

Taxation Policies and SME Growth in Uganda: A Case Study of Small Businesses in Kampala

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Abstract: *This study examined the impact of taxation policies on the growth and sustainability of small businesses in Kampala, focusing on the role of tax rates, the complexity of tax procedures, and tax incentives and exemptions. Data was collected from a sample of small businesses, and multiple linear regression analysis was conducted using SPSS and STATA to explore the relationships between taxation policies and business performance. The findings revealed that higher tax rates negatively affected business profitability, while the complexity of tax procedures hindered operational efficiency and compliance. In contrast, tax incentives and exemptions were found to have a positive impact on business growth and sustainability. The study concluded that taxation policies, including simplified tax procedures and targeted incentives, are critical factors influencing the success of small businesses in Kampala. Based on these findings, it was recommended that policymakers review tax rates, streamline tax procedures, and expand access to tax incentives to foster the growth of small businesses.*

Keywords: Taxation policies, small businesses, growth, profitability, tax rates, tax compliance, tax incentives, Kampala, Uganda.

Background of the study

In Uganda, SMEs are a critical component of the economy, contributing significantly to employment, poverty reduction, and economic growth (Frank et al., 2023). The sector is characterized by informal businesses that are often constrained by challenges such as access to finance, infrastructure, and regulatory environments (Brian et al., 2024). The role of taxation policies in either facilitating or hindering the growth of these businesses is an area of keen interest, especially in the context of Uganda, where SMEs contribute approximately 20% to the country's GDP and account for over 90% of private sector employment (Frank et al., 2023). In recent years, Uganda's government has made efforts to improve the tax system, recognizing that efficient tax policies can enhance the growth and sustainability of SMEs (Turyatemba et al., 2022). These efforts include reforms aimed at improving tax compliance, streamlining the tax collection process, and introducing tax incentives to stimulate business growth (Winny et al., 2023). However, SMEs in Uganda face various challenges related to the complexity of tax laws, high tax rates, and the lack of sufficient support services to help them navigate the tax system (Benard, 2023).

The tax system in Uganda is primarily governed by the Uganda Revenue Authority (URA), which oversees the collection of various taxes such as income tax, value-added tax (VAT), and excise duties (Amos et al., 2024). According to the Uganda Revenue Authority (2022), the formal tax system comprises a progressive tax rate structure, with small businesses required to pay taxes based on their annual turnover (Christopher et al., 2024). SMEs are generally taxed under the presumptive tax regime, where taxes are computed based on the turnover or size of the business (Faridah et al., 2023). This system, while simplified for small businesses, often results in tax rates that are still burdensome for many businesses struggling to stay afloat (Benard, 2023). The government has attempted to introduce tax incentives to ease the burden on SMEs, such as tax exemptions for start-ups in certain sectors, lower VAT rates, and capital allowances for businesses in specific regions (Tasha et al., 2023b). These policies aim to reduce the overall tax burden and encourage investment in the SME sector (Turyatemba et al., 2022). Despite these efforts, SMEs still report challenges in accessing tax-related information and compliance services. A report by (Ramadhan, Alex, Kazaara, et al., 2023) revealed that many small business owners are unaware of available tax incentives, leading to under-utilization of beneficial policies.

One of the most significant challenges facing SMEs in Uganda is the complexity of the tax system, which is often difficult to navigate, especially for business owners with limited education or financial literacy (Akankwasa et al., 2022). A 2022 survey by the Uganda National Chamber of Commerce and Industry (UNCCI) found that 47% of SMEs cited complicated tax procedures as one of the main barriers to business growth. Additionally, SMEs struggle with the lack of awareness about their tax obligations, which results in non-compliance, penalties, and missed opportunities for tax relief (Turyatemba et al., 2022). Moreover, high taxes are often considered a deterrent to business expansion. The Uganda National Bureau of Statistics (UNBS, 2022) reported that the average corporate income tax rate in Uganda stands at 30%, which is relatively high compared to neighboring countries such as Kenya and Tanzania. This tax burden, coupled with other regulatory hurdles, significantly impedes the growth potential of SMEs in Uganda, as it limits their ability to reinvest profits, expand their operations, and hire additional staff (Sarah et al., 2024). In fact, a study conducted by the World Bank (2021) revealed that 63% of Ugandan SMEs cited high taxes as a major challenge to business expansion and profitability (Polycarp et al., 2023). At the same time, Uganda's SMEs are crucial to the country's economic development, and it is

necessary to ensure that tax policies do not stifle their growth (Lydia et al., 2023). Research by the International Finance Corporation (IFC, 2021) emphasizes that SMEs play a key role in innovation, job creation, and poverty reduction in emerging markets. In Uganda, SMEs account for 90% of all businesses and 80% of employment, yet they contribute less than 30% to tax revenues, indicating a significant potential gap in tax compliance and business growth (Christopher et al., 2024).

Problem Statement

Small and medium-sized enterprises (SMEs) are crucial to Uganda's economy, contributing approximately 20% to the GDP and accounting for over 90% of private sector employment (Frank et al., 2023). Despite their significance, SMEs face numerous challenges that hinder their growth, with taxation policies being a prominent obstacle (Tasha et al., 2023a). The tax system in Uganda, while designed to facilitate business development, often imposes a heavy burden on small businesses. High tax rates, complex tax procedures, and a lack of awareness about tax incentives limit the capacity of SMEs to thrive (Nancy & Prudence, 2024). A 2022 survey by the Uganda National Chamber of Commerce and Industry (UNCCI) found that 47% of SMEs identified complex tax regulations as a barrier to growth, while 63% of SMEs reported high tax rates as a major challenge to profitability and expansion (UNBS, 2022). These tax-related challenges have contributed to low levels of tax compliance, resulting in underperformance in SME growth and a missed opportunity for significant economic contribution (Amos et al., 2024). Therefore, understanding the impact of taxation policies on SME growth in Kampala is essential for informing policy reforms that support the sustainable growth of SMEs.

Specific Objectives

1. To examine the impact of tax rates on the growth and profitability of small businesses in Kampala.
2. To evaluate the effect of the complexity of tax procedures on the operational efficiency and compliance of small businesses in Kampala.
3. To assess the role of tax incentives and exemptions in supporting the growth and sustainability of small businesses in Kampala.

Methodology

The study aimed to assess the impact of taxation policies on the growth of small and medium-sized enterprises (SMEs) in Kampala, Uganda, focusing on how taxation affects business operations and profitability (Annet et al., 2023). To achieve this, both qualitative and quantitative research approaches were employed. A descriptive research design was used to collect data from a sample of small businesses in the Kampala region, which allowed for an in-depth understanding of the various factors influencing SME growth and their relationship with taxation policies (Sarah et al., 2024). The study targeted SMEs across different sectors, including retail, manufacturing, and services. A stratified random sampling technique was used to select 150 SMEs, ensuring a representative sample that reflected the diversity of businesses within the city (Ramadhan, Alex, Ariyo, et al., 2023).

Data was collected through structured questionnaires and interviews with business owners, managers, and financial officers. The questionnaires were designed to capture information on business demographics, tax compliance, the perceived impact of taxation policies, challenges faced, and the strategies used to cope with the tax burden (A. Nafiu et al., 2012). A total of 120 completed questionnaires were returned, representing an 80% response rate (Olanrewaju, Waititu, & Nafiu, 2021). In addition to the questionnaires, interviews were conducted with a select group of business owners who provided deeper insights into their experiences with the tax system. The interviewees were chosen using purposive sampling to include individuals with significant experience in SME management and taxation (Anwar et al., 2022).

The data collected from the questionnaires were coded and entered into SPSS (Statistical Package for the Social Sciences) for analysis (Nelson et al., 2022). Descriptive statistics, such as means, frequencies, and percentages, were calculated to summarize the demographic data and the views of SMEs on taxation policies. Inferential statistics, including multiple linear regression analysis, were employed to examine the relationship between taxation policies and SME growth (Abiodun et al., 2022). The independent variables included in the regression analysis were tax rates, complexity of tax procedures, awareness of tax incentives, and tax compliance levels, while the dependent variable was the growth of SMEs, measured in terms of profitability, business expansion, and employment generation (Olanrewaju, Waititu, & Abiodun, 2021).

Additionally, STATA (Statistical Software for Data Science) was used for further data analysis, particularly for robustness checks (Nelson et al., 2023). STATA provided advanced tools for hypothesis testing, including the calculation of p-values, t-statistics, and confidence intervals to assess the reliability of the results. The regression outputs from STATA were interpreted to determine the strength and direction of the relationships between taxation variables and SME growth (Nafiu et al., 2012). The results were presented in terms of standard errors, coefficients, t-values, and p-values to establish statistical significance. To ensure the validity and reliability of the results, several diagnostic tests were conducted (Nafiu, 2012). Multicollinearity was checked using the Variance Inflation Factor (VIF), and heteroskedasticity was tested using the Breusch-Pagan test. The Durbin-Watson statistic was also calculated to assess autocorrelation in the regression model (Olanrewaju, Lukman Abiodun, Muse, et al., 2021). Qualitative data

from the interviews were transcribed and analyzed using thematic analysis. Key themes related to tax challenges, tax compliance strategies, and the impact of taxation on business expansion were identified and coded. These qualitative insights complemented the quantitative findings, providing a deeper understanding of the real-world experiences of SME owners and their perspectives on how tax policies affect their business growth.

Results

Table 1: The impact of tax rates on the growth and profitability of small businesses in Kampala.

Variable	Coefficient	Standard Error	t-Statistic	p-Value
Intercept	2.1	0.5	4.2	0
Tax Rates	-0.18	0.05	-3.6	0.001
Capital Investment	0.25	0.07	3.57	0
Business Size	0.15	0.06	2.5	0.015
R ²	0.62			
Adjusted R ²	0.61			

Source: Primary Data, 2025

The regression results suggest a negative relationship between tax rates and the growth and profitability of small businesses in Kampala. The coefficient for tax rates is -0.18 with a p-value of 0.001, indicating that an increase in tax rates negatively impacts profitability. Capital investment and business size both positively contribute to business growth, with significant coefficients of 0.25 and 0.15, respectively. The model explains 62% of the variance in business growth and profitability, as indicated by the R² value.

Table 2: The effect of the complexity of tax procedures on the operational efficiency and compliance of small businesses in Kampala.

Variable	Coefficient	Standard Error	t-Statistic	p-Value
Intercept	3.2	0.4	8	0
Complexity of Tax Procedures	-0.32	0.08	-4	0
Owner's Education Level	0.18	0.05	3.6	0.002
Tax Compliance	0.22	0.07	3.14	0.003
R ²	0.59			
Adjusted R ²	0.58			

Source: Primary Data, 2025

The regression analysis reveals a significant negative relationship between the complexity of tax procedures and the operational efficiency and compliance of small businesses in Kampala. The coefficient for complexity is -0.32, with a p-value of 0.000, suggesting that more complex tax procedures hinder operational efficiency and tax compliance. The owner's education level and tax compliance both positively influence efficiency and compliance, with coefficients of 0.18 and 0.22, respectively. The model explains 59% of the variance in operational efficiency and compliance.

Table 3: The role of tax incentives and exemptions in supporting the growth and sustainability of small businesses in Kampala.

Variable	Coefficient	Standard Error	t-Statistic	p-Value
Intercept	1.5	0.6	2.5	0.018

Tax Incentives & Exemptions	0.45	0.1	4.5	0
Business Experience	0.2	0.09	2.22	0.028
Access to Financial Resources	0.3	0.08	3.75	0
R ²	0.71			
Adjusted R ²	0.695			

Source: Primary Data, 2025

The analysis demonstrates a positive and significant relationship between tax incentives and exemptions and the growth and sustainability of small businesses. With a coefficient of 0.45 (p-value = 0.000), tax incentives significantly contribute to business sustainability. Furthermore, business experience and access to financial resources also positively impact business growth, with coefficients of 0.20 and 0.30, respectively. The R² value of 0.710 indicates that the model explains 71% of the variance in business growth and sustainability, suggesting that tax incentives are crucial for the success and longevity of small businesses in Kampala.

Conclusions

The study found a significant negative relationship between tax rates and the growth and profitability of small businesses in Kampala. Higher tax rates were shown to reduce business profitability, which indicates that taxation policies that impose higher rates can have a detrimental effect on small business success. However, business size and capital investment were positively associated with profitability, suggesting that larger businesses with higher capital investments tend to perform better despite higher taxes.

The complexity of tax procedures was found to negatively affect the operational efficiency and tax compliance of small businesses. More complex tax processes were shown to hinder business operations, causing inefficiencies and reducing the willingness and ability of businesses to comply with tax requirements. Additionally, the education level of business owners and tax compliance were positively linked to improved operational efficiency, highlighting the importance of simpler tax processes and educated business owners in enhancing business performance.

Tax incentives and exemptions were found to have a positive impact on the growth and sustainability of small businesses in Kampala. Businesses that benefited from tax incentives were more likely to experience growth and sustainability. Access to financial resources and business experience also positively contributed to business growth, further emphasizing the role of supportive taxation policies in fostering small business success.

Recommendations

Policymakers should consider revising tax rates for small businesses to create a more favorable environment for growth. Lowering tax rates, particularly for small businesses with limited capital, could help improve profitability and enable reinvestment in business expansion. The government could explore creating tiered tax structures that are more accommodating to small business owners.

To improve tax compliance and operational efficiency, the government should simplify tax procedures and provide clearer guidelines for small business owners. Implementing user-friendly tax filing systems and offering training or workshops on tax compliance could reduce the administrative burden on small businesses, making it easier for them to comply with tax regulations.

The government should expand the availability of tax incentives and exemptions for small businesses, particularly those in emerging industries. Providing targeted incentives, such as tax breaks for start-ups or businesses in high-growth sectors, can help enhance business sustainability and support long-term growth. Special focus should be given to businesses that meet certain criteria, such as job creation or innovation.

Small businesses could benefit from additional financial support and technical assistance in managing tax obligations. Collaboration between the government and financial institutions could help offer low-interest loans or grants to small businesses to offset the challenges posed by taxation policies. Additionally, providing more business advisory services to help small businesses navigate tax systems and financial planning will be crucial.

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