

Taxation And Performance Of Small And Medium Sized Enterprises In Uganda; A Case Study Of Kebisoni Town Council, Rukugiri District

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ABSTRACT

The study aimed at taxation and performance of small and medium sized enterprises in Uganda; a case study of Kebisoni town council, Rukugiri district and it was guided by the following objectives; To examine the relationship between tax compliance and the business performance of SMEs in Kebisoni Town Council, Rukugiri, to assess the relationship between tax rates and the business performance of SMEs in Kebisoni Town Council, Rukugiri and to analyze the relationship between tax incentives and the business performance of SMEs in Kebisoni Town Council, Rukugiri. A descriptive research design was adopted for the study since it focuses on the people as well as their attributes which enable the investigator to understand and examine the influence of taxation on SME performance. This was achieved using a survey questionnaire, observation schedule, and document analysis. The study population concentrated on Managers and employees of SMEs in Kebisoni Town Council. The study area was limited to this one SME in Rukugiri since the majority of the SMEs are established in urban areas. The findings in table 2 above reveal that tax rates had a significant effect on the performance of SMEs in Kebisoni Town Council since p – value (.000) was less than the significance level. The correlation coefficient (0.689) shown a strong positive relationship between tax rates, and the performance of SMEs in Kebisoni Town Council. Tax rates have a statistically significant strong positive effect on the performance of SMEs in Kebisoni Town Council, Rukugiri, Uganda. 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. This will lower the cost of production for the goods and services which will eventually ensure favorable prices for the goods and services being provided to the customers and thus increase sales turnover and the performance of SMEs in Uganda.

Key words: taxation, performance, small and medium sized enterprises

Background to the study

Taxation in Uganda has also been influenced by World Bank policies to promote economic growth and development (Brian & Jacob, 2023). The Ugandan government has transformed a number of tax policies to support the growth of small and medium-sized enterprises through the harmonization of tax rates and the formulation of new tax incentives, including to prevent double taxation and tax evasion. However, with all these tax reforms, Uganda still lacks a well-known clear

national tax policy for SMEs (Ramadhan et al., 2023). Recent tax policy focuses only on legal requirements regarding the administration of the tax regime instead of providing strategies to support the performance of SMEs in Uganda (Turyatamba et al., 2022). The taxation system used in any country determines the performance of businesses, with countries with favorable and progressive tax rates promoting successful businesses (Tasha et al., 2023). The scholar further argues that successful

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businesses have influenced the growth of economies by ensuring equitable distribution of income and investment in the country (Oromo et al., 2023). In essence, businesses and taxation are interdependent for survival in that when business performance is affected, the growth of the economy is equally affected (Faridah et al., 2023). According to the Ministry of Finance, Planning and Economic Development (MFPED), small and medium enterprises are defined as businesses employing 5 to 50 people with an annual turnover/revenue of up to 360 Ugandan shillings (USH.) million and a "medium-sized enterprise" as a business employing more than 50 people with annual turnover or assets between (USH.) 360 million and 30 billion (Alex & Kazaara, 2023). However, there is no globally accepted definition of SMEs as these businesses vary from country to country, for example the European Union defines small businesses as businesses that employ between 10 and 50 employees and have an annual turnover and/or balance sheet total of less than €10 million. while medium-sized enterprises as enterprises that employ 20-250 employees and a turnover and/or an annual balance sheet of 10-50 million EUR (Winny et al., 2023). Small and medium enterprises are important for the growth of society (Frank et al., 2023). These businesses have increased economic growth and development through; the supply of jobs that reduced unemployment, the solution to demographic problems associated with a high population, contributing, among other things, to the generation of domestic income

Statement of the problem

Rukugiri Town Council is one of the town councils that make up the town of Rukugiri, Uganda. The town council derives its name from Rukugiri, where the town council headquarters is located. The town council is a hub for small and medium enterprises and represents more than 25% of the more than 200,000 businesses that operate in Rukugiri town (Wegulo et al., 2023). Businesses in Uganda pay various types of taxes ranging from customs duty, excise duty, value added tax,

(Ramadhan et al., 2023). Small and medium enterprises account for about 90% of private sector output, which has greatly boosted the economy in Uganda. Small and medium enterprises have boosted the economy by creating new jobs and generating income among other things. However, SMEs face challenges from limited size and resources that have affected their operations. This is currently mitigated through; providing business development services (BDS) to build capacity and increase their performance in the areas of business planning, technology, communications and other services (Lydia et al., 2023). With over 80% of SMEs in Uganda located in urban areas, this study contextually examined SMEs in Rukugiri Town Council, located in Rukugiri, Uganda (Racheal et al., 2023). SME provides credit services to its clients in the form of discounted quick loans at a favorable interest rate. According to the views of various authors on taxation and business performance, it should be noted that high taxes and poor tax policies have negatively affected the performance of small businesses (Polycarp et al., 2023). This is complemented by (Sebikari, 2014) who stated that taxation not only reduces the capital of small firms but also hampers their performance, making tax incentives paramount to the survival of small firms. These, among other factors, hamper the growth of SMEs, although this study is concerned with the effect of taxation on the performance of SMEs in Uganda (Ntirandekura et al., 2022).

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corporation tax and stamp duty among others (Gracious, 2023). These taxes are the main source of revenue for government services and administration. These taxes are reported to have a negative effect on business performance. Coupled with bad tax policies and high rates, businesses still struggle to stay alive for more than five years.

However, through its efforts to support small and medium enterprises, the government has enacted tax policies to support and promote the performance of small and medium enterprises. This tax policy focused on the harmonization of tax rates and the introduction of new tax incentives to support small businesses (Allan et al., 2023). With the taxes collected, the government is able to provide social services in the city such as roads, street lights, security, drainage channels, etc. (Isaac et al., 2023). Taxes also enable the government to build public infrastructure, support healthcare, public insurance and public education. Despite the Ugandan government's efforts to enhance the growth and performance of SMEs, taxation still remains a major obstacle to these efforts as taxes continue to affect the performance of SMEs (FSD Uganda, 2019). Taxes reduce the profits of SMEs by increasing operating costs, thereby crippling business survival (Moses et al., 2023). Taxes also discourage hard work, are inconvenient and unpopular with SMEs. This explains why most SMEs in Uganda do not survive five years after inauguration, indicating poor performance in the SME sector (Sebikari, 2018; MFPED 2017). Taxes discourage innovation and leave entrepreneurs under pressure. This study will therefore investigate the effect of taxation on the performance of SMEs in Rukungiri Town Council, Rukungiri Town.

Purpose of the study

The purpose of this study was to examine the effect of the taxation policies on the performance of Small and Medium Enterprises in Rukungiri.

Specific objectives of the study

1. To examine the relationship between tax compliance and the business performance of SMEs in Kebisoni Town Council, Rukungiri.
2. To assess the relationship between tax rates and the business performance of SMEs in Kebisoni Town Council, Rukungiri.
3. To analyze the relationship between tax incentives and the business performance of SMEs in Kebisoni Town Council, Rukungiri.

Methodology

A research design is a strategy for conducting the research that specifies the procedures necessary to obtain the information needed to structure and solve the research problems (Cooper and Schindler, 2003). The descriptive design was adopted, which aimed at examining the effect of taxation on the performance of small and medium scale enterprises in Uganda. A descriptive research

design was adopted for the study since it focuses on the people as well as their attributes which enable the investigator to understand and examine the influence of taxation on SME performance. This was achieved using a survey questionnaire, observation schedule, and document analysis. The study population concentrated on Managers and employees of SMEs in Rukungiri Town

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Council. The study area was limited to this one SME in Rukugiri since the majority of the SMEs are established in urban areas. Based on the Krecjie and Morgan (1970) sampling table the researcher selected a sample size of 50 respondents from a population of 65 registered employees with the help of purposive sampling (Chuan,2006). This in accordance with Morgan Kreijic, (1970) sample determination table. The study employed both probability and non-probability sampling techniques. The researcher used the probability sample since the research is focused on the entire SME population. Employees employed in SMEs in Kebisoni Town Council were eligible to participate in the study. The simple random sampling technique was also used such that all population elements were accorded a proportionate likelihood of being nominated within the sample. The questionnaire is an effective method of data collection due to the following advantages: it is standardized since the same wording is used each time it's administered; it ensures confidentiality through use of a coding system. Thus, it can cover embarrassing, socially undesirable or illegal topics; it is cheaper to administer among others (Barker et al., 2002). The method was used to collect data from middle-level staff and other lower-level staff within the SME because they were directly involved in the operations of the organization. Self-Administered Questionnaires (SAQ) was employed to gather data from the study elements in a structured manner. SAQs with one open ended question per section was designed for SME employees to give additional or express their mind while

the rest were close-ended aimed at testing perception using a five-point like scale measuring from Strongly Disagree as response 1, Disagree as response 2, Not sure as response 3 Agree as response 4 and Strongly Agree as response 5 for easy measurements of variables (Jackson, 2009). This is the process of bringing order, structure, and meaning to the mass of raw information gathered for purposes of getting a feel for reliability and testing the research questions (Sekaran, 2004). Initially, data was entered into MS Excel computer program for cleaning. The data was also imported to SPSS version 23 statistical software for investigation (Nelson et al., 2022). Quantitative data analysis entailed descriptive statistics and inferential statistics. Descriptive statistics involved analysis using frequencies, percentages, mean, charts, and standard deviation. The Analysis of central tendency and dispersion based on; a 5-point likert scale ranging from strongly agree to strongly disagree. Similarly, inferential statistics were done based on the Pearson's correlation coefficient and linear regression analysis. Quantitative data was analyzed by reporting of summary results in numerical terms and was presented using a percentage distribution technique but maintaining a specified degree of confidence (Creswell, 2013). While Qualitative data was analyzed in the form of texts and themes, yet impressions was examined and presented using descriptive methods for in depth analysis to be generated from views of the respondents and to allow the reader to make their opinions freely (Bryman & Bell, 2003).

RESULTS

Table 1: Correlation matrix for tax compliance and the performance of SMEs

	Tax	Performance of

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		compliance	SMEs
Tax compliance	Pearson Correlation	1	.595**
	Sig. (2-tailed)		.000
	N	50	50
Performance of SMEs	Pearson Correlation	.595**	1
	Sig. (2-tailed)	.000	
	N	50	50

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

Source: Primary data, 2022

The study findings table 1 above will show that tax compliance significantly affects the performance of SMEs in Rukugiri Town Council since p- value (.000) is less than the significance level. The correlation coefficient is (0.595) which implies that there is a moderate positive relationship between tax compliance and the performance of SMEs. Therefore, according to the results, tax compliance has a statistically significant moderate positive effect on the performance of SMEs. So, in order to enhance the performance of SMEs in Uganda, the government will need 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 (Christopher, Moses, Muhindo, & Muhammad, 2022).

Table 2: 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	50	50
Performance of SMEs	Pearson Correlation	.689**	1
	Sig. (2-tailed)	.000	
	N	50	50

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

Source: Primary data

The findings in table 2 above reveal that tax rates have a significant effect on the performance of SMEs in Kebisoni Town Council 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 performance of SMEs in Rukugiri Town Council. Tax rates have a statistically significant strong positive effect on the performance of SMEs in Kebisoni Town Council, Rukugiri, Uganda. Therefore, answering the question of how Tax rates significantly affect the business performance of SMEs in Kebisoni Town Council,

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Rukugiri.” 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 this plays a key role in the performance of SMEs in Uganda (Christopher, Moses, Muhindo, & Komunda, 2022). **Table 3: Correlation matrix for tax incentives on the performance of SMEs**

		Tax incentives	Performance of SMEs
Tax incentives	Pearson Correlation	1	.776**
	Sig. (2-tailed)		.000
	N	50	50
Performance of SMEs	Pearson Correlation	.776**	1
	Sig. (2-tailed)	.000	
	N	50	50

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

Source: Primary data, 2022

Table 3 reveals that tax incentives have a significant effect on the performance of SMEs in Kebisoni Town Council, Rukugiri 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 (Nelson et al., 2023). Therefore, tax incentives have a statistically significant positive effect on the performance of SME’s in Kebisoni Town Council, Rukugiri which confirms the hypothesis that “Tax incentives significantly affect the performance of SME’s in Kebisoni Town Council, Rukugiri as earlier stated. And thus, tax incentives are paramount towards the growth and performance of SMEs in Uganda, therefore, the government should strengthen these tax incentives through enhancing the provision of investment deductions and allowances, tax holidays, special tax regimes among other tax incentives which will boost the performance of SMEs in Uganda.

Table 4: Regression analysis of the study variables

Unstandardized Coefficients			Standardized Coefficients		
Model	B	Std. Error	Beta	t	Sig.
(Constant)	.627	.269		2.329	.023

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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, 2022

Table 4 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) reveals that the study variables have a strong positive relationship with the performance of SMEs (Christopher, Moses, Muhindo, & Komunda, 2022). Thus, the study variables explain 68.4% of the performance of SMEs in Kebisoni Town Council, Rukugiri, Uganda. The findings further reveal 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.

Conclusions

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.

Based on the findings, the researcher concludes 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.

From the study findings, the researcher further concludes 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 a 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.

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Recommendations of the study

During the study, it found out that in order to promote the performance of SMEs in Kebisoni Town Council, Rukugiri, 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.

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. This will lower the cost of production for the goods and services which will eventually ensure favorable prices for the goods and services being provided to the customers and thus increase sales turnover and the performance of SMEs in Uganda.

According to the findings, this research will recommend 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. In addition, the tax incentives will help to protect and stimulate infant small and medium enterprises since these infant firms are unable to meet their tax obligations in their early years of operation due to the small capital base and lack access to financial loans. Therefore, the tax incentives implemented by the government will support these small and medium firms which eventually stimulate the performance of SMEs in the economy.

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