The Effect of Social Norms on Value Added Tax Compliance among Small and Medium Enterprises in Embu Town

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Abstract

Despite the increasing need to raise the level of revenue collection, Kenya still faces the challenges of low tax compliance. The broad objective of the study was to determine the effect of social norms on value tax compliance among small and medium enterprises in Embu town, Kenya. The study was guided by social influence theory. The study adopted an explanatory research design and targeted a population was 1050 small and medium enterprises in Embu town. A sample size of 290 was drawn from this population and the response rate was 74%. Primary data collection was employed using closed structured questionnaires from study's objective. The data was analyzed using descriptive, inferential statistics and multiple linear regression analysis. A correlation analysis conducted before testing for coefficients shows that there was a positive and significant linear relationship between social norms and value tax compliance r=0.696. The coefficient table indicates that social norms have a positive effect on VAT compliance β= 0.138 (p=0.006<0.05). Based on the findings the study recommends that Kenya Revenue Authority integrate insights from behavioral economics into tax compliance theories. Explore how psychological factors such as social norms can be incorporated into models predicting taxpayer behavior. Further research may be conducted to investigate the effect of technology on VAT compliance.

Keywords: *Small and Medium Enterprises, Social Norms, Value Tax Compliance*

1. Introduction

In developing countries, taxation is an important element in the management of the national economy and when it comes to tax compliance, governments are faced with difficult choices on what to tax, how much to tax, who to tax and what to tax.On the one hand, tax collection must be sufficient to provide necessary public goodsand services to their population. On the other hand, they want to avoid the risk of overburdening enterprises with hefty taxes and compliance expenses, which might stifle economic growth Lee& Gordon, (2019).

Value-added tax is imposed on the supply of taxable goods and services, Kenyan-made or imported. A person or company supplying taxable goods and services whose value is Kshs. 5 million or more in a year of transactions qualifies to register for VAT. Voluntary registration for persons below the annual 5 million threshold is also allowed by law, to enable them to compete fairly for the market share. The current VAT rates in Kenya are 16% applicable to taxable supplies other than the zero-rated supplies, 8% on petroleum products that came into

effect on 21st September 2018, and 0% applicable to zero-rated supplies listed in the second schedule (VAT Act 2013). According to KNBS (2014), VAT contributed about 23% of the total tax revenue collected bythe government in 2013. Other empirical studies conducted by Moyi and Ronge (2016), indicatethat VAT contribution is estimated to be an average of 5.4% of GDP between the year of its introduction (1990) and the year 2015. The average total tax contribution to gross domestic product (GDP) for the same period was 19.8%. This indicates that in Kenya, VAT contributes substantially to the growth of the economy.

Edlund & Åberg (2021) puts it that, social norms are generally accepted ways of thinking, feeling, or behaving that people in a group agree on and endorse as right and proper.The essence of a social norm is not basically what is legally defined; rather, it is informal or socially defined rules specifying what actions are regarded as proper and correct, or improper or incorrect. These rules are based on interests, values, and attitudes developed within the group. Thus, a social norm is composed of a socially defined rule of behavior based on common values. Fehr & Gächter (2018), define a social norm as a behavioural regularity that is based on a socially shared belief of how one ought to behave which triggers the enforcement of the prescribed behaviour by informal social sanctions. The concept of sanction goes hand in hand with the concept of social norms; sanctions are the group's punishments for violation of social norms. A social norm is composed of a socially defined rule of behavior based on common values, backed up by a system of sanctions.

1.1 Problem Statement

Despite the implementation of social norms aimed at improving VAT compliance among SMEs in Kenya, there is still a significant level of non-compliance among this group of taxpayers. Kenya Revenue Authority has been undertaking several measures to increase revenue collection but it has of late failed to meet its revenue targets, particularly VAT targets. For instance, in 2019/2020 financial year, the 2019/2020 revenue performance reports show that VAT reduced from KES 464.2 billion in 2018/2019 to KES. 380.8 billion in 2019/2020 (KRA 2020). Lastly, for the financial year 2020/2021, KRA missed target KES 2 billion as they only managed to collect KES,478 billion against a set target of KES 484 billion (KRA 2021).

Statistics from the Kenya Revenue Authority (KRA) show that of the 759,164 companies registered in Kenya,only 504,036 of them filed annual returns for the financial year 2021/2022. This shows that many enterprises still are not VAT compliant. Consequently, the government is not able to adequately provide the much-needed public serviceswhich include security, quality health care and education; water and better housing, and infrastructure developments. This thus has raised a concern as the Government aims to achieve its targets hence the need for this study. This study focused on the effect of social norms on value tax compliance among small and medium enterprises in Embu town, Kenya.

2. Literature Review

2.1 Theoretical Review

The social influence theory was proposed by Herbert Kelman in 1958 to behavioural changes caused by one person's influence on another. This change can be intentional or unintentional, depending on the relationship, one has around, and the societal influence. According to the theory, people are likely to conform to group norms and values, and the behaviours ofothers, to be accepted and to gain approval. The theory suggests that the presence of others can influence an individual's attitude and behaviours. For example, an

individual may be more likely to act in a certain way if they perceive that the group they are part of (Gueguen, 2015) will accept their behaviour.

Çevik and Yeniçeri (2013), indicate that peer pressure plays a role in how taxpayers decide whether to pay their taxes as mandated by law or to evade them. Tax compliance emanates whenpeople have negative impressions of the other tax evasion behavior, and vice-versa. Past studies have found that peer influence heavily influences tax evasion (Sinnasamy, 2018). The theoryalso contends that social stigmatization discourages taxpayers from filing their taxes and that the existing existence of social norms affects the taxpayer's compliance behaviour. According to this theory. Property owners are more likely to comply with tax payments when influenced by their social groups, family, friends, and other property owners (Slemrod, 2018).

This hypothesis affirms that social norms and individual behaviour have a significant impact on the tax compliance behaviour of individuals. This theory states that social interactions funder mentally shapes how taxpayers behave when it comes to taxes, just like they do with other behaviours (Ali, Fjeldstad & Sjursen, 2013). It further suggests that a taxpayer is most likely to observe tax obligations when they believe members of their affinity group will do so. Likewise, if members of an affinity group believe they are non-adherent, they are also less likely to adhere (Walsh, 2012). As the main social group, the family has the largest impact on their behaviour. The physical emotional and social interaction growth occurs in this setup. Human development happens physically, emotionally, socially, and intellectually based on the environment. In an attempt to conform to the norms and values of the family, a taxpayer may change his/her behaviour, values, and beliefs to fulfill the belonging and esteem needs and the approval of other members.

According to Hedstrom and Ibarra (2010), Social norms are the social influence to follow a pre-set rule of adequate or accurate taxpaying conduct and rational imitations under circumstances ofuncertainty vis-à-vis the likelihood of actually being audited and caught for tax evasion. Conforming to the social pressure and degree of influence when it comes to tax compliance may be a reasonable strategy and the fairness effects, which is the feeling unfairly, or unequally treatedin contrast with others, will transform their tax compliance accordingly.

Citizens pay taxes to the government and expect to receive services and social amenities. Disappointments and frustrations in the delivery of public services inform the taxpayers' thought processes and individual beliefs. The benefits and opportunity to evade taxes present the taxpayerwith an opportunity to form a belief process. Based on this theory KRA and government need to bring awareness by building the confidence of its citizens by delivering services as required which will bring an actual contribution to the beliefs of the taxpayers that benefits of paying their tax obligations out way the need for non-compliance. This theory therefore guides the objective, todetermine the effect of social norms on VAT.

2.2 Empirical Review

2.2.1 Value-Added Tax Compliance

Value Added Tax is a tax on the value added to the supply by the last seller (Radhakrishanan, 2008). VAT was introduced in Kenya in 1990 as a means of increasing the Government revenue by widening the tax base. VAT is imposed by Kenya Revenue Authority (KRA) as perthe laws of the Value Added Tax Act 2013. The Value Added Tax is an indirect tax onconsumption applicable to the sale of supplies at all levels of production and distribution. VAT-registered taxpayers act as Government agents in collecting and remitting VAT amounts collected to the government.The VAT paid on inputs in turn is claimed as credit when registered taxpayers declare output VAT on their sales (VAT Act 2013 Sec 17).

Suppliers of exempt goods & services (VAT Act 2013, first schedule) do not charge VAT on their supplies and cannot claim credit for VAT paid on their purchases. The VAT system also contains zero-rated goods and services (VAT Act 2013, 2nd schedule). Businesses charge VAT at a rate of 0% on their supplies and are allowed to deduct the input tax paid on the purchase of those zero- rated goods and services (VAT Act 2013 Sec 17). The government formulates policy and VAT laws, KRA oversees implementation of the laws, professionals offer services to ensure tax compliance, businesses act as agents in collecting VAT & remitting it to the government, and the general public is concerned about the VAT rate which influences their spending and how the government is utilizing the VAT revenue collected. VAT contributes about 23% of the total tax revenue collection by the government (KNBS 2014).

2.2.2 Social Norms and VAT Compliance

Social norms refer to injunctive norms (Cialdini *et al*, 2020) that is normative prescriptions regarding tax compliance or, conversely, the normative acceptability of noncompliance. Likewise, it has been argued that social norms, that is, the perceived practice or endorsement of evasion among reference others, impact tax compliance (Wenzel, 2019). Social norms, if internalized, should reduce the perceived opportunity structure and, as mentioned, reduce the will to cheat on taxes. Social norms have usually been studied as the perceived prevalence or acceptance of tax evasion among a reference group (DeJuan, *at el* 1994; Porcano, 1988; Webley *et al*, 2001); or as naturally varying between different cultural or sub-cultural groups (Alm, *at el*, 2019). In either case, the evidence is only of a correlation nature and we do not know whether social norms causally affect one's taxpaying behavior or whether social norms are constructed to explain and justify the behaviour.

Nonetheless following the logic of the moral/social actor view, social norms should influence taxpaying behavior, when they are internalized through a process of identification with the relevant social group (Wenzel, 2019). That is perceived social norms which will causally affect tax compliance when taxpayers are identified with the group to which the norms are attributed. The causal effect will be mediated by the internalization of social norms through which they become part of the taxpayer's own individual make-up. However, from a sociological perspective, it is often assumed that human behavior is determined by social norms to a substantial extent. Sometimes this also includes tax behavior as well as other economic behavior (Etzioni, 2019).

2.3 Conceptual Framework

Cooper and Schindler (2018) define a conceptual framework as a construct that shows the relationship between the variables in a study. The framework helps specify and define the concepts within the problem of the study. A conceptual framework is a visual pictorial diagram that shows the association between the independent variable and the dependent variable. The conceptual framework is illustrated in Figure 1.
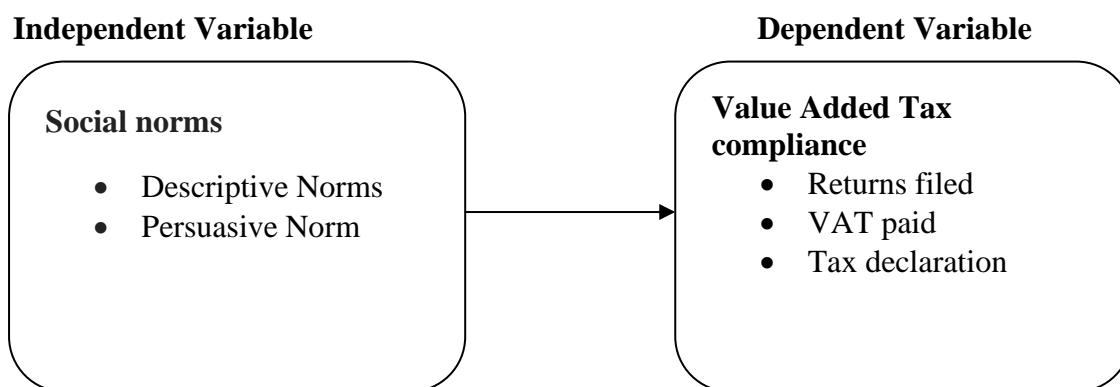
Independent Variable

Dependent Variable

Social norms

- Descriptive Norms
- Persuasive Norm

Value Added Tax compliance

- Returns filed
- VAT paid
- Tax declaration

Figure 1: Conceptual Framework

3. Methodology

The study used an explanatory research design and the primary purpose of explanatory research is to explain why phenomena occur, and also to predict future occurrences of that or similar phenomena. Explanatory studies are characterized by hypotheses that bring about the nature and direction of the relationship between or among the study variables. The target population was 1050 and a sample size of 290 Small and Medium Enterprises in Embu Town (KRA, 2023). The study collected primary data through questionnaires. The questionnaires were used because of their economy, their ability to ensure anonymity and use of standardized questions. It also provides time for subjects to think about responses. The questionnaires were made up of closed-ended questions in the form of a Likert scale. The researcher feels that some primary data added valueto the researcher especially objectives of the study.

Reliability is increased by including many similar items on a measure, by testing a diverse sample of individuals, and by using uniform testing procedures. To test the reliability of the instruments, internal consistency techniques were applied using Cronbach's Alpha of 0.7 which is a commonly accepted rule of thumb that indicates acceptable reliability, and 0.8 or higher indicates good reliability Mugenda, (2003). Table 1 shows the results that indicated that social norms were (0.939) and Value Added Tax compliance was (0.972) indicating that the items are reliable.

Table 1: Reliability test

Variables	Cronbach's Alpha	N of Items
Value-Added Tax Compliance	0.972	4
Social Norms	0.939	6

According to Berg and Gall (1989), validity is the degree by which the sample of test items represents the content of test designed to measure. Content validity which employed by this study is a measure of the degree to which data collected using a particular instrument represents a specific domain or content of a particular concept. The KMO and Brtlett's test was selected to test for Validity.

The study conducted diagnostic tests before using an ordinary least square regression model to test the study hypotheses. This ensured that assumptions of classical regressions were not violated. The tests of normality, multicollinearity, and homoscedasticity was conducted before running the respective regression models. The procedure entails summarizing and categorizing

the data to a reasonable length, identifying themes, analyzing, and evaluating it. The researcher then lookedfor meaning in the data and frequently compared findings to earlier studies to see if they supported existing research. The researcher used descriptive statistics to assess the data. The data collected was analyzed using descriptive and inferential statistics and then presented using tables and charts.

The linear regression model was;

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon$$

Where;

Y= Value added tax compliance (Dependent variable);

X₁=Social Norms;

β₁ = beta coefficient;

ε = Error term

4. Results and Discussion

In the context of questionnaire data analysis, response rate is the proportion of respondents who took part in and finished a survey or questionnaire. Response rates should be made public by researchers to uphold openness and confirm the reliability of the data gathering. Out of 290 questionnaires that were issued only 214 filled and submitted the questionnaires. Indicating a 74% response rate

Table 2 Indicates that the largest age group is 40 to 49 years old, representing 26.6% of the total. This is followed by the 29 to 39 years old group at 21.5%, and the 50 to 59 years old group at 20.1%. The 18 to 28 years old group represents 17.8%, and the smallest group is those aged 60 and above, representing 14.0% of the total. Number of Employees: The data shows that 38.3% of the entities have more than 10 people, making it the largest group. This is followed by entities with 1 to 5 people at 32.2%, and those with 6 to 10 people at 29.4%. In total, the data represents 214 respondents.

Table 2: Demographics Data

Demographics on Age		
18 to 28	38	17.8
29 to 39	46	21.5
40 to 49	57	26.6
50 to 59	43	20.1
60 and above	30	14.0
Demographics on Number of employees		
1 to 5 people	69	32.2
6 to 10 people	63	29.4
More than 10 people	82	38.3
Total	214	100.0

4.2 Descriptive Statistics

4.2.1 Social Norms

Table 3 shows descriptive statistics for social norms. In case of mistakes, I'm patient with KRA with a mean score is 4.04. My relationship with KRA can be described as a long-term venture with a mean of 4.05. I follow the rules and pay taxes correctly and on time had a mean

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score of 4.00. I usually take responsibility for all my financial obligations, which include filing taxes on time and paying them in full had a mean score of 3.88. I do not pay rental income tax because most of the property owners in the area do not pay had a mean score of 4.31. I follow the rules and pay taxes correctly and on time had a mean score of 4.04.

Table 3: Descriptive statistics of social norms

Items	N	Mean	Std. Deviation	Skewness	Kurtosis
In case of mistakes, we I'm patient with KRA	214	4.04	.924	-.977	.785
My relationship with KRA can be described as a long-term venture	214	4.05	.938	-1.092	.951
I follow the rules and pay taxes correctly and on time	214	4.00	1.000	-1.062	.498
I usually take responsibility for all my financial obligations, which include filing taxes on time and paying them in full	214	4.04	1.038	-1.065	.303
KRA helps me when I face problems	214	3.88	.822	-1.620	3.018
I do not pay rental income tax because most of the property owners in the area do not pay	214	4.31	1.092	-1.412	.779
I follow the rules and pay taxes correctly and on time	214	4.04	.924	-.977	.785

4.2.2 Value-Added Tax Compliance

Table 4 indicates descriptive statistics for Value-added tax compliance I filed my tax returns on time and had a mean score is 4.02. I have registered for Value Added Tax obligation with a mean score of 4.08. I pay the tax liability that arises from my VAT obligation without failure had a mean score of 4.02. The tax system in place motivates me to voluntarily comply with tax obligations had a mean score of 4.09.

Table 4: Descriptive statistics Value Added Tax Compliance

Items	N	Mean	Std. Deviation	Skewness	Kurtosis
I file my tax returns on time	214	4.02	.888	-.605	-.383
I have registered for Value Added Tax obligation	214	4.08	.846	-.818	.262
I pay the tax liability that arises from my VAT obligation without failure	214	4.02	.952	-.938	.092
The tax system in place motivates me to voluntarily comply with tax obligation	214	4.09	.974	-.989	.054

4.3 Correlation Analysis

Table 5; shows the results of the correlation analysis testing the strength and the significance of the linear relationship between the social norms and VAT tax compliance. Social norms had a Pearson Correlation coefficient of r= 0.696, indicating a strong positive correlation with VAT compliance.

Table 5: Summary of Correlations Statistics of Independent and Dependent Variables

	VAT compliance	**Social Norms**
VAT Compliance	1	0.696[**]
	0.696[**]	1
Social Norms		

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

4.4 Regression Analysis

A regression model was used to investigate the effect of social norms on value-added tax compliance among small and medium enterprises in Embu town, Kenya. The results in Table 6 show that social norms had a positive correlation with VAT compliance up to 69.6% or (R= 0.696). The results reveal that social norms caused a variation of 48.4% or (R^2=0.484 and adjusted R^2 =0.477) on VAT compliance.

Table 6: Model Summary

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	.696[a]	.484	.477	.41787

a. Predictors: (Constant), Social Norms_mean

The results of the ANOVA test, in Table 7, examined the effect of social norms on value-added tax compliance. The model included one predictor: social norms. The regression model accounted for a significant amount of variance in VAT compliance, F= 165.918, p =0.000< 0.05. This Analysis of variance suggests that the social norms significantly predict VAT compliance.

Table 7: ANOVA Effect of Social Norms on Value-Added Tax Compliance

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	46.789	1	46.789	165.918	0.000
1	Residual	59.904	212	0.282		
	Total	106.693	213			

a. Dependent Variable: VAT compliance
b. Predictors: (Constant), Social norms

The hypothesis that social norms have no significant effect on Value Added Tax compliance among small and medium enterprises in Embu town, Kenya was tested. The study found that social norms have a significant effect on value Added Tax compliance The p-value was 0.000, leading to the rejection of this null hypothesis.

Table 8: Coefficients Social Norms on value added tax Compliance

Model		Standardized Coefficients		Unstandardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(constant)	0.329	0.053		6.231	0.000
	Social norms	0.138	0.068	0.143	2.029	0.046

a. Dependent Variable: VAT compliance
b. Predictors: (Constant), Social norms

4.5 Discussion of the Findings

The objective was to determine the effect of social norms on value tax compliance among small and medium enterprises in Embu town. A correlation analysis conducted before testing for coefficients shows that there was a positive and significant linear relationship between social norms and value tax compliance r=0.696. (p=0.041<0.05) The coefficient table indicates that social norms have a positive effect on VAT compliance β= 0.138 (p=0.046<0.05). The study concurs with a study by Wentworth & Rickel (2019) which concluded that norm commitment may be a crucial factor in the decision to comply with or evade legally mandated taxes. McKee et el. (2020) give experimental evidence for such a conclusion, and Frey & Weck-Hanneman (2020) draw the same conclusion based on tax surveys. They found that their measure of tax morality was significantly related to the size of the hidden economy, estimated with the technique of unobserved variables.

5. Conclusions

The study was to determine the effect of social norms on VAT compliance among small and medium enterprises in Embu town, Kenya, demonstrating a positive and significant linear relationship between social norms and VAT compliance. As social norms encourage VAT compliance spread, compliance is likely to improve, suggesting the need to focus on shaping positive societal attitudes toward tax compliance.

6. Recommendations

Based on the findings the study recommends that Kenya Revenue Authority (KRA) integrate insights from behavioral economics into tax compliance theories. Explore how psychological factors such as social norms can be incorporated into models predicting taxpayer behavior. KRA is recommended to develop training programs for tax professionals that focus on the behavioral aspects of tax compliance. They should equip tax practitioners with the knowledge and skills to understand and address psychological factors influencing taxpayer behavior.

Further research should be conducted in diverse geographical settings beyond Embu town. Expanding the study to different regions with varying economic and cultural contexts can provide insights into how social norms interact in different environments. Further research may be conducted to investigate the effect of technology on VAT compliance.

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