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Effect of Digital Record Keeping on Turnover Tax Compliance Among Youth-Owned Micro and Small Enterprises in Central Business District, Nairobi, Kenya

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Abstract

Tax compliance plays a pivotal role in fostering economic growth across the globe, spanning both developed and developing nations. However, turnover tax compliance in Kenya has been low compared to other taxes, such as VAT, income tax, among others, despite it being mostly introduced to enhance tax compliance among youth owned youth-owned micro and small enterprises (MSEs). Nevertheless, there are limited studies that have attempted to understand business digitalisation and its effect on turnover tax compliance. Therefore, the general objective of this study was to determine the effect of digital record keeping on turnover tax compliance among youth-owned micro and small enterprises in the central business district, Nairobi, Kenya. The study was anchored on diffusion innovation theory. An explanatory research design was employed. The study target population of 3,218 registered youth-owned MSEs within Nairobi CBD. Stratified and random sampling were used to select a sample size of 356. The study used five-point Likert scale questionnaires to collect primary data. Data was quantitatively analysed by use of both descriptive (means, frequency, percentage, and standard deviations and inferential analysis (Pearson correlation and linear regression model). The beta coefficient results revealed that digital record keeping ($\beta = 0.204$, $p = 0.013$) had a statistically significant and positive effect on turnover tax compliance. Digital record keeping was found to have a significant impact on turnover tax compliance, with evidence suggesting that a supportive and equitable tax structure amplifies this effect. Managers and policy enforcers should prioritize initiatives that promote routine and accurate digital bookkeeping among youth-led enterprises. Further studies could explore how factors such as taxpayer education, trust in tax authorities, and peer influence mediate or moderate these relationships.

Keywords: *Digital Record Keeping, Turnover Tax Compliance, Micro and Small Enterprises*

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1. Introduction

Taxation remains the cornerstone of public finance, serving as the principal means by which governments fund infrastructure, education, health, and national development projects. Effective tax collection depends on the willingness of taxpayers to comply, as non-compliance erodes the tax base and undermines public service delivery (Ampah & Kiss, 2019; Alwi et al., 2022). Tax compliance, particularly the intention to comply, has been the subject of considerable academic and policy interest due to its role in sustaining fiscal health. However, developing nations continue to struggle with low compliance rates, leading to significant revenue shortfalls (Bagdad et al., 2017; Alshira'h & Abdul-Jabbar, 2020). This persistent challenge has driven scholars to explore new determinants of compliance behavior, including digital transformation in business processes.

The implementation of Turnover Tax (TOT) in Kenya was intended to simplify tax compliance for small and micro enterprises; however, its effectiveness can be significantly enhanced through digital business models and integration with digital tax systems. The rise of digital business platforms such as mobile money, e-commerce, and app-based services presents an opportunity for better tracking of business transactions and automating tax processes. For instance, businesses operating through M-Pesa or online marketplaces generate digital footprints that tax authorities can leverage to assess turnover and enforce TOT compliance more effectively. Digital platforms reduce reliance on manual bookkeeping, which has been a loophole for underreporting revenues among SMEs.

Turnover tax compliance refers to the extent to which taxpayers fulfil their legal obligations regarding the reporting, filing, and payment of turnover tax within the timelines prescribed by law. Traditionally, tax compliance has been defined as the degree to which taxpayers adhere to tax laws by accurately reporting income, filing returns, and paying dues on time (Le et al., 2020; Olaoye et al., 2017). This concept includes both procedural compliances, such as registration, timely filing, and payment, and substantive compliance, which involves correct computation and full disclosure of taxable income. While McBarnett (2016) distinguished three behavioural dimensions of compliance: committed, capitulated, and creative, recent studies have reaffirmed these classifications, noting that behavioural intent plays a critical role in compliance levels, particularly in informal sectors where monitoring is weak (Muturi & Moyi, 2021; Waweru & Omagwa, 2022).

Digital record keeping involves maintaining financial and operational records using software or digital tools such as Excel, QuickBooks, and cloud-based storage platforms. This dimension supports timely reporting, transparency, and accessibility of historical business data, which are crucial for compliance with tax regulations and informed decision-making (Otieno & Muli, 2023).

1.1 Problem Statement

Tax compliance plays a pivotal role in fostering economic growth across the globe, spanning both developed and developing nations. The correlation between tax compliance and economic growth, as measured by GDP (gross domestic product), has revealed a noteworthy upward trend over the years. However, it is essential to underscore that this positive trajectory in GDP is not uniformly matched by a corresponding improvement in tax compliance, particularly in developing countries. According to Castro and Rizzo (2014), both developing and developed nations are equally affected by turnover tax non-compliance, more so among Small and

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Medium Enterprises (SMEs). Most governments are thus working to improve turnover tax compliance as a result of an increase in government projects and a global economic slump (Jimenez & Iyer, 2016).

However, turnover tax compliance in Kenya has been low compared to other taxes such as VAT, income tax, among others, despite it being mostly introduced to enhance tax compliance among SMES. According to KRA, the Turnover Tax (TOT) has not yielded much, as the revenues are poor and decreasing with time. According to the KRA (2022) report, total revenue collected from the Turnover Tax in 2022 was Kenya shillings 561 million against a target of Kshs. 835 million, clearly indicating a deficit of 274 million, which was pegged on noncompliance in remitting turnover tax by some SMEs.

SMEs' noncompliance behaviour in Kenya resulted in a KSh. 10.8 billion shortfalls in 2018–2019 goals, and the shortfall increased to Ksh 14.6 billion in the period 2021-2022, demonstrating the enormous economic problem in raising revenue by the national government that noncompliance causes. In Nairobi County, the performance of turnover tax has, on average, been below 50% with 2,890 SMEs registering for turnover tax against a target of 6,928 between 2019 and 2021. Estimates of the turnover tax gap by the Parliamentary Budget Office (PBO) point to underperformance in the collection of a meagre 0.15% against the estimated potential of Kshs 79.3 billion (PBO, 2021). Therefore, the study sought to determine the effect of digital record keeping on turnover tax compliance among youth-owned micro and small enterprises in the central business district, Nairobi, Kenya.

2. Literature Review

2.1 Theoretical Review

2.1.1 Diffusion Innovation Theory

Diffusion of Innovation (DOI) Theory was first proposed by Everett Rogers (1962) and has since become one of the most influential theories in understanding how, why, and at what rate new ideas and technologies spread within a social system. Rogers (2003) argued that innovation diffusion is a social process whereby individuals or organizations adopt new practices over time based on communication channels, time, and the characteristics of the adopters. The theory identifies five categories of adopters: innovators, early adopters, early majority, late majority, and laggards, each with distinct traits and levels of risk tolerance. The theory further outlines five attributes of innovation that influence adoption: relative advantage, compatibility, complexity, trialability, and observability (Rogers, 2003; Greenhalgh et al., 2004; Sahin, 2006). The spread of innovation is not linear but shaped by social systems, opinion leaders, and the perceived usefulness of the new technology (Mahajan & Peterson, 2020). DOI has been widely applied across sectors, including healthcare, education, and ICT adoption, to explain behavioural patterns related to technological change.

In the context of business digitalization and tax compliance, DOI theory helps explain how micro and small enterprises adopt digital technologies such as digital payments, digital record keeping, and digital procurement tools. According to Rahayu and Day (2017), small businesses are more likely to adopt digital platforms if they perceive them as advantageous, easy to use, and aligned with their operational needs. Youth-owned MSEs often fall into the early adopter or early majority categories, especially in urban centres like Nairobi's CBD, where exposure to mobile and digital innovations is high. However, factors such as digital literacy, infrastructure,

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and perceived value influence the rate and extent of digital tax system adoption (Yusof et al., 2020; Tarus & Gichoya, 2021). As digital tax systems such as eTIMS are rolled out by the Kenya Revenue Authority, DOI theory provides a framework to understand why some businesses quickly adopt these tools while others delay, resist, or abandon the process. The theory underscores the need for awareness campaigns, technical support, and demonstrating the benefits of compliance to accelerate adoption.

This theory is highly relevant to the current study, as it provides a theoretical lens to understand how digital innovations such as e-invoicing and e-filing are accepted among youth-owned SMEs. Given that turnover tax compliance is being facilitated through digital means, understanding the adoption behaviour of SMEs is crucial. DOI theory explains how digital adoption affects behavioural outcomes such as compliance, since innovation adoption is not just a technological shift but a cultural and operational transformation (Mutua & Wamuyu, 2020). This study draws on DOI theory to analyse the relationship between digitalization dimensions and turnover tax compliance and to identify the characteristics of businesses more likely to comply through digital means. Thus, DOI not only offers predictive insight but also informs policy and training interventions for improving compliance among tech-enabled micro enterprises.

2.2 Empirical Review

2.2.1 Digital Record Keeping

Agbetunde et al. (2025) conducted a cross-sectional survey of 201 SMEs in Shinyanga Municipality, Tanzania, to examine internal and external determinants of tax compliance. Using OLS regression, they found that record-keeping practices measured by quality and consistency of financial documentation had a significant positive effect on compliance ($p = .006$), even after controlling for tax knowledge and firm size. Their results suggest that strengthening SMEs' capacity to maintain accurate, up-to-date records, ideally via user-friendly digital tools, can substantially boost turnover tax adherence.

Okello et al. (2023) surveyed 198 SMEs in Uganda to assess how record-keeping practices influence tax compliance. Applying factor analysis and OLS regression, they found that firms scoring higher on a digital record-keeping index capturing the use of computerised ledgers and cloud storage were significantly more likely to file and pay taxes on time. The authors recommend targeted interventions to equip SMEs with affordable accounting software and training to digitise their records and thereby improve compliance.

Mbise and Baseka (2022) examined the impact of the digital tax administration system, which integrates real-time tax data storage and electronic filing, on compliance among 133 SMEs in the Tanzania Revenue Authority's Tanga office. Through descriptive statistics and regression analysis, they found that adoption of the digital system is strongly associated with higher compliance. Their study underscores that end-to-end digital record-keeping (from invoice capture to automated reminders) is critical for boosting turnover tax compliance

Kimani et al. (2024) investigated the effect of an Electronic Tax Invoice Management System (ETIMS) on VAT compliance among 122 tented camps in Narok County, Kenya. Employing an explanatory survey design and multiple regression, they reported a positive and significant effect of ETIMS on compliance (indicating that automating invoice issuance and storage reduces input-tax errors and accelerates refund processing. They conclude that comprehensive

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digital invoice record-keeping is a vital lever for improving VAT remittance rates in the hospitality sector.

2.2.2 Turnover Tax Compliance

Turnover tax compliance refers to the extent to which taxpayers fulfil their legal obligations regarding the reporting, filing, and payment of turnover tax within the timelines prescribed by law. Traditionally, tax compliance has been defined as the degree to which taxpayers adhere to tax laws by accurately reporting income, filing returns, and paying dues on time (Le et al., 2020; Olaoye et al., 2017). This concept includes both procedural compliance, such as registration, timely filing, and payment, and substantive compliance, which involves correct computation and full disclosure of taxable income. While McBarnett (2016) distinguished three behavioural dimensions of compliance: committed, capitulated, and creative, recent studies have reaffirmed these classifications, noting that behavioural intent plays a critical role in compliance levels, particularly in informal sectors where monitoring is weak (Muturi & Moyi, 2021; Waweru & Omagwa, 2022).

In the context of turnover tax, compliance can be influenced by factors such as digital literacy, access to e-tax platforms, and perceived fairness of the tax regime. Mwangi (2014) operationalized tax compliance using indicators such as accuracy in reporting, timeliness in filing, and truthfulness in tax declarations. More recent studies by Gachanja and Were (2023) and Musau et al. (2022) have expanded this operationalization to include digital adoption metrics such as eTIMS, registration through iTax, and electronic payment behaviours. This aligns with OECD (2021) guidelines, which define tax compliance not only in terms of payment behaviour but also in terms of proper registration, complete and accurate reporting, and timely fulfilment of tax obligations. For turnover tax, these elements are crucial, especially since the system is designed to be final and simplified, removing the need for detailed annual returns.

Despite an extensive body of literature, there remains no universally agreed-upon definition of tax compliance. Some studies, particularly those anchored in psychological and economic theories, such as those by Kirchler et al. (2021) and Alm & Torgler (2020), focus on motivation, trust in authorities, and deterrence effects rather than clear-cut compliance metrics. Others, such as studies by OECD (2021) and the KRA (2023), adopt a more functional definition, emphasizing procedural indicators such as registration, timely filing, accurate reporting, and payment adherence. In this study, turnover tax compliance among youth-owned SMEs in Nairobi's CBD was measured through three key indicators: the number of SMEs registered for TOT, the frequency and accuracy of return filings, and the actual amount of TOT paid over the specified period. This approach will offer a holistic and empirical view of how digitalization and tax system modernization influence real-world compliance behaviour.

3. Methodology

The study adapted the explanatory research design. Tegan (2010) explains explanatory research design as a research design where a researcher explores why something happens when limited information is available. It can help increase your knowledge on a given topic, ascertain why a particular phenomenon is happening, and predict future occurrences. A target population of 3,218 registered youth-owned MSEs within Nairobi CBD was considered (Nairobi County, Ministry of Trade, 2025). Managers and owners were selected purposively on the grounds that they are at a higher management level to comprehend turnover tax decision issues of MSEs

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and are in a position to give the correct data. The study used the Yamane formula to calculate the sample size of 356 respondents. A total of 356 questionnaires were distributed to respondents across various businesses. Out of these, 276 were returned, yielding an initial response rate of 77.5%. Stratified and random sampling were used to select a sample size of 356. The study used five-point Likert scale questionnaires to collect primary data. Data was quantitatively analysed by use of both descriptive (means, frequency, percentage, and standard deviations and inferential analysis (Pearson correlation and linear regression model).

4. Results and Discussion

4.1 Descriptive statistics

4.1.1 Descriptive Statistics for Digital Record Keeping

Table 1 reveals generally positive perceptions toward digital record keeping among youth-owned MSEs in Nairobi, as indicated by an overall mean of 3.85 and a standard deviation of 0.65. This suggests that most respondents moderately agreed with the benefits and usage of digital record-keeping tools. Respondents indicated strong adoption of digital tools, with the highest agreement on the regular backup of digital records to prevent data loss (mean = 4.06, SD = 0.87). Similarly, the belief that digital record-keeping reduces errors compared to manual methods also scored high (mean = 4.05, SD = 0.65. There was also considerable agreement on maintaining electronic records (mean = 4.02, SD = 0.72) and confidence in the accuracy and completeness of digital business records (mean = 3.98, SD = 0.89. The ability to retrieve past transactions quickly through digital means also scored positively (mean = 3.96, SD = 0.83), indicating that digital record-keeping enhances operational efficiency.

Table 1: Digital Record Keeping

n=266	Mean	Std. Deviation
I maintain all my business records electronically using accounting or record-keeping software.	4.02	0.72
Digital record-keeping allows me to retrieve past transactions and documents quickly.	3.96	0.83
I feel confident in the accuracy and completeness of my digital business records.	3.98	0.89
I regularly back up my digital records to prevent data loss.	4.06	0.87
Using digital record-keeping has reduced errors compared to manual record-keeping.	4.05	0.65
Digital Record Keeping	3.85	0.65

4.1.2 Descriptive statistics for Turnover Tax Compliance

Table 2 presents the descriptive statistics related to turnover tax compliance among youth-owned Micro and Small Enterprises (MSEs) in Nairobi. The findings reveal that a majority of these businesses are formally registered (mean = 4.13, SD = 0.73), indicating strong compliance with legal business registration requirements. Additionally, most youth entrepreneurs reported consistently paying their turnover tax obligations (mean = 4.12, SD = 0.71), reflecting a commendable level of tax compliance. While compliance with tax registration and payment was high, slightly lower mean scores were reported for the timely

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filing of tax returns (mean = 3.59, SD = 0.97) and remitting taxes within the prescribed timeframe (mean = 3.75, SD = 1.02). These results suggest that, although most businesses meet their obligations, there may be challenges related to deadlines or procedural delays, particularly in the areas of filing and remittance. The overall composite score for turnover tax compliance was 3.72 with a standard deviation of 0.75.

Table 2: Turnover Tax Compliance

N=266	Mean	Std. Deviation
I run a registered business	4.13	0.73
I normally pay the required turnover tax for my business	4.12	0.71
I file my turnover tax returns in good time	3.59	0.97
I remit the required turnover tax within the required timeframe	3.75	1.02
Turnover Tax Compliance	3.72	0.75

4.2 Correlation Analysis

The correlation analysis aimed to explore the strength and direction of relationships between Digital record-keeping and turnover tax compliance among youth-owned MSEs in Nairobi. The Pearson correlation coefficients presented in Table 3 reveal an important insight that Digital record keeping was positively and significantly correlated with turnover tax compliance ($\rho = 0.741$, $p < 0.01$), indicating that proper electronic record management supports timely and accurate tax filing.

Table 3: Correlation Statistics

	Combating the illicit narcotics trade	K9 Operations
Turnover tax compliance	1	0.741**
Digital record keeping	0.741**	1
Sig.	0.01	

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

4.3 Regression Analysis

Table 4 showed that Digital record keeping had a positive correlation with turnover tax compliance up to 74.1% (R= 0.741). The results reveal that Digital record keeping caused a variation of (R^2=0.45.9 and adjusted R^2 =0.459) on turnover tax compliance.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.741^a	.0.459	.452	.45890

a. Predictors: (Constant), Digital record keeping _mean

Table 5 shows that there was an F statistic of 476.610 and a p-value of 0.000<0.05, which indicates that the model was significant in explaining the variance caused by turnover tax compliance.

Table 5: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	28.120	1	28.120	476.610	0.000
1	Residual	15.865	265	0.059		
	Total	43.985	266			

a. Dependent Variable: Turnover tax compliance

b. Predictors: (Constant), Digital record keeping

Table 6 showed that a unit change in digital record keeping caused a 0.204 increase in turnover tax compliance. The study found that digital record keeping had a positive and significant effect on turnover tax compliance, β =0.204, p-value =0.013<0.05. Consequently, the null hypothesis was rejected.

Table 6: Regression Coefficient

Model		Standardized Coefficients β	Std. Error	Unstandardized Coefficients β	t	Sig
1	(Constant)	-0.277	0.176		-1.574	0.117
	Digital record keeping	0.204	0.081	0.177	2.511	0.013

a. Dependent Variable: Turnover tax compliance

4.4 Discussion of the Findings

Digital record keeping also demonstrated a statistically significant positive effect on turnover tax compliance, with a regression coefficient of β = 0.204 and a p-value of 0.013. This finding led to the rejection of Hypothesis 2 (Ho2), confirming that the adoption and use of digital record-keeping systems have a substantial impact on how well youth-owned MSEs comply with their turnover tax obligations. A one-unit increase in the use of electronic or digital record-keeping systems such as cloud-based accounting software, digital ledgers, and real-time financial reporting tools is associated with a 0.204-unit increase in compliance. Agbetunde et al. (2025), in a cross-sectional study of Tanzanian SMEs, observed that good-quality financial records significantly predicted compliance, even when controlling for firm size and tax literacy. Similarly, Okello et al. (2023) demonstrated that Ugandan SMEs that adopted computerized ledgers and cloud storage systems were more likely to meet their tax obligations on time.

5. Conclusion

Digital record keeping was found to have a significant and positive effect on turnover tax compliance. This implies that youth-owned MSEs value proper financial documentation and support a fair taxation structure based on income. The digital tax system was also shown to significantly moderate the relationship between digital record keeping and tax compliance, suggesting that when the digital tax platform is functional and easy to navigate, it amplifies the benefits of digital record management.

6. Recommendations

Digital record keeping was found to have a significant impact on turnover tax compliance, with evidence suggesting that a supportive and equitable tax structure amplifies this effect. Managers and policy enforcers should prioritize initiatives that promote routine and accurate digital bookkeeping among youth-led enterprises. Further studies could explore how factors such as taxpayer education, trust in tax authorities, and peer influence mediate or moderate these relationships.

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