



**EFFECT OF GOVERNMENT TAXATION PRACTICES ON THE PERFORMANCE OF MICRO ENTERPRISES. A CASE STUDY OF ONGATA RONGAI, KAJIADO COUNTY**

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**ABSTRACT**

*Micro-enterprise businesses play a significant role in the economic development of Kenya's economy in a myriad of ways with the most prominent one being a source of employment opportunities which translate in improving and uplifting the living standards of the country's population. This therefore implies that their performance is of great significance to the key stakeholders due to the benefits accrued. One of such stakeholders is the government who not regulates business performance environment through various policies and legislation but also act as a source of government revenue through taxation. Taxation is essential and has a lot of influence on the performance, growth and survival of micro enterprises. Specifically, the study established the effect tax policy on the performance of micro enterprises in Ongata Rongai sub-county, Kajiado County. The researcher used Ability to pay theory and Benefit theory to explain the relationship between the independent and dependent variables. The study adopted a cross sectional survey and descriptive design. The target population of the study constituted all the 410 registered micro enterprises in Ongata Rongai with a sample size of 123 respondents who selected randomly through simple random sampling. Data collected was analyzed through the use of SPSS version 23.0 software. The analyzed data were thereafter presented in frequency tables and charts. Findings of the study showed a significant strong negative relationship between tax rates and performance of micro enterprises in Ongata Rongai sub-county. This implied that as more taxes are imposed on microenterprises, their performance gradually declines. The study results also revealed that performance of microenterprises and tax policies had a significant strong positive relationship ( $r=0.711$ ,  $p<0.05$ ). The study therefore concluded that high tax rates implemented by the government have a significant negative impact on the performance of microenterprises and therefore, the government needs to review its tax reforms to develop tax policies and tax rates that are equitable and fair to enable growth of businesses and other key industry players. The researcher suggests for more studies on how specific taxation policies affect performance of other related businesses in the sector because the study only focused on a general tax policy perspective.*

**Key Words:** Tax Policy, Development

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## INTRODUCTION

Tax collection is the method by which an administration or the governing authority issues or exacts tax on its residents and businesses (ClearTax, 2021). Tax payment is a necessary obligation set up by the association/organization on particular pay workers, affiliations, cash related specialists, exporters, and traders (Wangeci and Kaplelach, 2018). An economy that sanctions great and dynamic tax laws and techniques will raise gainful and account solid business affiliations (Wangeci and Kaplelach, 2018). The achievement of organizations make the economy to flourish likewise, as there could be no speedier technique for stirring up the issues of economy without assistance of affiliations that move organizations, product, money, and business ventures within the market (Baurer, 2005).

Basically, businesses and taxation approaches massively depend upon one another for endurance of economic changes that emerge. Micro Enterprises are generally considered as basic drivers of financial accomplishment. They are key components of a strong economy, as job creators, sales generators and wellspring of tax income. The significance of small ventures as job creators, especially for those with low skills level, is broadly and publicly appreciated (Wangeci and Kaplelach, 2018). Albeit more modest in size, SMEs are the main endeavors in the economy because of the fact that when every one of the individual effects are accumulated, they outperform that of the bigger organizations. Regulations and tax policies are accounted for to be one of the barriers of expansion of small enterprise in Kenya and globally. However, these undertakings like the rest of businesses in Kenya are obligated to various types of taxes paid at various stages of the business (Wangeci & Kaplelach, 2018). For purposes of this study, the emphasis is put on how the tax rates, tax policies and various types of taxes affected growth of small and medium sized enterprises.

Business performance is a composite evaluation of how well an association executes on its most significant boundaries, typical monetary, market and investor execution (Wigmore, 2015). Performance of Micro Enterprises must be recognized when the business can accomplish its objective as far as expansion in benefit, gives supportable employment and expansion in stock and furthermore the number of employees (Kariuki, 2018). Unreasonable rising of tax rates could raise the expense of production and at last lead to the closure of a business. As tax rates keep on expanding, firms will in general embrace endurance procedures including; tax avoidance and an increase in prices of final products, which at last influences the performance of Micro Enterprises (Nyame, 2018). In Kenya, several Micro Enterprises keep on shutting down because of high rates of tax assessment, which have contrarily influenced their performance (KAAA, 2016). Indeed, even there are other a few factors that influence the performance of Micro Enterprises in Kenya, this study solely focuses on the effects of taxation on the performance of Micro Enterprises.

In the past few years, the world economy has developed tremendously and this has been linked with operations of Micro Enterprises, specifically, in developing countries (Ocheni & Gemade, 2015). Although, they are smaller in size, they are the most fundamental enterprises in the economy because of the fact that when all their individual outcomes are aggregated, they surpass that of the larger companies. The social and economic advantages of small and medium scale enterprises cannot be overlooked (Ojeka, 2011). Micro Enterprises play a vital role in the development of the Kenyan economy especially with regard to creation of jobs to uplift the people's standard of living (Okong'o & Otieno, 2018). However, the closure rate of these small firms is very high. Among the factors responsible for these untimely close-ups are tax related issues, ranging from multiple taxations to enormous tax burdens

among other issues etc. (Ocheni & Gemade, 2015). In many government policies, micro enterprises are usually viewed and treated in the same light as large corporations (Ojeka, 2011).

High taxation and duty rates have made many small businesses to close down since the gap between expenditures and profits is not favorable and some have even suffered losses leading to their closure (KAAA, 2016). Therefore, tax policy must be one that will not encourage Micro Enterprises to remain in the informal sector or to evade or avoid tax payments but promote and advance their growth. More so, many small firms in Africa, including Kenya, choose to remain in the informal sector because the perceived benefits outweigh the perceived costs (Ocheni & Gemade, 2015).

### **Statement of the Problem**

Taxation plays important role in the development of every economy as well as the performance of micro enterprises. In a developing country like Kenya, the role of Micro enterprises is critical in pushing the socioeconomic development agenda of the country further. Therefore, alignment of the tax system to the specific performance needs can be considered an important agenda for the policy makers (Tee, Boadu and Opoku, 2016). Yet it has been noted, in previous studies (Tomlin, 2008) that Micro enterprises sacrifice funds to pay taxes, which could otherwise be invested in business growth.

There is a general perception that tax is an important source of fund for development of the economy and provision of social services, however, the problems faced are in the area of negative relationship between taxes and the business' ability to sustain itself and to expand (Ojeka, 2011). Micro Enterprises are faced with the problem of high tax rates, multiple taxation, complex tax regulations and lack of proper enlightenment or education about tax related issues (Mwendwa, 2020). Not minding other challenges that Micro Enterprises are facing in Kenya, namely;

inadequate capital, poor technical and managerial skills, environmental effects and government regulations which affect the operation of Micro Enterprises, in Kenya, the issue of multiple taxation is a pandemic consuming deeply the large part of revenues generated by the Micro Enterprises meant for their growth and survival. This has led to increase in the record of closure of Micro Enterprises across the country (Mwendwa, 2020).

Several studies have been done concerning the effects of taxation on micro enterprises. Kazemy (2011), evaluated the effective factors on survival of Micro Enterprises, a case study of Iran. Okong and Otieno (2018) explored impact of taxation on financial performance of small scale enterprises in Siaya County, Kenya. Wangeci (2018) evaluated the relationship between taxation and the growth of Small and Medium Enterprises in Mombasa. However, there exists an academic gap in that, while it is indisputable that these studies are important since they address factors that influence growth of Micro Enterprises, they do not address whether taxation affects performance in terms of financial and productivity. They also fail to mention alternative policy formulation strategies that will enhance the performance of Micro enterprises. There was also a geographical gap, since most of the previous studies had done in other parts of Kenya, none had been done in Ongata Rongai. Therefore, this study focused on identifying and determining the effects of taxation on performance of Micro enterprises in Ongata Rongai sub county, Kajiado County.

### **Objectives of the Study**

The general objective of this study was to establish the effect of government taxation practices on performance of micro enterprises in Ongata Rongai, Kajiado County. The study was guided by the following specific objective;

- To determine the effect of tax policy on the performance of micro enterprises in Ongata Rongai sub-county.

## LITERATURE REVIEW

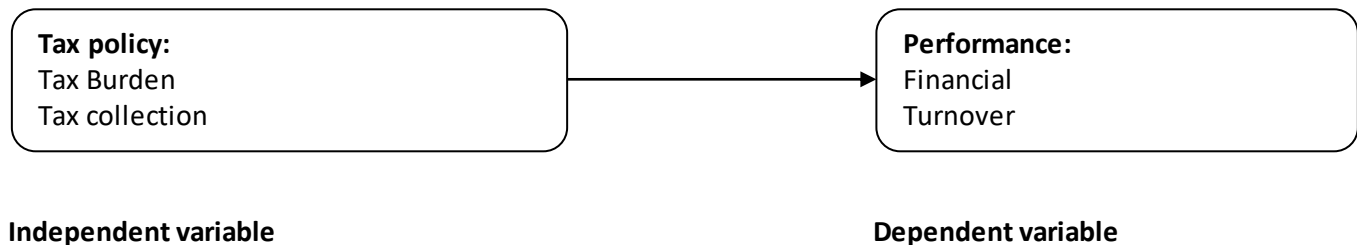
### Theoretical Review

#### Benefit Theory

According to this theory, the state should levy taxes on individuals/businesses according to the benefit conferred on them. The more benefits a person derives from the activities of the state, the more he should pay to the government (Economics Concepts, 2015). Two different types of claims were made for the implementation of the benefit principle of taxation by the European economists (Sandmo, 2015). The first was that taxes levied on individuals according to the benefits that they received from the provision of public goods would somehow establish a price system for public goods or publicly provided goods that would correspond to competitive prices for private goods with similar efficiency properties. The second claim is that the benefit principle represents justice in taxation and therefore, it is

important for normative judgments about income distribution in a mixed economy (Sandmo, 2015).

However, the theory received several criticisms. Firstly, if the state maintains a certain connection between the benefits conferred and the benefits derived (Economics Concepts, 2015). It will be against the basic principle of the tax since there is direct quid *pro quo* in the case of a tax. Secondly, most of the expenditure incurred by the state is for the general benefit of its citizens, it is not possible to estimate the benefit enjoyed by a particular individual every year and finally, if this principle is applied in practice, then the poor will have to pay the heaviest taxes, because they benefit more from the services of the state. If more is gotten from the poor by way of taxes, it is against the principle of justice (Economics Concepts, 2015). This principle is necessary for this study, as it will help explain the direct correlation between revenue and expenditure in a budget of micro enterprises.



**Figure 1: Conceptual Framework**

#### Empirical Review

Tax policy is the choice by the government to determine the amount and type of tax to levy and to whom to tax. A good tax policy system should meet five basic conditions: fairness, adequacy, simplicity, transparency, and administrative ease (OKPI, 2019). Every government must raise revenue. The basic principles of tax policy are to raise revenue, and to do so fairly, simply, and efficiently (Theressa, 2019).

Setting up an efficient and fair tax system is, however, far from simple, particularly for developing countries that want to become integrated in the international

economy. The ideal tax system in these countries should raise essential revenue without excessive government borrowing, and should do so without discouraging economic activity and without deviating too much from tax systems in other countries (Tanzi & Zee, 2001). A country's tax regime is a key policy instrument that may negatively or positively influence investment. A good tax policy meets the twin goals of offering a tax system attractive to investment, while at the same time raising revenues to support the key pillars of a business-enabling environment, such as infrastructure. A poorly designed tax system, where

the rules and their application are nontransparent, overly complex or unpredictable, may discourage investment adding to project costs and uncertainty (Causa & Hermansen, 2020).

Kenya has a broad taxation system covering income taxes, value-added tax (VAT) and Customs and excise duty. These are governed by independent legislations that make provisions for the charge, assessment and collection of the respective taxes (OBG, 2016). According to Wawire (2019) the Government of Kenya has over the years undertaken reforms in the income tax system with a view of making it elastic. Despite these efforts, studies have shown that the structure is still inelastic. Such reforms are included in the Finance Bill of 2019. They include an increase of Capital Gains tax which was increased from 5% to 12.5%, Taxation of Digital economy which became effective in 2020, 30% rebate on electricity, reduced corporate tax rate to 15% etc. (Deloitte, 2019).

The Kenyan government in a bid to raise government revenue introduced several new digital taxes. These includes 20% withholding tax rate applicable for sales, promotion, advertising and transportation services for non-resident persons in the Tax Laws (Amendment) Act, 2020, 1.5% digital tax in the Finance Act 2020 that came into force in January 2021 and the proposed Digital VAT Tax regulations on any business with online presence as highlighted in the definition of taxable scope in the regulations (Mwenda, 2020). These new taxes present a new challenge to existing and new startups. Majority of which fall under the Small and Medium (SMEs) sized categories. SMEs are the backbone of the country's economy constituting about 98% of Kenya's business sector and employ about 14.5 million Kenyans (Mwenda, 2020).

Even though, tax remains to be the major source of income for governments around the world, it is the responsibility of the governments through their taxing agencies to evaluate and monitor the needs

and challenges of Micro enterprises which comprise a larger part of the economy, and provide the needed support (Muqiao & Tamar, 2021). In regards to taxation policies, this study, therefore seeks to identify the effects of tax policies on performance of micro enterprises, specifically in Rongai, Kajiado County.

## **METHODOLOGY**

This study used cross sectional surveys that employed a descriptive design. The design was chosen for this study because it provided an in-depth view of the topic of the study (Sumeracki, 2021). The target population of this study comprised of all the 410 registered Micro Enterprises operating within Ongata Rongai sub-county, Kajiado County. These enterprises were grouped into clusters of farming, trading, manufacturing and transport as per SME 2012 Act. The sample frame constituted all businesses that had current trading licenses and whose names appeared in Ongata Rongai sub county business register. The study used multistage sampling and random sampling i.e. clusters sampling and simple random sampling in selecting its sample. Simple random sampling was used to select respondents the clusters. A random percentage of 30% was used to select respondents from each cluster. The researcher used structured questionnaires with likert type of questions to gather the primary data for the study. According to Creswell (2014) questionnaires are crucial in collecting unbiased data from a large sample. Data collected was thereafter examined thoroughly to check for completeness and errors and tabulated accordingly. The study used descriptive statistics to analyze data to establish patterns, trends and relationships. The data was analyzed using Statistical Package for Social Science. Correlation analysis was also carried out to establish relationship between the independent and dependent variables. The analyzed data was thereafter presented using frequency tables and charts.

## FINDINGS AND DISCUSSION

The researcher administered a total of 123 questionnaires to the respondents and only 105 were returned fully filled for analysis. This represented 85.4% response rate. 18 questionnaires which represent 14.6% were not returned by the respondents. The response rate was considered adequate as recommended by Mugenda (2003), who

affirmed that a response rate above 80% is excellent and sufficient for analysis.

### Descriptive Statistics of Study Variable

#### Effect of Tax Policies on Performance of Microenterprises

The researcher wanted to establish whether tax policies affected performance of micro enterprises in Ongata Rongai sub-county.

**Table 1: Effect of Tax Policies on Performance of Micro Enterprises**

Statement	1	2	3	4	5	Mean
Tax administration is complex in tax reforms	65%	29%	6%	0	0	3.44
Tax reform reduces tax complexity in enforcement	55%	37%	8%	0	0	3.48
There is equality of tax administration services	34%	12%	0	48%	6%	3.23
Tax authority provides greater assistance to tax payers creating favorable conditions for tax compliance	24%	44%	9%	23%	0	3.46
Tax administration has been changed from an enforcement paradigm to a service paradigm	8%	20%	16%	32%	24%	3.93
The paradigm reduces criminal aspects of tax evasion tax measures	12%	22%	14%	38%	14%	3.63
Tax authorities focus on helping taxpayer to file taxes by providing information needed	18%	39%	8%	25%	10%	3.56
The generalization of tax administration on financial performance is problematic	45%	34%	15%	6%	0	3.23
IT improves tax payers convenience in tax assessment	33%	37%	5%	20%	5%	3.33

From Table 1 above, the respondents were asked to give their opinion on the statement that tax administration was complex in tax reforms. Majority (65%) of the respondents strongly agreed that in deed that tax administration was a complex element in the tax reforms that were being championed by the government towards enhancing tax efficiency. 29% of the respondents also agreed with the statement while 6% were not sure whether tax administration was a complex feature.

Tax reform reduces tax complexity in enforcement as agreed by the majority of the respondents at 92%. They cited that reforms in taxation could significantly

help reduce chances of tax evasion and would help the government to raise significant amount revenue from businesses and persons. 8% of the respondents had no idea of the benefits of the reforms.

The respondents were consequently asked to whether there was equality in tax administration services. Majority 54% were in disagreement while 46% agreed. The majority argued that most tax policies in place were discriminatory as it did not factor on the different levels of income and economic status of the businesses and the population at large. For instance they cited that V.A.T was applicable and

subjected to all Kenyans at the same rate irrespective of their economic status.

Majority (68%) of the respondents agreed that tax authority provided greater assistance to tax payers by creating favorable conditions for tax compliance. They cited that generally the tax authority allows tax payers a period of six months to file their tax return which according to them was a flexible, accommodative and favorable approach to tax payers. This also allowed them opportune time span to arrange for their tax returns. 9% of the respondents had no clue and 23% did not agree saying that there was a lot in store that tax authorities needed to bring to the attention of tax payers in order for them to understand the nature and how to account for their tax returns and tax refunds for their business ventures.

The respondents were further asked whether there has been a change in tax administration from an enforcement paradigm to a service paradigm. 56% of the respondents did not agree, while 16% had no idea whereas 20% and 8% did agree and strongly agreed respectively. The researcher observed that due to lack of sufficient awareness on tax administration, most businesses could not understand whether there has been paradigm shift on tax policies to enable tax payers integrate the said changes.

Majority of the respondents (52%) refuted claims that paradigm reduces criminal aspects of tax evasion tax measures. They claimed that without proper tax policies and tax enforcement mechanisms in place, these paradigms would not bring any meaningful gains with respect to reduced tax evasion practices. Although 34% of the respondents had a contrary opinion saying that at least some tax vices would be reduced. 14% were not sure whether these changes would bring positive impact or not on taxation practices.

Tax authorities focus on helping taxpayers to file taxes by providing information needed that is relevant and which aid them in filing their tax returns as agreed by 57% of the respondents. While 35% did not agree and 8% were not sure with these developments. Majority of the respondents who were in agreement cited that with tax authority assistance, most of their firms were able to complete and successfully file their returns in time.

Majority of the respondents (79%) also agreed that generalization of tax administration was problematic affair especially on creating an understanding on the financial performance of their firms. They attributed their response to failure of their businesses to measure the level of performance that can be attached to taxation. 15% of the respondents were clueless on the matter whereas 6% disagreed.

Finally the respondents were asked whether IT helped in improving tax payers' convenience in tax assessment. Majority 70% of the respondents agreed to that fact whereas 5% were not sure, and 25% were not in agreement. The findings of this study resonates with the views of Wawire (2019) that Government of Kenya had over the years undertaken reforms in the income tax system with a view of making it elastic to improve on its revenue collection and generation. Though the researcher further noted that despite these efforts there were still no significant gains.

### **Inferential Statistics**

#### **Correlation Analysis**

The researcher used Pearson Correlation coefficient ( $r$ ) to determine the degree of relationship between the variables of the study. The correlation was done using a 5% significance level in a 2-tailed test and therefore the significance value was set at 0.05 above which the relationship is deemed insignificant. The dependent variable was Performance of micro enterprises and the independent variables were; tax rate, tax policies and types of different taxes.



**Table 2: Correlations analysis**

		Tax rate	Tax policies	Types of taxes	Performance of micro-enterprises
Tax rate	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	105			
Tax policies	Pearson Correlation	.625**	1		
	Sig. (2-tailed)	.014			
	N	105	105		
Types of Taxes	Pearson Correlation	.514**	.357	1	
	Sig. (2-tailed)	.007	.035		
	N	105	105	105	
Performance of Microenterprises	Pearson Correlation	-.828**	.711**	.522**	1
	Sig. (2-tailed)	.000	.002	.043	
	N	105	105	105	105

From table 2 above, it was observed that there is significant positive relationship between tax rate and tax policies ( $r=0.625$ ,  $p<0.005$ ). This can be attributed to the fact that various rates are stipulated in the tax policies that governs taxation practices. Tax rates and tax types were found to have a significant moderate positive relationship ( $r=0.514$ ,  $p<0.05$ ). This could be due to the fact that different tax types normally have a specific tax rate attached to it. Moreover, it was also found that tax types and tax policies had a significant weak positive relationship ( $r=0.357$ ,  $p<0.05$ ).

The findings presented clearly showed that there is a significant strong negative relationship between tax rates and performance of micro enterprises in Ongata Rongai sub-county which is represented by Pearson coefficient of  $r= -0.828$ , and  $p<0.005$ . This implies that as more taxes are imposed on microenterprises, their performance gradually declines. The study results also revealed that performance of microenterprises and tax policies had a significant strong positive relationship ( $r=0.711$ ,  $p<0.05$ ). This means that when the government improves on its tax policies there will be a reciprocal improvement in the performance of microenterprises. Therefore if the government wants to better the performance and protect these

small business enterprises then they should introduce tax reforms that are geared towards creating better tax policies. The type of taxes were found to have a moderate significant positive relationship with the performance of microenterprises in Ongata Rongai sub-county ( $r=0.522$ ,  $p<0.05$ ). This means that different types of taxes affect performance of microenterprises to different extents.

### CONCLUSION AND RECOMMENDATIONS

The general objective of the study was to establish the effect of government taxation practices on performance of micro enterprises in Ongata Rongai, Kajiado County. The study found that government taxation practices had a positive significant effect on performance of microenterprises in Ongata Rongai sub-county. The study results were found to be consistent with earlier researches that found that government taxation played a crucial role on performance of businesses. The study therefore concluded that for sustainable growth of small businesses there is need for the government to initiate tax reforms that are geared towards formulating tax policies that enhance equity and fair taxation practices that will enable growth of microenterprises and other key industry players. The

study therefore concludes that favorable taxes should be adopted by the government if they want small businesses and other allied enterprises to boost their performance and growth.

The study therefore recommended that the government should come up with suitable and viable tax policies that clearly defines and outlines taxation procedures, tax rates and tax returns frameworks among other fundamental issues that influence taxation. Microenterprises form a critical role in Kenya's economy by virtue of the opportunities it offers in terms of employment opportunities, tax

revenue generation among other significant benefits. Therefore, the study recommends that the government should formulate taxes that promote the growth and expansion of small businesses.

#### **Suggestions for Further Studies**

Similar studies should be done on how specific taxation policies affect performance of other related businesses in the sector because the study only focused on a general tax policy perspective without demystifying the extent to which each policy affects performance.

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