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Effect of Cost Obligation on Corporation Tax Compliance among Insurance Companies in Nairobi County, Kenya

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Abstract

Purpose: Corporation tax is a key revenue source for most governments worldwide, enabling them to provide public goods and services such as free education, subsidized medical services, and infrastructure. However, its performance in Kenya has fallen short of targets. This study aimed to determine the effect of cost obligation on corporate tax compliance among insurance companies in Nairobi County, Kenya. The study was guided by the Ability-to-Pay Theory and Transaction Cost Theory (TCT).

Methodology: The study adopted an explanatory research design. The target population was 124 insurance companies in Nairobi County, Kenya. A total of 110 questionnaires were completed for analysis, indicating an 88.7% response rate. The study employed census survey. The study collected primary data through structured questionnaires and analyzed them using descriptive statistics and multiple linear regression, presenting results in tables and charts.

Results: The study found that cost obligation had a significant negative effect on corporate tax compliance ($\beta = -0.372$, $p = 0.000$).

Recommendations: The study recommends that KRA streamline tax compliance procedures to reduce administrative burdens and associated costs. This includes simplifying record-keeping requirements, reducing audit frequency for consistently compliant firms, and providing free or low-cost tax preparation software. The Government of Kenya should consider introducing tax credits or deductions for compliance-related expenses, such as professional fees and software investments. Future studies could investigate the roles of enforcement measures on corporation tax compliance.

Keywords: *Cost Obligation, Corporation Tax Compliance, Insurance Companies*

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1. Introduction

Taxation remains the cornerstone of revenue mobilization for governments worldwide, serving as the primary source of funds for public service delivery, infrastructure development, and economic stability (OECD, 2021). Among various tax types, corporate tax is particularly significant as it targets business entities that generate substantial profits, making it a key

contributor to national revenue. In both developed and developing economies, corporate income tax accounts for a considerable share of tax revenue and directly influences fiscal sustainability and economic growth (World Bank, 2022).

In Kenya, the Income Tax Act, Chapter 470 of the Laws of Kenya, administers corporation tax and provides the legal framework for assessing and collecting income tax from companies (Republic of Kenya, 2015). Under this Act, resident companies are taxed on their worldwide income, while non-resident companies are taxed on income accrued or derived from Kenya (Kenya Revenue Authority (KRA), 2025). The Act sets the current tax rates at 30% for resident companies and 37.5% for non-resident companies without a permanent establishment, although Finance Acts have periodically amended them to reflect policy changes (Republic of Kenya, 2020). The Act also sets out rules on allowable deductions, exemptions, and compliance obligations, providing the statutory foundation for corporate taxation in the country.

Corporation tax is a direct tax that is levied on corporate bodies. In Kenya, resident and non-resident companies are taxed at 30% and 37.5%, respectively. Most tax authorities globally struggle to determine the most effective regulatory enforcement strategy for achieving long-term tax compliance among small taxpayers (Ndumia, 2022). A long-standing debate in the industry has been between the ideologies held by two dissimilar groups. The first group argues that confronting people with penalties and harsh sanctions is the only way to make individuals comply with rules and regulations, whereas the other group believes compliance is achieved through gentle persuasion and cooperation (Ayres & Braithwaite, 2023).

In Kenya, insurance companies are subject to corporation tax under the Income Tax Act, Cap. 470**,** with a standard rate of 30% for resident companies and 37.5% for non-resident companies without a permanent establishment (Republic of Kenya, 2020; KRA, 2025). The insurance sector plays a crucial role in the economy, yet tax compliance remains a persistent challenge. Studies show that insurance companies, like other corporate entities, often face issues such as underreporting income, complex tax regulations, and disputes over how premiums, claims, and investment income are treated in tax computations (Waweru, 2019; KRA, 2025). To address these challenges, the Kenya Revenue Authority (KRA) has implemented reforms, such as the iTax system, to improve transparency and efficiency in tax reporting (Ng'ang'a, 2020).

The insurance industry in Kenya is a key pillar of the financial sector, supporting risk management, investment mobilization, and economic stability. It is regulated primarily under the Insurance Act, Cap. 487 of the Laws of Kenya, and the Insurance Regulatory Authority (IRA) oversees it to ensure compliance, protect policyholders, and promote industry growth (IRA, 2023). Kenya's insurance market is among the most developed in East Africa, with products ranging from life, health, general, and microinsurance to emerging digital insurance products (PwC, 2022).

Despite this growth, the sector faces challenges, including low insurance penetration estimated at around 2.3% of GDP, compared with the global average of over 7%, due to low-income levels, limited awareness, and mistrust of insurance products (IRA, 2023; AKI, 2022). Furthermore, insurance companies must navigate a strict regulatory framework covering solvency requirements, taxation, and corporate governance, which can impact profitability and compliance (Ngugi & Waweru, 2020). Recent reforms, such as risk-based supervision, digital innovation, and regional integration under the East African Community, are expected to improve competitiveness and enhance consumer confidence (IRA, 2023; OECD, 2021).

1.1 Problem Statement

Corporation tax is a levy on the profits of companies and other incorporated entities and serves as a critical source of government revenue (James, 2022). Despite its importance, many countries struggle to ensure compliance, as some businesses fail to report profits accurately or understate their tax obligations (OECD, 2021). These practices undermine the tax system's effectiveness, reduce public revenue, and create inequities between compliant and non-compliant firms (Bird & Zolt, 2023). In Kenya, corporation tax compliance remains a significant concern, affecting not only revenue collection but also broader economic development and public service provision (KRA, 2023).

Corporation tax is a major contributor to Kenya's government revenue, contributing an average of 12% to the exchequer. For the financial year 2022/2023, KRA (2023) states that corporation income tax was Kshs 443.827 billion against a target of Kshs478.691 billion. In the 2023/2024 financial year, KRA collected KShs 464.2 billion in corporation taxes against the target of KShs 526.560 billion KRA, 2024). KRA (2025) reported a shortfall in revenue collection for the first half of the 2024/2025 financial year, missing its target by a staggering Sh163.46 billion. Against this background, the study sought to determine the effect of cost obligation on corporate tax compliance among insurance companies in Nairobi County, Kenya.

2. Literature Review

2.1 Theoretical Review

2.1.1 Transaction Cost Theory (TCT)

Transaction Cost Theory (TCT), first introduced by Coase (1937) and later developed by Williamson (1985), explains that organizations and individuals incur costs whenever they engage in economic exchanges. These costs include information acquisition, negotiation, monitoring, and agreement enforcement. In the context of taxation, TCT can be used to understand compliance costs, since fulfilling tax obligations involves various “transactions” between taxpayers and tax authorities.

From a taxation perspective, compliance costs such as record-keeping, bookkeeping, filing tax returns, and hiring accountants represent the transaction costs of interacting with the tax system (Sandford, 1989). Taxpayers weigh these costs against the potential risks of non-compliance. High compliance costs may discourage voluntary compliance, particularly for small and medium enterprises facing resource constraints (Coolidge, 2012). Conversely, when tax authorities simplify procedures and reduce administrative burdens, compliance costs fall, making it easier and more attractive for taxpayers to meet their obligations.

Transaction Cost Theory provides a strong theoretical foundation for understanding compliance costs in taxation. It emphasizes that taxpayers view compliance activities as transactions with the state, and their willingness to comply depends largely on whether the perceived costs of these transactions are manageable or excessive. The theory supports the cost obligation variable.

A limitation of Transaction Cost Theory (TCT) is that it mainly emphasizes the economic and administrative costs associated with transactions and may not adequately explain non-economic factors that influence corporation tax compliance. In addition, TCT assumes that organizations primarily seek to minimize transaction costs, yet insurance companies may

comply with tax obligations because of legal requirements, ethical considerations, or reputational concerns even when compliance costs are relatively high.

2.1.2 The Ability to Pay Theory

Classical public finance economists, particularly John Stuart Mill (1848), developed the Ability-to-Pay Theory, which economists such as Richard A. Musgrave and Peggy B. Musgrave (1989) later advanced. The theory holds that taxpayers should contribute to government revenue according to their economic capacity, thereby promoting fairness and equity in the distribution of tax burdens. Mill (1848) emphasized the principle of equal sacrifice, suggesting that taxation should distribute the burden fairly among taxpayers. Musgrave and Musgrave (1989) further explained that the ability-to-pay principle provides a foundation for tax equity, distinguishing between horizontal equity, in which taxpayers with similar economic capacities should face similar tax burdens, and vertical equity, in which taxpayers with different capacities may appropriately bear different burdens. Stiglitz and Rosengard (2015) also identify equity as central to designing taxation systems. In corporate taxation, the theory suggests that companies should pay corporate income tax based on their taxable profits and the applicable statutory tax rates, rather than on gross sales alone.

The theory is relevant to corporate income tax compliance among insurance companies in Nairobi County, Kenya because these businesses differ in sales volumes, operating expenses, inventory costs, financing obligations, profitability, and cash-flow positions. Companies with higher taxable profits may have greater financial capacity to meet their corporate income tax obligations, whereas dealers experiencing declining sales, high operating costs, or financial constraints may struggle to meet their tax liabilities. Alm (2019) observes that economic and behavioral factors influence tax compliance, while Slemrod (2019) highlights the importance of taxpayer behavior and enforcement institutions in explaining compliance decisions.

2.2 Empirical Review

2.2.1 Cost obligation and Corporation tax compliance

Demin and Efremova (2022) found that in Russia the costs of hiring tax agents (tax practitioners) and the burden of record-keeping materially affect taxpayer behaviour: their review shows that because the Russian system historically combines strong enforcement with underdeveloped taxpayer services, many firms, especially small enterprises, incur substantial outlays to hire agents or external accountants to manage complex filings and to maintain detailed records, and these costs sometimes push marginal firms toward simplified regimes or informality (result). Related IMF and policy analyses report similar findings: heavy administrative requirements raise collection and compliance costs and undermine voluntary compliance, whereas simplified/schemes and improved digital reporting reduce those burdens. The studies conclude that high agent fees and onerous record-keeping act as hidden taxes that depress compliance and economic activity unless better service delivery and simplification counter them.

Lignier et al. (2014) surveyed 10,000 SME taxpayers in Australia and found that small and medium-sized enterprises (SMEs) face significant, regressive, and escalating tax compliance costs. Luca et al. (2012) identified a scarcity of research on the relationship between tax compliance costs and compliance levels and recommended further studies to explore it.

Nahida et al. (2022) examined the relationships among the complexity of Bangladesh's Value Added Tax legislation, the costs associated with VAT compliance in Bangladesh, and Bangladeshi SMEs' noncompliance with VAT regulations. The study found that most compliant SMEs identified VAT law complexity and compliance costs as the primary factors driving VAT noncompliance.

Mas'ud et al. (2022) analyzed the correlation and impact of tax rates on tax compliance in Africa using cross-country data. The findings indicate a significant negative correlation between tax rate and tax compliance. Osebe (2020) examined the determinants of tax compliance in Kenya's real estate sector. The research employed an explanatory design. The findings indicated that compliance costs negatively affected tax compliance levels in Kenya's real estate sector.

2.2.2 Corporation tax compliance

Corporation tax compliance refers to the extent to which companies fulfill their legal obligations to accurately declare taxable income, file tax returns within statutory deadlines, and remit the correct amount of corporation tax to the revenue authority (OECD, 2021). Compliance goes beyond simply paying taxes; it includes both administrative compliance (filing, record-keeping, and reporting) and technical compliance (accurately interpreting and applying tax laws) (Mascagni, Moore, & McCluskey, 2024). In tax literature, compliance is viewed along two dimensions: voluntary compliance, where taxpayers willingly adhere to tax laws, and enforced compliance, where adherence is driven by audits, penalties, and enforcement mechanisms (Alm & Torgler, 2021).

Non-compliance, which includes tax evasion, avoidance, misreporting, and profit shifting, poses a major challenge to revenue mobilization and fairness in taxation (Slemrod, 2019; Clausing, 2020). The concept is also tied to behavioral factors, such as trust in tax authorities, perceptions of fairness, and taxpayer education, which influence compliance levels (Kirchler, Hoelzl, & Wahl, 2023). Therefore, corporate tax compliance is not only a legal requirement but also a behavioral and institutional outcome that determines the effectiveness of tax systems in financing government operations.

2.3 Conceptual Framework

The conceptual framework demonstrates the relationship between the dependent variable and the independent variable, as outlined by Mugenda & Mugenda (2013). The independent variable, cost obligation, was measured by the cost of hiring an agent and record-keeping cost. The dependent variable was corporate tax compliance, measured by Returns filed and Tax paid.

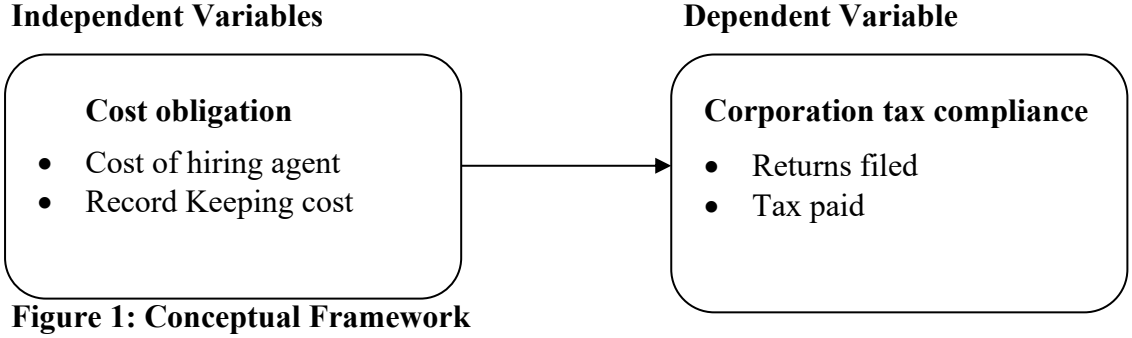


Figure 1: Conceptual Framework

3. Methodology

The study used an explanatory research design to describe the variables and investigate causal relationships between them. According to Leedy and Ormrod (2013), the explanatory method assesses a phenomenon by focusing primarily on quantities or amounts, which are then analyzed using generally accepted measurement standards. Target population is the entire set of individuals or other entities to which study findings are to be generalized (Berg, 2009). Kothari (2011) defines population as all items in a field of inquiry, also known as the universe. The target population was 124 insurance companies in Nairobi County, Kenya, as per the Insurance Regulatory Authority (IRA) (2025). The study employed a census survey. The response rate, shown in Figure 1, indicates that of the 124 questionnaires issued to the target population, 110 were submitted and included in the study. This corresponds to an 88.7% response rate.

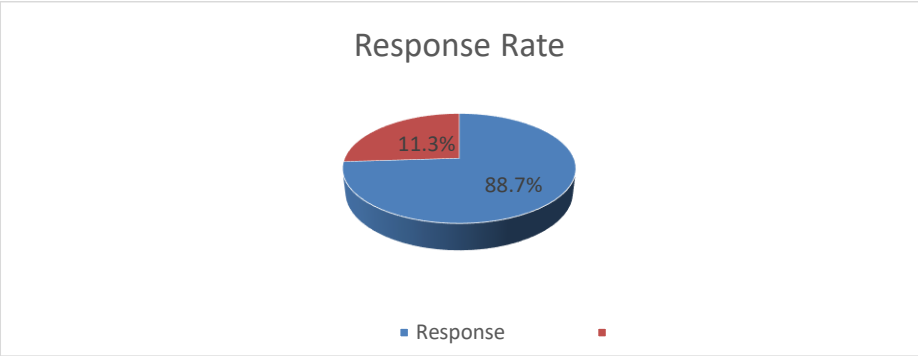


Figure 1: Response Rate

Reliability analysis

To test reliability, Cronbach's Alpha, which measures the internal consistency of the research questionnaire, was adopted. Sekaran (2003) stated that a measure's reliability indicates the stability and consistency with which the instrument measures the concept and helps assess the "goodness" of a measure. The reliability analysis used Cronbach's alpha, which is usually interpreted as the mean of all possible split-half coefficients. This study used a Cronbach's alpha of 0.7 as the benchmark. This study used a Cronbach's alpha of 0.7 as the benchmark to assess the internal consistency of the measurement instruments (Creswell, 2014). Table 1 shows that corporation tax compliance has a Cronbach's Alpha of 0.824 (> 0.7), indicating a high level of internal consistency. Cost obligation ($\alpha = 0.781$) exceeds the established threshold, confirming strong internal consistency for its measurement scale.

Table 1: Test of Reliability of Questionnaire

Factor	Number of Items	Cronbach Alpha score	Conclusion
Corporation tax compliance	5	0.824	Reliable
Cost obligation	5	0.781	Reliable

4. Results and Discussion

4.1 Descriptive Statistics

4.1.1 Descriptive statistics of Cost Obligation

Table 2: The descriptive summary indicates that, on average, respondents agreed with the statement "Record keeping for 5 years is expensive to maintain," with a mean of 4.22, as the mean was closer to 4 on the Likert scale. The standard deviation of 0.794 implies that the responses were moderately spread around the mean. Moreover, the descriptive summary shows that, on average, respondents agreed with the statement "Cost of hiring professional tax agents is expensive to the firm," with a mean of 4.33, as it was closer to 4 on the Likert scale. The standard deviation of 0.679 implies that the responses were moderately close to the mean. Additionally, the descriptive summary shows that, on average, respondents agreed with the statement "It is expensive to hire accountants," with a mean of 4.23, as the mean was closer to 4 on the Likert scale. The standard deviation of 0.630 implies that the responses were moderately close to the mean. Furthermore, the descriptive summary indicates that, on average, the respondents agreed with the statement "Tax audits are expensive to the company," with a mean of 4.05, since the mean was closer to 4 than to 3 on the Likert scale. The standard deviation of 0.531 indicates that responses were moderately close to the mean, with less dispersion than other items. Finally, the descriptive summary reveals that, on average, the respondents agreed with the statement "The cost of software, storage, and other resources for record keeping affects my willingness to comply with tax laws" with a mean of 4.38, because the mean was closest to 4 on the Likert scale, indicating strong agreement. The standard deviation of 0.574 implies that the responses were moderately close to the mean. The cost obligation construct mean was 4.24, which, when rounded to the nearest whole number on the Likert scale, indicates that, on average, respondents agreed with the statements measuring the perceived financial burden and compliance costs associated with tax obligations among insurance companies in Nairobi County, Kenya.

Table 2: Descriptive statistics: Cost Obligation

	N	Mean	Std. Deviation
Record keeping for 5 years is expensive to maintain	110	4.22	0.794
Cost of hiring professional tax agents is expensive to the firm	110	4.33	0.679
It is expensive to hire accountants	110	4.23	0.630
Tax audits are expensive to the company	110	4.05	0.531
The cost of software, storage, and other resources for record keeping affects my willingness to comply with tax laws	110	4.38	0.574
Mean aggregate		**4.24**	

4.1.2 Descriptive statistics for Corporation Tax Compliance

Table 3 indicates that, on average, the respondents agreed with the statement "Our business always declares the correct corporation tax" with a mean of 4.28, since the mean was closer to 4 on the Likert scale. The standard deviation of 0.744 implies that the responses were moderately close to the mean. Furthermore, the descriptive summary shows that, on average,

respondents agreed with the statement "I file our tax return on time," with a mean of 4.21. The standard deviation of 0.718 implies that the responses were moderately close to the mean. Moreover, the descriptive summary shows that, on average, the respondents agreed with the statement "I always report all tax liabilities following applicable tax laws," with a mean of 4.17; this is because the mean was closer to 4 on the Likert scale. The standard deviation of 0.752 implies that the responses were moderately close to the mean. Additionally, the descriptive summary indicates that, on average, respondents agreed with the statement "Our business pays the right amount of taxes," with a mean of 4.16, as it was closer to 4 on the Likert scale. The standard deviation of 0.698 implies that the responses were moderately close to the mean. Lastly, the descriptive summary shows that, on average, respondents agreed with the statement "Our business pays and declares corporation tax by the due date," with a mean of 4.25, as it was closer to 4 on the Likert scale. The standard deviation of 0.666 implies that the responses were moderately close to the mean. The corporation tax compliance construct was 4.21, which, when rounded to the nearest whole number on the Likert scale, confirms that, on average, the respondents agreed with the statements that measure their actual compliance behaviors, including accurate declaration, timely filing, and full reporting of tax liabilities among insurance companies in Nairobi County, Kenya.

Table 3: Descriptive statistics: Corporation Tax Compliance

	N	Mean	Std. Deviation
Our business always declares the correct corporation tax	110	4.28	0.744
I file our tax return on time	110	4.21	0.718
I always report all tax liabilities following applicable tax laws	110	4.17	0.752
Our business pays the right amount of taxes	110	4.16	0.698
Our business pays and declares corporation tax by the due date	110	4.25	0.666
Mean aggregate		**4.21**	

4.2 Correlation Analysis

The correlation analysis sought to determine the nature of the relationships between cost obligation and corporate tax compliance among insurance companies in Nairobi County, Kenya. The Pearson correlation ranges from -1 to +1, with significance tested at the 95% confidence level. Table 4 shows the correlations between the independent variables and the dependent variable. The correlation analysis also revealed a significant negative correlation between cost obligation and corporation tax compliance ($r = -0.581$, p-value < 0.05). This denotes that insurance companies in Nairobi County that perceive higher costs associated with tax compliance, such as record-keeping, professional fees, and software expenses, tend to demonstrate lower levels of corporation tax compliance. This finding suggests that excessive financial burdens from compliance activities may discourage firms from fully adhering to tax regulations, potentially leading to underreporting or avoidance to reduce operational costs.

Table 4: Correlation Statistics

	Corporation tax compliance	Cost obligation
Corporation tax compliance	1	-0.581**
Cost obligation	-0.581**	1

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

4.3 Regression Analysis

Table 5 showed that cost obligation had a positive correlation with corporation tax compliance of 58.1% (R = 0.581). According to the study findings, the model accounts for 33.7% (R-square = 0.337) of the variation in corporation tax compliance. This implies that the remaining 66.3% of the change was driven by other factors not included in the model. The results further reveal that even if the study adjusts, the model would still account for 33.2% (Adjusted R Square, 0.332) of corporation tax compliance

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.581[a]	.0.337	.332	.37890

a. Predictors: (Constant), Cost obligation _mean

Further ANOVA tests were conducted to determine whether the model explains the relationships among variables as postulated in the conceptual model. Table 6 shows an F value of 147.354 with a significance level of 0.000, which is far below the 0.05 confidence level, indicating that the model is statistically significant.

Table 6: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	56.142	1	56.142	147.354	0.000
	Residual	41.230	108	0.381		
	Total	97.372	109			

a. Dependent Variable: Corporate tax compliance
b. Predictors: (Constant), Cost obligation

Table 7 showed that a unit change in cost obligation caused a -0.372 change in corporation tax compliance. The study found that cost obligation had a negative and significant effect on corporation tax compliance $\beta = -0.372$, p-value = 0.000 < 0.05). The hypothesis was rejected.

Table 7: Regression Coefficient analysis

Variable	Standardized β	Std. Error	t-Statistic	Unstandardized β	Prob.
Constant	0.595	0.043	13.837		0.000
Cost obligation	-0.372	0.074	-5.027	-0.405	0.000

4.4 Discussion

The study objective sought to establish the effect of cost obligation on corporation tax compliance among insurance companies in Nairobi County, Kenya. The correlation matrix found a negative, significant correlation between cost obligation and corporation tax compliance ($r = -0.581$, $p < 0.05$). This implies that insurance enterprises that perceive higher costs associated with corporation tax compliance, including record-keeping expenses, professional fees, and software investments, tend to report lower tax compliance, likely because these financial burdens discourage full adherence to tax regulations. Additionally, cost obligation had a significant negative effect on corporation tax compliance ($\beta = -0.372$, $p = 0.000$). The finding that cost obligation significantly and negatively affects corporation tax compliance is aligned with Demin and Efremova (2022), who found that in Russia, the costs of hiring tax agents and the burden of record-keeping materially affect taxpayer behavior, concluding that high agent fees and onerous record-keeping act as hidden taxes that depress compliance and economic activity. Nahida et al. (2022) examined Bangladesh's Value Added Tax and found that most compliant SMEs identified complexity in VAT law and compliance costs as the primary factors affecting VAT noncompliance.

5. Conclusion

The study concludes that cost obligation is a significant negative driver of corporation tax compliance among insurance enterprises. This conclusion contributes to understanding compliance costs in developing economies by empirically showing that excessive financial burdens associated with tax compliance function not merely as administrative inconveniences but as deterrents that undermine voluntary compliance in the insurance sector. Earlier studies have mainly emphasized the technical aspects of tax administration, often overlooking the economic constraints taxpayers face in meeting their obligations. The finding that high compliance costs discourage full adherence highlights the need for tax authorities to streamline compliance procedures, reduce administrative burdens, and adopt taxpayer-friendly policies that alleviate financial pressures.

6. Recommendations

The study recommends that KRA streamline tax compliance procedures to reduce administrative burdens and associated costs. This includes simplifying record-keeping requirements, reducing audit frequency for consistently compliant firms, and providing free or low-cost tax preparation software. The Government of Kenya should consider introducing tax credits or deductions for compliance-related expenses, such as professional fees and software investments. Future studies could investigate the roles of enforcement measures on corporation tax compliance.

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