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# EFFECTS OF CORPORATE INCOME AND VALUE ADDED TAX INCENTIVES ON THE PERFORMANCE OF EXPORT PROCESSING ZONE (EPZ) FIRMS IN KENYA

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## ABSTRACT

With increased globalized economies characterized by stiff competition, there is a need for competitive tax systems, a strategy aimed at establishment of industries including EPZ so as to establish trading advantage. EPZs experience poor financial performance. There has been a decreasing trend in the number of employees recruited by EPZ firms in Kenya. The purpose of this paper was to establish the effect of corporate income tax incentive and VAT incentive on the performance of EPZ firms in Kenya. The study adopted a descriptive and explanatory research design. The study used a stratified sampling approach because the number of the EPZ firms in Kenya was categorized into 4 strata. The total numbers of firms used in the study were 86 registered EPZ firms in Kenya according to Export Processing Zones Authority (EPZA). The study adopted a census survey design. Primary data was obtained using questionnaires. Secondary data from the registered firms was collected on; ROA, total number of jobs created and the length of stay of the firms. The study used both descriptive and inferential statistics to conduct data analysis. The results of bivariate regression models adopted revealed that at 5% significance level corporate income tax incentive and VAT incentives had a positive and significant relationship with performance of EPZ firms measured using ROA and the total number of jobs. Based on the findings the study concluded that the government should continue to offer tax exemptions for it to attract and maintain foreign investors in the country. This study recommends that stakeholders in tax policy should reconsider the economic value of corporate tax incentive. Further, it was recommended that the government should reconsider its VAT policy by encouraging more VAT rebates to firms in order to boost their productivity and increase the volume of exports.

**Keywords**: *Corporate tax incentives, VAT incentive, performance, EPZ firms, ROA, number of jobs created and length of stay.*

## Background of the Study

Active promotion of countries as investment hubs has been and continues to be governments focus aimed at attracting scarce private capital, new and advanced technology as well as better administrative abilities so as to accomplish their improvement objectives (Olaleye, Riro & Memba (2016). They have progressively embraced measures to encourage the passage of taxation options that have proved to be one of the most effective means of solving the problem especially as a means of growing and establishment of domestic industries (Pham, 2015).

According to Aggarwal (2005), trade advancement is an imperative strategy for financial development in creating nations. As an arrangement method for accomplishing this objective, the



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idea of export processing zones (EPZs) has gained visible importance lately, organized commerce zones (FTZs) ordinarily cover motivating forces for establishing manufacturing sectors for production of products for exports. .Most countries export processing zone administrations advance the export of products that are fabricated, gathered or prepared (Njeru & Ndimitu, 2015).

Importation of goods has been and continues to be a problem faced by many countries in developing countries. Search for effective initiative aimed at resolving the problem lead to formation and adoption of EPZs to promote exports and diversification (Baissac, 2011). With increased globalised economy characterized by stiff competition, there is thus a need for competitive tax systems a strategy aimed at establishment of industries so as to establish trading advantage (Devereux, Maffini & Xing, 2015).

Tax incentives are widespread around the globe and are always advancing. They are measures that accommodate a more encouraging duty treatment of specific exercises or segments contrasted with what is conceded to general industry, it comes in form of an offer to pay less tax. According to Institute of Economic Affairs (2012), tax incentive is an arrangement that concedes any individual or action and great conditions that move away from the ordinary arrangements of the excise enactments (Adejare, 2015).

Export processing Zones (EPZs) were amongst the primary initiatives pioneered in developing countries so as to promote the growth of exports as well as diversification (Klinger & McFate, 2013). The primary generation EPZs initiated principally by new industrial countries of East Asia, took the shape of providing investors with remissions on import duties for inputs and raw materials, with increased or improved infrastructure and with speeded-up customs clearance procedures (Chukwumerije & Akinyomi, 2011). These schemes generated some substantial initial impacts, resulting in their adoption by an oversized majority of developing countries today (Din, 1994; Holland &Vann, 1998). Governments all over the world use tax incentives to enhance economic activities and investments by firms, they use these form of incentives to channel some special economic activities towards some important sectors of the economy where they are either not felt or not existing at all (Kaplan, 2001).

In Uganda and Kenya, VAT exemptions are widespread, where in Uganda, over thirty five merchandise and services such as gas, accessories, petrol are exempted from tax while for the case of Kenya, it suspended capital gains tax in the year 1985 according to a report by Ernst & Young (2014). In the year 2014 however, there was a reintroduction of the tax back in Kenya after an amendment of the Finance Act and at the moment, it is 5%in Kenya as compared to a figure of 30% in Uganda and Tanzania. According to Institute of Economic Affairs (2012), tax incentive is an arrangement that concedes any individual or action great conditions that move away from the ordinary arrangements of the excise enactments. Kelley (2004) argues that the main aim of having incentives on custom duty is to have improved balance of payments (BOP), to enhance competition and attract more FDI (Yatskovskaya, 2012).

The Kenyan government has continued to pursue a growth strategy centered on exports, a move, aimed at moving away from the previously favored import-substitution (Mangieri, 2006). That being the case, the government focused on improving exports by creation of EPZ which aimed to have tax incentives in order to spur exports. The overall aim of that was to have the Kenyan economy be more open and increase market access (Mangieri, 2006). Some of the tax incentives hence offered are the wear and tear allowance which is a deduction on the depreciation of assets

as well as the investment deductions allowance(IDA) on the expenditure on machinery (Institute of Economic Affairs, 2012). For other countries like Tanzania, tax incentives ranges from incentives on agricultural investors in the form of deferment of VAT payments on project capital goods as well as zero rated value added tax on agricultural exports (Network-Africa& Action Aid International, 2012).

In Kenya companies including those operating at EPZ benefit from major tax incentives especially capital allowances such as Investment building deductions (IBD), Investment deduction (ID) and Wear &Tear allowances by claiming deductions from their corporate tax liability. Incentives lowers the cost of the firm especially where the government offer subsidies and other forms of incentives to firms such as low interest rates, grants, lowering the cost of labor, and improving transportation networks to make transportation cost low, with reduced costs, the net profit posted by firms will be high and hence leads to high financial performance.

Ohaka & Agundu (2012) argue that firms that are eligible for tax incentives normally have higher returns. Tax incentives also make investments more attractive and in turn enhance profitability of a firm (John, 2013). Tax incentive generate employment and encourage self-employed to incorporate into limited companies, this leads to improved financial performance of firms because limited companies perform better given the fact they can assess external sources of capital as compared to sole-traders (Philips, 2011). Incentives lowers the cost of the firm especially where the government offer subsidies and other forms of incentives to firms such as low interest rates, grants, lowering the cost of labor, and improving transportation networks to make transportation cost low, with reduced costs, the net profit posted by firms will be high and hence leads to high financial performance.

**Statement of the Problem**

There is an increase in the number of countries using EPZs in sub-Saharan Africa (Singa, 2007). Despite this growth in EPZs activity, EPZs still experience poor financial performance. There has been a decreasing trend in the number of employees recruited by EPZ firms in Kenya. Also the number of jobs decreased significantly between 2007 and 2009 (EPZ financial report, 2015). This extension of poor financial performance of EPZs has now happened in the face of expanding global trade and stiff beneficial competition. The economic competition has seen developed countries dominate the domestic firms, a situation that calls for government intervention to encourage financial performance of EPZs.

Tembur (2016) conducted a study on the Effect of Tax Incentives on Financial Performance of Export Processing Zone Firms in Kenya. The study used IBD, W&T and ID as independent variables (and size and asset utilization as independent variables) and thus an indication of conceptual gap. The current study used corporate income tax incentives, capital allowances, VAT Incentives Excise Tax Incentives, custom duty incentives as independent variables (and firm size as a moderating variable). Chukwumerije & Akinyomi (2011) studied the impact of the tax incentives on the overall performance of registered small scale industries in Rivers State, Nigeria. They concluded that there was significant positive relationship between tax incentives and profitability, staff strength and the growth and development of small scale industries. Gumo (2013) conducted a study on the effect of tax incentives on foreign direct investments (FDI) in Kenya but did not focus on financial performance. His study established that investments deductions and mining operation deductions incentives policy have a positive effect on FDI while industrial allowance

has a negative influence. Therefore, this study sought to bridge the research gap by investigating on the effects of tax incentives on the performance of EPZ firms in Kenya.

**Purpose of the Study**

The purpose of the study was to investigate the effects of corporate income tax and VAT incentives on the performance of EPZ firms in Kenya.

**Research Hypotheses**

i. **$H_0$:** Corporate income tax incentive has no significant relationship with the performance of EPZ firms in Kenya.
**$H_1$**: Corporate income tax incentive has a significant relationship with the performance of EPZ firms in Kenya

ii. **$H_0$:** VAT tax incentive has no significant relationship with the performance of EPZ firms in Kenya.
**$H_1$**: VAT tax incentive has a significant relationship with the performance of EPZ firms in Kenya

**Justification of the Study**

A review of the current tax policies can aid in carrying out a cost benefit analysis (CBA) and guiding the policy makers on appropriate incentives. Government, through this research could evaluate the profitability of the tax incentives, that is whether the revenue forfeited by way of tax incentives are justifiable or not. On the other hand, it will enable government to know whether tax incentives can actually help to redirect investment pattern of individuals and corporate bodies towards the development of manufacturing firms.

The research will provide the corporate tax payers and especially those operating in the EPZ with an insight on available tax incentives and how to utilize them in order to increase their savings for future investments. Rise in level of investments in the country is likely to result to rise in level of revenue for the government through taxation.

The study will also be instrumental for researchers and academicians who will want to get information relating to tax incentives and performance of firms. It will also be of great use for researchers and students who will want to review the literature on tax incentives and financial performance.

**Literature Review**

**Theoretical Review: Optimal Tax Theory**

The theory discusses a best way of raising set revenues, reducing inefficiency and distortion through distortionary taxation (Mirrlees, 1976). A neutral tax is a theoretical tax which avoids distortion and inefficiency completely. Other things being equal, if a tax-payer must choose between two mutually exclusive economic projects (say investments) that face the same pre-tax risk and returns, the one with the lower tax or with a tax break would be chosen by the rational actor.



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With that insight, economists argue that generally taxes distort behavior. For example, since only economic actors who engage in market activity of "entering the labor market" get an income tax liability on their wages, people who are able to consume leisure or engage in household production outside the market by say providing housewife services in lieu of hiring a maid are not taxed or are taxed lightly.

There is distortion attributable to the incidence of taxes that are levied on commodities a classic example being the tax on restaurant prepared food while the foods bought from supermarkets to then be prepared at home after they have been bought are usually not taxed. Thus it will be safely concluded that tax discriminations in favor of household work over the work that can be executed in the market places can lead to gross inefficiency in tax operations. According to a theory that was developed by Ramsey (1927) on optimal sales taxes levied on commodities, he posited that producer surplus as well as consumer surplus arises where a demand curve sloping downwards intersects with a supply curve that slopes upwards. As a result of imposing a sales tax, there is a considerable reduction in the output apart from imposing a deadweight loss. A single rate of tax that is applied uniformly, of course making the assumption of invariant demand and supply elasticities will bring about minimization of the sum area of DWL triangles that have developed. The general idea about the theory is that if an assumption is made regarding the elasticity of suppliers such that we now assume that they have a perfect elasticity regarding their responses to tax changes, it will be concluded that a smaller DWL distortion will be experienced on taxes levied on commodities that have a more inelastic response to consumer demand. Marginal deadweight loss is the main focus of the modern version of the optimal taxation theory according to (Mayshar, 1990). It is this modern theory upon which the objective of this study will be based.

There is a vivid justification why the theory of optimal tax is pertinent to this study as it provides crucial information on VAT Incentives as well as Excise Tax Incentives. According to Ohaka & Agundu (2012), eligibility of EPZs firms on VAT Incentives and also Excise Tax Incentives enables these firms to pay much more less tax which eventually gives them a genuine upper hand to record increased return on assets as well as return on equity (ROE) both of which are arrived at from profit after tax. Tax incentives also make investments more attractive and in turn enhance profitability of a firm. Some of the studies which have used this theory include Dynarski and Scott-Clayton (2006), Kopczuk & Slemrod, (2006) and Saez & Stantcheva (2016).

**Empirical Review**

**Corporate Income Tax Incentives and Performance of EPZs**

Njeru and Ndimitu (2015) assessed the effect of tax incentives on performance among Export Processing Firms (EPZs) in Kenya. The study adopted a descriptive design. The findings from the study revealed that investments in EPZ firms increased with increase in sales, profit as well as tax incentives. However, the influence of tax incentives on investments in EPZ was insignificant. The study revealed that, the level to which EPZs have benefited on the following tax incentives include grants or loan guarantees; corporate income tax incentives; tax holidays or reduced tax rates, investment allowances; exemption from import tariffs; exemption from sales, wage income or property taxes and subsidized financing. Positive impact of various attractive incentives extended to the EPZs include increased foreign exchange earnings for the state, tax breaks, increased gross exports that are used to boost business investments in the country, high quality manpower, good source of labor training and learning by doing and assisting countries in developing an industrial

labor force as well as procedural incentives. Negative impacts, on the other hand include the administration is legally complicated and conflictive; unhealthy competitions in the manufacturing sector caused by the tax incentives to the EPZ.

Another study that was conducted by Devereux, Maffini & Xing (2015) focused on corporate tax incentives as well as firm performance. This study used data that was obtained from confidential tax return data that was combined with the data from financial statements for a panel of companies in the UK that were in operation between the fiscal years 2001/2002 - 2009/2010. The analysis of the study was based on the confidential tax return data in the UK at company-level. There were elaborate kinks in the corporate tax rate schedule that led to the variation in the company's marginal tax rates that therefore provided the leading identification strategy. A dynamic adjustment model that captured capital structure was used to arrive at a positive as well as substantial long run effect of tax on the competitive financial advantage of the companies. What this shows of course is that there were significant differences between the estimates of taxable profits as were captured in the tax returns data and the estimates of the financial statements. There was found to be a downward bias of the capital structure captured through financial statements as was influenced by the estimated tax. Variations in the marginal tax rate often necessitated an adjustment of capital structures as a gradual response to the change so as to match the demands of the new marginal tax rate. Additionally, there was a strong response to the corporate tax incentives that were extended to both the domestic stand-alone companies as well as the multinational companies based on their external leverage. They found the evidence that corporate tax incentives affected the external leverage of both domestic and multinational companies.

Another study that was carried out by Adejare (2015) focused on the effect of corporate tax on revenue profile of firms in Nigeria. The data that was used was secondary in nature and it was collected from Central Bank of Nigeria Statistical Bulletin for the period that ranged from 1993-2013. The relationship between the dependent variable that was GDP and the independent variables that were the company income tax, value added tax, petroleum profit tax as well as inflation was established using a multiple regression analysis. The conclusion of this study indicated that there was a positive significant effect of corporate income tax on the revenue profile in Nigeria that led to an improved growth in the country. It was also found that corporate tax funded most of the government obligations that included infrastructural improvement provision of education and public health. This led to an increase in the economic growth of the country that was directly attributed to the revenue from corporate tax. The study provided a recommendation whereby instead of eliminating corporate tax, the government should adjust the tax downwards. The reduced corporate tax could bring about an increase in the demand for labor and as a result of this increase there will be an increase in the wages that will also bring about an improvement in the consumption levels in the economy. There will be a reduction in the incentives so as to shift the profits out as a result of a reduced corporate tax and in the process this will protect the Corporate Tax base. Additionally, there will be an increase in the levels of investment as a result of the reduced corporate tax in the country. Despite this reduction in the corporate tax, the government should also devise additional assistance for the companies and other corporations in order to cushion them from the high cost of the corporate tax that will hinder investment and therefore lead to a deceleration in the rate of growth in the economy.

Thus the study hypothesized that;

*$H_{01}$: Corporate income tax incentive has no significant relationship with the performance of EPZ firms in Kenya.*

**VAT Incentives and Performance of EPZs**

In their study, Harju, Matikka, & Rauhanen (2015) sought to find out the effects of the value-added tax (VAT) threshold on the performance of small businesses. It was reported in this study that in Finland, firms that earned below 8,500in annual sales Euros were not liable to pay VAT. A robust and clear evidence of behavioral effects of the threshold was obtained in the study by applying the bunching method on detailed register data on the universe of businesses in Finland. The results of the study implied that small businesses were notably influenced by the VAT threshold. Notable efficiency implications were observed since the firms bunched actively just below the threshold. It was found that changing tax incentives at the threshold did not have a significant effect on the extent of the response. This implied that compliance costs were important in explaining observed responses. The study found no evidence of tax avoidance or evasion, which suggested that firms responded by reducing output. Also, it was found that bunching behavior was relatively permanent, which implied that the threshold decreased the growth of small businesses.

The study played a significant role in adding to the existing literature on tax incentives and performance of firms. The study however opened avenue for the current study to fill the contextual and conceptual knowledge gaps it left. The study by Harju, Matikka & Rauhanen (2015) focused on the performance of small businesses while the study focused on firms in export processing zones. It was forth comparing the findings to establish whether the situation with small firms is similar to that of large firms hence the importance of this study. Further, the situation in Finland (a developed economy) is different from the situation in Kenya (a developing economy). For that, there is a limitation in generalizing the findings of a study in developed economy to a developing economy. As such, the current study established whether there would be comparison in the findings between the two findings.

Ironkwe & Peter (2015) conducted a study aimed at investigating the impact of value-added tax incentive on corporate financial performance of quoted companies. Agribusinesses quoted in the Nigerian Stock Exchange Fact book of 2009 were considered as the population for this study. The population elements include the General Managers, Chief Accountants, Finance Managers, Chief Internal Auditors, External Auditors, and Tax Administrators of the selected companies. A total of forty (42) respondents were considered for this study. The study findings indicated that Value-Added Tax (VAT) impacted negatively on the financial performance of agribusinesses though the impact is of insignificant value. Based on the findings, the study recommended that agribusinesses should endeavour to keep appropriate source documents of all transactions for efficient VAT operations and that the governments should ensure that proper tax incentive scheme was designed and fully implemented to promote the growth of agribusinesses, in Nigeria.

In comparison to the study by Harju, Matikka & Rauhanen (2015), this study by Ironkwe & Peter (2015) also played a significant role in adding to the existing literature on tax incentives and performance of firms. More specifically, the study linked value added tax to performance. The study however opened avenue for the current study to fill the contextual and conceptual knowledge gaps it left. The study by Ironkwe & Peter (2015) focused on the performance of firms listed at Nigerian Stock Exchange while the study focused on firms in export processing zones. It was forth comparing the findings to establish whether the effect of tax incentives among listed firms in

Nigeria is similar to that of firms operating in export processing zones in Kenya. Further, the economic situation in Nigeria is different from the situation in Kenya and due to that contextual difference; this study was timely in investigating the effect of VAT tax on performance with a context of Kenya.

*$H0_2$: VAT Incentive has no significant effect on the performance of EPZ firms in Kenya*

**Research Methodology**

The research design was correlation research design. Correlation research design was best suited since panel data was used. Correlation design was suitable for this study because it enabled the researcher to establish the relationship between tax incentives available and performance of EPZ firms in Kenya. Such designs seek to explain how one variable affects another. The use of the correlation research design was considered appropriate to use any time there is need to clarify a perceived problem.

The study population was 86 finance managers drawn from all EPZ firms. The sampling frame of this survey was the finance managers in the firms. The study adopted a census survey design. Census survey was adopted because the population of interest is small and thus all the 86 registered EPZs firms was used in this study.

Primary data was obtained using questionnaires. Secondary data from the registered firms was collected on; profitability, share on profits expatriated, number and value of jobs created and the length of stay of the firms. This secondary data was collected from operating EPZ firms in Kenya. After data was collected through questionnaires, it was prepared in readiness for analysis by editing, handling blank responses, coding, categorizing and keying into statistical package for social sciences (SPSS) computer software for analysis. SPSS was used to produce frequencies, descriptive while STATA software in inferential analysis. The particular descriptive statistics were frequencies, mean scores and standard deviation. The particular inferential statistics were regression and correlation analysis.

The analysis of variance (ANOVA) was checked to reveal the overall model significance. In particular, the calculated f statistic was compared with the tabulated f statistic. A critical p value of 0.05 was used to determine whether the overall model was significant or not. The individual regression coefficients were checked to see whether the independent variable corporate income tax incentives significantly affected the performance of EPZ firms. A critical p value of 0.05 was also used to determine whether the variables were significant or not.

A regression models used to link the independent variables to the dependent variable as follows;

$$Y = \beta_0 + \beta_1 X + \beta_2 X_2 + \mu$$

Where;

$Y$ = Performance

$X_1$ = Corporate Income Tax Incentives

$X_2$ = VAT Incentives

$\mu$ = Error Term

The specific models were as follows;



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ROA = $\beta_0 + \beta_1$ Corporate Income Tax Incentives + $\beta_2$ VAT Incentives + $\mu$

Number of Jobs = $\beta_0 + \beta_1$ Corporate Income Tax Incentives + $\beta_2$ VAT Incentives + $\mu$

Length of stay = $\beta_0 + \beta_1$ Corporate Income Tax Incentives + $\beta_2$ VAT Incentives + $\mu$

In the model, $\beta_0$ = the constant term while the coefficient $\beta_i i$ = 1 and 2 were used to measure the sensitivity of the dependent variable (Y) to unit change in the predictor variables X. $\mu$ is the error term which captures the unexplained variations in the model (Olusola et. al, 2013).

**Research Findings and Discussion**

**Description of Corporate Income Tax**

The study conducted an assessment of corporate income tax incentive that the EPZ firms benefited from 2003 to 2014. The findings indicate an increasing trend of corporate income tax incentive waived for EPZ firms in Kenya. In 2003 a total of about Kshs 45,547,871 in terms of corporate income tax was waived. In 2004 the figures fall to about Kshs 40 million which decreased further to Kshs 36 million the following year. The highest corporate income tax waived within the study period was Kshs 73,982,932 which occurred in the year 2014.

**Table 1: Descriptive of Corporate Income Tax Incentive for EPZ firms**

| Year | N | Mean | Std. Deviation |
|---|---|---|---|
| 2003 | 27 | 45,547,871 | 60,823,670 |
| 2004 | 42 | 40,489,627 | 66,929,535 |
| 2005 | 45 | 36,086,590 | 75,262,294 |
| 2006 | 23 | 52,670,750 | 97,887,577 |
| 2007 | 44 | 29,609,336 | 48,066,636 |
| 2008 | 43 | 49,556,609 | 90,567,045 |
| 2009 | 40 | 46,786,138 | 88,042,342 |
| 2010 | 37 | 64,127,925 | 125,809,761 |
| 2011 | 45 | 73,548,136 | 128,357,226 |
| 2012 | 43 | 47,733,489 | 67,390,140 |
| 2013 | 51 | 47,204,195 | 77,683,517 |
| 2014 | 45 | 73,982,932 | 135,242,487 |
| Total | 485 | 50,603,003 | 92,805,538 |

**Trend for the Mean of Corporate Income Tax Waived For EPZ**

The trend analysis in the figure below indicates that corporate income tax incentive for the EPZ firms has been fluctuating from 2003 to 2014 with the lowest and the highest waiver occurring in 2007 and 2014 respectively. Figure 1 below illustrates the trend analysis of corporate income tax incentive for the study period.



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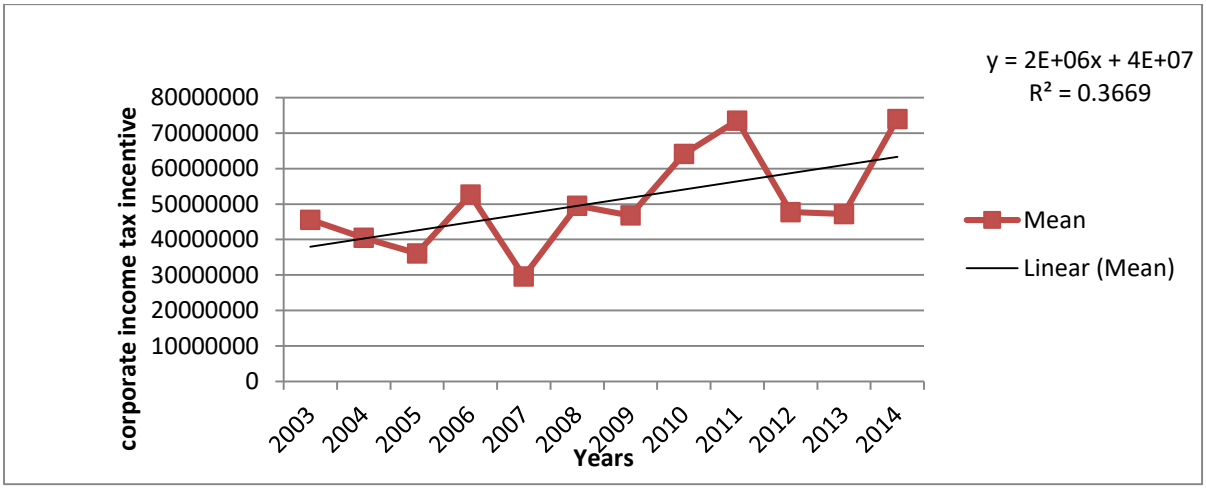


**Figure 1: Trend for the Mean of Corporate Income Tax Waived for EPZ**

## Effects of Corporate Income Incentive on ROA

The results presented in table 2 present the fitness of model used of the regression model in explaining the study phenomena. Corporate income incentives explained 31.3% of variation in ROA.

**Table 2: Model Fitness**

| Indicator | Coefficient |
|---|---|
| R | 0.56 |
| R Square | **0.313** |
| Adjusted R Square | 0.055 |
| Std. Error of the Estimate | 3.5556 |

The study conducted a linear regression to ascertain the influence of corporate income tax incentive on the EPZ firm's performance. The performance of firms was measured by ROA.

***Table 3: Effects of corporate Income Incentive on ROA***

| Parameter Estimate | B | Std. Error | Beta | t | Sig. |
|---|---|---|---|---|---|
| | 23,489,034.1 | 6,234,207 | | | |
| (Constant) | | | | 3.981 | 0.002 |
| Corporate Income Incentive | 2.345 | 0.2331 | 0.289 | 23.899 | 0.000 |

The following null hypothesis was tested:

**H0:** There is no significant relationship between corporate income tax incentive and performance of EPZ firms in Kenya.



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ROA (EZP Performance) = 23,489,034.1 + 2.345 *(Corporate Income tax Incentive)*

From the findings, the study rejected the null hypothesis that corporate income tax incentive has no significant relationship with performance of EPZ firms in Kenya. This is because the probability value (p-value = 0.000) was less than the conventionally value of 0.05. Therefore, the study concludes that corporate income tax incentive has a positive relationship with the performance of EPZ firms in Kenya.

**Effects of Corporate Income Incentive on Number of jobs**

The results presented in table 4 present the fitness of model used of the regression model in explaining the study phenomena. Corporate income incentives explained 21.2% of variation in Number of jobs.

**Table 4: Model Fitness**

| Indicator | Coefficient |
|---|---|
| R | 0.46 |
| R Square | **0.212** |
| Adjusted R Square | 0.0435 |
| Std. Error of the Estimate | 4.8953 |

The study conducted a linear regression to ascertain the influence of corporate income tax incentive on the EPZ firm's performance. The performance of firms was measured by the total number of workers.

**Table 5: Effects of Corporate Income Incentive on Number of jobs**

| | B | Std. Error | Beta | T | Sig. |
|---|---|---|---|---|---|
| (Constant) | -5.88 | 0.587 | | -10.01 | 0.000 |
| Log corporate income incentive | 0.656 | 0.036 | 0.64 | 18.296 | 0.000 |

The following null hypothesis was tested:

**H0:** There is no significant relationship between corporate income tax incentive and performance of EPZ firms in Kenya.

Y = -5.88+ 0.656 *X*

Y=Ln (Total Number of workers (EZP Performance))

X=Ln (Corporate Income tax Incentive)

From the findings, the study rejected the null hypothesis that corporate income tax incentive has no significant relationship with performance of EPZ firms in Kenya. This is because the probability value (p-value = 0.000) was less than the conventionally value of 0.05. Therefore, the study concluded that corporate income tax incentive has a positive relationship with the performance of EPZ firms as measured using the total number of workers created in Kenya.



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**Effects of Corporate Income Incentive on the Length of Stay**

The results presented in table 6 present the fitness of model used of the regression model in explaining the study phenomena. Corporate income incentives explained 24% of variation in Length of Stay

**Table 6: Model Fitness**

| Indicator | Coefficient |
|---|---|
| R | 0.49 |
| R Square | **0.240** |
| Adjusted R Square | 0.055 |
| Std. Error of the Estimate | 3.55566 |

The study conducted a linear regression to ascertain the influence of corporate income tax incentive on the EPZ firm's performance. The performance of firms was measured by the number of years in operation

**Table 7: Effects of Corporate Income Incentive on Length of Stay**

| Parameter | B | Std. Error | Beta | t | Sig. |
|---|---|---|---|---|---|
| (Constant) | -3.972 | 0.498 | | -7.969 | 0.000 |
| Log corporate income incentive | 0.339 | 0.03 | 0.515 | 11.356 | 0.000 |

The following null hypothesis was tested:

**H0:** There is no significant relationship between corporate income tax incentive and performance of EPZ firms in Kenya.

$Y = -3.972 + 0.339\ X$

Y=Ln (Length of stay)

X=Ln (Corporate Income tax Incentive)

From the findings, the study rejected the null hypothesis that corporate income tax incentive has a significant relationship with performance of EPZ firms in Kenya. This is because the probability value (p-value = 0.000) was less than the conventionally value of 0.05. Therefore, the study concluded that corporate income tax incentive has a positive relationship with the performance of EPZ firms as measured using the years in operation.

**Correlation Analysis for Corporate Income Tax Incentives and Performance**

The Table 8 below presents the results of the correlation analysis. The results presented shows that corporate income tax incentive and performance of EPZ firms are positively and significant related (r=0.239, p=0.000).



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**Table 8: Correlation Analysis Results**

| | | Performance | Corporate Income Tax incentives |
|---|---|---|---|
| Performance | Pearson Correlation | 1.000 | |
| | Sig. (2-tailed) | | |
| Corporate Income Tax incentives | Pearson Correlation | | 1.000 |
| | Sig. (2-tailed) | 0.239** | |
| | | 0.000 | |

**VAT incentives**

**Description of VAT Incentive Statement from Primary Data**

The third objective of the study was to determine the impact of VAT incentive. The respondents were required to state their level of agreement/disagreement on a Likert scale to the statement that VAT incentive leads to increase in the total sales by EPZ firms in Kenya. Majority 69.7% of the respondents affirmed the statement that VAT incentive leads to increase in the total sales by EPZ firms in Kenya, 19.6% were neutral while 10.7% were not in agreement with the statement. On the statement that exempting EPZ firms from paying VAT on export services lead to rapid expansion of EPZ firms in Kenya, majority 78.5% agreed, 5.4% were neutral while 16.1% disagreed. On the statement whether exempting from paying VAT on export services lead to rapid job creation by EPZ firms in Kenya, majority 67.8% agreed with the statement, 7.2% were neutral while 25% disagreed. On the statement, whether VAT incentive encourages more EPZ firms to be established and to continue operating in Kenya, majority 80.4% agreed, 17.9% were neutral while 1.8% disagreed. Further, whether EPZ firms operating in Kenya would shut down when VAT incentive is withdrawn, majority 62.5% agreed with the statement, 19.6% were neutral while 17.9% disagreed.

**Table 9: VAT incentive**

| Statement | Strongly disagree | Disagree | Neutral | Agree | Strongly agree | Mean | Std Dev |
|---|---|---|---|---|---|---|---|
| VAT incentive leads to increase in the total sales by EPZ firms in Kenya. | 3.60% | 7.10% | 19.60% | 53.60% | 16.10% | 3.7 | 0.9 |
| Exemption from paying VAT on export services lead rapid expansion of EPZ firms in Kenya | 0.00% | 5.40% | 16.10% | 58.90% | 19.60% | 3.9 | 0.8 |
| Exemption from paying VAT on export services lead rapid job creation by EPZ firms in Kenya | 1.80% | 5.40% | 25.00% | 46.40% | 21.40% | 3.8 | 0.9 |
| VAT incentive encourages more EPZ firms to be established and to continue operating in Kenya | 0.00% | 1.80% | 17.90% | 50.00% | 30.40% | 4.1 | 0.7 |
| EPZ firms operating in Kenya would shut down when VAT incentive is withdrawn. | 3.60% | 14.30% | 19.60% | 37.50% | 25.00% | 3.7 | 1.1 |
| VAT incentive affects the share of profits by EPZ firms | 1.80% | 7.10% | 16.10% | 37.50% | 37.50% | 4.0 | 1.0 |
| **Average** | | | | | | **3.9** | **0.9** |

Further on the statement that VAT incentive affects the share of profits by EPZ firms, majority 75% agreed with the statement, 8.9% disagreed while another 16.1% were neutral. On a five point scale, the average mean was 3.9 which means that majority of the respondents were agreeing to the statements in the questionnaire. The standard deviation was 0.9 meaning that the responses were clustered around the mean response.

**Description of VAT Incentive Statement from Secondary Data**

Assessment of VAT incentives waived for EPZ firms in Kenya revealed that a cumulative total of 402 firms benefited from this VAT waiver for between the period of 2003 and 2014. The study also revealed that a total of between Kshs 4,332,347 and Kshs 27,363,346 was lost through VAT incentive years for the study period between 2003 and 2014.



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**Table 10: VAT Incentives Descriptive**

| Year | N | Mean (Million) | Std. Deviation |
|---|---|---|---|
| 2003 | 36 | 4,332,347 | 11,565,259 |
| 2004 | 33 | 5,674,146 | 8,603,645 |
| 2005 | 31 | 19,296,465 | 75,316,436 |
| 2006 | 17 | 15,132,455 | 34,446,628 |
| 2007 | 34 | 9,419,316 | 24,133,209 |
| 2008 | 40 | 12,671,245 | 40,801,212 |
| 2009 | 36 | 12,664,328 | 30,401,847 |
| 2010 | 33 | 16,241,075 | 46,418,534 |
| 2011 | 35 | 15,427,012 | 59,800,258 |
| 2012 | 36 | 19,159,042 | 71,778,186 |
| 2013 | 37 | 25,369,213 | 69,161,290 |
| 2014 | 34 | 27,363,346 | 91,964,975 |
| Total | 402 | 15,214,719 | 53,638,486 |

**VAT Incentives Trend**

The graph below shows that the VAT incentive has been increasing across the study period. In 2005 there was significant increase in VAT incentive that EPZ firms received. On average the trend for VAT incentive has been increasing as illustrated in Figure 2.

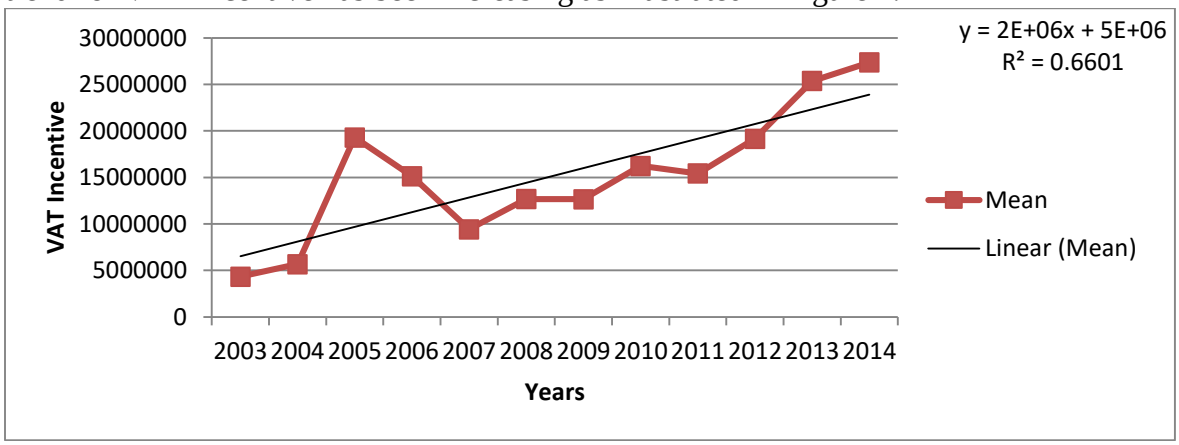


**Figure 2: Trend for the Mean of VAT Incentive Waived for EPZ Firms**

**Effects of VAT Incentive on ROA**

The results presented in table 11 present the fitness of model used of the regression model in explaining the study phenomena. VAT incentives explained 36% of variation in ROA.



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**Table 11: Model Fitness**

| Indicator | Coefficient |
|---|---|
| R | 0.600 |
| R Square | **0.360** |
| Adjusted R Square | 0.0224 |
| Std. Error of the Estimate | 4.27845 |

This study sought to investigate the influence of VAT incentive given to EPZ firms on the performance of the firms.

**Table 12: Effects of VAT Incentive on ROA**

| Parameter Estimate | B | Std. Error | Beta | t | Sig. |
|---|---|---|---|---|---|
| (Constant) | 65,349,981.23 | 10,345,786 | | 2.641 | 0.000 |
| VAT Incentive | 3.91 | 0.621 | 0.291 | 15.821 | 0.000 |

The study sought to test the null hypothesis below:

**H0:** There is no significant relationship between VAT incentive and performance of EPZ firms in Kenya.

ROA (EPZ Performance) =65,349,981.23 + 3.91 *(VAT Incentive)*

From the findings, the study rejected the null hypothesis that VAT Incentive has no significant relationship with the performance of EPZ firms in Kenya. This is because the probability value (p-value = 0.000) was less than the conventionally value of 0.05. Therefore, the study concludes that VAT Incentive has a positive significant relationship with the performance of EPZ firms in Kenya.

**Effects of VAT Incentive on the Number of jobs**

The results presented in table 13 present the fitness of model used of the regression model in explaining the study phenomena. VAT incentives explained 12.3% of variation in Number of jobs.



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**Table 13: Model Fitness**

| Indicator | Coefficient |
|---|---|
| R | 0.35 |
| R Square | **0.123** |
| Adjusted R Square | 0.2712 |
| Std. Error of the Estimate | 4.8952 |

The study conducted a linear regression to ascertain the influence of VAT incentive on the EPZ firm's performance. The performance of firms was measured by the number of jobs.

**Table 14: Effects of VAT Incentive on the Number of jobs**

| | B | Std. Error | Beta | t | Sig. |
|---|---|---|---|---|---|
| (Constant) | 1.208 | 0.665 | | 1.816 | 0.070 |
| Log VAT incentive | 0.212 | 0.046 | 0.226 | 4.649 | 0.000 |

The following null hypothesis was tested:

**H0:** There is no significant relationship between VAT incentive and performance of EPZ firms in Kenya.

$Y = 1.208 + 0.212\ X$

Y=Ln (Number of jobs (EPZ Performance))

X=Ln (VAT Incentive)

From the findings, the study rejected the null hypothesis that VAT incentive has no significant relationship with performance of EPZ firms in Kenya. This is because the probability value (p-value = 0.000) was less than the conventionally value of 0.05. Therefore, the study concluded that VAT incentive has a positive relationship with the performance of EPZ firms as measured using the number of total workers created in Kenya.

**Effects of VAT Incentive on the Length of Stay**

The results presented in table 15 present the fitness of model used of the regression model in explaining the study phenomena. VAT incentives explained 10.3% of variation in Length of Stay.

**Table 15: Model Fitness**

| Indicator | Coefficient |
|---|---|
| R | 0.320 |
| R Square | **0.103** |
| Adjusted R Square | 0.2489 |
| Std. Error of the Estimate | 4.2451 |

The study conducted a linear regression to ascertain the influence of VAT incentive on the EPZ firm's performance. The performance of firms was measured by the number of years in operation.

The following null hypothesis was tested:

**H0:** There is no significant relationship between VAT incentive and performance of EPZ firms in Kenya.

$Y = 0.143 + 0.078\ X$

Y=Ln (Length of Stay (EPZ Performance))

X=Ln (VAT Incentive)



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From the findings, the study rejected the null hypothesis that VAT incentive has no significant relationship with performance of EPZ firms in Kenya. This is because the probability value (p-value = 0.007) was less than the conventionally value of 0.05. Therefore, the study concluded that VAT incentive has a positive relationship with the performance of EPZ firms as measured using the number of years in operation.

**Table 16: Effects of VAT Incentive on the of Length of Stay**

| Parameter | B | Std. Error | Beta | t | Sig. |
|---|---|---|---|---|---|
| (Constant) | 0.143 | 0.418 | | 0.341 | 0.733 |
| Log VAT incentive | 0.078 | 0.029 | 0.158 | 2.728 | 0.007 |

## Conclusion, Recommendation and Areas for further research

### Conclusion

The study concluded that corporate income tax incentive and VAT incentives had a positive and significant relationship with performance of EPZ firms measured using ROA and the total number of jobs. Based on the findings the study concluded that the government should continue to offer tax exemptions for it to attract and maintain foreign investors in the country.

### Recommendation

This study recommends that stakeholders in tax policy should reconsider the economic value of corporate tax incentive. Further, it was recommended that the government should reconsider its VAT policy by encouraging more VAT rebates to firms in order to boost their productivity and increase the volume of exports.

The study recommends that the government should introduce a strong monitoring unit to oversee the administration of tax incentives. Government should equally pay attention to the issue of security and infrastructure which are basic in order to maximize the benefits of tax incentives. Tax incentives don't necessarily play a huge role if the other factors that support performance of companies are not taken care of.

### Areas for further research

The study recommended that future studies should aim to broaden the causes of low performance of EPZ firms in Kenya not identified in this study. The study also suggested that a study on the remedies to the low performance of EPZ firms be conducted. This would assist in improving EPZ firms in Kenya and to encourage more investors.



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