

TAXATION AND THE GROWTH OF SMALL AND MEDIUM ENTERPRISES IN VOI SUB COUNTY, KENYA

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Abstract

The main aim of the paper was to determine the influence tax on SMEs sector growth in Voi sub-County, Kenya. The investigation utilized a descriptive research design. The population of this study was managers, owners and employees of selected SME's in Voisub County. A stratified sampling method was employed to determine a sample of 626 study participants. The primary data obtained using questionnaire was analyzed using descriptive statistics and multiple regression model. The study established a significant correlation between taxation and the growth of the SMEs sector. From the findings of the study it was concluded that high tax rates have a significant effect on the growth of SMEs. The better the tax rates the more the SMEs grow. If the tax rates are high, the profit margins of the firms becomes too small to improve on the scale and size of the business as the SMEs will hardly have enough capital to re-invest. It can be also concluded that better tax policies have a positive effect on the growth of SMEs. Types of taxes are concluded to have a significant effect on the growth of SMEs. Since the types of tax are determined by the level of income that the SMEs receive, if better and favorable types of taxes are adopted, then they would boost expansion of SMEs. It is the recommendation of this research report that more friendly tax policies be employed for startup businesses such as tax holiday, or introducing a growth limit with a level that is sufficiently stable to sustain payment of taxes. The study is further of the view that the Tax agency, KRA, need to review its taxation procedures as well as heightened research on firm's management procedures, the role of taxation policy and distribution of taxes in micro enterprises.

Keywords: Tax Rates, Tax Policy, Taxation, Small and Medium Enterprises, Growth

INTRODUCTION

Organizations growth and tax policies enormously rely upon each other for survival of changes lately. With the assistance of different studies and research done by tax specialists, tax laws are being checked on with the point of repulsing obsolete clauses and simplifying the primary ones. Under current Kenyan laws, tax assessment is authorized by two levels of the administration, i.e. National government and county government with responsibilities of each in matters taxes and levis well cut out (Karingi, 2005).

The desire to have an enlightened state with strong as well as sound economy is a fantasy for most nations including Kenya. Tax installment is the show of such longing, though some income workers view it as techniques for abuse by the decision powers. Tax Payment is a required duty forced by the organization on singular wage laborers, associations, money related authorities, exporters, and merchants (Murphy, 2005). Income got from tax gathering is an imperative wellspring of income to the legislature of Kenya, and everything considered is fundamental instrument used as a piece of change of Kenya and her economy. A country's tax approaches and frameworks are immensely related with the business wanders in the country. An economy that sanctions good and dynamic tax laws and strategies will breed productive and finance strong business affiliations (Coso, 2002).

When business thrive, the economy prospers also, as there is no speedier method for mixing up the issues of economy without help of associations that move administrations, merchandise, cash and ventures from those with and products (Baurer, 2005). Basically, Small business enterprises are for the most part perceived as imperative drivers of monetary achievement. They are key element of a solid economy, as job creators, sales generators and source of tax income. In Kenya, the significance of small ventures as job creators, especially for those with low skills level, is broadly perceived. SMEs contribute 45% of Kenya's gross domestic product (GDP) and utilize around 98% Of the workforce in the private sector. In the course of the most recent couple of years the development of SMEs work has surpassed the development in their commitment to the GDP the motivation behind why the Kenyan government has been strikingly supporting them through monetary organizations credit lending (ROK, 2015).

Taxation is the key source of revenue that the government of Kenya uses to provide public services to its citizenry. Over the last decade tax performance in Kenya has significantly improved in nominal terms averaging about 24% of the size of the economy. This has enabled the government to finance 60% of the budget. Due to its importance, tax policy debates and decision making becomes a critical issue to the public, to businesses and the economy at large owing to the varied impact that it will have on each of these entities (Mutua, 2011). Regulations

and tax policies are accounted for to be one of the hindrances of expansion small enterprise in Kenya and globally. Nonetheless, these undertakings like the rest of businesses in Kenya are obligated to various types of taxes paid at various phases of the business. For purposes of this study, the emphasis is put on how the tax rates, tax policies and various types of taxes affected growth of small and medium sized enterprises (ROK, 2007).

Therefore the design and performance of the tax system has implications for inequality and as such it is the role of the government to ensure that it pursues an fair tax system for equitable distribution of income and welfare of the citizens. The other important benchmarks for assessing the tax system include simplicity, adequacy and neutrality. The tax system will hitherto passing the new Constitution of Kenya 2010 reflects a two tier system of government comprising the national and 47 county governments.

Income tax rates that are charged on small and medium enterprises are not accurate. In many instances, the tax rates are computed with lack of assessment of the actual revenue of an entity, despite these entities making losses. In addition, business rates have been enhanced since the introduction of devolved government hence increasing the tax burden to most small and medium sized enterprises. Profit maximization is the major goal of every small scale enterprise. However, this is not always the case as big percentage of them are not able to attain this goal (Patricoff, 2005). Income tax administration contributes greatly with regard to revenue collection and profitability of all entities. In a bid for the state to improve its tax base, the tax burden for majority of organizations increases. In spite of this, the tax administration system is often poor, the tax liability is based on mere estimates, incomplete record of SMEs, with some missing out completely, a situation that lead to tax overcharge and penalties. In return, this has a direct impact on the growth of the enterprise and may threaten its survival because taxes are paid out of profits (Murphy, 2008).

Kazemy(2011),evaluated the effective factors on survival of SME's, a case study of Iran. Their findings showed that human, marketing and financial factors were effective for the survival of the SME's in the studied population. As evidenced above, other research have focused on several other factors. Studies have shown that the SME sector in Kenya is a strong contributor to the national Gross Domestic Product. (McCormick & Dorothy 1988).However most studies in the past on SMEs and their growth have focused on accessibility to credit and inflation in the country as the main factors inhibiting growth and development of SMEs in Kenya. .It should be noted that the current government has promised to provide 1 million jobs to the many unemployed youths in the next 5 years and the government has identified the SME sector as the one to provide these jobs. This promise comes at the back drop of a similar promise by the previous government and out of which nothing much was achieved. However, there exists

an academic gap in that while it is indisputable that these studies are important since they address factor that influence growth of SME's, they do not address whether taxation affects growth of Small and Medium Enterprises- whether firms are more or less profitable from taxation . thus, the study hypothesized that;

Ho1: There is no significant effect between tax rates and the growth of small and medium enterprises in Voi sub County, Kenya.

Ho2: There is no significant effect between tax policy and the growth of small and medium enterprises in Voi sub County, Kenya.

Ho3: There is no significant effect between types of taxes and the growth of small and medium enterprises in Voi sub County, Kenya.

LITERATURE REVIEW

Theoretical Review

Economic theory of tax compliance are also termed as deterrence theories. As indicated by Trivedi and Shehata (2005), the hypothesis propose that citizens "play the audit lottery," that is they make counts of the financial outcomes of various agreeable options, for example, whether to engage in tax evasion practices, chances of being detected and the resulting repercussion and make the decision they feel increases their expected profits or revenues after tax. The hypothesis propose that citizens are moral utility maximizers; subsequently, financial hypotheses underline expanded audits and penalties as an answer for consistence issues. Monetary based examinations recommend that citizens' conduct is influenced by financial thought procedures, for instance the benefit amplification and possibility of identification (Trivedi and Shehata, 2005), underreporting (Erard and Ho, 2002), commercial wage citizens working in informal economy (Etchberry, 1992) among numerous variables. This hypothesis consequently give us the base of this research.

Empirical Review

As per Karingi (2005), encounters in the recent times have demonstrated that SMEs are undeniably the development motors of the continent's economy and consequently the Kenyan authorities place the issue of the SME at the top of their agendas. Sufficient evidence has been adduced to the effect that coming out of monetary and financial crisis requires the small enterprises. This lead to the need to nurture them.

The SMEs tax is one measure meant to nurture them. This tax was set toward another path in the income tax structure. Despite this certain segments of the structure that has been subjected to legislative process may regardless be balanced through the ordinary communal

and lawmaking prudent dialog, be that as it may consolidate – other than a more perfect duty rate – two computed contrasts whether the assessment claimed on essential purchaser items in the VAT charge 2013 was extraordinary or figuring for money impose in perspective of cash streams will bolster the SMEs (Keen, 2004).

As indicated by Moore(2004),Tax regimes and taxation of SMEs have turned out to be gradually up-to-date and administrations all over the globe have tried to oblige and give a way to such organizations to take part in standard monetary movement in a true blue manner. Already, tax organizations had contended that the cost of enlisting these ventures and handling their profits far surpassed the benefits as far as income yield.

This holds where such institutions are mandated to take an interest in the conventional taxpaying administration and this has encouraged a critical move worldwide to offer disentangled directions for this classification of citizens. Cost versus advantage is as yet a vital issue that should be deliberately adjusted. Nonetheless, a better balance is significantly encouraged where an improved administration is actualized (Lumumba, 2010).

There is a developing mindfulness that tax frameworks can go past simply opening up income gathering however completed the medium-to longer-term can ingrain a more elevated amount of tax compliance and make a stage to help undertaking and business progression. Over the span of time, recognitions with respect to small organizations have changed. In the late 70's, such organizations were normally seen as interminable duty avoiders and evaders. With the happening to private division drove change perspective through the middle of the 1980, the SMEs addressed an increased and rising degree of GDP both in third world nations and established States completing into much highlight on saddling these associations (James, 2002).

Summary of Literature review and Research Gaps

Fitting approaches have been made by the World Bank in improving tax strategies .In making an empowering and appropriate condition for the accomplishment of organizations, government change taxes to attire long haul monetary goals. Be that as it may, examined into tax arrangements by asking these three inquiries: How much cash should government assemble as taxes? By what method can tax liabilities be conveyed among potential taxpayers? In what manner can the financial cost of taxation be consumed or limited? Independent of these inquiries on tax strategies, tax approaches ought to create a tranquil situation in which SMES can extend their operations (Baurer, 2005).

According to Tomlin (2008), expert analysts hold that the assets littler organizations coordinate in the direction of tax compliance are assets that could some way or others be

employed in reinvestment, enhancing future economic growth. Subsequently, the position held is that duties as well as mind boggling tax structure set lopsided burden on minor institutions. Lesser taxpaying institutions and people under this arrangement are beleaguered, as the compliance inevitabilities, charge of compliance and rate of taxation are equivalent to those of huge ventures.

Cutting down on expenses incurred in driving compliance and tax rate expands the little endeavors general revenue. It moreover develops the Government's income tax, since the enhanced courses of action for a scaled down scale try certainly diminishing the measure of the shadow economy and the amount of non-going along listed taxpayers (Vasak, 2008). Besides, SMEs for the most part should operate under coercive administrative conditions with the numerous administrative organizations, multiple taxes, lumbering ingress mean and exorbitant costs that always add the operations.

A highly multifaceted administrative structure and duty policy or one misty in its organization and implementation makes fulfilling tax obligations excessively repressive (Masato, 2009). This outcome in a tax structure that achieves high expenses on the overall economy. A pitiful tax structure moreover encourages low adequacy, high amassing charges, and the deviation of perfect portion of advantages (Farzbod, 2000).

According to Evans (2003), existing literature well articulate the fact that medium enterprises are greatly impacted upon by costs such as being taxed in terms of their operations or resource capacity, and their cost of complying are much more as compared to the established institutions. There are numerous elements mitigating against Medium enterprises tax compliance including the high rates of the taxes, lack of effectiveness, and high cost of collection as well as the lack of adequate measures to curb evasion.

RESEARCH METHODOLOGY

The research embraced a cross sectional study approach that depended on the utilization of descriptive and quantitative designs used in the foundation of the connection between tax organization, and the execution of the SME's. The target population of this study was 5,912 comprising of business owners, managers and employees of Small and Medium Enterprises spanning eight industries according to the local Authority Integrated Financial Operations Management Systems Business Activity Code Summary. Using the formula by Mugenda and Mugenda (2003), a sample size of 626 was established. Primary and secondary data sources were used to obtain relevant data. Secondary data for this investigation was obtained from sources such as libraries, documented records from the County workplaces, records of those little scale undertakings, government productions, online data, reading material, daily papers,

and unpublished research reports. Self-directed questionnaire was utilized to collect primary data. Cronbach's alpha method was used to measure the internal consistency of the scale. A scale is considered reliable for a given sample if the Cronbach's alpha value is greater than 0.7. Cronbach's Alpha is a reliable coefficient that indicates how well items are positively related to one another. Cronbach's alpha values of 0.7 and above is considered adequate, the average Cronbach's Alpha value was 0.752 as shown in table 1 meaning the items under each variable, were consistent.

Table 1: Reliability test

Variable	Cronbach's Alpha	No of Items
Tax rate	.8258	
Tax policy	.8435	
Growth of SMEs	.704	4

Quantitative information was broke down by utilizing illustrative insights and inferential investigation utilizing Statistical Package for Social Sciences (SPSS) version 20. Regression analysis was conducted to examine the weight of each variable against the dependent variable. Growth of SMEs was regressed against three variables tax rate, tax policy and types of taxes. The equation was expressed as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Where:

Y = Growth of SMEs

β_0 = constant (coefficient of intercept)

X_1 = Tax rate, X_2 = Tax policy, X_3 = Types of taxes

β_1 , β_2 , β_3 = regression coefficient of Tax rate, Tax policy and Types of taxes respectively.

ε = Error term

FINDINGS

The research question tries to answer the three major components of tax administration, which include; identification of the taxpayer, assessment of income tax, and finally collection of tax dues, which are the bases upon which income tax, is administered. The study participants were asked to answer the question of whether they usually assessed their business for income tax purposes. This also shows how often they are supplied with the tax assessment forms. It was identified that most of the respondents are usually assessed their business for income tax purposes with 36%-48% agreeing that income tax is carried out on their businesses. This

implies that Voi sub-County carries out assessment of the small-sized enterprises before taxation.

The participants were required to answer on whether they obtained any form of assistance as regards tax awareness from the tax authorities. 68% did not receive any form of assistance and 32% said they received some assistance. Those who had received said it was in form of manuals, radio talk shows, meaning that there were very few workshops that could have had a bigger impact in creating awareness to the taxpayers. This information is also represented in the chart.

Income tax returns and computations

The respondents were asked how often they make income tax returns and if they are aware of income tax computations. This was shown using tables showing the percentages of respondents.

Table 2: Income tax returns and computation

Period	Number of respondent	Percentage(%)
Weekly	0	0
Monthly	157	28
Quarterly	135	24
Half yearly	112	20
Yearly	67	12
Do not know	91	16
Total	562	100

From the above table, 16% do not know how to compute income tax returns due to mainly due to lack of sensitization. The highest percentage of respondent was found to be filing tax returns on a monthly basis as it was the most convenient compared to all the other options.

Income tax administration and the growth of small-scale businesses in Voi

Respondents were asked as to whether income tax affects their level of performance (growth). The researchers aim was to find out the relationship between income tax administration and profitability as the major objectives of the study. The responses below was got. The researcher was interested in finding out if income tax administration impacted adversely on the performance of small scale businesses and how it affects profitability of the business. The response was as follows.

Table 3: Other causes of trend performance

Cause	Number of respondents	Percentage(%)
Stiff competition	135	24
Political environment	22	4
Unfavorable economic conditions	90	16
Poor income tax administration	225	40
Others	90	16
Total	562	100

Table 3 shows that the variations in the trend performance is mainly attributed to the different causes of poor business performance which may arise due to some of the above factors which show that most (40%) of the respondents are affected by poor tax administration which has greatly affected their profitability levels.

Correlations analysis

It is clear there is a significant positive relationship between tax rate and tax policy ($r=0.625$, $p<0.05$). This is because the various tax rates are stated in the tax policy. Tax rate and types of tax were found to have a significant moderate positive relationship ($r=0.514$, $p<0.05$). This could be due to the fact that every type of tax usually has a specific tax rate attached to it. Furthermore, it was found that types of taxes and tax policy had a significant weak positive relationship ($r=0.357$, $p<0.05$).

The findings presented clearly indicated that there was a significant strong negative relationship between growth of small scale businesses and the tax rates in Voi sub County. This is indicated by the Pearson correlation coefficient $r = - 0.826$ and $p<0.05$. This is interpreted to mean that as more taxes are imposed on SME's results to lower Growth rate of SMEs. Growth of SMEs and the tax policy were found to have a significant strong positive relationship ($r=0.712$, $p<0.05$). This is interpreted to mean that the better the tax policies, the better the growth trends for SMEs. The government should therefore come up with good tax policies on small scale businesses if they are to stimulate their growth. The types of taxes were found to have a significant moderate positive relationship with the growth of SMEs ($r=0.532$, $p<0.05$). This was interpreted to mean that the different types of taxes affect the growth of SMEs to different extents based on their level of sales turn-over among other factors.

Table 4: Pearson Correlation

		Tax rate	Tax policy	Types of taxes	Growth of SMEs
Tax rate	Pearson Correlation	1			
	Sig. (2-tailed)				
Tax policy	Pearson Correlation	.625**	1		
	Sig. (2-tailed)	.014			
Types of taxes	Pearson Correlation	.514**	.357**	1	
	Sig. (2-tailed)	.007	.035		
Growth of SMEs	Pearson Correlation	-.826**	.712**	.532**	1
	Sig. (2-tailed)	.000	.002	.043	

N=562

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

Regression Analysis

A multiple linear regression analysis was done to examine the relationship of growth with tax rates, tax policy and types of taxes. Table 5 below presents the values of R and R². The adjusted R² is the coefficient of determination. This value explains how growth of SMEs varied with the tax rates, tax policies and the types of taxes. The model summary table shows that 50.4% of change in growth of SMEs can be explained by three predictors namely tax rates, tax policies and the types of taxes an implication that the remaining 49.6% of the variation in growth in SMEs could be accounted for by other factors not involved in this study. In this study, R is 0.712, which is an indication of a strong positive correlation between the growth and the dependent variables namely tax rates, tax policies and types of taxes. Analysis of variance (ANOVA) was done to establish the fitness of the model used. The ANOVA table shows that the F-ratio (F=10.937, p=.000) was statistically significant. This means that the model used was a good fit.

Table 5: Regression Results Hypothesis Testing

	Unstandardized				
	Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	2.019	0.781		2.635	0.007
Tax rate	-0.952	0.219	0.813	2.921	0
Tax policy	1.989	0.185	1.636	3.569	0
Types of taxes	0.615	0.271	0.367	4.626	0

Summary Statistics

Table 5...

R	.712a
R Square	.0.507
Adjusted R Square	0.504
F	10.937
Sig.	.000b

a. Dependent Variable: Growth of SMEs

From the multiple regression results in the table above, the equation

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

becomes:

$$Y = 2.019 - 0.952X_1 + 1.989X_2 + 0.615X_3$$

Where:

Y = Growth of SMEs

β_0 = constant (coefficient of intercept)

X_1 = Tax rate X_2 = Tax policy X_3 = Types of taxes

$\beta_1, \beta_2, \beta_3$ = regression coefficients.

The estimated coefficients (β s) show the contribution of each independent variable to the change in the dependent variable. According to the regression equation established, holding all independent factors a constant then growth of SMEs will be average (2.019). This constant is significant in the model as it has $p = .007$ which is less than the 5% level of significance taken for this study. The coefficients table results show that tax rate ($\beta = -.952, p = .000$) negatively and significantly affected growth of SMEs in Voi Sub County. This is interpreted to mean that keeping all other independent variables constant, a unit increase in tax rate will lead to a 0.952 decrease in growth of SMEs. The results also show that tax policy ($\beta = 1.989, p = .000$) positively and significantly affected growth of SMEs at Voi Sub County. The coefficient is interpreted to mean that a unit improvement in tax policies will lead to a 1.989 increase in growth of SMEs all else held constant. Types of taxes ($\beta = 0.615, p = .000$) was found to be positively and significantly affect growth of SMEs at Voi Sub County. A unit increase in compliance to different types of taxes lead to a about a unit (0.615) increase in growth/performance of SMEs all else held constant.

The results further imply that tax policies contribute the most to the growth of SMEs. Better tax policies thus favor the growth of SMEs.

Hypothesis testing

Regression analysis also formed a basis for testing the hypothesis adopted in this study. This was done by considering the p values corresponding to each variable of interest in the Table

above. Therefore, based on the results of correlation of coefficient above we reject the null hypothesis that there is no significant effect between tax rates and growth of SMEs and conclude that there is significant effect between tax rates and growth at 5% level of significance as the p-value is 0.000. Consequently reject the null hypothesis that there is no significant effect between tax policies and growth of SMEs and conclude that there is significant effect between the two variables ($p=0.000$). Furthermore, the null hypothesis is rejected as there is no significant effect between types of taxes and growth of SMEs and conclude that there is significant effect between the two variables at 5% level of significance ($p=0.000$).

CONCLUSION

In conclusion, it was established that high tax rates have a negative effect on the growth of SMEs. The better (considerable) the tax rates the more the SMEs grow. If the tax rates are high, the profit margins of the firms becomes too small to improve on the scale and size of the business as the SMEs will hardly have enough capital to re-invest. It was also concluded that better tax policies have a positive effect on the growth of SMEs thus the more favorable the tax policies are, the better the growth trends for SMEs. Types of taxes are concluded to have a positive effect on the growth of SMEs. Since the types of tax are determined by the level of income that the SMEs receive, if better and favorable types of taxes are adopted, then they would boost expansion of SMEs.

RECOMMENDATIONS

From the findings of this study, we recommend that the government should set tax rates that are considerable so that SMEs and other investors can be motivated to expand their unlimited potential in the business world. This would in turn impact the economy of Kenya positively and the benefits would be passed on to all the citizens. The government should also seek to come up with a good tax policy that clearly defines and stipulates the tax procedures, governing acts, tax rates among other fundamental issues that influence taxes in and across the country's boundaries.

The types of taxes should be clearly defined and made depending on the size, nature, obligations and legal attachment of different businesses. Special treatment should be accorded to SMEs in developing the different types of taxes as they are the ones that are always close to the common citizen. Kenya revenue authority needs do more so in regard to sensitizing the public on tax rates, types of taxes and tax policies because people in business do little to enlighten themselves on income tax.

The owners of SMEs on their side should strive to understand their business environment which includes tax rates, tax policies and different types of taxes and device methods that will necessitate their growth while fulfilling their tax obligations. The county government should intensifying efforts in tax awareness campaigns to educate the public on the various types of taxes. This will increase the amounts of tax revenue collected which will ensure the provision of services to the general public.

This study was limited to a small area, that is, Voi Sub-County of Taita Taveta County. It is therefore recommended that further research be conducted on the same topic but capturing a bigger area and with some additional aspects of tax so as to ascertain their effects on the growth of SMEs in Kenya. This would give sufficient and efficient information under which better conclusions and worthwhile decisions can be made. The researcher recommends that a similar study be undertaken across the forty seven counties in the country in order to give an overview taxation and the growth of SME's across the country.

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