

# Tax Administration and Financial Performance of Small and Medium Enterprises in Nakawa Division, Kampala, Uganda

Emurwon Paul<sup>1</sup>, Sendagi Mohammed<sup>2</sup>, Rutaro Abas<sup>3</sup>

1 A Master of Science in Finance Student, Team University (TU), Kampala, Uganda

E-mail: aze.amen@yahoo.com

2 Lecturer, School of Graduate Studies and Research, Team University (TU), Kampala, Uganda

E-mail: sendagimoh@gmail.com

3 Lecturer, School of Graduate Studies and Research, Team University (TU), Kampala, Uganda

E-mail: [abas.rutaro@kiu.ac.ug](mailto:abas.rutaro@kiu.ac.ug), rutaro1982@gmail.com

**Abstract:** This study examined the relationship between tax administration and financial performance of Small and Medium Enterprises in Uganda. Specifically, the study assessed the relationship between tax compliance; tax incentives and the financial performance of SMEs. The study adopted the descriptive study design based on the quantitative and qualitative approaches. The study population of 17,573 registered SMEs owners in Nakawa was used to select a sample size of 377 respondents using simple random sampling. Data were collected using the self-administered questionnaire and interview guide. The study findings revealed that tax compliance has a statistically significantly moderate positive effect on the performance of SMEs since  $p$ -value (.000) is less than the significance level and the correlation coefficient (0.689). Tax rates have a statistically significant strong positive effect on the performance of SMEs since  $p$ -value (.000) is less than the significance level and the correlation coefficient (0.689). Tax incentives have a significant strong positive effect on the performance of SMEs, since the  $p$ -value (.000) is less than the significance level and the correlation coefficient (0.776). The study concluded that tax compliance, tax rates, and tax incentives have a statistically significant positive influence on the performance of SMEs. The study recommended that; strengthening the system of taxation through having a simplified system of taxation that can support SME tax payers to meet their tax duties; designing effective tax rates that are not based on the taxable profits as demarcated in the law but on an economic measure which includes the impact of the tax base; strengthening tax incentives to support infant small and medium firms so as to stimulate the performance of SMEs in the economy.

**Keywords**—tax administration; financial performance; Small and Medium Enterprises

## 1. INTRODUCTION

In Uganda, the history of taxation can be traced in times of the initial British colonial administrators which involved” compulsory public works such as road construction, the building of administrative headquarters and schools” among other works. The hut tax opened the genesis of formal taxation in the early 1900s. Conversely, the first common tariff was introduced that involved a 5% import tax rate for the goods going to Uganda via the port of Mombasa, Kenya (Jamal, 1978).

Gradually, taxation in Uganda has evolved over the years, which involved the East African Community (EAC) administering the income tax and customs duty through its departments until the EAC collapsed. This prompted the transfer of tax administration to the Ministry of Finance that was later transferred to Uganda Revenue Authority in 1991 through an Act of Parliament. In 1999, the EAC was re-established which later endorsed the East African Community Customs Management Act 2004 (EAC-CMA) to administer EA customs which involved operations, administrative and legal requirements (SEATINI-UGANDA, 2012). Camaron (1984) argues that during the evaluation of the performance of an organization, it is important to focus on the inhibiting factors of performance such as the problems, retarding

factors, etc. In the assessment of the financial performance of the SMEs, Pfeffer, and Salancik, (1978) highlight, the goal approach/method provides excellent results in the evaluations of SMEs due to its straight forwardness. Based on this historical background the study examined “the relationship of tax administration on the financial performance of Small and Medium Enterprises in Uganda.”

The system of tax administration used in any country determines the financial performance of businesses whereby countries with auspicious and progressive tax rates have propagated successful businesses. The scholar further asserts that successful businesses have influenced the growth of economies by ensuring equitable distribution of income and investments in the country. In essence, businesses and tax administration are interdependent for survival in that when the financial performance of businesses is affected, also the growth of the economy is equally affected (Ocheni, 2015). Ibrahim & Muritala, (2015) argued that taxes levied from individuals/ business organizations that are not proportionate to the income/wealth of the business organizations can be a demotivating factor that forces business people to transfer their capital to another sector. Equally, tax incentives enacted in favor of a given sector attracts more investments since the business people find it

favorable and profitable. This means that the ability of government to develop and implement appropriate tax policies does not only improve the financial performance of SMEs but also promotes economic growth in Uganda. According to the Ministry of Finance, Planning and Economic Development (MFPED), Small and Medium Enterprises is an enterprise employing between 5 and 50 people, with an annual sales/revenue turnover total asset of up to Uganda Shillings (USH.) 360 million, and a 'Medium Enterprise' as an enterprise that employs more than 50 people with an annual sales turnover or assets of between (USH.) 360 million and 30 billion" (FSD, 2015). However, there is no globally adopted definition for SMEs since these enterprises vary from country to country for instance the European Union refers to Small enterprises as "enterprises that employ 10 to 50 employees, and annual turnover and/or balance sheet total of less than EUR 10m while medium enterprises as enterprises that employ 20-250 employees and turnover and/or annual balance sheet of EUR 10-50m" (IMF, 2007). Several scholars have studied the financial performance using various measures which can be abridged into financial performance measures (Amran, 2011; Dele, 2012; Radipere and Dhliwayo, 2014). For purposes of this study, the financial performance measures adopted for this study consisted of; operating cash flow, return on investment, return on profit margins, inventory turnover used to determine the progress of SMEs.

SMEs account for about 90% of the private sector production which has greatly supported the economy in Uganda. The SMEs have supported the economy through creating new jobs, income generation among others. However, SMEs are facing challenges ranging from limited size and resources which have affected their operations. This is currently being mitigated through; "provision of Business Development Services (BDS) to build capacity and enhance their financial performance in areas of business planning, technology, communications and other services" (Uganda Investment Authority, 2008). Over 80% of the SMEs in Uganda are established in urban areas, and thus, this study contextually examined the SMEs located in Nakawa division, one of the divisions that form Kampala capital city of Uganda (Hatega, 2007). Various categories of SMEs were considered for this study and these included: "Retail and wholesale Trade, hard wares, Hotel and Restaurant, Computer and Electronics Repairs, Entertainments joints and bars, Metal fabrication, Manufacturing, and Food Processing" as adopted from (Ntayi et al., (2013). According to the views of different authors on taxation and business financial performance, it should be noted that high taxes and poor tax policies have negatively affected the financial performance of small businesses (Bruce & Mohsin, 2006). This is complemented by (Sebikari, 2014) who reported that taxation does not only reduce the capital of small firms but also hampers their performance which makes tax incentives paramount to the survival of the small firms.

Despite efforts by the government of Uganda to enhance the growth and financial performance of SMEs, in terms of return on investment, gross profits margin and inventory turnover has continued to decline (BOU, 2022). In addition, most SMEs in Uganda do not survive past their fifth year birthday after inauguration which shows poor financial performance in the SME sector (Sebikari, 2014; MFPED 2012). The deficiencies in the performance of SMEs may be associated with many factors such as Tax policy, inadequate capital, poor management skills among others. If the poor performance of SMEs if not immediately addressed may affect the economic growth and development of Uganda since these enterprises contribute to 90% of the "private sector production" in the economy. This, therefore, prompted the researcher to carry out a research on the relationship tax administration has on the financial performance of SMEs in Uganda.

### **Purpose of the study.**

The purpose of this study was to examine the relationship between tax administration and financial performance of Small and Medium Enterprises in Nakawa Division, Kampala.

### **Specific objectives of the study.**

- i. To determine the relationship between tax compliance and financial performance of SMEs in Nakawa Division, Kampala.
- ii. To establish the relationship between tax rates and financial performance of SMEs in Nakawa Division, Kampala.
- iii. To determine the relationship between tax incentives and financial performance of SMEs in Nakawa Division, Kampala.

## **2. METHODOLOGY**

### **Research Design**

The descriptive correlational cross-sectional survey design was used and adopted a mixed methods approach. A descriptive research design was adopted for the study since it focuses on the people as well as their attributes which enabled the investigator to understand and examine the influence of tax administration on SME performance.

### **Study Population.**

The study population was 17573 comprised managers and employees (owners /proprietors and their top management, employees) of 1000 registered SMEs (UBOS, 2023) within Nakawa Division, Kampala. The study area was limited to Nakawa division since the majority of the SMEs are established in urban areas.

### **Sample size and selection**

A sample size refers to the number of subjects in a sample (symbolized by n) or a subset of a population" (Creswell,

2013). Based on the Krecjie and Morgan (1970) sampling table, the researcher selected a sample size of 377 SME respondents from a population of 17,573 respondents with the help of convenient sampling (Chuan, 2006)

#### Data Collection Methods

Both quantitative and qualitative methods of data collection were employed during the study. The questionnaire survey method was used to pool quantitative statistics, while the interview and Documentary review method were employed to gather qualitative information. The Researcher chose a data collection method that better suited the intended purposes.

#### Questionnaire Survey Method

The questionnaire survey method is a set of questions used to obtain information from a large group of people in a given study (Amin, 2005). This method was used to collect data from middle-level staff and other lower level staff within the SMEs because they are directly involved in the operations of the SMEs.

#### Interview Method

An interview is a data-collection technique that involves oral questioning of respondents, either individually or as a group (Chaleunvong, 2009). The responses to the

interview questions were written down. The interviews were structured comprising a set of issues on tax compliance, tax rates, and tax incentives. This interview method was used to gather information from the SME proprietors, and other top management staff in these enterprises since these people have in-depth information concerning taxation policies and how they are influencing the performance of SMEs.

### 3. DATA PRESENTATION AND ANALYSIS OF FINDINGS

#### 3.1 Empirical findings based on objectives of the study.

##### 3.1.1 the relationship of tax compliance on the financial performance of SMEs in Nakawa division

During the study, a set of statements regarding tax compliance were presented to respondents in order to establish their opinion on the performance of SMEs in Nakawa division, Kampala. A likert scale of “Strongly Agree (SA) = 5, Agree (A) = 4, Not Sure (NS) = 3, Disagree (D) =2 and Strongly Disagree (SD) =1” quantified the responses.

**Table 3.1: Responses on tax compliance**

Item	Mean	Std. Deviation
<b>Simplified system of taxation</b>		
I understand the Ugandan tax system	2.32	.766
I can compute the income tax liability of our business with ease	2.31	.684
I always attend taxation seminars and workshops on behalf of the business to update myself on the tax system	4.31	.667
Payment of levies is straight forward hence the business does not hire professional consultancy services	2.35	.950
<b>Interpretation of tax laws and regulations</b>		
I am aware of most tax laws and guidelines about taxation of incomes for SMEs	4.44	.641
I understand the tax laws and regulations in Uganda	2.24	.711
I can interpret tax laws and compute tax liabilities	2.45	.710
I always file tax returns with URA on a timely basis as requires by law	4.34	.856
<b>Tax planning and functional expertise</b>		
I know how to treat the expenses incurred in relation to income tax in Uganda.	4.19	.856
I always advise management on income tax planning issues	4.02	.857
I am sure of the incomes /turnover on which we pay income taxes as a firm	4.15	.766

I am always part of the team that carries out budgeting process of my employer especially on income tax matters	4.24	.643
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**Source: Primary data**

Table 3.1, highlights that the majority of the respondents within the SME sector do not understand the Ugandan tax system as indicated by the average score of 2.32 (SD = 0.766). This means that these respondents cannot interpret what the various tax laws stipulate and the other tax compliance requirements. Most of the respondents revealed that they could not compute the income tax liability of their businesses with ease. This is confirmed by the mean score of 2.31 (SD = 0.684) which shows that the majority of the respondents need assistance to understand how much to pay when to pay according to the size and capital of their businesses. A bigger state of the respondents agreed that they always attend taxation seminars and workshops on behalf of their business to update themselves with the tax system as noted by the mean 4.31 (SD = 0.667). The above findings were supported by a respondent during face to face interviews who reported that; *“URA through the umbrella body KACITA engages the traders to ease provision of taxpayer services, which include tax advice and intensive taxpayer education (seminars/ workshops) on the rights and obligations of taxpayers in the designated blocks are among the benefits to taxpayers. For example, we able to learn how to avoid making mistakes which could result in penalties which are avoidable. This is because taxes are costly to businesses; therefore, managing penalties would significantly reduce business costs.”*

This means that the traders and other employees within the SME sector have attended taxation seminars and workshops which has improved their knowledge of tax policies and also enabled them to avoid tax penalties associated with tax evasion. This has reduced the tax compliance costs for the SMEs and thus boosted their financial performance.

The payment of levies is not straight forward hence the business has to hire professional consultancy services. This was confirmed by the majority of the respondents (mean = 2.35; SD = 0.950) who revealed that they usually hire someone to file their tax returns for them. In addition, most of the respondents agreed (mean = 4.44; SD = 0.641) that they are aware of most tax laws and guidelines about taxation of incomes for SMEs. This means that the majority of the respondents can comprehend their tax acquiescence as noted by tax authorities. The above findings were supported by a respondent who said; *“Recently, Uganda Manufacturers Association (UMA) conducted a seminar on Tax Legislation, Tax Compliance and the impact of company tax practices on business performance where I was able to know the rights and*

*obligations of my business regarding tax, know the various taxes to which my business may be subjected, application of tax planning techniques without evading tax and breaking the law, and learning the best techniques of tax computation.”*

This implies that the respondents have received tax education through seminars which have improved their awareness concerning tax laws, tax planning and compliance for small and medium businesses. This has also enabled them to know their rights and obligations of their businesses regarding taxes.

The study findings revealed that members of the small and medium enterprises do not understand the tax laws and regulations in Uganda which is represented by the mean score of

2.24 and standard deviation of 0.711. Furthermore, most of the respondents disagreed (mean = 2.45; SD = 0.710) that they can interpret tax laws and compute tax liabilities. This shows that the majority of the respondents do not have sufficient tax knowledge regarding the when to pay taxes and in what proportions. On whether the small and medium enterprises always file tax returns with URA on a timely basis as required by law, the majority of the respondents mean = 4.34; SD = 0.856) agreed that they always file their tax returns on time. The study findings further revealed that most of the respondents know how to treat the expenses incurred in relation to income tax in Uganda which was confirmed by a high average score of 4.19 and standard deviation of 0.856. On average, most of the respondents in the SME sector agreed (mean = 4.02; SD = 0.857) that they always advise management on income tax planning issues. The majority of the respondents noted that they are sure of the incomes /turnover on which they pay income taxes as a firm which is represented by the mean score of 4.15 and relatively low standard deviation of 0.766. The findings also show that the majority of the respondents with an average score of 4.24 (SD = .643) agreed that they are always part of the team that carries out the budgeting process of their employers especially on income tax matters.

### 3.2 The financial Performance of SMEs in Nakawa Division

Using a “five likert scale of Strongly Agree (SA)= 5, Agree (A)= 4, Not Sure (NS)= 3, Disagree (D)=2 while Strongly Disagree (SD)=1.” The respondents were given statements to assess the performance of SMEs in Nakawa division, Kampala.

**Table 3.2: Responses on performance of SMEs.**

Statement	Mean	Std. deviation
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Taxes have reduced the return on investments of small and medium firms	4.18	0.741
Taxes have not affected the sales turnover of SMEs through increasing the operational costs	2.17	1.373
Taxes have affected the liquidity position of SMEs	3.63	0.953
The profits of the small and medium enterprises before taxes are always high	3.81	1.244
Taxes have reduced capital resources for investment in research, innovation, and development	4.42	0.653
Taxes have inhibited the growth of SMEs in Uganda	4.57	0.349
The taxes levied from SMEs have made it difficult for the small and medium firms to achieve their goals	4.36	0.456

**Source: Primary data**

Table 3.2, above indicated that taxes have reduced the return on investments of small and medium firms. This was confirmed by the majority of the respondents with a mean score of 4.18 and standard deviation of 0.741. Most of the respondents also disagreed that taxes have not affected the sales turnover of SMEs through increasing the operational costs and this was represented by the mean score 2.17 (SD = 1.373). On whether taxes have affected the liquidity position of SMEs, most of the respondents agreed as highlighted by the average score of 3.63; (SD = 0.953). Similarly, the profits of the small and medium enterprises before taxes are always high and this was established by the majority of the respondents who agreed as noted by the average score 3.81; (SD = 1.244). A bigger proportion of respondents (mean = 4.42; SD = 0.653) agreed that taxes have reduced capital resources for investment in research, innovation, and development. The

majority of the respondent also strongly agreed that taxes had inhibited the growth of SMEs in Uganda as indicated by the average score of 4.57 and standard deviation of 0.349. This implies that taxes are a major obstacle to the prosperity and performance of small and medium enterprises in Uganda. On average, most of the respondents (mean = 4.36; SD = 0.456) agreed that the taxes levied on SMEs have made it difficult for them to achieve their goals. This indicates that the failure of SMEs to accomplish their objectives is partly due to the taxes levied from these enterprises.

**3.2.1 Correlation results of tax compliance and the financial performance of SMEs**

Pearson correlation coefficient established the extent to which tax compliance influences the performance of SME's in Nakawa Division, Kampala.

**Table 3.3 Correlation matrix for tax compliance and the performance of SMEs**

		Tax compliance	Performance of SMEs
Tax compliance	Pearson Correlation	1	.595**
	Sig. (2-tailed)		.000
	N	377	377
Performance of SMEs	Pearson Correlation	.595**	1
	Sig. (2-tailed)	.000	
	N	377	377

\*\*. Correlation is significant at the 0.01 level (2-tailed).

**Source: Primary data**

The study findings in table 3.3, show that tax compliance significantly affects the performance of SMEs in Nakawa division since p- value (.000) is less than the significance level of 0.01. The correlation coefficient is (0.595) which

implies that there is a moderate positive relationship between tax compliance and the performance of SMEs. So, in order to enhance the financial performance of SMEs in Uganda, the government needs to ensure that there is a proper mechanism to ease tax compliance through having a simplified system of taxation, proper tax planning, and functional expertise as well as the ease with the interpretation of tax laws and regulations. Results from the quantitative findings indicated that tax compliance significantly influences the financial performance of SMEs which coincided with the qualitative results which indicated that members within the SME sector have been able to enhance their knowledge on taxation where by URA through the umbrella body KACITA has engaged the traders to ease provision of taxpayer services, by delivering tax advice and intensive taxpayer education (seminars/ workshops) on the rights and obligations of

taxpayers in the designated blocks are among the benefits to taxpayers. This has benefitted the traders by equipping them with practical knowledge of tax compliance and best practices.

### 3.2.2 Relationship between tax rates and the financial performance of SMEs in Nakawa Division

During the study, statements on tax rates were presented to the respondents to establish its effect on the financial performance of SMEs in Nakawa division, Kampala. Results from the study were presented using a Likert scale as: "Strongly Agree (SA) =5, Agree (A) = 4, Not Sure (NS)= 3, Disagree (D)=2 while Strongly Disagree (SD) =1."

**Table 3.4 Responses on tax incentives.**

Statement	Mean	Std. Deviation
<b>Clarity of tax rates</b>		
The tax rates charged are clear in terms of payable taxes.	2.09	.675
There are diverse taxes imposed on small and medium enterprises,	3.73	.502
The government either increases or decreases tax rate at its own discretion	4.56	.388
<b>Correct level of taxation</b>		
The taxes charged are burdensome to the business	4.48	.410
SMEs pay taxes when it is convenient for them to pay	2.11	.973
Taxes are only charged when the business is operating. Hence allows for momentary closures of business	2.46	.5580
SME tax rates consider the scale of operation	4.35	.744
<b>Fair taxation rates</b>		
The tax rates charged are fair to small and medium business owners	2.72	.965
The regressive nature of taxes on SME reduces their revenue base	4.77	.949
The tax rates charged are economical to SMEs	2.36	.756
SMEs have information on how much tax when to pay tax, where to pay and mode of tax payment	3.20	.392

**Source: Primary data**

Table 3.4, indicates that for a total of 377 respondents with an average score of 2.09 and a relatively low standard deviation (0.675), most of the respondents disagreed that the tax rates charged are clear in terms of payable taxes. This means that respondents in the SME world are not

aware of how much to pay to the tax bodies. There are diverse taxes imposed on small and medium enterprises, which was confirmed by the majority of the respondents (mean = 3.73; SD = 0.502) who agreed that their business pays different taxes depending on the nature and size of business. Most of the respondents agreed (mean = 4.56; SD = 0.388) that the government either increases or

decreases tax rate at its own discretion. This means that the government of Uganda can always increase or decrease a tax rate without consulting the parties that will be paying the tax. In addition, this is supported by qualitative data collected from key informant interviews, as one informant had this to say;

*“Despite the contestations from traders, the government has continued to increase tax rates for instance with a tax increase as a result of the introduction of the specific excise tax alternative; there has been an increase in the prices of goods and services making it more expensive for the customers.”*

This means that the government of Uganda has continued to alter tax rates for the small and medium businesses without involving those in the SME sector which has negatively influenced the financial performance of their businesses due to the increased tax burden on the SMEs.

A bigger proportion of respondents agreed that the taxes charged are burdensome to their businesses as shown by the mean score 4.48; (SD = 0.410). This means that the taxes levied from the SMEs are inhibiting growth and performance of these enterprises in Uganda. The above conclusion was supported by an SME proprietor who had this to say;

*“Many small businesses have continued to evade taxes because they are high and imposes high costs on their businesses yet most of these enterprises are struggling to keep operating for instance; some traders evade VAT returns since out there on the streets, the one who is selling at lower prices will eventually make a sale. VAT is 18% addition to the price being paid; this means that if one has to pay all VAT without having considered deductions, this trader will be selling expensive goods and sooner than later will be out of business.”*

In addition, another respondent stressed that;

*“.... multiple taxations of the same business are a big problem and an obstacle to the performance of businesses, for example, a trader in his/her retail shop pays income tax to URA and pays import duty whenever he/she imports small merchandise in association with fellow traders. After all this it is Kampala’s turn, it comes in, and requests for license fees and then the syndrome continues....”*

This shows that taxes are not only an obstacle to the financial performance of SMEs in Uganda but have also contributed to the collapse of small and medium businesses due to the ever-increasing costs of operation associated with taxes which has discouraged financial performance within the SME sector.

On whether SMEs pay taxes when it is convenient for them to pay, most of the respondents disagreed as noted by the mean = 2.11; SD = 0.973. This indicates that the tax bodies always require these enterprises to meet their tax obligations regularly and on time. The majority of the respondents disagreed that taxes are only charged when the business is operating and hence allows for momentary closures of business. This was confirmed according to the low mean score of 2.46 (SD = 0.558). The findings further revealed that most of the respondents (mean = 4.35; SD = 0.744) agreed that the SME tax rates consider the scale of operation. This means that taxes are levied from SMEs depending on their capital size and nature of the business. On whether the tax rates charged are fair to small and medium business owners, most of the respondents disagreed (mean = 2.72; SD = 0.965) which shows that the taxes rates charged from the SMEs are irrational and thus affect the financial performance of these enterprises. On average, the majority of the respondents agreed (mean = 4.77; SD = 0.949) that the regressive nature of taxes on SMEs reduces their revenue base. In addition, most of the respondents also disagreed that the tax rates charged are economical to SMEs as noted by the mean score of 2.36 and standard deviation of 0.756. This means that the taxes levied from the small and medium enterprises are reducing the capital base of these enterprises and thus hindering the performance of SMEs. The study findings highlighted that most respondents were neutral on whether the SMEs have information on how much tax when to pay tax, where to pay and mode of tax payment which was confirmed by the mean score of 3.20 and standard deviation of 0.392.

**Table 3.1: Correlation Matrix For Tax Rates And The Performance Of Smes**

		Tax rates	Performance of SMEs
Tax rates	Pearson Correlation	1	.689**
	Sig. (2-tailed)		.000
	N	377	377
Performance of SMEs	Pearson Correlation	.689**	1
	Sig. (2-tailed)	.000	
	N	377	377

\*\*. Correlation is significant at the 0.01 level (2-tailed).

**Source: Primary data**

The findings in table 3.5, revealed that tax rates have a significant effect on the financial performance of SMEs in Nakawa division since  $p$  – value (.000) is less than the significance level. The correlation coefficient (0.689) shows a strong positive relationship between tax rates and the financial performance of SMEs in Nakawa division. Tax rates have a strong positive effect on the performance of SMEs in Nakawa Division, Kampala, Uganda. This means “*Tax rates significantly affect the performance of SMEs in Nakawa Division, Kampala.*” Therefore, the government of Uganda should carefully set tax rates by

ensuring Clarity of the tax rates, correct level of taxation and fair tax rates since these play a key role in the performance of SMEs in Uganda.

**3.2.3 The Relationship Between Tax Incentives and Financial Performance of SMEs in Nakawa Division.**

During the study, statements on tax incentives were presented to the respondents in order to establish the extent to which they affect the performance of SMEs in Nakawa division, Kampala. Using a likert scale of “Strongly Agree (SA) = 5, Agree (A) = 4, Not Sure (NS) = 3, Disagree (D) = 2 and Strongly Disagree (SD) = 1.”

**Table 3.6: Responses on tax incentives**

Item	Mean	Std. Deviation
<b>Investment deductions and allowances</b>		
Tax incentives for SMEs have lowered the operational costs associated with payment of taxes for small and medium enterprises	4.39	0.867
Tax incentives, investments, and performance of SMEs are closely linked.	4.53	0.641
Tax incentives have attracted private investors to the SME sector	4.33	0.795
<b>Tax holidays</b>		
The government has given special tax treatment to SMEs in the form of tax holidays	3.87	0.878
Tax holidays have helped my business to grow and expand.	3.68	0.929
Tax incentives have stimulated the growth and expansion of SMEs in Uganda.	4.41	0.726
<b>Special tax regimes</b>		
Tax incentives have encouraged a reasonable number of traders in the SME sector to continue operating	3.94	0.392
The special tax regimes for SMEs have reduced the operations of the small businesses in the informal sector.	3.79	0.356
Special tax treatment for SMEs has corrected market imperfections in the country.	3.08	1.364
Tax incentives have protected the infant small and medium enterprises in Uganda	2.47	0.904

**Source: Primary data**

The study findings revealed that the majority of the respondents agreed (mean = 4.39; SD = 0.867) that tax incentives for SMEs have lowered the operational costs associated with the payment of taxes for small and medium enterprises. Tax incentives, investments, and financial performance of SMEs are closely linked. This was confirmed by most of the respondents as highlighted by the mean score of 4.53 and standard deviation of 0.641. The majority of the respondents (mean = 4.33; SD = 0.795) agreed that tax incentives had attracted private investors to the SME sector. This means that the tax incentives have increased investment in the SME sector and thus improved the financial performance of small and medium enterprises. The above findings were corroborated by an interviewee who said;

*“My business has benefitted from tax exemption of With Holding Tax and we have a tax exemption certificate issued to the business from URA. This is because my business has demonstrated a good track record of paying the taxes on time. This has reduced the tax burden on the business and enabled me to reinvest and expand the business.”*

This implies that tax incentives like withholding tax exemption have had a positive contribution towards that financial performance of SMEs through reducing the tax burden on businesses which has stimulated performance in the SME sector.

On whether the government has given special tax treatment to SMEs in the form of tax holidays, most of the respondents agreed as represented by the mean score of 3.87 and a relatively low standard deviation (0.878). This implies that the tax holidays accorded to the SMEs have reduced the tax burden and boosted performance in these enterprises. A bigger proportion of respondents agreed that tax holidays have helped my business to grow and expand as shown by mean = 3.68 and standard deviation = 0.929. In addition, tax incentives have stimulated the growth and expansion of SMEs in Uganda which was established by the majority of the respondents according to the mean = 4.41 and SD = 0.726. This means that tax incentives are a prerequisite to improved performance of small and medium enterprises. This was confirmed during a personal interview with a key informant, who had this to say;



*"This company would not have survived in these hard times if it were not for the tax holiday that we are benefiting from the government. This tax holiday has reduced our operating costs and enabled us to break-even during these hard times when business is slow."*

This implies that the survival of some SMEs has been as a result of tax incentives which have reduced the operational costs and enabled the small and medium enterprises to continue operating and thus enhanced the performance of SMEs.

The findings also indicated that most of the respondents (mean = 3.94; SD = 0.392) agreed that tax incentives had encouraged a reasonable number of traders in the SME sector to continue operating. Likewise, the special tax

regimes for SMEs have reduced the operations of the small businesses in the informal sector. This was established by most of the respondents with an average score of 3.79 (SD = 0.356). On whether special tax treatment for SMEs has corrected market imperfections in the country, the majority of the respondents were neutral as indicated by the mean score = 3.08 (SD = 1.364). Similarly, most of the respondents are disagreed on whether tax incentives have protected the infant small and medium enterprises in Uganda, this was revealed by the mean score of 2.47 and standard deviation of 0.904.

**Table 3.7: Correlation Matrix for Tax Incentives and financial Performance of SMEs**

		Tax incentives	Financial Performance of SMEs
Tax incentives	Pearson Correlation	1	.776**
	Sig. (2-tailed)		.000
	N	377	377
Financial Performance of SMEs	Pearson Correlation	.776**	1
	Sig. (2-tailed)	.000	
	N	377	377

\*\* . Correlation is significant at the 0.01 level (2-tailed).

**Source: Primary data**

Table 3.7 revealed that tax incentives have positive impact on the financial performance of SMEs in Nakawa Division, Kampala since the p – value (.000) is less than the significance level. The correlation coefficient (0.776) indicates a strong positive relationship between tax

incentives on the performance of SMEs. Therefore, tax incentives have a positive effect on the performance of SME's in Nakawa Division, Kampala. Results from quantitative findings highlighted that tax incentive have a significant effect on the performance of SMEs.

**Table 3.8: Regression analysis of the study variables**

Model	Unstandardized Coefficients		Standardized Coefficients Beta		t	Sig.
	B	Std. Error				
(Constant)	.627	.269			2.329	.023
Tax incentives	.459	.094	.543		4.911	.000
Tax rates	.311	.108	.331		2.889	.005
Tax compliance	.171	.086	.206		2.014	.031

**R = .827      R- square = .684      F= 34.574      Sig = .000**

Dependent Variable: Performance of SMEs

**Source: Primary data**

Table 3.8, above shows the components of taxation, i.e. tax compliance, tax rates and tax incentives which significantly predict the performance of SMEs since the p – value (.000) is less than the significance level. The

correlation coefficient (.827) revealed that the study variables had a strong positive relationship with the performance of SMEs. Thus, the study variables explain 68.4% of the performance of SMEs in Nakawa Division, Kampala, Uganda.

The findings further revealed that tax incentives (Beta= .459, Sig. < .000) was a better predictor of the performance of SME's and this was followed by tax rates (Beta = .311, Sig. < .005), and lastly tax compliance with (Beta= .171,

Sig. < .031). This implies that strengthening and improving the existing taxation policies relating to tax compliance, tax rates and tax incentives, the performance of SMEs will improve in Uganda

#### 4. DISCUSSIONS CONCLUSIONS AND RECOMMENDATIONS

##### 4.1 Discussion of findings.

###### 4.1.1 Tax compliance and the financial performance of SMEs

During the study, a simplified system of tax administration was examined as a factor of tax compliance, and the findings highlighted that a bigger proportion of the respondents within the SME sector cannot understand the Ugandan tax system. This means that these respondents cannot interpret what the various tax laws stipulate and the other tax compliance requirements. This corroborated with Bozdoğanoglu, (2016) who asserts that on top of the direct costs incurred by tax payers especially the SMEs towards meeting their tax compliance costs, they face an extra tax burden associated to the diverse and complicated tax system. The scholar further maintains that tax compliance costs have continuously become a fixed cost element that has imposed a relatively higher burden on the small and medium enterprises compared to the large enterprises that accrue benefits from returns to scale due to prompt compliance. These high tax compliance costs inhibit the financial prosperity of both the proprietor and the employees in the SMEs (Bozdoğanoglu, 2016)

###### 4.1.2 Tax rates and the financial performance of SMEs

The findings revealed that the tax rates charged are not fair to small and medium business owners, which shows that the taxes rates charged from the SMEs are irrational and thus affect the performance of these enterprises. This is in line with Masato, (2009) who found out that the SMEs in a regular tax system are discriminated against since the tax rate for the small and large firms is the same which increases the costs of the small enterprises. This has distorted the growth of SMEs where most small firms have transformed into firms that are levied fewer taxes or no taxes at all. According to the study findings, the taxes charged are burdensome to the small and medium enterprises. This implies that the taxes levied from the SMEs are inhibiting growth and performance of these enterprises in Uganda. This is supported by Atawodi & Ojeka (2012) opine that the choice of the tax rate should depend on the tax preference accorded to small businesses to promote the growth of small enterprises which can be done by lowering tax rates, offering tax holidays as well as reliefs to the small businesses. The fundamental

objective is to ensure that tax income is successfully increased through methods that suit the country's environment and administrative ability (Atawodi & Ojeka, 2012).

###### 4.1.3 Tax incentives and the financial performance of SMEs

During the study, it was noted that that tax incentive for SMEs had lowered the operational costs associated with the payment of taxes for small and medium enterprises. In addition, the findings also indicated that tax incentives had attracted private investors to the SME sector. This means that the tax incentives have increased investment in the SME sector and thus improved the performance of small and medium enterprises. This corroborated with Philips, (2010) who asserts that tax incentives have been implemented by governments to attract and retain private investors within their economies. The prime objective of these incentives is to counterbalance the actual/ perceived operational costs associated with the payment of taxes. These incentives have become a catalyst for an enriched performance seen within the SME sector. Additionally, findings from this study revealed that the government had given special tax treatment to SMEs in the form of tax holidays. In the same way, study findings also highlighted that tax holidays have helped my business to grow and expand. This is in line with Feyitimi, Temitope, Akeem, & Oladele, (2016) who noted that the tax holiday is one of the most frequently adopted government tax incentives which exempts firms from their tax liability and also relieves some businesses certain tax deductions over the tax holiday."

#### 4.2 Conclusions

This sub-unit shows the conclusions centered on each of the research objectives, as drawn from the study findings.

###### 4.2.1 Tax compliance and the financial performance of SMEs

According to study findings, it was concluded that; the simplified system of taxation, tax planning and functional expertise, interpretation of tax laws and regulations play a fundamental role in enhancing the performance of SMEs. This implies that strengthening the system of taxation through a simplified system of taxation can support SME tax payers to meet their tax duties and thus reduce the burden of tax compliance within SMEs. Therefore, a streamlined tax administration strategy is important in enhancing the performance of SMEs.

###### 4.2.2 Tax rates and the financial performance of SMEs

Based on the findings, the researcher concluded that having a correct level of tax rates, ensuring clarity of tax rates and fair tax rates are essential for the growth and performance of SMEs. This implies that there is need to design an effective tax rate through lowering the tax rates and offering tax reliefs to small and medium businesses which will reduce the cost of running a business within

these enterprises and thus enhance the performance of SMEs in Uganda.

#### 4.2.3 Tax incentives and the financial performance of SMEs

From the study findings, the researcher further concluded that the performance of SMEs depends on the tax incentives in the form of investment deductions and allowances, tax holidays and special tax regimes according to the small and medium businesses. This implies that tax incentives are key in reducing the operational costs associated with the payment of taxes for SMEs by lowering the tax compliance burden inflicted on the SMEs. Therefore, efforts to stimulate the performance of SMEs in Uganda, require that tax incentives should be intensified to encourage the growth and expansion of SMEs in Uganda.

#### 4.3 Recommendations of the study

The study recommends the following:

- i During the study, it was found out that in order to promote the performance of SMEs in Nakawa Division, Kampala. Uganda's, primary consideration should be given to strengthening the system of taxation through having a simplified system of taxation that can support SME tax payers to meet their tax duties and thus reduce the burden of tax compliance within SMEs. This will contribute to lowering the presence and magnitude associated with these fixed costs of operation for SMEs as well as putting in place a simplified tax structure that will accommodate all tax payers including the SME sector.
- ii The study recommends that the government of Uganda should design an effective tax rate in such a way that it is not based on the taxable profits as demarcated in the law but on an economic measure which includes the impact of the tax base.
- iii According to the findings, this research recommends that the government of Uganda should strengthen tax incentives so as to stimulate the performance of SMEs in Uganda. These tax incentives will help to rectify market limitations faced by small and medium businesses, cut business operational costs as well as stimulate selected investments.

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