ISSN 2349-7807

International Journal of Recent Research in Commerce Economics and Management (IJRRCEM)
Vol. 1, Issue 3, pp: (60-75), Month: October - December 2014, Available at: www.paperpublications.org

FACTORS AFFECTING TAX COMPLIANCE AMONG SMALL AND MEDIUM ENTERPRISES IN KITALE TOWN TRANS-NZOIA COUNTY, KENYA

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Abstract: **This study seeks to establish factors affecting tax compliance by Small and Medium Enterprises, with special emphasis on Income Tax and Value Added Tax and their effects on government revenue. 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. The objectives of the study include establishing the influence of compliance cost, fines and penalties and attitudes of tax compliance among Small and Medium Enterprises. The study adopts a descriptive research design involving both qualitative and quantitative research methodology. The target population was 200, out of which a sample size of 132 respondents were drawn, using stratified and simple random sampling. Questionnaires were used to collect primary data from the respondents, which were analyzed using SPSS applying both descriptive and inferential analysis. There was a positive relationship between the tax and compliance cost (r=.514), fines and penalties (r=.415) attitudes (r=.546) and tax compliance. The findings showed that compliance cost, fines and penalties and attitude had significant relationship with tax compliance. It is recommended that the tax system should provide a clear and simple guideline on how to fill tax returns but also enhance taxpayer education services to enable the taxpayers understand their rights and obligations as taxpayers, there should be moderate levels of fines and taxes so that SMEs are encouraged to comply since they will keep accurate records for taxation purposes in order to avoid fines and penalties.**

Keywords: **Direct tax, Indirect tax, Medium enterprise, Productive expenditure, tax evasion, tax impact.**

1. INTRODUCTION

To date, the pervasiveness of tax noncompliance remains of serious concern to the majority of tax administrators around the world. Tax noncompliance not only poses a serious threat to effective tax and voluntary compliance; it also has a negative impact on the economy. In 2008/2009, Her Majesty's Revenue and Customs (HMRC) estimated the United Kingdom tax gap to be around £42 billion, and of this, £15 billion was due to tax fraud, evasion and some criminal activities (HMRC, 2010). Whilst the Inland Revenue Board of Malaysia (IRBM) reported that the additional taxes and penalties of 2010 amounted to about RM1, 013.63 million of the finalized audited corporate tax cases Inland Revenue Board of Malaysia, (IRBM, 2010). The rising tax noncompliance has urged the government and tax administrators to examine the factors that cause tax noncompliance.

ISSN 2349-7807

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In developing countries, tax noncompliance is a serious challenge facing income tax administration and hindering tax revenue performance. Despite the various tax reforms undertaken by governments to increase tax revenue over the years, prior statistical evidence has proven that the contribution of income taxes to the government's total revenue remained consistently low and is relatively shrinking (Alabede et al., 2011). However, from all the taxes, personal income tax has remained the most disappointing, inefficient, unproductive and problematic tax system (Kiabel & Nwokah, 2009).

Compliance costs involved in taxation are major impediments to elicit compliance behaviour of taxpayers. It is also believed by most tax policy researchers that compliance costs for tax payment are quite high especially for SMEs, which lack knowledge and skills of the tax laws and regulation (Shome, 2004). Sometimes the administration of income tax creates problems for business taxpayers when it imposes burdensome reporting and record keeping requirements. This has led to increased costs of tax for those who try to comply with the tax law (Baurer, 2005). Likewise most governments in developing economies have not adequately taken taxpayer compliance costs into account when designing tax rules, yet such expenses fall on to the taxpayers in form of reduced work effort or saving (Bankman, 2005), time spent on tax compliance process and monetary expenditures on salaries, overheads and seeking assistance from experts (Munnich, 2004).

Consequently, developing countries are still characterized by the low tax compliance levels, in the face of the numerous advocacies for voluntary compliance (Ayoki, 2008). Many of their governments have adopted tax compliance administrative measures like penalties, rates and tax audits to ensure tax enforcement instead of compliance (Kayaga, 2007). Moreover the tax regime is oriented more towards consumption taxes rather than income taxes. This has been accompanied by lower ratio of tax revenue to GDP of (21.2%), as compared to that of Namibia (31%), Uganda (13.5%), Mauritius (19.6%), Zambia (19.4%), Burundi (19%), Ghana (17.2), and Malawi (15.9%) in Sub-Saharan African countries with similar tax structure in 2006/07 (Ayoki, 2008).

Besides the tax potential of the informal sector (SMEs) in developing countries is partially exploited given the fact that most enterprises have small profits and do not keep accurate financial records (Bonjean and Chambas, 2001), hence the tax revenue contribution made by these enterprises especially the small enterprises in terms of presumptive tax to total tax revenue is insignificant (i.e. less than 0.5% of total tax). Although a lot has been done on tax compliance in relation with tax rates, penalty, social norms, tax administration and tax fairness, it is not clear whether tax competencies and compliance costs suffered by SMEs influence compliance levels. Most large companies have their roots in Small and Medium Enterprises suggesting that the future large corporations are the Small and Medium Enterprises of today that that must be nurtured to ensure their growth. Thus, Small and Medium Enterprises are generally perceived to be the seedbed for indigenous entrepreneurship and generate all the many small investments, which would otherwise not have taken place (Aryeetey & Ahene, 2004).

Taxes play an important role in the budget of any economy and one of the main reasons why the government imposes taxes is to generate income to manage the economy and redistribute resources. Over the years, the Kenya government has undertaken various revenue administration reforms aimed at enhancing revenue collection (Masinde and Makau, 2010). One of the measures that have been implemented in order to increase revenue collection in Kenya was the introduction of self-assessment systems (SAS) in 1992. The objectives of this system was to increase voluntary compliance, reduce tax authorities‟ burden of assessing tax returns and increase tax collection efficiency (reduce tax collection costs) (Masinde and Makau, 2010). However despite various administrative reforms, levels of tax compliance have remained quite low. A study conducted by KRA, KIPPRA and the Treasury, based on 1999/2000 data revealed that VAT payment compliance was as low as 55% while return lodgment compliance was 65% (Masinde and Makau, 2010).

Tax noncompliance is a substantive universal phenomenon that transcends cultural and political boundaries and takes place in all societies and economic systems. There many studies that explain the behavior of tax compliance in a more realistic situation. They focus on the determinants of tax compliance, respectively on economic and non-economic factors (Nicoleta, 2011). Tax non-compliance is an area of concern for all government and tax authorities, and it continues to be an important issue that must be addressed. Regardless of time and place, 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.

This research therefore is aimed at evaluating the factors that encourage non-compliance with tax obligation by Small and Medium Enterprises and consequently determine if government tax policies tops the list. In doing this, a study was conducted using Small and Medium Enterprises in Kitale, Trans-Nzoia County, Kenya.

1.2 Statement of the Problem

Taxpayers' behavior towards tax system has evoked great attention among many Revenue Authorities in the world especially in developed countries. However, it is debatable on what has been done towards the study of taxpayers behavior towards tax system in developing countries as they concentrate more in studies which would increase their budgets bottom-line in terms of huge revenue collection and enforcement efforts at the expense of studies on taxpayers behavior which would make increase in this tax revenue to be realized and enforcement efforts work.

1.3 General Objective

To assess factors affecting tax compliance among Small and Medium Enterprises.

1.4 Specific Objectives

a) To determine the effect of compliance cost on tax compliance level

b) To assess the effect of fines and penalties on tax compliance level

c) To establish relationship between attitudes and tax compliance behaviour among Small and Medium Enterprises.

1.5 Significance and Justification of the Study

The study will help the government and/or its agents during tax policy formulation and execution.

Small and Medium Enterprises will also find this study useful in that it will help them understand the moral obligations behind tax payment.

The study results shall also act as a useful source of information for reference purposes by students, scholars, businessmen and other interested parties who are desirous to make sound decision upon getting informed.

1.6 Scope of the Study

The research study shall cover Small and Medium Enterprises operating in Kitale central business district. The target population shall comprise of small and medium business enterprise operators because the problem of tax compliance is rampant as evidenced by the absence of electronic tax register (ETR Machine) among others. The study area was most suitable because it has the relevant, adequate and diverse target population to enable the researcher pick the sample size required, from which to obtain desired data.

2. LITERATURE REVIEW

The definition of tax compliance in its most simple form is usually cast in terms of the degree to which taxpayers comply with the tax law (James & Alley, 2004). Tax compliance is multi-faceted measure. The Organization for Economic Cooperation and Development (2001) advocates that ‘Compliance’ is divided into categories, considering the definition of tax compliance. These categories are administrative compliance and technical compliance. Theoretically, it can be defined by considering three distinct types of compliance such as payment compliance, filing compliance, and reporting compliance (Brown and Mazur, 2003). 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 (Silvani, 1992) and hence reduce tax gap (difference between taxes paid and owed for all taxes and all taxpayers) and “compliance gap.” However, tax compliance, according to Cobham (2005), is a problem for many countries as measured by tax to GDP ratio although it has been improving for many countries. For example, it is 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 (the recommended rate). It remains a big challenge to low income countries. This has promoted radical tax reforms in countries like Bolivia, Uruguay, Colombia, Jamaica and Spain with notable success (Bird & De Jantscher, 1992).

ISSN 2349-7807

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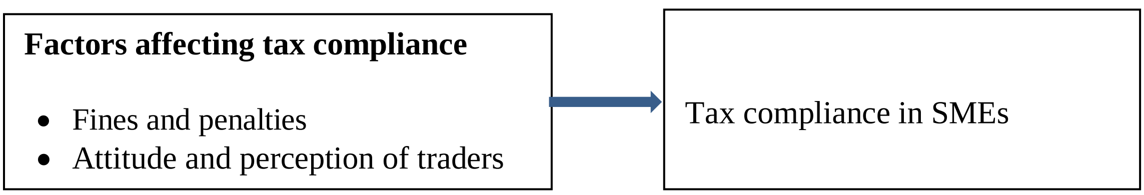
Tax compliance has also been segregated into two perspectives, namely compliance in terms of administration and compliance in terms of completing (accuracy) the tax returns (Chow, 2004). Tax Compliance in pure administrational terms therefore includes registering or informing tax authorities of status 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).

Decades of empirical work on tax compliance has produced awareness of the complexity of tax compliance and non-compliance globally. (Masinde and Makau, 2010) point out that tax compliance itself is now recognized as multifaceted construct. Many scholars such as Jackson *et al.* (1986) have put forward some explanatory variables in analysis of tax compliance behavior. In the midst of enormous diversity, a notably consistent theme over the past two decades of tax research has focused on identifying the costs, be they material, social or psychological, which would deter would-be evaders and counter the lure of the benefits of evasion. A preoccupation with identifying costs and benefits with the goal of developing a risk profile for tax collection agencies has meant that less attention has been directed towards managing non-compliance once it has occurred (Masinde and Makau 2010). Based on the available literature, the dominant environmental factors currently shaping the performance of revenue administrators in developing countries are globalization, large informal sectors and limited administrative capacity. Tax policy and administrative reforms generally have one or several of the following objectives: Increasing the equity of the tax system, creating an enabling environment for private sector development, Increasing revenue collection or compliance. On the implementation side, the challenge to coordinate policy reforms with parallel reforms in tax administration has rarely been fully addressed yet the menu of administrative reform options has been greatly enriched with new approaches to organizational design, taxpayer services, ICT solutions, human resource incentives and formal anti-corruption strategies. Compliance management is no longer based purely on an enforcement –focused approach, but on a combination of enforcement and enhanced taxpayer services.

The issue of tax compliance is extremely important both to those concerned with the key role the increased tax yields can play in restoring macroeconomic balance and those concerned with tax policy and its effects on the economy in general. The level of tax collection though important is an unsophisticated measure of the effectiveness of tax administration. A more accurate measure is the level of compliance. Facilitating compliance involves such elements as improving services to taxpayers by providing clear instructions, easy to fill forms and assisting and educating them on their duties and obligations. Monitoring compliance requires establishing and maintaining current accounts of taxpayers and management information systems covering both ultimate taxpayers and third party agents such as banks involved in the tax system as well as appropriate and prompt procedures to detect and follow up on non-filers, nil filers and delayed payments. Deterring noncompliance requires establishing both a reasonable risk of detection as well as applying penalties effectively. The ideal approach is to combine these measures so as to maximize their effect on compliance as it were, to move a country from a “low compliance to a high compliance environment”(Masinde and Makau 2010).

2.1 Conceptual Framework

The research adopted a conceptual framework where factors affecting tax compliance will be taken as an independent variable while tax compliance was itemised as dependent variable as illustrated in the Conceptual figure 2.1.



Independent variables Dependent Variable

Figure 2.1: Conceptual Framework: Factors affecting tax compliance.

2.2 Tax Compliance Cost

The costs of complying with tax obligations have generated widespread interest among academics, government policy makers and business organizations. Contemporary research in the area was pioneered by Sandford who examined the cost of complying with Valued Added Tax (VAT) and other taxes for taxpayers in the United Kingdom (UK) in the 1970s and 1980s (C Sandford, M Godwin and P Hardwick, 1989). Sandford (1989) defined Tax compliance costs as the costs Acknowledging the fact that high compliance costs diminish competitiveness of the country in terms of taxation attractiveness, public services have become increasingly interested in ways to simplify their tax legislation systems. Slemrod and Yitzhaki (1996) identified compliance costs as one of the three components of the social costs of taxation. These social costs can be paraphrased as costs incurred by society in the process of transferring purchasing power from the taxpayers to the government. Administrative costs are the costs that exist besides the occurrence of compliance costs that are borne by the companies. These costs are cited as costs that the government must also take into account as a public cost to ensure that the tax legislation is obeyed. For example, it obtains the costs to collect taxes and to maintain the system to collect the taxes. These are to some extent substitutable, for example when a country transfers from a system where the tax office calculates the tax owed, to a self- assessment system. Compliance costs can be divided into three parts: time spent, cash expenses and psychological costs. The total time spent contains employee costs (in-house staff) and external costs (fees paid to outside accountants and other advisors). These compliance costs include costs that are incurred by a company, but are beyond the control of its management (Hijattulah and Pope, 2008).

2.3 Fines and Penalties

Fines and penalty rates may substitute each other due to their multiplicative linkages as long as neither of them is set to zero (Kirchler et al 2007). Higher fines simply make evading taxes more hazardous for taxpayers and should deter them from evasion. Empirically, the deterrent effect of fines could not always be supported. The observed effects were weaker than expected and some studies even suggest that an increase of penalties can have undesirable effect and result in more tax avoidance (Kirchler et al, (2007). Alm et al., (1992) supports the evidence that fines do affect tax compliance though the impact was virtually zero. From the tax administration viewpoint, researchers have concluded that compliance could be influenced by educating taxpayers of their social responsibilities to pay and thus their intention would be to comply. As a behavior problem, tax compliance depends on the cooperation of the public. There are greater gains in assisting compliant taxpayers meet their fiscal obligations rather than spending more resources pursuing the minority of no-compliers. Assisting tax payers by improving the flow and quality of information or education them (e.g., TV campaigns) in to becoming more responsible citizens has the potential to yield greater revenue than if it were spent on enforcement activities.

2.4 Attitude and Perceptions towards Tax Compliance

While taxpayers are influenced by the system of tax structure either to comply or not, evidence suggest that attitude and perceptions of the taxpayer also play an important role in their compliance decisions. These involve perceptions of government spending, perceptions on the fairness of the system, poor social influence and the ethics and attitudes towards compliance.

3. RESEARCH METHODOLOGY

This study employed qualitative and quantitative research design that enabled collection of requisite information about the factors that affect the tax compliance among Small and Medium Enterprises. The target population was derived from the small scale business operators deemed knowledgeable of basic tax laws and policies such as restaurants, small scale professional practitioners such as Lawyers, Accountants, Debt collectors, Property agents, and Telecommunication shops. To ensure fair representation of the target population, the selection of Small and Medium Enterprises, from which to pick samples, was done using both purposive sampling and simple random sampling. Minimum sample size of 132 respondents was proportionately selected from the target population to participate in the study. Primary data was collected at source by the researcher through direct communication with the respondents using questionnaires. The major sources of this data are extracts from the Small and Medium Enterprises records, research reports and abstracts. A comprehensive questionnaire with structured questions was administered to the respondents sampled. Data was summarized using descriptive statistics such as mean standard deviation, frequencies and percentages, which helped in meaningfully describing the distribution of responses. Pearson’s correlation coefficient was used to establish relationships between variables.

ISSN 2349-7807

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4. RESEARCH FINDINGS AND DISCUSSION

4.1 Years worked in the Small and Medium Enterprises

The more a business person is experienced the more he or she can run their Small and Medium Enterprises as shown in Figure 4.5. From the study 46 (37.1%) of respondents, had between 6 and 10 years of working experience in the organization, with 27.4% having between 11 and 15 years and 21% having below 5 years of experience. The findings indicate that most of the respondents had worked in the organization for more than 6 years, experience enough to know about tax matters.

Figure 4.1 Years worked in the Small and Medium Enterprises

4.2 Age of Business

The longer a business has been in existence the more the entrepreneur run their Small and Medium Enterprises as shown in Figure 4.7. From the study 49 (39.5%) of respondents, identify that the business has been in existence for between 4 and 8 years, with 22.6% exist between 9 and 15 years and 17.7% in existence for more 15 years in existence. The findings indicate that most of the respondents had been in existence for more than 4 years and hence they are likely to know and understand taxation.

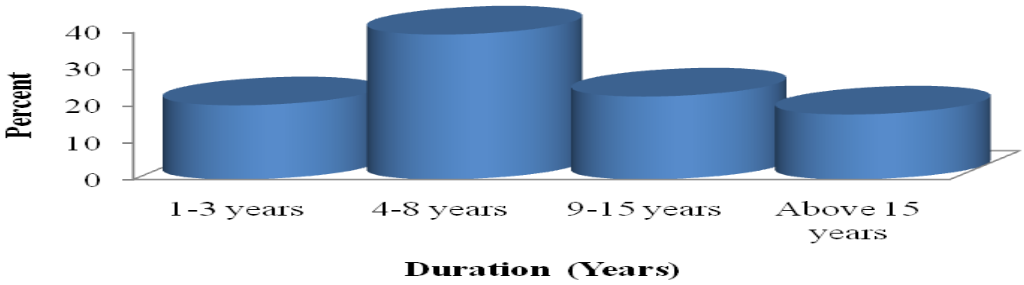

Figure 4.2 Period the business has been in existence

4.3 The Annual Turnover

From the study the 26.6% of the SMEs earned between 5,000,001 and 10,000,000, however 23.4% between 10,000,001 and 20,000,000 and 20.2% had a turnover of between 1,000,001 and 5,000,000 as shown in Table 4.1. Most of the firm's 83.1% had annual turnover above 1,000,001 and only 16.9% of the enterprises had an annual turnover below 1million. The results reveal that most of the SME have their annual turnover below 20 million.

Table 4.1. The Annual Organization Turnover

	Frequency	**Percent**
0 - 1,000,000	21	16.9
1,000,001 - 5,000,000	25	20.2
5,000,001 - 10,000,000	33	26.6
10,000,001 - 20,000,000	29	23.4
20,000,001 - 50,000,000	11	8.9
Above 50,000,000	5	4.0
Total	**124**	**100.0**

ISSN 2349-7807

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4.4 Tax Compliance

The respondents were requested to establish the extent they agree or disagree with statements relating to the tax compliance in SMEs in Kitale. From the study descriptive statistics which included the mean, standard deviation was used to determine the extent of tax compliance among SMEs in Kitale as summarized in Table 4.4. From the study the mean of each statement explaining tax compliance was computed from the five likert scale and the overall mean was obtained. After computation the mean of below 1.5 represented strongly disagree; between 1.55 and 2.45 represent disagree; a mean ranging between 2.55 and 3.45 uncertain; with a mean of between 3.55 and 4.45 agree and any mean above 4.55 comprised of strongly agree. These findings indicated that the overall mean score of tax compliance was 2.93 indicating that most of the respondents were not sure on compliance with respect to taxation. The respondents were not certain that KRA had never threatened them on an outstanding bill (mean of 3.06) and paying their KRA bills first before any other bills (2.92). Also they were not sure that they do not have an outstanding debt with KRA (2.65) and KRA had never penalized hem when they did not pay taxes on time (2.9). From the study most of the respondents agreed that they have never under declared income for tax assessment with a mean of 3.2, pay tax in time (3.1) and delay to pay tax KRA were penalized (3.1). The respondents were neutral with respect to have ever given wrong reports to KRA for assessment of their tax liability (2.67), disclose all income earned for tax purposes (2.86) and never failed to submit return to KRA (2.83). Also they were not certain on delayed to pay taxes (2.95), pay actual tax amount assessed (2.86) and had never attempted to avoid taxes (3.00).

Table 4.2 Tax Compliance of SMEs

	Mean	Std. Deviation	Skewness	Kurtosis
KRA has never threatened us about an outstanding bill	3.0565	1.15683	-.080	-.628
We pay our KRA bills first before any other bills	2.9194	1.39451	.091	-1.313
We do not have an outstanding debt with KRA	2.6452	1.22437	.575	-.658
KRA has ever penalized us when we did not pay taxes on time	2.8548	1.32943	-.109	-1.220
We have ever given wrong reports to KRA for assessment of our tax liability	2.6694	1.29867	.435	-.962
We have never under declared income for tax assessment	3.1694	1.35384	-.094	-1.293
We disclose all income earned for tax purposes	2.8548	1.18042	.407	-.721
We never fail to submit return to KRA	2.8306	1.31731	.015	-1.263
We have never delayed to pay taxes	2.9516	1.39602	.124	-1.338
We pay actual tax amount assessed	2.8548	1.16656	-.150	-1.028
We pay tax in time	3.0565	1.31472	-.127	-1.186
When we delay to pay tax KRA penalizes us	3.0484	1.34862	-.089	-1.253
We have never attempted to avoid taxes	2.9919	1.21973	.207	-.929
Overall mean	**2.9282**	**.39971**	**.779**	**1.191**

The tax compliance of SMEs in Kitale was found to be average, since the mean was 2.93. This agree with Terkper, (2003) that many small and medium taxpayers do not register voluntarily, while those who do register often fail to keep adequate records, file tax returns, and settle their tax liabilities promptly. The findings indicate that some of the SMEs were uncertain on their compliance and concurs with Ahmed & Braithwaite (2005) that in the small business context, opportunities for evasion are high and resources are often scarce for field auditing. Even when high investments are made in auditing, uncovering 'hidden cash' is never going to be an easy task without an adequate audit trail.

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4.5 Relationship between compliance cost and tax compliance among Small and Medium Enterprises

Pearson Product Moment Correlation Coefficient was used to establish the relationship between compliance cost and tax compliance among Small and Medium Enterprises as summarized in Table 4.4. There was a positive relationship between the compliance cost (r=.514, n=124, p<.05) and tax compliance. This indicated that an increase in compliance cost the tax compliance improves.

Table 4.3 Relationship between compliance cost and tax compliance among Small and Medium Enterprises

		Tax Compliance	Compliance cost
Tax Compliance	Pearson Correlation	1	
	Sig. (2-tailed)		
Compliance cost	Pearson Correlation	.514**	1
	Sig. (2-tailed)	.000	

***. Correlation is significant at the 0.01 level (2-tailed).*

The findings showed that compliance cost had positive relationship with tax compliance. It agrees with Hijattulah and Pope (2008) as costs incurred by a company, but are beyond the control of its management, hence tax compliance cost is likely to affect tax compliance in the SMEs.

4.6 Relationship of fines and penalties on tax compliance among Small and Medium Enterprises

Pearson Product Moment Correlation Coefficient was used to establish the effect of fines and penalties on tax compliance among Small and Medium Enterprises as summarized in Table 4.11. There was a positive effect of fines and penalties on compliance cost (r=.415, n=124, p<.05) and tax compliance. This indicated that an increase in fines and penalty the tax compliance improves.

Table 4.4. Effect of fines and penalties on tax compliance among Small and Medium Enterprises

		Tax Compliance	Fines and penalty
Tax Compliance	Pearson Correlation	1	
	Sig. (2-tailed)		
Fines and penalty	Pearson Correlation	.415**	1
	Sig. (2-tailed)	.000	

***. Correlation is significant at the 0.01 level (2-tailed).*

The observed effects were weaker than expected and some studies even suggest that an increase of penalties can have undesirable effect and result in more tax avoidance (Kirchler et al, (2007). The higher the penalty and the potential audit probability the greater discouragement for potential tax evasion. On the one hand fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on tax payers.

4.7 Relationship between attitudes and tax compliance behaviour

Pearson Product Moment Correlation Coefficient was used to establish the relationship between attitudes and tax compliance among Small and Medium Enterprises as summarized in Table 4.14. There was a positive relationship between attitudes (r=.546, n=124, p<.05) and tax compliance. This indicated that an increase in attitude of SMEs the tax compliance improves.

Table 4.5 Relationship between attitudes and tax compliance behaviour

		Tax Compliance	Attitude
Compliances	Pearson Correlation	1	
	Sig. (2-tailed)		
Attitude	Pearson Correlation	.546**	1
	Sig. (2-tailed)	.000	

***. Correlation is significant at the 0.01 level (2-tailed).*

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The attitude of SMEs towards tax influenced the tax compliance. This agrees with Eriksen and Fallan (1996) that taxpayer's attitude towards tax system has influence on reinforced desire toward tax evasion and compliance. Chan et al. (2000) reported that Hong Kong taxpayers have less favorable attitude towards tax system as a result lower level of compliance. Business owners are often mentioned as a high-risk group in terms of tax compliance because their opportunities to evade are high. Also it agrees with Oriviska and Hudson (2002) that attitudes to tax evasion are condoned by large number of people who are particularly benefiting from it.

4.8 Model Summary on Tax Compliance

The R^2 represented the measure of variability in tax Compliance that is accounted for by the predictors (independent variables which include fines and penalties, compliance cost and attitude). From the model, (R^2 = .635) shows that all the predictors account for 63.5% variation in tax Compliance (Table 4.15).

Table 4.6 Model Summary on Tax Compliance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df 1	df2	Sig. F Change	Durbin-Watson
1	.797[a]	.635	.623	.19690	.635	51.796	4	119	.000	1.687

The value of adjusted R^2 was .623, showing that the prediction of tax compliance account for approximately 62.3% less variance. The change statistics were used to test whether the change in adjusted R^2 is significant using the F ratio. The model caused adjusted R^2 to change from zero to .635 and this change gave rise to an F ratio of 51.80, which is significant at a probability of .05.

4.9 Analysis of Variance on Tax Compliance

The analysis of variance was used to test whether the model could significantly fit in predicting the outcome than using the mean as shown in (Table 4.7). The F- ratio represents the ratio of improvement in prediction that results from fitting the model, relative to the inaccuracy that exists in the model. The F- ratio was 51.80 which is likely to happen by chance and was significant (P<.05). The model significantly improved the ability to predict the tax compliance. Thus the model was significant. This represented the effect size of the regression model and was significant with a p-value of 0.000.

Table 4.7 Analysis of Variance on Tax Compliance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.032	4	2.008	51.796	.000[b]
	Residual	4.613	119	.039		
	Total	**12.646**	**123**			

The regression results in table 4.8 show that each of the predicted parameters in relation to the independent factors were significant with fines and penalty contributing 88%, attitude 28.7% and Compliance cost 26.7 % to tax compliance.

Table 4.8 Coefficients on Tax Compliance

Model		*Un standardized Coefficients*		*Standardized Coefficients*	*t*	*Sig.*	*Collinearity Statistics*	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-0.057	0.219		-0.26	0.795		
	Fines and penalty	0.088	0.025	0.212	3.506	0.001	0.839	1.192
	Compliance cost	0.268	0.065	0.256	4.128	0	0.799	1.251
	Attitude	0.287	0.056	0.315	5.132	0	0.813	1.23

5. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Relationship between compliance cost and tax compliance among Small and Medium Enterprises

From the study the overall tax compliance cost were found to be average with a mean of 2.82 and standard deviation 0.33. There was a positive relationship between the compliance cost (r=.514, n=124, p<.05) and tax compliance. This indicated that an increase in compliance cost the tax compliance improves. The findings showed that compliance cost had positive relationship with tax compliance.

5.2 Relationship between fines and penalties on tax compliance among Small and Medium Enterprises

From the study the fines and penalty factor was rated average by the respondents in influencing SMEs tax compliance. There was a positive effect of fines and penalties on compliance cost (r=.415, n=124, p<.05) and tax compliance. This indicated that an increase in fines and penalty the tax compliance improves. The higher the penalty and the potential audit probability the greater discouragement for potential tax evasion.

5.3 Relationship between Attitudes and Tax Compliance Behaviour among Small and Medium Enterprises

The findings on attitudes and tax compliance behaviour among Small and Medium Enterprises was found to have a mean of 2.95. There was a positive relationship between attitudes (r=.546, n=124, p<.05) and tax compliance. This indicated that an increase in attitude of SMEs the tax compliance improves. From multiple linear regression model (R^2 = .635) shows that all the predictors account for 63.5% variation in tax Compliance. The model significantly improved the ability to predict the tax compliance. The findings showed that tax competence, compliance cost, fines and penalties and attitude had significant relationship with tax compliance.

5.4 Conclusion

These study findings provide direct evidence that there was significant influence of tax compliance cost, fines and penalty and attitudes on tax compliance. The fines and penalties play a vital role in improving tax compliance.

5.5 Recommendations

i. The study finds strong support for the argument that fines and penalties impacts highly on tax compliance, thus there should be moderate levels of fines and taxes to employ. This way, SMEs will be encouraged to comply since they will keep accurate records for taxation purposes in order to avoid fines and penalties.

ii. Tax compliance cost had a profound effect on tax compliance. The findings suggest tax systems with low tax compliance costs are most likely to be complied with. Therefore, the tax compliance cost should be in a way that does not encourage taxpayers to evade tax.

iii. Attitude of tax has a significant influence on tax compliance, therefore the tax system should target individuals at all levels of income to seal loopholes that may encourage tax evasion.

iv. Tax systems should also enhance surveillance and monitoring to ensure that all the taxpayers are brought into the tax net.

5.6 Further Research Recommendations

In future, researchers should replicate this study to cover the whole country. A study on the self-assessment system can also be carried out to determine its effectiveness on enhancing tax compliance levels. Further the study should also put into consideration the influence of Economic conditions on tax compliance.

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