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Effect of Electronic Tax Service on Income Tax Compliance Among Retail Small and Medium Enterprises in Nairobi Central Business District, Kenya

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Abstract

Taxation serves as the primary source of government revenue in both developed and developing economies, providing financial independence from external aid. However, tax avoidance and evasion pose significant threats to this revenue source, with developing economies being the most affected. Income tax compliance remains a central concern for governments globally because it is critical to financing public goods and sustaining fiscal stability. Income tax reforms have been a key component of broader tax reform packages, such as the implementation of eTIMS and the widening of the income tax base to include other goods and services. Despite these reforms, overall tax revenue mobilization, including Income tax, remains low. This research aimed to determine the effect of electronic tax services on income tax compliance among retail Small and Medium Enterprises in Nairobi Central Business District, Kenya. This study was guided by the Ability-to-Pay Theory and the Unified Theory of Acceptance and Use of Technology. This study will use an explanatory research design. The target population was 3805 retail small and medium enterprises in Nairobi Central Business District, Kenya, and the sample size was 318 respondents out of the 362 questionnaires issued, resulting in an 87.8% response rate. The questionnaires collected primary data, and the analysis used both descriptive and inferential statistics. The study regression analysis found that electronic tax service had a significant positive effect on income tax compliance ($\beta = 0.096$, $p = 0.034$). The study recommends that policymakers at the Kenya Revenue Authority and the National Treasury prioritize continuous investment in the usability and accessibility of the iTax platform, ensuring system downtime is minimized and the interface is simplified for traders with limited digital literacy. Further studies should explore the influence of peer behaviour and social networks on income tax compliance within the same population.

Keywords: *Electronic tax service, income tax compliance, retail Small and Medium Enterprises*

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1. Introduction

Taxation is a primary source of government revenue in both developed and developing economies, providing financial independence from external aid (OECD, 2023). However, tax avoidance and evasion pose significant threats to this revenue source, with developing economies being the most affected. Although developing countries have relatively high tax performance levels at 35%, African countries report significantly lower levels at less than 23% (OECD, 2020).

Income tax compliance remains a central concern for governments globally because it is critical to financing public goods and sustaining fiscal stability. Broadly, income tax compliance refers to the degree to which taxpayers accurately report income, file returns on time, and pay tax liabilities in accordance with prevailing tax laws (Kirchler, Hoelzl, & Wahl, 2023). Despite extensive reforms, many countries still face significant compliance gaps driven by tax evasion, avoidance, weak enforcement, and low tax morale. According to Martinez-Vazquez (2022), non-compliance in income taxation undermines equity and efficiency in tax systems by shifting the tax burden to compliant taxpayers and constraining governments' ability to fund development priorities.

Income tax compliance in Kenya requires individuals and businesses to *register with the Kenya Revenue Authority (KRA), accurately report income, file returns on time, and pay taxes owed* under the Income Tax Act (Cap 470). The KRA promotes compliance through taxpayer education, voluntary disclosure programs, audits, penalties, and legal enforcement for non-compliance (Owino & Were, 2022). Challenges to compliance include complex tax laws, low taxpayer awareness, a large informal sector, and limited enforcement capacity, which contribute to underreporting and tax evasion (IMF, 2020). The study shows that digital tax platforms, risk-based audits, and taxpayer sensitization programs improve compliance, while socio-economic factors and trust in government influence taxpayers' willingness to comply (OECD, 2020). Effective income tax compliance is essential for revenue generation, funding public services, and ensuring fairness and integrity in Kenya's tax system (IMF, 2020).

Electronic Tax Service (ETS) refers to tax authorities' use of information and communication technologies to provide tax-related services through online platforms, enabling taxpayers to fulfill their tax obligations electronically (Juma et al., 2026). These services include taxpayer registration, tax return filing, tax payment, access to tax information, issuance of compliance certificates, and communication with tax authorities through digital channels (Bobokeldieva et al., 2025). Electronic tax services have emerged as a key component of modern tax administration because they simplify tax procedures, reduce compliance costs, and improve the efficiency of tax collection systems (Anggraeni, 2025).

The study was conducted in the Nairobi Central Business District. The Nairobi Central Business District (CBD) is located in the heart of Nairobi, Kenya's capital city. The area serves as the city's administrative, commercial, and social center and is characterized by a dense population, modern infrastructure, and extensive transport networks. Major roads surround Nairobi CBD, and it is easily accessible from different parts of the city, making it one of Kenya's busiest urban centers. The Nairobi CBD contains a mixture of office buildings, government institutions, educational institutions, retail shops, hotels, and public service centers. The area experiences heavy pedestrian and vehicular traffic on weekdays due to its

strategic location and concentration of services. In addition, Nairobi CBD continues to grow and expand infrastructurally, making it a significant metropolitan area in Kenya.

1.1 Problem Statement

Income tax reforms in Kenya have been a key strategy to improve revenue mobilization through better administration, digitalization, and a broader tax base. Through the Kenya Revenue Authority, initiatives such as the electronic Tax Management Information System (eTIMS), electronic filing systems, and broader income tax coverage have been introduced to strengthen compliance and improve tax collection efficiency. These reforms were designed to capture previously untaxed sectors, improve taxpayer monitoring, and reduce administrative bottlenecks. However, challenges such as a large informal sector, tax evasion, and limited taxpayer compliance continue to undermine these reforms despite technological improvements (Kenya Revenue Authority, 2025).

Despite these reform efforts, Kenya's income tax performance remains below expectations, reflecting persistent structural and economic constraints. Low taxpayer awareness, compliance costs, and SMEs' difficulties adapting to changing tax requirements have limited the effectiveness of digital tax systems. Broader economic challenges such as inflation, unemployment, and reduced business profitability have also negatively affected taxable income levels. As a result, in the 2024/25 financial year, the Kenya Revenue Authority set an income tax target of KSh 1.677 trillion but collected KSh 1.611 trillion, recording a shortfall of about KSh 66 billion (KRA, 2025).

This indicates that while reforms have improved systems, they have not fully translated into optimal revenue performance. Taxpayers in this sector have yet to comply with the requirements of the respective tax laws. This study therefore sought to determine the effect of electronic tax service on income tax compliance among retail Small and Medium Enterprises in Nairobi Central Business District, Kenya.

2. Literature Review

2.1 Theoretical Review

2.1.1 The Ability to Pay Theory

Ability-to-Pay Theory posits that taxpayers should contribute to government revenue in proportion to their economic capacity, a principle rooted in equity and fairness and formalized in modern public finance (Musgrave & Musgrave, 1989; Smith, 1776). This framework underpins progressive income tax systems, where higher-income individuals pay a larger share of their earnings, aligning tax obligations with the diminishing marginal utility of income and enhancing the tax system's legitimacy (Musgrave & Musgrave, 1989; Accounting Insights Team, 2024).

The Ability-to-Pay (ATP) Theory asserts that taxpayers should contribute to public revenue in proportion to their economic capacity, making taxation fair and equitable (Musgrave & Musgrave, 1989; Smith, 1776). In the context of income tax compliance, ATP provides a theoretical foundation for progressive taxation, where individuals or businesses with higher income pay a proportionally higher tax. This proportionality reflects equity and increases the legitimacy of the tax system, which is crucial for voluntary compliance (Fleming, Peroni, & Shay, 2001). When taxpayers perceive that their tax obligations are aligned with their ability

to pay, and that others are also paying their fair share, compliance behavior improves and tax evasion decreases.

Furthermore, studies in developing countries, including Kenya, show that taxpayers are less likely to evade income tax when they perceive the burden is distributed according to ability and when transparency in revenue use is high (Njilu, 2023). Conversely, when the tax system is perceived as regressive or unfair, charging low-income earners disproportionately, compliance declines, illustrating the critical role of ATP-aligned tax policies in fostering adherence to income tax regulations.

Overall, integrating the Ability-to-Pay principle into income tax policy through progressive rates, taxpayer education, and transparent administration enhances perceptions of fairness and promotes voluntary compliance, particularly among SMEs and individual taxpayers whose willingness to comply is sensitive to fairness considerations (Chelangat, 2025). In this way, ATP theory not only informs equitable taxation but also serves as a practical tool for strengthening income tax compliance.

2.1.2 Unified Theory of Acceptance and Use of Technology (UTAUT)

Venkatesh, Morris, Davis, and Davis developed the Unified Theory of Acceptance and Use of Technology (UTAUT) in 2003. The Unified Theory of Acceptance and Use of Technology (UTAUT) provides a robust theoretical foundation for understanding electronic tax service by explaining how and why individuals and organizations adopt and use new technologies. UTAUT posits that performance expectancy, effort expectancy, social influence, and facilitating conditions directly shape users' intentions and actual technology use, while factors such as age, gender, experience, and voluntariness moderate these effects (Venkatesh *et al.*, 2003).

In Kenya, Ahmed (2024) found that ease of use, perceived usefulness, and system security of digital platforms positively influence turnover tax compliance among textile SMEs in Eastleigh, Nairobi County, demonstrating how digital tools can enhance compliance when designed with user experience in mind (Abdi, 2024). Regional developments confirm this trend, with VAT digitalisation initiatives like Kenya's Electronic Tax Invoice Management System (eTIMS) and Uganda's electronic fiscal systems improving real-time tracking and reducing evasion challenges, as highlighted by (Obell, 2026), Commissioner for Micro and Small Taxpayers at the Kenya Revenue Authority (KRA), at an East African digital tax seminar.

Jedidah and Ruto (2020) further emphasize how data mining and pattern recognition technologies can support digital tax compliance by improving audit targeting and fraud detection. Collectively, the research insights and practitioner observations show that electronic tax services, when aligned with user acceptance conditions and supported by enabling infrastructure and clear policy frameworks, strengthen tax compliance outcomes by making systems more accessible, efficient, and trustworthy for taxpayers across diverse contexts. The theory supports electronic tax services.

2.2. Empirical Review

2.2.1 Income tax compliance

Income tax compliance refers to the extent to which taxpayers, including individuals and businesses, accurately report their income, file returns on time, and pay the taxes due under relevant tax laws (Owino & Were, 2022). It encompasses both voluntary compliance, where taxpayers willingly meet their obligations, and enforced compliance**,** where tax authorities ensure adherence through audits, penalties, and legal action (OECD, 2020). Factors such as taxpayers' awareness of tax laws, trust in government, perceived fairness of the tax system, regulatory complexity, and the efficiency of tax administration influence compliance (Lago-Peñas & Martinez-Vazquez, 2022; IMF, 2020).

Income tax compliance is the extent to which taxpayers, both individuals and corporations, fulfill their obligations under tax laws by registering with tax authorities, accurately reporting all taxable income, filing tax returns within stipulated deadlines, and paying the correct amount of tax due (Owino & Were, 2022). It involves both voluntary compliance**,** where taxpayers willingly adhere to tax regulations, and enforced compliance, where tax authorities intervene through audits, penalties, fines, and legal actions to ensure adherence (Kirchler et al., 2021). Multiple factors shape compliance, including taxpayers' knowledge and awareness of tax obligations, the complexity of tax laws, perceived fairness of the tax system, administrative efficiency, and trust in government institutions (Lago-Peñas & Martinez-Vazquez, 2022).

In Kenya, the Kenya Revenue Authority oversees income tax compliance through initiatives such as the iTax system, electronic tax filing, and taxpayer education programs aimed at improving voluntary compliance among individuals and businesses (KRA, 2024). Tax compliance is influenced by factors such as tax knowledge, perceived fairness of the tax system, enforcement measures, penalties, and trust in government institutions (KRA, 2023). Effective income tax compliance is important because it enhances government revenue collection and supports the financing of public services and economic development in Kenya (OECD, 2020).

2.2.2 Electronic Tax Service

Arner, Barberis, and Buckley (2023) argue that digital financial infrastructure fosters economic development by increasing transaction efficiency, reducing costs, and enhancing transparency. Central banks and governments have also embraced digital payment systems to promote cashless economies and strengthen oversight of financial activities. Zetzsche *et al.* (2020) highlight that digital payment platforms have been critical in sustaining economic activity during the COVID-19 pandemic by enabling remote transactions and reducing physical contact. In addition, Singh and Rana (2021) note that digital payments reduce the risk of corruption and tax evasion by creating traceable transaction trails, thereby improving governance. As a result, adopting digital payments is not only a technological shift but also a catalyst for economic modernization and inclusive growth.

A study by Mascagni et al. (2020) in sub-Saharan Africa found that adopting mobile money services significantly improved VAT compliance among small and medium enterprises (SMEs) by increasing transaction visibility to tax authorities. Similarly, Okunogbe and Pouliquen (2022) show that digital payment mandates in Rwanda increased declared revenues and tax remittances, especially when businesses had to use electronic billing systems.

Moreover, digital payments reduce the administrative burden of tax filing by integrating automated invoicing, real-time reporting, and streamlined audit trails, thus encouraging voluntary compliance (OECD, 2020).

Muturi and Kiarie (2024) conducted a study to establish the effects of the online tax system on tax compliance among small taxpayers in Meru County, Kenya. The study adopted a descriptive research design. The researchers collected data using a structured questionnaire and analyzed them using SPSS (version 20). In addition to descriptive statistics, the study conducted correlation and regression analyses and presented summaries. The findings of the study were that the online tax system does affect tax compliance level among small taxpayers in Meru County.

2.3 Conceptual Framework

A conceptual framework is a diagrammatic research tool that helps the researcher categorize and describe concepts relevant to the study and map relationships among them (Cooper & Schindler, 2011). It explains how they relate to each other (Adom *et al.,* 2016). The dependent variable was Income tax compliance. The independent variable was electronic tax service, as shown in Figure 1.

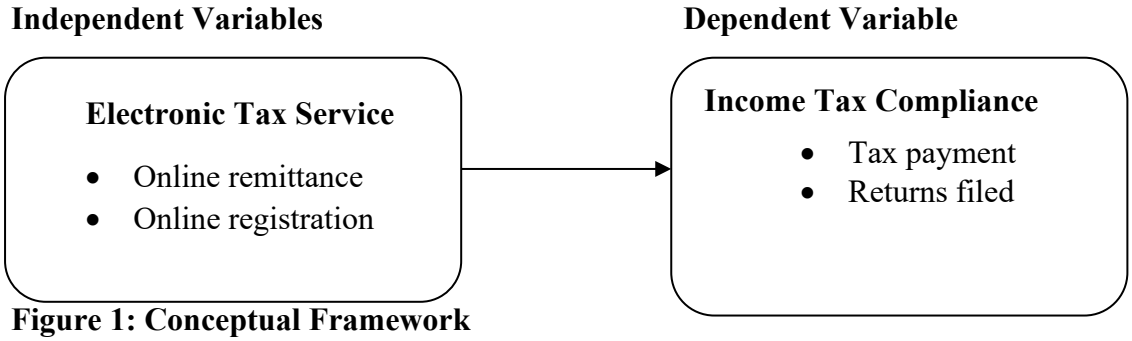


Figure 1: Conceptual Framework

3. Methodology

A research design is the plan and structure of an investigation designed to answer the research questions. The research design outlines techniques and strategies for collecting information for assessment or evaluation, including identifying the data collection method, the tools to be used, managing the tools, and organizing the information to be analyzed (Lawrence, 2012). The study adopted an explanatory research design, gathering information through questionnaires.

Population refers to all the items in the field of inquiry (Kumar, 2008). Kothari (2004) defines a population as all elements (individuals, objects, and events) that meet the sample criteria for inclusion in a study. The target population was 3805 retail small and medium enterprises in Nairobi Central Business District, Kenya KRA, 2025). The sample comprised 362 respondents. As shown in Figure 1, the response rate was 87.8%, meaning that of the 362 questionnaires issued, 318 were completed and submitted within the stipulated timelines. The remaining 44 questionnaires were not responded to because respondents were not interested in the topic, or they did not have time to complete the questionnaire.

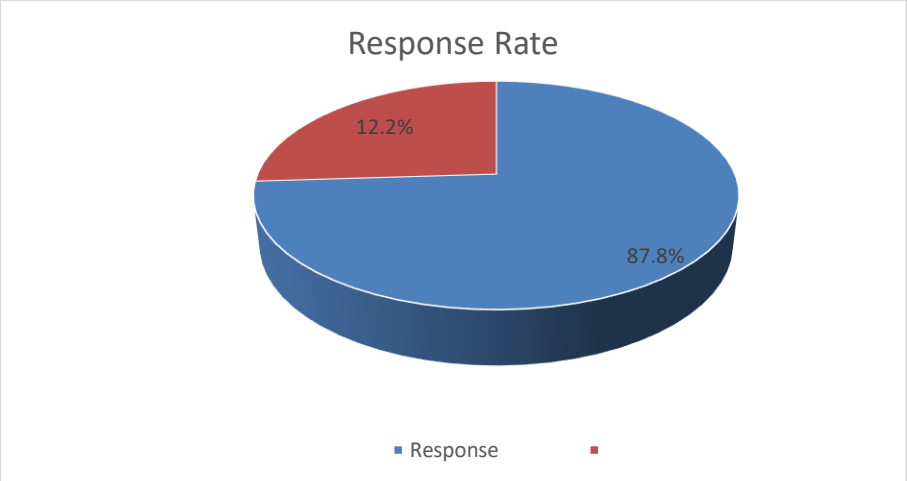


Figure 1: Response Rate

Reliability analysis

Reliability is the degree to which a research instrument yields consistent results or data across repeated trials (Higgins & Straub, 2006). Sekaran (2003) notes that reliability measures the stability and consistency with which an instrument measures the concept. Nunnally (1978) notes that many factors can prevent measurements from being repeated perfectly. Cronbach's alpha was used to evaluate the unidimensionality of a set of scale items and compare the scores obtained. Nunnally (1978) argued that a Cronbach's alpha value of 0.7 and above proves that the research instrument is reliable. This study used 0.7 as the reliability benchmark. Table 1 shows that for the 5 items measuring Income tax compliance, the alpha value was 0.890 (>0.7), indicating a high level of internal consistency in responses to the statements. Similarly, the alpha value for the 5 items measuring electronic tax service was 0.908 (> 0.7), also indicating high internal consistency.

Table 1: Test of Reliability of Questionnaire

Factor	Number of Items	Cronbach Alpha score	Conclusion
Income tax compliance	5	0.890	Reliable
Electronic tax service	5	0.908	Reliable

4. Results and Discussion

4.1 Descriptive statistics of Electronic Tax Service

Table 2: Results show that respondents indicated agreement that "online remittance allows our business to pay taxes conveniently from any location" with a mean response of 4.425, standard deviation of 0.514, indicating a fairly low level of variation of responses from the mean. For the item "online registration system saves time compared to manual registration," the mean response was 4.443 with a standard deviation of 0.540, reflecting fairly low variability among responses. The rounded mean of 4 corresponds to an "Agree" level of endorsement. Regarding the statement "eTIMS has simplified the process of filing, remitting taxes and has improved our compliance," the mean response was 4.409 with a standard deviation of 0.553, suggesting a relatively low level of dispersion. The rounded mean of 4 corresponds to an "Agree"

response. For the statement "the system provides immediate confirmation after tax payment," the mean response was 4.377 (SD = 0.602), indicating moderately low variation in responses. The rounded mean of 4 corresponds to an "Agree" response. For the item "online registration reduces our cost of complying with tax requirements," the mean response was 4.365 (SD = 0.604), indicating a moderately low level of dispersion. The rounded mean of 4 corresponds to an "Agree" response. The overall mean was 4.404, suggesting a general tendency toward agreement across all items.

Table 2: Descriptive Statistics: Electronic Tax Service

	N	Mean	Std. Dev
Online remittance allows our business to pay taxes conveniently from any location	318	4.425	.514
Online registration system saves time compared to manual registration	318	4.443	.540
eTIMS has simplified the process of filing, and remitting taxes and has improved our compliance.	318	4.409	.553
The system provides immediate confirmation after tax payment	318	4.377	.602
Online registration reduces our cost of complying with tax requirements	318	4.365	.604
Overall Mean		**4.40**4	

4.2 Descriptive statistics of Income Tax Compliance

Table 3: Descriptive results show that respondents agree with the statement, "Our business submits returns on time," with a mean response of 4.201 and a standard deviation of 0.633, indicating a fairly low level of variation of responses from the mean. Participants agreed that "Our business has registered for income tax compliance obligation," with a mean response of 4.179 and a standard deviation of 0.666, indicating a fairly low level of variation from the mean. The findings showed agreement with "We compute the income tax due in accordance with the tax laws," with a mean response of 4.126 and a standard deviation of 0.638, indicating fairly low variation from the mean. Respondents agreed that "Our business mostly files our returns accurately," with a mean response of 4.173 and a standard deviation of 0.624, indicating fairly low variation from the mean. Business owners agreed that "The tax system in place motivates us to voluntarily comply with tax obligations," with a mean response of 4.220 and a standard deviation of 0.716, indicating fairly low variation from the mean. The overall mean of 4.180 implies that, on average, the respondents agree with the statements measuring income tax compliance.

Table 3: Descriptive Statistics: Income Tax Compliance

	N	Mean	Std. Dev
Our business submits returns on time	318	4.201	.633
Our business has registered for income tax compliance obligations	318	4.179	.666
We compute the income tax due in accordance with the tax laws	318	4.126	.638
Our business mostly files our returns accurately	318	4.173	.624
The tax system in place motivates us to voluntarily comply with tax obligations	318	4.220	.716
Overall Mean		4.180	

4.3 Correlations Analysis

The correlation matrix measures how strongly the predictor variable relates to the dependent variable. When high predictor values are associated with high dependent variable values, a positive correlation exists. When high predictor values are associated with low dependent variable values, a negative correlation exists. We assessed correlation significance at the 95% confidence level.(Brown, n.d.). Additionally, the correlation matrix found that there is a positive and significant correlation between electronic tax service and income tax compliance ($r = 0.509$, $p=0.015 < .05$). This implies that enterprises which effectively utilize the iTax platform and other digital filing systems tend to report greater adherence to tax obligations, likely due to the reduced complexity and increased transparency these systems provide.

Table 4: Correlation Statistics

	Income tax compliance	Electronic tax service
Income tax compliance	1	0.509**
Electronic tax service	0.509**	1
Sig.	0.015	

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

4.4 Regression Analysis

Table 5 shows that electronic tax service had a positive correlation with Income tax compliance of 50.9% (R = 0.509). According to the study findings, the model accounts for 25.9% (R-square = 0.259) of the variation in income tax compliance. This implies that the remaining 74.1% of the variation is due to factors not included in the model. The results further reveal that even if the study adjusts, the model would still account for 25.5% (Adjusted R Square, 0.255) of income tax compliance

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.509[a]	.0.259	.255	.38347

a. Predictors: (Constant), Electronic tax service _mean

The ANOVA for direct effects in Table 6 showed a high ratio of explained to unexplained variance ($F = 390.206$, p-value $= 0.000 < 0.05$), indicating that Electronic tax service significantly affected the Income tax compliance model.

Table 6: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	47.215	1	47.215	390.206	0.000
	Residual	38.421	316	0.121		
	Total	85.636	317			

a. Dependent Variable: Income tax compliance
b. Predictors: (Constant), Electronic tax service

Table 7 showed that a one-unit change in electronic tax service caused a 0.096 increase in Income tax compliance. The study found that electronic tax service had a positive and significant effect on Income tax compliance β = -0.096, p-value = 0.034 < 0.05). The hypothesis was rejected.

Table 7: Regression Coefficient Analysis

Variable	Standardized β	Std. Error	t-Statistic	Unstandardized β	Prob.
Constant	4.324	0.050	86.480		0.000
Electronic tax service	0.096	0.045	2.133	0.104	0.034

4.4 Discussion

The study objective sought to determine the effect of electronic tax service on income tax compliance among retail Small and Medium Enterprises in Nairobi Central Business District, Kenya. The correlation matrix found that there was a positive and significant correlation between electronic tax service and income tax compliance (r = 0.509, p=0.015 < .05). This implies that enterprises which effectively utilize the iTax platform and other digital filing systems tend to report greater adherence to tax obligations, likely due to the reduced complexity and increased transparency these systems provide. Electronic tax service had a significant positive effect on income tax compliance (β = 0.096, p = 0.034). The result strongly supports the premise that a functional, user-centric e-filing infrastructure is a necessary technological component for facilitating voluntary compliance among retail traders. This finding aligns with Muturi and Kiarie (2024), who found that the online tax system significantly affects tax compliance among small taxpayers in Meru County, Kenya, using a descriptive research design and regression analysis.

5. Conclusion

The study concludes that electronic tax service is a significant positive driver of income tax compliance among retail SMEs. This conclusion adds to the taxation literature in developing economies by empirically showing that the technological functionality of e-filing platforms is not merely administrative modernization but a direct determinant of voluntary income tax compliance behavior in the informal and semi-formal retail sector.

6.. Recommendations

The study recommends that policymakers at the Kenya Revenue Authority and the National Treasury prioritize continued investment in the usability and accessibility of the iTax platform, minimize system downtime, and simplify the interface for traders with limited digital literacy. Additionally, the Kenya Revenue Authority should deploy mobile tax support units that visit retail market clusters within the Nairobi Central Business District on a scheduled, rotational basis to provide hands-on training for traders on navigating the iTax system, filing returns, and troubleshooting common errors.

Further studies should explore the influence of peer behaviour and social networks on income tax compliance within the same population.

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