

**THE EFFECT OF INCOME TAX RATES ON THE FINANCIAL PERFORMANCE OF  
SMALL AND MEDIUM ENTERPRISES IN LUZIRA, NAKAWA DIVISION**

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**UGANDA CHRISTIAN  
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**DECLARATION**

I **HIGENYI KENNETH GEOFREY** declare that this report is my original work and has not been submitted for any academic award to any institution and where the work of others was used, due acknowledgement has been made.


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**APPROVAL**

I hereby certify that this research report is the original and individual work of **HIGENYI KENNETH GEOFREY** and has been done under my supervision and is now ready for submission with my approval.

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Date: ..... 07/09/23 .....

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**GOD BLESS YOU**

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## **ABSTRACT**

The general purpose of the study was to evaluate the effect of income tax rates on the financial performance of small and medium enterprises in Luzira and the specific objectives were; to assess the financial performance levels of small and medium enterprises in Luzira suburb, Nakawa division, to explore the effects of income tax rates on small and medium enterprises in Luzira suburb, Nakawa division and to determine the relationship between income tax rates and financial performance of small and medium enterprises.

The researcher used purposive and systematic random sampling to get a representative sample size to obtain responses on the case study.

On the effect of income tax rates on the financial performance of small and medium enterprises most of the respondents were unsatisfied with the income tax rates based on the sales turn over and some of the income tax rates administrators did not fully have information about income tax rates and its payers. The findings of the study showed that the introduction of income tax rates have adversely affected the net profit margin of small and medium enterprises and according to the responses, they strongly agreed that income tax rates affects the returns of their business.

The researcher made the following recommendations as a way of reducing the burden of income tax rates on start-ups and small businesses as well as to increase the revenue of Luzira.

Uganda Revenue Authority should simplify the tax codes and streamline compliance procedures, Uganda Revenue Authority should reduce income tax rates for SMEs, Uganda Revenue Authority should improve awareness amongst the, Uganda Revenue Authority should introduce target income tax incentives.

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.0 Introduction**

This chapter entails the background to the study, the statement of the problem, objective of the study and research questions. It further highlights the scope of the study, justification of the study and significance of the study.

### **1.1 Background of the study**

Small and medium enterprises (SMEs) play a vital role in the economic development of any country. They are often considered the backbone of the economy, contributing significantly to employment generation, innovation, and overall economic growth. In Uganda, SMEs account for a substantial portion of the country's GDP and are responsible for creating employment opportunities for a large number of people. However, these enterprises face numerous challenges, with one of the key concerns being the impact of income tax rates on their financial performance. Income taxes are a fundamental aspect of a country's fiscal policy and serve as a major source of revenue for governments worldwide. They are levied on individuals and businesses based on their income, profits, or gains. The rates at which income taxes are imposed can have profound effects on the economic behavior of SMEs, including their investment decisions, business expansion plans, and overall financial performance.

Globally, numerous studies have explored the effects of income tax rates on SMEs in different contexts and have yielded varying findings. For instance, research by Djankov et al. (2010) conducted across 85 countries found that higher income tax rates were associated with lower levels of entrepreneurship, as individuals were discouraged from starting businesses or expanding existing ones. The study concluded that high income tax rates create a disincentive for SME growth and hinder economic development. On the other hand, some researchers argue that the relationship between income tax rates and SME financial performance is more complex and nuanced. Clausing (2012) suggests that the effect of income tax rates on SMEs depends on factors such as tax administration efficiency, tax compliance costs, and the presence of tax incentives or exemptions specifically targeted at small businesses. In some cases, a moderate level of taxation may be seen as fair and justifiable if the government provides adequate public goods and services to support SME growth and development.

In the African, many countries including Uganda, there is a prevailing sentiment among SME owners that high income tax rates act as a deterrent to business growth and profitability. Entrepreneurs argue that excessive tax burdens hinder reinvestment, limit access to finance, and reduce the overall competitiveness of SMEs (Etemad, 2012). This perception is rooted in the belief that income tax rates should be conducive to fostering entrepreneurship and supporting SME development. African countries have implemented income tax rates to generate revenue for public expenditure, but the African Development Bank (ADB, 2019) report highlights potential negative consequences for SMEs. Understanding the relationship between income tax rates and SME financial performance is essential for informed policy decisions. Researchers have examined the relationship between income tax rates and SME financial performance, providing valuable insights into the African context. One notable study by Adegbite and Akinbuli (2017) explored the impact of income tax rates on SMEs in Nigeria, another African country with a vibrant SME sector. The study found that high income tax rates were associated with lower SME profitability, reduced investment, and limited job creation. This research serves as an essential reference point for understanding the potential implications of income tax rates on SME financial performance in Uganda. Additionally, Okwu et al. (2019) conducted a comprehensive study in Ghana, another African nation with a burgeoning SME sector, to analyze the impact of tax policies on SME growth and development. Their findings indicated that high income tax rates had a negative effect on SME financial performance, hampering investment, innovation, and expansion. These results align with the perceptions expressed by Ugandan SME owners, highlighting the need for further examination of the issue in the specific Ugandan context.

In Uganda, the small business sector plays a critical role in employment generation, poverty reduction, and economic diversification. A considerable fraction of the businesses in Uganda are sole traders operating small and medium enterprises, locally owned and managed by individuals or families and often with very few employees working at a single location. However, Ugandan SMEs face various challenges, including limited access to finance, inadequate infrastructure, and complex regulatory frameworks. A study by Kato and Musoke (2017) revealed that high tax rates had a detrimental effect on the survival and growth prospects of small businesses in Uganda. In September 2016, the Uganda Revenue Authority after a review of the tax system, brought all taxes under its control including income tax. However, small enterprises in the Luzira

neighborhood, one of the largest settlements in the Kampala area, face tax challenges that negatively affect their productivity. The Luzira neighborhood is home to over 50 small and medium enterprises run by local families and individuals, which play a vital role in the local economy. Despite their significant contribution, these businesses struggle with tax constraints limiting their growth and profitability. Research has shown that income tax rates can discourage entrepreneurship and hinder the growth of small and medium enterprises. According to a study by the National Bureau of Economic Research, higher tax rates reduce the profitability of becoming an entrepreneur and also reduce the likelihood of survival for the small and medium enterprises (Kaufmann & Dant, 2019). Furthermore, high tax rates can also reduce the amount of capital available for small and medium enterprises to invest in growth and expansion. In Uganda, researchers have also recognized the importance of studying the effect of income tax rates on small and medium enterprises. Okello and Okello (2021) conducted a study on the challenges faced by small and medium enterprises in Uganda and identified high tax burdens as one of the significant obstacles to their growth and sustainability. Their findings suggest that high income tax rates can limit the potential of small and medium enterprises to expand, hire more employees, and contribute to the economy.

## **1.2 Statement of the problem**

The Ugandan government recognizes the importance of small and medium-sized enterprises in the economy and has taken measures to support their growth and development. The success of these businesses is crucial to the well-being of society, and as such, the government has put in place programs to ensure that they have access to the necessary resources and services. The provision of microfinance services and other public services helps to create a favorable environment for small business growth, allowing them to contribute to the economy and society as a whole. However, income tax rates have been identified as a significant hurdle that hinders their growth and sustainability (Ayagre, 2018).

Uganda has experienced a steady increase in income tax rates over the past decade, which has raised concerns about its consequences on the viability and financial performance of small and medium enterprises (UBOS, 2020). According to recent studies, income tax rates can lead to reduced profitability, limited reinvestment capabilities, and hindered access to finance for these enterprises (Ayagre, 2018; Wang et al., 2017). Moreover, the effect of income tax rates on small and medium enterprises goes beyond financial constraints. It also affects their competitiveness, discouraging entrepreneurial activity, and potentially leading to business closures and job losses (Nkurunziza & Ahimbisibwe, 2016). The negative consequences of these closures extend to the overall economy, including reduced tax revenues, increased unemployment, and stifled economic growth. Understanding the relationship between income tax rates and the financial performance of small and medium enterprises in Uganda is crucial for policymakers, entrepreneurs, and other stakeholders. By identifying the specific challenges faced by these enterprises due to high tax rates, appropriate strategies and policies can be developed to support their growth and sustainability. Therefore, this study investigated the effect of income tax rates on the financial performance of small and medium enterprises in Uganda

### **1.3 Main objective of the study**

The major objective of the study was to evaluate the effect of income tax rates on the financial performance of small and medium enterprises in Luzira suburb, Nakawa division.

#### **1.3.1 Specific objectives of the study**

- i. To assess the financial performance levels of small and medium enterprises in Luzira suburb, Nakawa division.
- ii. To explore the effects of income tax rates on small and medium enterprises in Luzira suburb, Nakawa division.
- iii. To determine the relationship between income tax rates and financial performance of small and medium enterprises.

### **1.4 Research questions**

The study was guided by the following research questions;

- i. How do income tax rates affect the financial performance of small and medium enterprises in Luzira suburb, Nakawa division?
- ii. What are the financial performance levels of small and medium enterprises in Luzira suburb, Nakawa division?
- iii. Is there any relationship between income tax rates and the financial performance of small and medium enterprises in Luzira suburb, Nakawa division?

### **1.5 Research Hypothesis**

**Ho:** There is no significant relationship between income tax rates and the financial performance of small and medium enterprises in Luzira

### **1.6 Scope of the study**

In the scope of study, the researcher focused on the following key areas of the study that is to say; content scope, geographical scope and time scope.

#### **1.6.1 Content scope**

The study covered the financial performance of small and medium enterprises in Luzira suburb, Nakawa division. The study therefore was specifically to determine the financial performance of small and medium enterprises, the awareness of the tax payers regarding their obligations, the problems that they face and the relationship between the tax paid with the small and medium enterprises.

### 1.6.2 Geographical scope

The study was carried out in Luzira suburb, Nakawa division. Mainly the small and medium enterprises. This is because the region was highly populated and has small and medium enterprises facing income tax rate challenges which affects their financial performance.

### 1.6.3 Time scope

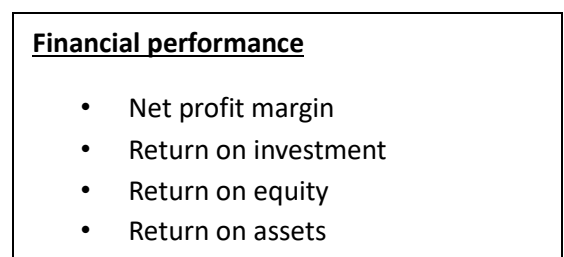
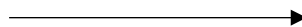
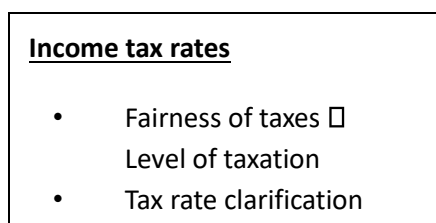
The research utilized a cross-sectional design with an explanatory design. This was to enable the researcher to come up with coherent information from the respondents who were giving responses that are typical of their opinion and the observations made over this period.

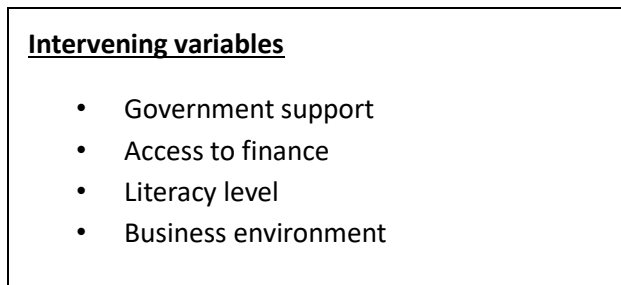
### 1.7 Significance of the study

The findings of the study were significant in the following ways;

- i. The results are anticipated by academics and researchers to add to the body of knowledge already available about income tax and the harm it does to the economy as a whole.
- ii. The study will assist the government and the tax authority in determining how to modify the income tax laws in favor of small and medium enterprises.
- iii. It will give aspiring academics insight into taxation, start-ups, and small companies. After the study is completed, the researcher will be able to practice processing research work and data analysis.
- iv. The study is important for the general public because it will reveal how taxes affect investments and provide a foundation for the future

### 1.8 Conceptual Frame Work





**Figure 1: Conceptual frame work**

According to figure 1. Given above, the researcher conceptualized income tax rates as a dependent variable by identifying the activities fairness of taxes, level of taxation, and tax rate clarification based on capacity to pay and efficient revenue collection process in the sector. The attributes such as government support, access to finance, literacy level, and business environment represent the intervening variables since the financial performance of small and medium enterprises is highly determined by three factors. Therefore, as per the researcher’s conceptual frame work, financial performance of small and medium enterprises is comprised of net profit margin, return on investment, return on equity, and return on equity monitor the financial performance of small and medium enterprises in Luzira, Nakawa division.

**1.9 Limitations of the Study**

- i. Limited access to data. The findings were not easy to access as most respondents were not willing to fill the questionnaires provided to them.
- ii. Time constraints. The study needed a lot of time in collecting and analyzing the findings.

**1.10 Solutions to limitations of the Study**

- i. Identify alternative data sources. To overcome the limitation of limited access to data, the researcher looked for publicly available data such as government reports, or economic surveys that might contain relevant data on income tax rates and SME financial performance.
- ii. Utilize existing research and literature. Despite time constraints, the researcher leveraged existing research and literature related to the topic. Conducting a comprehensive literature review to gather insights, theories and empirical evidence from previous studies conducted in Uganda to draw a meaningful conclusion about the relationship between income tax rates and SME financial performance.

### **1.11 Definition of key terms**

**Income tax.** This is a tax that is annually charged on both earned income and un earned income of an individual.

**Investment.** Refers to investing money in an asset in the hope of receiving dividends from its capital growth.

**Tax policy.** Refers to a choice by the government on what taxes to levy, in what amounts, and on whom.

**Chargeable income.** Is the gross income of a person for the year less total deductions allowed under the income Tax Act Cap 340 for the year 2021/22.

**Tax administration.** Refers to the identification of the taxpayers, assessment of tax payable, collection of taxes and enforcement of tax liability.

**Profitability.** Is a company's capacity to generate more money than it spends over the long term.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

The effect of income tax rates on the financial performance of small and medium enterprises has been a topic of considerable interest in the field of economics. Income tax rates can significantly affect the growth and sustainability of these enterprises. This literature review aimed to explore the existing research on the effect of income tax rates on the financial performance of small and medium enterprises in Uganda. This chapter was addressed to discuss about the background, scope and justification of the study, this chapter reviewed the theoretical and empirical literatures related to the study.

#### **2.1 Concept of Income tax**

Income tax is a direct tax imposed on individuals and businesses' income by the government. It is usually levied based on a progressive tax system, where higher incomes are subject to higher tax rates. This system aims to redistribute wealth and fund public goods and services. Scholars like Smith (1776) and Ricardo (1817) argue that income taxation is essential for social welfare and economic stability. Income tax is an important tool used by governments to generate revenue and support economic development. According to the supply-side economics theory, lower tax rates increase the after-tax income available for investment and business expansion, stimulating entrepreneurship and job creation (Laffer, 1981). For instance, in their study on Asian economies, Tan and Batra (2006) found that lower income tax rates positively influenced SMEs' profitability and investment. On the other hand, high tax rates may reduce the after-tax income available for reinvestment, leading to lower investment levels and slower business growth. A study by Aidt and Jensen (2009) in Denmark found that higher marginal tax rates decreased entrepreneurship rates, particularly for individuals with the potential to start innovative ventures. Income tax rates can have a significant impact on SMEs' investment decisions and expansion plans. High income tax rates may discourage SMEs from reinvesting their profits into their businesses or undertaking new ventures (Odhiambo, 2017). This can hamper economic growth and limit job creation, as SMEs are a major source of employment in Uganda (Kirungi et al., 2021). The competitiveness of SMEs in Uganda can be influenced by income tax rates. Higher

tax rates relative to other countries or regions can make Ugandan SMEs less competitive in both domestic and international markets (Namagembe et al., 2019). This can have implications for export-oriented SMEs and their ability to compete effectively with businesses from low-tax jurisdictions.

## **2.2 Concept of Small and medium enterprises**

SMEs are often referred to as the backbone of the economy, primarily due to their ability to create employment opportunities and foster innovation. According to Piva and Vivarelli (2006), SMEs have a higher employment growth rate compared to large enterprises. Furthermore, the International Finance Corporation (IFC, 2010) states that SMEs contribute significantly to GDP growth and poverty reduction in developing countries. SMEs are characterized by their size, which falls within specified thresholds in terms of annual turnover, number of employees, or capital investment. The precise definitions and classifications of SMEs may vary across different countries and regions (Lumpkin & Dess, 1996). In Uganda, the classification typically considers criteria such as employment, annual sales, and assets (Nakibirige, 2017). SMEs are recognized as significant drivers of economic growth, job creation, and poverty reduction in both developed and developing countries (Storey, 1994). In Uganda, SMEs constitute a significant proportion of the private sector, contributing to GDP and providing livelihood opportunities for the population (Okurut et al., 2018). The financial performance of SMEs can be influenced by numerous factors, including access to finance, infrastructure, and government policies. Income tax rates, in particular, have been identified as a critical determinant of SME financial performance. A study conducted by Beck et al. (2019) found that high income tax rates can discourage entrepreneurial activity, reduce investment, and hinder the growth of SMEs. Taxation policies, particularly income tax rates, can significantly influence SMEs' financial performance. High income tax rates can reduce the profitability and cash flow of SMEs, limiting their reinvestment capabilities and hindering their growth (Abdullahi et al., 2019). Conversely, lower tax rates can stimulate business activities and encourage entrepreneurial endeavors. Complying with tax obligations can be challenging for SMEs due to limited resources, lack of tax knowledge, and administrative burdens (Gebremeskel & Ramachandran, 2021). Non-compliance with tax regulations can lead to penalties and legal issues, affecting the financial stability and reputation of SMEs.

## **2.3 Relationship between Income tax rates and the financial performance of SMEs**

The financial performance of small and medium enterprises (SMEs) is crucial for economic growth and development in Uganda. One factor that can significantly impact their financial performance is the income tax rates imposed on these businesses. In our definition of tax, it is clearly illustrated that a tax is not a price paid by the tax payer for any definite service or benefit from the government in return, and the tax payers have no right to any benefit from public expenditure on the ground that they are paying taxes. Taxes tend to stifle the growth of small private sector and especially hinder the graduation of the informal sector to visible small and medium enterprises, Mamun, A. (2015). The authorities taxing incomes of start-up and small business owners leads to problems of failing to raise adequate resources in the market and the businesses.

High income tax rates can impose significant cash flow constraints on SMEs. When a substantial portion of their income is diverted towards tax payments, it limits their ability to invest in essential areas such as expansion, innovation, and employee development. Researchers like Njogo and Udeh (2018) emphasize that cash flow constraints resulting from high tax rates can curtail the growth potential of SMEs, negatively impacting their overall financial performance. Income tax rates can influence SMEs' investment decisions and their ability to innovate. High tax rates reduce the available funds for investment and limit the financial resources necessary for research and development activities. Kasirye and Ntozi (2017) found that high tax rates discourage SMEs from investing in new technologies and innovations, ultimately affecting their competitiveness and financial performance. The financial performance of SMEs is a key indicator of their overall success and sustainability. Income tax rates can directly influence the profitability, cash flow, and investment capacity of SMEs. According to Murungi (2017), high income tax rates can reduce SMEs' net income, leaving less capital for reinvestment or business expansion. On the other hand, Van and Nam (2019) argue that moderate income tax rates, combined with supportive tax policies, can encourage SMEs to improve their financial performance and contribute to economic growth. Taxation policies, including income tax rates, can have implications for SME employment and growth. High tax rates can discourage SMEs from hiring additional employees, leading to limited job creation. Okumu et al. (2021) explored the relationship between tax rates and employment in Uganda and found that high income tax rates negatively impact job creation and hinder SME growth. Given the importance of SMEs for Uganda's economic development, it is crucial to consider the impact of income tax

rates on their financial performance. Based on the reviewed literature, some recommendations for policy makers include: Conducting periodic reviews of income tax rates to ensure they are conducive to SME growth and competitiveness, implementing tax incentives or exemptions specifically targeted towards SMEs to reduce their tax burden, simplifying tax compliance procedures to alleviate the administrative burden on SMEs and promoting entrepreneurship and SME development through capacity-building programs and access to financial resources

#### **2.4 Effect of Income Tax rates on the financial performance of SMEs**

Financial performance refers to the ability of a business to generate profits and create value for its stakeholders. It is often measured through various indicators such as profitability, liquidity, solvency, and efficiency (Mazzarol, 2019). For SMEs, financial performance is particularly important as it directly affects their growth, sustainability, and ability to compete in the market. Numerous studies have explored the relationship between income tax rates and the financial performance of SMEs. These studies have provided valuable insights into the effects of income tax rates on SMEs' profitability, investment decisions, and overall financial health. Research has shown that high income tax rates can have a negative impact on SMEs' profitability. A study conducted by Ahmed and Alshamrani (2017) found that higher tax rates reduce the after-tax profits of SMEs, limiting their ability to reinvest and expand operations. Similarly, Mwaura and Namusonge (2018) examined SMEs in Kenya and discovered that higher income tax rates were associated with lower profitability ratios. Income tax rates can also influence SMEs' investment decisions. High tax rates may discourage SMEs from undertaking new investments or expanding their businesses. According to research by Agus, Yusof, and Hassan (2020), higher income tax rates reduce the financial resources available for SMEs to invest in new technologies, research and development, and other growth-enhancing activities. The financial health of SMEs is significantly influenced by income tax rates. A study conducted by Adu, Akotey, and Amankwah-Amoah (2019) in Ghana revealed that high tax rates negatively affect SMEs' liquidity and solvency positions. The burden of paying high income taxes can strain their cash flows, limit their ability to meet financial obligations, and increase the risk of insolvency. These are effects that result from poor tax assessment and poor tax administration. Muwanga J (2014), stated the following effects which are because of poor tax administration. Some of the taxes levied are complicated and not simple to understand and this has brought about a lot of confusion. There is always poor tax assessment since many small business people do not give

correct information concerning their businesses in fear of paying higher taxes. Increase in the tax rate particularly income tax erodes disposable income of the people affecting the financial performance of small and medium enterprises and the economy. Income tax tends to discourage savings and wealth accumulation. This is because it takes a big percentage of the income of the entrepreneurs owning the small and medium enterprises. They worsen income inequality. Income tax rates take a big proportion of a person's income especially for low-income earners who own the small and medium enterprises compared to high income earners. Income tax rates erodes the popularity of the government in power. This is because they make the tax payers forego consumption and saving as part of their income is taken away by the state in form of taxes making the government look exploitative. Income tax rate discourages effort and hard work. This is because they are progressive in nature therefore the rate of paying taxes increases as incomes increase which makes the people to put in less effort hence negatively affecting economic growth rate.

## **2.5 Relationship between Tax Compliance and the financial performance of SMEs**

Tax compliance is a vital aspect of SMEs' operations, as it affects their relationship with the government and overall business environment. Several studies have examined the impact of income tax rates on tax compliance behavior by SMEs. For instance, a study by Asongu et al. (2018) found that high income tax rates can lead to increased tax evasion among SMEs in Uganda. Conversely, Obwona et al. (2017) argued that lower income tax rates can encourage voluntary compliance by SMEs, resulting in a broader tax base and increased revenue for the government. Turyahikayo and Kibirige (2020) investigate the relationship between tax compliance and SME financial performance in Uganda. They find that high income tax rates can increase the likelihood of tax evasion, which negatively affects SME profitability and hinders sustainable growth. A study by Nanteza and Byamugisha (2019) reveals that high tax rates lead to decreased tax compliance among SMEs, resulting in reduced access to credit and limited ability to attract investors. Noncompliance further strains the relationship between SMEs and tax authorities, impeding their financial performance. Tax compliance costs, including the administrative burden of tax reporting and record-keeping, can disproportionately affect SMEs. High income tax rates can exacerbate these costs, potentially diverting resources away from productive activities. A study by Chittenden et al. (2019) highlights that excessive tax compliance costs hinder the growth and profitability of SMEs, ultimately affecting their financial

performance. To tackle the issue of non-compliance, most tax regimes integrate punitive measures, such as fines, closure or even jail term, to enforce compliance (Swistak, 2016). Compliance cost, poor internal controls, tax rates (Mwangi, 2014), auditing of account/tax assessment, referral group and tax knowledge (Inasius, 2015), fairness, prompt enforcement (Swistak, 2015), attitude (Nkwe, 2013), high tax rates and complex filing procedure determine SMEs' tax compliance behaviour. Ameyaw et al. (2016) claim that taxes cannot be avoided without attracting punishment. Differences in tax compliance behaviour between small and medium enterprises may again be attributed to the position of the ability to pay tax theory espoused earlier (Kendrick, 2019).

Empirically, in Tanzania, Masanja (2019) found that issues, such as high taxes, multiple taxes unreasonable taxes, unfriendly attitude of tax administrators, difficulty in paying taxes, bureaucracy in paying taxes and changes in taxes, affect tax compliance behaviour for SMEs. Firm size positively related significantly with ability to pay tax (Ocheni & Gemade, 2015). For instance, Mukhlis and Simanjuntak (2016) found low tax compliance behaviour among SMEs. Elsewhere in Greater Accra, Okpeyo, Musah and Gakpetor (2019) found that tax compliance is higher among medium enterprises than small firms. Others also believe small firms bear higher tax compliance costs than larger companies hence having higher default risk of non-payment (Atawodi & Ojeka, 2012; Lokhande, 2020).

## **2.6 Relationship between Tax assessment and the financial performance of SMEs**

Tax assessment refers to the job of determining the value and use of property usually to calculate a tax. In Uganda, income taxes are assessed on individuals and businesses based on their earnings within a given financial year. The tax rates vary depending on the income bracket and business category. For instance, companies with an annual turnover of up to 150 million Ugandan shillings (UGX) are taxed at a rate of 20% while those with an annual turnover exceeding UGX 150 million are taxed at a rate of 30% (Uganda Revenue Authority, 2021). According to a study by Turyakira and Bbaale (2017), the income tax rates in Uganda have negatively affected the financial performance of small businesses. The authors noted that the tax system is complex and cumbersome, leading to high compliance costs for small businesses. Additionally, the high tax rates reduce the amount of disposable income available for investment and growth, thereby limiting the capacity of small businesses to innovate and expand. As a result, small businesses are less likely to create employment opportunities and contribute to the

overall economic growth of the country. Moreover, according to the World Bank's Ease of Doing Business Report (2020), Uganda ranked 115th out of 190 countries, indicating that the country's tax system is not conducive to business growth and development. The report cited high tax rates, complex tax regulations, and inefficient tax administration as some of the challenges facing small businesses in Uganda. Therefore the income tax rates in Uganda have a negative impact on the financial performance of small businesses and start-ups. The complex tax system, coupled with high compliance costs, reduces the amount of disposable income available for investment and growth, limiting the capacity of small businesses to innovate and expand. Therefore, there is a need for the Ugandan government to review and reform the tax system to make it more conducive to small business growth and development.

### **2.7 Effects of tax assessment on sales revenue**

Tax assessment has adverse effect on business financial performance and profitability therefore it is important that assessment be carried out accurately so that taxpayers are not excessively assessed. Changes in how revenue is recognized for financial statement purposes under the Generally Accepted Accounting Principles (GAAP) and the International Financial Reporting Standards (IFRS) may have significant implications on the tax revenue recognition methods currently used by many taxpayers. Since most taxpayers either follow book revenue recognition methods or determine tax revenue based on book income, changes in how revenue is recognized for financial statement purposes will affect not only how taxable income is calculated, but also potentially other taxes and non-tax calculations. As further explained below, the IFRSB is further evaluating the impact of new standards on taxpayers' methods of accounting and is expected to issue procedural guidance to implement such method changes. Software, entertainment, life science, manufacturing and construction industry businesses are likely to be particularly affected by the new guidance which makes significant changes to revenue methods.

### **2.8 Effects of tax policy on profitability**

Profitability is considered as the most complicated feature for a company to be understood and evaluated. These ratios included in profitability are applied for evaluating the business capabilities and making the wages in comparison with all costs during a specified period of time. In a more accurate way, the ratios indicate the profitability of a company, having calculated the total costs and tax on revenue, operational efficiency and company pricing policies, assets profitability and the company's shareholders. There's a need for a tax system that can be used as

a veritable tool for establishing and developing Uganda, particularly in rural areas. The revenue authority will need to be focused on the objective of industrial development, economic growth and employment generation. Therefore, Uganda Revenue Authority should look at the role of tax in promoting sound industrial financial performance and scale down unemployment.

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.0 Introduction**

This chapter describes the research methodology that was used in the research study. These included the research design, area of study, target population, sample size, sampling techniques, sources of data, procedure of data collection, validity and reliability, data analysis, ethical considerations, and limitations. This chapter generally contains the approach that was used to achieve the objectives of the study.

#### **3.1 Research Design**

Research design refers to the overall strategy and plan that is to be employed to address the research questions and objectives. In this study, a qualitative research design was used. Qualitative research is a design that aims to explore and understand the subjective experiences, meanings, and perspectives of individuals or groups. It involves collecting and analyzing non-numerical data, such as interviews, observations, and to uncover in-depth insights and rich descriptions of the phenomenon under investigation. This design allowed for a comprehensive exploration of the complex factors influencing the financial performance of small and medium enterprises in Luzira in relation to income tax rates. By conducting interviews with business owners and managers, observing their behaviors and practices, and analyzing relevant documents, the study captured the contextual factors, and diverse perspectives that contribute to a holistic understanding of the topic.

### 3.2 Study Population

Population is the entire group of people, events or things that a researcher wishes to investigate. The target population was comprised of a population of 100 small and medium enterprises, which included Mini-supermarkets, hardware shops, retail shops and URA tax administrators; all selected and used in order to obtain reliable and valid information.

### 3.3 Sampling method and sample Size Determination

The researcher therefore used stratified sampling which is a method under probability sampling technique. The study was carried out using the stratified sampling method whereby samples were selected from the SME owners or managers in Luzira grouped under segmented businesses and those that deal in assorted merchandize. This was due to their convenience about the topic and area under study hence they were expected to represent each element in the population. This technique helped in reducing on the costs of collecting and analyzing data.

In order to obtain reliable and valid information, out of the target population of 100, a sample size of 80 respondents were derived using, Slovene's formula as shown below;

$$n = \frac{N^2}{1 + N(e)}$$

Where; n= sample size

N= population of the study

l= constant                      e = level of significance, e =

0.05 in social science

Basing on Slovene's formula, the minimum sample size will;

$$n = \frac{N}{1 + N(e)}$$
$$n = \frac{100}{1 + 100(0.05)^2}$$
$$n = \frac{100}{1 + 100(0.0025)}$$

$$n = \frac{100}{1 + 0.25}$$

$$n = \frac{100}{1.25}$$

Therefore, n = 80 respondents.

**Table 1. Categories of respondents**

Sample / department	Population	Formula	Sample size
Mini-supermarkets respondents	20	$\frac{20}{100} * 80$	16
Hardware shops respondents	20	$\frac{20}{100} * 80$	16
Retail shops respondents	60	$\frac{60}{100} * 80$	48
<b>Total</b>	<b>100</b>		<b>80</b>

### 3.4 Data collection method

The study used both primary and secondary sources of data;

#### 3.4.1 Primary Source

Primary data means original data that has been collected specially for the purpose of mind. This means someone collected the data from the original source. The research gathered primary data by conducting personal interviews and distributing self-administered questionnaires to a chosen sample of respondents, with the objective of obtaining their viewpoints. Acquiring primary data is crucial as it allowed the researcher to collect information that directly serves the purpose of the study. The researcher personally administered the questionnaires to ensure data accuracy and completeness.

#### 3.4.2 Secondary Source

Secondary data is the data that has already been collected by the readily available from other sources. In the context of a historical research project, secondary sources typically refer to scholarly books and articles, which was utilized to gather information from existing literature such as e-books, journals, published articles, and periodicals. Categorizing documentary resources is important to streamline the process of data collection and textual analysis.

### 3.5 Research tools

The research tools that were used in the study are questionnaires, interviews and observation. A questionnaire is a reformulated written set of questions to which respondents record their answers, usually within rather closely defined alternatives. The study used open ended questionnaires. Respondents were free to Agree or Disagree with any question on the questionnaire or a continuum ranging from Strongly agree to Strongly disagree as follows; Strongly agree (4 points), Agree (3 points), Disagree (2 points) and strongly disagree (1 point).

**Table 2: Interpretation of the mean range**

Scale	Response mode	Meaning
4	Strongly agree	Very high
3	Agree	High
2	Disagree	Low
1	Strongly disagree	Very low

**Source: primary data, 2023**

The observation method was used by visiting the owners of the small and medium enterprises in order to retrieve some useful information for the study.

### 3.6 Validity and Reliability

According to Patton (2015), validity and reliability are two factors that researchers should be concerned while designing a study, analyzing results and judging the quality of the study. Validity in a study concerns the accuracy and trustfulness of findings. Reliability is concerned with consistence of the measuring instrument. Reliability will tested using Cronbach's alpha and validity will tested using factor analysis.

Validity is the extent to which the instruments are used during the study to measure the issues they are intended to measure. To ensure validity of instruments, they are developed under close guidance of the supervisor. After designing the questions, the researcher conducted a pre-test. This helped to identify ambiguous questions in the instruments and helped in re-aligning them to the objectives. The researcher used the following formula to establish validity of the research instruments as seen below;

Content validity Index (CVI) = Relevant items by all judges as suitable

Total number of items judged.

If the CVI is equal to or greater than the recommended 0.70, this will imply that the questionnaire is valid for data collection.

### **3.7 Data collection Procedure**

The questionnaires were ready then after going to the field and collecting data that is required for the study. Only willing respondents were contacted to participate in the process to avoid biased information.

### **3.8 During Data Gathering**

Due to the nature of work and busy schedules of some prospected respondents, the researcher scheduled appointments for such respondents. The researcher gave necessary explanation on certain questions where needed. The researcher then used a pilot study before the actual research to check feasibility of the research instrument in order to make necessary improvements and adjustments in the tool and to avoid time wastage.

### **3.9 After Data Gathering**

After the scheduled time, the primary data was collected through questionnaires which were collected from the respondents for data analysis. After this, the data was coded, edited, categorized and entered into a computer by using Statistical Package for Social Science (SPSS) for data processing and analysis.

### **3.10 Data Analysis**

Firstly, the data was analyzed using descriptive statistics through the mean and standard deviation. Secondly, the inferential statistics were used via a correlation analysis to measure the linear relationship between income tax, start-ups and small business basing on Pearson's linear coefficient calculation.

### **3.11 Ethical considerations**

In the context of research, ethics refers to the appropriateness of your behavior in relation to the rights of those who become the subject of your work, or are affected by its findings (Saunders, Lewis, & Thornhill, 2009). This means that the researcher ensured that the research design was both mythological sound and morally defensible to all those who were involved. The researcher

ensured that the respondents were not coerced into participating in the research, they were also informed about the procedures and risks involved in research and given their consent to participate. The researcher did not put the respondents in a situation where they might be at risk of harm as a result of their participation. High levels of confidentiality were kept.

**CHAPTER FOUR**

**DATA PRESENTATION, ANALYSIS AND INTERPRETATION OF THE FINDINGS**

**4.0 Introduction**

This Chapter presents data analysis, tables and figures that were presented and interpretation made in accordance with the research objectives of the study. The chapter was divided into sub-chapters namely; demographic characteristics of the respondents and findings in relationship to the objectives of the study.

**4.1 Demographic characteristics of respondents**

This section presents features that emerged from the analysis of the respondent’s sociodemographic characteristics which includes; gender, age, education level and years of experience. The aim was to find out whether there were variations in the respondent’s background and whether these had an impact on the respondent’s views. Their responses are summarized and shown below.

**4.1.1 Gender of respondents**

**Table 3: Gender of respondents**

Respondents were asked to state their gender status as shown in the table below

<b>Gender</b>		<b>Frequency</b>	<b>Percent</b>	<b>Valid percent</b>	<b>Cumulative percent</b>
<b>Valid</b>	<b>Male</b>	44	55.0	55.0	55.0
	<b>Female</b>	36	45.0	45.0	100.0
	<b>Total</b>	80	100.0	100.0	

### Source: Primary data 2023

Table 3 shows the sex of the respondents and it was revealed that male are 44 (55%) and female were 36 (45%) of the total sample of the entire sample, indicating that the view of males dominated the study.

### 4.1.2 Age of the Respondents

**Table 4: Age of the respondents**

Age of the respondents		Frequency	Percent %	Valid percent	Cumulative percent
Valid	Below 20	0	0.0	0.0	0.0
	21 - 25	7	8.8	8.8	8.8
	26 – 30	11	13.8	13.8	22.6
	31 - 35	41	51	51	73.6
	36 - 40	16	20	20	93.6
	Above 41	5	6.4	6.4	100
	<b>Total</b>	80	100.0	100.0/0	

Source: primary data, 2023

From the above table 4, the study revealed that no respondent was aged below 20 years old therefore, the respondents were in the age group of 21-25 years(7) 8.8%, 26-30 years(11) 13.8%, 31-35 years(41) 51%, 36-40 years(16) 20%, and above 40 years(5) 6.4%. This implies that the majority of the respondents were in the age range of 31-35 years.

### 4.1.3 Education level of the respondents

**Table 5: Education level of the respondents**

Gender		Frequency	Percent %	Valid percent %	Cumulative percent %
Valid	Primary	7	8.8	8.8	8.8

O' level	13	16.2	16.2	25
A' level	5	6.3	6.3	31.3
Certificate	24	30	30	61.3
Degree	31	38.7	38.7	100
Masters	0	0	0	0
Total	80	100.0	100.0	

**Source:** primary data, 2023

Table 5 revealed there is no respondent whose education level is indicated masters being 0%, 7 (8.8%) were primary, 13 (16.2%) O' level, 5 (6.2%) A' Level, 24 (30%) were certificate, and 31 (38.7%) had degrees. The study was dominated by respondents having which was 38.7% of the respondents and indicates that most of the respondents had knowledge about income tax rates.

#### 4.1.5 Working experience of respondents

**Table 6: Working experience**

Experience level		Frequency	Percent	Valid percent	Cumulative percent
<b>Valid</b>	Below 1 year	8	10.0	10.0	10.0
	1-5 years	43	53.8	53.8	63.8
	Above 5 years	29	36.2	36.2	100.0
	Total	80	100.0	100.0	

**Source:** primary data, 2023

The bio-data table 6 shows us the years of experience of the respondents which indicates that 8 (10%) have below 1 year and 43 (53%) have between 1-5 years while 29 (36.2%) have above 5 years of experience an indication that the majority understand the taxation system and business cycles that may lead to a change of the financial performance of the business.

#### 4.2 Awareness of income tax payers

Respondents were asked if they were aware of the income taxes they pay, any record kept by the business, how records are kept, whether the tax authority has given any tax assistance and how the assistance in regards to income tax awareness was. The following results were obtained.

##### 4.2.1 Whether respondents are aware of the income taxes they are to pay

Respondents were asked if they were aware of the income taxes they pay. The figure below illustrates the results.

**Table 7 Showing how businesses keep records**

<b>Response</b>	<b>Frequency</b>	<b>Percentage</b>
Bin cards	13	16.3
Store ledgers	48	60
Both	19	23.7
Total	80	100

**Source: Primary data 2023**

From table 7 above, 16.3% of small and medium enterprises sampled keep their records using bin cards, 60% used store ledgers and 23.7% used both bin cards and store ledgers.

**4.2.2 Assistance as regards to income tax assistance**

The researcher asked respondents if the business entrepreneurs had got any assistance as regards to income tax awareness and the form of awareness. The table below illustrates how they responded.

**Table 8: Shows if the tax authority has ever given assistance as regards to income tax awareness.**

<b>Response</b>	<b>Frequency</b>	<b>Percentage</b>
Yes	16	20
No	64	80
Total	80	100

**Source: Primary data 2023**

From the table 8 above, 80% of the respondents said they had not received any assistance from the tax authority towards income tax awareness and 20% said they had received some assistance.

**Table 9: Nature of assistance given to income tax payers.**

<b>Statement</b>	<b>Strongly Disagree (%)</b>	<b>Disagree (%)</b>	<b>Uncertain (%)</b>	<b>Agree (%)</b>	<b>Strongly Agree (%)</b>
The methods used in assessing the income taxes rates are fair	50	21.3	0	20	8.7
Whenever income taxes collected from me, the income tax rates are fair	40	26.3	0	30	3.7
Tax authorities do not harass me whenever they come to collect income taxes	50	25	0	10	15

**Source: Primary data 2023**

Scale: 5. Strongly Agree 4. Agree 3. Uncertain 2. Disagree 1. Strongly Disagree The response mean is 1.00-1.80 Strongly disagree, 1.81-2.60 Disagree, 2.61-3.40 Uncertain, 3.41-4.20 Agree, 4.21-5.0 Strongly Agree.

According to table 9, the results show that the nature of assistance given to income tax payers is poor. This is from the fact that 71.3% of the respondents disagreed that the methods used were fair, 66.3% rejected the statement that whenever income taxes are collected from them, the income taxes are fair and also 75% rejected the statement that tax authorities do not harass them whenever they come to collect income taxes.

### 4.3 Income taxes paid by SMEs

#### 4.3.1 Common income taxes paid by SMEs

From the findings of the study, most of the respondents revealed that they pay rental tax, personal income tax and withholding tax.

#### 4.3.3 Average amount of income tax paid

Respondents were asked about how much on average the amount they pay as income taxes annually. The table below illustrates the response.

**Table 10: Average amount of income tax paid**

Shillings (000)	Frequency	Percentage
Zero	0	0
100 – 190	55	68.8
200 – 290	13	16.2
300 – 390	12	15
400 – 490	0	0
500 and above	0	0
Total	80	100

According to table 10, among the businesses sampled. No business does not pay income taxes, 68.8% pay average income taxes of 100,000/= - 190,000/=: 16.2% pay on average between 200,000/= - 290,000/= and 15% of the businesses pay between 300,000/= - 390,000/=: The above results show that SMEs in Luzira were paying more money in income taxes.

### 4.4 Problems faced by tax payers on income tax rates

#### 4.4.1 Specific effects of income tax rates on businesses

The following are specific effects that were given by respondents and proprietors of small and medium enterprises in Luzira.

**Reduce the net profit margin.** Income tax rates directly reduce the net profit margin as a significant portion of earnings is allocated to tax payments. This limits the financial resources available for reinvestment or expansion.

**Reduce the return on investment.** Return on investment represents the profitability of an investment relative to its cost. Higher income tax rates decrease the after tax profit and this discourages investment in new projects or hinder the growth of existing SMEs.

**Decrease in efficiency and return on assets.** Return on investment measures how efficiently a company utilizes its assets to generate profits. Income tax rates indirectly affect the return on assets by reducing the net income available relative to the assets employed. Therefore high income tax rates lower the return on assets signalling decreased efficiency.

**Compliance costs.** Higher income tax rates often come with increased compliance requirements. Small and medium enterprises may need to allocate more resources to ensure they accurately calculate and report their taxes which can add administrative burdens and costs.

#### **4.4.2 Give any suggestions about the problems that may have been encountered while complying with income tax obligations**

The respondents were asked to give suggestions on how their problems can be dealt with. The following were the responses.

**Lower income tax rates.** Reducing income tax rates for SMEs could alleviate the financial burden and increase their return on investment. This would allow them to allocate more funds towards growth and innovation.

**Simplify tax regulations.** Simplifying the tax codes and streamlining compliance procedures would make it easier for SMEs to understand and meet their income tax obligations. This could involve providing clear guidelines and offering support services to assist with tax compliance.

**Tax incentives.** Introducing targeted income tax incentives or exemptions specifically for SMEs could encourage their growth and development. These incentives could include reducing income tax rates and tax breaks for investment.

#### **4.5 Analysis based on the objectives of the study**

The major findings of the specific objectives of the study were exclusively interpreted in this section. To get an exhaustive answer for this specific objective, the respondents were asked to rank various questions in the questionnaire by indicating the level of their agreement. Five point like scale were used with 1 denoting choice for those who strongly agree while 2 denoted those who just disagreed. For the respondents who agreed had the choice of 4 and 5 to showing their level of agreement with 4 denoting a choice for those who agreed and 5 for those who strongly

agreed. Those who had no choice and were neutral had a choice of 3 also to reveal their mind. The means and standard deviations for all the questions were computed, ranked and interpreted as revealed in the table below.

#### 4.5.1 Level of financial performance of small and medium enterprises in Luzira

The first objective of the study was to find out the financial performance levels of small and medium enterprises in Luzira, the variable investigated was financial performance such as net profit margin, return on investment, return on assets and return on equity. For the first objective, the responses and interpretations were based on the measurement tool of mean as follows:

Mean range	Response range	Interpretation
3.41 - 4.20	Strongly agree	Very high
2.61 – 3.40	Agree	High
1.81 – 2.60	Disagree	Low
1.00 – 1.80	Strongly disagree	Very low

**Table 11: Showing the level of financial performance of small and medium enterprises in Luzira**

Scale	Strongly Disagree (%)	Disagree (%)	Uncertain (%)	Agree (%)	Strongly Agree (%)	Mean
Net profit margin has increased regardless of the income tax rates	15.8	10	-	35	39.2	3.72
The market size has increased regardless of the income tax rates	10.3	20	-	30.7	39	3.68
The return on assets has increased regardless of the income tax rates	5	15	5	30	45	3.95
The sales volumes have increased regardless of income tax rates	12.4	10	-	27.6	50	3.93

The number of customers have increased regardless of income tax rates	2.7	10	-	37.3	50	4.22
The return on investment has increased regardless of income tax rates	29.67	10	-	30.33	30	3.21
The revenue has increased regardless of income tax rates	8	3	-	50	37.2	4.0
Selling costs increase when the income tax rates increase	5	4.24	-	44	46.8	4.24
Generally income tax rates affect the financial performance of my business	28.4	-	-	21	50.6	3.65

**Source:** survey data, 2023

From table 11, it is evident that most of the respondents agreed that the financial performance of small and medium enterprises has increased regardless of the income tax rates as most of them agreed with the statement used to measure this objective with the highest percentage. This is based from the fact that 74.2% of the respondents agreed that net profit margin has increased regardless of the income tax rates with a mean of 3.72, 69.7% agreed that the market size has increased regardless of income tax rates with a mean of 3.68.

Furthermore, 75% agreed that return on assets has increased regardless of income tax rates with a mean of 3.95, 77.6% of the respondents agreed that sales volume have increased regardless of income tax rates with a mean of 3.93, 60.33% agreed that the return on investment has increased regardless of income tax rates with a mean of 4.22, 87.2% of the respondents agreed that the revenue has increased regardless of income tax rates with a mean of 4.0, 90.8% agreed that Selling costs increase when the income tax rates increase with a mean of 4.24

Lastly, 71.6 agreed that generally income tax rates affect the financial performance of my business with a mean of 3.65.

#### **4.5.2 To find out the effect of income tax rates on the financial performance of small and medium enterprises in Luzira.**

The second objective of the study was to find out whether income tax rates affect the financial performance of small and medium enterprises in Luzira. As far as our hypothesis was concerned which stated that there is no relationship between income tax rates on the financial performance of small and medium enterprises. The study reveals the following report.

**Table 12: Effects of Income tax rates on the financial performance of small and medium enterprises in Luzira.**

Statements	Mean	Std. Deviation	Interpretations	Rank
Income tax rates change annually	3.48	0.98300	Very high	1
I had received expected returns on income taxes I pay	3.44	0.85101	Very high	2
Income tax rates are the same for both small and large businesses	3.43	0.95883	Very high	3
I satisfied the amount of income tax	3.41	0.86585	Very high	4
Income tax rates lowers the net profit margin of my businesses	3.39	0.95883	Very high	5
Income tax administration is the major cause of my business stagnation in terms of return on investment of small and medium enterprises	3.37	0.86585	Very high	6

Has the tax authority given me any assistance in regards to income tax awareness	3.36	0.91246	Very high	7
Tax administration have relevant information about tax payer	3.31	0.98300	Very high	8
<b>Overall means</b>	<b>3.40</b>		<b>Very High</b>	

**Source:** Survey data, 2023

The findings from table 12 indicated that respondents when asked whether income tax rates change annually had the first mean vale of 3.48, the corresponding standard deviation was rated very high and this was ranked 1<sup>st</sup>.

The results further showed that I had received expected returns on income taxes I pay, the average value was 3.44 and its corresponding standard deviation was rated very high. It can also be observed from the table above that this particular question was ranked 2<sup>nd</sup>.

The average based on response that tax rates are the same for both small and large enterprises with standard deviation was rated very high with a mean of 3.43 and ranked 3<sup>rd</sup>.

The rank on the statement “I satisfied the amount of income tax rates” from the above table 7 is 4<sup>th</sup> and this was interpreted as very high and this is truly revealed by the corresponding mean value of 3.41.

The results from table showed a mean value of 3.39 and standard deviation rated very high for the statement that the income tax rates net profit margin of my business. The rank for this question was the 5<sup>th</sup>.

Additionally, the findings from the above table indicated that respondents when asked whether Income tax administration is the major cause of my business stagnation in terms of return on investment, had the mean value of 3.37, the corresponding standard deviation was rated very high and ranked 6<sup>th</sup>.

The results further showed that when asked whether the tax authority has given me any assistance in regards to income tax awareness, the average mean was 3.36 and its corresponding standard deviation was rated very high. It can also be observed from the table above that this particular question was ranked 7<sup>th</sup>.

The results as seen from the table also showed a mean value of 3.31 and standard deviation rated very high for the statement that the tax administration has relevant information about tax payers, the corresponding standard deviation was rated very high and ranked 8<sup>th</sup>.

Finally, by observing the overall mean, the above analysis reveals that most of the respondents supported the agreement that income tax rates affects the financial performance of small and medium in Luzira as the overall mean had a value of 3.40 and standard deviation was rated very high and was therefore interpreted as satisfactory to the respondents.

#### **4.5.3 Relationship between income tax rates and the financial performance of small and medium enterprises in Luzira**

However much the study was guided by the null hypothesis, there is no relationship between income tax rates and the financial performance of small and medium enterprises in Luzira.

**Table 13: Pearson correlation between income tax rates and the financial performance of small and medium enterprises**

<b>Correlations</b>	<b>Income tax rates</b>	<b>Financial Performance</b>
Income tax rates		
Pearson Correlation	1	0.276*
Sig. (2-tailed)		0.013
N	80	80
Financial Performance		
Pearson Correlation	0.276	1
Sig. (2-tailed)	0.013	
N	80	80

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

Table 13 showing the relationship between income tax rates and the financial performance of small and medium enterprises in Luzira, whereby the correlation results were; Pearson's correlation r value was 0.276\* implying a weak positive relationship between the two variables

under our study. A P-value of 0.013 and the alpha value of 0.025 were established. Due to the fact that the P-value was less than the alpha, the researcher rejected the null hypothesis and accepted the alternative to state that “there is a significant relationship between income tax rates and the financial performance of small and medium enterprises in Luzira.

**4.5.4 Regression analysis**

**Table 14. ANOVA Coefficients**

	Unstandardized coefficients		Standardized coefficients		
	B	Std. Error	Beta		
(Constant)	1.076	0.519		2.073	0.040
Tax policy	0.167	0.077	0.135	2.166	0.032
Tax assessment	-0.162	0.078	-0.132	-	0.040
Income tax rates	0.236	0.083	0.211	2.859	0.005

**Source:** Primary data, 2023

Dependent Variable: Financial performance

The elements of the independent variables are the factors influencing financial performance. This can be determined by the following equation below:

$$Y = a + b_1X_1 + b_2X_2 + b_3X_3 + e$$

Y = financial performance  
 a = constant

X1 = Tax policy

X2 = Tax assessment  
 b = regression of coefficient

of Xi, i= 1, 2, 3  
 e = an error term, normally

distributed by mean 0.

$$Y \text{ (financial performance)} = 1.076 + 0.167 \text{ (Tax policy)} - 0.162 \text{ (Tax assessment)} + 0.236 \text{ (Income tax rates)}$$

Under this regression equation, it illustrates the relationship between income tax rates, tax policy, and tax assessment factors towards financial performance.

Based on the model summary table, the three independent variables which are tax assessment of results, tax policy and income tax rates factors are slightly correlated with the dependent variable financial performance. This is because the correlation  $R$  for this research is 0.505 whereas the coefficient of determination ( $R^2$ ) is 0.255 for the examined regression model. From the analysis, it means the regression line could significantly account for 25.50% of the total variations in financial performance. In contrast, it shows that there is 74.50% of the variation of financial performance could not be presented by the equation. This means there are other additional variables that are also important in explaining financial performance that has not been covered in this study. Hence, the results show that 25.50% of the variables in the financial performance have been slightly significantly explained by the three independent variables.

In the ANOVA table above, it shows that the F- value of 13.305 is significant at the 0.05 level. This is because the P- value is 0.00 which is less than 0.05 ( $P < 0.05$ ). In overall, there regression model with those three independent variables of tax assessment, tax policy and income tax rates factors were suitable in explaining the variation in financial performance.

Based on the coefficient tables, Tax policy has the significant positive influence towards financial performance since  $t = 2.166$ ,  $p = 0.032$  and  $b_1 = 0.167$ , this means that for every one-unit increase in tax policy, the financial performance will increase by 0.167 units.

Besides, for tax assessment, it also shows significant negative influence towards financial performance. From the results gained,  $t = -2.069$ ,  $p = 0.040$  and  $b_2 = -0.162$ , thus, it shows that every one-unit increase in tax assessment, financial performance will decrease by 0.162. In addition, there is also positive significant influence towards financial performance for income tax rates. The results shown were  $t = 2.859$ ,  $p = 0.005$  and  $b_3 = 0.236$ . Hence, this shows that for every one-unit increase in income tax rates, financial performance will be increased by 0.236.

## **CHAPTER FIVE DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS**

### **5.0 Introduction**

This chapter discusses the findings of the study and presents them in summaries, conclusions and recommendations made based on the findings of each objective. The summary presents findings from the study, its conclusions are then drawn from these findings and then recommendations are eventually made.

### **5.1 Summary of major findings**

#### **5.1.1 Level of financial performance of small and medium enterprises in Luzira**

The findings of the study revealed that most of the respondents agreed that the financial performance of small and medium enterprises in Luzira has increased regardless of the income tax rates as most of them agreed with the statements used to measure this objective with the highest percentage. This is based from the fact that 74.2% of the respondents agreed that net profit margin has increased regardless of the income tax rates with a mean of 3.72, 69.7% agreed that the market size has increased regardless of income tax rates with a mean of 3.48, 75% agreed that return on assets has increased regardless of income tax rates with a mean of 4.25, 77.6% of the respondents agreed that sales volume have increased regardless of income tax rates

with a mean of 3.92, 60.33% agreed that the return on investment has increased regardless of income tax rates with a mean of 3.21, 87.2% of the respondents agreed that the revenue has increased regardless of income tax rates with a mean of 4.12, 90.8% agreed that Selling costs increase when the income tax rates increase with a mean of 4.30, and 71.6 agreed that generally income tax rates affect the financial performance of my business with a mean of 3.65.

### **5.1.2 Income tax rates effects on the financial performance of small and medium enterprises in Luzira**

From the findings, indicated that respondents when asked whether income tax rates change annually had the first mean value of 3.48, the corresponding standard deviation was rated very high, the results further showed that I had received expected returns on income taxes I pay, the average value was 3.44 and its corresponding standard deviation was rated very high, the average based on response that tax rates are the same for both small and large enterprises with standard deviation was rated very high with a mean of 3.43, the statement “I satisfied the amount of income tax rates” had mean value of 3.41, the results further showed a mean value of 3.39 and standard deviation rated very high for the statement that the income tax rates net profit margin of my business, additionally, the findings from indicated that respondents when asked whether Income tax administration is the major cause of my business stagnation in terms of return on investment, had the mean value of 3.37, the corresponding standard deviation was rated very high, the results further showed that when asked whether the tax authority has given me any assistance in regards to income tax awareness, the average mean was 3.36 and its corresponding standard deviation was rated very high, a mean value of 3.31 and standard deviation rated very high for the statement that the tax administration has relevant information about tax payers, finally, by observing the overall mean, the above analysis reveals that most of the respondents supported the agreement that income tax rates affects the financial performance of small and medium in Luzira as the overall mean had a value of 3.40 and standard deviation was rated very high and was therefore interpreted as satisfactory to the respondents.

### **5.1.3 Relationship between income tax rates and the financial performance of small and medium enterprises.**

The study results on the relationship between income tax rates and the financial performance of small and medium enterprises in Luzira whereby the correlation results were; r value was

0.276\*, P-value was 0.013 and the alpha value was 0.0025 in determining the research hypothesis, the researchers considered the alternative of the null hypothesis which states that “there is significant relationship between income tax rates and the financial performance of small and medium enterprises in Luzira” and also the null hypothesis which states that “there is no relationship between income tax rates and the performance of start-ups and small business” was rejected. This made the researcher conclude that there is a weak positive relationship between income tax rates and the financial performance of small and medium enterprises in Luzira. This is in line with Nieman et al (2003) who noted that the small and medium business growth includes the extent to which SMEs generate significant positive cash flows or earnings, which increase at significantly faster rates. There are several indicators of SME growth such net profit margin, return on investment, return on equity and return on assets among others and all these can be affected by microfinance services. Net profit margin refers to the portion of earnings allocated to tax payments, return on investment represents the profitability of an investment relative to its cost, and return on assets measures how efficiently a company utilizes its assets to generate profits.

#### **5.1.4 Tax policy**

Based on the coefficient table, Tax policy has the significant positive influence towards financial performance since the  $t = 2.166$ ,  $p = 0.032$ ,  $b_1 = 0.167$ , this means that for every one unit increase in tax policy, financial performance will increase by 0.167 units.

In the ANOVA table above, it shows that F-value of 13.305 is significant at the 0.05 level. This is because the P-value is 0.00 which is less than 0.05 ( $P < 0.05$ ). In overall, the regression model with those three independent variables of tax assessment of results, tax policy and income tax rates factors were suitable in explaining the variation in financial performance.

Tax policies can be designed in such a way that they do not only directly affect SMEs but also indirectly push for their growth for example the practice in China where tax policies have been designed to encourage small and medium enterprises by granting exemptions from business tax for financial corporations that provide guarantee for loans to SMEs and granting tax deductions to market entities and venture capitalists that invest in high-tech in SMEs. The tune of 70% of the investment value. Another way is by designing tax policies that encourage human capital training. It is important to note that the awareness of the dangers of inadequate attention to the taxation of small and medium enterprises has grown (Schreiner and Colombet, 2016)

### **5.1.5 Tax assessment**

Besides, for tax assessment, it also shows significant negative influence toward financial performance. From the results gained,  $t = -2.069$ ,  $p = 0.040$ ,  $b_2 = -0.162$ . Thus, it shows that for every one unit increase in tax assessment, financial performance will decrease by 0.162. In addition, there is also positive significant influence towards financial performance for income tax rates. The results showed were  $t = 2.859$ ,  $p = 0.005$  and  $b_3 = 0.236$ . Hence, this shows that every one unit increase in income tax rates, financial performance will be increased by 0.236.

Tax assessment has adverse effect on business performance and profitability thus it is important that assessment can be carried out accurately so that taxpayers are not excessively assessed.

### **5.2 Conclusions**

Based on the findings of the study; the following conclusions were made.

In general, the majority of the respondents were mature and they could give the independent view and most of them had a certificate or bachelor's degree. This shows that they had knowledge about income tax rates and also most of the respondents were unsatisfied with the income tax rates based on the sales turn over and some of the income tax rates administrators did not fully have information about income tax rates and its payers. The findings of the study showed that the introduction of income tax rates have adversely affected the net profit margin of small and medium enterprises and according to the responses, they strongly agreed that income tax rates affects the returns of their business. The study also showed tax policies can be designed in such a way that they do not only directly affect SMEs but also indirectly push for their growth. Tax assessment has adverse effect on the financial performance and return on investment thus it is important that assessment be carried out accurately so that income tax payers are not excessively assessed.

### **5.3 Recommendations**

The researcher made the following recommendations as a way of reducing the burden of income tax rates on start-ups and small businesses as well as to increase the revenue or Luzira.

- Uganda Revenue Authority should simplify the tax codes and streamline compliance procedures to make it easier for SMEs to understand and meet their income tax

obligations. This could involve providing clear guidelines and offering support services to assist with tax compliance.

- Uganda Revenue Authority should reduce income tax rates for SMEs to alleviate the financial burden and increase their return on investment. This would allow them to allocate more funds towards growth and innovation.
- Uganda Revenue Authority should improve awareness amongst the taxpayers of the need to pay taxes and how their tax liability is determined and the time process of the tax assessment.
- Uganda Revenue Authority should introduce target income tax incentives or exemptions specifically for SMEs to encourage their growth and development. These incentives could include reducing income tax rates and tax breaks for investment.

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#### **APPENDICES APPENDIX I: QUESTIONNAIRE Dear Respondents,**

HIGENYI KENNETH GEOFFREY is a student of Uganda Christian University carrying out an academic research on the topic “The effect of income tax rates on the financial performance of small and medium enterprises in Luzira”, as part of the requirement for partial fulfilment for the award of the degree of Bachelor of Science in Accounting and Finance at Uganda Christian University. We therefore humbly request you to spare a few minutes of your time and fill in this questionnaire. Please do note that whatever information you will provide here will be strictly for academic purposes and will be treated with utmost confidentiality.

**Thank you for your positive response.**

## Part A: Personal Data

Kindly tick [√] in the blank spaces, the items that best describe your choice for each question

### 1. Gender:

Male

Female

### 2. Age of the respondent:

Below 20 years

21-25 years

26-30 years

31-35 years

36-40 years

Above 41

### 3. Education level:

Primary

'O' level

'A' level

Certificate

Degree

Masters

None

### 4. Years of experience:

Below 1 year

1-5 years

Above 5 years

## Part B: Awareness of the tax payers

5. Are you aware of the income taxes you are to pay? Yes  No

Is there any tax record kept by the business? Yes  No

7. Which of the following does your business use to keep records? Bin cards  Store ledgers  Both

8. Have you ever received any income tax assistance? Yes  No

**9. How was the assistance as regards to income tax awareness?**

Direction: Under the following sections, please tick according to your level of agreement.

5. Strongly Agree 4. Agree 3. Uncertain 2. Disagree 1. Strongly Disagree

Please evaluate the statement by ticking in the box with the number that best suits you.

Statement	1	2	3	4	5
The methods used in assessing the income taxes rates are fair					
Whenever income taxes collected from me, the income tax rates are fair					
Tax authorities do not harass me whenever they come to collect income taxes					

**Part C: Income Taxes paid by SMEs**

10. Mention the examples of income taxes you pay

.....  
 .....  
 .....  
 .....

11. What is the average amount of income taxes paid per year?

Zero  100,000-190,000  200,000-290,000   
 300,000-390,000  400,000-490,000  500,000 and above

**Part D: Problems faced by tax payers on income tax rates**

12. What are the specific effects of income tax rates on your business?

- i. ....  
.....
- ii. ....  
.....
- iii. ....  
.....
- iv. ....  
.....

13. Give any suggestions about the problems that may have been encountered while complying with income tax obligations

- i. ....  
.....
- ii. ....  
.....
- iii. ....  
.....
- iv. ....  
.....

**Part E: Financial performance of SMEs business**

Directions: Under the following sections, please tick according to your level of agreement.

5. Strongly Agree 4. Agree 3. Uncertain 2. Disagree 1. Strongly Disagree

Please evaluate the statement by ticking in the box with the number that best suits you.

N	Scale	1	2	3	4	5
1	Net profit margin has increased regardless of the income tax rates					

2	The market size has increased regardless of the income tax rates					
3	The return on assets has increased regardless of the income tax rates					
4	The sales volumes have increased regardless of income tax rates					
5	The number of customers have increased regardless of income tax rates					
6	The return on investment has increased regardless of income tax rates					
7	The revenue has increased regardless of income tax rates					
8	Selling costs increase when the income tax rates increase					
9	Generally income tax rates affect the financial performance of my business					

**Part F: Effects of Income tax rates on the financial performance of small and medium enterprises**

Directions: Under the following sections, please tick according to your level of agreement.

5. Strongly Agree 4. Agree 3. Uncertain 2. Disagree 1. Strongly Disagree

Please evaluate the statement by ticking in the box with the number that best suits you.

Statements	1	2	3	4	5
Income tax rates change annually					
I had received expected returns on income taxes I pay					

Income tax rates are the same for both small and large businesses					
I satisfied the amount of income tax					
Income tax rates lowers the net profit margin of my businesses					
Income tax administration is the major cause of my business stagnation in terms of return on investment of small and medium enterprises					
Has the tax authority given me any assistance in regards to income tax awareness					
Tax administration have relevant information about tax payer					

**Thank you for your valuable time**

**APPENDIX II: INTRODUCTORY LETTER**



# UGANDA CHRISTIAN UNIVERSITY

A Centre of Excellence in the Heart of Africa

School of Business

July 18<sup>th</sup> 2023

To whom it may concern

Name: HIGEMU KENNETH GEOFFREY Reg. No. 820833/005

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

MEDIUM ENTERPRISES IN LUZIRA, MAKARA DIVISION  
"THE EFFECT OF INCOME TAX RATES ON THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN LUZIRA, MAKARA DIVISION"

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

