Towards Enhanced Tax Compliance in Kenya

San Lio & John M.Mirichii-conference paper

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Abstract

Tax is the bottom line source of revenue for the world’s governments. Marina et al. (2002) contends that, “taxation is the only known practical manner for collecting resources in order to finance public expenditure for goods and services Consumed by any citizenry”. This piece of research work is undertaken to unravel efficient mechanisms to be employed in Kenya to enhance tax compliance to boost tax revenue for the current and future governments. With the new governance structure of forty seven county governments in place following the promulgation of the new constitution 2010, this exercise is timely. The study will make use of both secondary and primary sources of data in eliciting the required information necessary for the research findings. The sample size will be made up of twenty five companies drawn from different sectors of the Kenyan economy operating within the Nairobi County.

The Statistical Package for the Social Sciences (SPSS) version 19 was used in the data analysis. Simplicity is critical, and it aims to ensure that the tax system has simple rules for citizens to understand and at the same time guarantee that the cost of tax collection and administration is not higher than the actual tax revenue raised. A tax system for example is made complex if it has many tax exemptions such as tax credits, tax breaks, and tax holidays, among others, and numerous and complex legal frameworks.

The research findings lead to a conclusion that multiple rates of income tax, varied dates of making tax returns and bulky legal tax framework make income tax compliance unforeseeable in Kenya.

Key works

Kenya Revenue Authority (KRA), taxable income, tax rates, tax burden, tax base, tax regimes, legal tax framework.

1. Introduction

The purpose of taxation in Kenya is to finance government planned activities. Article 209 of the Constitution of Kenya 2010 grants powers to impose taxes as a revenue source by both the national and the county governments. Tax may be defined as a levy charged by governments either on individuals’ or corporate entities’ incomes and/or on the price of a good or service. The former is known as direct tax and the latter indirect tax.

Kenya’s GDP for the year 2013 is estimated at $40.7 billion, with economic growth of 4.6% in the year 2012 compared to 4.4% in the year 2011. This growth was envisaged to be 5.7% in 2013 and 6.0% in 2014(1); with income tax revenue averaging ten percent of GDP.

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1 World bank, Kenya economy update June 2013
The country however has the potential to achieve a double digit growth rate as the economic performance over the past decade has lagged behind the average for sub-Saharan Africa, even when resource rich countries are excluded. Accordingly, the country’s income tax potential is untapped. Income tax is a direct tax charged on incomes of individuals and corporate entities, from employment, self-employment, profits on trading activities, rent, dividends, interests, pensions, royalties, professional fees, and other incomes. These sources of income on individuals may not all be accounted for via the PAYE system, with different rates applied, making the process of accountability and compliance difficult. Kenyan resident and non-resident corporate entities are charged different tax rates. The tax is also dependent on whether the company is listed in the Nairobi Stock Exchange (NSE), percentage of issued share capital, number of years as a listed company, gross income, and whether the company is in the Export Processing Zone (EPZ).

The tax is charged on the income earned by persons resident in Kenya. A resident is defined for tax purposes as an individual who has permanent residence in Kenya, and has spent any part of the working year(s) in the country; or, one without permanent residence in Kenya but has spent one hundred eighty three days or more, working in the country during the period of assessment. A foreign employee in a non-Kenyan firm who is resident in Kenya is subject to income tax on all emoluments. To avoid double taxation on resident individuals and corporate entities earning income by contacting business in other countries, Kenya has signed double taxation treaties with most nations.

Income tax is governed under the Income Tax Act Cap 470, of the Laws of Kenya. The principle law of the Income Tax Act has 14 parts, 133 sections and 13 schedules, all directing its implementation. This brings to fore, a glaring complexity on the ordinary citizen and professionals alike. Indirect taxes may be categorised as including the VAT, excise duty, import duty and stamp duty & other taxes. VAT is levied on the consumption of goods and services, and charged at each stage of production and distribution chain to the retail stage. The tax is charged on the value added on the good or service. It is also levied on imported taxable goods and services. Traders are allowed to offset input VAT against output VAT in the final accounting, usually done on or before the twentieth day following the trading month. The rates vary, ranging from zero, for the items that are zero rated and twelve percent on petroleum products. The standard rate in Kenya is sixteen percent. VAT is governed under the VAT Act Cap 476, of the Laws of Kenya, which has fifty nine sections, nine schedules and nine subsidiaries.

Excise duty is a tax charged on traders, but passed on to the consumers in form of increased prices. The rates vary accordingly: ordinary beer is charged at Kenya Shillings Seventy a litre or fifty percent

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2 Doing Business: Know your taxes, East Africa Tax guide 2013/14, PWC
of ex factory selling pricing; other alcoholic beverages between Kenya Shillings seventy, eighty or one hundred twenty a litre or thirty five percent of the value (whichever is higher) or fifty percent ex factory selling pricing; tobacco at Kenya Shillings one thousand two hundred per mile or thirty five percent of recommended selling price (RSP), excisable services are charged between seven and fifty percent depending on the service and various other rates for other excisable products. There is no specific chapter of law dealing with this particular tax.

Import duty is charged on imported goods and services, and paid before the items are allowed passage into the country from the ports. The rates are: rice thirty five percent, wheat grain ten percent, maize grain fifty percent, of the selling prices among other rates charged on various imported items. Other than the East African Community Customs Union (EACCU) established in the year 2005 to harmonize importation of goods and services into the partner states, and which provides the rates to be applied accordingly, there is no chapter of the Kenyan laws dealing with this particular tax. There is currently no export duty/tax charged in Kenya. In fact the Government of Kenya through the Tax Remission for Exports Office encourages local manufacturers to export their products. This is achieved by remitting duty and VAT on raw materials used in the manufacture of goods for export (3).

Stamp duty tax is charged as follows: transfer of immovable property within a county, four percent; outside a county, two percent; issue of debentures or mortgage, point one percent; transfer of unquoted and quoted stock of marketable securities, one and zero percent respectively; creation and/or increase of share capital, one percent; lease of a period of zero to three years and more, one and two percent respectively, among others.

In the case of excise, import and stamp duty taxes, there is inconsistence in as far as the legal framework is concerned.

2. Statement of the problem
Tax compliance in Kenya has been at its lows since independence, as witnessed by the low tax revenues. In the financial year 2000/01 for example, revenue collected from taxes amounted to Kenya Shillings two hundred billion, rising to only Kenya Shilling eight hundred billion in the financial year 2011/2013, a period of over ten years (4). Kenya’s GDP has been growing steadily at almost the same rate, rising from sixteen billion USA dollars in the financial year 2003/4 to thirty seven billion dollars in the financial year 2012/13(5). The tax revenue base should have been expected to grow at a much higher rate than what has been witnessed to sufficiently fund government planned development projects, with deficits experienced to date; as can be seen in the table below.

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4 Statistical Annex to the Budget Speech for FY 2007/08 & 2011/12
5 http://www.tradingeconomics.com/kenya/gdp
<table>
<thead>
<tr>
<th>Vote</th>
<th>Year</th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Ksh billion</td>
<td>Ksh billion</td>
<td>Ksh billion</td>
<td>Ksh billion</td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td></td>
<td>574.10</td>
<td>673.27</td>
<td>781.63</td>
<td>971.33</td>
</tr>
<tr>
<td>Expenditure</td>
<td></td>
<td>574.30</td>
<td>733.35</td>
<td>833.02</td>
<td>1,123.42</td>
</tr>
<tr>
<td>Deficit</td>
<td></td>
<td>0.20</td>
<td>60.08</td>
<td>51.39</td>
<td>152.09</td>
</tr>
</tbody>
</table>

Source: Kenya bureau of statistics, facts & figures 2013

Budgetary planned activities for the current financial year 2013/14, whose theme is transformation and shared prosperity amount to Kenya shillings one point six trillion (Ksh 1.6 trillion). KRA plans to collect the amount of Kenya Shillings nine hundred seventy four billion only, hence an anticipated deficit of Kenya Shillings six hundred twenty six billion (6).

These accumulated deficits have continued to raise the debt burden on the Kenyan people, currently estimated at Kenya Shillings two point one trillion (Ksh 2.11 trillion), which is fifty eight percent of the country’s GDP (7).

The types of tax revenue streams in Kenya, from which the above mentioned revenue is derived, include income tax, VAT, excise duty, import duty and stamp duty & others; accounting for forty percent, twenty eight percent, fifteen percent, eight percent and nine percent respectively (8).

Income tax accounts for the lion’s share of the Kenya’s tax revenue at forty percent hence the focus of this research work. The amounts collected in recent years relative to GDP are summarized below

<table>
<thead>
<tr>
<th>Item</th>
<th>Year</th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Ksh billion</td>
<td>Ksh billion</td>
<td>Ksh billion</td>
<td>Ksh billion</td>
<td></td>
</tr>
<tr>
<td>Income tax revenue</td>
<td></td>
<td>219</td>
<td>272</td>
<td>329</td>
<td>403</td>
</tr>
<tr>
<td>Government Expenditure</td>
<td></td>
<td>574</td>
<td>733</td>
<td>833</td>
<td>1,123</td>
</tr>
<tr>
<td>% Contribution</td>
<td></td>
<td>38%</td>
<td>37%</td>
<td>39%</td>
<td>36%</td>
</tr>
<tr>
<td>Expenditure</td>
<td></td>
<td>GDP</td>
<td>2367</td>
<td>2554</td>
<td>3049</td>
</tr>
<tr>
<td>% contribution</td>
<td></td>
<td>9%</td>
<td>11%</td>
<td>11%</td>
<td>12%</td>
</tr>
</tbody>
</table>

6 Kenya national bureau of statistics: facts & figures 2013
8 Citizen handbook on taxation in Kenya, 2012, IEA
These figures translate to an average of thirty seven percent contribution on government planned expenditure, and eleven percent of GDP for the financial periods. This in a nutshell, is dismal performance, and can be improved.

The question the researchers seek to answer is why this poor performance?

The researchers identify fundamental issues, as a possible cause for the ill performance: multiple tax rates charged to individuals and corporate entities alike, on various incomes for income tax purposes; various dates set by KRA for filing and accounting for income tax; and bulky legislation with unfriendly legal jargon.

3. Literature review

The World Bank’s main message in its article, ‘Kenya Economic Update June 2013, Edition No. 8’ (p. IV-v) is that Kenya economy is still operating below its potential. The triumphant elections held in March 2013 and the peaceful handover of power in the following month of April ushered in a new era of political leadership, which will guide the implementation of Kenya’s ambitious program of devolution. If these developments reflect the maturing of Kenya’s political system, there is equal optimism that Kenya has put behind the troubling economic periods that have regularly followed its previous election cycles. Kenya could do much better, and there is no doubt that the new government wants to unleash the potential of the Kenyan economy. This will see poverty levels reduce from the currently estimated forty two percent and bring in more individuals into the income tax bracket. Income tax revenue averages only ten percent of GDP.

The average income tax rate is thirty percent and hence this revenue stream’s potential is untapped. Many authors have taken interest in the administration of income tax in its current bureaucratic form, and largely ignored the more fundamental issues of simplicity and transparency, expected to enhance revenue.

The IMF contends that simplicity is paramount, in its Economic Issue No. 27 ‘Tax Policy for Developing Countries, March 2001’. The authors suggest that in developing countries where market forces are increasingly important in allocating resources, the design of the tax system should be as neutral as possible so as to minimize interference in the allocation process. The system should also have simple and transparent administrative procedures so that it is clear if the system is not being
enforced as designed (p.4). The ideal tax system in these countries should raise essential revenue without excessive government borrowing, and should do so without discouraging economic activity (p.1). The IMF author goes on: ‘Since most workers in these countries are typically employed in agriculture or in small, informal enterprises, and are seldom paid a regular, fixed wage, their earnings fluctuate, and many are paid in cash, "off the books." The base for an income tax is therefore hard to calculate’. ‘The political power of rich taxpayers often allows them to prevent fiscal reforms that would increase their tax burdens. This explains in part why many developing countries have not fully exploited personal income and property taxes and why their tax systems rarely achieve satisfactory progressivity’.

The Kenyan economy is also largely informal, and therefore finding statistical data necessary to bring every income earner within the bracket is elusive.

Finding an ideal income tax system for Kenya is thus timely.

In its journal, ‘Taxation and State Building in Kenya: Enhancing Revenue Capacity to Advance Human Welfare’, the Tax Justice Network for Africa (TJN-A), notes that the tax system in Kenya was introduced to Kenya as a result of the different waves of colonization and settlement of foreign rulers. The authors note (p. 11) ‘Tributes and local money taxes did exist in the native African Kingdoms and among pastoralists, but only after the advent of foreign rule did taxation appear in a systematic manner’. The tax systems of the developed nations are fairly complex since the populations are adequately educated and economies formal. Although Kenya can continue to learn from these nations, there is the need to embrace the country’s large informal economic realities and illiterate populations. This is important if a fair audit is to be undertaken to improve the current income tax system, still deeply influenced by the post independence colonial laws. The authors of this article make an important observation (p. 13), ‘the assumption that tax plays an insignificant role in funding state expenditures in Africa is a fallacy’.

According to the IEA-K, in its research paper ‘Taxation and Tax Modernization in Kenya: A Diagnosis of Performance and Options for Further Reform (IEA, December 2006’ Kenya introduced a Tax Modernisation Programme in 1986 with the hope that this would, among other things, enhance revenue collection, improve tax administration and reduce compliance and collection costs. The findings of this piece of work indicate that, despite the tax modernization, there are concerns that the challenges that confront the Ministry of Finance and Kenya Revenue Authority today are not much different from the challenges that faced these revenue authorities before the reforms. There are also concerns that tax competitiveness in Kenya is low and the country remains among the most tax unfriendly countries in the world. Further, the tax structure is less buoyant and possibly inelastic although indirect taxes, and not direct taxes, hold the capacity to improve the flexibility of the tax system. Although the tax system has been stable over the 1996-2006 period, partial results show that
it was inflexible, yielding a buoyancy index of 0.662. The tax system yielded a 0.662% change in tax revenue for every 1% change in GDP. In other words, the tax system failed to respond favourably to changes in economic activity as well as discretionary tax measures (p. 30).

In his handbook, ‘A citizen’s handbook on taxation in Kenya, IEA-K, 2012’, Mutua J. Notes that the handbook attempts to break down Kenya’s complex tax system into a user friendly form for consumption by the average person (p.6). He however does this by merely attempting to explain how the many rates of various taxes affect different categories of income and how computations should be done (p.19-21). No recommendations are provided to influence income tax policies to simplify the income tax system.

This approach has been used by other experts, and particularly the ‘big’ four: PricewaterhouseCoopers, Deloitte & Touché, KPMG and Ernst &Young.

PriceWaterhouseCoopers (PWC), provides a detailed schedule of tax rates on various taxable goods and services in East Africa in an annual East African Tax guide, ‘Doing business: Know your taxes, East Africa Tax Guide’. This guide is a one stop-shop for most tax rates applied in the four of five East African states: Kenya, Uganda, Tanzania and Rwanda. Burundi is excluded.

Deloitte & Touché Provides a similar Guide for the whole of Africa, ‘Guide to Fiscal Information, Key Economies in Africa 2013/2014’. Kenya’s schedule of most tax rates is provided accordingly (p.128-145) and so are all the African states.

Ernst & Young, ‘Worldwide VAT, GST and sales tax guide 2013’ provides schedules for nations on the mentioned taxes. Kenya’s schedule is provided (p.417-422). Ernst & Young however do not provide any guide on income taxes.

KPMG provides global tax comparative figures, with less emphasis on Kenya’s taxation regime.

Cheeseman N. & Robert G, in the article ‘Increasing Tax Revenue in Sub-Saharan Africa, The case of Kenya 2004’ note, the fact that attempts to increase tax revenue through increasing the capacity of the KRA have failed is not seen as critical by either the international financial institutions or the Kenyan government (p.14). They contend that governance issues have been largely to blame for ill tax revenue performance in most sub-Sahara African nations, but admit that KRA has not been successful in increasing tax revenue, a view considered true by the researchers of this piece of work. KRA’s focus should have been working on mechanisms to simplify particularly the income tax system since this tax accounts for the biggest percentage of government revenue. Chessman’s work date back to 2004, and to date, no notable efforts have been made by KRA to this end.
In an article, ‘KRA to entrench a compliance culture, 2006’, the immediate former KRA Commissioner General Waweru M. said that the Kenya Revenue Authority is committed to upholding the spirit of recognising tax compliance among taxpayers as a way of making tax administration effective and less costly. The Commissioner General said the Authority had adopted a compliance model which requires that KRA respond to taxpayers according to their compliance status. This attitude seems to appreciate the status quo, in terms of the complexity of the income tax system, and KRA commits to making efforts to enforce the system as it is, rather than proposing reforms to simply the system.

Another KRA article, ‘About Revenue Administration Reforms and Modernization Program (RARMP), 2014’ (p.1) notes that, the aim of RARMP is to entrench the reforms at the operational levels to achieve operational efficiencies and enhance service delivery. Accordingly, the current reform and modernization is focused on improving the agency’s operational capacity as opposed to income tax systems reforms.

The KRA downloads and Publications provide detailed procedures on income tax administration and the agency’s strategic direction, (9). No research work is currently ongoing to improve systems and enhance income tax revenue.

The Income Tax Act, Cap 470, of the Laws of Kenya, has fourteen parts, one hundred thirty three sections and thirteen schedules(10). The Act is bulky, with heavy legal jargon undertones. Subsequent Finance Bills and Acts are issued on a continuous basis, with the aim of making amendments on the tax laws appearing in the Income Tax Act; for example the Finance Act 2012(11), assented to on January 7th 2013, to make amendments to the Finance Bill 2012(12). This complicates the system further, making it more unfriendly.

These findings are in tandem with the need to undertake this research work.

4. Methodology

The population of the study consisted of twenty companies drawn from different sectors of the Kenyan economy operating in the Nairobi County. Primary data was collected from the financial managers and accounts officers of the select companies. These companies were selected independently using the stratified sampling technique to capture the various sectors of the economy as

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9 www.revenue.go.ke
described in the income tax Act Cap 470, of the Laws of Kenya. The questionnaire was designed based on the expected analysis and interpretation of the variables, and administered by the researchers. The variables affecting income tax compliance include: first, income tax rates; second, tax incentives; third, legal framework; forth, modernization; fifth, accountability; sixth, the structure of the economy.

The data was analysed using descriptive statistics specifically frequencies and charts; using the Statistical Package for the Social Sciences (SPSS) version 19.

5. Results and findings
The results and study findings on the various variables are summarized in the table and chart below

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>Understood</th>
<th>Not understood</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax flat rates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paye</td>
<td>88%</td>
<td>12%</td>
</tr>
<tr>
<td>Corporation</td>
<td>76%</td>
<td>24%</td>
</tr>
<tr>
<td>Tax Incentives</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax holidays</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Capital allowances</td>
<td>47%</td>
<td>53%</td>
</tr>
<tr>
<td>Reliefs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pensions</td>
<td>14%</td>
<td>86%</td>
</tr>
<tr>
<td>Insurance</td>
<td>17%</td>
<td>86%</td>
</tr>
<tr>
<td>Mortgage</td>
<td>17%</td>
<td>86%</td>
</tr>
<tr>
<td>Legal framework</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Filing returns</td>
<td>100%</td>
<td>0%</td>
</tr>
<tr>
<td>Corporation</td>
<td>94%</td>
<td>6%</td>
</tr>
<tr>
<td>Tax Act and Bills</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Penalties</td>
<td>29%</td>
<td>71%</td>
</tr>
<tr>
<td>Tax refunds</td>
<td>6%</td>
<td>94%</td>
</tr>
<tr>
<td>Modernization</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ICT</td>
<td>83%</td>
<td>17%</td>
</tr>
<tr>
<td>Reforms</td>
<td>59%</td>
<td>41%</td>
</tr>
<tr>
<td>Accountability of income tax revenue</td>
<td>47%</td>
<td>53%</td>
</tr>
<tr>
<td>The structure of economy</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The average of eight two percent of the respondents understood and applied income tax flat rates, and eighteen percent did not.

The average of a mere nineteen percent of the respondents knew about the tax incentives offered tax payers by KRA meant to motivate them to comply with income tax payment, and eight one percent did not know.

A hundred percent of the respondents filed PAYE returns and ninety four percent filed corporation tax returns. Eighty two percent of the respondents read the income tax Act but said they did not understand it as it was lengthy and complex. Twenty nine percent of the respondents understood the income tax penalties. A mere six percent of the respondents knew and applied for tax refunds; and only eighteen percent knew how long financial records should be preserved for income tax purposes.

On average, seventy one percent of the respondents were aware of efforts being made by KRA to improve the compliance on income tax; eighty three percent used KRA ICT platform to make income tax transactions.

Forty seven percent of the respondents were satisfied with the utilization of income tax revenues by the Government.
6. Discussion
The purpose of the study was to establish the factors which determine income tax compliance in Kenya. The primary data was collected from twenty companies operating within the Nairobi County using the stratified sampling technique. Nairobi was selected for the sampling since it contributes to --% (REFERENCE SOURCE) of the country’s total income tax revenue. All the selected companies are from the formal sector of the Kenya’s economy which accounts for a hundred percent of the income tax revenue. The analysis of the data was made using the SPSS version 19, and tables and graphs on each of the variables produced representing the results and findings of the study.

Income tax is a direct tax charged on incomes of individuals and corporate entities. Individual income tax rates are based on employment income and benefits, self-employment, profits on trading activities, rent, dividends, interests, pensions, royalties, professional fees, and other incomes. Employment benefits include housing, car, per diem, commissions, international passage, medical cover, insurance premiums, loans, utilities, school fees for children, meals, pensions & gratuities and benefits in kind. Some of these sources of income on individuals may not be accounted for via the PAYE system, with different rates applied on each. In addition, there are different income tax rates for residents and non-residents as well as directors. The tax is charged on the income earned by persons resident in Kenya. A resident is defined for tax purposes as an individual who has permanent residence in Kenya, and has spent any part of the working year(s) in the country; or, one without permanent residence in Kenya but has spent one hundred eighty three days or more, working in the country during the period of assessment. A foreign employee in a non-Kenyan firm who is resident in Kenya is subject to income tax on all emoluments. To avoid double taxation on resident individuals and corporate entities earning income by contacting business in other countries, Kenya has signed double taxation treaties with most nations. This makes the process of accountability and compliance very difficult.

The tax rates for business entities are dependent on business sector, turnover, residence, and whether the company is listed in the Nairobi Stock Exchange (NSE), the percentage of issued share capital, number of years as a listed company, and whether the company is in the Export Processing Zone (EPZ).

Only fifteen percent of the respondents were willing to disclose other benefits paid to employees other than salaries and wages, for tax purposes. Therefore we could not establish how various benefits including insurance premiums, mortgage payments, car benefits, per diems, housing allowances, and utilities were treated for income tax purposes. It is important to note that these benefits are taxed at different rates on a graduated scale. Eighteen percent of the respondents did not include salaries and
wages in the PAYE payroll system, meaning employees were not taxed. Thirty percent of the respondents did not endeavor to find whether employees in their payrolls could be working for other entities and/or earning taxable income from other sources. However, most taxpayers appreciated that most benefits were taxable.

Thirty five percent of the respondents did not know their business’s initial capital outlay, making it difficult to claim capital allowances. Twelve percent of the respondents had initial capital outlay ranging from Ksh 5 to 10 million, but only forty seven percent claimed capital allowances. A hundred percent of those with turnover of less than Ksh 5 million, and are supposed to apply three percent tax rate, actually applied thirty percent, translating to a huge tax expense. A hundred percent of the respondents from the listed companies did not indicate the percentage of listed shares, and neither did they indicate the number of years they have been listed, and yet tax rates are a function of both.

The taxation authorities provide tax incentives aimed at improving on income tax compliance. These are tax holidays, capital allowances and reliefs. A tax holiday is a temporary period, during which time the government removes certain taxes on certain items, in order to encourage the consumption or purchase of these items. Capital allowance is a reduction in the amount of corporation tax payable, offered as an incentive for investment in large-scale projects. A certain percentage of the capital asset's cost is allowed as capital allowance during the accounting period in which it was purchased. This amount is greater than the depreciation charge on the asset during that period \(^{(13)}\). A tax relief is any program or incentive that reduces the amount of tax owed by an individual or business entity. A hundred percent of the respondents did not apply for tax holidays, indicating that they were unaware about it. Forty seven percent of the respondents were unaware of the existence of the capital allowances. Fourteen percent, seventeen percent and seventeen percent of respondents did not apply pensions, insurance and mortgage reliefs for income tax purposes respectively. Eighty eight percent of the respondents engaged consultants and other professionals; eighty percent of these withheld tax on the payments. Eighty five percent applied National Social Security fund (NSSF) and National Hospital Insurance Fund (NHIF) tax reliefs correctly.

Income tax is governed under the Income Tax Act Cap 470, of the Laws of Kenya. The principle law of the Income Tax Act has 14 parts, 133 sections and 13 schedules, all directing its implementation. The Act is bulky, with heavy legal jargon undertones. Subsequent Finance Bills and Acts are issued on a continuous basis, with the aim of making amendments on the tax laws appearing in the Income Tax Act. The Finance Acts and Bills are written on a ‘delete—insert’ basis, further complicating the system, and making it more unfriendly. This brings to fore, a glaring complexity on the ordinary citizen and professionals alike. The results of our survey indicate that none of respondents understood the Acts and bills. A mere twenty nine percent, six percent, and eighteen percent of the respondents

\(^{(13)}\) Business Dictionary
understood the income taxation penalties, refunds and preservation of financial records respectively. Seventy one percent of those aware of the applicable penalties described them as unfair. Penalties are charged by the tax authorities as a deterrent to non-income tax compliance. Penalties are applied on instalment, final, withholding, PAYE, and the filing of self-assessment tax returns. Penalty rates range from five to twenty five percent on the unpaid amount, and a monthly compound interest charge of two percent. Tax refunds are payments made by KRA to the tax payer on account of overpayments of income tax. KRA has been weak in making the follow-ups on this important area to the tax payer. Individuals and corporate entities are required under the Act to preserve their financial records for a minimum period of seven years. A hundred and ninety four percent of the respondents filed their PAYE and corporation tax returns correctly, respectively; but none of them knew the date of filing the corporation tax returns against seventy seven percent who knew the date of filing the PAYE returns. Five percent claimed that their corporation returns are filed by their external auditors. Seventy one percent did not know the amendments introduced in the new finance bill requiring that individual employees file their own personal income tax returns.

Modernization of the income tax system involves the transformation of the structural tax agency and the inculcation of ICT and is crucial for improved income tax compliance. Eighty three percent of the respondents were using the KRA ICT platforms, but indicated that the system is inaccessible most of the times. This explains why there are always long queues at the KRA offices. Furthermore, respondents complained that penalties applied even when the system was to blame for their delays in making returns and payments. Fifty nine percent of the respondents were aware of efforts being made by the tax agency to improve on income tax compliance; however sixty three percent of them said they needed continuous tax education, with some twenty percent suggesting the restructuring of the agency. Visits by KRA staff are important in the modernization efforts. Eighty two percent of respondents said they were never visited by KRA staff, and those visited suggested that the cycle should be reduced from the current five year one. All of those visited indicated that the KRA staff are competent.

Fifty three percent of the respondents indicated that the income tax revenues were not properly utilised and accounted for. This no doubt, discourages the income tax compliance.

6.1 Recommendations
Based on the research findings, there is the need to simplify the income tax systems to improve income tax compliance by:

1) Rewriting the income tax laws in a friendly business language to make them understandable and clear to the common tax payer, as opposed to the current legal jargon.

2) Minimizing the number of applicable tax brackets and rates in similar tax categories in an effort to reduce the income tax schedules so as to simplify them.
3) Companies employing professional tax officers. To achieve this goal, it is recommended that Kenya Accountants & Secretaries National Examinations Board (KASNEB) should design a program to train the officers.

4) KRA employing tax educators and supervisors to improve that ratio of officers to tax payers.

5) KRA making deliberate efforts to net the informal sector, currently non-tax compliant.

6) Improving on the accountability of tax revenues by the taxation authorities. The tax authorities should reconcile individual tax payers’ accounts regularly, and communicate the results without undue delay.

7) Rolling modernization programs at the County level.

8) KRA Publicizing tax laws publications.

### 7. Conclusion

The researchers conclude that there is the need to carry out more elaborate research in this area.

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