.6 Level of Income and Tax Compliance

Further, level of actual income and tax compliance was inquired from the respondents (Table 4.6). From the study results, mean 2.77 was low, thus the study showed that it was difficult fill returns. Also from the findings rental income owners find it hard to file complains for any tax irregularities (mean=2.62). It was however, shown that use of ETR machine was easier among rental income owners (mean=2.93). They also showed a high level of understanding all the processes of the current tax system (mean=2.83). Further, they do not complain about ETR programmers' (mean=2.51).Generally the simplicity was (mean=2.7336)

Table 4. 6: The perception about tax system among the Rental Incomes Owners in Eldoret town

	Mean	Std. Deviation
It can easily file my returns	2.77	1.137
It's easy to file complains for any tax irregularities	2.62	1.229
It's easy to use ETR machine	2.93	1.393
It's easy to understand the processes of the current tax system	2.83	1.384
We never complain about ETR programmes	2.51	1.374
Simplicity	2.7336	1.03738

4.7 Tax compliance

On findings on Tax compliance (Table 4.7), respondents have never attempted to avoid tax (mean=4.23) and have never been penalized for tax failure (mean=4.26), in addition to that, respondents pay tax as actually assessed (mean=4.16). Further, respondents have never delayed to pay taxes (mean=2.76). In Overall, the average value of tax compliance was found to be 4.1024.

Table 4. 7: Analysis of Tax Compliance among the Rental Incomes Owners in Eldoret town

	Mean	Std. Deviation
I have never attempted to avoid taxes	4.23	0.883
I have never been penalized for tax failure	4.26	0.844
I pay actual tax as assessed	4.16	0.751
I have never delayed to pay taxes	3.76	1.265
Tax compliance	4.1024	0.68778

4.8   Correlation Statistics

Correlation statistics is a method of assessing the relationship between variables/factors. To be precise, it measures the extent of association between two random variables although; a significant correlation does not necessarily indicate causality but rather a *common linkage* in a sequence of events. Thus, the study analyzed the relationships that are inherent among the independent and dependent variables as well as among the independent variables/ factors. The results regarding this were summarized and presented in Table 4.8

Pearson Correlations results in Table 4.8 show that tax audit was positively and significantly correlated to tax compliance (r=0.199, ρ<0.05). Thus tax audit had 19.9% positive relationship with perceived fairness in tax system. Level of income was the second component to be positively related with tax compliance (r = 0.262, ρ<0.05) an indication that level of income had 26.2% significant positive relationship with tax compliance. Simplicity was positively and significantly associated with tax compliance as shown by(r = 0.239, ρ<0.05) implying that simplicity had a positive relationship with tax compliance.

Finally, perceived fairness was positively and significantly correlated to tax compliance (r=0.269, ρ<0.05). Thus perceived fairness had 26.9% positive relationship with tax compliance.

Table 4. 8: Correlation Statistics among the Rental Incomes Owners in Eldoret town

	Perceived Fairness	Tax Audit	Level Income	Simplicity	Tax Compliance
Perceived Fairness	1 0				
Tax Audit	.613** 0	1			
Level Income	.675** 0	.664** 0	1		
Simplicity	.710** 0	.488** 0	.513** 0	1	
Tax Compliance	.269** 0	.199** 0.001	.262** 0	.239** 0	1

** Correlation is significant at the 0.05 level (2-tailed).

4.9   Regression

A Multiple linear regression model was used to predict perceived fairness of tax in the study. The prediction was carried out basing on the effect of the four independent factors: tax audits, level of income, simplicity and tax compliance. In addition, the b-coefficients for each independent variable generated from the model have been subjected to a t-test, in order to test each of the hypotheses under study. The study thus came up with a model summary, the results of the analysis of variance and the coefficient model as presented in Tables 4.9, 4.10 and 4.11.

From Table 4.9, the findings indicated that the model correlation coefficient was 0.804 which indicated that the model predicted over 80% of the change in the

independent variable. This relationship was significant considering the coefficient of determination (R squared) value of 0.647. the model can further be generalized at adjusted R squared of 0.638), The model was adequate in this case as indicated by the Durbin-Watson statistic value of 1.929 which is in the range of 1 to 2.

Table 4. 9: Model summary on dependent and independent variables

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
0.804	0.647	0.638	0.56069	1.929
a)Predictors: (Constant), Perceived fairness of tax, Level of Actual Income, Simplicity of tax system, Tax Audit				
b)Dependent Variable: Tax compliance				

The ANOVA model in Table 4.10 showed that the regression model was also adequate. The effect size of the regression model was shown to be over 75 that contributed by the residual mean sum of squares. The F-ratio was 75.739 at 4 degrees of freedom which are the four factors. This represented the effect size of the regression model and was significant with a p-value of 0.000.

Table 4. 10: Results of the analysis of variance of the factors that influence tax compliance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	119.05	5	23.81	75.739	0.000
Residual	65.075	207	0.314		
Total	184.124	212			
Dependent Variable: Tax compliance					
Predictors: (Constant), Perceived fairness of tax, Level of Actual Income, Simplicity of tax system, Tax Audit					

4.10   Coefficients Model

The regression results in Table 4.11 show that each of the predicted parameters in relation to the independent factors were significant; $\beta_1 = 0.317$ (p-value = 0.000 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between perceived fairness of tax and tax compliance. This indicates that for each unit increase in the positive effect of perceived fairness of tax, there is 0.317 units increase in tax compliance. Furthermore, the effect of tax compliance was stated by the t-test value = 6.531 which implies that the standard error associated with the parameter is less than the effect of the parameter.

The Table also shows that $\beta_2 = 0.331$ (p-value = 0.000 which is less than $\alpha = 0.05$) which indicates that we reject the null hypothesis stating that there is no significant relationship between tax audits and tax compliance. This implies that for each unit increase in tax audit, there is up to 0.331 unit increase in tax compliance. Also the effect of tax audits is shown by the t-test value of 6.557 which implies that the effect of tax audits surpasses that of the error by over 6 times.

The findings also showed that β_3 was 0.194 (p-value = 0.000 which is greater than $\alpha = 0.05$) which implies that we reject the null hypothesis that states that there is no significant relationship between simplicity of tax and tax compliance. This implies that there is up to 0.194 unit increase in tax compliance for each unit increase in simplicity of tax. The effect of simplicity of tax is more than 3 times the effect attributed to the error, this is indicated by the t-test value = 3.646.

The value of $\beta_4 = 0.111$ (p-value = 0.021 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship

between level of actual income and tax compliance. This indicates that for each unit increase in Level of actual income, there is up to 0.111 units increase in tax compliance. The effect of the level of actual income is stated by the t-test value = 2.334 which indicates that the effect of the Level of actual income is over 2 times that of the error associated with it.

The rule of thumb was applied in the interpretation of the variance inflation factor (VIF). From Table 4.11, the VIF for all the estimated parameters was found to be less than 5 which indicate the absence of multi-collinearity among the independent factors. This implies that the variation contributed by each of the independent factors was significant independently and all the factors should be included in the prediction model.

Table 4. 11: Coefficients model on predicted parameters on tax compliance

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	**Std. Error**	**Beta**	**t**	**Sig.**	**Tolerance**	**VIF**
(Constant)	-0.391	0.274		-1.428	0.155		
Perceived fairness of tax	0.302	0.046	0.317	6.531	0.000	0.725	1.379
Tax Audit	0.386	0.059	0.331	6.557	0.000	0.669	1.495
Level of actual income	0.169	0.072	0.111	2.334	0.021	0.759	1.317
Simplicity of tax system	0.208	0.057	0.194	3.646	0.000	0.600	1.666

Dependent variable = Tax compliance

CHAPTER FIVE

DISCUSSIONS

5.1 Introduction

The purpose of this study was to establish and analyze the determinants of tax compliance among the rental income owners. In order to meet this, it was necessary to meet certain goals; effect of perceived fairness of tax system on tax compliance, effect of tax audit on tax compliance, effect of simplicity of the tax system on tax compliance and the effect of level actual income on tax compliance. Once this was achieved the researcher was able to proceed.

5.2 Summary of findings

Findings on Gender showed that there are more male than females among the rental income owners. It was also affirmed that majority of the respondents were between the age bracket of 36 and 45 years and they were able to give information desired by the researcher. It was also brought to light that majority of respondents were fairly educated, those with a diploma contributing the highest percentage followed by those with an undergraduate degree affirming that there were moderate levels of literacy among the respondents.

Findings on tax characteristics confirms that majority of the rental income owners are in possession of a KRA pin number (91.9%). The use of e-filling was unknown to most of the respondents and majority of the rental income owners have never been audited as compared to those who have been audited and a small percentage of the respondents have attended a formal taxation course organized by KRA or university.

As stated by Hypothesis 1,there is no effect of perceived fairness of tax system on tax compliance, research findings show inconsistency with the hypothesis hence, perceived fairness of tax system on tax compliance was positively correlated to perceived fairness (coefficient estimate $\beta_1 = 0.317$, p-value $=0.000$).This study finding is in agreement with Spicer and Becker, (1980) that if a specific group perceives that their tax liability is higher than other groups, then tax evasion might occur among the group members thus this might affect their tax compliance hence wide scale tax evasion is likely to occur Barjoyai, (2007).Therefore, tax payers of the same level should be taxed the same, that is to say tax payers with the same abilities should pay equal amount of tax and individuals with superior abilities should pay more tax thus such individuals should have a higher tax burden as compared to those with lower abilities. Rental income owners expect tax authorities to provide proper and sufficient guidelines about the tax law and regulations so that they can complete their tax return in the appropriate way. It is therefore argued that increased information about tax law and regulations can increase fairness perception and compliance (Wartick, 2004).

Hypothesis 2 states that there is no effect of tax audit on tax compliance, research findings is not in agreement with the hypothesis since tax audit, (coefficient estimate $\beta_2 = 0.331$, p-value $=0.000$), hence hypothesis 2 does not hold. This in agreement with study by Butler (1993) that tax audits can change compliance behavior from negative to positive. This clearly indicates that tax audits create a situation where there is voluntary compliance by taxpayers in paying tax. Annual Report of the IRS for the years 1977-1985 found that higher rates of tax audits often have a positive impact on tax compliance and also found that taxpayers who are not themselves audited pay more in taxes when audit rates increase thus this in agreement with the study findings that tax audit has a significant effect on tax compliance. Studies by

Evans,*et al* (2005) on small and medium size enterprises (SME) in Australia specifically on the relationship between record keeping practices of SMEs and the potential exposure to tax compliance problems, affirmed that the SMEs do record keeping as a measure for tax compliance rather than for managerial purposes. Thus, as tax audits increase, this will in turn increase level of record keeping in order to meet tax compliance confirming that tax audits contributes significantly to tax audits.

Hypothesis 3, there is no effect of simplicity of the tax system on tax compliance. Research findings show inconsistency with the hypothesis; hence simplicity was positively correlated to tax compliance, (coefficient estimates $\beta_3 = 0.111$, p-value =0.021).This is in agreement with studies by Silvani and Baer, (2007) that uncomplicated returns play a vital role in improving tax compliance.

This study's findings are in agreement with Baldry, (1999) that simplifying tax laws in self assessment system might encourage compliance among taxpayers as they might more easily interpret and understand the law and the tax structure, and in so doing they are better able to declare their income and compute correctly their tax liabilities as required. Therefore, when tax rules and systems become less complicated cases of tax avoidance and evasion reduce thereby asserting that simplicity has a significant effect on tax compliance.

Hypothesis 4 states there is no effect of level actual income on tax compliance, research findings is not in agreement with the hypothesis since actual income recorded (coefficient estimates $\beta_4 = 0.194$, p-value =0.000).The study findings are in agreement with Australia and Loo (2006) in Malaysia that high income earners were less compliant hence it is in concurrence that income level has a significant impact on compliance. On the contrary study by Torgler (2007) revealed that high income

earners are more compliant to taxation as compared to low income earners. Mohani, (2001) conceded that in a country where income redistribution is not satisfying, high income earners tend to evade tax more since they feel the tax system is not treating them fairly. However, study by Loo(2006) show that a high level of education which in turn leads to a high level of income, contributes immensely to tax compliance.

CHAPTER SIX

CONCLUSIONS AND RECOMMENDATIONS

6.1 Overview

This chapter presents conclusions and recommendations based on the objectives and findings of the study.

6.2 Conclusion

➢ This study's direct evidence that perceived fairness of the tax system is a contributory factor in tax compliance, and an indication of its magnitude effect. From the study findings there is enough proof to conclude that perceived fairness of the tax system is associated with high levels of tax compliance. Tax compliance will increase with increase in perceived fairness.

➢ The study also provides some preliminary evidence that tax audit plays a vital role in improving tax compliance. Specifically, for a tax system with high tax rates of audits, tax compliance is likely to improve.

➢ The study results also inferred that simplicity in the tax system has a significant effect on tax compliance. This is because through simplicity, tax payers are able to fill their returns easily and understand it well therefore encouraging them to comply.

➢ Finally; the study concludes that level of actual income has a significant effect on tax compliance. It is therefore prudent for all individuals in all the income levels to comply with taxpaying.

6.3 Recommendations

From the study findings it was deduced that perceived fairness of the tax system has a profound effect on tax compliance. The findings suggest tax systems with perceived fairness are most likely to be complied with. Therefore, the tax system should be fair to all individuals at all income levels. The burden of tax should be felt by all but at different levels, with those earning low income being taxed differently as compared to high income earners.

The study finds strong support for the argument that tax audits impacts highly on tax compliance, thus there should be increased tax audits carried out. This way, rental income owners will be encouraged to comply since they will keep accurate records for tax audits hence tax compliance.

Finally, simplicity has a significant effect on tax compliance. Thus the tax system should provide a clear and simple guideline on how to fill tax returns so that individuals who are not well educated are able to fill their tax returns. This way tax compliance will increase. Also the level of income has a significant effect on tax compliance, therefore the tax system should target individuals at all levels of income in order to avoid tax evasion.

6.4 Further Research Recommendations

The main limitation of this study was lack of comprehensive data on the landlords in Eldoret town and other major towns in Kenya. Thus, further research on how to come up with a comprehensive database should be conducted to map out all rental property in urban areas. Secondly Eldoret town was included in the sample, future research should try to include other towns in Kenya and extend this research by investigating

the actual impact of taxation on disposable income of rental income owners. Further the study should also put into consideration the influence of Economic conditions on tax compliance.

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APPENDIX I: RESEARCH QUESTIONNAIRE

Dear respondent

RE: REQUEST TO FILL THE QUESTIONNAIRE

I am a Postgraduate Student at the University of Eldoret Pursuing a Master of Business Management Degree Program. This questionnaire is part of my research to be carried out in partial fulfillment of my Degree. **The Study Seeks to find out the Determinants of Tax Compliance among Rental income owners.** The information you provide shall be held with strict confidentiality and used for the stated purpose only. Please answer all questions as accurately and honestly as possible.

SECTION A: Background Information

Please tick the appropriate choice.

1. What is your Gender?
   ( ) Male   ( ) Female
2. What is your Age Bracket?
   ( ) 18-25   ( ) 26-35   ( ) 36-45   ( ) 46- Above
3. What is the level of your academic qualification?
   ( ) Certificate   ( ) Diploma   ( ) Degree   Others
(specify)………….
4. Do you have KRA pin Number?
   ( ) Yes   ( ) No

5. Have you ever used E-filling   ( ) Yes   ( ) No

6. If yes how long have you been using 'E-filing' to file your tax returns?

YEARS	TICK APPROPRIATELY
0-5	
6-10	
11-20	
OVER 21	

7. If   no,   why   have   you   not   used
   it?...

8. Have you attended any formal taxation course organized by KRA or university or
   any other

Yes ☐ No ☐

9. Have you ever been audited by KRA

Yes ☐ No ☐

10. If Yes, how many times? ……………

SECTION B: Perceived Fairness of Tax System

Please tick the most appropriate number that corresponds closely to your desired response. Specify on scale of 1-5 representing the degree to which you agree or disagree with the following attributes.

Key: Where   *5 = Strongly Agree, 4 = Agree, 3 = Neutral, 2 = Disagree*
1= Strongly Disagree

Tick Appropriately	5	4	3	2	1
I believe that the income tax system is fair					
I believe that the manner in which the income tax burden is distributed across taxpayers is fair					
Generally, I feel the income tax is a fair tax					
On the whole, the burden of income taxes is fairly distributed					
Current tax laws don't require me to pay more than my fair share of income taxes					
Compared to other taxpayers, I don't pay less than my fair share of income taxes					
Special provisions in the income tax law that apply to only a few people are fair					

SECTION C: Tax audit

On the items listed below please tick the number that is appropriate to your desired response where *5 = Strongly Agree, 4 = Agree, 3 = Neutral, 2 = Disagree 1= Strongly Disagree*

.

	Tick Appropriately	**5**	**4**	**3**	**2**	**1**
1	Fear of Tax Audits and prosecution induces us to comply.					
2	Audit Standards and Procedures are well communicated by the Tax Auditors					
3	Audit Findings are availed to us on Time.					
4	Tax Auditors are friendly and informative to us.					
5	The fear of being is sufficient to act as a restraint.					

SECTION D: The Level of Income and Tax Compliance

On the items listed below please tick the number that is appropriate to your desired response where; *5 = Strongly Agree, 4 = Agree, 3 = Neutral, 2 = Disagree 1= Strongly Disagree*

	Tick Appropriately	**5**	**4**	**3**	**2**	**1**
1	The level of income has been stable over the years.					
2	We disclose the level of our income to the relevant regulatory bodies.					
3	All incomes are reported for financial reporting purposes.					
4	I claims all the deductible allowances in arriving at the net taxable income.					

On the items listed below please tick the number that is appropriate to your desired response where; *5 = Strongly Agree, 4 = Agree, 3 = Neutral, 2 = Disagree*

1= Strongly Disagree

.**Key Attributes**	5	4	3	2	1
The process of calculating tax is easy					
I can easily file my returns					
It easy to file complaints for any tax irregularities					
It is easy to use ETR machine					
It easy to understand all the processes of the current tax system					
We never complain about ETR programmers'					

SECTION F: Tax Compliance

On the items listed below please tick the number that is appropriate to your desired response where; *5 = Strongly Agree, 4 = Agree, 3 = Neutral, 2 = Disagree*
1= Strongly Disagree
.

Tick Appropriately	**5**	**4**	**3**	**2**	**1**
I have never attempted to avoid taxes					
I have never been penalized for tax failure					
I pay actual tax as assessed					
I have never delayed to pay taxes					

Any   other   information   you   deem   relevant-

_____

_____

_____

Thank you

APPENDIX II: RESEARCH AUTHORIZATION

REPUBLIC OF KENYA

NATIONAL COUNCIL FOR SCIENCE AND TECHNOLOGY

Telephone: 254-020-2213471, 2241349, 254-020-2673550
Mobile: 0713 788 787 , 0735 404 245
Fax: 254-020-2213215
When replying please quote
secretary@ncst.go.ke

P.O. Box 30623-00100
NAIROBI-KENYA
Website: www.ncst.go.ke

Our Ref:

NCST/RCD/14/013/150

Date:

18th April, 2013

Timon Kipleting Kogo
Chepkoilel University College
Eldoret.

RE: RESEARCH AUTHORIZATION
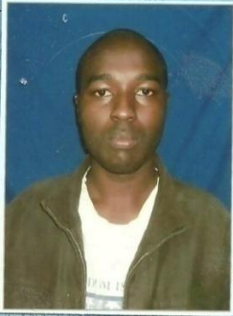
Following your application dated *8th February, 2013* for authority to carry out research on "*Determinants of tax compliance by Private Firms in Iten Town,*" I am pleased to inform you that you have been authorized to undertake research in **Keiyo District** for a period ending **31st July, 2013.**

You are advised to report to **the Directors of the selected Private Firms** before embarking on the research project.

On completion of the research, you are expected to submit **two hard copies and one soft copy in pdf** of the research report/thesis to our office.

DR M.K. RUGUTT, PhD, HSC.
DEPUTY COUNCIL SECRETARY

Copy to:

The Directors
Selected Private Firms.

"The National Council for Science and Technology is Committed to the Promotion of Science and Technology for National Development".

APPENDIX III: RESEARCH PERMIT