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RELATIONSHIP BETWEEN TAX POLICIES AND FINANCIAL PERFORMANCE OF MEDIUM SIZE ENTERPRISES IN KENYA, A CASE OF KIAMBU COUNTY

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Abstract

Medium sizes Enterprises form the core of majority of the Kenyan economy. Although smaller in size, they are the most important enterprises in the economy due to the fact that when all their individual effects are aggregated, they surpass that of the larger companies. This study was done to establish the existence of any relationship between the various tax policies and performance of Medium size Enterprises in Kenya. The specific objectives was; to determine the relationship between corporate taxes and performance of Medium size Enterprises, to ascertain the relationship between value-added tax and the performance of Medium size Enterprises, to determine the impact of custom duty on the performance of Medium size Enterprises and to examine the relationship between capital gains and the performance of Medium size Enterprises. The study targeted Medium size Enterprises within Kiambu County. The study adopted descriptive research design questionnaires and interview guides were used to collect data from the respondents. The study used both quantitative and qualitative data. The hypothesis were tested using correlation analysis. A multiple regression was conducted to determine the relationship between independent and dependent variables. The study found that tax policies influences financial performance.

Keywords: Financial Performance, Medium size Enterprises, Tax policies

1.1 Background Information

Taxation has always been a concern of global significance because it affects every economy irrespective of national differences. Tax can be described as an amount, effort, contribution or service rendered either in kind or monetary value contributed into a common purse for the running of the society. Omotoso (2001) defined tax as a compulsory charge imposed by a public authority on the income of individuals, firms and companies as stipulated by the government acts or case laws irrespective of the exact amount of services rendered to the payer in return. Tax does not include fines unrelated to tax offences and compulsory loans paid to government. Borderline cases between tax and non-taxes revenues in relation to certain fees and charges, thus, taxes constitute the principal source of government revenue and the beauty of any government is for its citizen to voluntarily execute their tax obligations without much coercion and harassment. Tax evasion and fiscal corruption have been a general and persistent problem throughout history with serious economic consequences, not only in transition economies, but also in countries with developed tax systems In general, tax evasion and corruption can have ambiguous effects on Economic growth: tax evasion increases the amount of resources accumulated by entrepreneurs, but it also reduces the amount of public services supplied by the government, thus leading to negative Consequences for economic growth.

The Kenya Revenue Authority is the tax collection agency of Kenya which was formed July 1, 1995 to enhance tax collection on behalf of the Government of Kenya. It collects a number of taxes and duties, including: value added tax, income tax and customs. Since its inception, revenue collection has increased dramatically, enabling the government to provide much needed services to its citizenry like free primary education and Health Services to all. It is however important to establish whether the observed increased revenue collection effectiveness has resulted from aggressive tax management by Kenya Revenue Authority (KRA) or whether it is, in part, due to increased use of the new economy business model. This is important because the sources of tax avoidance have distinct policy implications. The policy response to tax avoidance arising from aggressive tax schemes and investments in tax planning is likely to be very different from the response to tax avoidance stemming from a shift in many firm organizational, operating, and financing attributes, which enable them to exploit their operating flexibility to naturally align with tax incentives that generate tax savings. By imposing taxes, the state seeks to collect financial resources to the budget. When referring to the economic, tax, representing a sampling of financial resources at their disposal to the state, have the effect of reducing economic and financial performance achieved.

1.2 Statement of the problem

Many Kenyans currently are filled with anxiety about their annual tax forms. Many people wistfully dream about how nice it would be to have a simple and fair flat tax policy. Unfortunately, there are many obstacles to better tax policy for instance imposing higher tax rates on those who

contribute more to economic output. Scarlett (2011) conducted a survey on tax policy and economic growth in Jamaica. His general objective was to ascertain the impact of taxation on economic growth. The paper uses a standard growth function, within an autoregressive distributed lag framework, with quarterly data from 1990 to 2010. The research does not discount the fact that tax measures could be a function of the economic condition, a very familiar situation for Jamaica and other small open economies. The findings also indicated that increasing revenue from indirect taxes was more conducive to economic growth in the long run as compared to short run

Arnold *et al* (2011) on their research about tax policy for economic recovery and growth indicated that tax changes that are geared towards innovation and entrepreneurship may have persistent and positive long run growth effects. They also argue that if taxes are reduced, it will require the government to balance its budget in the short run by increasing borrowing. The implementation of any tax policy has to bear in mind the potential fiscal imbalance of the country. Additionally, the impact that a tax policy is likely to have on economic growth will vary and depend greatly on country's stage of development and the level of production. As indicated by Jones (2001), the distribution of income towards the factors of production, such as capital and labour, plays a vital role in the level of production. He indicated that external factors do contribute to the level of growth in output, given the fact that there exists a close relationship between the growth in output and growth in the volume of international trade.

No doubt that tax policies developed by Medium Enterprises can influence economic choices, it is by no means obvious that tax rate cuts will ultimately lead to economic growth. While the rate cuts would raise the after-tax return to working, saving, and investing, they would also raise the after-tax income people receive from their current level of activities, which lessens their need to work, save, and invest. The first effect normally raises economic activity (through so-called substitution effects), while the second effect normally reduces it (through so-called income effects). In addition, if they are not financed by spending cuts, tax cuts will lead to an increase in federal borrowing, which in turn, will further reduce long-term growth. The historical evidence and simulation analysis is consistent with the idea that tax cuts that are not financed by immediate spending cuts will have little positive impact on growth. The results from these researches suggest generally that tax policies developed by particular economy leads to economic growth. This therefore means that the existing literature does not expound on my variables. However, these policies do not affect the economy in the same way. The strength of the effect of one policy differs with the other. In as much as these policies will strive to growth of the economy, not all tax changes will have the same impact on growth. Other aspects like improvement of incentives, reduction of existing subsidies, and avoiding deficit financing will have more auspicious effects on the long-term size of the economy. This research therefore was aimed at determining the relationship between the said tax policies and financial performance.

1.3 Objectives of study

1.3.1 General Objective

The general objective of this study was to determine the relationship between tax policies and financial performance of Medium size Enterprises in Kenya.

1.3.2 Specific objectives

i) To establish the relationship between corporate tax policy and financial performance of Medium size Enterprises in Kenya
ii) To ascertain the relationship between value added tax policy and financial performance of Medium size Enterprises in Kenya
iii) To examine the relationship between custom duty tax policy and financial performance of Medium size Enterprises in Kenya
iv) To determine the relationship between capital gains tax policy and financial performance of Medium size Enterprises in Kenya

1.4 Hypotheses of the study

The research was be guided by the following hypotheses as derived from the specific objectives.

i) H_0 – There is no relationship between corporate tax policy and financial performance of Medium size Enterprises in Kenya
ii) H_0 – There is no relationship between value added tax policy and financial performance of Medium size Enterprises in Kenya
iii) H_0 – There is no relationship between custom duty tax policy and financial performance of Medium size Enterprises in Kenya
iv) H_0 – There is no relationship between capital gains tax policy and financial performance of Medium size Enterprises in Kenya

2.0 LITERATURE REVIEW

2.1 Theoretical Review

2.1.1 Modigliani-Miller tax model

The Modigliani-Miller Theorem of taxation is a cornerstone of modern corporate finance and taxation policies. At its heart, the theorem is an irrelevance proposition: The Modigliani-Miller Tax theory stipulates conditions under which a firm's financial decisions do not affect its value. According to Modigliani (1980), with a well-functioning markets, neutral taxes and rational investors, who can undo the corporate financial structure by holding positive or negative amounts of debt, the market value of the firm depends *only* on the income stream generated by its assets. It follows, in particular, that the value of the firm should not be affected by the share of debt in its financial structure or by what will be done with the returns – paid out as dividends or reinvested (profitably).

Modigliani and Miller (1958). Asserts the importance of taxes for the irrelevance of debt versus equity in the firm's capital structure more specifically, showing that under some conditions, the optimal capital

structure can be complete debt finance due to the preferential treatment of debt relative to equity in a tax code. Modigliani and Miller (1958) gave an example of the U.S. interest payments on debt are excluded from corporate taxes. As a consequence, substituting debt for equity generates a surplus by reducing firm tax payments to the government. Firms can then pass this surplus on to investors in the form of higher returns. This raised the further provocative question that were firms that issued equity leaving stockholder money on the table in the form of unnecessary corporate income tax payments? Modigliani and Miller (1963) resolved this problem by showing that a firm could generate higher after-tax income by increasing the debt-equity ratio, and this additional income would result in a higher payout to stockholders and bondholders, but the value of the firm need not increase. The argument is that as debt is substituted for equity, the proportion of firm payouts in the form of interest on debt rises relative to payouts in the form of dividends and capital gains on equity. Higher taxes on interest payments than on equity returns reduce or eliminate the advantage of debt finance to the firm.

Modigliani and Miller (1958) also had a feeling that equity risk premium from leverage is decreasing in the firm's estimated marginal tax rate before financing. They therefore concluded that tax benefit from debt reduces the cost of equity and increases market value. Personal tax penalty associated with debt, increases the equity risk premium but not in cross-sectional regressions. Overall, the results provide support f or the hypothesis that the corporate tax benefit from debt reduces the equity risk premium associated with leverage. Further, the effect of personal taxes on the leverage related premium appears to be driven by temporal variation in statutory tax rates.

2.1.2 Benefit Theory

Neumark and Charles (2013) illustrates that in this theory, the state should levy taxes on individuals 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. This principle has been subjected to severe criticism on the following grounds; firstly, if the state maintains a certain connection between the benefits conferred and the benefits derived. It will be against the basic principle of the tax. A tax, as we know, is compulsory contribution made to the public authorities to meet the expenses of the government and the provisions of general benefit. There is no direct quid pro quo in the case of a tax. Secondly, most of the expenditure incurred by the slate is for the general benefit of its citizens, it is not possible to estimate the benefit enjoyed by a particular individual every year. Thirdly, if we apply this principle in practice, then the poor will have to pay the heaviest taxes, because they benefit more from the services of the state. If we get more from the poor by way of taxes, it is against the principle of justice?

Ezatollah and Myles (2006) identifies that Benefit taxation is a system in which individuals are taxed according to the benefits they receive from public expenditures. Under the benefit principle, taxes are seen as serving a purpose similar to that of prices in private transactions ; that is, they help determine what activities the

government undertakes as well as who pays for them. If this principle could be implemented, resource allocation would be directly responsive to the wishes of citizens as consumers of public services, not just as voters. One important reason for examining the feasibility of financing public expenditures through benefit taxation is the demands made on the revenue structure by the growth of expenditures. They concluded that, benefit taxation cannot be seen as a principle of taxation distinct from ability-to-pay taxation. Any differences between the two are consequences of informational restrictions and not representative of some fundamental distinction. Equal absolute sacrifice taxation is different even with complete information it is more restrictive than the other two when consumers are not identical.

2.1.3 Ability to Pay Theory

The most popular and commonly accepted principle of equity or justice in taxation is that citizens of a country should pay taxes to the government in accordance with their ability to pay. It appears very reasonable and just that taxes should be levied on the basis of the taxable capacity of an individual. For instance, if the taxable capacity of a person A is greater than the person B, the former should be asked to pay more taxes than the latter. It seems that if the taxes are levied on this principle as stated above, then justice can be achieved. But difficulties do not end here. The fact is that when this theory in practice, difficulties actually begin. According to Henderson *et al* (2004) the trouble arises with the definition of ability to pay. The economists are not unanimous as to what should be the exact measure of a person's ability or faculty to pay.

2.2 Empirical Literature

2.2.1 Corporate Taxes and Financial performance

Stavroula and Theofanis (2012) did a study on the extent of corporate tax evasion and its implications on the protection of the shareholders and on the function of the capital market. The mean rate of tax evasion was estimated at about 16 per cent, showing that the incentive for tax evasion doesn't diminish when the companies are listed in the stock exchange. Specifically, the companies alter their tax behavior (i.e. appear more tax compliant) only in the year of the IPO and the year before. They also found out that the type of the audit firm is likely to affect the extent of tax evasion committed. This provided an evidence that corporate tax evasion was widespread and calls for appropriate measures. This issue had become more crucial than ever, as Greece is in the middle of the financial crisis. Moreover, the findings regarding audit effectiveness in detecting tax evasion have significant implications, as the 2010 Greek tax bill grants the audit firms the right to issue certificates for tax purposes.

Antonio (2015) did a study on The Portuguese corporate tax reform and international trends. The purpose was to discuss if the Portuguese corporate tax reform, implemented in 2014, moved the system towards international trends. It was also used to analyze what areas the similarities and disparities are more pronounced when assessing the Portuguese reform against the Common Consolidated

Corporate Tax Base. They found that Portugal was increasingly out of line with international trends in corporate taxation. The bailout asked for the Portuguese Government in 2011 placed a heavy burden in public finances, with an apparent lack of room to follow international trends of corporate tax reform. However, it can be concluded that, after convincing the troika that investment and growth were paramount to overcome the severe economic and social crisis that fell upon the country, the corporate tax was seen as an important policy tool to promote these goals.

The reform was thus possible even in the context of a restrictive public finance situation, and followed most guidelines put forward in highly regarded international reports. A broad corporate tax reform, including rate reduction, a participation exemption regime, a more flexible rule on cost acceptance, an extension of loss carry over period, to name a few, was possible in a very constrained public finance situation. By placing the emphasis on moving the system towards international trends and promoting measures to enhance investment and growth, international creditors could accept such a reform. Also, a consensus with the main opposition party was a very important factor in securing much needed political support. The findings from what can be considered as an experiment in corporate tax reform in tough economic and social times can be useful to policymakers, tax authorities and international bodies dealing with tax reform processes. The impact on managerial decisions such as investment and financing is also relevant (Antonio, 2015)

2.2.2 Value added tax policy and financial performance

Gordon (1989) did a study on some macroeconomic implications of the value-added tax. His work examined the macroeconomic impact of a consumption-based value-added tax (VAT) using simulations of a large-scale model. The VAT was imposed as a structural reform of the tax code rather than as a revenue-raising device, that is, the revenues from the VAT were offset by compensatory reductions elsewhere. Three basic scenarios were examined,

1) VAT is offset by individual rate reductions,
2) Abolition of the corporate profits tax in conjunction with a small individual rate cut, and
3) Investment tax credit with the balance of the revenues offset by a personal rate cut.

Additionally, Gordon (1989) examined the effects of the microeconomic incidence of the VAT, i.e., whether it is fully passed through to output prices or shifted back onto profits. The finding was that the VAT in general raises the long-term level of output, but at the cost of initial output losses, which are in evidence even when the associated rise in the price level is accommodated by a corresponding shift in monetary policy. In addition to changes in the intertemporal distribution of growth, there are significant changes in the composition of GNP, which shifts away from consumption, toward business fixed investment and net exports. These changes are particularly pronounced when the VAT is fully passed through. When the tax is partially shifted back, the gains in investment and trade are less

marked, while business profits are reduced, and the long-term increase in output is smaller.

Swardt, and Oberholzer (2006) did a study about Digitized products on how compliant was South African value-added tax. One instance of this was that it had made the digitization of products possible. This shift had severe implications for traditional consumption taxes, which were developed under the premise of a physical presence in a tax jurisdiction. A large number of countries in the world that imposed Value-Added Tax (VAT) on the supply of goods and services, including South Africa, were affected by this shift. The Organization for Economic Cooperation and Development (OECD) had suggested a number of principles that should apply to consumption taxes in e-commerce. These principles were intended to provide fiscal climates in which e-commerce had to flourish and ensure taxation systems that secure individual countries' tax bases. A comparison between the principles and the rules pertaining to the imposition of VAT in South Africa on the supply of digitized products reveals several discrepancies and uncertainties. A baseline survey among VAT specialists in South Africa, conducted in order to substantiate these findings, confirmed these discrepancies and uncertainties in practice.

2.2.3 Custom Duty tax policy and financial performance

A tax levied on imports (and, sometimes, on exports) by the customs authorities of a country to raise state revenue, and/or to protect domestic industries from more efficient or predatory competitors from abroad. Customs duty is based generally on the value of goods or upon the weight, dimensions, or some other criteria of the item such as the size of the engine, in case of automobiles. Customs/import duties are imposed on some goods that are imported into South Africa. Import duties are imposed to protect local producers. In addition, excise duties are also imposed on selected imported goods. Excise duties are also imposed on similar goods that are produced in South Africa (Kay and King, 1999)

A tax collected at the source of transactions (for example, excise duties) by a party other than the ultimate taxpayer will rank higher on the index of tax effectiveness than a tax, which depends on a declaration of liability by the taxpayer himself. Taxes with exemptions and deductions will be less effective than taxes that are imposed without exemptions and deductions on strictly defined bases. Taxes that are obtained from a few collection points, such as customs duties on imports and excise duties on manufactured items, will be more effective than taxes that have to be collected from widely diffused sources. For the same reason, taxes imposed on manufacturers or wholesale distributors may be expected to rank higher on the effectiveness index than single-stage retail sales taxes. In sum, it can be said that direct taxes are more prone to evasion compared to indirect taxes. That is why countries that are not able to enforce their tax la ws more effectively rely more on commodity taxes at source. Alternatively, as long as other sources of revenue do not develop, commodity taxes will be

compulsion rather than choice for developing economies (Larkins, 2004)

2.2.4 Capital gains tax policy and financial performance

Clare *et al* (2002) studied the effect of capital gains tax policy on investment company capital gains realizations. They identified that investment companies dominate the United States equity markets, both in terms of the large proportion of equity capital they control and the sizable trading volume they generate. This shift in the ownership of U.S. equity securities could lessen the impact of changes in U.S. capital gains tax policy which are aimed at individual investors. The study examined the effect of capital gains tax rates on investment company capital gains realizations. Empirical tests on cross-sectional, time-series data provide evidence of an unlocking effect of lower marginal capital gains tax rates. Investment companies exhibit economic response behavior consistent with the lock-in effect characteristic of individual investors. Capital gains realized are higher during periods of low marginal capital gains tax rates. The significant permanent tax effects estimated in the analysis are strengthened when transitory effects are introduced into the model.

Horn-Chern and Zeng, (2005) examined the stock market reactions and capital gains tax. The study provides evidence suggesting capital gains tax affects stock returns and trading volume. The Canadian federal government budget of May 23, 1985 provided individual taxpayers with a cumulative tax exemption for capital gains, up to a lifetime limit of $500,000. The empirical results, using daily stock return and trading volume data from the Toronto Stock Exchange, show that stock prices decreased three days before the announcement of the lifetime capital gains exemption. The empirical results also show that stock trading volume increased two days and four days before the announcement and five days following the announcement. These results are consistent with the argument that the capital gains tax constrained some individual shareholders from selling appreciated shares (often called "lock-in effect").

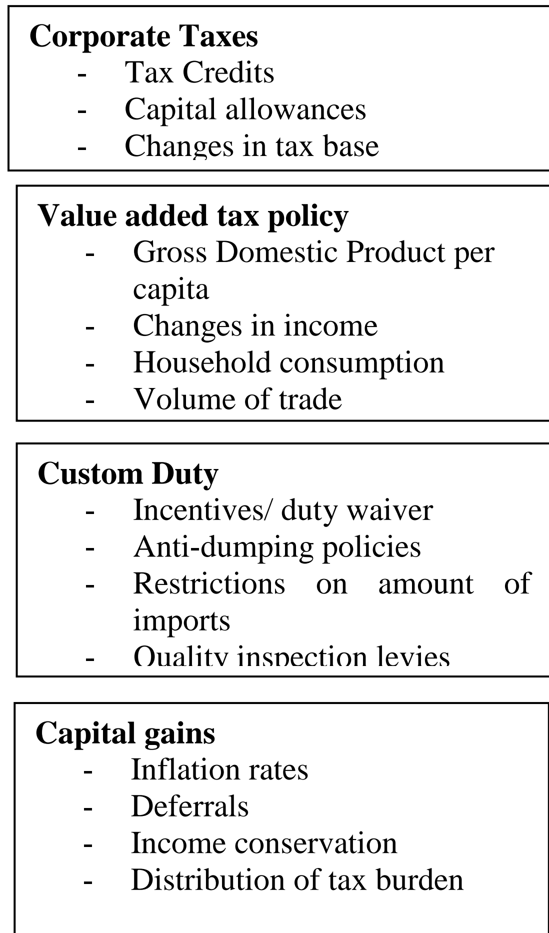
Teresa (2008), also looked at an analysis of dividend and capital gains tax rate differentials and their effect on the structure of corporate payouts. The aim of the study was to investigate whether corporations consider shareholder-level taxes when setting corporate distribution policy. I investigate the relation between the tax-rate differential on dividend and capital gains income and its effect on firms' distribution policies. The author further found that firms consider shareholder-level taxes and that this association varies with the percentage of the firm owned by individual shareholders. Hence, firms increase share repurchases and decrease the percentage of total corporate payout in the form of a dividend as the tax-rate differential increases. Thus, an increased substitution effect occurs as capital gains become relatively more tax-advantaged compared to dividends.

2.3 Conceptual Framework

Kombo and Tromp (2006) defines conceptual framework as a visual or written product that explain either graphically or in a narrative, the main things to be studied, the

key factors, concepts or variables and the presumed relationship among them. It is therefore a model used in research to outline possible courses of action or to present a preferred approach to an idea or thought. A conceptual framework is very important in any research study being undertaken. It shows the relationship between the dependent variables and the independent variable.

Independent Variables **Dependent Variable**



Financial Performance

- Return on Investment
- Sales turn-over
- Profit before tax.

Figure 1 Conceptual Framework

3.0 RESEARCH METHODOLOGY

This research adopted a descriptive research design to gather data. The location of the study was Kiambu County. The target population was the 10,000 Medium size Enterprises who are registered and are therefore licensed with Kiambu County government. The Medium size Enterprises provided information on the relationship between tax policies and financial performance. The sampling frame for the proposed study was drawn from Kiambu County offices whereby the researcher obtained a list of all registered Medium size Enterprises within the county. The sampling frame comprised of 10,000 Medium Enterprises owners who are registered. The sampling technique that the study adopted was, purposive stratified and simple random sampling. Purposive sampling techniques involve selecting a certain units or cases based on specific purpose rather than

randomly (Kvale 2003). Open ended are used in qualitative research, although some researchers will quantify the answers during the analysis stage. The questionnaires were hand delivered by the researcher and were collected upon filled up at the time agreed upon. The enumerator explained the objectives of the study to the respondents and helped them to tackle some of the difficult areas that may not be properly understood in the questionnaire by the respondents. A pilot test was conducted to test the reliability of the instruments and the validity of the study using 10 respondents. Questions which were found to be inappropriate were revised. The researcher carried out a pilot test to test the validity and reliability of the questionnaires in gathering the data required for the purpose of study. The data processing and analysis was done bearing in mind the objectives of the study. All the data that will be collected will be processed and analyzed. A multiple linear regression was conducted for this study. Multiple linear regression attempts to model the relationship between two or more explanatory variables and a response variable by fitting a linear equation to observed data. Every value of the independent variable x is associated with a value of the dependent variable y. this relationship was summarized as follows;

$$Y=\beta_0+\beta_1X_1+\beta X_2+\beta X_3+\beta X_4+E$$

Where;

$Y=$ Financial Performance
$\beta_0=$ Constant
$X_1=$ Corporate Taxes
$X_2=$ Value added tax policy
$X_3=$ Custom Duty
$X_4=$ Capital gains
$\beta_1\ \beta_2\ \beta_3\ \beta_4=$ Regression co-efficient
E=Error term

4.0 RESEARCH FINDINGS AND DISCUSSION

The general hypothesis of the study was that there was no relationship between tax policies and financial performance of medium size enterprises within Kiambu County. This hypothesis was tested through correlation and regression analysis between tax policies and financial performance. Table 1 indicate the correlation test conducted between tax policies and financial performance.

Table 1 Correlation Test between Tax Policies and Financial Performance

		Performance	Corporate tax	Value-added	Custom duty	Capital gains
Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	176				
Corporate tax	Pearson Correlation	-.419	1			
	Sig. (2-tailed)	.000				
	N	176	176			
Value-added	Pearson Correlation	-.320	.057	1		
	Sig. (2-tailed)	.002	.449			
	N	176	176	176		
Custom duty	Pearson Correlation	-.345	.103	.037	1	
	Sig. (2-tailed)	.008	.172	.622		
	N	176	176	176	176	
Capital gains	Pearson Correlation	-.625**	-.019	-.032	-.132	1
	Sig. (2-tailed)	.000	.804	.677	.080	
	N	176	176	176	176	176

**. Correlation is significant at the 0.01 level (2-tailed).

The results presented in table 1 revealed that there was a significant correlation between tax policies and financial performance of medium size enterprises, with p- value of 0.000 which is less than 0.01 and Pearson Correlation coefficient was -0.419 for corporate tax and financial performance, -0.32 for value added tax policy and financial performance, -0.345 for custom duty tax policy and financial performance and -.625 for capital gains tax policy and financial performance. This results does not confirm the null hypothesis but concurs with the alternative hypothesis that tax policies have a significant relationship with financial performance of medium enterprises. According to Mugenda and Mugenda (2008) a correlation coefficient (R) of 0.3 is enough to conclude that there is a significant relationship between the dependent variable and independent variable. The negative R value implies that there is a negative relationship between the tax policies and financial performance by medium enterprises in Kenya. Thus the null hypothesis was rejected and the alternative hypothesis accepted.

4.9 Regression Analysis

A multiple regression analysis was conducted to determine the relationship between tax policies and financial performance of medium size enterprises in Kiambu County and the model summary was presented in table 2.

Table 2 Regression analysis for tax policies against financial performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	-.425[a]	.356	.377	.14246

a. Predictors: (Constant), capital gains, corporate tax, value-added, custom duty
b. Dependent variable: Financial performance

The results indicated that there was relationship between Tax policies and financial performance by medium size enterprises in which R^2 was 0.356 implying that 35.6% of financial performance by medium size enterprises was explained by tax policies. This shows that an increase in tax policies by one unit causes a decrease in financial performance by SMEs by 0.386. The adjusted R square of 0.377 means the information asymmetry without the constant explains 37.7% variation in access to finance by the SMEs. The remaining 61.4% variation in access to finance by the SMEs is explained by other variables which are not in the model. Table 2 indicates the regression coefficients. The dependent variable was financial performance and the independent variables were corporate tax policy, value added tax policy, custom duty tax policy and capital gains tax policy.

Table 3 Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients
	B	Std. Error	Beta
(Constant)	13.168	3.284	
Corporate Tax	-.409	0.054	-.365
Value Added	.050	1.026	.024
Custom Duty	.167	.075	.247
Capital Gains	-0.0567	.043	-0.278

Dependent variable. Financial Performance

The coefficient for corporate tax is -.409, value added tax policy is .050, custom duty tax policy is .167 and capital gains tax policy is -0.0567. Corporate tax policy has a negative relation with financial performance with coefficient of -.409. This implies that as the manufacturing companies pay more tax their financial performance decrease and the reason could be that tax reduced the earnings levels of the companies. Manufacturing companies should engage in tax planning so that, the net effect of their tax contributions to government would not impact so much on their revenue generating activities. This can be done by taking full advantage of the manufacturing industry concessions. Value added tax policy showed a positive relationship with financial performance having recorded a coefficient of 0.05 implying that the value added tax of the manufacturing companies contributes about 5 percent to every unit of financial

performance achieved by the companies. A coefficient of 0.167 and a significance level of 7.5 percent, shows that custom duty positively affect the financial performance. Capital gains tax policy shows a negative relationship with financial performance. From the foregoing discussions, the final model estimation from the regression analysis is stated as;

$$FP = 13.168 - 0.409CT + 0.05VA + 0.167CD - 0.0567CG + E$$

Where FP – Financial Performance
CT – Corporate Tax Policy
VA – Value Added Tax policy
CD – Custom Duty Tax Policy
CG – Capital Gains Tax Policy

5.0 CONCLUSION AND RECOMMENDATION

5.1 Conclusion

The conclusion for this study was derived from the findings of the variables. In general, tax policies were found to influence the financial performance of medium sized enterprises. Regarding corporate income tax, the study concluded that the government provided tax credits to various medium enterprises. This was because majority of the respondents had agreed when asked the same. It was also concluded that there were a number of notable tax credits that the enterprises obtained in order for them to survive in the industry. Some of them included enacting tax incentives for businesses to hire workers, tax exclusions for local bonds, mortgage interest deductions, and Individual retirement account and hybrid tax credits. All this tax credits were found to have been offered to the enterprises in lowering their costs of production.

5.2 Recommendations

The study has found that, there is a significant relation exist between tax policies and financial performance. From this backdrop it is recommended that organizations should employ the services of tax experts to aid them in tax planning in order to reduce the net tax payment so as to increase their financial performance. Again they should increase their asset size and ensure efficient use of those assets to reflect in the production turnover of the companies.

Tax policies are primarily aimed at financing public expenditures. Tax policies are also used to promote other objectives, such as equity, and to address social and economic concerns. They need to be set up to minimize taxpayers' compliance costs and government's administrative cost, while also discouraging tax avoidance and evasion. But taxes also affect the decisions of households to save, supply labour and invest in human capital, the decisions of firms to produce, create jobs, invest and innovate, as well as the choice of savings channels and assets by investors. What matters for these decisions is not only the level of taxes but also the way in which different tax instruments are designed and combined to generate revenues. The effects of tax levels and tax structures on agents' economic behavior are likely to be reflected in overall living standards of every tax payer. Therefore recognizing this, the study recommends structural reforms on tax

systems. Likewise, most tax reforms should be driven by the desire to promote competition and avoid tax-induced distortions. These tax reforms can be characterized as involving rate cuts and base broadening in order to improve efficiency, while at the same time maintain tax revenues.

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