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The Effect of Peer Influence on Turnover Tax Compliance among Small and Medium Enterprises in Meru County, Kenya

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Abstract

Purpose: Turnover tax was introduced in Kenya in 2007 to enhance revenue collection, improve tax administration and reduce non-compliance and collection costs among the micro, small and medium enterprises. The main objective of the study was to determine the effect of peer influence on turnover tax compliance among small and medium enterprises in Meru County, Kenya. The study was guided by theory of planned behaviour.

Methodology: The study adopted an explanatory research design to enable the generalization of the study hypotheses. The target population was 1756 small and medium enterprises in Meru town and a sample size of 325 respondents. The study showed that the response rate for the questionnaire was 72.0%, showing that 234 out of 325 participants correctly filled the and submitted their questionnaires. The study used primary data, collected through questionnaires which was administered through drop and pick later method.

Results: The study found that peer influence had a positive and significant effect on turnover tax compliance ($\beta = 0.237$, $p = 0.000$).

Conclusion: Based on the findings, the study recommends that the government enhance programs that foster peer influence, as it has been shown to positively affect tax compliance. Future studies could also investigate the effects of KRA m-service on turnover tax compliance.

Keywords: *Small and Medium Enterprises, Peer Influence, Turnover Tax Compliance*

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1. Introduction

Taxation is the major avenue of revenue collection by governments all over the world. Revenue collection is very important as it enables the government to acquire assets that are not liable to debt and which the government uses to develop its economy. So, revenue is collected by the government upon its citizens for support or to facilitate service delivery in a country. It is neither a voluntary payment by the taxpayer nor a donation. Rather it is an enforced payment to the government (Aamir et al., 2021). A study by Edward (2019) revealed that revenue collection is a major challenge facing many countries worldwide but the challenges are more in developing countries in comparison to developed countries.

Turnover tax is under the Income Tax Cap 470. It was introduced under the subsidiary legislation; The Income Tax (Turnover Tax) Rules 2007. The rule took effect from the 1st of January 2008. It was liable to any resident person whose income from business was accrued or derived from Kenya and whose turnover did not exceed KES5 million during any year of income. There have been changes in Turnover Tax Law, where it was scraped in the year 2018/2019 and reintroduced again and took effect from the 1st of January 2020. Currently, there have been various changes to the prevailing tax laws in Kenya, KRA, (2019).

Peer influence, also known as peer pressure, refers to the impact that a peer group or individual peers have on an individual's attitudes, behaviors, and values. This influence can be positive or negative and can affect various aspects of a person's life, including academic performance, social behaviors, and personal choices, Brown, (2022). Peers are defined generally to mean the taxpayer's associates that can coherently include relatives, friends, co-workers, and colleagues (Bidin et al., 2018; Jackson & Milliron, 1986). Previous studies have examined the significance of peer influence as far as income taxpayer compliance is concerned including Clotfelter (1983) who stated that peers play an important role in income taxpayer compliance

The small business taxpayers who do not qualify for VAT pay the turnover tax. This tax was aimed at bringing businesses in the informal sector into the tax bracket. These businesses include small-scale manufacturing firms and Jua Kali businesses, agricultural enterprises, and transport industries. The turnover tax rate was set at three percent. Turnover tax does not apply to rental income, management or professional fees, or training fees, income is subject to withholding tax as a final tax and income of turnover companies (Ojeka, 2020).

Several studies have been carried out on Small and Medium Enterprises (SMEs) both locally, regionally, and globally. One important finding by a majority of these studies is that SMEs contribute greatly when it comes to employment and gross domestic product (GDP). According to Quader, (2009), the general argument is that SMEs contribute significantly to a country's GDP in Kenya. For example, Miller and Nyauncho, (2014) say that SMEs are estimated to contribute about 20% of the GDP. On employment, it is estimated that 80% of job opportunities in Kenya are provided by SMEs (Miller and Nyauncho, 2014). Other contributions of SMEs to the economy are through tax base expansion and driving innovation (Katua, 2014). In Kenya, Economy Recovery Strategy (ERS) estimates that 500,000 jobs would be created annually with 88% of these generated through SMEs.

1.1 Problem Statement

Despite undertaking many tax reforms, the Kenya Revenue Authority has been trying to establish ways of ensuring that the set revenue targets are achieved. The Kenya Revenue Authority has consistently missed its turnover tax targets over the years although the revenue collections have been growing KRA, (2020). This could explain KRA's failure to meet revenue targets over the years. In the financial year 2021/2022, TOT collection amounted to Kshs. 99,739,158 against a target of Kshs 135,050,379 representing a performance of 73.6%(KRA,2022). In the 2022/2023 financial year, TOT collection was Kshs 112,653,556 compared to a target of Kshs 128,112,921 which resulted in a deficit of Kshs 15,459,365 (KRA,2023). Furthermore, as of the close of March 2023, total revenue collection averaged 95.1% on original target and 93.4% on Supplementary target (KRA reports,2023). Since the implementation of TOT in 2007, various attempts and efforts have been made to bring the SME sector into the tax bracket however, despite these efforts, tax compliance among SMEs is low although its productivity is increasing. This is a problem for the government as it should ensure that there is sufficient revenue to support its operations.

2. Literature Review

2.1 Theory of Planned Behaviour (TPB)

The theory of planned behaviour developed by Icek Ajzen attempts to make predictions about how people will act based on the premise that behaviour is usually deliberate. (Ajzen, 1991). This theory sought to clarify and extend the theory of reasoned action and multi-attribute attitude. Ajzen and Fishbein (1974), states that behavioural decision-making process of human beings is aimed at understanding and predicting the behaviour of the individual and advocating that the successful completion of human behaviour is controlled by the individual's will.

LaMorte (2022) states that human behaviour is governed by three elements: attitudes, subjective norms, and perceived behavioural control. According to Zhang (2018), attitude and subjective norms, which are influenced by societal views and attitudes, which can be either positive or negative are the two elements that govern people's behaviour and intention. Ajzen (1985), also highlights that human behaviour is more often affected by factors of external and objective circumstances rather than completely controlled by the individual's will. The concept aimed at improving the prediction power by including perceived behaviour controls besides subjective norms and attitudes. He continues to state that the behaviour of individuals within the society is influenced by defined factors, which emanate from certain emerged planned ways. The ability to perform a particular behaviour intention depends on the three attributes.

The theory of planned behaviour is a principal theory in various research studies such as alcohol drinking (Reynolds & Klik, 2020), and saving behaviour (Satsios & Hadjidakis, 2018) additionally, an individual may also be more likely to conform to the norms and values of a group to gain approval or to avoid rejection. Social influence theory assumes that specific individual behavior in taxation, like other forms of behaviours, is fundamentally influenced by social interaction (Bello & Danjuma, 2014).

2.2 Empirical Review

2.2.1 Peer Influence and Turnover Tax Compliance

Grasmick and Scott (2020) indicated that taxpayers with peers who are tax noncompliant are more likely to be tax non-compliant as well. Mason et al (2021) also found that taxpayers practicing tax noncompliance have a high likelihood of discussing tax issues with their peers. Another study carried out by Chan et al (2020) also revealed that taxpayers may decide to be non-compliant as long as this noncompliance is regular with in-group beliefs and norms.

According to Kelman (2021), the social influence theory postulates that surrounding environmental factors affect the behaviour of people, either deliberately or non-deliberately. It focuses on how other people's beliefs, views, and behaviours affect an individual (Sussman and Gifford 2019). The social influence theory is connected to the theory of social learning, which is based on Bandura's (2023) idea that an individual's environment influences them. It also emphasizes the effect of peer opinions and level of social influence on an individual's relationships in socialization, as being essential in identifying tax evasion behaviour (Sutinen & Kuperan, 2018).

Lu et al. (2022) found that the capital structure of Chinese enterprises is affected by the capital structure of their peers. Further, they found that the influence mechanism of peer effects mainly includes the managers' reputation consideration. Adhikari and Agrawal (2018) found that companies' dividend and share repurchasing policies are significantly influenced by peer company policies. Grennan (2019) also confirmed that a company's dividend distribution policy has a significant peer effect. While there is substantial literature documenting peer effects in other settings, the study of peer effects in taxes is novel; little research exists on peer effects in corporate tax avoidance and their impact mechanism. In this study, we investigate the role of peer effects in corporate tax avoidance.

King'oina (2019) indicates that despite the existence of administrative reforms, the compliance level for Value Added Tax has been low in Kenya due to factors such as poor understanding of VAT laws and negative perceptions and attitudes towards payment of VAT. On average about 30% of all taxpayers fail to submit their VAT returns and many each year face prosecution for failing to file complete returns (Onditi, 2022). Other studies have been done in the areas of Value Added

2.2.2 Turnover Tax Compliance

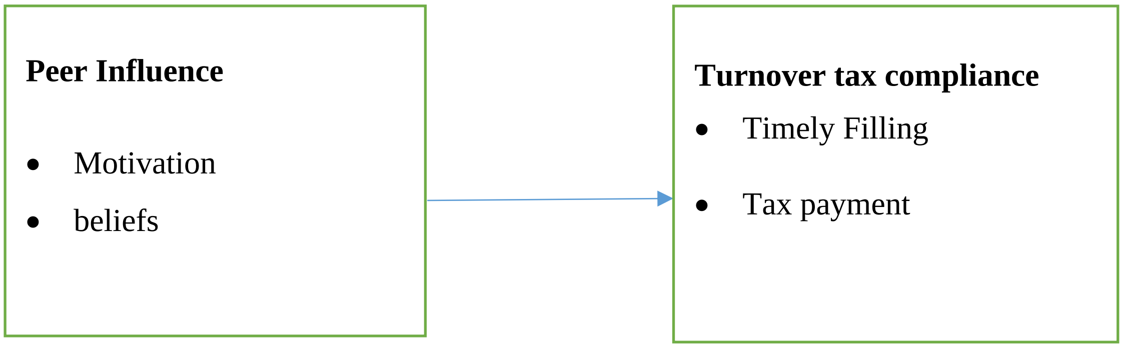
The turnover tax is a tax charge on a businesses' gross income without deducting expenses. Taxpayers must comply with the aspects of the tax code concerning indirect taxes, collecting taxes as directed, and sorting transactions eligible for taxation. This information is submitted at a time taxes are paid to show how much was collected on the government's behalf (Parkin, 2018)

According to Deloitte (2020), the Tax Laws Amendment Bill (2020) assented to by the President introduced new provisions that guide Income Tax Act. The TOT tax falls within this category of taxes affected by the 2020 provisions. The tax is charged at one percent of the gross monthly sales. It is filed every 20th day of the month after the review month. The presumptive tax is an integral part of taxation laws in Kenya. According to Tirimba, Muturi, and Sifunjo (2019), it has been argued that presumptive tax and turnover tax amounts to double taxation because they are charged together.

According to Mwangi (2020), TOT is a tax payable by small and medium-scale enterprises taxpayers in Kenya. The tax is charged as 3 percent of the gross revenue from the operations of a business enterprise. Notably, the tax is charged on the revenues and does not net the expenses in the year under review. The tax is charged on businesses that earn an income not exceeding Kshs. 50 million or a business whose turnover is not expected to exceed the amount.

2.3 Conceptual Framework

A conceptual framework is a diagrammatic representation of the variables of the study (McGaghie et al, 2018). Miles and Huberman (1994) defined a conceptual framework as a visual or written product, one that explains either, graphically or in a narrative form, the main aspects to be studied the key factors, concepts, or variables, and the presumed relationship among them. The conceptual framework is created to demonstrate relationships between independent variables and dependent variables. As shown in Figure 1, the independent variable was peer influence was measured by motivation and beliefs and the dependent variable was turnover tax compliance which was measured by Timely Filling and Tax payment.



Independent Variable **Dependent Variable**

Figure 1: Conceptual Framework

3. Methodology

A research design constitutes the collection, measurement, and analysis of data. Cooper and Schindler (2018), defines research design as the plan and structure of investigation to answer the research question. This study employed an explanatory research design to draw the nature and the direction of the association between the study variables. This is intended to generalize the study findings from which the sample is chosen. Explanatory research design answers why questions which help to develop causal explanations (Kerlinger, 2022). The population of interest which is the unit of analysis will be 1,756 small and medium enterprises in Meru town Kenya, KRA, (2023). Meru is known for its agricultural activities, especially the production of tea, coffee, and miraa (khat). SMEs involved in agro-processing, distribution, and support services benefit from a steady demand for agricultural products. The response rate for the questionnaire was 72%, showing that 234 out of 325 participants correctly filled the and submitted their questionnaires. Table 1 presents a summary of respondent details.

Table 1: Response Rate

	Number	Percentage %
Response Rate	234	72.0%
Non-Response Rate	91	28%
Sample Size	325	100%

Sekaran (2003) stated that the reliability of a measure is an indication of the stability and consistency with which the instrument measures the concept and helps to assess the "goodness" of a measure. The Cronbach's alpha coefficient of 0.7 was used as the benchmark for this study. Table 2 shows the results indicate high internal consistency for all constructs. Specifically, turnover tax compliance (α = 0.905, 5 items), and peer influence (α = 0.892, 4 items), These findings suggest that the items within each construct are highly correlated and measure the same underlying concept, providing confidence in the reliability of the scales used in this study.

Table 2: Test of Reliability of Questionnaire

Factor	Number of Items	Cronbach Alpha score	Conclusion
Turnover tax compliance	5	0.905	Reliable
Peer influence	4	0.892	Reliable

4. Results and Discussion

4.1 Descriptive statistics

4.1.2 Descriptive statistics peer influence

Table 3: showed that the item "My friends, neighbours, and other business owners comply with tax matters" received a mean score of 4.01 (SD = 1.123), indicating that respondents generally agree with this statement. The standard deviation suggests moderate variability in responses. The statement "The government should reward those who are TOT compliant" had a mean score of 4.04 (SD = 1.050), showing that respondents tend to agree. The standard deviation reflects moderate variability. For the item "There is a high degree of being detected for not complying," the mean score was 3.82 (SD = 1.132), suggesting that respondents are somewhat uncertain but lean towards agreement. The standard deviation indicates moderate variability. The statement "Other business owners motivate me to comply with tax laws" received a mean score of 4.00 (SD = 1.066), indicating agreement among respondents. The standard deviation shows moderate variability.

Table 3: Peer Influence

	N	Mean	Std. Deviation	Skewness	Kurtosis
My friends, neighbours, and other business owners comply with tax matters	234	4.01	1.123	-.732	-.710
The government should reward those who are TOT-compliant.		4.04	1.050	-.684	-.837
There is a high degree of being detected for not complying.		3.82	1.132	-.466	-1.063
Other business owners motivate me to comply with tax laws.		4.00	1.066	-.737	-.572

4.1.2 Descriptive Statistics for Turnover Tax Compliance

Table 4: shows that the statement, "My business files its tax returns on time," received a mean score of 3.92 (SD = 1.111). The mean suggests that respondents generally agree with the statement, while the standard deviation indicates a moderate variability in responses. For the statement, "I have registered for turnover tax compliance obligation," the mean score was 4.01 (SD = 1.050), indicating agreement among respondents. The relatively small standard deviation implies moderate variability in responses. The statement, "I pay the tax liability that

arises from my TOT obligation without failure," received a mean score of 3.77 (SD = 1.134). This means that respondents tend to agree with the statement, although with some uncertainty. The standard deviation suggests moderate variability in responses. For the statement, "The tax system in place motivates me to voluntarily comply with tax obligations," the mean score was 4.02 (SD = 1.082), indicating a general agreement. The standard deviation shows moderate variability in responses. Lastly, the statement, "I file my returns accurately," had a mean score of 4.00 (SD = 0.998), indicating respondents generally agree with this statement. The standard deviation suggests lower variability in responses.

Table 4: Turnover Tax Compliance

	N	Mean	Std. Deviation	Skewness	Kurtosis
My business files its tax returns on time	234	3.92	1.111	-.634	-.689
I have registered for turnover tax compliance obligation.		4.01	1.050	-.631	-.905
I pay the tax liability that arises from my TOT obligation without failure.		3.77	1.134	-.409	-1.109
The tax system in place motivates me to voluntarily comply with tax obligations.		4.02	1.082	-.739	-.642
I file my returns accurately.		4.00	.998	-.810	-.143

4.2 Correlation Analysis

The correlation analysis was used to determine the relationship between each of the variables of the study and the significance of the relationship. Table 5 shows the correlations between several variables and TOT compliance. Peer influence had a positive and significant correlation with TOT compliance ($r = 0.459$, $p = 0.012$), suggesting that as peer influence increases, so does compliance with turnover tax obligations.

Table 5. Correlations Statistics

	Value-added tax Compliance	Court Suits
TOT Compliance	1	0.459**
Peer influence	0.459**	1

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

4.3 Regression Analysis

Table 6 showed that peer influence had a positive correlation with TOT compliance up to 45.9% or (R= 0.459). The results reveal that peer influence caused a variation of 21% or (R^2=0.210 and adjusted R^2 =0.204) on TOT compliance.

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Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.459[a]	.0.210	.204	.35809

a. Predictors: (Constant), Peer influence _mean

Table 7 showed that there was an F statistic of 354.652 and a p-value of 0.000<0.05, which indicates that the model was significant in explaining the variance caused by TOT compliance.

Table 7: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	168.460	1	168.460	354.652	0.000
	Residual	110.319	232	0.475		
	Total	278.779	233			

a. Dependent Variable: TOT compliance

b. Predictors: (Constant), peer influence

Table 8 showed that unit change in peer influence caused a 0.237 increase in TOT compliance. The study found that peer influence had a positive and significant effect on TOT compliance β =0.237 p-value =0.000<0.05. The hypothesis was rejected.

Table 8: Regression Coefficient analysis

Variable	Standardized β	Std. Error	t-Statistic	Unstandardized β	Prob.
Constant	0.124	0.057	2.175		0.012
Peer Influence	0.237	0.055	4.309	0.262	0.000

4.4 Discussion of the Findings

The study objective sought to determine the effect of peer influence on turnover tax compliance among small and medium enterprises in Meru County, Kenya. The correlation matrix found that peer influence had a positive and significant correlation with TOT compliance (r = 0.459, p = 0.012), suggesting that as peer influence increases, so does compliance with turnover tax obligations. The coefficient analysis showed that peer influence had a positive and significant effect on turnover tax compliance (β = 0.237, p = 0.000), thus indicating that stronger peer influence is significantly associated with improved turnover tax compliance. The study was in agreement with Mason et al (2021) also found that taxpayers practicing tax noncompliance have high likelihood of discussing tax issues with their peers. Another study carried out by Chan et al (2020) also revealed that taxpayers may decide to be noncompliant as far as this noncompliance isregular with in-group beliefs and norms.

5. Conclusion

The study sought to determine the effect of peer influence on turnover tax compliance among small and medium enterprises in Meru County, Kenya. Based on the findings, the study concludes that peer influence has a significant positive effect on turnover tax compliance. SMEs that experience stronger peer influence are more likely to comply with turnover tax obligations, suggesting that peer networks play a crucial role in promoting tax compliance.

6. Recommendations

Based on the findings, the study recommends that the government enhance programs that foster peer influence, as it has been shown to positively affect tax compliance.

Future studies could also investigate the effects of KRA m-service on turnover tax compliance.

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