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Effect of Tax Morale on Corporation Tax Compliance among Manufacturing Firms in Ruaraka Sub-County, Nairobi, Kenya

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Abstract

Corporation tax is a key source of revenue for most governments across the globe that enables them to provide public goods and services such as free education, subsidized medical services, and infrastructure. Despite the tremendous growth of the manufacturing industry for the past few years, the corresponding tax collection from the sector has remained very low. The key aim of the study was to determine the effects of tax morale on corporation tax compliance among manufacturing firms in Ruaraka Sub-County, Nairobi, Kenya. The study was anchored on the Tax Morale. An explanatory research design was employed in this study, and the study population was 219 manufacturing firms in Ruaraka Sub-County, Nairobi. A census survey was used in this study. The response rate for the questionnaire was 79.9%, with 175 out of 219 participants accurately filling and submitting the questionnaires, while the non-response rate was 20.1%. The study used primary data collected through questionnaires. The data collected was analyzed using descriptive statistics, inferential statistics, and multiple linear regression analysis, and presented through tables and charts. The study found that tax morale has a significant positive effect on corporation tax compliance ($\beta = 0.495$, p-value = 0.024). The study recommends that policymakers prioritize initiatives that foster intrinsic motivation among taxpayers. This can be achieved by promoting transparency, fairness, and trust in the tax system through public awareness campaigns and stakeholder engagement programs. Further studies could also explore the influence of cultural factors and social norms on tax compliance.

Keywords: *Manufacturing Firms, Tax Morale, Corporation Tax Compliance*

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1. Introduction

Every government relies on taxes as a major source of revenue to sustain developmental growth. Indeed, governments across the world have devised and legislated provisions establishing different tax heads such as VAT, income tax, and excise duty, to enhance tax performance. Corporation income tax is one of the tax heads used by governments to raise revenue. It is the tax paid on profits earned by corporate taxpayers. States have adopted two approaches to how corporate tax is treated: worldwide and territorial approaches (Siripurapu, 2021). Under the territorial approach, only profits earned domestically are subject to taxation,

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while in the worldwide approach, both domestic and foreign profits are subject to tax with tax credits paid to the foreign tax authority (Siripurapu, 2021).

Corporate tax compliance at the global level, particularly in the United Kingdom (UK), refers to the obligation of businesses to adhere to tax laws, regulations, and reporting requirements set by His Majesty's Revenue and Customs (HMRC). It involves timely and accurate payment of corporate taxes, proper record-keeping, and compliance with international tax standards such as the OECD's Base Erosion and Profit Shifting (BEPS) framework. The UK has implemented various measures, including the Corporate Criminal Offence (CCO) for tax evasion and the requirement for large businesses to publish tax strategies, ensuring transparency and accountability in tax matters (HMRC, 2024).

Corporation tax compliance in Kenya involves the correct computation of annual tax based on the corporation's income for the year, filing of the information required by tax laws, and payment of the due tax quarterly in installments through the iTax system. In Kenya, the Corporate Income tax rate is a tax collected from companies. Its amount is based on the net income companies obtain while exercising their business activity, normally during one business year, at 30% for resident companies, while for the non-resident companies are charged 37.5%. Tax assessment is characterized in the field of financial aspects as a necessary commitment of assets from the residents to the states or government, exacted/charged on a premise of foreordained criteria or reference base (Lipsey & Chrystal, 2007; Kandie, 2011; Kinuthia, 2011; OECD, 2013).

Tax morale was introduced for the first time during the 1960s by the "Cologne school of tax psychology" (Schmölders, 1970; Strümpel, 1969) but received little attention from tax researchers for several decades (Alm and Torgler, 2004). Starting in the 1990s, tax morale increasingly attracted attention and has become a central issue in empirical research on tax compliance (Torgler, 2011; Torgler et al., 2007a). Tax morale is defined most often as the intrinsic motivation to pay taxes (Torgler, 2002b, 2005c, 2012; Torgler & Schneider, 2007a). Luttmer and Singhal (2014) define tax morale as the totality of non-pecuniary motivations and factors for tax compliance that fall outside the expected utility maximisation. As mentioned above, in this paper, using an institutionalist lens, the intrinsic motivation to pay taxes, tax morale, is viewed primarily to result from the interaction between formal and informal institutions.

The manufacturing industry accounted for 12% GDP in 2013/2014 (GOK, 2015). Despite Kenya's manufacturing firms are viewed as small; they form the largest manufacturing sector. Industry in East Africa. The manufacturing companies are diverse. They include: Transformation and value addition of agricultural materials, i.e., of coffee and tea, canning of fruit and meat, wheat, barley, and cornmeal milling, and refining of sugar. Production of electronics, assembly of motors, vehicles, and processing of soda ash are all parts of the sector. The assembly of computers was first done in 1987. Textiles, ceramics, cement, shoes, aluminum, steel, glass, wood, cork, and plastics are other products manufactured in Kenya. Foreign investors own twenty-five per cent of Kenya's manufacturing sector, most being from the United Kingdom, followed by the Americans (KAM, 2015).

1.1 Problem Statement

Despite the tremendous growth of the manufacturing industry over the past few years, the corresponding tax collection from the sector has remained very low. For instance, in

2022/2023, Kenya Revenue Authority (KRA) statistics indicate that of the 759,164 companies registered for corporate tax in Kenya, only 487,230 of them filed annual returns. In the 2022/2023 financial year, KRA collected a total of KShs. 38.808 billion against a target of 56.367 billion. This demonstrates unequivocally that to reach its revenue targets, the government and the tax authority must reassess their efforts to encourage tax compliance among manufacturing firms. From both the local and international empirical evidence, few studies have been done on the effect of tax morale on corporate tax. This underscores the need to investigate the effect of tax morale on corporation tax compliance among manufacturing firms in Ruaraka Sub-County, Nairobi, Kenya.

2. Literature Review

2.1 Tax Morale Theory

This theory was developed by the German scholars, which was centred on Gunter Schmolders in the year 1965, known as the Cologne school of tax psychology. The morale connected to tax payment can refer to the individual aspect that inspires a person to adhere to the set tax requirements. As an element of behaviour in tax payment, the tax morale is intended to describe how and why the tax payer's morality in perspective influences his or her behaviour in tax. The analysis of McGee (2006) offers an explanation in connection on how individuals will commonly not pay taxes if they conceive that they can escape being caught evading taxes. Further, if the respective society advocates for payment of tax, it promotes groups and various tax persons to comply with the set regulations in connection with tax of a particular nation. This theory avails the moral justification that results in either compliance or non-compliance with tax payment. It is equally significant to realise that what morality is can differ from one individual to another and from one society to another.

Many tax morale channels may be inelastic to the types of interventions that are feasible to test experimentally. For example, a letter arguing that tax revenue is important for funding public goods may not be effective if individuals have strong and perhaps accurate beliefs that revenues are often expropriated or inefficiently spent. These arguments, however, do not imply that tax morale cannot be affected by actual policies undertaken by governments (Besley, Jensen & Persson, 2014). Balla (2017) noted that tax morale theory often applies to individuals, where individuals may have some intrinsic motivation to pay taxes or feel guilty or shame for failure to comply. They may comply due to reciprocal motivations, that is, the willingness to pay taxes in exchange for benefits that the state provides to them or others, even though their pecuniary payoff would be higher if they didn't pay taxes.

The theory of tax morale is relevant to the study since tax morale is one of the concepts that the study sought to investigate and its effect on corporate tax compliance. Tax morale is an intrinsic behavior that could be influenced by an individual's perceptions and beliefs about the government's handling and management of public resources that inform their tax payment, and compliance behaviour (Togler, 2012). When taxpayers perceive that their taxes are put to good use in the provision of public goods and services, they would feel most encouraged to contribute by paying their tax dues (Balla, 2017). The reverse may also be true in situations where their perception negates the importance of paying taxes; then the compliance level would be low. The theory specifically supports the independent variable of tax morale. This further helps the study ask for questions that would meet the objective of the effect of tax morale on corporation tax compliance.

2.2 Literature Review

2.2.1 Tax morale

Doerrenberg and Peichl (2023) examined the effects of tax morale on PAYE. Specifically on tax audit and staff capability. Using a cross-country analysis, Doerrenberg and Peichl (2023) found that women and married people are high tax morale possessors compared to men and singles. In addition, religiosity was revealed to affect tax morale positively. In confirmation, religion – as a demographic factor – was observed to affect tax morale positively in Turkey (Bilgin, 2021). However, Bilgin's (2014) study, using data from the World Value Survey, yielded different results among countries. Regarding statistically significant related issues, age, educational level, and income level were significant determinants of tax morale (Bilgin, 2014). Further, Yew et al. (2020) revealed that income level influenced motivation to pay tax inversely. Additionally, gender, educational level, and income level were revealed to positively influence motivation to pay tax (Muazu et al., 2022).

In the DeBacker, Heim, and Tran (2022) study of US corporate tax evasion mentioned above, for example, we can compare compliance at different observed levels of tax morale, but cannot assess what compliance would have been if tax morale were zero. While we cannot quantify the relative importance of enforcement and tax morale, our view is that enforcement is the primary driver of tax compliance but that tax morale meaningfully enhances compliance.

Horodnic (2021) conducted a study on tax morale and institutional theory: a systematic review of factors that shape tax morale across the United Kingdom. The study adopted a systematic search using a library catalogue, which provided access to more than 400 databases. The findings of the study showed that the theory of tax morale has several factors that can be identified with tax morale, except for the control variables and socio-demographic factors. The study found that the most salient factor is trust, with both vertical and horizontal trust positively related to tax morale. Based on the empirically reviewed literature, it is evident that tax morale is determined by a myriad of factors that can generally be considered intrinsic human behavior. The proposed study will look at perception and beliefs as some of these intrinsic factors.

Musgrave's (2023) study in South Africa considered three requirements of fiscal policy: the allocation, the distribution, and the stabilization aspect. In the context of tax morale, the first two aspects are especially of interest. While the allocation branch influences tax morale by an efficient allocation of resources, the distribution aspect touches equity and incidence considerations, which have an impact on tax morale, too. The allocation branch is important because the spending in the sense of tax revenue allocation affects morale considerations. While the distribution branch is important because fairness considerations are strongly related to (tax) morale beliefs. Thus, an optimal tax morale or tax compliance strategy is based on efficiency as well as equity measures.

2.2.2 Corporation Tax Compliance

Corporation tax is an assessment levied by the state and federal governments on profits made by the business (Arachi & Alworth, 2001). Corporation tax equates to the taxes imposed on normal people. It is a tax imposed on the firm's net income. A corporation is a legal entity created under the statute of state, separate from its owners. Corporation tax can be said to be either a tax on the profits (gross corporation income fewer production costs) or corporation capital (opportunity cost of capital from shareholders) (Rosen, 1995).

The purpose of corporation tax includes being used as a means of protecting against excessive profits because of illegal and unethical corporate practices. Opponents argue that the tax is simply passed on from the corporations to the customers. Corporations in many jurisdictions are taxed based on their income. The corporation tax is imposed using specific rates on taxable income as defined by the system. Many jurisdictions have a separate body of law or systems that deal with corporate taxation (Hassett & Hubbard, 2022). In such instances, the law might apply to the entity and not to people who are engaged in trading activities. Broad types of income will be taxed differently based on what the corporations earn. However, in most instances, income from corporations may be taxed similarly.

Both foreign and domestic corporations are taxed in most jurisdictions. In most cases, taxation of foreign corporations is based on the income earned within their jurisdiction. On the other hand, domestic corporations are taxed based on income earned worldwide. The income tax is imposed in an establishment having permanent jurisdiction. Moreover, corporations are also subjected to other types of indirect taxes under the Income Tax Act, Cap. 470 of the laws of Kenya, such as payroll tax, excise tax, property tax, customs duties, VAT, and withholding tax, just in almost the same manner as other taxpayers. Corporation tax in Kenya is a type of income tax that is imposed on companies ' end-of-year income. The income tax rate for resident companies is 30% per financial year, while the non-resident companies are taxed at the rate of 37.5% per fiscal year of the company (KRA, 2018).

2.3 Conceptual Framework

According to Creswell (2003), a conceptual framework is the graphic presentation of the relationship between the study variables. The variables in the study were the dependent variable, corporation tax compliance, which was measured by Returns filed and Tax revenue collected. The independent variable, tax morale, was measured by perception and beliefs, as shown in Figure 1.

Independent Variable **Dependent Variable**

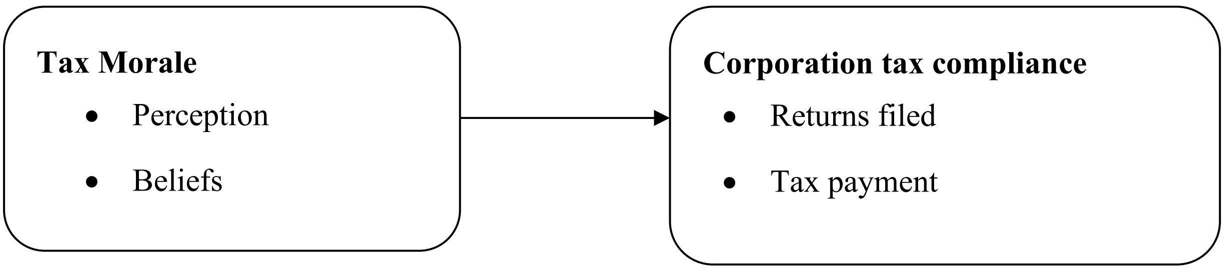

Figure 1: Conceptual Framework

3. Methodology

Research design is a master plan that specifies the methods and procedures for collecting and analyzing data to obtain answers for testing the formulated hypotheses (Kothari, 2004). This study used an explanatory research design. According to Borg and Gall (2007), the target population consists of all members of a real or hypothetical set of people, events, or objects from which a researcher wishes to generalize the results of their research, while the accessible population consists of all the individuals who realistically could be included in the sample. The study population was 219 accounts managers from manufacturing firms in Ruaraka Sub-

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County, Nairobi, KRA (2024). A census survey was conducted in this study; therefore, there was no need for sampling. The response rate for the questionnaire was 79.9%, with 175 out of 219 participants accurately filling and submitting the questionnaires, while the non-response rate was 20.1%.

Table 1: Response Rate

	Number	Percent %
Response Rate	175	79.9
Non-Response	44	20.1
Sample Target	**219**	

Reliability analysis

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. A reliability test on the pilot items for each construct was conducted. A Cronbach's alpha of 0.7 and above implies the instrument is reliable. The corporation tax compliance construct achieves a Cronbach's alpha of 0.817 across 5 items, indicating strong reliability, while the tax morale construct shows excellent consistency with an alpha of 0.870 for its 4 items.

Table 2: Test of Reliability

Factor	**Number of Items**	**Cronbach Alpha score**	**Conclusion**
Corporation tax compliance	5	0.817	Acceptable
Tax morale	4	0.870	Acceptable

4. Results and Discussion

4.1 Descriptive statistics

4.1.1 Descriptive statistics for Tax morale

Table 3: The descriptive statistics for the items in Table 3 for tax Morale are reported with each statistic interpreted in APA style using a Likert scale ranging from Strongly Agree (5) to Strongly Disagree (1). For the statement, I feel that tax revenue is often lost due to corruption, and that discourages me from being compliant, shows a mean response score of 3.75 and a standard deviation of 1.157. The standard deviation indicates moderate variability in responses, while the mean suggests that respondents tend to agree with this statement. The statement When I pay taxes, my contribution does not count due to misappropriation of tax revenue by the government" has a mean response score of 4.03 and a standard deviation of 1.074. The standard deviation reflects moderate variability, and the mean indicates that respondents generally agree with this statement. The statement My faith often encourages me to pay all my taxes as provided for in tax laws because it is the right thing to do has a mean response score

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of 3.74 and a standard deviation of 1.081. The standard deviation reflects moderate variability, and the mean suggests that respondents tend to agree with this statement. The statement I trust the government with my tax payments, and this encourages me to effectively comply with all tax requirements, has a mean response score of 4.06 and a standard deviation of 1.024. The standard deviation reflects moderate variability, and the mean suggests that respondents tend to agree with this statement.

Table 3: Tax Morale

	N	Mean	Std. Dev
I feel that tax revenue is often lost due to corruption, and that discourages me from being compliant.	175	3.75	1.157
When I pay taxes, my contribution does not count due to the misappropriation of tax revenue by the government.		4.03	1.074
My faith often encourages me to pay all my taxes as provided for in tax laws because it is the right thing to do		3.74	1.081
I trust the government with my tax payments, and this encourages me to effectively comply with all tax requirements.		4.06	1.024
Mean		3.90	

4.1.2 Descriptive statistics for Corporation Tax Compliance

Table 4: The descriptive statistics for the questionnaire items measuring the dependent variable construct, corporation tax compliance, are reported in Table 4, with each statistic interpreted using a Likert scale ranging from Strongly Agree (5) to Strongly Disagree (1). The statement that the company files its return on income by the prescribed date has a mean response score of 3.77 and a standard deviation of 1.142. The mean suggests that respondents generally agree with this statement, while the standard deviation indicates moderate variability in responses. For the statement that the company pays tax dues by the prescribed date, the mean response score is 4.04, with a standard deviation of 1.058. The high mean indicates strong agreement among respondents, while the standard deviation suggests relatively low variability in responses. The statement that the company makes a timely and accurate tax declaration has a mean response score of 3.96 and a standard deviation of 1.131. The mean suggests that respondents tend to agree with this statement, while the standard deviation indicates moderate variability in responses. For the statement that the company pays fines and penalties for overdue taxes, the mean response score is 3.98, with a standard deviation of 1.083. The mean suggests that respondents generally agree with this statement, while the standard deviation indicates moderate variability in responses. Finally, the statement that the company cooperates with KRA officers in conducting audits by providing all the necessary records has a mean response score of 4.02 and a standard deviation of 1.077. The high mean indicates strong agreement among respondents, while the standard deviation suggests relatively low variability in responses.

Table 4: Corporation Tax Compliance

	N	Mean	Std. Dev
The company files its return on income by the prescribed date	175	3.77	1.142
The company pays tax dues by the prescribed date.		4.04	1.058
The company makes timely and accurate tax declarations.		3.96	1.131
The company pays fines and penalties for overdue taxes.		3.98	1.083
The company cooperates with KRA officers in conducting audits by providing all the necessary records.		4.02	1.077
Mean		**3.95**	

4.2 Correlation Analysis

Table 5 shows that tax morale demonstrates a positive and significant correlation with corporation tax compliance up to 34.3% (r = .343), indicating that higher levels of tax morale are associated with improved compliance among corporations.

Table 5: Correlation Statistics

	Corporation Tax Compliance	Tax morale
Corporation tax compliance	1	0.343**
Tax morale	0.343**	1

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

4.3 Regression Analysis

The model summary in Table 6 indicates that the predictor tax morale explains a moderate proportion of the variance in corporation tax compliance. The multiple correlation coefficient (R) of 0.343 suggests a moderate linear relationship between the predictor and corporation tax compliance at 34.3%. The R-square value of 0.117 indicates that approximately 11.7% of the variance in corporation tax compliance is accounted for by the effects of tax morale. The remaining 88.3% variance is caused by factors not included in the model.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.343[a]	.0.117	.112	.316120

a. Predictors: (Constant), Tax morale _mean

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Table 7 shows that there was an F statistic of 213.883 and a p-value of 0.000<0.05, which indicates that the model was significant in explaining the variance caused by Corporation tax compliance.

Table 7: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	108.011	1	108.011	213.883	0.000
	Residual	87.531	173	0.505		
	Total	195.542	174			

a. Dependent Variable: Corporation tax compliance
b. Predictors: (Constant), Tax morale

Table 8 showed that a unit change in Tax morale caused a 0.253 increase in Corporation tax compliance. The study found that Tax morale has a positive and significant effect on corporate tax compliance, β =0.253, p-value =0.008<0.05. Consequently, the null hypothesis was rejected.

Table 8: Coefficient Regression Analysis

	Standardized Coefficients β	Std. Error	Unstandardized Coefficients β	t	Sig.
(Constant)	2.970	0.414		7.174	0.000
Tax morale	0.253	0.094	0.221	2.691	0.008

Dependent Variable: Corporation tax compliance

4.4 Discussion of the Findings

The study sought to establish the effect of tax morale on corporation tax compliance among manufacturing firms in Ruaraka Sub- County, Nairobi. The study correlation analysis found that tax morale has a significant and positive correlation with corporation tax compliance, r = .343, implying that higher levels of tax morale are associated with improved corporation tax compliance among manufacturing firms in Ruaraka Sub-County, Nairobi, Kenya. The regression analysis shows that tax morale has a significant positive effect on corporation tax compliance (β = 0.253, p-value = 0.008). This suggests that manufacturing firms with higher levels of tax morale, reflecting their intrinsic motivation to pay taxes, are more likely to comply with tax regulations. Several empirical studies concur with the findings of this study, which indicate that tax morale has a significant positive effect on corporation tax compliance. For instance, Cummings et al. (2019) found that higher tax morale results in greater tax compliance, particularly in African contexts. Similarly, Torgler and Schneider (2020) established that higher tax morale is associated with smaller shadow economies, suggesting a strong link between intrinsic motivation and compliance behavior.

5. Conclusion

The study sought to determine the effect of tax morale on corporation tax compliance among manufacturing firms in Ruaraka Sub-County, Nairobi, Kenya. The study concludes that tax morale significantly enhances corporation tax compliance among manufacturing firms in Ruaraka Sub-County, Nairobi. This highlights the importance of fostering ethical responsibility and trust in tax systems to improve voluntary compliance. The study contributes to the field by reaffirming the critical role of intrinsic motivation in tax compliance, particularly in a developing economy context.

6. Recommendations

The study recommends that policymakers should prioritize initiatives that foster intrinsic motivation among taxpayers. This can be achieved by promoting transparency, fairness, and trust in the tax system through public awareness campaigns and stakeholder engagement programs. Further studies could explore the influence of cultural factors and social norms on tax compliance

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