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Taxation System, Legal Framework and Compliance Efficiency of Digital Taxation in Kenya: A Case of Starehe Constituency

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Abstract

The purpose of this study was to examine the effect of the taxation system on the efficiency of digital tax compliance in Kenya, with a specific focus on the online tax registration system and the moderating role of the legal framework. The study was motivated by persistent underperformance in digital tax revenue collection despite the expansion of Kenya's digital tax regime. An explanatory research design was adopted, targeting 2,500 internet merchants in Starehe Constituency, Nairobi County, from which a random sample of 345 respondents was selected. Primary data were collected using structured questionnaires and analyzed using the Statistical Package for the Social Sciences (SPSS). Descriptive statistics and regression analysis were employed to establish relationships among the study variables. The findings revealed that the online tax registration system had a positive, statistically significant effect on the efficiency of digital taxation ($\beta = 0.550$, $p < 0.001$). The study further established that the legal framework significantly moderated the relationship between the online tax registration system and compliance efficiency, indicating that clear, consistent, and simplified tax laws enhance the effectiveness of digital tax administration. Automated online systems were found to reduce processing time, minimize human error, enhance transparency, and limit opportunities for corruption compared to manual systems. The study concludes that efficient online tax registration systems, supported by a robust, simplified legal framework, are critical to improving digital tax compliance in Kenya. It recommends that the Kenya Revenue Authority enhance the reliability, usability, and security of online tax platforms and invest in taxpayer education. Policymakers should simplify digital tax laws, reduce the number of tax layers, and strengthen regulatory clarity to support compliance and the sustainable growth of the digital economy.

Keywords: *Digital taxation, Online tax registration, Legal framework, Tax compliance efficiency*

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1. Introduction

Tax collection is generally carried out by government agencies responsible for managing revenue, such as a tax authority or revenue service. These agencies oversee the administration of tax laws, ensure compliance, and enforce penalties for non-compliance. There has been an unexpected uptick in the use of digital services and businesses, such as online advertising, social media, online shopping, and blogging, and these have not yet been taxed in the same way as income (Kamau et al., 2020). According to Odio et al. (2021), the taxation of digital services has emerged as a highly complex and divisive issue in international tax policy. Because of the rapid growth of the digital economy, traditional tax systems, designed primarily for physical goods and operations, have struggled to adapt to the new digital reality. Concepts such as "nexus" and "physical presence" led to taxing businesses in the jurisdictions where they actually had a physical presence. Since digital services such as software-as-a-service (SaaS), online advertising, cloud computing, and e-commerce do not necessitate a physical presence, it becomes difficult for tax authorities to determine the appropriate allocation of taxes (Elumilade et al., 2021).

To legally do business in Malaysia's digital economy, one must: obtain a tax reference number; record all profits and losses from business and digital economy-related endeavors. You can pay your taxes conveniently through a variety of ways, and you can fill out an e-B (business) form electronically. But it's harder for the IRB to collect income tax from digital economy enterprises because they can't distinguish between traditional economic activities and their income-sealing business operations. To streamline, improve, and organize the tax audit data-gathering process, it is necessary to conduct an Algorithm Performance Analysis using several classification algorithms (Wahab & Bakar, 2021).

Many online firms in Nigeria remain unregistered, making enforcement challenging. This is especially true as the digital economy grows internationally, making it more difficult to monitor and tax online transactions (Ariyo & Fagbemi, 2020). The Nigerian government implemented policies, such as a Value Added Tax (VAT) on digital services, to offset revenue losses from tax evasion and avoidance (FIRS, 2021). However, due to lax enforcement, inadequate infrastructure, and opposition from digital entrepreneurs, compliance is still low. As international platforms like Amazon and Alibaba enter Nigeria (Uchenna, 2021), defining the tax nexus for online activities becomes even more challenging (Adedoyin et al., 2025).

Online purchases in Kenya were subject to VAT as early as 2019. The Digital Service Tax was established by the Finance Act of 2020 and took effect on January 1, 2021. Income earned in Kenya from a business conducted entirely online, whether via a digital marketplace or any other electronic network, is subject to the digital service tax under Section 12(e) of Kenya's Income Tax Act. Nevertheless, resident and non-resident individuals with a permanent establishment are already subject to individual and corporate income taxes; the digital service tax won't apply to them (Haggai & Odunga, 2025). Statista predicts that by 2022, the Kenyan e-commerce market will reach $1.7 billion. The majority of Kenyans (72.9%) use mobile money, while a sizable minority (26.1%) use digital platforms to pay bills and make purchases (World Bank, 2021). Nevertheless, Kenya still faces the challenge of effectively taxing digital economic activities. To start with, establishing a taxable presence (nexus) for digital businesses is difficult because digitalization allows companies to conduct significant business activities

without meeting the criteria for a permanent establishment in the country (Wanjagi & Ruto, 2020).

The existing legal frameworks for tax compliance are crucial in ensuring that individuals and businesses fulfill their tax obligations. These frameworks encompass laws and regulations governing tax compliance, including enforcement mechanisms and penalties for non-compliance (Azim & Sano, 2025). However, with the rise of digital transactions, the adequacy of current tax laws to address them has come into question. The difficulty of identifying the correct country for tax purposes and the cross-border nature of digital transactions both pose obstacles. As a result, digital companies can exploit loopholes, raising concerns about tax avoidance and profit shifting (Adelakun et al., 2024).

1.1 Problem Statement

Kenya has increasingly relied on digital taxation to broaden its tax base amid limited non-tax revenue sources, leading to amendments in tax laws and the introduction of new digital taxes. Despite these efforts, the approach has faced significant challenges, including administrative inefficiencies and difficulties in taxing businesses without physical presence (Philip, 2021; Opiyo, 2022). Revenue performance has remained below expectations, with collections from digital platforms falling short of the USD 1.7 billion target in 2023, and only 63% of active taxpayers filing returns despite the adoption of digital systems (KRA, 2022; KRA, 2025).

Empirical evidence indicates that digital taxation systems account for only a modest share of the variation in tax compliance outcomes, explaining about 27% of the variation in tax compliance (Muya, Olweny & Koske, 2025). While studies from other contexts show that e-filing and e-billing can enhance compliance (Sentanu & Budiartha, 2019; Mandasari, 2024), Kenyan studies reveal mixed, context-specific findings (Opiyo, 2022). This gap underscores the need for deeper, context-specific analysis, which the current study addresses by examining how taxation systems affect the compliance efficiency of digital taxation in Kenya, with a focus on Starehe Constituency.

1.2 Research Hypotheses

$H0_1$: Online tax registration system has no significant effect on compliance efficiency of digital taxation in Kenya: a case of Starehe Constituency.

$H0_2$: The legal framework does not moderate the relationship between the online tax registration system and the compliance efficiency of digital taxation in Kenya: a case of the Starehe Constituency.

2. Literature Review

2.1 Theoretical Review

The study is anchored on benefit theory. The benefits-received principle, or benefit theory of taxation, was created by Krauss in 1932. According to this method, a person's tax liability is determined by the benefits they receive from the state. The quantity of advantages a person receives from the state should be taken into account when determining their tax obligation. According to the benefit theory of taxation, taxes ought to be imposed in proportion to the advantages that people derive from public goods and services. In essence, those who benefit more from government-provided goods and services should pay more in taxes to support them. This theory views taxes as analogous to market prices, where individuals pay for the goods or

services they consume (Seriah, 2024). The theory suggested that individuals should pay taxes in proportion to the benefits they receive from government services. In the context of digital tax compliance, this theory implies that those who benefit most from public goods and services should contribute more to their funding through taxation.

2.2 Empirical Review

2.2.1 Online Tax Registration System and Compliance efficiency of digital taxation

In his study, Mandasari (2024) examined how an electronic tax system can encourage greater taxpayer compliance. Using multiple linear regression analysis, the study takes a quantitative approach. Data are gathered by distributing questionnaires and using cross-sectional sampling. The findings showed that individual taxpayer compliance is positively and significantly impacted by e-filing, e-billing, and e-SPT. These systems are seen by taxpayers as effective, dependable, and accessible, which increases their desire to pay taxes. Data show that digital tax services are more likely to be adopted when they are easy to use and perceived as valuable, supporting the Technology Acceptance Model (TAM).

Asista and Setyowati (2022) focused on the implementation of the online tax system through the digitalization of tax administration and its costs and benefits. The purpose of this essay is to discuss the advantages and disadvantages of digitizing tax administration through the use of an online tax system. According to the literature review, tax authorities still need to take corrective action to improve the accessibility and simplicity of online tax services. This is because online tax users expect different benefits, leading to inefficiencies in the flow of online tax contributions to local tax revenue. Maintaining the sustainability of online tax service users requires tax authorities to socialize tax digitalization and to improve the infrastructure that supports online tax services.

2.2.2 Legal Framework, Taxation System on Compliance efficiency of digital taxation

Taxation frameworks for the digital economy: balancing openness and compliance was the subject of Azim and Sano's (2025) research. Focusing on international initiatives to develop equitable and efficient tax laws, this article investigates the changing regulatory frameworks for taxes in the digital economy. Initiatives such as the OECD's Base Erosion and Profit Shifting (BEPS) project and the implementation of digital services taxes (DST) highlight the ongoing efforts to modernize tax systems. Additionally, advancements in technology, including blockchain and artificial intelligence, offer potential solutions for enhancing tax compliance and reporting. However, achieving a balance between compliance and transparency remains a key challenge, as businesses seek clarity on tax obligations while governments aim to prevent revenue losses due to tax evasion. Despite progress, inconsistencies in tax policies across jurisdictions create uncertainty for multinational corporations, leading to disputes and risks of double taxation. This paper analyzes the potential for a unified global tax framework, the role of digital platforms in tax collection, and the impact of emerging technologies on regulatory compliance. By examining current policies and future trends, this study underscores the importance of collaborative policymaking to ensure an equitable and transparent taxation system in the digital economy.

The research group of Al Nabhani et al. (2025) compared domestic and international legal frameworks governing digital currencies. This study delves into the worldwide web of regulations, illuminating the methods used by various governing bodies in places such as the EU, the US, and the GCC. Among the listed obstacles are regulatory ambiguity, consumer risks, and financial instability; these are among the technological, social, and economic factors that call for thorough regulation of digital currencies. This study examines legislative changes and the effects of digital currency transactions using analytical and descriptive approaches. Oman is one of several GCC nations that have taken a cautious and inconsistent approach to digital currencies, reflecting the region's geographical and social complexity. This contrasts with the more liberal attitudes held by many developed economies.

3. Methodology

This study used an explanatory research design. The design provides a clearer explanation of the cause-and-effect relationship between variables. The target population was 2500 online traders in Starehe constituency, Nairobi County (Capital Markets Authority (CMA) of Kenya, 2025). The sample comprised 345 online traders in the Starehe constituency, selected using simple random sampling. The study collected primary data using semi-structured questionnaires. Descriptive statistics and inferential statistics were utilized to analyze the data. Results were presented in Tables and charts. Obtaining participants' informed consent was a top priority, as was maintaining their identity and the confidentiality of their data both before and after the research.

4. Results and Discussion

4.1 Descriptive Analysis

The descriptive analysis results for the study variables are presented in this section.

4.1.1 Online tax registration

Descriptive statistics for Online tax registration are presented in Table 1. The variable was measured using a Likert scale from 1 (totally disagree) to 5 (totally agree). In interpreting the findings, the percentages for total disagree and disagree are combined to mean deny, while agree and totally agree are combined to mean affirm.

Table 1: Online Tax Registration

Statement	Totally disagree	Disagree	Not sure	Agree	Totally agree	Mean	std. dev
The online tax registration system is friendly	39.50%	22.40%	13.20%	21.70%	3.20%	2.27	1.27
I understand the online tax registration process	7.80%	14.90%	13.50%	29.50%	34.20%	3.67	1.30
Online tax registration has reduced corruption	40.60%	26.30%	5.30%	14.90%	12.80%	2.33	1.45
Online tax registration system has reduced time wastage on queues at KRA	11.70%	3.90%	20.60%	45.90%	17.80%	3.54	1.18
Tax registration has greatly enhanced access to technical support.	7.50%	6.80%	19.60%	44.10%	22.10%	3.67	1.12
Tax registration process is straightforward.	43.40%	11.00%	19.20%	16.70%	9.60%	2.38	1.42
Tax registration has reduced the documentation required.	17.10%	7.80%	17.40%	40.20%	17.40%	3.33	1.33

With a mean score of 2.27 and a standard deviation of 1.27, the results demonstrated that 61.9% of respondents disagreed with the statement that the online tax registration method is friendly. Results also revealed that, on average (with a standard deviation of 1.30), 63.7% of respondents understood the online tax registration process. The data also demonstrated that online tax registration has reduced corruption, with 66.9% of respondents disagreeing (mean = 2.33, standard deviation = 1.45). An additional finding revealed that, with a mean score of 3.54 and a standard deviation of 1.18, the majority of respondents (63.7%) agreed that the online tax registration system has reduced time wasted waiting at KRA.

In addition, the results showed that 66.2% of respondents agreed that tax registration has greatly enhanced access to technical support, with a mean of 3.67 and a standard deviation of 1.12. Furthermore, the data showed that 54.4% of respondents disagreed with the statement that the tax registration process is uncomplicated, with a mean score of 2.38 and a standard deviation of 1.42. Additional results showed that 57.6% of respondents (mean=3.33, standard deviation=1.33) agreed that tax registration had reduced the amount of paperwork required.

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In the open-ended questions, respondents were asked to indicate how online tax registration otherwise affected compliance with digital taxation. The respondents indicated that online registration helped tax authorities create comprehensive databases of taxable entities, including those operating in the digital economy. In addition, it reduces the administrative burden for both taxpayers and tax authorities by simplifying procedures, improving record-keeping, and eliminating physical interactions.

4.1.2 Legal Framework

Descriptive statistics for the Legal Framework have been presented in Table 2. The variable was measured using a Likert scale from 1 (totally disagree) to 5 (totally agree). In interpreting the findings, the percentages for total disagree and disagree are combined to mean deny, while agree and totally agree are combined to mean affirm.

Table 2: Legal Framework

Statement	Totally disagree	Disagree	Not sure	Agree	Totally agree	Mean	std. dev
Mandatory registration of digital service providers is a good measure in enforcing revenue collection in the sector	4.30%	11.40%	6.40%	38.80%	39.10%	3.97	1.14
The licensing requirements of digital business have been put into place	17.10%	3.90%	10.30%	41.30%	27.40%	3.58	1.38
There is awareness of the digital currency regulations	16.00%	4.30%	11.40%	44.50%	23.80%	3.56	1.33
There is a clear and simple system for digital business	12.80%	4.30%	10.00%	46.60%	26.30%	3.69	1.26
Regulations changes in the enforcement of digital businesses are communicated in good time	10.70%	3.20%	14.20%	43.10%	28.80%	3.76	1.21

The results showed that the majority of respondents (77.9%) agreed that requiring digital service providers to register is an effective strategy for ensuring revenue collection in business, with a mean score of 3.97 and a standard deviation of 1.14. The results also showed that most respondents (68.7%) agreed that the licensing requirements for digital firms have been met, with a mean score of 3.58 and a standard deviation of 1.38. Additionally, the results indicated that 68.3% of respondents agreed that they have a clear understanding of the regulations relevant to digital currency, with a mean score of 3.56 and a standard deviation of 1.33.

The survey also revealed that 72.9% of respondents thought digital business systems were simple and easy to use, with a mean score of 3.69 and a standard deviation of 1.26. Also, with a mean score of 3.76 and a standard deviation of 1.23, the results showed that most respondents (71.9%) agreed that changes in legislation regarding the enforcement of digital enterprises are disclosed on time.

4.1.3 Compliance Efficiency of Digital Taxation

Descriptive statistics on the compliance efficiency of digital taxation are presented in Table 3. The variable was measured using a Likert scale from 1 (totally disagree) to 5 (totally agree). In interpreting the findings, the percentages for total disagree and disagree are combined to mean deny, while agree and totally agree are combined to mean affirm.

Table 3: Compliance Efficiency of Digital Taxation

Statement	Totally disagree	Disagree	Not sure	Agree	Totally agree	Mean	std. dev
I file digital service tax returns every month	32.00%	21.40%	3.90%	25.60%	17.10%	2.74	1.54
I declare correct monthly online retailing income	53.70%	11.70%	11.00%	22.40%	1.10%	2.05	1.28
I file digital service tax returns only to avoid penalties	4.30%	18.90%	6.00%	40.20%	30.60%	3.74	1.20
KRA has offered an enabling environment for filing digital service tax	4.30%	11.70%	22.40%	44.10%	17.40%	3.59	1.04
I file digital service tax returns on time and as required by law	47.30%	16.00%	2.10%	32.00%	2.50%	2.26	1.39
KRA has created a lot of public awareness on digital service tax	14.90%	5.00%	20.30%	43.10%	16.70%	3.42	1.26

According to the findings, 53.4% of participants didn't agree with the claim that they submit monthly digital service tax reports. 2.74 was the average score, and 1.54 was the standard deviation. A mean of 2.74 and a standard deviation of 1.54 indicated that 65.4% of respondents disagreed with the statement that their monthly revenue from online shopping is accurate.

With a mean score of 3.74 and a standard deviation of 1.20, the results showed that 70.8% of respondents agreed that the sole reason they file digital service tax reports is to avoid penalties.

Additionally, statistical research showed that, on average, 61.5% of respondents agreed that KRA had created a favorable environment for filing digital service tax returns (with a standard deviation of 1.04). Additionally, the findings indicated that 63.3% of respondents did not agree with the claim that I file my digital service tax reports in a timely and legal manner. The standard deviation was 1.39, and the mean score was 2.26. With a mean of 3.42 and a standard deviation of 1.26, additional findings revealed that 59.8% of respondents agreed that KRA has greatly increased public awareness of the digital service tax.

The participants were further asked whether the government of Kenya has done enough to support digital infrastructure and what needs to be done to make it available to the masses. While the Kenyan government has made significant strides in supporting digital infrastructure, particularly with its national fiber backbone, ambitious new initiatives, and high mobile penetration, it has not done enough to ensure mass availability. The primary challenges preventing widespread access include persistent rural-urban and gender divides, high costs for last-mile connectivity, and low digital literacy rates.

4.2 Regression Analysis Results before Moderation

A linear regression analysis was conducted to assess the effect of the online tax registration system on the efficiency of digital taxation compliance. Results are presented in Table 4.

Table 4: Regression Coefficients

	Unstandardized Coefficients		**Standardized Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	-0.15	0.142		-1.054	0.293
Online tax registration	0.541	0.039	0.550	13.921	0.000

Results showed that online tax registration had a positive and significant effect on compliance efficiency of digital taxation in Kenya (β=0.550, p=0.000). This indicates that simplifying and automating the initial registration process can lead to higher tax compliance rates in the long run. The study's results corroborated those of Getu (2023), who also discovered that taxpayer compliance was significantly impacted by technical filing skills and online tax registration systems. The study's results corroborated those of Mandasari (2024), who found that e-registration has a positive and substantial effect on taxpayer compliance.

4.3 Hierarchical Regression Models

The following Hierarchical Regression models were used to assess the moderating effect of the legal framework on the online tax registration system and the compliance efficiency of digital taxation.

Table 5: Coefficients of Regression for the Moderating Effect of Legal Framework

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.244	0.208		1.176	0.241
Online tax registration	0.297	0.072	0.302	4.143	0.000
Legal framework	0.032	0.061	0.038	0.531	0.596
X1.M	0.039	0.017	0.255	2.304	0.022

The coefficient for the interaction term between online tax registration and the compliance efficiency of digital taxation in Kenya (X1*M) was 0.255, with a p-value of 0.022. This means the legal framework had a statistically significant moderating effect on the relationship between online tax filing and the efficiency of digital tax compliance. This implies that the effectiveness of digital tax systems in enhancing compliance is significantly moderated by the robustness and clarity of the legal framework. The study findings agreed with Gitari (2020), who identified the legal framework as crucial for building public trust and ensuring a fair tax collection system, particularly in the context of implementing digital tax reforms. Al Nabhani et al. (2025) also found that the effectiveness of digital tax systems in enhancing compliance depends heavily on factors such as taxpayer education, digital literacy, and the government's role in facilitating technology adoption.

5. Conclusion

The study concluded that online tax registration had a positive and significant effect on the efficiency of compliance with digital taxation in Kenya. Research confirms that online tax registration, specifically through the Kenya Revenue Authority's (KRA) iTax system, significantly improves the efficiency of digital tax compliance in Kenya. Online tax registration reduces the processing time and minimizes human errors associated with manual filing. Online systems allow for convenient, 24/7 access, saving taxpayers time and effort previously spent waiting in queues at KRA offices. Furthermore, the study concluded that the legal framework significantly moderated the relationship between the online tax registration system and the efficiency of digital taxation compliance.

6. Recommendations

The study recommends strengthening the reliability, usability, and security of KRA's digital tax systems to enhance taxpayer experience and compliance, particularly among SMEs. This includes simplifying tax administration through user-friendly platforms and APIs, and ensuring clear accountability for digital and AI-driven decisions. KRA should also invest in taxpayer education, especially in computer literacy; promote inclusive, business-friendly digital tax

policies; ensure transparency; and provide support to taxpayers facing access or language barriers to prevent exclusion.

For policymakers, the recommendations emphasize simplifying the digital tax framework by reducing the number of layers of taxation, streamlining legal and administrative procedures, and standardizing tax registration through a single Tax Identification Number. Policymakers should promote fairness by introducing graduated tax thresholds, revenue-based obligations, and grace periods for start-ups, while improving system accessibility, security, and trust. These measures aim to balance revenue mobilization with the sustainable growth of Kenya's digital economy.

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