Effect of Tax Holiday on Tax Revenue Collection among Export Processing Zone Companies in Kenya: (A Case Study of Export Processing Zone Athi River)

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Abstract

The purpose of this study was to examine the effect of tax holiday on tax revenue collection among the Export Processing Zone (EPZ) companies in Kenya. The study adopted a descriptive research design. The study covered eight companies in EPZ Athi River. The data was collected from secondary data (tax incentives and revenue collection) sources collected from Kenya Revenue Authority (KRA), Treasury and Kenya National Bureau of Statistics (KNBS) for a period of five years from 2009-2013. Descriptive statistics, correlation and panel regression analyses were used in data analysis, where STATA software was utilized in generating the output. Correlation results indicated that there is a positive and significant association between tax holiday and revenue collection among EPZ companies in Kenya (r=0.286*), at 10 percent level of significance. Further, repression results revealed that tax holiday had a positive and significant relationship with tax revenue collection (β=33.32375, p=0.000) at 5 percent level of significance. This implies that a unit increase in tax holiday accounts for 33.32375 unit increase in tax revenue collection among EPZ companies in Kenya. Based on the findings, the study concluded that there was a positive and significant relationship between tax holiday and tax revenue collection. This implied that an increase in tax holiday is expected to boost ax revenue collection among EPZ companies in Kenya. Further, the regression results led to the rejection of the null hypothesis that tax holiday has no significant effect on revenue collection among the EPZ companies in Kenya. The study recommended that there is need for the government to rationalize the tax incentive schemes in the county. It is important to note that this process has now begun, by the government scrapping various tax remission and exemption provisions in the VAT Act 2013 including the program and it is expected that the intended review of the Income Tax Act will also comprehensively address this issue. This will ensure that the tax incentive scheme is both efficient and beneficial to the economy. As mentioned in the introduction of this study, It is important for the government and policy makers to put in place tax reforms that ensure that its tax system achieve the main three objectives of a good tax system which include raising tax revenue for funding government operations without excessive government borrowing.

Keywords: *Tax Holiday, Tax Revenue Collection Export Processing Zone Companies*

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1.0 Introduction

1.1 Background of the Study

Tax incentive is a government measure to reduce the amount of tax expected from business undertakings over a given period of time (Feibel, 2012). The Kenya Revenue Authority defines it as a relaxation of the normal tax rules aimed at availing an attractive environment for investment. According to Keen and Simone, (2004), lowering level of revenue collection from business entities offers space for investors to save. Wells and Allen, (2001) with a similar observation points to the fact that tax enticement by the government are never permanent reprieves. Investors can only enjoy its benefits for a specific period of time. The desire by the government to engage in tax incentives is to decrease on tax burden for both public and private business entities. Businesses that experience high revenue collection can replicate its revenue in business expansion to increase on employment opportunities among other things.

To attract investments, governments can come up with various forms of tax incentives. These forms can include but not limited to, tax holidays, reduction of tax rate on profits and reduced tariffs on imported products, equipment and raw materials (Haufler & Schjelderup, 2000). Exempting some businesses from taxation can lead the government to incurring losses. However, this extent cannot hinder it from making businesses to enjoy tax exemptions, tax credit and allowances directed at increasing on the level of economic activities and increased levels of employment.

Andersen, Kett and von Uexkull (2017) posited that policy makers in developing countries often find themselves in a dilemma over the use of tax incentives to attract foreign direct investment (FDI). They would likely prefer that no country offer tax incentives and that all firms contribute equitably to public coffers. However, the World Bank Group offers confirmation that tax incentives are more effective in attracting efficiency-seeking FDI motivated by lowering production costs than for other types of investment.

In more formal usage, revenue is a calculation or estimation of periodic income based on a particular standard accounting practice or the rules established by a government or government agency (Mirera, 2014). Two common accounting methods, cash basis accounting and accrual basis accounting, do not use the same process for measuring revenue. Corporations that offer shares for sale to the public are usually required by law to report revenue based on generally accepted accounting principles or International Financial Reporting Standards.

Revenue collection plays a pivotal role for every government in the world as it enables the government to acquire assets which are not liable to debt and which the government uses to develop its economy. Owing to its macro characteristics, revenue collection is usually done by the central government in order to allocate the collected revenue towards economic development (Koskei, Cheruiyot & Naibei, 2019). Having considered the above, revenue can be collected through many channels (including fees and levies among others) and one of the main one is the use of Tax system. Tax is the charge levied by the government of a country upon its habitants for its support or for the purpose of facilitating the service delivery in a country (Aamir, Qayyum, Nasir, Hussain & Butt, 2011).

Export Processing Zone (EPZ) is a Customs area where one is allowed to import plant, machinery, equipment and material for the manufacture of export goods under security, without payment of duty. The imported goods are subject to customs control at importation, through the manufacturing process, to the time of sale/export, or duty payment for home consumption. Other benefits of operating such enterprises include; free trade conditions, streamlined

Government red tape allowing for one stop registration and licensing and also a facility of long-term tax concession (World Bank, 2018).

In Kenya, Export processing zones (EPZs) are designated parts that are aimed at promoting and facilitating export-oriented investments and to develop an enabling environment for such investments. Currently there are over 40 gazetted zones in Nairobi, Voi, Athi River, Kerio Valley, Mombasa and Kilifi in various stages of development by both private and public zone developer/operators. These zones are managed and promoted by the Export Processing zones Authority (EPZA, 2018).

1.2 Statement of the Problem

Taxes are the main revenue for the government and thus the department or the government should seek to increase its tax base in more bearable way possible and thus there is need to impose an incentive as a way of ensuring the processes of expanding its tax base is friendly to the target population. They should start with industry identification so as to register and educate the targeted group. They are then supposed to assess after which they are sensitized on how and when to submit taxes. Through the procedures put in place then revenue is collected. The system must be monitored to ensure it can help avoid tax evasion and combat wrong submissions. Once these are in place and the right tax incentive is followed, then we can be sure of collecting the right amount of tax hence increase on the amount of revenue count. This will be applicable when there is no any political interference and the season targeted is right.

The study was on the relationship between tax holiday and the amount of revenue collected and thus, the amount of revenue collected is highly determined by the type of tax holiday imposed by the government within a specific period of time. The study sought to find the effects of tax holiday towards the amount of revenue collected in Kenya.

The assumption to this study is that, the students do not understand the relationship that exists between tax holiday imposed by our government and its impact on the amount of revenue collected. They tend to see it as a way of trickery benefitting the little targeted group and hence it happens not to be of bother to them. This study aimed at filling in that gap of perception by the majority citizens who are our most targeted tax payers, by establishing the relationship between tax holiday and the amount of revenue collection in Kenya by studying the EPZ companies in Kenya.

1.3 Purpose of the Study

The purpose of this study was to examine the effect of tax holiday on tax revenue collection among the EPZ companies in Kenya.

1.4 Hypothesis of the Study

Ho: Tax holiday has no significant effect on tax revenue collection among the EPZ companies in Kenya.

2.1 Theoretical Review: Industrial Development Theory

Sweezy, (2006) suggests that industrialization is the process through which an economy undergoes a structural transition by devoting greater parts of its energies to building new means of Production. Marx, (2005) with a supportive insight adds that nations that are highly industrialized enjoy reduced costs of production with increased efficiency. They also have a consolidated means of production due to highly skilled labor force. It is also true that industrialization calls for emphasis on technology which calls for replacing human labor force

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with mechanical power. The features of industrialization include but not limited to extensive division of labor, formal industrial organization, use of complex machinery, greater yields and interdependence between the industrial organization and the wider society.

A progressive industrial development leads to economic liberalization. It is necessary for the government to give up controls over certain aspects of the economy such as taxation for the industries to thrive. For instance, the industrialization process of England in the 18th and 19th centuries took place due to the protests by employers resisting government control over wages. This extent enabled the government to offer tax holidays to various firms that ended up creating enough resources to pay workers' industrial prosperity.

Proponents of the industrial development theory such as Sweezy (2008), Akerman (2013) and Galbraithe (2014) assert that the industrial development process undergoes three stages before maturation. Stage one is dominated by the production of consumer goods and production is aimed at the domestic market. The government plays a pivotal role in the industrial development process at this stage. Such is through providing the force to repress opposition to the industrial process. For example, there is need to keep wages low even amid protests by workers and trade unionists. At this stage also, the state imposes tariffs to protect the young industries.

2.2 Empirical Review

Ross and Lozano-Rojas (2017) further sought to investigate the influence of sales tax holidays on incidence using a dataset of high frequency scanner data on school supplies from 35,000 retailers across the US from 2006 to 2014. While the over shifting results of previous literature are replicated on a long panel covering 117 sales tax holidays, the richer data allowed the study to uncover seasonal shifts in the market around school start dates that likely biases the findings into this result. When the study focused on cases where this seasonality does not occur the over shifting does not manifest, and pretax prices either increase or stay the same. Thus, the study concluded that the concern of retailers capturing the tax holiday savings to be unsubstantiated by the data, and that the holidays' market weighted average effect on pretax prices is zero. However, the study used complementary data that demonstrate tax holidays to be poorly targeted if judged by the intention of arranging transfers to low income households or households with children. These findings should be helpful to policymakers in weighing the policy's trade-offs.

In Indonesia, Sari, Dewi and Sun (2015) analyzed the implementation and the impact of tax holiday policies from the perspective of foreign investment and tax revenues in Indonesia. The results showed that tax holiday is considered to give effect to the increasing in investment activities in Indonesia and it will not have a negative effect in the form of the loss of tax revenue. Tax holiday policy is considered capable to provide a positive impact on investment activities in Indonesia, but Indonesia still has to give priority to the improvement of infrastructure and bureaucracy.

Chow, Hoopes and Maydew (2018) undertook the first large-sample analysis of foreign tax holiday participation by U.S. firms to establish the effect of US firms on foreign (tax) holidays. Tax holidays are temporary reductions of tax granted by governments, usually contingent on the firm making new operational investments in the country. The study hypothesized and found that firms are more likely to participate in foreign tax holidays if they are highly capital-intensive and have highly profitable foreign operations, and less likely to participate in foreign tax holidays if they are capital constrained and if the firm is headed by a short-term focused

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CEO. Finally, while foreign tax holidays reduce taxes on foreign income, we also find that during our sample period they increase the amount of U.S. tax on foreign income.

Newton (2017) conducted a study on directed Tax Holidays as an economic Stimulus or Corporate Dream in the United States of America. According to Newton (2017), U.S. corporations currently have more than $2.4 trillion stashed in the accounts of their overseas subsidiaries (a sum that costs the domestic economy billions of dollars every year). A directed tax holiday is one potential method of inducing repatriation of those funds and stimulating the domestic economy. Although a previous tax holiday failed to meet expectations, current proposals from the public and private sectors suggest that a directed tax holiday could fund much-needed infrastructure investment. The study indicated that a tax holiday is not a lasting solution and there are significant dangers to repeating a plan that was only ever meant to be a one-time occurrence. There is a real possibility that American multinationals will develop Pavlovian tendencies and simply stash even more cash overseas in hope of another holiday in the future. However, the evidence seems to suggest that a directed tax holiday is a good idea. A directed tax holiday would significantly benefit the U.S. economy.

3.0 Methodology

The study adopted a descriptive research design. The study covered eight companies in EPZ Athi River. The data was collected from secondary data (tax incentives and revenue collection) sources collected from Kenya Revenue Authority (KRA), Treasury and Kenya National Bureau of Statistics (KNBS) for a period of five years from 2009-2013. Descriptive statistics, correlation and panel regression analyses were used in data analysis, where STATA software was utilized in generating the output. Findings were presented using tables and graphs.

4.0 Results and Discussions

4.1 Descriptive Statistics

Table 1: Descriptive Results

Variable	Obs	Mean	Std. Dev.	Min	Max
Tax Revenue Collection	40	494,000,000	191,000,000	170,000,000	946,000,000
Tax Holiday	40	15,000,000	6,698,817	5,322,843	34,200,000

Results in Table 1 indicate summary of the descriptive statistics of revenue collection and tax holiday. The mean of tax revenue collection from EPZ companies in Kenya for the period from 2009 to 2013 was Ksh. 494,000,000, with a standard deviation of Ksh. 191,000,000 indicating a wide variability in revenue collection over time. The minimum revenue collection was Ksh. 170,000,000, while the maximum revenue collection was Ksh. 946,000,000. Results also indicate that, the mean of tax holiday to EPZ companies in Kenya for the period from 2009 to 2013 was Ksh. 15,000,000, with a standard deviation of Ksh. 6,698,817 indicating a wide variability in tax holiday over time. The minimum revenue collection was Ksh. 5,322,843, while the maximum revenue collection was Ksh. 34,200,000.

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4.2 Trend Analysis

This section presents the trend analysis for the study variables: tax revenue and tax holiday.

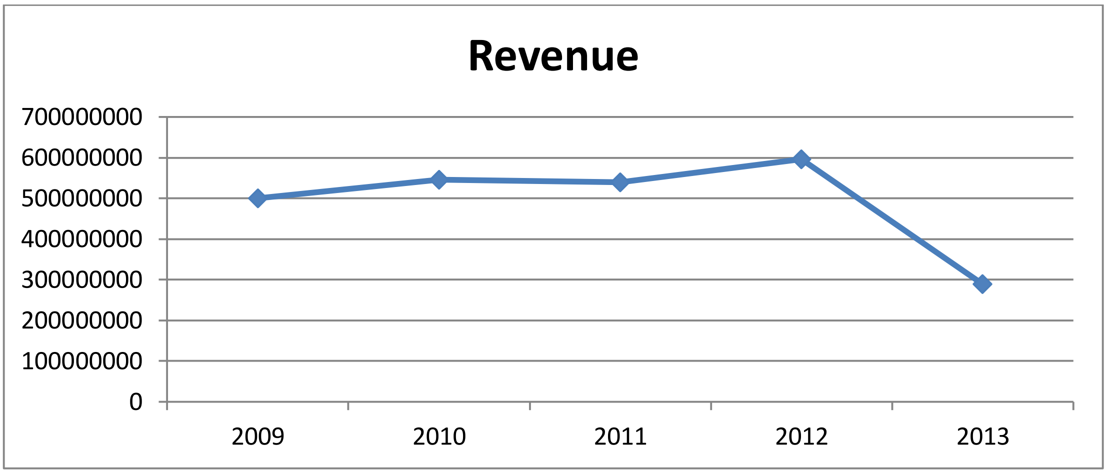

Figure 1: Revenue

Figure 1 indicates that revenue collection from EPZ companies increased slightly from 2009 to 2012. However, revenue collection declined from to 2012 to 2013.

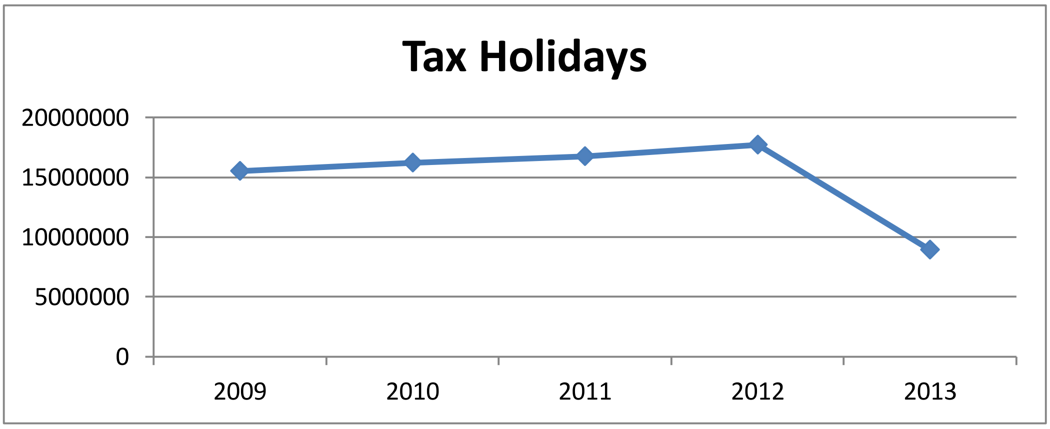

Figure 2: Tax Holidays

Figure 2 indicates that tax holidays issued to EPZ companies increased slightly from 2009 to 2012 but declined from to 2012 to 2013.

4.3 Correlation Results

Table 2 present results on the correlation between Tax revenue collection and tax holiday.

Table 2: Correlation Results

	Tax Revenue Collection	Tax Holiday
Tax Revenue Collection	1	
Tax Holiday	0.2860*	1

>*< significance at 0.1

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The findings indicated that there is a positive and significant association between tax holiday and revenue collection among EPZ companies in Kenya (r=0.286*), at 10 percent level of significance. This implied that tax holiday and tax revenue collection change in the same direction.

4.4 Regression Results

This section presents regression results on the relationship between tax holiday and revenue collection among the EPZ companies in Kenya.

Table 3: Tax Holiday and Revenue Collection

Revenue	**Coef.**	**Std. Err.**	**t**	**P>|t|**	**[95% Conf.**	**Interval]**
Tax Holiday	33.32375	2.190334	15.21	0.000	28.85653	37.79096
_cons	-6807212	3.43E+07	-0.20	0.844	-7.68E+07	6.31E+07
R squared	8.18E-02					
F statistic	231.47					
Prob > chi2	0.000					

Tax Revenue Collection = -6807212+33.32375 Tax Holiday

The model was found to be significant (Prob > chi2=0.000<0.05) implying that tax holiday is a good predictor of tax revenue collection among EPZ companies in Kenya. In addition, the R squared was 0.0818 implying that tax holiday contributes 8.1% to variations in tax revenue collection among EPZ companies in Kenya.

Further, results revealed that tax holiday had a positive and significant relationship with tax revenue collection (β=33.32375, p=0.000) at 5 percent level of significance. This implies that a unit increase in tax holiday accounts for 33.32375 unit increase in tax revenue collection among EPZ companies in Kenya.

The findings agree with those of Sari, Dewi and Sun (2015) and Ross and Lozano-Rojas (2017), who also found that tax holidays play a significant role in determinant tax revenue collection. In particular, tax holiday policy is considered capable to provide a positive impact on investment activities. However, the findings disagreed with Newton (2017) who observed that tax holiday is not a lasting solution and there are significant dangers to repeating a plan that was only ever meant to be a one-time occurrence.

4.5 Hypothesis Testing

Hypothesis testing was done using regression results in Table 3. The acceptance/rejection criteria were that, if the p value is greater than 0.05, we fail to reject the null hypothesis but if it's less than 0.05, the null hypothesis is rejected.

The null hypothesis, H_{01}: Tax holiday has no significant effect on revenue collection among the EPZ companies in Kenya. The p value was 0.000 which was less than 0.05, therefore the null hypothesis was rejected and therefore, Tax holiday has a significant effect on revenue collection among the EPZ companies in Kenya.

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5.0 Conclusion

Based on the findings, the study concluded that there was a positive and significant relationship between tax holiday and tax revenue collection. This implied that an increase in tax holiday is expected to boost ax revenue collection among EPZ companies in Kenya. Further, the regression results led to the rejection of the null hypothesis that tax holiday has no significant effect on revenue collection among the EPZ companies in Kenya.

6.0 Recommendations

The study makes a few policy recommendations that may be affected by the key decision makers. There is need for the government to rationalize the tax incentive schemes in the county. It is important to note that this process has now begun, by the government scrapping various tax remission and exemption provisions in the VAT Act 2013 including the program and it is expected that the intended review of the Income Tax Act will also comprehensively address this issue. This will ensure that the tax incentive scheme is both efficient and beneficial to the economy. As mentioned in the introduction of this study, It is important for the government and policy makers to put in place tax reforms that ensure that its tax system achieve the main three objectives of a good tax system which include raising tax revenue for funding government operations without excessive government borrowing, ensuring equitable distribution of income in a nation and encouraging or discouraging specific activities.

There is need for KRA to improve its systems and procedures to ensure that taxpayers only get the benefit due to them under the stipulated laws and pay taxes due to the government as required ensuring that the law is complied with. Deductions average about 3% of the taxable income declared over the period which is quite high. Given that revenue needs keep increasing annually, all loopholes must be sealed to ensure minimum leakages in the economy.

There is also need for the Government and KRA to put in place proper system to capture accurate data for purposes of monitoring and proper decision making as far as tax incentives or exemptions is concerned. In particular there is no adequate data on the EPZ enterprises. Both KRA and The EPZ authority do not capture adequate or complete financial data on these businesses and therefore it is difficult to review the performance of these businesses. The law should make it mandatory for these entities to file returns even though they are exempted from paying taxes because such data will be useful in decision making and even more important to KRA once the tax holiday period for these entities lapse.

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