ADOPTION OF TURNOVER TAX IN KENYA: A SNAPSHOT OF SMALL AND MEDIUM ENTERPRISES IN GIKOMBA MARKET, NAIROBI KENYA

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ABSTRACT

Turnover tax was introduced in Kenya in 2007 to enhance revenue collection, improve tax administration and reduce compliance and collection costs. On turnover tax recruitment, the performance has on average been below 50% with 2,890 SMEs registering for turnover tax against a target of 6,928 between 2009 and 2010. Despite the benefits accrued from the use of turnover tax and the low adoption, very few studies have been done on the same. This leaves a wide knowledge gap which this study seeks to fill-in. This study sought to establish the factors affecting the adoption of turnover tax in Kenya. Specific objectives were to establish whether tax administration practices, turnover tax training and tax environment policy influence the adoption of turnover tax by SMEs in Gikomba Market in Nairobi, Kenya. The target population of the study was 1405 SMEs at Gikomba market. Stratified random sampling technique was used to identify the respondents. Results revealed that most Gikomba traders did not understand the administration and actually saw the tax computation as very tedious and complicated. Tax amount were not collected in a timely manner and that enforcement powers of the staff was applied injudiciously. The study concluded that Kenya .Revenue .Authority need to fully utilize the established channels to educate the traders on importance of proper accounting systems and tax compliance. Simplifying registration of businesses would enable majority of the small enterprise operators to comply with tax payment making it easy for adoption of turnover tax.

Key Words: *Turnover tax, Tax administrative practices, Small and Medium Enterprises*

INTRODUCTION

Tax is a pecuniary burden laid upon individuals or property owners to support the government (a payment exacted by legislative authority). It is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority and is any contribution imposed by government whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise, subsidy, aid, supply, or other name (Cobham, 2007). A turnover tax is similar to a sales tax or a value added tax (VAT), with the difference that it taxes intermediate and possibly capital goods. It is an indirect tax, typically on an ad valorem basis (meaning that they are based on the value of the good in question, rather than being flat taxes), applicable to a production process or stage. Turnover tax is at a very low rate compared to most taxes, but it is calculated on gross income without any deductions (KIPPRA, 2006).

Turnover tax is available to individuals (sole proprietors), partnerships, close corporations, companies and co-operatives and it is elective i.e. qualifying small businesses can choose to register for the standard tax system or for turnover tax. Unlike the income tax system that makes use of comprehensive inclusion rules and a reduction process that requires proof of expenditure to be maintained, the Turnover Tax will be calculated by simply applying a tax rate to a "taxable turnover" (McCluskey,2005). Nations that use a turnover tax have parameters in place to determine when such taxes should be assessed, and at what rate. Under a value added tax, a little bit more tax is paid at each stage to collect the desired amount. Cascade taxes, on the other hand, do not account for taxes already paid, with a new tax being collected at each phase (Parkin, 2006).

The turnover tax is a form of indirect tax, collected by third parties rather than the government itself. Businesses must comply with the aspects of the tax code concerning indirect taxes, collecting taxes as directed and logging transactions eligible for taxation. This information is submitted at the time that taxes are paid to demonstrate how much was collected on behalf of the government (Parkin, 2006). The structure of a turnover tax can vary. Some governments charge different amounts for different types of goods. This is intended to keep necessities affordable for everyone, while taxing luxuries. Turnover taxes can also be punitive in nature, designed to create a disincentive for buying particular products. Environmental regulations sometimes encourage this practice, taxing people more on purchases that are harmful to the environment (Cheeseman & Griffiths, 2005). According to a study done by KRA (2010), the main challenges that affect the TOT adoption rate are: large size of the SME sector making recruitment difficult, lack of training on TOT to staff, inadequate attention by the tax administration towards the informal sector, mobility of SMEs making compliance difficult and poor attitude towards government and taxation (Mwangi, Gachoka & Siagi, 2010).

Statement of the Problem

The large numbers of SMEs, their high turnover rates and their sheer diversity presents challenges to all administrations (Karingi, Wanjala, Pamba & Nyakang'o, 2005). Attempts have been made to bring the SMEs sector into the tax bracket by the introduction of TOT in 2008. But despite these efforts, by mid 2011, only 435 SMEs had adopted the tax system out of a possible 1405 SMEs in Gikomba market; representing a 31% uptake of TOT (KRA, 2011). This has increased the formality of the sector by making the tax system complex due to their inability to maintain books of accounts for their transactions and complexities that are inherent in the regular tax regimes (Okello, 2005).

Introduction of TOT is an affirmative action which was aimed at incorporating the SME sector into national taxation system. However, the performance of TOT has not been satisfactory and TOT revenue has been below average in most months since its inception. According to KRA (In total revenue collected from the TOT system is Kshs. 221 million against a target of Kshs. 645 million which is far from attaining the set target of creating an additional Kshs 2,400 million per year. On TOT recruitment, the performance has on average been below 50%. In year 2008/09, the number of SMEs which were registered with TOT was 10,605 against a target of 18,347. Between July 2009 and March 2010, 2,890 SMEs had registered with the TOT against a target of 6,928 (Mwangi, Gachoka & Siagi, 2010). This is a problem to the government in its endeavor to ensure that there is sufficient revenue to support its operations (Mwangi, Gachoka & Siagi, 2010). This study sought to investigate the factors affecting the adoption of turnover tax in Kenya. Specifically the study sought to establish the relationship between tax administration practices, TOT training & tax environment policy and the adoption of turnover tax by SMEs in Gikomba Market.

Conceptual Framework

Figure 2.1: Conceptual Framework
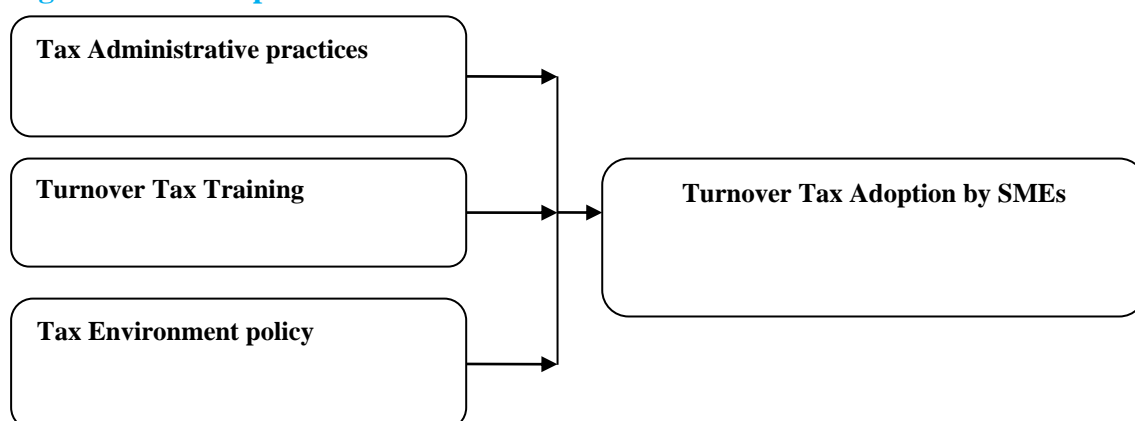
Research Methodology

The study adopted descriptive research design, a survey approach aimed at investigating challenges to turnover tax administration. A descriptive design is concerned with determining the frequency with which something occurs or the relationship between variables (Bryman & Bell, 2003). Thus, this approach was appropriate for this study, since the study intended to collect detailed information through descriptions and is useful for identifying variables. Mugenda (2008) noted that a descriptive design seeks to obtain information that describes existing phenomena by asking questions relating to individual perceptions and attitudes.

Research Findings and Discussion

From the findings, majority, 74.8% of the respondents disagreed they knew well the tax administration system while very few, 25.2% understood it as shown in the following figure 4.1 below. According to a study done by KRA (2010), the turnover tax implementation challenges faced were: owing to large size of the SME sector recruitment was difficult, lack of training on TOT to taxpayers made it difficult for them to understand the tax administration making compliance difficult. This means that from most of the explanations given, most small scale traders in Gikomba do not understand the administration process and that's the reason why most did not comply with it.

majority, 53.7% of the respondents indicated that tax compliance influenced adoption of turnover tax to a great extent. They were followed by, 31.7% of them who indicated to a very great extent. This concurs with Moyi & Muriithi, (2003) that a significant number of businesses also fail to register or file tax declarations. This only increases the burden on those taxpayers who try to comply with the tax law, and discourages their future compliance. The result is a vicious cycle which tends to preserve the status quo. Only meaningful reforms to the tax system can break the cycle and result in an improved business climate which will stimulate economic growth. From this outcome, it shows that most of the businesses saw the necessity of tax compliance in ensuring most businesses adopted the turnover tax system.

Majority, 41.5% of the respondents indicated that to great extent total businesses tax compliance costs tend to be higher for large companies, as a percentage of sales they are significantly higher for SMEs, while, 8.1% of the investors indicated to a little extent. For higher compliance burden for latter tax system, 65.9% investors in the busy market indicated it tends to discourage SME creation to great extent, according to a majority, 62.6% of them reducing tax compliance costs by lowering the overall tax burden on small businesses helps to a great extent achieve more neutral tax treatment of firms of varying sizes. This outcome, with small businesses placed at a competitive disadvantage relative to larger firms, implies an inefficient allocation of capital, with underinvestment in small businesses relative to a situation where

the fixed component of compliance burden on small businesses is lessened through simplification measures. (Thisen, 2003)

Correlation Matrix of the Variables

Table 4.2 illustrates that the correlation matrix shows that turnover tax is correlated to tax administration practices at 5 percent significance level (.743). The relationship between TOT training to adoption of TOT is high and positively correlated at 5 percent significance level (.601). This is because the more you get to train small and medium operators on TOT compliance, the more closer we will get to a fully adopted Turnover tax system. The tax environment policy is also positively correlated to adoption of turnover tax (.699) at 5 percent significance level. It is also indicated that there is correlation between the tax administration practices and tax environment policy to a lower significant level. Correlation analysis shows in general a high and positive relationship between all the independent variables and the dependent variable, that is, adoption of turnover tax therefore it is significant at 5 significant level and so we can rely on this to conclude that adoption of turnover tax is appropriate.

Table 4.2: Correlation Matrix of the Variables

	Tax administration practices	TOT training	Tax environment policy	Adoption of TOT
Tax administration practices	1			
TOT training	.211	1		
Tax environment policy	.449*	.301*	1	
Adoption of TOT	.743**	.601	.699	1

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

Table 4.3 shows the summary of how the three variables influence the level of SMEs adoption of the turnover tax by presenting the multiple correlation coefficient results. The results indicate that there is a strong correlation between the independent variables and the dependent variable (R= 0.8087, p= 0.49) which is statistically significant at 5%. With an adjusted R -squared of 0.56, it means that tax administration practices; TOT training and Tax environment policy explain 56% of the variations in adoption of Turnover tax for SMEs. This is in line with Mahon,(1997) study that the responsiveness, integrity, and quality of tax administration governed by tax laws must meet a very high standard and that an effective and efficient tax administration system is integral to any country's well being and dictates effectiveness of tax collection. Meaning it should be simple and comprehensible to all small and medium enterprises for them to comply with tax payment. This means that the three independent variables have an impact on the adoption of turnover tax which is the dependent variable.

Table 4.3 Multiple Correlation Coefficient (Model Summary)

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics			
				F Change	df1	df2	Sig. P Change
.7087	.5174	.56	.9593	.820	3	29	.049

Table 4.4 shows the results of the regression analysis based on the sign of the coefficient and the t-ratio. From the analysis the constant has a t-ratio of 3.6. This indicates that the other factors that affect adoption of turnover tax and have not been included in the model are statistically significant in determining the adoption. The constant is also positively related to the TOT implying that the impact of these factors which are not in the model will impact on adoption of TOT positively.

Table 4.4 Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.293	.201		3.6	.034
Tax administration practices	1.437	.441	.083	2.741	.515
TOT Training	.793	.408	.271	2.215	.050
Tax environment Policy	.961	.582	.389	2.139	.041

Dependent variable: adoption of TOT for SMEs

Tax administration practices are positively related to adoption of TOT and have the most statistically significant coefficient as indicated by a t-ratio of 2.741. This concurs with Moyi & Muriithi, (2003) that a significant number of businesses also fail to register or file tax declarations. This only increases the burden on those taxpayers who try to comply with the tax law, and discourages their future compliance. This implies that a one unit change in tax administration practices will change the adoption of TOT by 1.437 units. There is a positive relationship between adoption of TOT and TOT training. TOT training also has a statistically significant coefficient as indicated by a t-ratio of 2.215. This concurs with a study done by Jean, (2009) that lack of training initiatives have led to significant poor improvement in the introduction of payments of taxes through banks thus investor become reluctant to comply with policies of tax. This means that one unit change in the TOT training will change the adoption of TOT by .793 units.

The tax environment policy is positively related to the adoption of TOT. This is shown by the positive sign of the coefficient. The coefficient of tax environment policy is also statistically significant as indicated by a t –ratio of 2.139. On tax environment policy, the study found out that the tax environment policy affect turnover tax compliance by ways of increasing the complexity of the tax rules, increasing frequency of submitting tax returns and increasing the levels of government involvement in levying and collecting tax. This concurs with a study done by Wickerson, (2003) that in particular, certain measures such as reducing compliance cost may directly encourage business creation and tax compliance for some small businesses, but not others, suggesting the need to analyze a range of measures. This means that one unit change in tax environment policy will change the adoption of TOT by 0.961.

Table 4.5: T-Tables and T-Critical

Variables	T-values	T-critical
Tax administration practices	2.741	2.770
TOT training	2.215	2.770
Tax environment policy	2.139	2.770

Summary, Conclusions and Recommendations

This chapter highlights summary of key findings, conclusions and most importantly the Recommendations. All these attributes are guided by the research questions and the identified variables supporting the holistic study.

Conclusions

From the findings of this study it could be concluded that most traders who trade businesses in busy markets and other markets such Gikomba market do not understand the tax administration system in Kenya. From most of the explanations given, a common one was that most do not get to be taught on how it works and are usually busy to get to sit and understand the system. Thus most do not get to feel encouraged in paying taxes. It could be concluded that most of the traders feel discouraged with the system since it is always not simple and that the staff are usually not friendly to them or their businesses.

It could be concluded that very few of the tax administration staff have high level of integrity and thus the reason they normally get to harass and be violent in handling most of the owners of the small and medium businesses in Gikomba market. It can be sited that most of the small businesses find the tax computation tedious and that amount of tax is not collected in a timely manner and the enforcement powers of the tax administration is applied injudiciously and in a not so even handed fashion.

So most businesses believe that tax administered does not provide an even playing field for all businesses by ensuring all owners of the businesses meet their tax filing and paying requirement. It could be concluded that tax administration does not balance in educational and assistance role with its enforcement role and neither do the staffs respond to the needs of the clients meaning that it would be rare indeed to not hear complaints about the complexity and/or ambiguity of the tax laws, high tax rates, and the lack of an integrated fiscal strategy that takes social taxes, and local taxes and fees into account when determining the overall tax burden placed on the business community. Thus for this reason most of the traders experience difficulties in dealing with government in general and the tax administration staff. Some of the major recommended brought out by the SMEs included streamlining the administration system by removing corrupt officials, having a designated and comfortable place to carry out their business without disturbance from the tax administrators. This concurs with Moyi & Muriithi, (2003) that a significant number of businesses also fail to register or file tax declarations. This only increases the burden on those taxpayers who try to comply with the tax law, and discourages their future compliance.

It could be concluded that most owners of businesses trading in the market are usually not aware of the training on tax turnover. For those that are aware of the training, K.R.A conducts its training awareness

through seminars, using local media stations, mobile tax clinics and public barazas. From the explanations given it could be concluded that area such as how to calculate the tax payments and balancing their accounts afterwards, how to fill in the files while registering for the turnover tax and being taught the benefits that accrues from many businesses complying with the tax payment. Thus a majority can agree that training on TOT affects its adoption to a large extent. From the ones who knew about the training they knew how to calculate the turnover tax.

It can be concluded that training of TOT improves accounting standards of most businesses and that the businesses are able to grow as a result of proper bookkeeping and accounting. The approach that is used in the introduction of training on TOT is not that effective and acceptable. It can be concluded that most businesses do not participate in tendering processes of government.

agencies and other private companies after registering with TOT. For most of the businesses to get the proper training, major suggestion given is to ensure that government makes the training aware more often by carrying out it on a monthly basis. This concurs with a study done by Jean, (2009) that lack of training initiatives have led to significant poor improvement in the introduction of payments of taxes through banks thus investor become reluctant to comply with policies of tax.

It can be concluded that tax compliance does influence adoption of turnover tax for SMEs to a large extent. Tax policies affect turnover tax compliance by ways of increasing the complexity of the tax rules, increasing frequency of submitting tax returns and increasing the levels of government involvement in levying and collecting tax. For tax compliance, total business tax compliance costs tend to be higher for larger companies, as a percentage of sales they are significantly higher for SMEs.

To a great extent, higher compliance burden for latter tax system tends to discourage SME creation and that reducing tax compliance costs by lowering the overall tax burden on small businesses helps to achieve more neutral tax treatment of firms of various sizes. It can be conclude that simplifying the registration of businesses should be affected; facilitating the registration of businesses into TOT and publishing more information for small businesses are the most recommended measures that should be taken by KRA to ensure turnover tax compliance among SMEs in Kenya is high. This concurs with a study done by Wickerson, (2003) that in particular, certain measures such as reducing compliance cost may directly encourage business creation and tax compliance for some small businesses, but not others, suggesting the need to analyze a range of measures.

Recommendations

The study recommends that to have a fully functioning turnover tax system among SMEs in Kenya, the small traders should be made to understand the tax administration through the turnover tax education so that they are encouraged to pay taxes promptly. The computation of taxes should also be made simple and comprehensible to all small scale businessmen.

That K.R.A should make more frequent friendly visits to the small traders to educate all traders in the importance of adopting the turnover tax through channels like seminars, door to door, mobile tax clinics should be enforced in thorough manner.

That there should be a reduced complexity of the tax rules, frequency of submitting tax returns and an increase in the level of government involvement in levying and collecting of taxes under the tax policies affecting turnover tax compliance.

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