

## Effect of Tax Invoice Management System on Value Added Tax Compliance Among Small and Medium Enterprises in Eldoret Town, Kenya

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### Abstract

**Purpose:** Tax is an important stream of revenue for government's development projects and therefore all efforts must be made by governments to ensure that it is accurately and efficiently collected so as to facilitate the government's operations. The objective of the study was to investigate the effect of tax invoice management system on Value Added Tax compliance among small and medium enterprises in Eldoret town, Kenya. The study was guided by Diffusion of Innovation (DOI) Theory.

**Methodology:** The research design for this study was explanatory. The population of this study will be 3872 SMEs in Eldoret town and sample size of 362 SMEs who are SME owners/Managers. Questionnaire was used to collect primary data and analysis will include both descriptive and inferential statistics.

**Results:** The study found that Tax invoice management system and value Added Tax compliance is positive and statistically significant  $\beta=0.483$ .

**Conclusion:** In conclusion the study revealed that there was a significant relationship between Tax invoice management system and Value Added Tax compliance among small and medium enterprises in Eldoret town, Kenya. The study recommends that that KRA should formulate policies to enhance and actively promote the adoption of Tax invoice management systems among SMEs.

**Keywords:** *Small and Medium Enterprises, Tax Invoice Management System, Value Added Tax Compliance*

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### 1.0 Introduction

Digital tax platforms are crucial to making tax systems lean in that they permit real-time access from across the globe and enable risk mitigations (Mcluskey & Huang, 2019). For instance, the use of ETRs in VAT administration in Kenya has gone a long way towards enhancing accuracy and completeness in disclosure of value-added tax computations. Use of digital platforms has been noted to improve compliance rates among businesses due to cost reductions that characterize the platforms. Electronic tax management reduces corporate tax evasions without increasing overheads of the tax departments. IT transforms activities and improves capacities of public organizations to offer service delivery.

KRA has since rolled out the TIMS aiming to automate the existing ETR which was rolled out in 2005. The system can transmit the tax invoices that are being generated from the registers to KRA on real-time or near real-time basis with the integration of trader systems. TIMS system aims at plugging loopholes resulting from weakness, through the regime of integration with the trader system and verification of the validity of Tax invoices by KRA officers. From 1<sup>st</sup> August 2022, all invoices that are being generated from VAT-registered taxpayers will be validated through TIMS and then transmitted into the KRA system. TIMS will be beneficial to a taxpayer by fostering a fair business environment, simplifying VAT return filling (Pre-Filled), automate activation of tax registers, and making VAT refunds faster. The system will also benefit the public by building trust between the customer and business entity, participating in enhancing Tax compliance, and fostering patriotism OECD, (2021).

In the year 2013, Value Added Tax Act was adopted and implemented; at this time VAT policy, faced several drawbacks by the business owners as well as the government. Since the inception of the VAT, the taxman has removed some provisions and added some provisions into the Act. The most noteworthy changes comprise of removing of the Value Added Tax remission; exclusion of a lowered rate of twelve percent, combination of previous subordinate regulations and the main regulations, reducing the scheduling of 8 to 2 as well as raising the rates of zero-rated tax charges and exempting basic supplies (Ernst & Young, 2016). VAT is collected at specified points by registered persons who remit it to the Commissioner. Since the tax is paid by the final consumer of products, registered persons serve solely as VAT agents in collecting and paying the tax.

### **1.1 Problem Statement**

Tax compliance has been a crucial subject for researchers in many countries around the globe. In most third world countries house rental taxation has been classified as economic. (Tilahun & Yidersal, 2014; Palil, 2010). Like the other tax systems, the system of value-added tax compliance has been confronted with many challenges both on the side of the taxpayers and the officials (Berhane & Yesuf, 2013). Effects of an Add-on Value Added Tax observed that non-compliance is a growing concern in the administration of VATs, partly because under a credit-invoice tax the gross amount of taxes paid by firms plus refunds returned to firms is so large relative to the net taxes collected by the government (Robert Carroll, 2010).

For instance, the 2018/2019 annual revenue performance report by KRA shows that KRA managed to collect only KShs.409.5 billion from VAT against a target of KShs. 464.2 billion (KRA 2019). In 2019/2020 financial year, the 2019/2020 revenue performance reports show that VAT was reduced from Ksh. 464.2 billion in 2018/2019 to Ksh. 380.8 billion in 2019/2020 (KRA 2020). In 2020/2021 financial year, the VAT collected amounted to KShs. 478.2 billion against a target of KShs.484.2 billion missing targets by KShs. 6 billion. These revenue shortfalls have been blamed on tax evasion and other behaviors of tax non-compliance by SMEs and other small taxpayers. It is this worrying trend in revenue collection statistics and the knowledge gap that warrants research to be done in this area.

Underperformance on VAT, however, denies the government the much-needed revenue for growth and development Notably, compliance among small and medium enterprises was noted to be a major challenge that significantly contributes to VAT revenue underperformance. The study will add value to the challenging environment of tax revenue collection through Kenya Revenue Authority. The study was to determine the effect of tax invoice management system on value Added Tax compliance among small and medium enterprises in Eldoret town, Kenya.

## **2.0 Literature Review**

### **2.1 Theoretical Review**

This hypothesis was created by Lazarsfeld in the year 1949. It tries to depict the examples of selection of innovation, clarifying the instrument of the reception and further anticipating whether and how another creation or advancement will be fruitful. The Diffusion of Innovation hypothesis recommends that mechanical development is imparted through specific channels, after some time, amongst individuals from a social framework. In light of this definition, utilizing e-recording innovation is a genuinely new practice in Kenya and can be viewed as a development for every individual web client. As indicated by Rogers (2003), the phases through which a mechanical development passes include five stages which normally take after each other in a period requested way. The stages are Persuasion, Knowledge, Decision, Confirmation, and Implementation. Advancement choices might be discretionary, group, or expert-based (Sahin, 2006). Usually, this hypothesis demonstrates that mechanical development is conveyed by means of particular channels, after some time, amongst the people from a social system. The hypothesis identifies with the nation Kenya in that the advancement of itax framework is imparted through the different channels by the KRA and got to by means of the web to achieve every individual client.

### **2.2 Empirical Review**

#### **2.2.1 Value Added Tax Compliance**

Value-added tax (VAT) was introduced in Kenya in 1990 to replace sales tax. It was introduced as a measure to increase government revenue through expansion of tax base. The VAT Act, no 35 of 2013 of Kenyan laws governs the administration of Value Added Tax. The VAT framework has goods and services that are taxable except for zero-rated products that comprise basic goods as well as exports. Value Added Tax was adopted with an ordinal rate of seventeen percent but incorporated with other fourteen rates with the highest ever being two hundred and ten percent. Two hundred and ten percent rate made VAT look like a tax system that targeted differentiated commodities.

#### **2.2.2 Tax Invoice Management System**

Le and Nguyen (2021) undertook a study that evaluated tax compliance in Vietnam. Data was collected from four hundred small taxpayers using a structured questionnaire. Results showed that electronic devices in tax systems boosted compliance. Moreover, the level of compliance was influenced by perceived ease of use of electronic tax devices, tax awareness, efficiency of the revenue authority, and perceived tax policy fairness

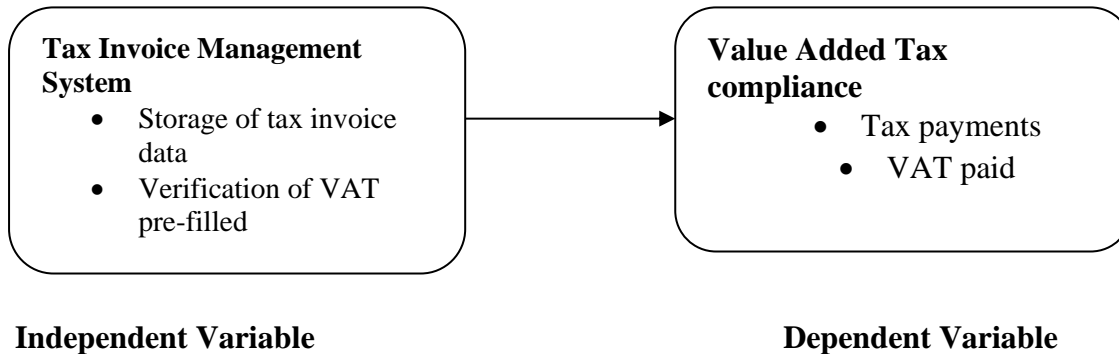
Obert *et al.* (2018) focused on e-tax systems and its role in tax compliance in Zimbabwe. The study focused on taxpayers in Harare. In this study, primary data was sourced and processed in line with the tenets of descriptive statistics. The results were that e-tax systems significantly improved tax compliance for both large taxpayers and small taxpayers. This is attributed to time savings and cost efficiencies linked to e-tax system. Moreover, the study found that e-tax system fostered accurate self-assessment of taxes thus boosting compliance.

Kabochi (2019) opines that to improve VAT compliance through use of technology, the KRA implemented the Tax Invoice Management System to regulate the invoice issuance process. Tax invoice management system integrates trader systems such as electronic tax register, point of sale, and ERP-billing/invoicing system with the KRA's iTax platform, to monitor the transmission of electronic tax invoices. The connection between TIMS and iTax is expected to increase efficiency in tax administration, while introducing user-friendly

experience for taxpayers. Tax invoice management system provides KRA with real-time access to invoices issued by traders thus curbing tax evasion. The use of technology as a compliance enabler was a necessity to enhance VAT compliance and curb tax evasion.

### 2.3 Conceptual Framework

The Conceptual framework is a scheme of variables that a researcher carries out to achieve the identified objectives. A variable is a measure of characteristics that takes different values between subjects (Mugenda & Mugenda, 2003). The conceptual model represented in Figure 1 describes the relationship between the variables of study accordingly.



**Figure 1: Conceptual Framework**

### 3.0 Methodology

This study adopted an explanatory research design which looks for explanations of the nature of certain relationships and investigates the causal relationship between variables. The target population for this study was 3872 and a sample of 362 business owners of SMEs in Eldoret town, Kenya. Out of 362 questionnaires that were issued, only 281 were filled and returned implying a response rate of 78%. The primary data was collected using a structured questionnaire. Data collected was edited, cleaned, and coded for completeness. Cleaned data was then analyzed using descriptive and inferential statistics. Descriptive statistics including mean, standard deviation, and coefficient of variation (CV), while inferential statistics was used to evaluate the hypotheses presented in the study.

The linear regression model was;

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

Where; **Y**= VAT Compliance (Dependent variable); **X<sub>1</sub>**= Tax invoice management system; **β<sub>1</sub>** = beta coefficient; **ε** = Error term

## 4.0 Results and Discussion

### 4.1 Descriptive Statistics

#### 4.1.1 Tax invoice management system

Table 1 illustrates that Our business enjoys input tax while trading with registered VAT suppliers with a mean score of 4.07. ETR invoices issued to all VAT transactions had a mean score of 4.06. Our business keeps records for electronic Tax Invoice had a mean score of 4.00. Lastly, our business monitors sales by use of ETR receipts had a mean score of 3.99.

**Table 1. Tax invoice management system**

Items	N	Mean	Std. Deviation	Skewness	Kurtosis
Our business enjoys input tax while trading with registered VAT suppliers.	281	4.07	1.070	-.794	-.713
ETR invoice is issued to all VAT transactions.	281	4.06	1.062	-.769	-.728
Our business keeps records for electronic Tax Invoice.	281	4.00	1.059	-.672	-.833
Our business monitors sales by use of ETR receipts.	281	3.99	1.062	-.688	-.805

#### 4.1.2 Value Added Tax Compliance

Table 2 illustrate that we filed our returns accurately had a mean score of 4.11. Our business pays VAT by the due date because we believe it is morally right and had a mean score of 4.01. We always remit our VAT to KRA on time with a mean score of 3.81. I compute and pay my VAT correctly and in good time as stipulated by the law had a mean score of 4.08.

**Table 2. Value Added Tax compliance**

Items	N	Mean	Std. Deviation	Skewness	Kurtosis
We file our returns accurately.	281	4.11	1.010	-.789	-.606
Our business pays VAT by the due date because we believe it is morally right.	281	4.01	1.038	-.645	-.845
We always remit our VAT to KRA on time.	281	3.81	1.086	-.401	-1.150
I compute and pay my VAT correctly and in good time as stipulated by the law.	281	4.08	1.049	-.755	-.749

## 4.2 Correlation Analysis

A correlation coefficient enables the researcher to quantify the strength of the linear relationship between two ranked or numerical variables. Pearson correlation analysis was done to determine the relationship between study variables. A correlation coefficient value ( $r$ ) in the range of 0.1 to 0.29 is considered weak, 0.3 to 0.49 is considered moderate while 0.5 to 1.0 is considered strong extracts from O'Brien, 2007. Table 5 indicates that Tax invoice management system is positively correlated with VAT compliance ( $r= 0.534$ ).

**Table 3: Correlations Statistics of Independent and Dependent Variable**

	VAT Compliance	Tax invoice management system
VAT Compliance.	1	0.534**
Tax invoice management system	0.534**	1

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

### 4.3 Regression Analysis

#### Model Summary

The results in Table 4 indicated that Tax invoice management system had a positive correlation with VAT compliance up to 5.34% or (R= 0.534). The results reveal that Tax invoice management system caused a variation of 28.5% ( $R^2=0.285$  and adjusted  $R^2 =0.279$ ) on VAT compliance. This implies that the remaining 71.5 % of the change was caused by other factors not included in the model.

**Table 4: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.534 <sup>a</sup>	.285	.279	.45680

a. Predictors: (Constant), Tax invoice management system \_mean

The ANOVA was used to analyze the significance of the variation caused by Tax invoice management system on VAT compliance. Table 5 indicates that there is an F statistic of 143.174 and a P-value of  $0.000 < 0.05$  indicating that there is a significant variation caused by Tax invoice management system on VAT compliance. The implication is that independent variable (Tax invoice management system) contributes significantly to changes in the dependent variable (VAT compliance). This shows that the model works and thus accounts for significantly more variance in the dependent variable than would be expected by chance.

**Table 5: Analysis of Variance**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	26.201	1	26.201	143.174	.000 <sup>b</sup>
	Residual	51.178	279	.183		
	Total	77.379	280			

a. Dependent Variable: VAT compliance

b. Predictors: (Constant), Tax invoice management system

The hypothesis ( $H_{01}$ ) stated that Tax invoice management system have no significant effect on VAT compliance among small and medium enterprises in Eldoret town, Kenya. Tax invoice management system has a positive relationship effect on VAT compliance among small and medium enterprises in Eldoret town, Kenya. The results in Table 6 revealed that p-value was less than 0.05,  $\rho=0.000$  which implies that relationship was statistically significant and therefore hypothesis was rejected.

**Table 6: Regression Coefficients**

Model	Standardized Coefficients		Unstandardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3.125	0.123		25.406	.000
1 Tax invoice management system	.483	.102	.247	4.735	.000

a. Dependent Variable: VAT compliance

#### 4.4 Discussion

The objective was to establish the effect of Tax invoice management system on Value Added tax compliance among small and medium enterprises in Eldoret town, Kenya. A look at the correlation analysis found that there is a positive and statistically significant relationship between Tax invoice management system and VAT compliance  $r= 0.534$  ( $p=0.000<0.05$ ), The regression analysis indicated that there is a positive and significant effect of Tax invoice management system on Value Added Tax compliance  $\beta=0.483$  ( $p=0.000<0.05$ ). This means that tax invoice management systems have a direct positive influence in improving VAT compliance among firms, adopting more efficient systems would be impactful in improving VAT compliance. The study concurs with a study by Obert et.al., (2018) who focused on e-tax systems and its role in tax compliance in Zimbabwe. The study focused on taxpayers in Harare. In this study, primary data was sourced and processed in line with the tenets of descriptive statistics. The results were that e-tax systems significantly improved tax compliance for both large taxpayers and small taxpayers.

#### 5.0 Conclusion

The study established that Tax invoice management systems have a positive effect on value Added tax compliance among small and medium enterprises in Eldoret town, Kenya. The study findings revealed that the business enjoys input tax while trading with registered VAT suppliers and an ETR invoice is issued for all VAT transactions.

#### 6.0 Recommendations

Based on the findings the study recommends that KRA should formulate policies to enhance and actively promote the adoption of Tax invoice management systems among SMEs. KESRA is recommended to initiate programs to raise awareness about the benefits of digital payments in improving VAT compliance and also to facilitate Awareness campaigns highlighting the positive impact of such systems on VAT compliance.

Future studies may be conducted to find out whether or not other factors such as tax incentives and compliance costs influence VAT performance.

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