

**EFFECT OF TAXATION ON THE PERFORMANCE OF SMALL AND MEDIUM SIZE  
ENTERPRISES (SMES) IN NAALYA KIRA- MUNICIPALITY, WASIKSO DISTRICT:**

**A case study of Naliyaa Market**

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**UGANDA CHRISTIAN  
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**DECLARATION**

EMMANUEL IVU DRAMANI BISSO, hereby declare that this is my original research work and that it has never been presented to any University or any other Institution of higher learning for any academic award.

Signed by .....  .....

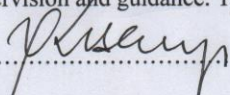
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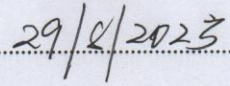
**APPROVAL**

This is to certify that EMMANUEL IVU DRAMANI BISSO undertook his a research work titled "The impact of Taxation on the performance of small and medium enterprise"

A case study of small scale businesses in Naliyaa market Kira municipality in wakiso district, under my supervision and guidance. This work is now ready for submission with my approval.

Signed by .....  .....

MR. KISENYI VINCENT.

Date.....  .....

## DEDICATION

This work is dedicated first of all to the Almighty God who gave me life, knowledge wisdom and good health to pursue my study, my father MARTIN DRAMANI DOMINIC, Mother VICKY LETIO, my aunt MARY ACHIRO SHEPHEN, Brother MOGA UMARI, SIMON IDDA, ANZO INNOCENT DRAMANI, TALUGA SHADRACK who contributed generously for my education, my Sisters ANNET MURAA, NAUMI ANZOA, LINDO CHARITY, ANDUWA JENIFER, AYURU GRACA, friends JAMES ALPHONES RAIMONDO who stand with me since the start this journey you supported me in all kind of support and you made me understand being friend is pointing out the wrong did that made me to stand by myself, and my lecture who start nurturing me since my stepping in this university MR BENARD OCHAN, ANTHONY AGUME

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## **Abstract.**

This research study investigates the impact of taxes on the financial performance of small scale businesses in Naaliya market-Kira municipality wakiso district Uganda. The study is motivated by the increasing tax burden on SMEs in Uganda, which has led to the winding up of some small scale business enterprises. The study employs a mixed-methods approach, including interviews, surveys, and observation, to collect data from SMEs in Naaliya market. The findings reveal that SMEs in Uganda face multiple taxes, including income tax, value-added tax, and local taxes, which significantly affect their financial performance. The study identifies tax policy, level of technology, government policy, tax ignorance, and level of infrastructure as the key independent variables that affect the performance of SMEs. The study recommends that the government should simplify the tax system, reduce tax rates, and provide tax incentives to SMEs to promote their growth and development. The study concludes that reducing the tax burden on SMEs is crucial for promoting economic growth, creating jobs, and reducing poverty in Uganda. This research study provides valuable insights into the challenges faced by SMEs in Uganda and offers practical recommendations to improve their financial performance.

## **LIST OF ABBREVIATIONS**

US\$: United States dollar

URA:	Uganda Revenue Authority
VAT:	Value Added Tax
GDP:	Growth Domestic Product
SSB:	Small Scale Business
UIA:	Uganda Investment Authority
ITA:	Income tax Act.
SMEs:	Small medium enterprise.
UGX:	Ugandan shillings.

## **CHAPTER ONE.**

### **INTRODUCTION.**

## 1.0 Introduction.

This chapter consists of the background of the study, problem statement, and Purpose of the study, research objective, and research question, scope of the Study, significance of the study and the structure of the study.

## 1.1 Background

The financial performance of SMEs is important for the growth of Uganda's economy. SMEs are often the drivers of innovation and job creation, and they can help to promote competition and economic efficiency. When SMEs are successful, they contribute to economic growth by generating income, creating jobs, and stimulating demand for goods and services. According to the World Bank, SMEs contribute an estimated 40% to Uganda's GDP. This means that the financial performance of SMEs is essential to the overall health of the economy. The study is being carried out to evaluate the effect of taxes on the financial performance of small scale businesses in Naaliya market-Kira municipality wakiso district Uganda. Thus the study is indebted to find various means of reducing the increasing tax burden brought about by tax rates which are revised annually on SMEs in Uganda. These rates seem to be taking an upward trend which has led to winding up of some small scale business enterprises. This prompted the researcher to investigate more about the impact of taxes on performance of small scale business enterprises.

## 1.2 Historical Perspective

Historically, taxation in Uganda is based on system that existed in Britain as it was a British colony. This also applied to other colonies elsewhere and for East Africa, one tax system operated under British administration. This process began in 1900 with the hut tax regulation which imposed a standard charge for every hut/dwelling. During that period, taxation was aimed at raising revenue for the administrative structure imposed by the colonial government but also as a means of encouraging monetary/economic activities. It was the Local Authority Ordinance of 1991 that governed the collection of taxes. In September 1991, after a period of review the URA was established. All taxes including income tax came under the umbrella of the URA. From 1992, URA has been organizing and strengthening the administrative procedures and in 1993 this process assisted by a grant from the British government of approximately US \$10 million. Taxes have existed virtually as long as there have been organized governments. The first

tax law legislation was introduced in 1919 and ever since then taxes have evolved through a number of reforms. The government in an attempt to widen the tax base and collect more revenue has had to levy several taxes especially on business enterprises in Uganda which constitute a large part of the formal sector. The taxes charged on business enterprises in Uganda include; corporation tax, value added tax, presumption tax and exercise duty, in 1997 the Income Tax Act was made. This was to give guidance in assessment and computation of taxes (Campsy,1997).

The Ugandan government has made some recommendable efforts to promote development through taxation since the inception of the current taxation laws for purposes of promoting development. The main objective of taxation in Uganda has always been to mobilize resources needed to meet the aspiration of government. This is because for any government to be effective, strong, competent and capable of spearheading development, resources have to be readily available in its treasury so as to be in position to provide goods and services to the people adequately. The Ugandan government has always had to ensure proper resource mobilization (Musa, 2012). According to the Uganda Bureau of Statistics, the tax system has been under revision since the beginning of 1990, mainly due to poor domestic revenue collections and mobilization as a percentage of GDP to public expenditure was 24.5% in 2009 and 44.4% in 1996. According to URA report 2005/2006, taxes are broadly divided into two categories namely; direct and indirect taxes. The major direct taxes as of 2005/2006 were Pay as You Earn (PAYE) cooperate tax, and withholding tax whereas indirect taxes include; Value Added Tax (VAT) which was introduced in Uganda in 1996 among others (Aruwa, 2013). The government in an attempt to widen the tax base and collect more revenue has had to levy several taxes especially on business enterprises in Uganda which constitute a large part of the formal sector. The taxes charged on business enterprises in Uganda include; corporation tax, value added tax, presumption tax and exercise duty. In 1997 the Income Tax Act was made. This was to give guidance in assessment and computation of taxes (Campsy, 1997). The Ugandan government has made some recommendable efforts to promote development through taxation since the inception of the current taxation laws for purposes of promoting development (Musa. 2012).

### 1.3 Theoretical Perspective

The study was based on the Grounded theory approach on measuring performance of SMEs developed by Chong (2008); the theory will help to set the process of extensive in-depth semi-structured interviews and observations while maintaining the natural settings of the business processes. It will thus identify the financial and non-financial measures based on short-term and long-term matrices of small and medium sized enterprises. The theory was in line with the goal approach, the owners-managers focused their evaluation process on abilities to attain the internally generated goals and targets in the market. The study will also base on Alberto et al.,(2013) theory, which developed a SMEs theory of planned behavior on what marketing for SMEs entrepreneurs, the need to market the marketing approach. The theory stated that, the adoption of the marketing approach is conditioned by entrepreneurs' own conception of marketing, which may be substantially different from that proposed, in paradigmatic way, by academics under different names that, is, the transactional, relationship existing between and among these SMEs, or induction marketing. This implied that, the potential benefits for SMEs, coming from its adoption, rely upon what entrepreneurs really do when they think they are implementing a marketing programmed (Alberto et al. 2013). Therefore the aim of this theory was: to shed light on SME entrepreneurs' conception of marketing, in order to verify whether their interpretation differs from that proposed by marketing researchers, and to assess quantitatively the psychological determinants of the entrepreneurs' intention (marketing technique) to adopt a marketing approach by applying a well-known model for predicting both human and organizational behaviors (Alberto., 2013).

### 1.4 Conceptual Perspective

Taxes: A tax is a financial charge or other levy imposed upon a taxpayer (an individual or legal entity) by a state or the functional equivalent of a state to fund various public expenditures. A failure to pay, or evasion of or resistance to taxation, is usually punishable by law. Taxes consist of direct or indirect taxes and may be paid in money or as its labor equivalent. Most countries have a tax system in place to pay for public/common/agreed national needs and government functions: some levy a flat percentage rate of taxation on personal annual income, some on a scale based on annual income amounts, and some countries impose almost no taxation at all. or a very low tax rate for a certain area of taxation. In modern taxation systems, governments levy taxes in money; but in-kind and corvée taxation are characteristic of traditional or pre-capitalist

states and their functional equivalents (Norberg, 2014). The method of taxation and the government expenditure of taxes raised are often highly debated in politics and economics.

Small Medium Enterprises (SMEs): There are varying global definitions of SMEs depending on the level of economy. Although there is so far no common definition in almost all East African Community countries (Kenya, Tanzania, Uganda, Burundi and Rwanda) they all use the same basics of capital investment; turnover; and number of employees. SMEs are defined in multiple benchmarks: the size of capital employed in machinery, manpower directly engaged and sales turnover (URT, 2009)

The study is being carried out to evaluate the effect of taxes on the financial performance of small scale businesses in Naaliya market-Kira municipality wakiso district Uganda. Thus the study is indebted to find various means of reducing the increasing tax burden brought about by tax rates which are revised annually on SMEs in Uganda. These rates seem to be taking an upward trend which has led to winding up of some small scale business enterprises. This prompted the researcher to investigate more about the impact of taxes on performance of small scale business enterprises.

### 1.5 Problem Statement

Taxes have been raised by the Government of Uganda to generate revenue used to provide services to the public such as; Health centers, telecommunication, roads, schools and electricity and this have helped to improve on the financial performance of small scale business enterprises. Despite the services provided, small scale business enterprise's performance in Naliya Market is still poor. This could be due to the increasing tax burden brought about by tax rates which are revised annually. In this regard the study will intended to find out the effect of taxation on small scale businesses (Naaliya Market) in Kira Municipality wakiso district. Thus in a bid by the government of Uganda in association with Uganda Revenue Authority (URA) to widen tax base, it appears that existing small scale businesses in Naaliya Market bear an incremental in tax burden because as the tax rates are revised annually these rates seem to be rising from 50%-75%, where by Gross Turnover ranging from Shs5m-20m, Taxation was shs 100,000 , shs 20m-30m taxation is 250,000, Shs 30m-40m tax is Shs 350,000 while the Gross Turnover ranging from shs 40m-50m Shs tax is 450,000 which has led to winding up of some small scale business enterprises. (URA, 2014).

According to URA source In addition, the general VAT threshold is to be raised from Ush50 million to Ush150 million in a strategic decision intended to weed out inactive, small firms from the VAT register. Thus in order for SME's sectors to grow, the level of taxation set must be friendly and not stifle the running of the business.

This prompted the researcher to investigate more about the effect of taxes on financial performance of small scale business enterprises.

### **1.6 Main Objective**

The purpose for conducting this research is to establish the relationship between taxation and performance of the SMEs in terms of their profitability and survival in the short and long run of operation.

### **1.7 Purpose of the Study**

Purpose of the study will be to establish the relationship between taxation and the performance of SMEs in terms of their profitability and survival in the short and long run of operations.

### **1.8 Research Objectives**

- i. To evaluate the operation of taxation in Naalya market.
- ii. To assess the performance of small scale business in Naalya market.
- iii. To establish the relationship between taxation and performance of small scale businesses.

### **1.9 Research Questions**

- i. How does taxation operate in Naalya market?
- ii. What is the performance of small medium enterprises (SMEs) in Naalya market?
- iii. What is the relationship between taxation and small and medium enterprises (SMEs) in Naalya market?

### **1.10 Scope of the Study**

The study will be limited to the effect of taxation on the performance of small scale businesses. And the research will be confined to URA which is located in Naalya Kira municipality in wakiso district.

### **1.11 Geographical Scope**

The geographical scope of the study will be focused in Naalya market in wakiso district.

### **1.11.1 Time Scope**

Time scope of the research will be for two Month so that all information of the research should be collected and processed to make the study complete.

### **1.12 Significance of the Study.**

The findings of the study are significant on the following ways;

Enable tax payers to realize the contribution of income taxes towards economic development of small scale business.

Benefit the income tax department by providing information towards improvements of the standards of administering and collecting taxes.

Contribute literature on income tax and performance to other potential researchers during the study on related topics,

To the tax authority and government, the study will guide them in adjusting tax policies so that they suit requirements of small scale businesses.

The accomplishment of the study will the researcher to acquire hands on skills about processing of research work and data analysis. This proficiency will enable the researcher to handle such related work with a lot of precision and proficiency.

To the tax authority and government, the study will guide them in adjusting tax policies so that they suit requirements of small scale businesses.

### **1.13 Conceptual Frame Work**

The research study will contain five chapters explaining different issues concerning taxation on the performance of small scale businesses. Where one is introduction of the study, background, problem statement purpose of the study. Research objective, research question, scope of the study, and significance of the study, chapter two is about literature review, chapter three covers the research methodology, chapter four is about interpretation and discussion of findings and

chapter five will cover conclusion and recommendation Positive Impacts Better services delivery Good performance of the business.

INDEPENDENCES VARIABLES

DEPENDENCES VARIABLES

TAXATION POLICY

PERFORMANCE OF SMEs

- Value added tax.
- Business income tax.
- Import duty.

- Return on investment.
- Cash flow ~~statement.~~ →
- Income statement

Adapted from: Sandmo, A ('2012,)

The conceptual framework above shows the relationship between the variables.

Independent variables and dependences variables in relation to the impact of taxes on the financial performance of small medium enterprise (SMEs) businesses in Uganda. Thus it demonstrates that local taxes are the independent variable which is indicated by different forms of local taxes, income tax, sales tax, property tax, estate tax, fuel tax, miscellaneous taxes, etc while the dependent variable is Financial Performance of SMEs which includes different determinants of financial Performance like; Infrastructural development, Increased savings and investment, Controlled market failure,

Redistributing income, Raising government revenue, Control mechanism and many others.

1.15 Definition of Key Terms

**A Tax:** This is a compulsory contribution to state revenue, levied by the government on workers income and business profits or added to the cost of some goods and services, and transactions. Taxes are generally an involuntary fee levied on individuals or corporations that is enforced by a government entity, whether local, regional or national in order to finance government activities.

**Government:** This is the political direction and control exercised over the actions of the members, citizens, or inhabitants of communities, societies, and states; direction of the affairs of a state, community, etc.; political administration

**Income:** Income is money that an individual or business receives in exchange for providing a good or service or through investing capital. Income is consumed to fuel day-to-day expenditures.

**Bank loan:** This is an amount of money loaned at interest by a bank to a borrower, usually on collateral security, for a certain period of time. A bank loan is the most common form of loan capital for a business.

**SMEs:** Small and medium-sized enterprises (SMEs) are non-subsidiary, independent firms which employ less than a given number of employees. This number varies across countries

**Financial performance:** This is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues.

## CHAPTER TWO

### Literature Review.

#### 2.0 Introduction

This chapter contains the review of various studies related to the topic of investigation. The purpose of this chapter is to provide information about recent research that has been conducted to examine how taxes have impacted the financial performance of small scale businesses in Uganda. The information collected from the few studies in this area was used to design the research instruments and it thus conducted basing on the study objectives.

#### 2.1 Types Of Taxes Levied On Small And Medium Sized Enterprise In Naalya Market

According to Parvaiz and Ishaq, (2010), taxes are of various types to meet particular fiscal policy but for purposes of this research, direct taxes on which tax incidence or burden rest directly up on the tax payers are to be considered and they include the cooperation tax PAYE tax, taxes on property and withholding tax.

**Direct taxes** Dalton, (1991) noted that a direct tax is one that is paid by the person or company on whom it is legally imposed and cannot be shifted to other firms or individuals. Stuart, (2014) agrees with Dalton. He defined a direct tax as one which is demanded from every person who it is intended or desired should pay it. In line with the Dalton, (1991), Sessaka, (2006), defined it as one that is imposed on individuals or companies and has to be paid on cash basis. He brought in an element of “cash” examples of direct taxes include, taxes on payroll and labor, taxes on net wealth, and taxes on property (Onyach, 2003).

**Corporation tax;** this is a tax levied on company’s profits. All limited liability companies are expected by law to file their returns declaring profits for the year to URA. The tax rate is 30% on profits above the set threshold by URA (Franzoni, 2009)

**Property tax;** this is a tax charged on individuals who receive rental income from renting residential houses, commercial properties, machinery and other real assets. The tax rate applicable to rental income is 20% on income exceeding the threshold (OQU, 2009).

**Withholding tax;** this is advance income tax which is had by URA on supplies of goods and services. The Tax Credit Certificate (TCC) is prepared by the authority for each tax payer. The tax payer is required to present his TCC at the end of the financial year if he has to benefit from

the payments withholding rate is 6% on payment of goods and services whose value exceeds 1 m Uganda shillings (Tanzi, 2012). Pay As You Earn (PAYE); this is a tax collected by URA from employees through the employer which is normally deducted before payment of salaries and other employee benefits like bonus, retirement benefit and gratuity. It is deducted basing on various tax brackets which depend on the level of earning (Etzion, 2006).

**Personal Income Tax** Residents of Uganda are required to pay personal income tax on their worldwide income. According to Mugerwa, (2010), non-residents of Uganda whose income comes from sources in Uganda are required to pay the tax. For the purposes of the tax, people are considered residents of Uganda if they have a permanent home in the country, if they are a Ugandan employee or official posted abroad, if they are present in Uganda for 183 days out of the tax year or if they are present in Uganda for an average of 122 days per year for three consecutive years (Abigaha. 2009).

**Business Income Tax** Uganda also levies income tax on the worldwide income of resident businesses. As with personal income taxes, non-resident companies are taxed only on income sourced in Uganda. The tax rate for all businesses other than mining companies is 30 percent. Income tax for mining companies is calculated using a formula and is dependent upon the chargeable income and gross revenue of the company, but the tax rate must be at least 25 percent and at most 45 percent (Adams. 2005).

Uganda has determined special tax rates for small businesses with annual sales between five million and fifty million Ugandan shillings. These special rates are determined based upon the gross income of the business (Sandmo, 2012).

**Value Added Tax (VAT)** is required on every taxable supply made by a taxable person, every imported good and the supply of any imported services by any person. Taxable supplies are goods or services made under the business activity of a taxable person. Taxable persons are people who make, or expect to make, taxable supplies valued at one-quarter of the annual registration threshold during three calendar months of the year. Taxable persons must register. Value added tax (amendment) act of 2015 section 7(2)), the annual registration threshold is 150 million Uganda shilling (approximately \$41000). The standard rate for VAT in Uganda is 18 percent (Allingham, 2012). Uganda's principal taxes are income tax, both personal and business, and value added tax (VAT). Compared to other sub-Saharan African nations, which collect, on

average, about 23 percent of gross domestic product (GDP) in revenue, Uganda's taxes is low, consisting of 11.9 percent of GDP in the 2008-2009 fiscal years.

## 2.2 The Relationship between Income Tax and Profitability Levels of SMEs's In Naalya Market in Wakiso District

According to income tax Act 2005, Section 22, income tax is levied on incomes of all Ugandan residents not only on income arising in the country but also from non-residents whose originating from within Uganda is also liable to income tax irrespective of where the tax payer lives. With the exception of exempted ones as provided for in the income tax Act. Any tax levied on a person's income generally qualifies as an income tax. (Etzion, 2006), this general definition includes all taxes levied on income. Income tax is an example of direct tax levied on individuals and entities usually imposed on their benefit, reward, compensation, games and enrolments.

The income tax Act refers to income on which tax is charged as a chargeable income. Chargeable income of a person for the year of income is the gross income of the year of a person less total deductions allowed under the year's tax Act for the year of income (O'Bryan, 2010).

In Uganda, income tax Act finds it hard to spell out the sources of income tax and how they are to be determined for purposes of income tax. Income may not be easy to define because what is income in the hands of one person may be a capital receipt in the hands of another. Gross income refers to the aggregate income earned by a person in a given year of income from different resources and hence income includes any employment, business and property that is earned by a person in a given year of income (O'Bryan, 2010).

Taxes have an important role to play in the investment as it can have substantial impact on the desirability or otherwise of an investment opportunity. Generally, taxes affect almost every area of financial decision making both in practice and theory context. According to income tax Act 1997 a provision was made for businesses whose annual gross turnover is less than 50m. Such business had an option either to pay a fixed tax amount or 1% of annual gross turnover whichever is lower. However, if any of such businesses feel that it should submit returns, then it must comply with all the procedures and regulations of tax assessment.

According to the Income tax act (2005), the presumptive is considered to be a final tax on business income of a tax payer. No any other deduction is allowed for any expenditure incurred in the production of business income and no tax credit is allowed.

According to Byamukama (2000), a tax payer with annual gross turnover of ugx. 30m having to pay 350,000 force him out of business because he will have very little to survive on and in order to survive he was forced to increase prices of their products so as to incorporate the tax element, but this will rather leave most of them unhappy as the number of consumers will decrease and as such financial health will also worsen accordingly.

This implies that income tax has a negative significance on the performance of small enterprises. However, according to Balunywa, there are other factors which contribute to poor performance of small scale enterprises such as inadequate managerial skills, market opportunities, access to finance, level of technology and unfavorable emoluments (salaries).

### 2.3 The Other Factors That Affecting the Profitability Levels of Sme's In Naalya Market in Wakiso District.

**Interest Rates:** affect the performance of SMEs since they make the cost of borrowing expensive. Which has a negative effect on the growth and development of SMEs, Therefore, an increase in the rate of interest is not desirable in SMEs as this might lead to the poor performance of SMEs. The government of Uganda must, therefore, subsidize the interest rate. In addition, SMEs should also which SMEs pay on borrowed funds, Search for alternative sources of finance which are less expensive than the financing offered by the banking sector of Uganda to reduce their costs of production. Instead of making use of bank loans, SMEs must use family funds from savings; also they must form partnerships and cooperatives in order to pull their financial resources together (Beck, and Demirguc-Kunt, 2006).

**Currency:** This is the exchange value of the Ugandan shilling against major currencies US dollar and the British Pound. SMEs are affected by the continual loss in value of the Ugandan shilling, which result in an increase in the cost of raw materials with specific reference to imports. It is therefore recommended that the government must subsidize the SME sector when importing raw materials and inputs. This they can do by setting a special fund for SMEs that relies on imported raw materials (Christofidis, and Debande, 2001).

**Investment Level:** The Ugandan government should try to attract investors through incentives such as Tax incentives ,a scheme whereby a small and medium sized business will required to only pay tax after a certain government can further boost investment levels period of operation,. Thereby encouraging the Reserve Bank of Uganda to reduce interest rates on borrowed funds. This will ensure that SMEs have access to affordable financing options (Babbie, 2007)

**Exchange Rate:** The weak currency is affecting the performance of SMEs as their products become less competitive in the world market. Currently exporters are paid a certain percentage for their exports in foreign currency and the remainder in the local currency. The Ugandan government should ensure that SMEs are paid for their exports in foreign currency after exporting (Minniti, 2008).

**Firm Size:** There are various result of the effect between firm size and profitability (A. Vijayakumar, 2011) found a positive influences between firm size and profitability. The study found that size has a positive large effect with profitability of the business. (Minniti, 2008) also found that size of the firm positively influences the profitability the business (Arnoros, 2011). The study found the positive effect between size and returns on assets (ROA) While Orobia, (2013) found that firm size have a negative effect to the profitability. Orobia, (2013) also found that the firm size negatively related to the firm performance which specifically added, companies that have a smaller size will result in higher profits but no longer competitive than larger companies (Kizza, 2005).

**Lagged Profitability:** According to Orobia, (2013), the study found that lagged profitability have a positive large effect with the profitability. The study also investigates that profitability is significantly associated with profitability. According to Wannenburg, Drotsky, (2015) the study have examined that lagged profitability of the firm positively influence the profitability (Salman and Yazdanfar, 2012). The findings indicate that lagged profitability influence the profitability. According to Jager, (2009), the study also found that lagged profitability is the main profitability determinants. Based from the previous research, the following hypothesis is formulated:

**Shortage of Finance:** SME development is severely affected by a shortage of finance. For expansion purposes SMEs require adequate finance, banks and credit institutions which have stringent requirements when SMEs want to borrow from them, primarily in the form of collaterals (Drotsky, 2009). Furthermore, sources of finance which are available to SMEs such as

bank loans and mortgage bonds are expensive which results in an increase in the cost of production.

**Skills Shortages:** The economic performance of SMEs is highly affected by skills shortages are experienced in the fields of financial management, and marketing management SMEs fail to attract qualified personnel since the majority of Ugandans view SMEs as offering insecure personnel employment opportunities due to the high rate of failure. The skilled involve those employees with the necessary skills required in the SME sector.

The study was conducted from small medium enterprises (SMEs) in Naaliya Market located in Wakiso district. The study was based on the findings of Mateev and Anastasov (2010) who conducted a research on determinants of small and medium sized fast growing enterprises in central and Eastern Europe. They used a panel data analysis for a set of 560 fast-growing SMEs whereby they used variables such as: SMEs growth which was independent variable, and firm characteristics (size and age) and more specific determining factors (total assets, leverage, internally generated funds, future growth opportunities, and factor productivity) as explanatory variables (Mateev and Anastasov, 2010). They found that: a firm's growth was related not only to the traditional determinant of size but also to other specific characteristics associated with its financial structure and productivity, secondly they found that, firm size as measured by its total assets tend to increase sales revenues, thirdly, was the growth in the number of employees in those firms showed a marginal impact on their growth in assets, fourthly, in case of opportunities, they found that, the relation between future growth opportunities as proxies by the share of intangible assets in a firm's total assets and its growth was weak, fifthly, SMEs in transition economies rely pre-dominantly on internally generated funds to support their sales growth but need access to external capital to support growth in their assets, and lastly results showed that, both capital and labour productivity were positively related to firm growth (both in sales and assets) that mean, improved factor productivity would generate larger growth in those firms (Mateev and Anastasov, 2010).

Aidis (2002) conducted an analysis to find out the gendered influence on SME development under economic transition in Lithuania. He used descriptive statistics and regression models (OLS) to test his hypotheses whereby data from the Litsme survey to look at the gendered aspects of business size, turnover, financial success, planned business growth and business

success amongst small- and medium-sized enterprise owners was used. The results indicated that, there were considerably fewer female SMEs owners than male SMEs owners (Aidis, 2002). The estimation results under business size showed that, sex was strongly and significantly negatively associated with business size and also individuals who started their businesses for economic reasons had a negative effect on business size.

Biggs and Shah (1998) conducted a research on SMEs networks, and manufacturing performance in Sub-Saharan Africa, and they found that, large firms were the dominant source of net job creation in the manufacturing sector and also the results suggested that firm size was not a good predictor of labor intensity, and that labor intensity varied more across industries than across firm-size groups within industries. But also they found that, many small firms were more capital intensive than large firms in the same industry. This suggested that SMEs are not necessarily more suitable to the labor abundance and capital shortage characteristics of developing countries (Biggs and Shah, 1998).

Mcintyre (2011) also conducted a research on the role of SMEs in transitional: growth and entrepreneurship theory he argued that, the direct economic effects of making new services and products available and creating employment, the SMEs has several equally important effects on the functioning of transitional societies that move through more indirect channels. The development of this sector is essential to create the political and social environmental conditions' necessary to allow desirable changes to occur elsewhere in the system. The SMEs sector must simultaneously absorb resources and workers from the large enterprise sector and at the same time help to create a labour market situation in which the process of re-orientation and fundamental reorganization of the large enterprise sector can be carried through without threatening social peace (McIntyre, 2001). In addition to slowing down the restructuring process, the failure to develop the small medium enterprise (SMEs) business may increase the volume of required transfer payments for unemployment, early retirement and other programmers and (under certain fiscal policy assumptions) crowd-out investment and other employment creating expenditures (Ntyre, 2001).

## CHAPTER THREE.

### METHODOLOGY.

#### 3.1 Introduction

This chapter covers the background which data will be gathered. It discusses the research design, methods of collecting data, data processing, analysis and presentation as well as limitations to the study and it includes the target/research population and the sample size and sample design and the appendix instrument.

#### 3.2 Research Design

This study will be both analytical and explanatory in nature and it will basically analyze taxation and performance of small medium enterprise (SMEs). It will be qualitative and quantitative.

#### 3.3 Target /Research Study Population.

The study population will be 200 shops on the market selected to represent the small medium enterprise (SMEs) around the market in my research, Using sample technique.

##### 3.3.1 Sample Size.

The samples will be 50 shops out of the 200 shops which is the research population it selected to represent the small scale business around the market.

Table 1: Showing the number and composition of respondents

CATEGORY OF RESPONDENCE	NUMBER OF RESPONDENCES
SMEs OWNER(VENDORS AND TRADER)	43
WORKERS WITHIN THE SHOPS	7
TOTAL	50

##### 3.3.2 The Sampling Techniques

The researcher shall employ three sampling techniques for carrying out the research. This will include, quota sampling, multi- stage cluster sampling and purposive judgmental sampling in data collection.

A. Quota sampling this will address the issues of repetitiveness where the matrix describing the characteristics of the largest population will be used to determine what proportion of the population is male and female and for each sex, what proportion falls into the various educational levels.

B. Multi -stage sampling this sampling technique will involve two basic steps; listing and sampling of the study population; the list of the primary sampling units will comprise of forty three (43) small medium enterprise (SMEs) owner, seven (7) workers within the shop, this sample of those units will be selected and then listed.

C. Purposive sampling in this sampling technique, the researcher will sample the population basing on the researcher's own knowledge of the population, its elements and the nature of the research designed, especially in the initial design with the questionnaires wishes to select the particular respondents to test the broad applicability of the research questions designed.

### **3.4 Data Collection Methods**

The researcher will get information from secondary data sources this include literature on taxation and small scale business in records of small business activities and primary data from the questionnaires administered, observation of the business activities and interviewers.

### **3.5 Instruments of Data Collection.**

The following instruments will be applied in data collection and analysis:

#### **3.5.1 Questionnaires.**

These will be advanced by the researcher to get information on facts of how taxes affect the performance of small scale business. The researcher anticipates that questionnaires will help to collect data from respondents who will have no time to be interviewed within the market and also those who may have time. The respondents will have to answer or fill in the answers at their own place or free time.

#### **3.5.2 Interview**

The researcher shall carry out interview with the sampled such as shops owner or small scale businesses owners. By get the information that may be relevant for him to draw logical conclusion on which he may base his opinion. The researcher shall try to create a conducive environment for interview by building a rapport through explanation of the purpose of the study

and assurance. The researcher prefer this data collection methods since he hopes that it will give him room to make clarification on some of the questions through probing for easy understanding and will ensure validity and reliability of data.

### **3.5.3 Observation.**

In this method, the researcher will use the eye to observe what actually happens on the ground and will take the record, more so, the researcher will observe the activities of the correspondents, selling and buying activities of shops and how they carry their business activities. This will be done using observation technique such as natural observation.

### **3.6 Sources of Data.**

The researcher will use mainly two sources of data to get information on how taxes affect the performance of small scale businesses include the following discuss:

#### **3.6.1 Primary Sources.**

The researcher shall be involved in face to face contact and conversation with the respondents or interviewing from whom he hopes to get the information pertaining to the topic of the study, the researcher will also be active asking questions or give to them questionnaires and the information will be filled by the respondents on the questionnaire.

#### **3.6.2 Secondary Sources**

The researcher will collect and use data from the previous reports or result on the study of different text books, Journals, internets, reports from small scale businesses performance among others secondary Literature.

### **3. 7 Data Processing**

The processing of data will be done so as to verify the data collection. This is so in order to ensure the completeness and uniformity, editing will be done by the researcher which will involve checking the data for error, omissions and gaps. This will help the researcher to detect the errors that may influence the results. Editing will also help the researcher to ensure that every question in the interview guide has an answer and these answers given are accurate and correct.

### **3. 9 Data Analysis**

Under data analysis, both quantitative and qualitative method will be used in this statistical and non- statistical approaches will be used in the analysis of the finding.

## CHAPTER FOUR

### PRESENTATION OF FINDINGS, INTERPRETATION AND DISCUSSION OF SUCH FINDINGS.

#### 4.0 Introduction.

This section reflects the findings of the study, the related interpretations and discussion on the effect of taxation on the performance of small scale businesses in Uganda using the literature review obtained in pervious chapter in the line with the research objective such as;

- i. To evaluate the operation of taxation in Naalya market.
- ii. To assess the performance of small scale business in Naalya.
- iii. To establish the relationship between taxation and performance of small scale businesses.

#### 4.1 Response rate

Out of the 50 questionnaires distributed to respondents, all were returned giving a response rate of 100%.

Table 1: Showing distribution of respondents by gender

<b>Gender of respondent</b>	<b>Frequency</b>	<b>Percentage</b>
Males	22	44%
Females	28	56%
Total	50	100%

Source primary data.

From the table above 56% of the respondents were female and 44o/o were male thus there was no bias on either sex. This implies that majority of the respondents are female who own small scale business and have shops.

Figure 4.1

<b>Levels of Education</b>	<b>Small scale business owners</b>	<b>Worker within the shop</b>	<b>Frequency</b>	<b>Percentage (%)</b>
O' Level	-	5	20	40%
A' Level	-	2	15	40%
Diploma	5	-	10	10%
Degree	5	-	5	10%
Total	10	7	50	100%

Table 2: Shows responses on how the tax system is related to the performance of their small scale businesses

<b>Sex of the respondents</b>	<b>No. of respondents</b>	<b>Percentage</b>
Males	22	40%
Females	28	60%
Total	50	100%

Table 2 show that out of 50 respondents who participated, 22 were males forming the percentage of 40% whereas the female respondents were 28 with the percentage of 60%. The subtotal of the respondents were 50 meanwhile the sub percentage of the respondents was 100%. The above disparity between the figures and the percentages of the female and male respondents could be as a result of gender equality in most of the small scale businesses around the market. When the researcher consulted those who were not working within the market or they just come as customers, the following responses were obtained.

Table 3: Shows responses on how taxes Systems were related to Performance of the small scale businesses &om those who did not working within the market they are just customers.

Item	No. of respondents	Percentage (%)
Aware	25	50
No aware	25	50
Total	50	100

When the respondents were asked about their education levels the following responses were obtained.

Level of education	SMEs owners	Worker within the shop	Frequency	Percentage.
O' level	-	5	20	40%
A 'level	-	2	15	40%
Diploma	5	0	10	10%
Degree	5	0	5	10%
Total	10	7	50	100%

Source: Primary data

From the table above 10% were degree holders, 10% were diploma holders, 40% were 'A' level drop outs and also 40% were 0' Level drop outs. This indicates that the majority of the respondents were '0' level and 'A' level holders have enough skills to carry out their work and they were able to interpret the questionnaires as majority of the population knows how to read and write and more so it showed that the majority of the respondents had knowledge about the tax system since they are educated men and female with some qualifications.

The researcher further consulted the respondents to determine their ages. The researcher found out the following responses.

Table 5 : Show the ages of respondents

Age group bracket	Number of respondent	Percentage%
18-25	10	20%
26-30	20	40
30-35	10	20%
36-40	10	20%
45 and above	0	
Total	50	100%

Table 5 Shows that the respondents within the age bracket of 18-24 formed represented the percentage of 20%, 25-30 formed represented the percentage of 40%, those between 30-45 years formed represented the greatest percentage of 20% where as those above 45 years formed the percentage of 20% out of the sub percentage of 100.

Table 6: Shows the Marital Status of Respondents.

Marital status	Frequency	Percentage%
Single	10	20%
Married	30	60%
Separated	8	16%
Divorced	0	0%
Widowed	2	4%
Total	50	100%

Source: Primary data

The table above shows that 20% of the respondents were single, 60% are married, 16% were separated and 4% were widowed and there were no findings on divorced respondents. This shows that most respondents were married which can also be explained by majority middle aged respondents.

#### 4.1.1 Objective one.

The operation of Taxation in Uganda. The research revealed that taxation referred to as process of administering and collecting taxes, it's concerned with public revenue, public expenditure and public debt. It is a process of tax administrating, which involve enumeration, assessment, tax collection, tax services and control m Uganda tax administration is the responsibility of Uganda Revenue Authority. Taxes play an important role in the economy as one of the major source of government revenue and even though the general behind taxation in the prevision of public goods and services.

Different scholars in the subject classified taxes as either direct or indirect basing on incidence, proportional versus progressive, regressive versus digressive basing on their behavior in the relation to the tax base. It derived from the four function of government that is allocation, regulation, distribution and stabilization.

The study also found out that economists looked at taxation as a process of circular flow of income in public sector. The study also revealed on taxation that the performance of small scale businesses to be called and for it to be able to achieve their objective, they should consider the income act 1997 section three

The research revealed that in Uganda small scale business pay different taxes is; corporation income tax charged income earned by a person such as a company. Individual income tax charged on income earn individual, Rental income tax charged on rent earn by individual, presumptive tax charged on small scale businesses whose gross turnover is less than shillings 50,000 million.

The research revealed that the presumption tax is taxed according to their category of annual turnover in which the business income lies. Rental tax and individual income tax are levied on a personal income, of the taxpayers and reduce their revenue of small scale business hence affecting their performance negatively.

#### **4.2 Objective two:**

The financial performance of small scale businesses in Uganda The study revealed on the performance of small scale businesses, it was based on profits. The study found out that profit in simple term is the function of revenue and cost. Also the study found out the profit is the responsibility of an enterprise to the society that is the first responsibility of an enterprise in the society is to make profit.

This means that the performance depend on the level of production, where the level of production is low the profit will be from the operation of the enterprise while where the level of production is high will be increase in profits.

The study found out that different scholars looked at profit is excess of revenue earned over total costs incurred in the process or event of providing goods and services. Hence profit is the responsibility of an enterprise in the society.

The research revealed that Income Tax Act of Uganda section three defined small scale businesses as a business whose total annual sale turnover doesn't exceed Ugandan shillings 50,000,000 million. Also the study found out that small business is based on some general. Feature as explained in chapter three. Therefore the study found out that most business groupings are based on the investment code Act 1993, under Ugandan Manufacturers Association. The various groups are in the term of the number of people employed the capital investment in United State dollars.

#### **4.3 Objective three.**

The relationship between taxation and financial performance of small scale businesses The research revealed that there is a relationship between taxation and small scale business performance means that high direct taxes will lead to high prices of goods hence a shift in consumption pattern from highly taxation and performance of small scale businesses are mutually related. The study also found out those Keynesian modes shows that government revenue can be realized through fiscal policy mechanism, fiscal policy include tax policies therefore meaning that , taxation and small scale businesses financial performance are related. Hence own view taxation and small scale business level is low business pay high taxes and when

taxes are high the level of business is low. Therefore low taxes repaid leaving too many incomes for day today running of the enterprise and increasing their performance.

The research also found out that apart from taxation lack of good managerial skills affect the financial performance of small scale businesses. A challenge only comes when small businesses fail to prepare proper books of accounts thus affecting their financial performance.

## CHAPTER FIVE

### CONCLUSIONS AND RCOMMENDATION

#### 5.0 Introduction

This chapter presents conclusion drawn from discussion of findings and are closely related to the purpose and objectives of the study, it is also recommendation on the performance of small scale businesses and further research based on the literature review.

#### 5.1 Summary of Findings

The findings in chapters four indicated that taxation has negative effect on the small scale business performance in terms of profits. Taxes charged on small scale businesses have gross effect on the expansion of these businesses as they encroach on the expected revenue.

Hence reducing investment finance since most small businesses are financed out of their profits and saving, as a result the performance of these small business has been undermine.

The findings also revealed that taxation system on small scale businesses aim at increasing tax revenue while maximizing constraints to small scale business survival. The Policy regarding tax burden like presumption tax encourage these firms to prepare proper books of accounts, locating taxpayer's tax rates, tax penalties, incentives needed to be applied on small scale business under different income levels. Thus taxation policies aim at protecting them although tendering of tax collection endangers the objectives of tax collection.

#### 5.2 Conclusions

Generally there has been poor taxation system by tax authority with focus being on the small scale businesses, hence resulting into a greater scope to taxation for instance VAT. Also there is need to receive and improve the legal system in order to ensure efficiency, enforcement of tax

laws to increase compliance to introduce tax education to enlighten small scale businesses on the importance of paying taxes.

Poor performance of small scale businesses is as a result of inadequate identification assessment and collection, which are aspects of taxation performance. Therefore tax policy should focus on improving taxation performance in favor of small businesses. Likewise other factors also affecting this variable should be taken into account. Taxation performance remains a major area to be explored by revenue authorizes of various classes of taxes, since improving taxation performance enhances almost all aspects of tax policy, including tax from small scale businesses.

Small scale businesses are those annual gross turnover does not exceed million Uganda shilling, while large scale businesses are those with capital of more than fifty million Uganda shillings. The small business taxed depending on gross turnover and they pay fixed amount or 1% of the annual turnover which is lower while large businesses are taxed at rate of 30 %. Therefore URA tried to avoid business income tax difference by imposing a fixed rate of 30% on businesses regardless of whether it is a small or large business. High direct taxes will be high prices of goods hence a shift in consumption pattern from highly taxation and performances of small scale businesses are mutually related.

### **5.3 Recommendation**

Basing on the study carried out, the researcher recommends the following: The government through URA should embark on intensive tax education program especially for business community. This should be done through various media and in different languages on radio stations, televisions. URA should carry out massive training of its staff about tax assessment collection methods, as well as how to handle taxpayers.

Taxpayers should employ skilled people like accountants to ensure proper and complete records keeping in their businesses. This will enable them to pay only the taxes that they must pay and infringe on their profits.

Tax education should be included in primary school syllabus to ensure greater sensation even among the young generation since a greater percentage of small scale business owner have as far as primary least with this knowledge taxpayers can control their liquidity position.

#### 5.4 Areas For Further Research

- The role presumption tax on performance of small business.
- Tax evasion and tax avoidance of small scale businesses in developing countries.
- Effect of taxation on growth of small business enterprise.

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## Appendix A. QUESTIONNAIRE.

Dear respondent, as a student of Uganda Christian University Mukono main campus pursuing Bachelor of Science in accounting and fiancé, I am carrying out a research on the topics: The impact of taxation on the small and medium enterprise scale.

Case study: - Small shops in Naliyaa market and medium enterprise business.

The purpose of this study is to collect information on the impact of taxation on the small and medium enterprise.

Your response will be treated with high degree of confidentiality and the information gathered or obtained is strictly for academic purposes.

### **PERSONAL DATA (QN 1-4).**

Please help to tick the most appropriate and fill the blank spaces where applicable.)

1 Age

a) 18-24

c) 30-45

b) b) 25-30

d) 45-and above

2. Sex:

a) Male

b) female

c) Others.

3. Marital status

a) Married

b) single

4. Level of education

a) '0' level

c) 'A' level

b) Diploma

d) Degree

e) Other

**RESEARCH QUESTION ONE (Qn. 5-7)**

5. How do you find the tax system on the small scale business?

a) V. good

c) Fair

b) Good

d) Non

6. Is there any relationship between the taxes and how it affects the performance of the small scale business?

a) Yes

c) Some how

b) No

d) others (specify')

7. How do you determine the efficiency of taxes that are collected from your business?

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**RESEARCH QUESTION 1WO (Qn. 8-9)**

8. Does the tax system cope up with the technology changes in the country?

a) Yes

b) somehow

c) No

d) None

9. Does the tax system affect your business performance?

Yes

No

If yes, how?

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**RESEARCH QUESTION THREE (Qn. 10)**

11. Which of the following taxes is levied on your business?

a) Corporation Income Tax

Yes

No

b) Individual Income Tax

Yes

No

c) Rental income Tax

Yes

No

d) Presumptive Tax

Yes

No

**RESEARCH QUESTIONS FOUR (11-14)**

11. Has there been important in the taxation system?

a) Yes

b) No

If yes, explain

12. What are the specific effects are of taxes on the performance your businesses?

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13. How do you manage and solve the problems of tax at your business?

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14. What technique do you use to follow up your business tax activities?.....

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.....  
.....

**THANK YOU FOR YOUR VALUABLE TIME AND INFORMATION.**



# UGANDA CHRISTIAN UNIVERSITY

A Centre of Excellence in the Heart of Africa

SCHOOL OF BUSINESS

1<sup>st</sup> Aug 2023

TO WHOM IT MAY CONCERN

Name: EMMANUEL WU DASHMAN Reg. No. 1S19B00/043.

A bachelor's student who is seeking permission from your office to collect data for his/her dissertation titled

"Effect of Taxation on the Financial performance of small and medium size enterprises (SMEs)"

We shall be grateful if you could render assistance to him/her in collecting the necessary data for his/her dissertation

The Uganda Christian University School of Business thanks you in advance

Mukisa Simon Peter  
Research coordinator