

## Effect of Excisable Goods Management Systems on Domestic Tax Compliance Among Small and Medium Enterprises in Thika Sub-County

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### Abstract

**Purpose:** Despite the rapid adoption of e-filing in Kenya, the filing system is still unreliable especially at peak period and on voluntary usage which lead to low level of compliance perceived by taxpayer. The aim of the study was to determine the effect of excisable goods management system on domestic taxes compliance among small and medium enterprises in Thika town, Kenya. The study was anchored on the standard economic theory.

**Methodology:** The explanatory research design was employed. The target population was 2052 small and medium enterprises in Thika town with sample size of 334 small and medium enterprises. Primary data was collected using structured questionnaires out of the 334 issued questionnaires, 261 filled the questionnaires and submitted them accordingly, resulting in a 78.1% response rate. The data was analyzed using descriptive and inferential statistics.

**Results:** The study found that excisable goods management system had a positive and significant effect on domestic tax compliance  $\beta = 0.179$  and  $p = 0.004$ .

**Conclusion:** The government should invest in further enhancing the Excisable Goods Management System to ensure it is user-friendly and accessible to SMEs

**Keywords:** *Small and Medium Enterprises Excisable Goods Management Systems, and Domestic Tax Compliance*

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### 1.0 Introduction

Taxation is essential for sustainable economic development and tax administration is a basic function of a successful state. In most countries, taxation is the largest source of government budgetary resources. Taxation is therefore used to raise sufficient revenue to fund public spending without recourse to excessive public sector borrowing and it is also used to mobilize revenue in ways that are equitable and that minimize its disincentive effects on economic activities. However, one of the biggest threats to this method of financing governments is tax avoidance and evasion (Kiring'a et al., 2019).

Kenya government gets its major source of revenue from income tax. The government is able to fund public goods in order to improve the gross domestic product of the country. Mebratu (2016), contend that taxes collected by government enables the government to meet basic needs

of its citizens, provide security, and promote economic growth and development. Despite the outstanding revenue performance realized in the year 2018/2019 taxes such as PAYE, and other income tax accounts performed below the target, tax revenue is said to be optimal when we have a favourable outcome. This will mean that the country can depend on tax collected to run its affairs without borrowing debts to support the development agenda. The study is conducted to find out whether effective charge on immovable assets, court suits and tax agency of notices can affect tax revenue to close the gap between revenue and national debts.

EGMS was first rolled out in 2013 on alcohol and cigarettes. Since then the system has enabled KRA to raise Sh5.6 billion monthly. EGMS has also contributed immensely to the fight against illicit trade and leveled the playing ground for traders as well as protected consumers from substandard products. Through the system, KRA has seized illicit products worth millions of shillings and saved the country from losing revenue. The installation of the KRA EGMS equipment on the manufacturers' production lines is done at no cost to the Industry. Any incidental costs may occur depending on the contractual and warranty requirements between manufacturers and their equipment suppliers. EGMS is designed to have minimum impact on the efficiency of manufacturers' production lines. To this end, EGMS operates at speeds that are at least 2.5 times faster than the highest installed production speed in the country. EGMS has redundancies that allow production to continue in the case of a lack of connectivity to KRA. The Authority provides round a clock technical support service framework to ensure limited interruptions (KRA, 2019).

SMEs refer to businesses that have maintained revenues, assets, and employees below a certain threshold. In Kenya, SMEs are characterized to have less than 99 employees and contribute roughly 50% of total employment and 40% of the GDP according to OECD (2016). In Malaysia Small and Medium Enterprises (SMEs) constitute a large proportion of Malaysian enterprises and make significant contributions to employment, GDP, and exports, it is vital for the achievement of Malaysia's development aspirations (Kuriakose & Haris, 2022). Small and medium enterprises are considered those enterprises which have fewer than 250 employees. In distinguishing between small and medium sized enterprises, the small enterprise is defined as an enterprise, which has fewer than 50 employees. These businesses are often referred to as SME's and are traditionally associated with owner operators (Meredith 2001, ATO 2004, Schaper & Volery 2004).

Small and Medium Enterprises (SMEs) have been defined as propellers for the future economy. Studies on SMEs and entrepreneurship have risen considerably over the past decade (Mwangi, 2018). It has been increasingly acknowledged that small and medium-sized enterprises are not only essential to job creation and wealth creation but also to foster entrepreneurship, competition, and innovation leading to sustainable growth and development. SME growth has long been seen as vital to achieving wider development goals, including poverty alleviation, economic development, and promoting more democratic and pluralistic societies (Ombongi & Long, 2018).

### **1.1 Problem Statement**

SMEs have long been recognised as a priority sector for growth and development in Kenya with more than 70 percent of the gross domestic product (GDP) under SMEs' control. Locally, KRA continues to experience revenue shortages against targets. Focus on KRA Thika Tax Service office (TSO) indicate that, in year 2020/2021 actual collection for TOT, advance tax, VAT and PAYE was Kshs.3.1M, Kshs.26.9M, Kshs.1,152M and Kshs.1,261M respectively against targets of Kshs7.3M, Kshs.43.3M, Kshs.1,174M, and Kshs.1,329M respectively. These

represent a performance of 42%, 62%, 98% and 95% respectively against targets. Further, year 2021/2022 actual collection for TOT, Advance tax, VAT, and corporate tax was Kshs.4.7M, Kshs.19.1M, Kshs.1,104M, and Kshs.585M respectively against targets of Kshs5.9M, Kshs.28.3M, Kshs.1,229M, and Kshs.831M respectively. This indicates performance of 78%, 67%, 90%, and 70% respectively against targets (KRA,2022). Most SMEs do not pay taxes and tax evasion among SMEs remains far above the ground, with a tax gap of about 35% and 33.1% in 2019 and 2020 respectively. A Thika-based factory was shut down in February 2019 over KSh 41 billion tax evasion allegations (KRA, 2020).

Past studies have been conducted on electronic tax systems and tax compliance It is on the basis of the aforementioned research gaps that the current study seeks to determine the effect of electronic tax systems, such as Itax, excisable goods management system, and electronic tax register on domestic taxes compliance among small and medium enterprises in Thika town, Kenya.

## **2.0 Literature Review**

### **2.1 Theoretical review**

Cairnes (1888) asserts that men desire to obtain wealth with the least exertion of labor possible. IDT which was developed by Rogers in 1962 is one of the oldest social science theories to study any kind of innovation (Tornatzky and Klein, 1982). This theory was a result of several diffusion studies which had been done in 1950s and focused on individuals' differences in innovativeness. Rogers (2003) proposed the following four major factors for determining behavior: innovation, communication channels, time, and social systems.

For the application of IDT in information technology field, Fichman (1992) mentioned that IDT is a good application for studying technology adoption, evaluation, and implementation. In addition to assessing both quantitative and qualitative studies of diffusion of technology. The quality of services provided determines the extent of qualitative advantage accurate by system (Ibrahim, Hilles, Adam, and ELEbiary, 2016). For the extension work of the IDT in information technology done by Moore and Benbasat (1991), they adopted the five attributes of innovations presented in IDT and refined a set of constructs that could be used to study individual technology acceptance (Udeh, 2008).

This work contributes to individuals' initial adoption of IT in organizations and technology diffusion within organizations. They added the voluntariness of use and image to the Rogers model's constructs. As a consequence, the factors compatibility, perceived usefulness (relative advantage), and ease of use (complexity) were the most influential factors on usage decisions, while demonstrability result, image, visibility, and trialability were not significantly influencing in determining individuals' usage.

### **2.2 Empirical review**

#### **2.2.1 Excisable Goods Management System**

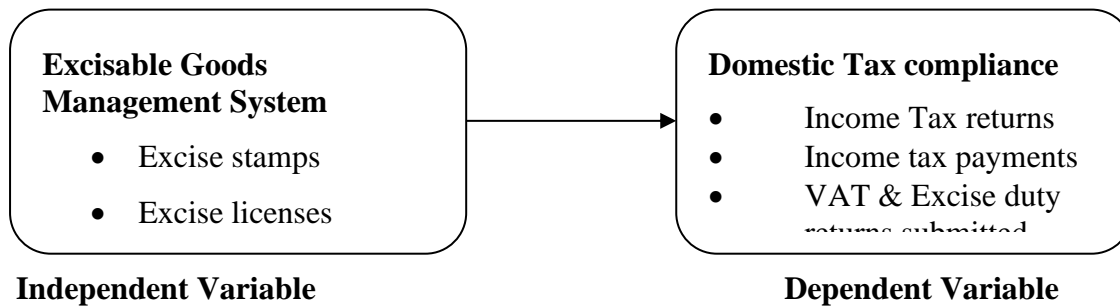
Ndayisenga and Shukla (2016) examined the effects of electronic tax management system on revenue collection by Rwanda Revenue Authority. The research had three specific objectives namely; to analyze the effect of internet payment system on tax collection in Rwanda; to examine the effect of mobile payment system on tax collection in Rwanda and to examine the effect of electronic billing machines on tax collection in Rwanda. The researcher used a descriptive method of study based on qualitative and quantitative approaches to get a better analysis of the study. The population size was 120 and sample taken is 75 respondents. Both primary and secondary sources with their relevant tools like questionnaires and documentary

analysis to come up with required data. The results indicated there was a significant relationship between electronic tax management system and effectiveness of revenue collection in Rwanda. The study concluded that electronic tax management systems contribute positively to revenue collection in Rwanda.

Gitaru (2017) studied the impact of system automation on revenue collection in Kenya Revenue Authority. This study employed a descriptive study design. The study used secondary data collection. The study utilized KRA Customs data for ten financial years after Simba System. The data was analyzed using Gretl and presented in figures and tables. The study findings established that the number of transactions increased significantly after the implementation process this means that due to revenue systems automation, a high number of imported consignments were processed and passed through the centralized Document Processing Center (DPC). The study findings also established that the revenue collected increased at an increasing rate after the implementation of Simba system. The study recommended that the ICT department should ensure that there is effective project coordination and change management for success of this automated system.

### 2.3 Conceptual Framework

A conceptual framework is a concise description of the phenomenon under the study, accompanied by a graphical description of the major variables of the study. The conceptual model represented in Figure 1 describes the relationship between the variables of study accordingly:



**Figure 1 Conceptual Framework**

### 3.0 Methodology

The explanatory research design was employed. The target population was 2052 small and medium enterprises in Thika town with a sample size of 334 small and medium enterprises. Primary data was collected using structured questionnaires. The technique was suitable since the target population is classified into three strata (groups), which include manufacturing, trade and service. The target respondents were owners of these businesses.

Sekaran (2003) notes that reliability is a measure of stability and consistency with which instrument measures the concept. The Excisable Goods Management System had a Cronbach's Alpha of 0.809, and Domestic Tax Compliance achieved an acceptable reliability with an alpha of 0.800, indicating a relatively stable and consistent measurement across its five items.

**Table 1: Test of Reliability of Questionnaire**

Factor	Number of Items	Cronbach Alpha score	Conclusion
Domestic Tax Compliance	5	0.800	Reliable
Excisable goods management systems	5	0.809	Reliable

## 4.0 Results and Discussion

### 4.1 Descriptive Statistics

Table 2 is composed of: EGMS has contributed immensely in the fight against illicit trade with a mean score of 4.16, SD of 0.892. EGMS has leveled the playing ground for me as well as protected me from substandard products with a mean score of 4.20, SD of 0.982 EGMS has redundancies that allow production to continue in the case of lack of connectivity with a mean score of 3.93, SD 0.940. The authority provides round a clock technical support service framework to ensure limited interruptions mean score of 3.97, SD 0.782. Lastly, EGMS is designed to have minimum impact on the efficiency of manufacturers' production lines with a mean score of 4.03, SD 0.874.

**Table 2: Descriptive Statistics Excisable Goods Management System**

	N	Mean	Std. Deviation	Skewness	Kurtosis
EGMS has contributed immensely to the fight against illicit trade.	261	4.16	.892	-.612	-.335
EGMS has leveled the playing ground for me as well as protected me from substandard products.		4.20	.982	-.281	-1.526
EGMS has redundancies that allow production to continue in the case of lack of connectivity		3.93	.940	.146	-1.860
The authority provides round a clock technical support service framework to ensure limited interruptions.		3.79	.782	.381	-1.268
EGMS is designed to have minimum impact on the efficiency of manufacturers' production lines.		4.03	.874	-.067	-1.693
Mean		4.02			

Table 3 shows: that I am aware of the due dates for filing tax returns with a mean score 4.00., SD 0.792. I make tax payments on time with a mean score 3.90, SD 0.904. I make correct tax declaration with a mean score 3.96, SD 0.958. I comply with tax registration requirements by KRA with a mean score 4.03, SD 0.946. I comply with tax reporting requirements, procedural rules and regulations set by KRA. with a mean score 4.05, SD 0.952

**Table 3: Descriptive statistics of domestic tax compliance**

	N	Mean	Std. Deviation	Skewness	Kurtosis
I am aware of the due dates for filing tax returns	261	4.00	.792	.007	-1.403
I make tax payments on time.		3.90	.904	-.470	-.275
I make correct tax declaration.		3.96	.958	-.445	-.886
I comply with tax registration requirements by KRA.		4.03	.946	-.630	-.469
I comply with tax reporting requirements, procedural rules, and regulations set by KRA.		4.05	.952	-.740	-.159
Mean		3.99			

#### 4.2 Correlation Analysis

Correlation analysis is a statistical tool used to identify the direction of the relationship between variables in a study. Table 4 shows excisable goods management systems has a positive and significant correlation to domestic tax compliance up to 47.2%:

**Table 4: Correlations Statistics of Independent and Dependent Variable**

	Domestic compliance	Taxes excisable management systems.	goods management systems.
domestic taxes compliance	1	0.472**	
Excisable goods management systems.	0.472**	1	

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

#### 4.3 Regression Analysis

The results in Table 5 indicated that Excisable goods management systems had a positive correlation with Domestic tax compliance up to 4.72% or (R= 0.472). The results reveal that excisable goods management systems caused a variation of 18% or (R<sup>2</sup>=0.223 and adjusted R<sup>2</sup> =0.216) on Domestic tax compliance.

**Table 5: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.472 <sup>a</sup>	.223	.216	.44870

a. Predictors: (Constant), Excisable goods management systems \_mean

The ANOVA was used to analyze the significance of the variation caused by excisable goods management systems on domestic tax compliance. Table 6 indicates that there is an F statistic of 117.084 and P-value of  $0.000 < 0.05$  indicating that there is a significant variation caused by Excisable goods management systems on domestic tax compliance. The implication is that Excisable goods management systems contribute significantly to changes in domestic tax 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 6: Analysis of Variance**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	29.271	1	29.271	117.084	.000 <sup>b</sup>
	Residual	64.751	259	0.250		
	Total	94.022	260			

The hypothesis  $H_{01}$  stated that Excisable goods management systems have no significant effect on Domestic tax compliance among small and medium taxpayers in Thika sub-County. Excisable goods management systems have a positive relationship effect on the domestic tax compliance among small and medium taxpayers in Thika Sub County. The results in Table 7 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 7: Regression Coefficients**

Model		Standardized Coefficients		Unstandardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.844	0.227		3.718	0.001
	Excisable goods management systems	0.179	0.061	0.183	2.934	0.004

a. Dependent Variable: Domestic Tax Compliance

#### 4.4 Discussion of the Findings

The study was to establish the effect of excisable goods management system on domestic tax compliance among small and medium enterprises in Thika Sub-County. The correlation matrix exhibited that excisable goods management system demonstrated a positive correlation with Domestic tax compliance, with a coefficient of 47.2% this indicates that enhancing the management of excisable goods contributes positively to tax compliance. The study found that excisable goods management system had a positive and significant effect on domestic tax compliance  $\beta = 0.179$  and  $p = 0.004.$ , Suggesting that better management of excisable goods enhances domestic tax compliance substantially. The study agreed with Ndayisenga and Shukla (2016) who examined the effects of electronic tax management systems on revenue collection by Rwanda Revenue Authority. The results indicated there is was a significant relationship between electronic tax management system and effectiveness of revenue collection in Rwanda. The study concluded that electronic tax management systems contribute positively to revenue collection in Rwanda.

#### 5.0 Conclusion

The study concludes that an effective Excisable Goods Management System significantly contributes to improved domestic tax compliance among SMEs. The positive impact observed suggests that better management and regulation of excisable goods are vital for encouraging compliance, underscoring the need for continuous improvements in the management of these goods to boost tax compliance.

#### 6.0 Recommendations

The government should invest in further enhancing the Excisable Goods Management System to ensure it is user-friendly and accessible to SMEs. The government should also mandate regular training and workshops for SMEs to educate them on the benefits and use of the Excisable Goods Management System. This can help reduce the learning curve and encourage more businesses to comply. Future studies should be conducted on the effects of behavioral factors on Domestic Tax Compliance

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