

Influence of Cost of Tax Compliance on Tax Compliance Among Investors in The Export Processing Zones in Kenya.

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Abstract

The objective of this study was to establish the influence of cost of tax compliance on tax compliance among the Export Processing Zones investors in Kenya. This research used a cross sectional survey research design. The study population comprised of 152 duly registered and licensed firms by the Export Processing Zones Authority. Since all the registered investors in the three Kenyan Cities were considered for the study, a census sampling technique was employed. Primary data was gathered using structured questionnaires and captured through a 5-point type Likert Scale questionnaire. Statistical Package for Social Sciences (SPSS) was used in the analysis of data. Data was analyzed by use of descriptive and inferential statistics. Analysis of Variance (ANOVA), multiple regression and correlation analysis was carried out to test the hypothesis. The study findings indicated that the cost of tax compliance influenced tax compliance to a great extent with a mean score of 4.02. This implies that tax compliance cost is a key determinant of tax compliance. Tax compliance costs play a key role in determining the level of a firm's tax compliance. These costs include both direct and indirect costs such as auditing costs, costs of hiring tax personnel, agents & experts, time taken to complete tax assessment & returns filing as well as the accessing, employing and retaining knowledgeable staff; all for purposes of tax compliance. The study concludes that the cost of tax compliance is statistically significant in explaining tax compliance. The findings imply that taxpayers will comply more when tax compliance costs are lower and tax systems adequately simplified. The study recommends that governments and revenue authorities need to actively engage business enterprises through regular sensitizations on proper record keeping. Proper record keeping will facilitate; simplified tax preparations, returns filing, advance knowledge on tax laws and regulations as well as tax payments. Sensitization on basic tax calculation procedures is also key in the reduction of indirect costs associated with tax compliance.

Key Words: *Tax compliance, Cost of Tax Compliance, Export Processing Zones.*

1. Introduction

Tax compliance can theoretically be described by categorizing compliance in three different types; payment compliance, filing compliance and reporting compliance (Brown & Mazur, 2003). Further, Organization for Economic Co-operation and Development (2009) indicate that these categories of compliance are administrative compliance and technical compliance. Administrative compliance involves observing administrative rules of lodging and paying taxes (OECD, 2009). Procedural compliance or regulatory compliance refers to complying with the technical requirements of tax laws in calculating taxes or provisions of tax laws in paying the share of the tax (Brown & Mazur, 2003).

Tax Compliance can be defined as the degree to which a taxpayer abides (or fails to abide) by the tax rules of his country, for example by declaring income, filing a tax return, and paying the taxes due in a timely manner (Cummings, 2007). While Tax evasion can be defined as the failure by a person or business to comply with its tax obligations, it is a serious challenge to tax authorities in both the developed and developing countries. It diminishes the mobilization of resources that governments need to invest in critical areas of social and personal development including health, education and infrastructural development

(Cummings, 2007). In 2011, tax noncompliance cost governments worldwide about 5.1 % of their Gross Domestic Product (GDP) (Helhel & Ahmed, 2014). In Europe, tax evasion constitutes about 8% of the GDP of economies in the region. In North and South America, tax evasion costs economies 2% and 10% of their GDP respectively (Mansor, Tayib & Yusof, 2013). Even in the most advanced economies in the world, tax evasion undermines revenue collection substantially (Rile, 2011).

Compliance costs involve a myriad of expenses or difficulties encountered by the taxpayer in complying with the tax law. Compliance is divided into administrative as well as technical. Administrative compliance includes, registration, filing and subsequent payment of the taxes while technical compliance involves maintenance of appropriate records, machines and organisation of the supply chain so as to observe the requirements of the law.

Taxpayers' behavior towards tax systems has evoked great attention among many Revenue Authorities in the World especially in Developed Countries (Porcano, 2011). However, it is still debatable on what has been done on the study of taxpayers' behavior towards tax systems in developing countries. The tax authorities concentrate more on studies which would increase their budgets' bottom-line in terms of huge revenue collections and enforcement efforts at the expense of these studies. Perhaps the less developed countries are not to blame as they run on budget deficits hence, scarce resources to see through such studies which are perceived as adding no direct value to revenue collection. Empirical evidence on the ground shows that there has been hostility between the taxpayers and tax collectors on issues relating to tax compliance (Porcano, 2011).

Of the three East African countries; Kenya, Uganda, and Tanzania, tax evasion as a function of GDP is high. Uganda loses the least amount in tax evasion. In 2011, it lost 856 million USD, followed by Tanzania at 1.9 billion USD, and Kenya lost slightly over 2 billion USD. Tax compliance levels in Kenya is still considered low at 54% in 2013 against KRA's target of 65% by 2018 (Kenya Revenue Authority, 2016). From the above figures, it can be inferred that the level of tax compliance is still relatively low despite the fact that several initiatives have been initiated to rope in more taxpayers into the tax bracket. This study therefore sought for an understanding of the reasons for low levels of tax compliance in Kenya.

2. Statement of The Problem

Taxes plays an important role in the budget of any economy. One of the main reasons why governments impose taxes is to generate income to manage the economy and redistribute resources. Over the years, the Kenyan government has undertaken various revenue administration reforms aimed at enhancing revenue collection (Masinde & Makau, 2010). One of the measures was the introduction of self-assessment systems (SAS) in 1992. The objective of this system was to increase voluntary tax compliance, reduce tax authorities' burden of assessing tax returns and increase tax collection efficiency (reduce tax collection costs) (Masinde & Makau, 2010).

Despite the employment of various tax administrative reforms, levels of tax compliance have remained quite low. A study conducted by KRA, KIPRA and the Treasury (2010), based on 1999/2000 data revealed that VAT payment compliance was as low as 55% while returns filing compliance was 65% (Masinde & Makau, 2010). Tax noncompliance is a substantive universal phenomenon that transcends cultural and political boundaries and takes place in all societies and economic systems.

Tax compliance costs involve a myriad of expenses or difficulties encountered by the taxpayers in complying with the tax law both in terms of administrative and technical compliance. Administrative compliance is mostly direct and therefore, a major area of concern in most research. Thiga and Muturi (2015), when studying Tax Compliance among SME's in Kiambu County observed that low compliance costs are associated with high compliance levels, these findings have been vindicated by several researchers including Lumumba, Migwi, Peterson and Mageto, (2010) and Slemrod, (1992). Despite the fact that various researchers have investigated factors that determine tax compliance, a clear understanding of the level of non-compliance by individuals and businesses that are liable to pay tax is a basic requirement for effective management of taxpayer compliance. This study aimed at addressing this gap and to gain insight into the influence of cost of tax compliance on tax compliance among Export Processing Zones investors in Kenya.

3. Purpose of The Paper

The purpose of this paper was to establish the influence of cost of tax compliance on tax compliance among Export Processing Zones investors in Kenya.

4. Literature Review

Tax compliance costs are those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax (Sandford, 2009). These costs of compliance can be categorized into the following depending on where they are incurred; Accounting Costs; Economic Costs; Lobbying Costs; Training Costs and Lost Revenue. The real cost of taxation goes beyond the amount that is paid to the tax authority. The most important cost of taxation is compliance. Compliance costs are the real costs associated with calculating taxes due and making a tax payment. These costs can be substantial, especially for businesses (Pope, 2008).

The costs of tax preparation can vary, but unlike the taxes themselves, preparation costs don't get any smaller for low-income people. At times, they can even get larger. One way of measuring the compliance costs associated with taxation for businesses is to measure the number of hours it takes a business to calculate and pay its taxes. Taking the time to just figure out what you owe, calculate it, then file it in, requires a business to give up a more productive activity. In response to this concern about tax compliance costs, governments have often endeavored to implement tax policies in the form of concessions that produce favourable outcomes for the small business sector (Pope, 2008). Such special tax concessions for small businesses fall mainly into two categories: positive concessions that provide a lower rate of taxation, an exemption or an accelerated deduction; and relieving concessions that excuse the taxpayer from requirements otherwise imposed (Payne, 2003).

Empirical evidence has suggested that progressive versus flat tax rate is the significant structural variable in association with tax compliance behavior (Clotfelter, 2006). Friedland (2008), using audited tax returns for individual taxpayers in Jamaica found out that high tax rates are linked to less tax compliance. This is because the high tax rates make the whole issue of tax compliance more expensive to the business people as it reduces their profits. In this regard since businesses must make more profits to stay afloat they mis-declare and hide their incomes under fictitious expenses resulting to non-compliance. Thananga, Wanyoike and Wagoki (2013) carried out a study on how landlords in Nakuru Municipality responded to new taxation measures, and factors which influence compliance. The study used a sample of 94 respondents and questionnaires for data collection. The findings of the study revealed that the tax compliance level to provisions of rental income tax policy by landlords, was very low. The compliance was due to expenses overstatement and deductions which would in turn reduce taxable pay.

Kemboi and Tarus (2012), examined determinants of tax compliance in Kenya for a period between 2007 to 2009 using quarterly secondary data. The hypothesis on the existence of co-integrated relationships between determinants and compliance was tested using Johansen-Julius co-integration technique. The result indicated that, tax compliance cost, fines and penalties, perceived opportunity for tax evasion and tax knowledge and education are important determinants of tax compliance.

Olweny and Omondi (2011), investigated the determinants of tax compliance on the firms listed at the Nairobi Securities Exchange, Kenya. It used monthly time series data for five years, a period between January 2008 to December 2013; they found out that tax compliance costs and perceived opportunity for tax evasion affect tax compliance levels among firms.

5. Methodology

This research used a cross sectional survey research design since it provides accurate means of assessing information and help in collecting uniform and comparable data that captures respondents' similarities and differences across the sampled organizations to enrich the study findings. The target population that formed the units of analysis for this study comprised of all the 152 firms licensed under the EPZ programme in the three Kenyan cities; Nairobi, Mombasa & Kisumu. According to the Export Processing Zones Authority, the licensed number of operating enterprises as at the close of the year 2016 was 152 firms spread across the three Kenyan cities. A census technique was employed in order to include all the 152 enterprises with senior or middle management level employees in the finance or accounting departments as the respondents. Primary data was gathered using structured questionnaires and captured through a 5-point type Likert scale

questionnaire. Statistical Package for Social Sciences (SPSS) was used in the analysis of data. Reliability and validity tests were conducted to determine the internal consistencies of the variables under investigation. The data was further analyzed by use of descriptive and inferential statistics. Analysis of Variance (ANOVA), multiple regression and correlation analysis was carried out to test the hypothesis. Results were presented on frequency tables.

6. Results And Discussions

6.1. Response Rate

The number of questionnaires, administered to all the respondents, was 152. A total of 127 questionnaires were properly filled and returned from various firms in the Export Processing Zones in Kenya. This represented an overall successful response rate of 84%. According to Mugenda and Mugenda (2003), a response rate of 50% or more is adequate. Babbie (2004) also asserted that questionnaire return rates of 50% are acceptable to analyze and publish, 60% is good while a return rate of 70% is considered as a very good response rate.

6.2. Descriptive Statistics

To establish the extent to which cost of tax compliance influences tax compliance among investors in the Export Processing Zones in Kenya, various results were deduced. Table 1 shows that the respondents felt that there was a lot that can be done on their tax systems to ease the work of preparation of tax returns and payment with a mean of 4.09. The statement on whether the Kenya Revenue Authority had put in place enough measures to ensure that taxpayers knew their tax obligations and reparations of non-compliance attracted a mean of 4.05. The statement on if the taxpayers were able to correctly calculate the taxes due and pay had a mean of 3.97. In addition, the respondents agreed that they used professionals to compute and file their tax returns with a mean of 3.97, while the statements on whether there were high costs associated with Tax compliance; and if they were aware of the tax due dates that related to their business and if tax compliance costs were always lower than penalty costs had mean scores of 3.89, 4.06 and 4.10 respectively. The mean score for the responses for this section was 4.02 indicating that majority of the respondents agreed that tax compliance costs is a key determinant of tax compliance among investors in the Export Processing Zones in Kenya.

Results are in corroboration with Kemboi and Tarus (2012) who examined determinants of tax compliance in Kenya for the period between 2007 to 2009 using quarterly secondary data and indicated that factors like tax compliance cost, fines and penalties, perceived opportunity for tax evasion and tax knowledge and education are important determinants of tax compliance. Similarly, Olweny and Omondi (2011) investigated the effect of determinants of tax compliance on the firms listed at the Nairobi Securities Exchange, Kenya and found out that tax compliance costs and perceived opportunity for tax evasion affect tax compliance levels among firms.

Table 1: Cost of Tax Compliance Descriptive Statistics

Statement	Mean	Std. Deviation	Coefficient of Variance
We feel that there is a lot that can be done on our tax systems to ease the preparation, filing and payment of taxes.	4.090	1.054	0.258
KRA has put in place enough measures to ensure that taxpayers know of their tax obligations and reparations of non-compliance.	4.050	1.007	0.249
We are able to correctly calculate the taxes due and payable by ourselves.	3.970	1.105	0.278
We hire professionals to compute and file our tax returns.	3.970	1.221	0.308
There are high costs associated with Tax compliance.	3.890	1.280	0.329

We are aware of the tax due dates that relate to our business.	4.060	1.112	0.274
Tax compliance costs are always lower than penalty costs.	4.100	1.246	0.304
Average	4.020	1.146	0.285

KRA – Kenya Revenue Authority

7. Regression Analysis

Regression analysis was conducted to empirically determine whether cost of tax compliance was a significant determinant of tax compliance. The coefficient of determination R^2 and correlation coefficient (r) shows the degree of association between the independent and dependent variable. The results of the linear regression indicate $R^2 = 0.695$ and $R = 0.834$ as shown in Table 2. This is an indication that there is a strong relationship between the independent variable; cost of tax compliance and tax compliance. From the model summary R squared of 0.695 indicates that 69.5% of the variations in tax compliance are explained by the variations in cost of tax compliance. Therefore, further research should be conducted to investigate the other factors that influence tax compliance among Export Processing Zones investors in Kenya.

Table 2: Model Summary for Cost of Compliance

Indicator	Coefficient
R	0.834
R Square	0.695
Adjusted R Square	0.693
Std. Error of the Estimate	0.50245

The cost of tax compliance coefficients are presented in Table 3. The results show that cost of tax compliance contributes significantly to the model since the p-value for the constant and gradient are less than 0.05. The findings imply that one positive unit change in cost of tax compliance leads to a change in tax compliance at the rate of 0.756.

Table 3: Coefficients of Cost Compliance

Variable	Beta	Std. Error	t	Sig.
Constant	0.445	0.183	2.436	0.016
Cost of Compliance	0.756	0.045	16.889	0.000

8. Conclusions

The cost of tax compliance plays a key role in determining the level of compliance. The costs include both direct and indirect tax costs such as auditing costs, costs of hiring personnel and experts for the purposes of tax compliance. The study concludes that cost of tax compliance is statistically significant in explaining tax compliance. The findings imply that taxpayers will comply more when the tax compliance costs are lower and the tax system adequately simplified.

The respondents also confirmed to incur costs in engaging the services of tax agents and tax professionals to handle tax filing issues. This cost is normally a burden to the firms.

9. Recommendations

From the study findings; The government needs to actively engage business enterprises in regular sensitization meetings on proper record keeping geared towards simplified tax preparations, returns filing as well as tax payments. As such, evaluation of procedural elements geared at growing levels of tax compliance should be explored. Taxpayers should also be sensitized on basic tax calculations to reduce the indirect costs associated with tax compliance.

10. Areas for Further Study

This study focused on the Export Processing Zones investors in Kenya. It is imperative to undertake similar studies on other countries running Export Processing Zones programmes. The research should also be carried out on firms operating under the newly introduced Special Economic Zones programme and compare their findings with this study.

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