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Research Article

Tax Service Quality, Trust in Government and Tax Compliance among Small and Medium Enterprises in North Rift Economic Bloc

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Abstract

Purpose- The study sought to establish the indirect effect of trust in government on the relationship between the tax service quality and tax compliance among SMEs in North Rift Economic Bloc, Kenya.

Design/Methodology- Based on the social contract theory, this study has a positivist philosophy that is informed by an explanatory research design. The target population was 21,232 SMEs; the sample size used in this study consisted of 393 SME owners/managers selected through a stratified sampling technique. Data were collected using a self-administered questionnaire, and Cronbach's alpha with factor analysis was used to establish the instrument's reliability and validity. Descriptive and inferential statistics were employed to test the hypothesis, and hierarchical regression using the Hayes Process macro was performed.

Findings-The study revealed that tax service quality (β =.541, p=.000<0.05) and trust in government (β =.375, p=.000<0.05) are significantly positively related to tax compliance. In addition, the tax service quality was found to have a significant effect on trust in government (β =.395, p =.000<0.05). In addition, the results showed that trust in government mediates the relationship between tax service quality and tax compliance (β =.1482, CI=.0981, .2015).

Practical Implications- These findings underscore the need for governments to improve the quality tax services, as this may be able to help in gaining public trust which will ultimately increase SMEs compliance with taxes. There is scope for future research to incorporate mixed-method approaches in order to discover yet more factors affecting tax compliance.

Introduction

Taxation is crucial for generating government revenue for financing government expenses such as public goods, infrastructure, and poverty alleviation initiatives (Alshira'h et al., 2020). It also plays a very significant role in maintaining fiscal policy and encouraging economic growth and sustained government accountability (Sebele-Mpofu, 2020). Effective tax systems are fundamental in ensuring fiscal space, reducing reliance on foreign aid to finance deficits, and further supporting economic growth and development (Ho et al., 2023). In developing countries, where the informal sector often dominates the economy, tax systems are particularly important in fostering financial independence, reducing poverty, and promoting sustainable growth.

However, despite the critical importance of taxation, many governments face significant challenges in collecting sufficient tax revenues to meet their budgetary needs (Dang & Nguyen, 2022). These difficulties often arise from structural inefficiencies in tax systems, tax evasion, and a lack of trust between taxpayers and tax authorities (Abdu & Adem, 2023). Tax non-compliance undermines government efforts to collect adequate revenues, leading to budget deficits that often necessitate borrowing or external aid (Yong & Freudenberg, 2020). Addressing these challenges requires a deep understanding of the factors influencing tax compliance, particularly in sectors that are difficult to tax, such as the informal economy and small and medium enterprises (SMEs).

Tax compliance refers to taxpayers' adherence to tax laws and regulations, encompassing aspects of ethics, legal infrastructure, and other prevailing environmental forces within a given context (Nguyen, 2022). It refers to the extent to which a taxpayer adheres to tax laws by honestly and fully reporting the taxable income, filing tax returns, and paying taxes on time (Santoro & Waiswa, 2024). Tax compliance is a dynamic interplay where taxpayers engage with tax authorities, influenced by perceptions of fairness in the tax system. Compliance is viewed through two lenses: enforced compliance, driven by penalties and audits, and voluntary compliance, rooted in trust, civic duty, and perceived societal benefits. Non-compliance can be intentional or unintentional and includes failure to file tax returns, underreporting of income, and overstatement of tax deductions (Randlane, 2016). Both forms of non-compliance adversely impact the delivery of public goods and services, undermine the government's legitimacy, lead to social injustices, and aggravate budget deficits. When individuals or businesses do not pay their fair share of taxes, it places a disproportionate burden on those who do comply, exacerbating social divisions and undermining the legitimacy of the tax system (Di Nola et al., 2021).

The scale of the tax compliance problem varies across different regions and income levels. In OECD countries, it causes an annual tax revenue loss of 2-3% compared to 6-13% revenue loss in low-income countries. In developing countries, the informal economy and lack of a sophisticated tax framework worsen tax evasion (Prichard & Dom, 2022). In many developing countries, such as Kenya, the informal economy accounts for a substantial portion of economic activity, yet it remains largely untaxed due to administrative inefficiencies, lack of enforcement, and the complexity of tax systems (Maritim, 2020). As a result, governments are often unable to collect the revenue needed to fund critical social programs and invest in infrastructure, which are essential for fostering long-term economic growth and poverty reduction.

The SME sector in Kenya is a critical yet under-taxed component of the economy, serving as the backbone of economic activity by providing a significant share of employment and contributing to overall growth (Odongo & Munene, 2023). Despite their importance, many SMEs exhibit non-compliance with tax regulations, primarily due to high compliance costs, the complexity of tax laws, and a pervasive lack of trust in government institutions (Murunga et al., 2021). The informal nature of numerous SMEs further complicates their monitoring and taxation, hindering the government's capacity to generate sufficient revenue to fulfill its budgetary obligations.

Kenya's tax revenues are the main source of government funding, accounting for 89.4% of total government budget. However, the tax revenue to GDP ratio has declined over the years despite tax reforms, leading to fiscal deficits and higher levels of borrowing (Murunga et al., 2021). Despite ongoing tax reforms aimed at improving tax compliance and expanding the tax base, the ratio of tax revenue to GDP has been declining, leading to growing fiscal deficits. These deficits have forced the government to increase its reliance on borrowing, both domestically and internationally, to finance its budget. This reliance on debt has raised concerns about the sustainability of Kenya's fiscal policy and the long-term health of its economy.

Given the importance of tax compliance for fiscal sustainability and economic development, understanding the factors that influence SME compliance is critical. Previous research on tax compliance reveals that both economic and socio-psychological factors influence taxpayers' compliance (Mohammed & Tangl, 2023). Traditional economic theories suggest that the likelihood of audits and the severity of penalties impact taxpayer compliance behavior (Feld & Frey, 2019). While enforcement activities have their effects on deterrence, recent studies advocate for a broader approach that psychological and social factors as reasons for compliance (Alm, 2023). Empirical studies show that many individuals comply with tax obligations despite low fines and audit probabilities, suggesting that other factors are also at play. Social psychologists have linked tax compliance to trust in government, perceptions of government legitimacy, and societal norms. Therefore, tax compliance is influenced not only by economic factors but also by social factors, personal values, and a sense of moral responsibility.

This study's theoretical framework is based on social contract theory, which illustrates the relationship between taxpayers and the government. This theory suggests that individuals willingly surrender certain freedoms, including part of their income as taxes, in exchange for the protection of their rights and the provision of public goods (Makovicky & Smith, 2020). This reciprocal relationship hinges on trust: when citizens believe the government acts in their best interest, they are more likely to comply with tax laws. Voluntary tax compliance increases when taxpayers are confident their contributions will be used effectively for essential services like education and healthcare. Conversely, low trust, often stemming from perceptions of corruption or inefficiency, can lead to non-compliance. Empirical evidence supports that trust in government significantly influences tax compliance, especially in developing countries where governance issues persist. Enhancing public service quality and demonstrating accountability can help rebuild trust and promote voluntary compliance (Goren et al., 2022).

Service quality is essential for businesses to survive in today's competitive market. Recent studies emphasize the quality of public service delivery, especially tax services, to improve taxpayers' compliance behavior (Psomas, 2020). According to Fandy Tjiptono (2019), service quality is achieved when customer expectations are satisfied. In the context of tax services, quality reflects taxpayers' perceptions of the services provided by the tax authorities and government. Zeithaml et al. (1988) identified five dimensions of service quality, including reliability, responsiveness, assurance, and tangibles. Thornton et al. (2019) added information, interaction, and transaction services. Holis and Asmarani (2021) highlighted interaction quality and the physical environment as critical points of service quality in tax offices. Mustapha and Obid (2015) emphasized responsiveness, informativeness, and reliability is critical. Higher service quality promotes tax compliance and citizen adherence, with developed countries treating taxpayers as important customers that boost compliance (Muhammad & Saad, 2016). Conversely, poor service quality remains a problem in many developing countries, mirrored by low tax revenues. A client-centric approach by tax authorities, which recognizes the need for multiple delivery channels to maintain compliance through guidance rather than enforcement, can enhance tax compliance. Such an approach increases satisfaction and compliance, while also enhancing the image of the tax authority.

For democratic stability, governance, and policy implementation, citizens' trust in their government is crucial, affecting the legitimacy of government decisions and fostering cooperation towards tax compliance (Goren et al., 2022). Mas' ud et al. (2019) define trust in government to be citizens' confidence in the morality of the

government's actions, creating a sense of duty for people to fulfil their tax obligations. Trust is intricately linked with democratic social capital, legitimacy, governance, and the ability of societies to make collective decisions. It is also dependent on fair treatment perceptions, equitable tax systems, and government accountability in the collection and use of tax revenue, where transparency and reliability enhance mutual trust (Byaro & Kinyondo, 2020). Prastiwi et al. (2021), argue that a psychological contract based on mutual cooperation is important for promoting policy conformity. Effective taxation regimes enhance compliance and address tax evasion by promoting a psychological bond between taxpayers and tax authorities. Furthermore, the government owes it to the people to ensure that taxes contribute to the public good, which in turn boosts taxpayers' faith in returns from their contributions and spurs motivation toward compliance (Castaneda & Doyle, 2019). Therefore, understanding the nexus between trust in government and tax compliance is central to society's democratic functioning.

Low tax compliance is a significant challenge for tax administrations globally, particularly in developing economies where it hampers the delivery of essential services like education and healthcare, crucial for poverty alleviation (Alm, 2019; Modica et al., 2018). The International Monetary Fund (IMF) emphasizes the urgent need for low-income countries to increase their revenue and fiscal resources to 15.4% of their Gross Domestic Product (GDP) to meet the Sustainable Development Goals by 2030, yet low- and middle-income countries averaged 10.7% in 2020, in stark contrast to 33.51% in OECD countries (Gaspar et al., 2019; Hamilton, 2021). Factors such as poor administrative performance, corruption, profit shifting by companies, low tax morale, lack of public trust, and the extensive presence of an informal economy contribute to this disparity (Dom et al., 2022). Kenya, exemplifies these fiscal challenges, with its tax-to-GDP ratio declining from 18% in 2013 to 14% in 2023, below both the sub-Saharan average of 16.5% and the East African Community target of 25%, prompting increased reliance on borrowing to cover fiscal deficits (Commission & Forum, 2023; Gort & Brooks, 2023; Ndikumana et al., 2020). Additionally, the informal economy, comprising 98% of all businesses in Kenya, contributes insignificantly to tax revenues, accounting for less than 1% of the total tax revenue collected (Larzen et al., 2020; Murunga et al., 2021). Despite initiates like taxpayer education and audits, non-compliance remains high (Oyollo, 2022).

Existing studies predominantly focus on the direct factors that influence taxpayers' intentions to comply (Bani-Khalid et al., 2022; Kassa, 2021), including the influence of tax service quality on tax compliance (Susuawu et al., 2020), and the impact of public trust on taxpayer behavior (Haning et al., 2020). Despite many studies having been carried out, findings on tax compliance are divergent, mixed, and at times conflicting (Yong & Freudenberg, 2020). While previous studies have explored the direct effects of tax service quality on compliance, few have examined the role of trust as a mediating variable. The majority of these studies have been conducted within industrialized countries with few studies specifically examining tax compliance in developing countries like Kenya remain. This study contributes to the literature by examining the mediating role of trust in government in the relationship between tax service quality and tax compliance among SMEs in Kenya. By focusing on the SME sector in Kenya, this study provides new insights into the challenges of tax compliance in developing countries and offers practical recommendations for improving tax administration.

Literature Review

Social Contract Theory

Social contract theory, advanced by such philosophers as Hobbes, Locke, and Rousseau during the 17th and 18th centuries, seeks to explain the emergence of state power and its role in maintaining social order (Smith et al., 2009). It describes the formation of a central authority that assumes the role of protecting its people in return for giving up some of their natural freedoms, driven by rational self-interest and the desire for self-

preservation. This exchange, interpreted as a 'social contract,' sets the foundation for social cooperation and state legitimacy. Hobbes emphasized that without social arrangements, life would be "nasty, brutish, and short" due to perpetual competition and war. He argued that self-sufficiency is unattainable without collective action, and governance emerges for security and economic stability. Locke and Rousseau further developed these ideas, with Locke emphasizing property rights and Rousseau focusing on the common good in shaping legitimate governance.

In the context of taxation, social contract theory provides a powerful framework for understanding tax compliance. It suggests that compliance with tax laws is strongly influenced by citizens' perceptions of government legitimacy and fairness. A representative government that is transparent and accountable will instill trust in taxpayers, encouraging voluntary compliance. In contrast, when governments are perceived as corrupt or untrustworthy, citizens may feel less obligated to pay taxes (Goren et al., 2022). The theory posits that compliance is not driven solely by coercive measures but by a perceived reciprocal relationship. Taxpayers view paying taxes as part of their social contract, expecting their contributions to fund essential public services such as infrastructure, healthcare, and education (Feld & Frey, 2019). When governments meet these expectations and demonstrate accountability, taxpayers are more likely to comply voluntarily, recognizing their role in societal welfare.

Social contract theory also emphasizes that taxation is integral to state legitimacy (Castaneda & Doyle, 2019). A government that fails to provide adequate public goods or misuses tax revenues risks undermining its legitimacy, leading to reduced tax compliance. This relationship highlights the importance of trust in government, not only as a mediator of tax compliance but as a core element of the social contract itself. Trust, built on perceptions of fairness, transparency, and effective service delivery, is crucial for fostering compliance in tax systems.

Tax Service Quality and Tax Compliance

The quality of tax services enhances compliance among taxpayers. Studies have consistently shown that if taxpayers perceive the services offered by the tax authorities as easy to reach, effective, and responsive to their needs, compliance levels improve. Larasati and Kurnia (2020) found that efficiency at the tax offices enhances compliance through improved understanding and satisfaction of processes among taxpayers. Sukesi and Yunaidah (2020) showed significant direct and indirect effects of tax socialization and service quality on taxpayer satisfaction and compliance in East Java, Indonesia. Conversely, Bihabwa (2017) found in Uganda that service quality enhancements have not directly translated to an improved perception of service delivery among taxpayers.

H_{01}: Tax service quality has no significant effect on tax compliance.

Taxpayer Government Trust and Tax Compliance

Trust in government institutions and tax authorities is a critical determinant of tax compliance. institutional trust positively affects the taxpayer's contribution to additional taxes regarding the welfare society under diverse settings (Habibov et al., 2018). Mas' ud et al. (2019) explained that trust in the authorities significantly influences compliance, indicating that the fairness and transparency of government actions increase trust among taxpayers. Damayanti and Supramono (2019) found that mutual trust between the taxpayer and the tax-collecting agency offsets the harmful effects of perceived governmental power on compliance, highlighting the importance of building trust to enhance tax discipline.

H_{02}: Trust in government has no significant effect on tax compliance.

Tax Service Quality and Taxpayer Government Trust

High-quality public services play a critical role in building trust between government and citizens as a precondition for compliance. Alkraiji and Ameen (2022) emphasized the effective delivery of public service meets the pragmatic needs of citizens and cultivates mutual trust, which is indispensable for further compliance. Nurkholis et al. (2020) conducted a meta-analysis indicating that improvements in service quality, simplification of tax procedures, and creation of public confidence in state organs effectively reduce tax noncompliance. Dharmayanti (2023) found out that better quality service at tax offices promoted taxpayers trust and satisfaction, leading to improved observance of tax responsibilities. Budaharini et al. (2022) pointed out that quality service impacts customer trust, satisfaction, and loyalty towards tax compliance. These research findings collectively underline the role of service quality in establishing taxpayer trust and fostering compliance.

H_{03}: Tax service quality has no significant effect on trust in government.

Mediating Role of Taxpayer's Trust in Government

Trust in government institutions is crucial for tax compliance, serving as a mediator between service quality and voluntary compliance among MSME taxpayers (Ardhianto et al., 2022). It also positively impacts governance quality on tax compliance in Africa, underscoring accountability and political stability (Masud et al., 2021). Trust enhances the positive impact of service quality on voluntary compliance and is linked to perceptions of tax justice (Güzel et al., 2019). Effective tax policies build trust and reduce tax evasion, emphasizing trust's broader role in encouraging compliance (Adekoya et al., 2022).

H_{04}: Trust in government has no significant mediating effect on the relationship between tax service quality and tax compliance.

Methods

This study adopted a positivist philosophy, and established a scientific approach that focuses on objective truth and observable facts to understand social behavior . Positivism involves unbiased research, assuming that the research subject is independent of the researcher, and is grounded on hypothesis development based on existing theory (Bell et al., 2022).

The study used an explanatory research design to establish the mediating role of taxpayers' trust in government in the relationship between tax service quality and tax compliance among SMEs in the North Rift Economic Bloc, Kenya. An explanatory design helps to reveal causality and meaning, increases internal validity, and allows for replication (Zikmund et al., 2013). The deductive approach involves formulating hypotheses based on existing theory, testing these hypotheses, reviewing the findings, and then refining the theory as necessary. Consistent with the deductive approach and appropriate for hypothesis testing , a survey research strategy was undertaken to collect data. Surveys enable access to a wide range of participant perspectives and are thus cost-effective when data collection from large populations is required (Neuman, 2012).

The research focused on the North Rift Economic Bloc (NOREB) of Kenya, comprised of eight counties with varying socio-economic characteristics, thus providing a representative case. The target population was 21,232 SMEs in NOREB. The sample size was estimated to be 393 using Taro Yamane's formula. Each sector was equally represented by stratified sampling. Simple random sampling was used to determine the sample.

Primary data were collected using four sections: demographics, quality of the tax service, trust in government, and tax compliance. Structured questionnaires were used in collecting the data. Variables were measured on a 5-point Likert scale; operational items were taken from established previous research to keep the relevance of the present study.

Tax compliance, the dependent variable, refers to the adherence to tax laws through appropriate reporting of income, tax liabilities, and timely filing of taxes, along payment of taxes. This study measured the compliance of taxes on four dimensions, including accurate reporting of income, correct reporting of tax claims, filling returns, and payment of tax obligations, by adopting 13 items from previous studies in that area i.e., (Wanjohi et al., 2010), and responses quantified on a 5-point Likert scale format from Strongly Disagree to Strongly Agree.

Tax service quality, the independent variable, was assessed using five dimensions including tangibility, reliability, responsiveness, assurance, and empathy, using 12 modified items (Hardiyansyah & Efrina, 2018). Quality was evaluated based on the difference between expected service and actual service received, rated on a 1 to 5 Likert scale.

Trust in government, the mediating variable, was measured through three subscales: fairness, equity, reciprocity, transparency, and accountability. Thirteen items were adapted from prior research (Güzel et al., 2019), and respondents rated their trust on a Likert scale from Strongly Disagree to Strongly Agree.

Control variables included firm age, sector, and size. Firm age was categorized into four groups based on operation duration. The SME sector was categorized into manufacturing, service, trade, and agriculture. Firm size was evaluated by annual turnover, categorized into three ranges.

This study developed a multivariate model incorporating mediator variables to create a mediation model. Hypotheses H_{01} to H_{04} were tested using foundational methods from Baron and Kenny (1986), and Hayes (2013). The model applied hierarchical regression to examine the direct effects (H_{01}-H_{03}) on tax compliance (dependent variable). The model used equations to test the impact of control variables, the independent variable (tax service quality), and the mediator (trust in government).

Model 1: Testing Direct Effects:

$Y = \beta 0 + \beta 1C + \varepsilon$ 1

$Y = \beta 0 + C + \beta 1X + \varepsilon$……..…….... 2 ($H_{01}$)

$Y = \beta 0 + C + \beta 1X + \beta 2M + \varepsilon$……..……..……. 3 ($H_{02}$)

$M = \beta 0 + C + \beta 1X + \varepsilon$……..……...……. 4 ($H_{03}$)

Model 2: Testing for mediation

For mediation (H_{04}), MacKinnon's (2012) four-step method was applied, along with a bootstrap method to confirm indirect effects.

Mediation = $a_1 \times b_1$……..……..…….. (H_{04})

Or C (Total effect) - C' (Direct effect)

The bias-corrected percentile bootstrap method determines whether the last condition is satisfied (H_{04}).

The total effect (C) is represented by the following equation: $Y = CX + \varepsilon = (a_1 \times b_1) + C'$.

Where: Y: Tax compliance; X: Tax service quality; M: Trust in government; and C: Covariates (firm age, sector, size)

Results

Table 1 presents descriptive statistics for the study's key constructs: tax compliance, tax service quality, and taxpayers' trust in government. These statistics shed light on respondents' perceptions and behaviour.

Tax Compliance had a mean score of 4.2241, suggesting a moderate level of compliance with tax regulations among respondents. The standard deviation of 0.3535 indicates moderate variability around this mean, while the skewness of 0.078 points to a near-normal distribution slightly skewed to the right, indicating a slight tendency towards higher compliance. The kurtosis value of 0.126 supports the reliability of this mean score, showing a relatively normal distribution without significant outliers.

Tax Service Quality shows a mean score of 4.4002, reflecting generally positive perceptions of tax service quality. The standard deviation of 0.41349 shows moderate variability in these perceptions. The skewness value of -0.100 suggests a slight left skewness, indicating a tendency towards higher ratings of service quality. Similar to TC, the kurtosis value of 0.126 indicates a normal distribution, further supporting the reliability of the mean score.

Taxpayers' Trust in Government had a mean score of 4.0477, indicating a moderate level of trust in government among taxpayers. The standard deviation of 0.40056 suggests moderate variability in trust levels, highlighting differences in how individuals trust government institutions. The skewness value of 0.102 points to a near-normal distribution with a slight right skewness, indicating a tendency towards higher levels of trust. The kurtosis value of 0.743 indicates a distribution slightly more peaked than normal, suggesting some concentration of responses around the mean but without extreme values impacting the overall trust perception.

Table 1: Summary of the Descriptive Statistics for the Constructs

	N	**Mean**	**Std. Deviation**	**Skewness**		**Kurtosis**	
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
Tax compliance (TC)	377	4.2241	.35353	.078	.126	-.067	.251
Tax service quality (TSQ)	377	4.4002	.41349	-.100	.126	-.600	.251
Taxpayers' trust in government (TGT)	377	4.0477	.40056	.102	.126	.743	.251
Valid N (listwise)	377						

These descriptive statistics provide a comprehensive overview of the respondents' perceptions and behaviors related to tax compliance, tax service quality, and trust in government. They highlight both the central tendencies and the variability within each construct, offering valuable insights for further analysis and interpretation in the study.

Table 2 below displays the correlation results, revealing that all variables were positively associated with tax compliance. Trust in government (TGT) had a moderate positive correlation ($r = .551^{**}$, $p < .01$), indicating that higher quality tax services are associated with increased tax compliance among taxpayers. Tax service quality also showed a moderate positive correlation ($r = .568^{**}$, $p < .01$), suggesting that greater trust in the government leads to higher tax compliance. Although weaker, there is still a positive correlation ($.443^{**}$, $p < .01$) between tax service quality and taxpayers' trust in government, implying that better tax service quality can enhance trust in the government. These findings underscore the importance of improving tax service quality and building trust in government as effective strategies for increasing tax compliance. Tax authorities should prioritize high-quality service delivery and foster trust to achieve better compliance rates. The highest correlation coefficient is 0.568, which is below the threshold of 0.8, therefore, there is no evidence of multicollinearity in this study.

Table 2: Pearson Correlation results

	Tax compliance	Tax service quality	Trust in government
Tax compliance	1		
Tax service quality	.568**	1	
Trust in government	.551**	.443**	1
**** Correlation is significant at p <.01 (2-tailed)**			

The hypotheses were examined using the direct effects and mediation. The direct effects model assesses the impact of a given predictor variable on an outcome variable. To assess mediation, Hayes (2018) Model 4 was utilized. Mediation occurs when the effect of tax service quality on tax compliance is conveyed through Taxpayers' trust in government. The trust in government variable is crucial for comprehending how tax service quality is linked to it, leading to a mediation variable that subsequently affects tax compliance. Taxpayers' trust in government is proposed to measure the mechanism through which tax service quality exerts its influence.

Effect of the Covariates in the study

The results from Model 1, shown in Table 3, indicate that firm age, sector, and turnover are all significant predictors. Specifically, firm age ($\beta = .120$, $t = 3.474$, $p < .01$), sector ($\beta = .083$, $t = 2.302$, $p < .05$), and firm size ($\beta = .167$, $t = 3.211$, $p < .01$) have positive effects. The model accounts for 8% of the variance in SMEs' tax compliance ($R^2 = .080$), with an adjusted R^2 of .073, slightly lower to account for the number of predictors. The standard error of the estimate (SEE) is .61144, and the F-statistic (10.845, $p < .001$) shows that the model is statistically significant overall.

Effect of tax service quality on SME's tax compliance (H_{01})

The hypothesis H_{01} stated that tax service quality does not significantly affect SMEs' tax compliance. This was tested using regression Model 2 in Table 3, controlling for firm age, sector, and firm size. The results show significant positive influences from firm age ($\beta = .099$, $t = 3.392$, $p < .01$), sector ($\beta = .074$, $t = 2.461$, $p < .05$), and firm size ($\beta = .175$, $t = 4.021$, $p < .001$). Additionally, tax service quality significantly and positively predicts tax compliance ($\beta = .541$, $t = 12.541$, $p < .001$). The model explains 35.4% of the variance in tax compliance ($R^2 = .354$), a notable improvement from Model 1 ($\Delta R^2 = .273$), with an adjusted R^2 of .347 and a decreased standard error of .51330. The F-statistic (157.273, $p < .001$) confirms the model's significance, leading to the rejection of Hypothesis H_{01}, which posited no significant effect.

Effect of Taxpayers' Trust in Government on Tax Compliance (H_{02})

The hypothesis H_{02} proposed that taxpayers' trust in government does not significantly affect SMEs' tax compliance. This was tested using a regression model controlling for firm age, sector, firm size, and tax service quality. Results revealed that all covariates significantly impacted tax compliance, with firm age ($\beta = .103$, $p = .007$), sector ($\beta = .116$, $p = .002$), and firm size ($\beta = .160$, $p < .001$). Tax service quality remained a significant predictor, though with a reduced coefficient ($\beta = .393$, $t = 9.444$, $p < .001$). Crucially, taxpayers' trust in government significantly influenced tax compliance ($\beta = .375$, $t = 9.631$, $p < .001$), explaining 48.3% of the variance in tax compliance ($R^2 = .483$). The model's overall significance was high ($F = 92.754$, $p < .001$), leading to the rejection of H_{02}.

Table 3 Results for Covariates and Direct Effects Hypotheses

Var.	Model 1		Model 2		Model 3	
	Unstandardized Coefficients		Unstandardized Coefficients		Unstandardized Coefficients	
	β	***t***	***β***	***t***	***β***	***t***
(Constant)	3.101***	22.476	.926***	4.438	.035	0.168
Firm age	0.120**	3.474	.099**	3.392	.071**	2.711
Sector	0.083*	2.302	.074*	2.461	.083**	3.066
Firm size	0.167**	3.211	.175***	4.021	.167***	4.263
TSQ			.541***	12.541	.393***	9.444
TGT					.375***	9.631
R^2	.080		.354		.483	
***Adj.* R^2**	.073		.347		.476	
SEE	.61144		.51330		.45972	
ΔR^2	.080		.273		.129	
F	10.845***		157.273***		92.754***	

Note: *p <.05, **p <.01, ***p <.001
Where; β = unstandardized parameter of estimates coefficients, Var = Variable Name, ETSG = tax service quality, TGT = trust in government.

Effect of Tax Service Quality on Taxpayers' Government Trust (H_{03})

The hypothesis H_{03} posited that tax service quality does not significantly affect taxpayers' government trust. Initial results showed firm age had a positive effect on government trust ($\beta = .090$, $t = 2.400$, $p < .05$), but sector and firm size were insignificant. This model explained a mere 1.6% of the variance ($R^2 = .016$). Adding tax service quality increased explained variance to 15% ($R^2 = .150$), with significant impact ($\beta = .395$, $t = 7.683$, $p < .001$), confirming the rejection of H_{03}.

Table 4: Results for tax service quality on trust in government

Var.	Model 1			Model 2		
	Unstandardized Coefficients			Unstandardized Coefficients		
	β	***t***		***β***	***t***	
(Constant)	3.966***		26.699	2.376	***	9.549
Firm age	.090	*	2.400	.074	*	2.123
Sector	-.017		-.435	-.023		-.640
Firm size	.017		.308	.024		.452
TSQ				.395	***	7.683
R^2	.016			.150		
***Adj.* R^2**	.008			.141		
SEE	.65828			.61237		
ΔR^2	.016			.135		
F	1.973			59.026***		

Note: *p <.05, **p <.01, ***p <.001
Where; β = unstandardized parameter of estimates coefficients, t = t-statistic, Var = Variable Name, TSQ = tax service quality, TGT = trust in government.

Testing Mediating Effects of Government Trust (H_{04})

The study examined whether government trust mediates the relationship between tax service quality and tax compliance. Using MacKinnon's procedure and Hayes' PROCESS macro, conditions for mediation were met: tax service quality significantly affected government trust (β = .3952, p < .001), government trust influenced tax compliance (β = .3749, p < .001), and tax service quality had a significant direct effect on tax compliance (β = .3926, p < .001). Mediation analysis confirmed a significant indirect effect (β = .1482), with the total effect being .5408. This indicated partial mediation, leading to the rejection of H_{04}.

Table 5: Results for Mediation and Total Effect

Predictors names	**Model 1** **TGT**	**Model 2** **TC**	**Model 3** **Mediation** **M3= *a*1×*b*1**	**Model 4** **Total effect=CI** **(TC)**
	β	*β*	*β*	*β*
Firm age	.0738	.0712		.0988*
Sector	-.0231	.0830*		.0744
Firm size	.0235	.1666***		.1754***
TSQ	.3952***	.3926***		.5408***
TGT		.3749***		
R^2	.1504	.4828	a1=.3952x.3749=.1482	.3535
MSE	.3750	.2113	CI=.0980, .1994	.2635
F	14.0012***	90.4736***		59.1772***

*Note: *p <.05, **p <.01, ***p <.001*
Where; TGT = trust in government trust, TC = tax compliance, TSQ = tax service quality, CI = Confidence intervals, β = Unstandardized parameter estimates coefficients.

Discussion

The research delves into the significant factors influencing Small and Medium Enterprises (SMEs) tax compliance, analyzed within the framework of existing literature and theories.

The study identified a significant positive link between tax service quality and SMEs tax compliance. The statistical analysis revealed that tax service quality is a significant predictor of tax compliance (β = .524, p = .0000), accounting for 27.3% of the variance in compliance levels. This establishes a baseline that governments will get taxpayers to comply more often, but only if provided with good services in the first place . This result is consistent with the study carried out by Jonis and Handryno (2021), which finds service quality to positively influence taxpayer compliance. However, contrasting findings were reported by Sugiyarti et al. (2021), who indicated a negative significant relationship between tax service quality and tax compliance for taxpayers, suggesting ineffectiveness in enhancing compliance.

In this study, the results emphasized the role of government trust on the aspect of influencing SMEs' tax compliance. The findings show that high trust in the government significantly influences tax compliance: β = 0.390, p = 0.000. According to the Political Legitimacy Theory, therefore, given political legitimacy by a government institution, there should be an assurance of tax compliance. The findings align with most studies for instance, the ones done by (Byaro & Kinyondo, 2020) indicating that trust in the government significantly increases the magnitude of tax compliance. Conversely, low levels of compliance could result from uncertainty over tax spending and lack of trust.

The results showed that there is an increase in trust in the government due to better tax service quality delivery; this is significant at the 1% level of significance (β = .395, p = .000). This denotes that excellent and effective tax services can genuinely build public trust in governmental institutions, thus supporting the Social Contract Theory. The same was also found by (Bernarto et al., 2019), where it emerged that the higher the tax service quality, the more positive the influence on trust in government.

In the research, government trust was found to mediate the relationship between tax service quality and compliance. It mediates the relationship by adding the total effect to 54.08% when placed together with the direct impact. Trust as a mediating variable aligns with the fiscal exchange theory, which posits that efficient government services can build trust, leading to increased tax compliance behaviors. This finding extends the current literature in that it has specified and contextualized the complementary mediation, which reveals that both direct and indirect paths are significant and have a positive relationship.

Conclusion

The primary objectives of the study were to investigate the relationships between tax service quality, taxpayer trust in government, and tax compliance among SMEs. In particular, it aimed to ascertain the direct influence of the tax service quality and the taxpayer trust in government on tax compliance for SMEs and the direct impact of the tax service quality on taxpayer government trust. additionally, it explored the mediating role of taxpayers' government trust in the relationship between tax service quality and tax compliance among SMEs.

The findings demonstrate that both tax service quality and taxpayer trust in government have a significant positive impact on tax compliance among SMEs. High-quality tax services lead to increased compliance, highlighting the importance of delivering efficient, reliable, and user-centered services. Furthermore, tax service quality directly influences taxpayer trust in government, underscoring the role of well-managed tax systems in building trust, which is essential for voluntary compliance. Importantly, taxpayer trust in government also mediates the relationship between tax service quality and compliance, suggesting that improving tax service delivery not only directly enhances compliance but also promotes compliance by increasing trust in government. These results underscore the need to improve tax service delivery and strengthen taxpayer trust as critical strategies for enhancing tax compliance among SMEs.

Recommendations and Future Research

This study makes significant contributions to the understanding of tax compliance, particularly in the SME sector, by examining the relationships between tax service quality, taxpayer trust in government, and compliance behavior. It provides clear evidence that both higher service quality and increased trust in government play critical roles in fostering voluntary tax compliance among SMEs. The findings highlight that delivering efficient, reliable, and responsive tax services directly enhances compliance, while also strengthening taxpayer trust in government, which acts as an additional catalyst for compliance.

The practical implications of these results are substantial for policymakers and tax authorities. Improving the quality of tax services by streamlining processes, providing better customer support, and ensuring transparency, can not only directly increase compliance but also build long-term trust in government institutions. Trust-building measures, such as demonstrating accountability in the use of public funds and offering clearer communication about the benefits of tax contributions, are equally essential. By fostering a reciprocal relationship between the government and taxpayers, these strategies can reduce reliance on coercive enforcement mechanisms, making compliance more sustainable.

In terms of future research, this study opens several promising avenues. First, exploring the role of cultural factors in shaping trust and compliance behaviors could provide deeper insights, especially in diverse socio-political contexts. Trust in government may vary significantly based on cultural attitudes toward authority and governance, and understanding these differences could help tailor compliance strategies to different regions or demographic groups. Additionally, conducting similar studies in other economic blocs, both within and beyond Kenya, would offer comparative insights and help generalize the findings to different economic settings. Examining the interplay of service quality, trust, and compliance in more developed economies or in contexts with different governance structures could further refine strategies for enhancing tax compliance.

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