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Effect of Tax Knowledge on Residential Rental Income Tax Compliance Among Landlords in Embu Municipality, Embu County, Kenya

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Abstract

Tax compliance is a big challenge facing small, medium, and large taxpayers, and governments in both developed and developing countries, because it threatens the capacity of tax authorities to raise expected revenue. Therefore, the study aimed to establish the effect of tax knowledge on residential rental tax compliance among landlords in Embu Municipality, Embu County, Kenya. The study was guided by social learning theory. An Explanatory research design was adopted for this study, targeting a population of 2600 landlords, with a sample size of 346 respondents in Embu Municipality, using a simple random sampling technique. Of the 346 questionnaires that were administered, 265 were properly filled out and returned, which represents a 76.6 % response rate. Primary data was collected through the use of closed-ended questionnaires. The study found that tax knowledge has a significantly positive effect on residential rental income tax compliance ($\beta = 0.138$, $p = .026$). Based on the findings, the study recommends that the government should develop comprehensive taxpayer education programs specifically tailored for landlords in the residential rental sector. These programs should simplify complex tax concepts and be delivered through accessible channels to improve fiscal literacy. Future research should investigate the effects of moral obligations on residential rental income tax compliance.

Keywords: *Landlords, Tax Knowledge on Residential Rental Tax Compliance*

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1. Introduction

Tax compliance continues to be a contemporary policy concern in many developing countries as the governments search for ways to enhance effectiveness in tax revenue mobilization to finance their expanding budgets (Maseko, 2014). The tax system in most developing countries is generally suspected to be extremely inefficient and riddled with evasion, corruption, and compulsion. Unfortunately, despite some improvement, the general array of tax compliance remains low in many instances, and a significant segment of the economy's informal economy remains untaxed (McKerchar & Evans, 2009).

Residential income tax is tax on behalf of every resident person who earns or obtains income from the use and occupation of residential accommodation in Kenya. From the year 1st January

2016, residents earning income from landlords were allowed a simplified tax. The legislation of Finance Act in 2020 enhanced the limits that set the annual gross rental income of KES 10 million till increase the new limit of setting to KES 15 million. The landlords falling under this category are liable to pay residents rental income tax on the gross rental income at the rate of 10% whereby no expenses are allowed in the computation of tax. The other laws include; The Finance Act 2023 which sought to lower the rental income tax rate to 7.5% effective 1st of January, 2024.

Tax knowledge and education are also considered to be a vital part of attitudes towards tax compliance. Kirchler *et al.* (2008) point that knowledge of tax is crucial since when an individual knows what is supposed to be done at any time, he/she will always comply. Knowledge is power as they say. Poor knowledge of taxation can lead to a distrust and negative attitude towards tax; while good tax knowledge correlates with a positive attitude towards tax (Hofmann, Hoelzl & Kirchler, 2008). According to Mwangi (2014) one of the main tax evasion reasons is the high personal income tax rates, which tend to lead taxpayers to evade tax.

Embu County is one of the counties in the Republic of Kenya. Embu is centrally located in Embu County; it was also the headquarters of the former Eastern Province it has a population of 608,599 persons. The county shares the following borders: Kirinyaga County to the west, Kitui County to the east, Tharaka Nithi to the North, and Machakos to the South. It covers a geographical area of 2,821-kilometer square kilometers with the following Chain of the County Map.

1.1 Problem Statement

Residential income tax is tax on behalf of every resident person who earns or obtains income from the use and occupation of residential accommodation in Kenya. From the year 1st January 2016 residents earning income from landlords were allowed a simplified tax. The legislation of Finance Act in 2020 enhanced the limits that set the annual gross rental income of KES 10 million till increase the new limit of setting to KES 15 million. The landlords falling under this category are liable to pay residents rental income tax on the gross rental income at the rate of 10% whereby no expenses are allowed in the computation of tax. The other laws include; The Finance Act 2023 which sought to lower the rental income tax rate to 7.5% effective 1st of January, 2024.

Besides the tremendous growth from the real estate sector during the past few years, the corresponding tax collection from the sector has remained very low. For instance, the Revenue Authority did not meet its target in 2022/2023 financial year; Kenya Revenue Authority collected 10,758.03 billion as compared to the target of 12,444.11 billion (KRA report, 2021). According to a report by KRA (2024), KRA has continuously performed below its targets. For instance, in 2023/2024 financial year, the authority collected Kes 14.4 billion against a set target of Kes 16.3 billion. Therefore, there was a need to carry out a study on the effect of tax knowledge on residential rental income tax compliance among landlords in Embu Municipality, Embu County, Kenya.

2. Literature Review

2.1 The Social Learning Theory

The proponent of this theory was Bandura (1977) and its main argument is that people learn and therefore acquire knowledge by observing, modeling and reinforcement from their social environment including peers and other influential figures. Thus, taxpayers are likely to increasingly comply with their established tax laws when they observe that other taxpayers are also doing so. Taxpayers are also likely to comply if some social rewards are evident after their compliance, and social punishment in case of lack of compliance

Furthermore, this theory places emphasis on the implication of self-efficacy or beliefs from an individual's point of view to carry out a specific behavior and action, like compliance with residential rental income tax. In light of residential rental income, taxpayers feeling confident in their ability to comprehend tax laws are likely to comply with their tax obligations (De-Neve, Imbert, Spinnewijn, Tsankova, & Luts, 2021). Taxpayers receiving education programs are more likely to comply with the laws governing taxation as compared to those with limited education and knowledge.

According to Kogler *et al* (2013), the education programs of taxpayers should place more emphasis on enhancing the confidence level of the taxpayers in their ability to comply with established tax regulations. Tax knowledge is an important variable that can support and enhance tax compliance among taxpayers in a country. This knowledge can be acquired through formal and informal training programs. Thus, this theory was used to underpin the independent variable of tax knowledge as it relates with compliance with residential rental income tax compliance.

2.2 Empirical Review

2.2.1 Tax knowledge

Knowledge in taxation is necessary to enhance public awareness of the rules of taxation and the role it plays in national development, affirms a study by Palil (2010. Once they possess the relevant knowledge pertaining to the importance of taxation, such persons will therefore be influenced to comply voluntarily without any enforcement or pressure being exerted on them. In addition, tax attitudes could also be enhanced by applying knowledge on taxation, and thus when a taxpayer develops an attitude that is positive attitude towards the tax, this may affect him or her in compliance as expressed by Eriksen and Fallan (1996).

Abdu and Wondimu (2019), studied the level of tax compliance by taxpayers and its determinant factors in Bench Maji, Sheka, and Kaffa zones of Southwest Ethiopia. Their investigation found that tax compliance was influenced positively by tax knowledge, simplicity of the tax system, attitude of taxpayers towards tax, perceived role of government expenditure, and a rewarding scheme of for loyal taxpayers. However, age, sex of respondents, tax penalties and enforcement, organizational strength of the tax authority, fairness of the tax system, tax rate, and tax audit were not significant factors influencing compliance behavior of taxpayers.

Thananga *et al.* (2013) assessed the factors affecting compliance with the Rental Income Tax Policy by landlords in Nakuru Municipality. He argued that knowledge of rental income tax policy was low, especially on the provisions of the policy itself, which also contributed to high levels of non-compliance. He also cited that the cost of compliance played a key role in determining the level of compliance which are both direct taxes and indirect tax costs such as auditing costs, costs of hiring personnel and experts for the purposes of compliance.

2.2.2 Residential Rental Income Tax Compliance

Residential rental income tax is one of the basic sources to derive national income being the major source of government revenue to finance its expenditure. It provides for a steady stream of funds for development projects in most countries across the world, such as the provision of social amenities like good roads, constant power supply, and constant water supply, which all enhance the growth of businesses and, in extension, the economy at large (Ojochogwu & Ojeka, 2012). As stated by Sapiei, Kasipillai, and Eze (2014), residential rental income tax compliance refers to the extent and process of submitting tax returns concerning the actual and appropriate taxes determined by law. Timely registration, submission of returns and payment of residential rental income tax are widely adopted indicators of measuring compliance in respect to residential rental income tax.

The rental income tax rate of 10% tax on gross rent took effects on 1st January 2016 and applies to rental income received from calendar month January 2016. Eligible persons are required to file their tax return via i-tax System (KRA, 2015). The 10% tax rate on gross rental income is payable by a resident person whether individual or an entity and will apply to rental income that has accrued in or is derived from Kenya for the use of residential property where the rent income does not exceed KShs.10 million per annum (The Finance Act, 2015). The change is part of the KRA efforts to encourage property owners to be tax compliant. The tax is simple to compute since it is based on a percentage of the gross rentals and is lower than the standard rate of 30 to reflect the fact that the landlords do not receive a deduction for the expenses incurred to generate the income (KPMG, 2015).

The current tax rate for rental income taxes effective May 2024 is 7.5% which is a final tax for annual rental income of Kes.288, 000 and below Kes.15 million. Note that this only applies to residential properties. Commercial properties, non-resident landlords, and landlords with rental income (over Kes. 15 million) are subject to different taxes. The 7.5% tax rate is a decrease from 10% on rental income tax in January 2024. However, note that this only applies to landlords who earn less than Kes 15 million annually.

2.3 Conceptual Framework

Conceptual framework is a written or visual presentation that explains either graphically or in narrative form the main things to be studied, the key factors, concepts, or variables, and the presumed relationship among them (Miles et al., 1999). The conceptual framework illustrates the association between the dependent and the independent variable (Mugenda & Mugenda, 2013). The independent variables were Tax knowledge and the dependent variable include Residential rental income tax compliance, as presented in Figure 1.

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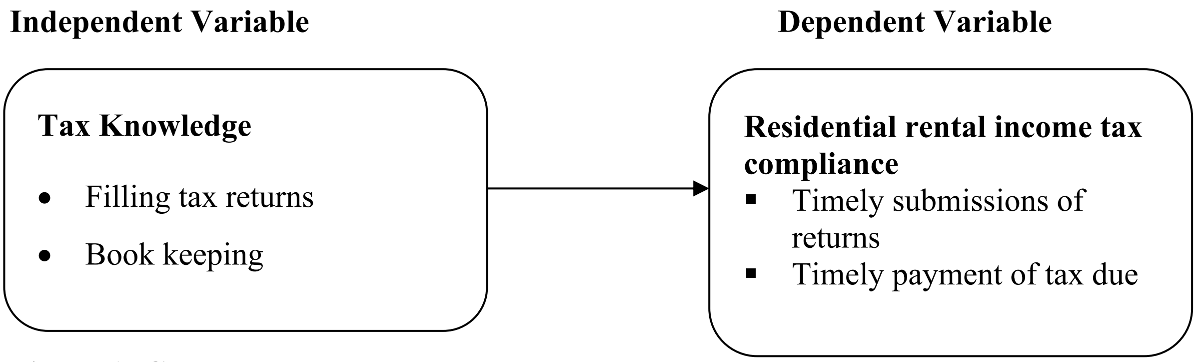

Figure 1: Conceptual Framework

3. Methodology

A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure (Kothari, 2004). It is essentially the framework and design of an investigation (Mugenda and Mugenda 2003). In this study the explanatory research design was used by the researcher to specify the nature and direction of the relationship between variables being studied. According to Kothari (2004), a population constitutes an aggregation of items sharing common characteristics, and in this case, the 2,600 residential property owners in Embu Municipality (Kenya National Bureau of Statistics, 2023; Embu County Government) and Sample size is 346 respondents. that of the 346 questionnaires that were administered, 265 were properly filled and returned which represents 76.6 % response rate while 81 which represents 23.4% respondents never respondent due to time constraints and disinterest in the questionnaire topic.

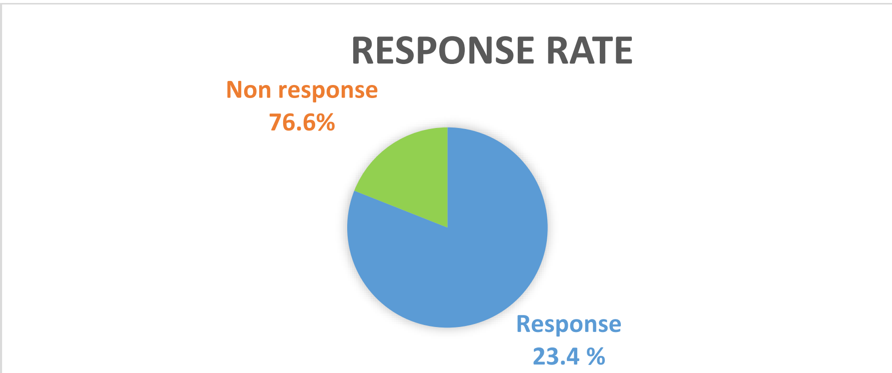

Figure 2: Response Rate

Reliability analysis

In this study, the reliability of the study instrument was tested using the Cronbach's alpha coefficient with an accepted threshold of 0.7. Cronbach's alpha is computed by correlating the score for each scale item with the total score for each observation and then comparing that to the variance for all individual item scores (Ummah, 2019). Table 1 shows that residential rental income tax compliance had a Cronbach’s alpha of 0.946, tax knowledge had alpha value of 0.945. There was high level of reliability in the pilot questionnaire since all alpha values were above 0.7.

Table 1: Test of Reliability

Factor	Number of Items	Cronbach Alpha score	Conclusion
Residential rental income tax compliance	6	0.946	Acceptable
Tax knowledge	6	0.945	Acceptable

4. Results and Discussion

4.1 Descriptive Statistics

4.1.1 Descriptive statistics Tax knowledge

Table 2: Presents the descriptive statistics for tax knowledge among respondents. The statement "I know about residential rental income tax" yielded a mean response of 3.85 (SD = 0.754), indicating that respondents generally agreed with this statement. For the statement "Taxpayers' knowledge about residential rental income tax contributes to high compliance by property owners," the mean was 4.02 (SD = 0.731), showing strong agreement that such knowledge improves compliance. The standard deviation indicates low variability in the responses. Respondents agreed (Mean = 4.00, SD = 0.786) that they "know how to calculate and file a self-assessment residential rental income tax return. The statement "I understand the rental income tax threshold and dates for filing a return" had a mean of 3.97 (SD = 0.841), reflecting agreement, though with greater response variability due to the standard deviation. For "Maintaining proper books and records helps you to be tax compliant," the mean was 3.94 (SD = 0.746), indicating agreement that maintaining books and records helps with compliance. Finally, respondents strongly agreed (Mean = 4.05, SD = 0.579) that they "understand [their] rights and obligations as a taxpayer." the standard deviation indicates low variability in the responses.

Table 2: Tax knowledge

	N	Mean	SD
I know about residential rental income tax	265	3.85	.754
Taxpayers Knowledge about residential rental income tax contributes to high compliance by property owners		4.02	.731
I know how to calculate and file a self- assessment residential rental income tax return		4.00	.786
I understand the rental income tax threshold and dates for filing a return		3.97	.841
Maintaining proper books and records helps you to be tax compliant		3.94	.746
I understand my rights and obligations as a taxpayer		4.05	.579

4.1.2 Descriptive Statistics for Residential Rental Income Tax Compliance

Table 3: For the statement "I file returns by or on the 20th of every month following receipt of income," the mean was 3.95 (SD = 1.029), reflecting moderate to strong agreement, with a low level of variability in the responses. Similarly, "I pay tax by or on the due date" had a higher mean (4.09, SD = 0.965), with a low level of variability in the responses. For "I declare and file accurate returns," the mean was 4.05 (SD = 1.072), with a low level of variability in the responses. The statement "I've registered for a KRA Pin" had a mean of 4.08 (SD = 0.884), with a low level of variability in the responses. For "I pay correct taxes" yielded a mean of 4.03 (SD = 1.099), with a low level of variability in the responses. Finally, "I maintain proper books and records" had a mean of 3.99 (SD = 0.832).

Table 3: Residential Rental Income Tax Compliance

	N	Mean	SD
I file returns by or on 20th of every month following receipt of income.	265	3.95	1.029
I pay tax by or on the due date.		4.09	.965
I declare and file accurate returns.		4.05	1.072
I've registered for KRA Pin.		4.08	.884
I pay correct taxes.		4.03	1.099
I maintain proper books and records.		3.99	.832

4.2 Correlation Analysis

Tax knowledge showed a significant and positive correlation with residential rental income tax compliance (r = .449, p-value = .021), supporting previous findings that taxpayers' understanding of fiscal regulations significantly influences compliance behaviour (Kogler *et al*., 2015).

Table 4: Correlations Statistics

	Residential rental income tax compliance	Tax knowledge
Residential rental income tax compliance	1	0.449^{**}
Tax knowledge	0.449^{**}	1
Sig.	0.021	

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

4.3 Regression Analysis

Table 5 showed that Tax knowledge accounts for 20.1% (R^2 0.201) of the variance in residential rental income tax compliance. The remaining 79.9% of variation in residential rental income tax compliance was caused by factors not included in the model.

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.449[a]	.0.201	.194	.40675

a. Predictors: (Constant), Tax knowledge _mean

Table 6 showed that there was an F statistic of 352.521 and a p-value of 0.000<0.05, which indicates that the model was significant in explaining the variance caused by Residential rental income tax compliance.

Table 6: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	72.267	1	72.267	352.521	0.000
1	Residual	54.113	263	0.205		
	Total	126.38	264			

a. Dependent Variable: Residential rental income tax compliance

b. Predictors: (Constant), Tax knowledge

Table 7: Tax knowledge also had a significant positive effect on residential rental income tax compliance, with a standardized beta coefficient of 0.138 ($\beta = 0.138$, $p = 0.026$). A unit change in Tax knowledge was associated with a 0.138 increase in Residential rental income tax compliance, indicated that improved Tax knowledge enhanced Residential rental income tax compliance levels.

Table 7: Regression Coefficient analysis

Variable	Standardized β	Std. Error	t-Statistic	Unstandardized β	Prob.
Constant	0.434	0.202	2.149		0.033
Tax knowledge	0.138	0.061	2.262	0.236	0.026

4.4 Discussion of the Findings

The study objective was to determine the effect of tax knowledge on residential rental income tax compliance of among landlords in Embu municipality. The correlation analysis found that tax knowledge had a significant and positive correlation with residential rental income tax compliance (r =.449, p-value = .021), supporting previous findings that taxpayers' understanding of fiscal regulations significantly influences compliance behavior (Kogler et al., 2015). The regression analysis further found that tax knowledge has a significantly positive effect on residential rental income tax compliance ($\beta = 0.138$, $p = .026$). The modest effect size suggests that while knowledge matters, its impact may be mediated by other factors like enforcement or social norms. Several studies support the positive relationship between tax knowledge and compliance. Palil (2010) affirmed that tax knowledge enhances public awareness of taxation rules and their role in national development, leading to voluntary compliance.

5. Conclusion

The study concludes that tax knowledge has a significant positive effect on residential rental income tax compliance, reinforcing the importance of knowledge of tax laws, and systems in enhancing voluntary tax adherence. This finding contributes to existing literature by highlighting that even in informal rental markets, improving fiscal literacy can foster compliance, particularly in contexts where tax awareness is limited.

6. Recommendations

Based on the findings, the study recommends that the government should develop comprehensive taxpayer education programs specifically tailored for landlords in the residential rental sector. These programs should simplify complex tax concepts and be delivered through accessible channels to improve fiscal literacy. Future research should investigative the effects of moral obligations on residential rental income tax compliance.

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