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Critical Analysis of the Taxation Policy on Small Businesses and Entrepreneurial Enterprises in Uganda

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Abstract

The Ugandan government has been conducting tax policy reforms to create entrepreneurship conditions for the growth of small and medium enterprises (SMEs). SMEs play a very important role in the development of economies. Taxation and tax regimes are used by government to provide means for small businesses to participate in economic growth. Therefore, the paper critically analyses the taxation policy on small businesses and entrepreneurial enterprises in Uganda. The specific objectives of this paper are: To examine tax treatment on the performance of SMEs in Uganda; To find out the influence of taxation policy on small business and entrepreneurial enterprises in Uganda; and To find out if tax payers are aware of all their tax obligations and policies. The research is primarily carried out in kampala district and it covers four markets of Nakasero in central division, Nakawa in Nakawa division, Kasubi in Lubaga division and kalarwe in Kawempe division. The respondents were small business owners and in operation between 2005 and 2014. A mixed method of both qualitative and quantitative was employed. 50 respondents were considered out of the entire population in each market, and a total of 200 respondents selected for this paper. Data collected was analyzed using SPSS Version 17. The result of the research will benefit small business and entrepreneurial enterprises owners under study to know the defects of taxation and this will help to lobby with the government. The findings will assist the policy makers to amend the income tax law so as to make it friendly to small businesses.

Keywords: Entrepreneurship, small businesses, entrepreneurial enterprises, taxation, tax policy, tax relief, tax system

1. Introduction

Entrepreneurship is the emergence and growth of new enterprises. Many scholars view entrepreneurship as important to small business enterprises because it is critical to the well-being of society and development (Kelley, Bosma & Amoros, 2011; Kongolo, 2010:18; Briggs, 2009:786; Waweru, 2007:1; Ekpe, 2011:287).

There has been a considerable effort to support small businesses and entrepreneurial enterprises in Uganda through training of the small business owners and entrepreneurs in entrepreneurship development. It is entrepreneurs who create enterprises to benefit society and act as development agents, and as such the sustainability of small businesses is an important prerequisite for the success of Uganda's economy (Balunywa *et al*. 2010:12; UBOS, 2010).

Governments are required to provide an the enabling environment for entrepreneurship development particularly by creating conducive financial and economic policies (Minniti, 2008:35). In Uganda, a considerable number of the enterprises are operating small businesses with very few employees (Uganda Development Bank, 2010:15). It is argued that for development to take place, government needs to adopt policies geared towards promotion of small businesses and entrepreneurial enterprises all over the country (Ministry of Finance, Planning and Economic Development (MFPED), 2004:20).

1.1 Problem Statement

Acs & Virgill (2010:53) suggest that there is a need for policy makers to assess whether a country's business and regulatory environment act as a barrier to entrepreneurial enterprises. The entrepreneurship centre of Makerere university business School (MUBS) identified management skills but more importantly entrepreneurship, leadership and financial skills as the major constraints that hinder business growth in Uganda; lack of market, poor recordkeeping, lack of professional tax advice, limited understanding of the tax laws, limited access of finance, limited managerial skills (Balunywa et al. 2010:31). Such problems emanate from government policies like the unfair rates, which are aggressive on income taxation of small businesses. This unfair taxation has even forced some of the entrepreneurs to move out of the operation. It should be noted that high taxes and poor taxation policies largely affect small business and entrepreneurial enterprises. Therefore taxation has an indirect relationship towards small businesses.

1.2 Research Questions

This paper was guided by the following questions:

- To what extent should the tax treatment of small businesses seek the improvement of business environment in Uganda?
- What general tax provisions are important to small businesses in Uganda?
- What are the implications for the proper tax treatment of small businesses?
- What is the influence of taxation policy on small business and entrepreneurial enterprises in Uganda?

1.3 Research Objectives

The paper focuses on the following specific objectives:

- To examine the impact of tax treatment on the performance of SMEs in Uganda;
- To find out the influence of taxation policy on small business and entrepreneurial enterprises in Uganda; and
- To find out if tax payers are aware of all their tax obligations and policies.

1.4 Hypothesis

The following hypotheses guided the research objectives:
H1: There is no significant performance of small business enterprises in Uganda;
H2: There is no significant difference between Taxation and the survival of small business enterprises; and
H3: Tax payers are not aware of all their tax obligations and policies.

1.5 Significance of the Study

- The findings will benefit small business owners under study to know the defects of taxation and help to lobby with the government to reduce the burden of tax on them;
- The findings will assist the Ministry of Finance and Economic Development to lobby with government to amend the income tax law so as to make it friendly for small business enterprises;
- To the tax authority (URA), the research will guide them in adjusting tax policies so that they suit requirements of small businesses; and
- The findings will be used by future researchers.

2. Literature Review

The paper looks at the most of the available literature mainly focusing on taxation policy and small businesses as the research variables as well as the researcher's critiques on the literature.

2.1 Tax Policies

The World Bank has influenced many countries in reforming their tax policies (World Bank, 2007). According to Ddumba-Ssentamu (2004:412) governments carry out tax reforms to suit medium to long term economic objectives for example creating an enabling environment for businesses to thrive. A good tax policy will depend on effective tax administration to raise the revenue (Kayaga, 2007:63). Moore (2007:7) further asks three questions regarding tax policy: How much money should government gather as tax? How should the tax burden be distributed among actual or potential taxpayers? How can the potential adverse economic costs of taxation be contained or minimized?

According to Balunywa *et al*. (2010:7) Taxation policy was enacted by the government to promote small business enterprises. Despite the fact that the policy was enacted to promote Small business enterprises, they have continued to perform poorly (Kiiza, 2005:6). Most of small business enterprises do not survive for more than one year (Wannenburg, Drotsky & De Jager. 2009:786). Moving the argument along Rooks, Szirmai, Sserwanga (2009) research argues that many of these businesses don't live more than a year. Tax policy should target the creation of conducive environment and assistance in which small businesses can expand their activities.

Uganda has no clear national tax policy for small and medium enterprises. The country has gone through a number of policy reforms to support small businesses for example harmonisation of tax rates and new tax incentives. Such tax reforms seek to avoid double taxation, tax evasion and strengthen the rights of the tax payers in tax laws. However, Ddumba-Ssentamu (2004:415) argues that tax reform policy in Uganda focuses on the legal structures that govern the administration of the tax regime rather than supporting the improvement of small business and entrepreneurial enterprises. Therefore, this paper critically analyses the taxation policy on small businesses and entrepreneurial enterprises in Uganda

2.2 Small Businesses in Uganda

No single definition of small enterprises is appropriate. World Bank (2004) states micro enterprises employees 10 or fewer, small enterprises employee 10 to 50, medium 50 to 300 employees. However, for the purpose of this paper: Small businesses are enterprises that employ 1 to 50 people, with annual turnover of up to shs. 360millions (MFPED, 2011:4).

2.2.1 Characteristics of Small Businesses and Entrepreneurial enterprises in Uganda

Small businesses comprise about 1,100,000 enterprises, employing approximately 2.5 million people; the sector contributes about 75% of the country's GDP. They are predominantly engaged in hospitality and entertainment, education, wholesale and retail trade, manufacturing, furniture, agriculture, services, and Information and Communication Technology (ICT). More females are engaged in micro enterprises with low levels of productivity and predominantly informal (MFPED, 2011:4).

2.2.2 Promoting Start-up, Survival and Growth of Small Businesses and Entrepreneurial Enterprises

Ministry of Finance, Planning and Economic Development (2011:22) **s**uggests that for government to achieve the above, it should:

- Promote entrepreneurial mindset change for the economically active population;
- Conduct awareness campaigns and provide incentives for small businesses;
- Foster small business cluster development including development and operationalisation of industrial parks;
- Strengthen existing small business associations and promote the formation of new ones through training.

2.3 The Concept of Taxation

Omagor & Mubiru, 2008:118) defines taxation as a legally compulsory transfer of money from the public to the government mainly as a source of government revenue while Balunywa et al. (2010) argues that taxation is a payment which cannot be avoided without attracting a punishment and in return of which no gain/quid pro-quo is promised by the government to the tax payer. There are two main tax authorities; the local government authority and the central government authority through Uganda revenue authority (URA).

2.3.1 Definition of a Tax

According to Mulooki & Mugisha (2012:4) a tax is an involuntary payment by a person referred to as a tax payer therefore taxes are distinguished by their compulsory nature and by lack of relationships between the amount paid and the values of the basic services received by the tax payers. Taxes are essential (World Bank, 2014:66).

2.3.2Principles of Taxation

Ddumba-Ssentamu (2004:396) identifies four principles of taxation: convenience, certainty, economy and equality or equity. According to Omagor & Mubiru (2008: 119) principles of taxation are rules and regulations which should be observed in tax assessment collection and administration, the principles of good tax system include:

Fairness*:* It should be fair to the tax payer. The tax payers should pay according to the ability and the tax burden should be matched with the benefits that tax payers receive;

Convenient*:* The time and manner of paying taxes should be convenient to the tax payers. This means that every tax ought to be levied at a time or in the manner in which it is most likely to be convenient;

Economic growth*:* A good tax system should serve as an instrumental towards economic growth with the capacity of increasing savings and investments in order to create economic development;

Economical*:* It should be economical so that the work of collection is done as cheaply as possible. It should not hamper the development of trade and industry;

Certainty*:* The tax which the tax payer is meant to pay should be certain and clear where the time of payment and the amount to be paid ought to be clear and known; and

Equity*:* The tax liability should match with the tax payers income and expenditure levels.

2.3.3Purpose of Taxation

According to Doing Business Report, Uganda stands at 98 out of 189 economies on the ease of paying taxes globally (World Bank, 2014: 67). According to Omagor & Mubiru (2008: 119) suggests that governments impose taxes for reasons as explained below**;**

Collecting Revenue*:* It is a source of government income for financing public activities;
Promote domestic industries*:* Taxes can be used to protect domestic industries from competition of dumped cheap commodities from other countries;
Correcting Externalities*:* Taxes are levied to address negative externalities;
Controlling monopoly power*:* Government can impose taxes of either lump sum type or specific type to reduce on the profit levels of a monopolist;
Checking income inflation: This is done by imposing high taxation on people's income so as to reduce disposable income and reduce on the aggregate demand:
Checking income inequality*:* this means the transfer of wealthy from the rich to the poor. It is widely accepted in the most economies, although the extent to which this should happen is always controversial;
Balance of payment position*:* This is through imposing high taxes on imports so as to control the importation of commodities and reduce foreign exchange outflow; and
Savings*:* It also encourages the public to develop the savings culture although it remains a challenge.

2.3.4Classification of Taxes

Taxes can be classified according to the administrative arrangements for its collection, the tax base or behaviour of the tax rates. Thus they can be classified as direct or indirect, progressive, regressive and proportional (Omagor & Mubiru, 2008:20). Direct taxes are those that affect the individual or firm directly through a deduction from earnings (Omagor & Mubiru, 2008:20) and according to Ddumba-Ssentamu, (2004:401) direct taxes are normally paid with variations in the tax payer's status while Indirect taxes are those levied on the activities of an individual, they include export duties, exercise taxes, and import duties (Omagor & Mubiru, 2008:20). A proportional tax is one with a constant tax liability as income increase, progressive tax is one whose tax liability increases as income increases while a regressive tax is one whose tax rate falls with an increase in incomes (Omagor & Mubiru, 2008:20; Ddumba-Ssentamu, 2004:402).

2.3.5Taxation of Small Businesses and Entrepreneurial Enterprises

A small business tax payer is defined as a person whose gross turnover for a year of income is less than Uganda shillings 50 million (Omagor & Mubiru, 2008: 127). The small business tax rates are summarized in table 1 as follows;

Table 1: Computation of tax for a small business

Gross Turnover	Tax
shs 5m – 20m	Tax shs 100,000
shs 20m – 30m	Shs 250,000.
Shs 30m – 40m	Shs 350,000
shs 40m – 50m	Shs 450,000
Source: URA (2014)	

Taxation as an expense and when hiked reduces the profitability of small businesses (Mulooki & Mugisha, 2012). Balunywa *et al. (*2010:45) argues that profitability is a function of all the expenses made during a particular accounting year period among which taxation is inclusive while Turyahebwa *et al*. (2013:21) states that profitability is crucial indicator for determining the financial position of the enterprise. Through taxation, the government takes away financial capital from people, which they would otherwise use for business expansion. They further asserted that, one of the most frequent arguments against high income tax is that it destroys the incentive to business people and employees to work harder and more efficiently. It also revealed that small business owners were inclined to run their businesses informally in fear of being caught thus making tax implementation difficult (Najeeb, 2010:1).

2.3.6Tax Payer's Knowledge

According to the World Bank (2014:72) many traders have expressed ignorance about taxes imposed on their businesses; this is highly attributed to the poor work being done by the tax authorities leaving traders ignorant about issues like the way taxes are assessed and advantages of paying taxes. The following types of taxes were identified: trading license, value added tax, stamp duty and property tax. Therefore there is a need to sensitize the public especially business owners. The sensitization should be done on different taxes that impact on the business owners and the rationale that underlines the imposition of taxes (World Bank Survey, 2012).

2.3.7Contribution of Taxation to the Economy

Taxation is a major tool in regulating the economy by the government; hence the government achieves many objectives through taxation which include provision of government revenues, wealth and income distribution, acceleration of economic growth and savings. Therefore, taxation if well administered leads to the good performance of the economy (Mulooki & Mugisha, 2012:12).

3. Research Methodology

Methodology is the theory on the research undertaken and various steps taken to ensure dependability of the data (Cooper & Schindler, 2011:568; Creswell, 2009:15; Saunders *et a*l. 2007:5). The methodology involved the research design, study population, sample size, data sources, data collection methods, data processing and analysis criteria. The detailed methodology is described as follows:

3.1 Research Design

In attempting to answer the research question, a mixed method of both qualitative and quantitative was used for data collection and testing the hypotheses. The use of both methods ensured that the data is effectively interpreted using SPSS. Statistical measures were applied to categorize qualitative information.

3.2 Research Population

The population for this paper comprised of small business owners from Nakasero, Nakawa, Kasubi and Kalerwe markets. The list of small businesses and the tax payers in each selected markets were provided by Kampala city council authority (KCCA) for the period of 2005-2014. This guided to identify the small businesses that pay the required tax by URA. The sampling frames were compiled and established with assistance from the office of the Market community based social workers/URA tax assessors and collectors in the area. After the lists were compiled, respondents were identified using the inclusion criteria and purposive/judgement sampling method discussed below;

3.3 Sample Size

It is from the large group of people who constituted the study population, a sample of 200 was selected, and of which 50 respondents were selected from each market. This particular sample size was selected because it would be easier to manage and it is enough to generate findings as well as to generalize the findings to a bigger population.

3.3.1 Purposive Sampling

A purposive sampling was used. This is a deliberately non-random method of sampling, which aims to sample a group of people or settings, with a particular characteristic, usually in qualitative research designs. This is also sometimes called judgement sampling where respondents are selected because they have knowledge that is valuable to the research process (Bowling, 2002:188).

3.4 Source of Data

The data was collected from both primary and secondary sources. Primary data was obtained from small business owners by the use of questionnaires and interview guide. Secondary data was obtained by reviewing market records/documents, reports brochures and other existing documents relevant to the topic of the study.

3.4.1 Data Collection Instruments

Qualitative Tools of Data Collection

Unstructured Interviews: Unstructured interviews were used for the data collection. This guided the discussion with the respondents who were key informers and thus needed to elaborate on several issues. Each interview lasted for 50 minutes.

Quantitative Tools of Data Collection

Questionnaires: The questionnaires were used to obtain the quantitative information because it is specific for the respondents to explain the exact situation without giving room for unnecessary and irrelevant information for the study topic. The selected markets and number of respondents are illustrated in table 2 below;

Table 2: Selected market for each division in Kampala district that were considered

Selected Markets	**Number of Respondents**
1. Nakasero market in central division	50
2. Nakawa market in Nakawa division	50
3. Kasubi market in Lubaga Division	50
4. kalarwe market in Kawempe division	50
Total number of respondents	200

3.4.2 Data Processing and Analysis

According to Cooper & Schindler (2011:90) data analysis involves reducing collected data in a manageable size. After collecting data from the field, it was edited to check for accuracy and consistency to the study objective to ease analysis. The data put in tables for easy interpretation with aid of specialised computer package known as SPSS Version 17.

4. Findings

Respondents were asked about their gender, age, education levels and the form the business. Their responses were summarized below:

It was evident that the female respondents were more than the male respondents; of the 200 respondents, there were 132 females (66%) and 68 males (34%). This was an indicator that majority of small business owners are female thus supporting MFPED (2011) findings. Further support is from Orobia (2013) who established gender differences among small business owners. 10% were in the age bracket of 20-30, 20% were between 31-40 years, 38% were in the bracket of 41-50 and 32% were above 50 years. The findings revealed 44% of the respondents were secondary and primary holders, 30% were certificate and diploma holders, 24% were degree holders while 2% were master holders. This implied that respondents had capacity to interpret the questionnaires given and able to give relevant answers. The study findings showed that 52% of businesses operated are sole proprietorship, 34% are corporations and 14% are partnerships. This was a clear indication that most enterprises were sole proprietorship as argued by Uganda Development Bank (2010:15).

*Tax Treatment***:** The first objective of the paper was to examine tax treatment on the performance of SMEs in Uganda. In order to generate findings, respondents were asked about the tax system, business resource, tax payment, tax policies, tax design and tax relief. The respondents were asked to the statements using strongly agree, agree, natural, disagree and strong disagree. The findings indicates that 94% of the respondents strongly agree that tax system is fair to all traders and with equal treatment of businesses at the same level and type, 3% agree, 1% neutral, 1% disagree and 1% strongly disagree. Therefore, the tax system is fair to all small business owners. For instance, Minniti (2008:782)'s research show that favourable tax system encourage more people to start businesses. Further, the findings revealed that 90% of the respondents strongly agree that taxation reduces small business resources, 6% agree, 1% neutral, 2% disagree and 1% strongly disagree while 46% of respondents strongly agreed that tax payments have stopped reasonable number of traders in the markets from operating, 4% agreed, 2% neutral, 28% disagreed and 20% strongly disagreed hence high tax rates encourage tax evasion and discourage business owners from starting enterprising firms (Minniti, 2008:782). The majority of the respondent 96% strongly agreed that there are various tax policies in place, 1% agreed, 1% Neutral, 1% disagreed and 1% strongly disagreed. The findings show that 86% of the respondents strongly agreed that tax design focus on capacity building, 10% agreed, 1% neutral, 2% disagreed and 1% strongly disagreed. According to the findings, 78% of the respondents strongly agreed that tax reforms and performance are closely linked, 14% agreed, 2% neutral, 45 disagreed and 2% strongly disagreed. Business owners are faced with various forms of taxes; 50% said they pay corporation tax, 36% presumptive tax and 14% paid property tax. 112 (56%) of respondents said that income tax is a tax relief measure available to small businesses and 44% said capital gains tax. Accordingly the null hypothesis H1 is rejected.

*The Influence of Taxation Policy***:** The second objective was to assess the influence of taxation policy on small business and entrepreneurial enterprises in Uganda as summarized below. 120 (60%) of the respondents have been in operation of small business for a period of 1-5 years, 30% gave 6-10 years and 10% have been in operation for above 10 years. This implies that majority of the enterprises do not survive for more than five year after commencement which supports MFPED (2011) research that most of the small businesses in Uganda are in age between 1-5 years. The findings revealed that 108 (54%) of small businesses employed less than 3 people in their business, 34% employed 3-10 employees, 8% said 10-50 employees and 4% employed 50 people and above. In addition, 98%of the respondents accepted that stock levels have an effect on the level of profitability and 2% disagreed with that fact. 102 (51%) of the respondents revealed that the average daily sales of their business is less than 29,000 shillings, 40% between 30,000-49,000, 6% between 50,000-69,000, 2% between 70,000-89,000 and only 1% above 100,000. Small businesses are characterized by low capital investment, 55% of the respondents had invested less than 10m shillings, 18% invested 11-20m, 12% invested 21-30m, 8% invested 31-40m, 4% invested 41-50m and 3% invested above 50m.This implied that majority of small business comprised of limited capital. Furthermore, 144 (72%) of small business owners revealed that taxes are paid on an annual basis, 26% said monthly and 2% said quarterly basis. 196 (98%) of the respondents indicated that the tax system used is progressive in nature forexample the higher the size and return, the higher the tax and vice versa. 1% said proportionate and 1% said regressive system is used. Moreover, 128 (64%) of the respondents accepted to have complaints as far as taxation of small business enterprise is concerned and 36% said that there are no complaints. 108 (54%) complained that there is high tax rates, 26% complained of forceful tax collection and 20% did not give any complaint. The findings showed 98% agreed that there is a relationship between taxation and the survival of business, 2% said there is no relationship between taxation and survival of enterprise. Accordingly the null hypothesis H2 is rejected.

Tax Obligations: The third objective was to find out if tax payers are aware of all their tax obligations and policies, the results are presented below. The findings revealed that, 194 (97%) of small business owners accepted that they fulfill their tax obligations and 3% said they do not fulfill their tax obligations. In addition, the findings indicated 88% of the respondents strongly agree that government promotes a culture of tax compliance, 9% agreed, 1% neutral, 1% disagreed and 1% strongly disagreed. Therefore the government of Uganda promotes tax compliance. 70% of the respondents strongly disagree that there is lack of information on how to register the business, 10% disagreed, 1% neutral, 3% agreed, 7% strongly agreed. This implied that government provided information on how to register the business. The findings showed that 55% of the respondents strongly agreed that URA expand its mandate to include education for small business owners and outreach tax payers on accounting skills, 10% agreed, 1% neutral, 22% disagreed and 12% strongly disagreed. This shows that more improvement is required. The findings revealed that 198 (99%) of the respondents do not keep tax records, 1% did have the tax records for their business. In regard to the tax authority giving assistance on tax awareness; 198 (98%) of the respondents accepted that the tax authority provides awareness, 2% disagreed while 80% of the respondents said that the tax authority (URA) was using manuals to spread tax awareness, 20% said that it was done through workshops. Accordingly the null hypothesis H3 is rejected.

Implication of Findings: Taxation reduces the capital base of small business enterprises. In addition, taxes hinder the performance of small and entrepreneurial enterprises in Uganda thus more tax relief measures are imperative. The tax policies and reforms that applied to small businesses need better implementation from government. URA should give more assistance to tax payers in regard to tax awareness.

5. Conclusion and Recommendation

According to views of different writers on tax, taxation and business performance, it should be noted that high taxes and poor taxation policies largely affect small business performance (Bruce & Mohsin, 2006). The URA system should ensure periodic reviews and revisions, strengthen measures to ensure proper keeping and maintenance of records and books of accounts, taxpayers education to focus on small businesses, regular investigative audits be carried out to ensure that non-compliant taxpayers are penalized and fined according to the tax laws, rules and regulations. It is necessary, if not imperative that government promotes tax compliance that contribute positively and encourage productive among small businesses and entrepreneurial enterprises in Uganda.

5.1Recommendations

From the findings the following recommendations were made: The URA should educate the business community about different tax rates, mode of payment because some tax payers do not know those rates and the mode of assessment; URA should improve on the methods of collecting taxes by designing and updating simplified system, simplicity of the system; the government should hormonise the tax base by defining sanctions for taxpayers non-compliance.

Areas for Further Research

The study was not exhaustive owing to constraints in terms of scope, time and finance. Further research is therefore needed in areas such as: Factors leading to tax evasion among small businesses; Tax compliance policy and profitability of small businesses in Uganda.

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