

Effect of Tax Literacy on Consumption Taxes Compliance among Retailers in Starehe Sub County Nairobi, Kenya

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Abstract

Purpose: The ultimate purpose of Kenyan government is to raise sufficient revenue to finance its expenditure. There have been continuous reforms in the administration of consumption taxes. Government is unable to adequately raise revenue through tax collection and hence the need for this study. The purpose of the study was to determine the effect of tax literacy on consumption taxes compliance among retailers in Starehe sub -county Nairobi, Kenya. The study was guided by Theory of Planned Behaviour.

Methodology: Explanatory research design was adopted and the target population of this study was 4639 retailers in Starehe sub -county Nairobi, with a sample size of 368 respondents. Primary data was collected by use of questionnaires. In this study, 276 out of 368 distributed questionnaires were accurately completed and returned, reflecting a 75% response rate. The statistics generated was descriptive and inferential statistics that was analyzed using correlation and linear regression.

Results: The study showed that tax literacy ($\beta = 0.189$, $p < 0.05$) significantly improve consumption tax compliance.

Conclusion: The study recommended that the KRA should launch comprehensive tax literacy programs aimed at educating retailers about consumption tax regulations and their benefits.

Keywords: *Tax Literacy, Consumption Taxes Compliance and Retailers*

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1.0 Introduction

Taxes are the major source of public revenue. Tax is a compulsory unrequited payment to the general government. The term compulsory means that the taxpayers have an obligation to pay tax. The term unrequited means that the benefits that are provided by the government to the taxpayers are not in proportion to the amount paid as tax by the taxpayers. The general government includes both the local and national governments and their administrations (OECD, 2020). Taxes are necessary to finance public spending and to ensure that the burden of paying for such spending is distributed in a way that is administratively feasible, economically sustainable and politically acceptable (Bird & Wilkie, 2021).

Consumption taxes such as VAT, sales taxes, and excise duties are often categorized as indirect taxes. They are generally levied on transactions, products, or events Glossary of Tax Terms

(OECD, 2022) and collected from businesses in the production and distribution chain, before being passed on to final consumers as part of the purchase price of a good or service. They are not directly imposed on income or wealth but rather on the expenditure that is income and wealth finance. Tax literacy is something new in a taxation concept, especially related to behavior (Ramutumbu, 2019). Chardon (2022); and Brackin, (2022) argue that tax literacy is a financial literacy component. Cvrlje (2022) states that tax literacy is a person's understanding of tax rules and obligations and mapping of tax risks that may occur in his organization or company. In addition, Bornman (2019) stated that tax literacy is a process of increasing skills and understanding aspects that influence decisions in the field of taxation. Someone who understands the tax aspect in terms of definitions, obligations, rights, and other tax aspects will be able to calculate the tax and monitor the use of taxes paid in general. As a result of this understanding, individuals will have good morals and have an awareness of fulfilling their tax obligations (Gerger, 2019).

Retailers in general are the entity that purchases goods from a manufacturer, wholesaler, or some other distributor to resell them. They sell goods to the consumer at a markup and earn revenue, Bradshaw et al., (2019). Walmart and Target are good examples of big retail companies: they buy goods in large volumes from wholesalers and manufacturers both big and small and make them available to the end customer. Wholesalers are different from retailers in that they sell goods to businesses instead of direct consumers. Levy, (2022). Here in Kenya, small ventures are characterized by fewer than 50 staff, and sales in a calendar year is less than Kshs. 5 million while medium staff have no more than one hundred staff (Kenya National Bureau of Statistics, 2021). Retailers are vital since they play a huge role in reducing the unemployment menace, are a source of government revenue, and are platforms through which individuals create and harness wealth thus improving the general standards of living in Kenya. However, micro and small ventures are more often than informal sole proprietorships which are owners managed thus may fail to keep proper records to enable fulfilment of tax obligations.

1.1 Problem Statement

In the modern society, governments in both developed and developing countries collect taxes to fund public services and although tax systems are among the oldest institutions, they remain fundamental to the functioning of any economy. Consumption taxes form an important source of revenue for an increasing number of governments, accounting for almost 31% of all revenue collected by governments across the world, OECD, (2021). In 2020, consumption taxes accounted for 30% of the total tax revenue in OECD countries on average, representing 9.9% of these countries' GDP. Approximately two-thirds of revenue from consumption taxes is attributable to taxes on general consumption (mainly VAT and sales taxes) and one-third to taxes on specific goods and services.

Consumption taxes such as Value Added Tax (VAT) and Excise Duty contribute significantly to government revenue KRA, (2022). In the year 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. Further, in actual revenue generated from excise duty in the year ended June 2023, the KRA collected KES 264.5 billion on account of excise duty against a target of KES 294 billion, representing a revenue gap of 29.5 (KRA, 2023). In considering other economies, Hammour and Mckeown (2022) supported the findings of Omodero and Eriabie (2022) by confirming that VAT helps to improve business activities. Permadi and Wijaya (2022) also witnessed that VAT increased government revenue but made foreign purchases to decline. As a result, the primary goal of this research was to determine the moderating effect of

sociocultural factors on the relationship between tax aggressiveness, tax literacy, system automation, and consumption taxes among retailers in Starehe Sub-County Nairobi, Kenya.

2.0 Literature Review

2.1 Theoretical Review

Ajzen (1991) created the Theory of Planned Behaviour, which is essentially the refined version of the Theory of Reason Action proposed by Ajzen and Fishbein (1970) as an explanation for cognitive activities. The theory is a significant theory that attempts to shed light on human behavior in the field of psychological science. According to both views, a person's intention to engage in an action determines that person's behaviour. Four constructs were incorporated into the initial reasoned action theory: beliefs, attitudes, intentions, and behaviors.

The theory of planned behaviour expanded on this theory by including a new construct called perceived behavioural control, which is the idea that one can influence particular behaviours (Modi & Driscoll, 2020). According to Cooke, Dahdah, Norman and French (2016), the theory of planned behaviour (TPB) asserts that, a person's intent to carry out a certain conduct is the most significant factor influencing that behaviour. Three cognitive variables—attitudes, subjective standards, and perceived behavioural control—are seen to be the direct determinants of intention. Attitudes are evaluative judgments that are typically consistent and range from negative to positive about many aspects of an individual's experience. These judgments are impacted by situational factors, including observations of one's conduct.

Tax education, based on the theory of planned behaviour (TPB), aims to promote tax compliance by influencing taxpayers' attitudes, subjective norms, and perceived behavioural control. It emphasizes the importance of positive attitudes towards paying taxes, shaping subjective norms that favour compliance, and enhancing taxpayers' perceived ability to meet their tax obligations (Efebera, Hayes, Hunton & Neil, 2004). Research suggests that tax education programs can positively impact taxpayers' intentions to comply with tax laws. However, the relationship between intentions and actual compliance behaviour is influenced by various factors. Overall, tax education programs grounded in the TPB framework contribute to fostering compliance, reducing tax evasion, and promoting a culture of voluntary compliance (Klee, Bamberg, Erten & Graf, 2000).

2.2 Empirical Review

2.2.1 Tax literacy

Alexander et al., (2019) stated tax literacy is a relatively new and still developing concept closely related to financial literacy. The definition of financial literacy itself is a combination of awareness of the knowledge, skills, and behaviors needed to make sound financial decisions and ultimately achieve economic well-being, so it is necessary to understand taxation from taxpayers to the existing tax system, given that in the taxation system in Indonesia, taxpayers are given complete trust and responsibility in filling out the SPT, which starts from calculating and depositing to self-reporting the amount of tax owed (self-assessment).

Kurniawan (2020) examined if tax literacy at an institution of higher learning level affects personal tax compliance by raising awareness of taxes in Indonesia. The mixed method employs a convergent parallel technique. Using a parallel convergent procedure, the researcher concurrently gathered all quantitative and qualitative data from a survey of 100 learners who frequently participate in Politeknik Negeri Batam (Polibatam) evening classes and who meet the tax specifications. The data were then analyzed.

According to the study's findings, tax compliance is significantly impacted by tax literacy. Then, tax compliance is also greatly impacted by the indirect effect of tax literacy through tax knowledge. Adekoya (2019) investigated how tax literacy and tax compliance relate to one another in Lagos State, Nigeria. A cross-sectional investigation was carried out in Lagos state on a subset of private citizens 'taxpayers. A five-point Likert scale questionnaire was used to gather primary data. Four hundred individual taxpayers who were purposefully chosen made up the sample. Descriptive statistics were utilized to present the data, and the regression models created for the study were estimated using both basic linear regression and multiple regression. The analyses' findings demonstrated that taxpayer education significantly and favorably impacts tax compliance. The research suggested that to better educate taxpayers and, eventually, increase tax compliance and internally generated revenue, the Lagos State government should enhance its taxpayer awareness initiative by putting in place the necessary policies and tools.

2.2.2 Consumption tax compliance

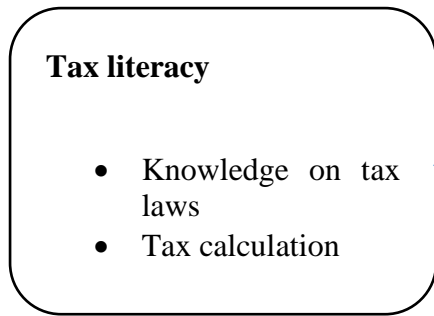
Consumption taxes are levies placed on goods and services purchased by consumers. Unlike income taxes, which are based on an individual's earnings, consumption taxes are imposed at the point of sale. The primary forms of consumption taxes include sales taxes, value-added taxes (VAT), and excise taxes. These taxes aim to generate government revenue in a manner that directly correlates with spending behavior, OECD (2019). Consumption taxes are levied on the spending on goods and services. These taxes are typically applied at the point of sale, meaning they are paid by the end consumer. Compliance with consumption taxes involves ensuring that businesses and individuals adhere to the regulations and requirements set forth by tax authorities regarding the collection, reporting, and payment of these taxes Evans, (2022).

Consumption taxes such as Value Added Tax (VAT) and Excise Duty contribute significantly to government revenue. Taxes on consumption are typically collected by an intermediary, such as a retailer. However, an intermediary cannot ultimately bear the burden of a consumption tax as this must rest with individuals, either as consumers, recipients of income, or owners of assets Mirrlees, (2021). The question is how, in the presence of an intermediary, a consumption tax comes to be passed through to its ultimate bearer. The difficulties posed by this question go a long way to explaining why most studies on the distribution of household income focus on personal income taxes and government cash transfers (which are in effect negative income taxes). In the case of personal income taxes, the convention is to assume that the economic (or final) incidence is on the recipient of the income flow: this enables the economic incidence of personal income taxes to be estimated using survey data on individuals' income Kaldor, (2022).

2.3 Conceptual Framework

A conceptual framework diagrammatically represents the study variables with clear lines of expected relationship (Yin, 2018). It identifies the various variables in the study including independent variable Tax literacy and the dependent variable consumption tax compliance.

Independent Variable



Dependent variable

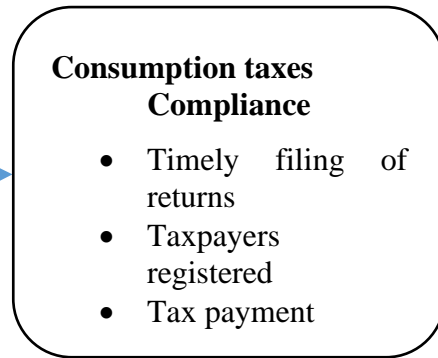


Figure 1 Conceptual Framework

3.0 Methodology

Research design is an overall structure that provides an outline of how the study is to be carried out. Bernard (2017). The study was employed an explanatory research design, which was used to determine the cause and effect of the relationship between the variables. This study had a target population of 368 retailers in Starehe sub-county Nairobi. In this study, 276 out of 368 distributed questionnaires were accurately completed and returned, reflecting a 75% response rate.

Sekaran (2003) notes that reliability is a measure of stability and consistency with which instrument measures the concept. According to Nunnally (1978), many factors can prevent measurements from being repeated perfectly Cronbach alpha was used to test for reliability of data. The acceptance value of 0.7 was used as cut-off of the reliability for the study showed that consumption taxes compliance and tax literacy each had alpha values of 0.913 and 0.978, respectively. All the Cronbach’s alpha values were greater than 0.7 indicating reliability in the responses.

Table 1: Test of Reliability of Questionnaire

Factor	Number of Items	Cronbach Alpha score	Conclusion
Consumption Taxes Compliance	0.913	5	Reliable
Tax Literacy	0.978	5	Reliable

4.0 Results and Discussion

4.1 Descriptive Statistics

4.1.1 Descriptive Statistics for Tax Literacy

Our business knows tax calculations received a mean score of 3.97 and SD = 0.848. Our company is aware of tax payment procedures and received a mean score of 4.01 and SD = 0.853. Our firm is aware of tax sanctions and received a mean score of 4.03 and SD = 0.811. Our business understands governance and how to register as a taxpayer received a mean score of 4.00 and SD = 0.802. Our firms are aware of procedures for filing returns received a mean score of 3.95 and SD = 0.841 represented in table 2.

Table 2: Tax Literacy

Items	N	Mean	Std. Deviation	Skewness	Kurtosis
Our business knows tax calculations	276	3.97	.848	-.017	-1.447
Our company is aware of tax payment procedures		4.01	.853	-.099	-1.453
Our firm is aware of tax sanctions		4.03	.811	-.046	-1.477
Our business understands governance and how to register as a taxpayer		4.00	.802	-.007	-1.445
Our firms are aware of procedures for filing returns		3.95	.841	-.022	-1.339
Aggregate Mean		3.99			

4.1.2 Descriptive statistics for Consumption taxes compliance

Our company has been faithful in declaring all output for VAT or Excise duty received a mean score of 3.93 and SD = 0.884. Our firm files tax returns every month" received a mean score of 3.99 and SD = 0.868. Our company always declares the correct taxes received a mean score of 4.05 and SD = 0.836. KRA has offered our firm an enabling environment for tax filing which can enhance consumption taxes performance received a mean score of 4.02 and SD = 0.840. Our business always meets the deadlines on filing and payment of taxes received a mean score of 4.01 and SD = 0.825.

Table 3: Consumption Taxes Compliance

Items	N	Mean	Std. Deviation	Skewness	Kurtosis
Our company has been faithful in declaring all output for VAT or Excise duty	276	3.93	.884	-.190	-1.077
Our firm files tax returns every month.		3.99	.868	-.282	-.981
Our company always declares the correct taxes.		4.05	.836	-.140	-1.462
KRA has offered our firm an enabling environment for tax filing which can enhance consumption tax performance		4.02	.840	-.078	-1.488
Our business always meets the deadlines for filing and payment of taxes.		4.01	.825	-.138	-1.234
Aggregate Mean		4.00			

4.2 Correlation Analysis

Pearson's correlation coefficients were analyzed to assess the strength of the relationship between the independent variables. A value nearer to 1 signifies a stronger correlation between the two variables. There is a moderate positive correlation between Tax Literacy and Consumption tax compliance at 41.2%.

Table 4: Correlation statistics

	Consumption compliance	tax	Tax literacy
Consumption tax compliance	1		0.412**
Tax literacy	0.412**		1

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

4.3 Regression Analysis

The model summary to determine the overall correlation and coefficient of determination. Table 5 indicates that Tax literacy had a positive correlation with Consumption tax compliance up to 41.2% or (R= 0.412). The results reveal that tax literacy caused a variation of 16.9% or ($R^2=0.169$ and adjusted $R^2 =0.162$) on consumption Tax compliance.

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.412 ^a	0.169	0.162	0.72375

a. Predictors: (Constant), tax literacy

The ANOVA results in Table 6 indicate a significant regression model predicting consumption tax compliance $F(140.416)p < 0.05$. This implies that tax literacy has a significant relationship with consumption tax compliance.

Table 6: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	16.850	1	16.850	140.416	0.000 ^b
1	Residual	33.104	274	0.120		
	Total	49.954	275			

a. Dependent Variable: Consumption tax compliance

b. Predictors: (Constant) tax literacy

Hypothesis H_{01} stating that tax literacy has no significant effect on consumption tax compliance among retailers in Starehe sub-county Nairobi, Kenya, was rejected since the study found that Tax literacy significantly affected consumption tax compliance $p\text{-value } 0.000 < 0.05$.

Table 7: Regression Coefficients

Model		Standardized Coefficients		Unstandardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.305	0.240		13.771	.000
	Tax Literacy	0.189	0.046	0.046	4.109	.000

a. Dependent Variable: Consumption tax compliance

4.4 Discussions of findings

The topic established the effect of tax literacy on consumption tax compliance among retailers in Starehe sub-county Nairobi, Kenya. The study found that there is a moderate positive correlation between Tax Literacy and Consumption tax compliance at 41.2%. This suggests that higher tax literacy is associated with higher compliance with consumption taxes. The correlation is statistically significant at the 5% level. The hierarchical regression found that tax literacy ($\beta = 0.189$, $p < 0.05$) has significant and positive effects on consumption tax compliance. The study agreed with a study by Kurniawan (2020) who examined if tax literacy at an institution of higher learning level affects personal tax compliance by raising awareness of taxes in Indonesia. The mixed method employs a convergent parallel technique. Using a parallel convergent procedure, the researcher concurrently gathered all quantitative and qualitative data from a survey of 100 learners who frequently participate in Politeknik Negeri Batam (Polibatam) evening classes and who meet the tax specifications. According to the study's findings, tax compliance is significantly impacted by tax literacy. Then, tax compliance is also greatly impacted by the indirect effect of tax literacy through tax knowledge.

5.0 Conclusion

The findings revealed that tax literacy positively influences consumption tax compliance among retailers in Starehe sub-county. The positive correlation, statistically significant at the 5% level, suggests that improving tax literacy leads to higher compliance rates. This highlights the importance of educational initiatives and resources aimed at increasing tax knowledge among retailers, as better-informed taxpayers are more likely to adhere to tax obligations.

6.0 Recommendations

The KRA should launch comprehensive tax literacy programs aimed at educating retailers about consumption tax regulations and their benefits.

The study further studies should be conducted to research the effects of behavioral factors on Consumption tax compliance.

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