UNEMPLOYMENT: TAX INCENTIVES AS A MEANS OF CURBING YOUTH UNEMPLOYMENT IN KENYA

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DECLARATION

I, AZIZAH ALI SWALEH TIMIMI, do hereby declare that this research is my original work and that to the best of my knowledge and belief, it has not been previously, in its entirety or in part, been submitted to any other university for a degree or diploma. Other works cited or referred to are accordingly acknowledged.

Signed: ....

Date: 30th July 2021

This dissertation has been submitted for examination with my approval as University Supervisor.

Signed: ....

Mercy Mbovi Mbithi

ABSTRACT

Many existing resources show the importance of Small and Medium Enterprises (SMEs) in an economy. This study analyses the legislative framework of SMEs and their taxation in Kenya. SMEs are a great source of employment for people in a country and this, in turn, leads to the economic growth of the country and alleviating poverty. This is because they employ many people, especially the youth as most of them cannot secure jobs in the formal sector. SMEs are mostly categorised under the informal sector due to their size, their form of ownership, and the type of economic activity that they undertake. However, they do not perform well financially due to the numerous taxes imposed on them and this has led to most of them shutting down as they do not have an enabling environment for them to survive. It also analyses the tax incentives that are available in Kenya as provided by legislation. The study aimed to identify tax incentives available to SMEs to curb youth unemployment in Kenya and to aid the survival of SMEs. This study adopted doctrinal methodology and a comparative study. In addition, the study also evaluates the legislative and taxation framework for SMEs in South Africa as a comparative study to Kenya. South Africa and Kenya have similar demographics, and this makes it a good comparative study as South Africa's economy is better than Kenya in that it has enabled SMEs to survive, thus, having a prosperous economy. This study also evaluates the tax incentives available to SMEs in South Africa in their legislation. Furthermore, it draws out recommendations for Kenya to benefit from South Africa's tax administrative and legislative framework. The major recommendation that has been drawn from this study is to enact an *Employment Tax Incentive Act* in Kenya similar to the one in South Africa.

LIST OF STATUTES

1. *Constitution of Kenya* (2010).
2. *Customs and Excise Act* (CAP 472).
3. *Employment Services Act* (Act 4 of 2014) (South Africa).
4. *Employment Tax Incentive Act* (Act No 26 of 2013) (South Africa).
5. *Income Tax Act* (CAP 470).
6. *Income Tax Act* (Act No 58 of 1962) (South Africa).
7. *Micro and Small Enterprises Act* (Act No 55 of 2012).
8. *National Small Business Act* (Act No 102 of 1996) (South Africa).
9. *Universal Declaration of Human Rights*, 10 December 1948.
10. *Value Added Tax Act* (Act No 35 of 2013).

LIST OF ABBREVIATIONS

BBI – Building Bridges Initiative

COVID-19 - Coronavirus Disease 2019

CWP - Community Works Program

EPZs – Export Processing Zones

ETI – Employment Tax Incentive

GDP – Gross Domestic Product

ILO – International Labour Organisation

KNBS – Kenya National Bureau of Statistics

KRA – Kenya Revenue Authority

MEs – Medium Enterprises

MSEs – Micro and Small Enterprises

MSMEs – Micro, Small and Medium Enterprises

NEET - Not in Employment, Education or Training

PAYE – Pay As You Earn

PSDS - Private Sector Development Strategy

SARS - South African Service Revenue

SBC - Small Business Corporation

SEZs – Special Economic Zones

SMEs- Small and Medium Enterprises

VAT – Value-added Tax

VCCs- Venture Capital Companies

YEDF – Youth Enterprise Development Fund

CHAPTER 1: INTRODUCTION TO TAXATION OF SMALL AND MEDIUM ENTERPRISES

1.1 BACKGROUND TO THE STUDY

Recently, newspapers have reported high unemployment rates in Kenya, with the youth being the most affected group.[1] Almost four in every ten Kenyans of working age have no job positions and this is the worst level of joblessness East Africa.[2] As per the Kenya National Bureau Statistics (KNBS) report, Kenya's unemployment rate is at 10.4%.[3] Kenya has the highest unemployment rate in East Africa as compared to Tanzania's 9.7%[4] and Uganda's 9.7%.[5] Young people represent roughly forty percent of the world's unemployed and they are up to four times more bound to be jobless than adults.[6] Young people in Kenya constitute 30 percent of the total population while youth unemployment adds up to 78 percent of the total unemployment.[7] In addition to this, the ongoing Coronavirus Diseases (COVID-19) pandemic is also aggravating youth unemployment.[8] The impact of the COVID-19 pandemic on the Kenyan economy can be seen in the disruption of supply chains, shortage of goods, mass unemployment, and loss of income.[9]

However, the government of Kenya has tried adopting a few policies to curb the levels of unemployment in the country. This is because small and medium enterprise (SMEs) advancement initiatives are probably going to have the greatest effect on job creation[10] as they are the main

[1] Ng'ethe V, 'Analysis: How Many Young Kenyans are Unemployed? A look at the Numbers', 8 October 2018, --< https://africacheck.org/2018/10/08/analysis-how-many-young-kenyans-are-unemployed-a-look-at-the-numbers/>-- on 2 January 2020.

[2] Otuki N, UN Report shows Kenya's Jobs Crisis the Worst in Region, 3 May 2017, --< https://www.theeastafrican.co.ke/tea/business/un-report-shows-kenya-s-jobs-crisis-the-worst-in-region--1365484>-- on 11 February 2020.

[3] Kenya National Bureau of Statics, *Quarterly Labour Force Report Quarter 2 April – June 2020*, August 2020, 4.

[4] Labour Market Information in Tanzania, *Employment Projections*, 2018, 2.

[5] Uganda Bureau of Statistics, *National Labour Force Survey 2016/17*, June 2018, iii.

[6] S4YE Toward Solutions for Youth Employment, A 2015 Baseline Report, 2015, 15.

[7] Munyao MB, 'The Nature, Challenges and Consequences of Urban Youth Unemployment: A Case of Nairobi City, Kenya' 2 *Universal Journal of Educational Research* 7, 2014, 496.

[8] CGTN, 'COVID-19 has exacerbated unemployment among Kenyan youth: President Kenyatta' 6 August 2020 --< https://newsaf.cgtn.com/news/2020-08-06/COVID-19-has-exacerbated-unemployment-among-Kenyan-youth-Kenyatta--SIzrGa5o4M/index.html>-- on 20 September 2020.

[9] Policy Brief, Articulating the Pathways of the Socio-Economic Impact of the Coronavirus (COVID-19) Pandemic on the Kenyan Economy, Issue No. 4 of 2020, 7.

[10] Munyao MB, 'The Nature, Challenges and Consequences of Urban Youth Unemployment, 497.

sources of employment in countries.[11] In Kenya, the SME sector creates work for 80% of the labour force population[12] and this accounts for the youth too. The government has implemented various interventions such as the Youth Enterprise Development Fund (YEDF), which tries to generate employment opportunities for young people through business and urging them to be job generators. It also creates employment opportunities by providing easy and reasonable monetary and business advancement support services to youth who are determined to begin or grow businesses.[13]

The Ministry of Industrialisation, Trade and Enterprise Development was set up to advance the enlargement, growth, and graduation of SMEs.[14] The largest creator of employment in Kenya is the informal sector as confirmed by the Economic Survey 2015 given by the Kenyan government. Most SMEs are based in the informal sector and are the primary sources of employment for Kenyan people.[15] Due to the establishment of the YEDF, the number of SMEs has risen because the funds provided under the YEDF has expanded opportunities for the youth to establish enterprises in both rural and urban areas of Kenya.[16] In addition, the *Micro and Small Enterprises Act*[17] was passed in 2012 and under Section 3 of this Act, it provides that *the object and purpose is to give a lawful and institutional structure for the advancement, improvement, and guideline of micro and small enterprises*.[18] Micro and small enterprises in Kenya are taxed under the *Income Tax Act*, where they pay a rate of 3% turnover tax[19] paid monthly. They are subjected to a presumptive tax of 15% of the business permit fee and license to be paid yearly.[20] Presumptive tax is an advance tax that is deducted from the turnover tax. Medium Enterprises (MEs), on the other hand, are taxed depending on the design of the venture. For example, if a ME is a corporation, it will then be taxed

[11] Stephen KM, Njeru A and Ibrahim TO, 'Factors Affecting the Performance of Small and Micro Enterprises in Limuru Town Market of Kiambu County, Kenya, 4 *International Journal of Scientific and Research Publications* 12, 2014, 1.

[12] Stephen KM, Njeru A and Ibrahim TO,' Factors Affecting the Performance of Small and Micro Enterprises in Limuru Town Market of Kiambu County, Kenya, 2.

[13] --<http://www.youthfund.go.ke/>-- on 12 February 2020.

[14] --<http://www.industrialization.go.ke/index.php/downloads/282-kenya-s-industrial-transformation-programme>-- on 19 March 2020.

[15] Institute of Economic Affairs, State of Implementation of the Micro and Small Enterprises Act 2012, Policy Brief, 2.

[16] Institute of Economic Affairs, State of Implementation of the Micro and Small Enterprises Act 2012, Policy Brief, 3.

[17] *Micro and Small Enterprises Act* (Act No 55 of 2012).

[18] Section 3, *Micro and Small Enterprises Act* (Act No 55 of 2012).

[19] Section 12C (1), *Income Tax Act* (CAP 470).

[20] Section 12C (5), *Income Tax Act* (CAP 470).

a corporation tax at 30% as stipulated in the Third Schedule of the *Income Tax Act*. SMEs contribute significantly to our economy; however, they face challenges like taxes and regulation being the top obstacle.[21] SMEs are significant in tax administration because of their huge number, and this makes tax administrations face challenges in appropriately regulating the SMEs segment due to the capacity constraints in terms of financial resources and skills.[22] Despite the efforts from the government, many youths in Kenya remain unemployed.[23]

The scenario in South Africa paints a similar picture as Kenya, however, their government legislated the *Employment Tax Incentive Act* (ETI) to accelerate job creation and raise employment. The ETI was implemented by the South African Government as an incentive primarily pointed toward urging businesses to enlist the youth and less experienced work seekers to curb the high rate of youth unemployment.[24] There have been positive returns from the implementation of the ETI,[25] and this suggests that Kenya could potentially reap similar benefits from the institutionalisation of such a law.

1.2 STATEMENT OF PROBLEM

As per Article 23(1) of the *Universal Declaration of Human Rights*, everybody has the right to work, to free choice of employment, to just and favourable conditions of work, and to protection against joblessness.[26] This will drive progress and improve the living standards of people.[27] The current situation in Kenya is that the youth unemployment rate is high at a rate of 12.5% as per the KNBS report. There are many SMEs in Kenya that promote employment to the youth and thus boost economic growth.[28] Thus, the SMEs contribute notably to the tax revenue available to the government. However, they face a lot of challenges with the top obstacle being taxes and

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[21] Elizabeth NM, 'The Law on Tax Incentives of Medium Enterprises: A Case Study of Kenya and the Republic of Korea' Unpublished LLM Thesis, University of Nairobi, Nairobi, 2014, 5.
[22] Elizabeth NM, 'The Law on Tax Incentives of Medium Enterprises: A Case Study of Kenya and the Republic of Korea' Unpublished LLM Thesis, University of Nairobi, Nairobi, 2014, 2.
[23] Munyao MB, 'The Nature, Challenges and Consequences of Urban Youth Unemployment, 497.
[24] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 37.
[25] Ebrahim A, Leibbrandt M and Ranchod V, 'The Effects of the Employment Tax Incentive on South African employment' WIDER Working Paper 2017/5, --<wider.unu.edu/sites/default/files/wp2017-5.pdf>--, 2017.
[26] Article 23(1), *Universal Declaration of Human Rights*, 10 December 1948.
[27] --<https://www.un.org/sustainabledevelopment/wp-content/uploads/2016/08/8.pdf>-- on 2 January 2020.
[28] Stephen KM, Njeru A and Ibrahim TO,' Factors Affecting the Performance of Small and Micro Enterprises in Limuru Town Market of Kiambu County, Kenya, 2.

regulation[29] and this then leads to low revenue. The SMEs in Kenya do not enjoy specific tax incentives from the *Income Tax Act*, and this shows that Kenya has a tax system that is unfavourable to SMEs. The specificity of tax incentives to SMEs can show an aspect of inequity, however, this does not mean that other businesses are being discriminated against. This is because this specificity will lead to a good outcome in that there will be more jobs created hence, it will not necessarily go against the principle of equity. The SME sector will be favoured against other sectors by having tax incentives only specific to them to ensure that all sectors are on the same level playing field, hence, guaranteeing fairness and equity. In response to this problem, this research will analyse the tax policies and legislative framework in Kenya while adopting relevant Sections of South Africa's *ETI Act* to suggest specific tax incentives for SMEs Kenya to promote employment creation and economic growth.

1.3 JUSTIFICATION OF THE STUDY

This research is conducted because SMEs form a big impact on taxpayers in Africa as SMEs create employment for a large part of the economy,[30] however, they face challenges such as taxation that hinder their performance[31] and hence, cannot create employment for the youth. The legislation available on tax has not given great conditions to guarantee the development of these SMEs. Thus, it is necessary to conduct this study as tax incentives are needed to reduce youth unemployment in Kenya.

1.4 SIGNIFICANCE OF THE RESEARCH

This research will benefit the Government of Kenya by increasing its economic development through the creation of employment, and through an additional collection of revenue that is collected from the taxes from SMEs which can be used for development. In addition, policymakers such as the Kenya Revenue Authority (KRA), the treasury, the parliament, and civil society, will also benefit in terms of taxation and it will provide suggestions that may guide it in adjusting tax policies to accommodate SMEs.

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[29] Elizabeth NM, 'The Law on Tax Incentives of Medium Enterprises: A Case Study of Kenya and the Republic of Korea' Unpublished LLM Thesis, University of Nairobi, Nairobi, 2014, 5.

[30] Institute of Economic Affairs, State of Implementation of the Micro and Small Enterprises Act 2012, Policy Brief, 2.

[31] Sitharam S and Hoque M, 'Factors Affecting the Performance of Small and Medium Enterprises in KwaZulu-Natal, South Africa' 14 *Problems and Perspectives in Management* 2, 2016, 284.

1.5 AIM AND OBJECTIVES OF THIS STUDY

The general aim of the study is to identify tax incentives that can be made available to SMEs to curb youth unemployment in Kenya.

The objectives of the study are:

1. To give a background of SMEs establishment and its impact on youth employment in Kenya.
2. To identify the taxation of SMEs and analyse how the taxation impacts youth unemployment.
3. To identify the tax incentives given to SMEs that promote youth employment.

1.6 RESEARCH QUESTIONS

The research questions are as follows:

1. How does the establishment of SMEs impact youth employment in Kenya?
2. How are SMEs taxed in Kenya and what is the impact of this taxation on youth unemployment?
3. Whether there are tax incentives given to SMEs that promote youth employment?

1.7 HYPOTHESES

The following research hypotheses were developed to address the issues of the study properly. These hypotheses are as follows:

1. There is an impact of SMEs establishment on youth unemployment in Kenya.
2. SMEs are taxed in Kenya as per the *Income Tax Act* and it affects their survival.
3. There should be tax incentives given to SMEs that subsequently promote youth employment.

1.8 LITERATURE REVIEW

The term ''youth'' covers people between 15 to 24 years and ''adult'' refers to persons aged 25 years and above as per the International Labour Organisation (ILO).[32] However, Ng'ethe states

[32] --<https://www.ilo.org/wcmsp5/groups/public/---dgreports/---stat/documents/publication/wcms_422439.pdf>-- on 2 February 2020.

that countries differ fairly in their definitions.[33] The United Nations also utilizes a similar meaning of ''youth'' as given by the ILO. However, the African Youth Charter characterises ''youth'' as people between the ages of 15 and 35 years.[34] The *Kenyan Constitution* of 2010 defines youth as people who have reached the age of eighteen years but not yet reached the age of thirty-five years.[35] The rate of unemployment is determined as the percentage of the level of people in the workforce who are jobless.[36] The labour force is characterized as the total amount of persons employed and persons unemployed. People outside the labour force are individuals of working age who are neither employed nor jobless[37] and this comprises of children and retired people.

Kenya in 2017 had an estimated 61% of its population being either children from 0 to 14 years or youth from the ages of 15 to 24.[38]The country is currently faced with a youth bulge, which occurs when more than 20% of a country's population is composed of young people.[39] The youth bomb can be a demographic bomb if countless youth cannot obtain work and this can be an expected source of social and political instability.[40] Figure 1[41] below shows the rate of youth unemployment in Kenya according to the KNBS. As per the KNBS report, 4 million out of 11.8 million Kenyan youth lacked employment and it also indicates that 86% of 9 million Kenyans within 35-60 years were employed during the October to December period in 2019.[42]

From the statistics, it is evident that the youth are more affected in terms of unemployment as compared to the older population. To curb unemployment, the government of Kenya set up the YEDF to help the youth obtain work expertise and lessen joblessness.[43] However, there were many

[33] Ng'ethe V, 'Analysis: How Many Young Kenyans are Unemployed? A look at the Numbers', 8 October 2018, --< https://africacheck.org/2018/10/08/analysis-how-many-young-kenyans-are-unemployed-a-look-at-the-numbers/>-- on 2 January 2020.

[34] African Union Commission, African Youth Charter, 11.

[35] Article 260, *Constitution of Kenya* (2010).

[36] --<https://www.ilo.org/ilostat-files/Documents/description_UR_EN.pdf>-- on 24/02/2020.

[37] Resolution concerning statistics of work, employment and labour underutilization, adopted by the 19th International Conference of Labour Statisticians, Geneva, October 2013, 16.

[38] Hall S, Youth Employment in Kenya, Literature Review, October 2017, 9.

[39] Hall S, Youth Employment in Kenya, Literature Review, October 2017, 10.

[40] Lin JY, Youth Bulge: A Demographic Dividend or a Demographic Bomb in Developing Countries? 5 January 2012 --<https://blogs.worldbank.org/developmenttalk/youth-bulge-a-demographic-dividend-or-a-demographic-bomb-in-developing-countries#:~:text=The%20youth%20bulge%20is%20a,have%20a%20high%20fertility%20rate.>-- on 20 September 2020.

[41] --<https://www.statista.com/statistics/1134402/youth-unemployment-rate-in-kenya-by-age-group/>-- on 20 September 2020.

[42] Gitau D, 'Youth Unemployment Remains High, KNBS Reveals', 1 April 2020, --< https://cytonnreport.com/news/youth-unemployment-remains-high--knbs-reveals>-- on 20 September 2020.

[43] --<http://www.youthfund.go.ke/>-- on 12 February 2020.

challenges faced by the fund such as credit defaults, long reimbursement periods that diminished new loans, and an absence of expertise to continue businesses.[44]

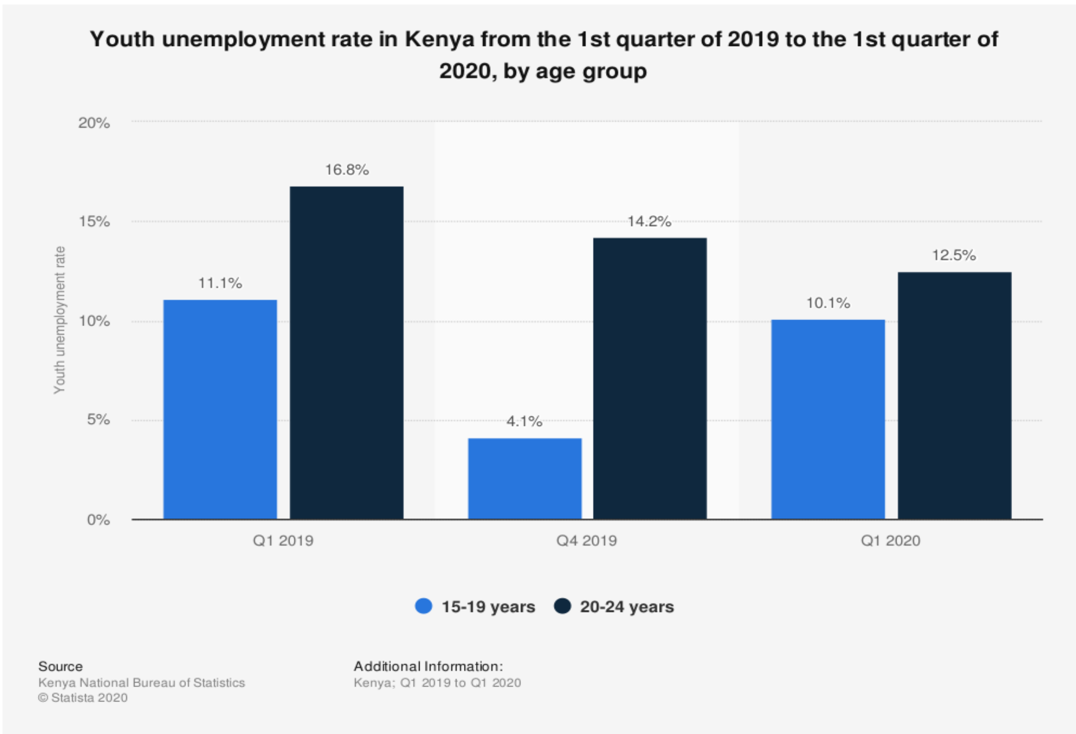

Figure 1.

Milgo focused his study on the impact of the *Micro and Small Enterprise (MSE) Act* and he states that the *MSE Act* was enacted to grow the economy through the SME sector as it seeks to improve the business environment and grow small enterprises to become more productive.[45] Murithi established the significance of SMEs by stating that they are significant as they alleviate poverty, help countries' Gross Domestic Product (GDP), and give work to the greater part of the population. Ajibade, Abdulraheem, and Mordi state that there is a need to define what a small business is as they vary worldwide.[46] The businesses' definitions differ from those requiring minimal

[44] Ng'ethe V, 'Analysis: How Many Young Kenyans are Unemployed? A look at the Numbers', 8 October 2018, --< https://africacheck.org/2018/10/08/analysis-how-many-young-kenyans-are-unemployed-a-look-at-the-numbers/>-- on 02/01/2020.

[45] Milgo EC, 'Effect of the Micro and Small Enterprise Act 2012 on The Growth of Youth-Owned SMEs in Nairobi CBD, Kenya' Unpublished Thesis, University of Nairobi, Nairobi, 2017, 1.

[46] Ajibade TA, Abdulraheem I and Mordi C, 'The Characteristics and Challenges of Small Businesses in Africa: An Explanatory Study of Nigerian Small Business Owners' 3 *Economic Insights – Trends and Challenges*, 4, 2014, 3.

expenditure to begin to those that require a large amount of money to begin.[47] For instance, a small business can be defined as a company with a capital base between $125 to $193,500, or it is viewed as small if it is independently owned, operated, and financed; has less than 100 employees, and has generally little effect on the industry.[48] In low and lower-middle-income countries, it is recognisable that the recently concurred definition from various researches characterise SMEs as those with under 100 employees as stated by Beck and Cull.[49] However, the *MSE Act* provides for the definition for microenterprise as a firm, trade, service, industry, or a business activity whose yearly turnover does not surpass five hundred thousand shillings and employs under ten individuals.[50] A small enterprise, on the other hand, is defined as a firm, trade, service, industry, or business activity whose yearly turnover ranges between five hundred thousand and five million shillings and employs ten to fifty people.[51] A medium enterprise is defined as an enterprise that has 50 and 99 employees.[52] In general, definitions of SMEs globally use one or other defining measurements: the number of employees and the turnover.[53]

Stephen, Njeru, and Ibrahim stated in their article that SMEs are the primary source of employment in developed and developing countries including more than 90% of African business operations and adding to more than half of African employment and GDP.[54] This is important to the study as they are a source of income for about 80% of the population[55] hence, showing how they contribute to employment. In addition, they are engaged with all areas of industrial development, from mining, producing, service industry to agribusiness, fishing to environmental change.[56] Most SMEs are engaged with the service sector of different economies which in many countries

[47] Murithi S, 'African Small and Medium Enterprises (SMEs) Contributions, Challenges and Solutions' 37.
[48] Ajibade TA, Abdulraheem I and Mordi C, 'The Characteristics and Challenges of Small Businesses in Africa' 3.
[49] Beck T and Cull R, 'Small and Medium Sized Enterprise Finance in Africa' Africa Growth Initiative, Working Paper 16, 2014, 1 --< https://www.brookings.edu/wp-content/uploads/2016/06/SME-Finance-in-Africa-Designed_FINAL.pdf>-- on 21 February 2020.
[50] Section 2, *Micro and Small Enterprises Act* (Act No 55 of 2012).
[51] Section 2, *Micro and Small Enterprises Act* (Act No 55 of 2012).
[52] Mwangi Z, The 2016 National Micro, Small and Medium Establishment (MSME) Survey: Highlights of Basic Report, 3.
[53] Katua NT, 'The Role of SMEs in Employment Creation and Economic Growth in Selected Countries' 2 *International Journal of Education and Research* 12, 2014, 463.
[54] Stephen KM, Njeru A and Ibrahim TO, 'Factors Affecting the Performance of Small and Micro Enterprises in Limuru Town Market of Kiambu County, Kenya, 4 *International Journal of Scientific and Research Publications* 12, 2014, 1.
[55] Murithi S, 'African Small and Medium Enterprises (SMEs) Contributions, Challenges and Solutions' 37.
[56] Murithi S, 'African Small and Medium Enterprises (SMEs) Contributions, Challenges and Solutions' 38.

represent 66% of employment levels.[57] The SME sector in Kenya contributes an approximated 18% of the GDP and makes jobs for 80% of the labour force population.[58] The *MSE Act* provides that both micro and small enterprises are involved in the manufacturing sector and service and farming enterprises.[59]

The role of SMEs as studied by Thomas is to fuel financial development since they create new jobs, expand the tax base, and are drivers of transformation.[60] SMEs contribute significantly to our economy; however, they face challenges that hinder the development of the country. Some of the challenges are political instability, financial constraints, tax problems, work issues, absence of coordination, and standard information exchange mechanisms among institutions.[61] Elizabeth asserts that from the list of obstacles, taxes and regulations are the prominent obstacles.[62] The unfavourable tax systems do not only impact SMEs creation but also the collection of revenue from income tax as well. Taxation is a significant source of funds for the improvement of the economy; however, SMEs face high tax rates, different taxes, complex tax guidelines, and an absence of legitimate education or training about tax-related issues.[63] On the other hand, Otieno asserts that several SMEs avoid tax because of the discernment that the expense of tax compliance is excessively high.[64]

A turnover tax of 3% was introduced in the *Income Tax Act* to tax the informal sector. Section 12C of the *Income Tax Act* accommodates the taxation of micro and small enterprises in Kenya. This Section states that a turnover tax will be paid if the turnover from the business does not surpass five million shillings. From the definitions above on a micro and small enterprise, their yearly turnover does not surpass five hundred thousand and five million shillings, therefore they are

[57] Stephen KM, Njeru A and Ibrahim TO, 'Factors Affecting the Performance of Small and Micro Enterprises in Limuru Town Market of Kiambu County, Kenya, 1.
[58] Stephen KM, Njeru A and Ibrahim TO,' Factors Affecting the Performance of Small and Micro Enterprises in Limuru Town Market of Kiambu County, Kenya, 2.
[59] Section 2, *Micro and Small Enterprises Act* (Act No 55 of 2012).
[60] Thomas NK, 'The Role of SMEs in Employment Creation and Economic Growth in Selected Countries, 2 *International Journal of Education and Research* 12, 2014, 464.
[61] Thomas NK, 'The Role of SMEs in Employment Creation and Economic Growth in Selected Countries, 467.
[62] Elizabeth NM, 'The Law on Tax Incentives of Medium Enterprises: A Case Study of Kenya and the Republic of Korea' Unpublished LLM Thesis, University of Nairobi, Nairobi, 2014, 5.
[63] Ocheni SI and Gemade TI, 'Effects of Multiple Taxation on the Performance of Small and Medium Scale Business Enterprises in Benue State, 5 *International Journal of Academic Research in Business and Social Sciences* 3, 2015, 347.
[64] Otieno GO, 'Impact of Taxation on Financial Performance of Small-Scale Enterprises in Ugenya Sub-County, Siaya County, Kenya' Unpublished Thesis, Catholic University of Eastern Africa, Nairobi, 2018, 6.

subject to Section 12C of the *Income Tax Act* and they are to pay the tax to the Commissioner.[65] However, if one does not want to be subjected to Section 12C of the *Income Tax Act*, then he or she may by notice in writing address the Commissioner to request not to be subjected to this Section, but the other provisions of the *Act* will apply.[66]

Micro and small enterprises as per the *Income Tax Act* are also needed to pay a presumptive tax of 15%.[67] However, the *Tax Laws Amendment Act*, 2020 removed the presumptive tax. The *Income Tax Act* provides for an advance tax under Section 12A. This is a huge burden on them as the employees of these SMEs additionally pay multiple taxes for example value-added tax (VAT), pay as you earn (PAYE), customs, and excise duty.[68] These SMEs pay the turnover tax which impacts them directly and the same SMEs also must account for all the taxes that their employees pay which then affects their cash flow thus, puts a huge compliance burden on them. SMEs are taxed depending on their structure, whether they are sole proprietorships, partnerships, or corporations. MEs pay corporation tax of 30% as provided for in the Third Schedule of the *Income Tax* Act. All these numerous taxes that have been highlighted above choke the survival of SMEs. However, the government of Kenya has lowered the turnover rate from 3% to 1% and the corporation tax from 30% to 25% due to the COVID-19 pandemic[69] and this is a relief for the SMEs. However, a recent press statement indicates that the corporate tax rate will revert to 30% in the recovery of the economy.[70]

There are no specific tax incentives given to SMEs in Kenya however, they can take advantage of incentives that are enjoyed across the board.[71] For instance, they can utilise the tax deductions present in the *Income Tax Act*, such as the capital deductions established in the Second Schedule to encourage new industrial enterprises.[72] The other tax incentive is reduced tax rates as per the Third Schedule of the *Income Tax Act* for newly listed companies in an approved securities

[65] Section 12C (4), *Income Tax Act* (CAP 470).
[66] Section 12C (2), *Income Tax Act* (CAP 470).
[67] Section 12C (5), *Income Tax Act* (CAP 470).
[68] Gitau M, Income Tax Issues Relating to SMEs, ICPAK Training, 12.
[69] PWC, Highlights of the Tax Laws Amendment Act, 2020.
[70] Republic of Kenya, The National Treasury and Planning Office of the Cabinet Secretary, Press Statement: Return to Pre-Covid-19 Taxes on VAT and Income Tax, 04 December 2020, 3.
[71] Elizabeth NM, 'The Law on Tax Incentives of Medium Enterprises: A Case Study of Kenya and the Republic of Korea' Unpublished LLM Thesis, University of Nairobi, Nairobi, 2014, 48.
[72] Second Schedule, *Income Tax Act* (CAP 470).

exchange.[73] From this, it can be adduced that Kenya has an unfavourable tax system for SMEs as it lacks tax incentives that cater specifically to SMEs that can curb youth unemployment.

1.9 LIMITATION

The research study is desk-based which means that the author is limited to primary and secondary sources such as Statutes, books, and journal articles that are relevant to the research study. In addition, the author can only access certain documents as the author is restricted from resources that have been locked by other authors.

1.10 CHAPTER BREAKDOWN

This research is structured as follow; the current chapter one provides the research background, statement of the problem, justification of the study, the significance of the study, aim, and objectives of the study, research questions of the study, hypotheses of the study, literature review, and limitation of the study. It gives an overview of youth unemployment, SMEs, and the challenges facing SMEs in Kenya. Chapter two provides the theoretical framework by analysing Adam Smith's maxims of taxation and John Maynard Keynes' general theory and it also indicates the research methodology that is used in the paper. Chapter three addresses the research questions which are youth unemployment, SMEs, and their taxation regime, and hence, a connection is drawn between the youth and SMEs. Chapter 4 has the comparative analysis, showing South Africa's taxation regime and how the tax incentives have alleviated poverty in South Africa. Chapter five has the conclusion and recommendations of the study. These recommendations are useful for administrative and legislative reforms of the taxation policies of SMEs in Kenya.

[73] Third Schedule, *Income Tax Act* (CAP 470).

CHAPTER 2: THEORETICAL FRAMEWORK

This chapter analyses Keynes' general theory and Adam Smith's maxims of taxation, which illustrate the ideal taxation regime. These two theories justify the study in that they both apply to SMEs and how tax incentives should be implemented.

2.1 JOHN MAYNARD KEYNES' GENERAL THEORY

Keynes' general theory overturned the possibility that free economies would naturally give full employment.[74] According to Keynes, aggregate demand is the main thrust in an economy whereby aggregate demand is estimated as the amount of expenditure by families, organisation, and the government. Keynes further states that free markets do not have self-regulating mechanisms thus leading to employment. Hence, he proves the need for government intervention through public policies that intend to accomplish price stability and employment.[75] In his book, he states that the State should practice a controlling impact on success to consume mostly through its taxation scheme, partly by fixing the interest rate, and partly, maybe, in other ways.[76]

The multiplier effect as per Keynesian economists infers that adjustments in income tax policies and rates have a lot more prominent stabilising or destabilising impacts than might have initially been normal. The impact of a tax cut or tax expenditure can have continuous effects on the economy through the multiplier effect.[77] Keynesian economists believe that fiscal policy can move an economy in light of the impact of an increment in spending or a cut in taxes would be duplicated by stimulating extra interest for utilisation products by family units.[78] Keynes' stressed the potential for government spending and tax to impact aggregate demand.[79] Keynes had two assumptions whereby desired expenditures, in the form of utilisation, investment, or government spending, must equal production and that savings should be equal to investment. Savings is

[74] Jahan S, Mahmud AS and Papageorgiou C, 'What is Keynesian Economics', 51 *Finance and Development* 3, 2014, 1.
[75] Jahan S, Mahmud AS and Papageorgiou C, 'What is Keynesian Economics', 1.
[76] Keynes JM, *The General Theory of Employment, Interest, and Money*, Palgrave Macmillan, UK, 1936, 187.
[77] Listokin Y, 'Equity, Efficiency, and Stability: The Importance of Macroeconomics for Evaluating Income Tax Policy', 29 *Yale Journal on Regulation* 45, 2012, 51.
[78] Nelson CR, 'Keynesian Fiscal Policy and the Multipliers', Internet Edition as of 1 January 2006, 5.
[79] Nelson CR, 'Keynesian Fiscal Policy and the Multipliers', 2.

characterised as disposable income minus consumption, and where disposable income is equivalent to total income minus taxation.[80]

According to Keynes, there are three principal tenets of how the economy functions; the first is that aggregate demand is affected by public and private monetary choices. The subsequent principle is that costs react gradually to changes in market interest bringing about occasional deficiencies and overflows.[81] The last precept is that adjustments in aggregate demand have their most prominent short-run impact on genuine yield and business.[82] To stabilise the economy Keynes contended that governments ought to take care of issues in the short run as opposed to wait for market influences to fix things over the long haul. State intercession is important in the public eye to direct the wins and fails in financial movement.[83] State intervention can be achieved by a fiscal policy whereby the government changes its spending and income to impact the more extensive economy. The government can utilise a monetary approach to spike financial growth by increasing government spending, decreasing tax revenue, or a blend of the two.[84]

2.1.1 ANALYSIS

Based on Keynes' assumptions that savings must equal investment from his theory, this then means that incentives given to SMEs will cause an increase in their disposable income which will further increase savings and cause an increase in SMEs to invest. This will then allow SMEs to create employment for the youth thereby reducing youth unemployment and ultimately growing the economy. From the above, it is seen that the monetary approach has two significant parts, government consumption and tax. Moreover, the government can control every one of these two factors to accomplish a specific degree of economic activity and targets that would support the generality of its residents.[85] Taxes are necessary for a society to finance desired public spending and to guarantee that the weight of paying for such spending is circulated justly and a good tax strategy looks to limit these expenses.[86] In addition, tax policy reflects political variables like

[80] Listokin Y, 'Equity, Efficiency, and Stability: The Importance of Macroeconomics for Evaluating Income Tax Policy', 51.
[81] Jahan S, Mahmud AS and Papageorgiou C, 'What is Keynesian Economics', 1.
[82] Jahan S, Mahmud AS and Papageorgiou C, 'What is Keynesian Economics', 2.
[83] Jahan S, Mahmud AS and Papageorgiou C, 'What is Keynesian Economics', 2.
[84] Congressional Research Service, *Fiscal Policy: Economic Effects*, 2009, 1.
[85] Igwe A,Chukwudi EE and Ukpere WI, 'Impact of Fiscal Policy Variables on Economic Growth in Nigeria (1970-2012): A Managerial Economics Perspective', 12 *Investment Management and Financial Innovations* 2, 2015, 169.
[86] Bird RM and Zolt EM, 'Introduction to Tax Policy Design and Development', April 2003, 9.

justness, thus, efficiency, equity, and administrative feasibility are key components in planning and assessing tax frameworks.[87] Governments adopt tax incentives with other reforms designed to improve investment.[88]

Tax incentives can be defined as those special provisions that allow for exclusions, credits, preferential tax rates, or deferral of tax liability.[89] Tax incentives can be grouped into tax holidays, investment allowances and tax credits, timing differences, reduced tax rates, and free economic zones.[90] Certain elements need to be achieved for the effectiveness and efficiency of incentives and they are: it should stimulate investment with minimal revenue leakage and minimal opportunities for tax planning. It should be straightforward, transparent, and expressed precisely in legislation and not frequently changed. The other element is that it ought to be created, executed, directed, and checked by a single agency that ensures low administrative costs. Additionally, it should include follow-up and monitoring to guarantee that the incentive measures are being met and to give an assessment feedback loop.[91] This research proposes that tax incentives given to SMEs should achieve the elements for its effectiveness and efficiency.

2.2 ADAM SMITH'S MAXIMS OF TAXATION

The theoretical framework of this study is also based on the principles of taxation as discussed by Adam Smith. He states that taxes are imposed on three significant incomes which are rent, profit, and wages. In Book V of Chapter 2, he develops four maxims concerning taxation. The first one is that the subjects of each State are to contribute towards the help of the government with respect to the income, which they enjoy under the State's protection.[92] The second one is that the tax an individual will undoubtedly pay should be sure and not subjective. The third maxim is that each tax is supposed to be levied at the time, or way, in which it would be generally advantageous for the taxpayer. The final maxim is that each tax should be devised to be so contrived as both to take out and keep out of the pockets of the individuals as meager as could be expected, over and above

[87] Bird RM and Zolt EM, 'Introduction to Tax Policy Design and Development', 10.
[88] United Nations, 'Design and Assessment of Tax Incentives in Developing Countries', 2018, 4.
[89] United Nations, 'Design and Assessment of Tax Incentives in Developing Countries', 5.
[90] Holland D and Vann RJ, 'Income Tax Incentives for Investment' in Thuronyi VT, *Tax Law Design and Drafting, Volume 2*, International Monetrary Fund, 1998, 4.
[91] Barbour P, 'An Assessment of South Africa's Investment Incentive Regime with a Focus on the Manufacturing Sector' Overseas Development Institute, ESAU Working Paper Number 14, 2005, 9 --<https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/2515.pdf>-- on 19 October 2020.
[92] Smith A, *An Inquiry into The Nature and Causes of The Wealth of Nations*, Metalibri, 2007, 639.

what it brings into the public depository of the State.[93] These four maxims are commonly known as cannons of taxation as equity, certainty, convenience, and simplicity, respectively.

Taxation is supposed to have both the principles of neutrality and equity between different types of business activities.[94] A neutral tax system will contribute to the principle of efficiency which will make sure that optimal allocation of the means of production is attained.[95] Efficiency is defined as a situation where it is no longer possible to improve the welfare of any individual whereas at the same time, it does not make any person worse off and this is called Pareto-efficiency.[96] Efficiency happens when we can attain extreme fulfillment from a given sum of resources hence, it can be obtained when we cannot increase our fulfillment of wants and needs by creating more of one good and less of another.[97] An efficient tax system as per Adam Smith must possess three elements and these are in relation to the principle of economy. These are the cost of collection of taxes to be decreased to the least possible, the taxes collected should not debilitate investment and the repercussions of tax avoidance should not be so punitive that it results in unemployment and forces businesses to shut down.[98] The interrelated principle to efficiency is cost-effectiveness which is also a principle of economy whereby it means that compliance expenses to business and administration costs for governments must be minimised as much as possible.[99] Thus, this means that the costs of the government in tax collection must be minimised as well as the costs that are incurred by the taxpayer.

The principle of equity in taxation applies as more of a social and economic equity and less as a matter of law. It becomes an important aspect to the government due to integrity and it brings in the fairness principle as a taxpayer is to pay his/her fair share.[100] It essentially means that taxes should be fair. Legislators have tried to meet the fairness objective by enacting tax rules pointed toward destroying and moderating undesired monetary and social conditions that may already be existing and they may provide incentives for different financially favourable exercises. However,

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[93] Smith A, *An Inquiry into The Nature and Causes of The Wealth of Nations*, 640.
[94] OECD, Addressing the Tax Challenges of the Digital Economy, 2014, 30.
[95] OECD, Addressing the Tax Challenges of the Digital Economy, 2014, 30.
[96] Schaffer HB and Ott C, *The Economic Analysis of Civil Law*, Edward Elgar, UK, 2004, 8.
[97] Leijon LHO, 'Tax Policy, Economic Efficiency and the Principle of Neutrality from a Legal and Economic Perspective' Upsala Universitet, Working Paper Number 2015:2, 13 --<https://www.jur.uu.se/digitalAssets/585/c_585476-l_3-k_wps2015-2.pdf>-- on 18 October 2020
[98] Smith A, *An Inquiry into The Nature and Causes of The Wealth of Nations*, 677.
[99] OECD, Addressing the Tax Challenges of the Digital Economy, 2014, 30.
[100] Salis GL, 'Brief Introduction to the Principle of Tax Equity', 2007, 3.

over the years, this idea of equity has been coordinated by two guidelines the benefit principle and the ability to pay principle.[101]

2.2.1 BENEFIT THEORY

This principle is considering the standard that all tax rates are to be appropriated to similar extents as the advantages derived from the government.[102] There is the old and new benefit principle. The old benefit principle states that people should contribute to the government according to the benefits they receive from it. This means that anyone who receives government spending should contribute towards it. However, this principle is hard to apply as it was critiqued by John Stuart Mill on the impracticality of measuring government benefits received by individuals and the incoherency of maintaining this benefit principle in a welfare State.[103] Mill states that it is unworkable and further led to the conclusion that the poor should pay more taxes than the rich as the poor obtained more from the government than the rich.[104] The new principle states that the proportion of an individual's advantage from the government is by their monetary well-being and this relates to Adam Smith's maxim of proportionality. The monetary prosperity of citizens is made conceivable by government establishments, laws, and projects that establish an environment where private wealth is developed and allowed to thrive.[105]

2.2.2 ABILITY TO PAY THEORY

This theory is based on Adam Smith's proportionality where he states that the highest taxes ought to be demanded on those with the most elevated capacity to pay. It essentially states that the ability to pay taxes can be probably best measured by someone's net income.[106] Each entity is to add to the financing of regular necessities in terms of its ability to pay.[107] This theory is based on two strands which are horizontal equity and vertical equity. Horizontal equity is where taxpayers pay similar amounts of tax in similar circumstances. Vertical equity is where taxpayers in better circumstances should pay higher levels of tax compared to taxpayers who are in lower

[101] Salis GL, 'Brief Introduction to the Principle of Tax Equity', 4.
[102] Salis GL, 'Brief Introduction to the Principle of Tax Equity', 4.
[103] Dodge JM, 'Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles' 58 *Tax Law Review*, 2005, 399.
[104] Dodge JM, Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles', 404.
[105] Dodge JM, 'Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles', 406.
[106] Buehler AG, 'Ability to Pay', 1 *Tax Law Review* 3, 1946, 244.
[107] Podlipnik J and Koritnik B, 'The Ability-to-Pay Principle as a Primarily Constitutional Basis for Tax Norms of a Financial Nature', 2017, 4.

circumstances.[108] The justification of this theory is on sacrifice, whereby paying taxes to the government is seen as a deprivation to the taxpayer.[109] Hence, it brings two aspects to the sacrifice principle which are equal sacrifice and minimum sacrifice.

John Stuart Mill developed an equal sacrifice from Bentham's utilitarian rule that expresses that it is the greatest happiness of the greatest number that is the proportion of right and wrong.[110] Bentham formulated that the best government is one that reduces tax sacrifices to the smallest amount.[111] Equal sacrifice states that every man should sacrifice equally in paying taxes while the minimum sacrifice states that society all in all should sacrifice the least sum.[112] This theory essentially states that the rich should pay more tax given their capability. However, it has brought in numerous debates as to how much they should be paying. If citizens pay a similar level of their pay, the tax is proportional.[113] If the rich pay smaller percentages of their income and they have large amounts of tax, then the tax is regressive. If the rich pay a greater percentage of their income, then the tax is called progressive.[114]

2.2.3 ANALYSIS

Considering the above, for an ideal tax system, the principles of equity, certainty, convenience, and simplicity should be achieved. The incentives provided ought not to increase the inefficiency of tax administration, but they should ensure that revenues to the government increment and simultaneously ensure the growth of SMEs. Tax incentives will ensure that there is an efficient system in that they would encourage the investment and growth of SMEs. Both the benefit and ability to pay theory advocate for the principle of equity in taxation, however, there is a difference between the two theories. The benefit theory brings in an aspect of gaining benefits from the State while that is not the case in the ability to pay theory. The benefit theory does not apply to this research as it is impractical to measure benefits that are received from the government but the ability to pay theory does apply. Adam Smith's principle of horizontal equity should be upheld

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[108] Mutua JM, *A Citizen's Handbook on Taxation in Kenya, Institute of Economic Affairs*, Nairobi, 2012, 11.
[109] Kendrick SM, 'The Ability-to-Pay Theory of Taxation, 29 *The American Economic Review* 1', 1939, 92.
[110] Burns JH, 'Happiness and Utility: Jeremy Bentham's Equation', 2005, 46.
[111] Buehler AG, 'Ability to Pay', 248.
[112] Rothbard MN, *Power and Market: Government and the Economy*, 4th ed, Ludwig von Mises Institute, Auburn, 2006, 186.
[113] Mutua JM, *A Citizen's Handbook on Taxation in Kenya*, 12.
[114] Mutua JM, *A Citizen's Handbook on Taxation in Kenya*, 12.

whereby taxpayers are to pay similar amounts of tax in similar circumstances.[115] The ability to pay theory is anchored on this paper and it is justified on sacrifice. The ability to pay theory advocates that an individual is to pay tax according to his or her ability and this is the premise of a progressive tax. The author finds progressive taxation being the most equitable tax system as low-income earners have a lower rate of taxation as compared to high-income earners who have a higher tax rate. The ability to pay theory is suitable for this research because tax strategies towards SMEs ought to be considerate enough to encourage their benefit, financial performance, and survival. This research proposes appropriate tax policies for SMEs that will promote their survival and hence, promote employment to the youth by assessing South Africa's situation.

2.3 RESEARCH METHODOLOGY

This research used statistical data and doctrinal methodology that involved the review of existing relevant primary and secondary sources. These included primary sources such as Statutes and secondary sources such as journals, books, newspapers, and online internet resources. These sources were read and reviewed, and an analysis was done to present information on taxation of the SMEs and their need for tax incentives to reduce youth unemployment in Kenya. In addition, South Africa was used as a case study alongside Kenya by analysing the tax incentives available to SMEs in South Africa and how tax incentives have reduced youth unemployment in South Africa. It was chosen because it would provide information that is needed for this research. The two countries are both common law jurisdictions hence, the structuring of the laws and legislative processes of the countries are similar. South Africa is similar to Kenya in that they both use the level of turnover sales to classify a small enterprise. South Africa has dealt with providing tax incentives to SMEs and this can be thus, adopted by Kenya to curb youth unemployment.

[115] Mutua JM, *A Citizen's Handbook on Taxation in Kenya*, 11.

CHAPTER 3: THE REGULATION OF SMEs IN KENYA

This chapter discusses the relationship between the youth and unemployment and also analyses the formal and informal sectors in Kenya to determining where SMEs fall under. It additionally looks at the role of the SMEs in a country's economic growth and their challenges. The taxation regime of SMEs and the evolution of the SMEs policies and laws are also addressed. The chapter then discusses the tax incentives and their importance and looks at the advantages and disadvantages and the types of tax incentives available in Kenya.

3.1 YOUTH AND UNEMPLOYMENT

Unemployment in Africa particularly among the youth and women is high.[116] Unemployment undercuts productivity, spending, and investment, which in turn, stunts national growth. It also contributes to inactivity among the youth and joblessness.[117] Joblessness results from a moderate growth in demand for labour, accompanied by a quickly developing supply of labour aggravated by the significant levels of population growth.[118] The literature review concluded that the youth are more affected than the old people in terms of unemployment. The imperatives to youth employment may be borne by the individual, or result from the market or government failure, or be a manifestation of a weak or unsupportive macroeconomic environment. There is a lack of creation of opportunities to absorb the high number of college and university graduates.[119] Furthermore, inadequate access to capital and the innovative skills to begin, support, and grow a business are other factors that constrain youth employment.[120]

Kenya has a dual economy as it has a large and rapidly growing informal economy that creates most new jobs, and a small, relatively stagnant formal economy.[121] The informal sector is

[116] African Development Bank, Organization for Economic Co-operation and Development, United Nations Development Programme and United Nations Economic Commission for Africa, African Economic Outlook 2012: Promoting Youth Employment, 2012, 100.
[117] S4YE Toward Solutions for Youth Employment, A 2015 Baseline Report, 2015, 32.
[118] International Labour Organisation, Youth Employment Interventions in Africa: A Mapping Report of the Employment and Labour Sub-Cluster of the Regional Coordination Mechanism (RCM) for Africa, 2012, 5.
[119] Farah SA and Ali HA, 'A Study on the Causes of Unemployment Among University Graduates in Kenya: A Case of Garissa County, Kenya' 3 *European Journal of Social Sciences Studies* 1, 2018, 184.
[120] Schott T, Kew P and Cheraghi M, Future Potential: A GEM Perspective on Youth Entrepreneurship 2015, 2015, 30.
[121] Were SM, 'Effect of Social Economic Development on Youth Employment in the Informal and Formal Sectors in Nairobi Kenya' 22 *International Journal of Business* 2, 2017.

associated with self-employment while the formal sector is associated with wage employment.[122] Due to the high rates of youth joblessness, young people will, in general, get more employment opportunities in the informal sector because the opportunities in the formal sector do not catch up with the number of new young people searching for occupations,[123] hence, young people would rather be employed in the informal sector rather than remain unemployed.[124]

3.2 ROLE OF SMEs IN ECONOMIC GROWTH

Modern-day businesses have become significantly dynamic with SMEs.[125] Data from the European Union show that 99 out of 100 businesses are SMEs.[126] In Africa, SMEs have assumed a critical part in the economy, about 25% of the people employed outside agriculture depend on SMEs for their livelihood which, in turn, improves the conditions for small businesses, thus, a solution to unemployment and alleviating poverty.[127] SMEs in South Africa have produced more than 55% of all jobs and 22% of the country's GDP.[128] SMEs account for over 70% of the business population worldwide as they create jobs and contribute to the GDP.[129] SMEs can fuel economic growth in a country as they create new jobs, expand the tax base, and are drivers of advancement[130] dynamism, and flexibility. The SME sector is very important to a country's economy as they provide jobs and pay taxes.[131]

MSMEs in Kenya have been recognised for over years in the provision of merchandise and enterprises, enhancing competition, encouraging development, creating businesses, and alleviating

[122] Sana O, 'Youth Initiatives in Response to the Unemployment in Nairobi Slums' in Danner H, Kerrets-Macau M and Nebe JM, *Youth Unemployment in Kenya: A Ticking Time Bomb*, Longhorn Publishers Ltd, Nairobi, 2016.
[123] International Labour Organisation, Youth Employment Interventions in Africa: A Mapping Report of the Employment and Labour Sub-Cluster of the Regional Coordination Mechanism (RCM) for Africa, 2012, 5.
[124] Escudero V and Mourelo EL, 'Understanding the Drivers of the Youth Labour Market in Kenya' ILO Research Paper No. 8, 2013 --<https://www.ilo.org/wcmsp5/groups/public/---dgreports/---inst/documents/publication/wcms_222527.pdf>-- on 27 November 2020.
[125] Khan MWJ, 'An Overview of Small and Medium Enterprises in Malaysia and Pakistan: Past, Present and Future Scenario' 2 *Business and Management Horizons* 2, 2014, 39.
[126] European Commission, *Annual Report on European SMEs 2013/2014*, 2014, 6.
[127] Ndagijimana JP, 'Determinants of Working Capital Management Practices in Small and Medium Enterprises in Nairobi' 5 *International Journal of Business and Social Science* 12, 2014, 160.
[128] Kedogo BK, 'Factors Influencing Growth and Development of Small and Medium Enterprises in Kenya, A Case of Huruma Division, Nairobi County' Unpublished MA Research Project, University of Nairobi, Nairobi, 2013, 1.
[129] Gitau M, Income Tax Issues Relating to SMEs, 2015, 8.
[130] Katua NT, 'The Role of SMEs in Employment Creation and Economic Growth in Selected Countries', 464.
[131] Ackah J and Vuvor S, 'The Challenges Faced by Small and Medium Enterprises (SMEs) in Obtaining Credit in Ghana' Unpublished MBA Thesis, 2011, 10.

poverty.[132] SMEs establish 98% of all businesses in Kenya, they create 30% of occupations every year and contribute 3 percent of Kenya's GDP.[133] There are about 1.56 million MSMEs that are licensed and 5.85 million businesses that are unlicensed and they are both in the formal and informal sectors.[134] Micro and small enterprises in Kenya are divided into 4 areas: agriculture, trade, manufacturing, and provision of services. Therefore, they are occupied with all areas of the economy notwithstanding most of the numbers being in the agriculture and provision of services. The agricultural sector and services sector are the largest and second-largest employer of the youth in Kenya, respectively.[135] The diversity of micro and small enterprises shows that they have substantial economic contribution and that they support many livelihoods.[136] There are numerous factors that either facilitate or restrain the success of SMEs which contributes to economic development[137] and they can be internal or external.

3.3 CHALLENGES FACING SMEs

SMEs face numerous difficulties that thwart their advancement and their contribution to economic development.[138] The most important problems are unfavourable tax regimes with high taxation rates,[139] unfavourable policy environment, limited access to markets and financial services, and entry barriers.[140] In addition, they face political instability, labour issues, the absence of coordination, and regular information exchange mechanisms among establishments.[141] The 2017 Kenyan economic survey by the KNBS revealed that 46.3% of SMEs closed their businesses during the first year of operation[142] and one of the reasons was legal problems and government

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[132] Kenya National Bureau of Statistics, *Economic Survey 2017*, 2017, 296.
[133] Viffaconsult, 2018 Kenyan SME Finance Survey, 2018, 1.
[134] Kenya National Bureau of Statistics, *Economic Survey 2017*, 2017, 296.
[135] Hall S, Youth Employment in Kenya, Literature Review, October 2017, 34.
[136] Institute of Economic Affairs, State of Implementation of the Micro and Small Enterprises Act 2012, Policy Brief, 1.
[137] Mwangi RM, Sejjaaka S, Canney S, Maina R, Kairo D, Rotich A, Owino E, Nsereko I and Mindra R, 'Constructs of Successful and Sustainable SME Leadership in East Africa' ICBE-RF, Research Report Number 79, 2013, 10 --<https://www.researchgate.net/publication/299536552_Constructs_of_Successful_and_Sustainable_SME_Leadership_in_East_Africa>-- on 27 November 2020.
[138] Katua NT, 'The Role of SMEs in Employment Creation and Economic Growth in Selected Countries', 467.
[139] Odinga EO, 'Challenges Facing Growth of Small and Medium Enterprises Owned by Women in Kakamega Municipality' Unpublished MA Research Project, University of Nairobi, Nairobi, 2012, 35.
[140] Gitau M, Income Tax Issues Relating to SMEs, 2015, 9.
[141] Katua NT, 'The Role of SMEs in Employment Creation and Economic Growth in Selected Countries', 467.
[142] Kenya National Bureau of Statistics, *Economic Survey 2017*, 2017, 305.

regulations.[143] Most SMEs think that taxes constrain their growth.[144] The current tax regime in Kenya chokes the SMEs survival by subjecting them to high tax rates. Kenyans believe that they are over-taxed and at times taxed twice because of poor coordination between the two levels of government.[145]

3.4 TAXATION OF SMEs

Section 15 of the *Income Tax Act* provides for income tax. It states that the total income that is relevant for taxation purposes is determined by deducting all expenditure incurred in a year of income which is the expenditure that is incurred in the production of that income.[146] Income upon which tax is chargeable is on gains or profits, dividends or interests, pension, charge or annuity, income accruing through a digital marketplace.[147] Withholding tax is a method where the payer of earnings is responsible for deducting tax at source from payments that are made and remitting the deducted tax to KRA.[148] This tax is charged on interest, royalties, consultancy fees, training, rent or leasing, and contractual fees.[149]

The other type of tax imposed is the VAT which is a consumption tax stipulated under the *VAT Act*. This tax will be imposed on a taxable supply made by a registered individual in Kenya, the importation of taxable merchandise, and a supply of imported taxable services.[150] The rate applied is 16%,[151] however, due to COVID-19, the government reduced the rate to 14%. Excise duty depends on whether the imported item is excisable or not[152] and this means that it applies to goods that are made in Kenya or imported into Kenya. The rates on excise duty are provided for in the *Customs and Excise Act* in the First Schedule. Micro and small enterprises to be specific are subject to turnover tax as per Section 12C of the *Income Tax Act*. MEs are taxed depending on their

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143 Kenya National Bureau of Statistics, *Economic Survey 2017*, 2017, 306.
144 Ackah J and Vuvor S, 'The Challenges Faced by Small and Medium Enterprises (SMEs) in Obtaining Credit in Ghana' Unpublished MBA Thesis, 2011, 37.
145 Republic of Kenya, *Report of the Steering Committee on the Implementation of the Building Bridges to a United Kenya Taskforce Report*, October 2020, 13.
146 Section 15(1), *Income Tax Act* (CAP 470).
147 Section 3, *Income Tax Act* (CAP 470).
148 --<https://www.kra.go.ke/en/individual/filing-paying/types-of-taxes/paye>-- on 27 November 2020.
149 PWC, Corporate – Withholding Taxes --<https://taxsummaries.pwc.com/kenya/corporate/withholding-taxes#:~:text=WHT%20is%20levied%20at%20varying,tax%20or%20creditable%20against%20CIT.>-- 03 August 2020, on 27 November 2020.
150 Section 5(1), *Value Added Tax Act* (Act No 35 of 2013).
151 Section 5(2)(b), *Value Added Tax Act* (Act No 35 of 2013).
152 --<https://www.kra.go.ke/en/business/companies-partnerships/companies-partnerships-pin-taxes/company-partnership-imports-exemptions>-- on 27 November 2020.

structure and they pay corporation tax of 30%.[153] MEs also pay telecommunications tax[154] and a fringe benefit tax.[155] They also pay an advance tax[156] which is for every commercial vehicle with the rates specified in the Third Schedule if they have commercial vehicles.[157]

3.5 EVOLUTION OF SMEs POLICIES AND LAWS

This can be traced back to the ILO report of 1972[158] that recognised SMEs as an important sector in Kenya's economy for creating income and employment. The Sessional Paper No. 1 of 1986 set out that the informal sector provides for an unmatched potential to provide new jobs for the labour force that is expanding.[159] Hence, the government set out an enabling environment for SMEs. The government's report, The Strategy for Small Enterprise Development in Kenya: Towards the Year 2000, of 1989 set out the components for eliminating the limitations to development and the improvement of the SME area.[160] The other effort by the government was in the Sessional Paper No. 2 of 1992, Small Enterprise and Jua Kali development in Kenya. This Sessional paper recommended the relevant ministries establish an enabling environment for SMEs and looking at the laws that negatively impact the growth of SMEs.

Moreover, there was the Development Plan for 1989-1993 which inferred that the government would accelerate the review of the local authorities that had restricted SMEs growth as the aim of this plan was to expand Kenya's economy to create productive employment in the labour force.[161] In addition, the Small Enterprise Policy Implementation Programme mission report of 1994 identified the issues that had not been addressed such as poor infrastructure, land allocation, and legislative reform which inhibited the development of SMEs.[162] Sessional Paper No. 2 was

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[153] Third Schedule, *Income Tax Act* (CAP 470).
[154] Section 3(1), *Telecommunications Tax Act* (CAP 473).
[155] Section 12B (1), *Income Tax Act* (CAP 470).
[156] Section 12A, *Income Tax Act* (CAP 470).
[157] PWC, Highlights of the Tax Laws Amendment Act, 2020.
[158] International Labour Force, *Employment, Incomes and Equality*, 1972.
[159] Sessional Paper No. 1 of 1986, Economic Management for Renewed Growth, Nairobi, Kenya, 1986, 54.
[160] Wanjohi AM, SME Policy in Kenya: Issues and Efforts in Progress, 2010, 2.
[161] National Development Plan for the Period 1989 to 1993, Kenya, 1989 --<https://agris.fao.org/agris-search/search.do?recordID=KE8941947>-- on 27 November 2020.
[162] Ong'olo D and Awino S, 'Small and Medium Enterprises and Devolved Government System: An Assessment of the Regulatory and Institutional Challenges Affecting the SMEs Development in Kenya' ICBE-RF, Research Report Number 71, 2013, 19 --<https://media.africaportal.org/documents/ongolo1.pdf>-- on 27 November 2020.

published in 2005 on the improvement of micro and small enterprises for wealth and for job creation to alleviate poverty.

Furthermore, there was the Private Sector Development Strategy (PSDS), 2006-2010 which was considered as the focal connection between the private sector and decreasing destitution. The government developed the PSDS and Private Sector Development Strategy Implementation Plan (PIP), 2007-2012, to help the advancement of the private area and were centered around improving the competitiveness and productivity of the MSMEs.[163] One of the goals of the PSDS was to facilitate SMEs competitiveness by supporting the advancement of new undertakings.[164] The government has implemented various interventions such as the YEDF which looks to create job opportunities for the youth through business and urging them to be job creators.

Employment opportunities were created by giving simple and moderate monetary and business improvement support services to youth who are keen on beginning or growing businesses.[165] The Ministry of Industrialisation, Trade and Enterprise Development was set up to advance the development, growth, and graduation of SMEs.[166] To address the issues affecting SMEs, the government enacted the *Microfinance Act*, the *SACCOS Act*, and the *MSE Act*.

3.6 TAX INCENTIVES

Tax incentives can be characterised as measures that accommodate a more favourable tax treatment of specific activities or areas contrasted with what is allowed to the overall business.[167] They can similarly be characterised as any incentives that reduce the taxation rate of ventures to prompt them to put resources into explicit activities or areas.[168] Most countries utilise a wide variety of incentives to realise their investment objectives in certain sectors. They are special

[163] African Development Bank Group, *The State of Kenya's Private Sector, Recommendations for Government, Development Partners, and the Private Sector*, 2013, VII.
[164] Ong'olo D and Awino S, 'Small and Medium Enterprises and Devolved Government System: An Assessment of the Regulatory and Institutional Challenges Affecting the SMEs Development in Kenya' ICBE-RF, Research Report Number 71, 2013, 19 --<https://media.africaportal.org/documents/ongolo1.pdf>-- on 27 November 2020.
[165] --<http://www.youthfund.go.ke/>-- on 12 February 2020.
[166] --<http://www.industrialization.go.ke/index.php/downloads/282-kenya-s-industrial-transformation-programme>-- on 19 March 2020.
[167] Klemm A, 'Causes, Benefits, and Risks of Business Tax Incentives' *International Tax and Public Finance* 17, 2010, 315.
[168] United Nations Conference on Trade and Development, Tax Incentives and Foreign Direct Investment: A Global Survey, 2000, 12.

provisions allowing exclusions, credits, preferential tax rates, or deferral of tax liability.[169] Developing countries will in general utilise a mix of focused and more broad incentives which may be included in the income tax law or different laws or essentially government orders.[170]

Governments frequently pick tax incentives over different sorts of action as it is simpler to give tax benefits than to address inadequacies in the overall set of laws or to improve the communications system in a country.[171] Tax incentives do not need the use of assets by the government as opposed to providing grants.[172] Tax incentives and money grants may be similar regarding their monetary expense to governments, yet it is simpler to give tax benefits than to give funds to investors.[173] Developing countries use tax incentives to attract investments and boost their economies' growth.[174] Governments should adjust their imaginable expenses and possible benefits when choosing tax incentive policies.[175] Tax incentives contribute to the promotion of employment as a result of high investments.[176] This then leads to better housing facilities, supply of water, electricity and telephone services and all these contribute to the small business environment being more favourable.[177]

3.6.1 ADVANTAGES AND DISADVANTAGES OF TAX INCENTIVES

Tax incentives may work if they are well designed and implemented by achieving certain conditions. The advantages are that businesses could benefit greatly from tax holidays and hence, become more profitable and leading to higher profits for investors. Tax incentives play a part in compensating for other shortages in the investment climate where authorities may attract

[169] United Nations, Design and Assessment of Tax Incentives in Developing Countries: Selected Issues and a Country Experience, 2018, 5.
[170] Zee HH, Stotsky JG and Ley E, 'Tax Incentives for Business Investment: A Primer for Policy Makers in Developing Countries' 30 *World Development* 9, 2002.
[171] United Nations, Design and Assessment of Tax Incentives in Developing Countries: Selected Issues and a Country Experience, 2018, 13.
[172] United Nations Conference on Trade and Development, Tax Incentives and Foreign Direct Investment: A Global Survey, 2000, 12.
[173] United Nations, Design and Assessment of Tax Incentives in Developing Countries: Selected Issues and a Country Experience, 2018, 14.
[174] James S, Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications, 2013, v.
[175] James S, Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications, 2013, 3.
[176] Jordaan D, An Overview of Incentives Theory and Practice: A Focus on the Agro-Processing Industry in South Africa, 2012, 7.
[177] Calitz E, Wallace S and Burrows LR, 'The Impact of Tax Incentives to Stimulate Investment in South Africa' ICEPP, Working Paper 13-06, 2013, 3 -- <https://scholarworks.gsu.edu/cgi/viewcontent.cgi?article=1036&context=icepp>-- on 28 November 2020.

investment but may find it hard to deal with main issues that could discourage investors.[178] In addition, tax incentives are less complicated to provide rather than improving infrastructure or skills.[179] Effective and efficient incentives; stimulates investment, has low administrative costs for both governments and firms, includes follow-up and monitoring, and includes a cap on expenditure, or taxes forgone.[180]

However, on the other hand, tax incentives lead to a loss of revenue by the government and this occurs when the tax incentives are more generous than others.[181] Tax incentives could also mean that one sector can be prioritised over the other and this may cause an imbalance in the allocation of resources within the different sectors which then becomes unfair.[182] If there are non-transparent tax incentives, it can lead to tax evasion, complicating tax administration and hence, encouraging corruption.[183] Tax incentives additionally lead to the revenue base being eroded when taxpayers abuse the tax incentives regime to avoid paying tax.[184] Entities can sometimes take advantage of loopholes through the tax holiday to increase their profits by channeling high profits through transfer pricing from a profitable company to another which is covered by tax holiday and hence, avoiding paying tax.[185]

3.6.2 TYPES OF TAX INCENTIVES

Tax incentives can be grouped into many categories such as tax holidays, investment allowances and tax credits, reduced tax rates and tax reductions, tax deductions, Export Processing Zones (EPZs) incentives, and Special Economic Zones (SEZs) incentives.

A tax holiday is directed to new firms. With a tax holiday, new firms are permitted a period when they are excluded from paying certain charges.[186] Sometimes, the grace period is extended to a

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[178] Calitz E, Wallace S and Burrows LR, 'The Impact of Tax Incentives to Stimulate Investment in South Africa', 8.
[179] James S, Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications, 2013, 37.
[180] Barbour P, 'An Assessment of South Africa's Investment Incentive Regime with A Focus on the Manufacturing Sector' ESAU, Working Paper 14, 2005, 9 --<https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/2515.pdf>-- on 28 November 2020.
[181] Zolt EM, Tax Incentives and Tax Base Protection Issues, Draft Paper Number 3, 2013, 12 --<https://www.un.org/esa/ffd/wp-content/uploads/2014/10/20140604_Paper3_Zolt.pdf>-- on 28 November 2020.
[182] Ssennyonjo P, 'A Comparative Study of Tax Incentives for Small Business in South Africa, Australia, India and the United Kingdom' Unpublished Master of Philosophy in Accounting Sciences, University of South Africa, South Africa, 2019, 52.
[183] Calitz E, Wallace S and Burrows LR, 'The Impact of Tax Incentives to Stimulate Investment in South Africa', 7.
[184] Zolt EM, 'Tax Incentives and Tax Base Protection Issues', 2013, 11.
[185] James S, Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications, 2013, 41.
[186] United Nations, Design and Assessment of Tax Incentives in Developing Countries: Selected Issues and a Country Experience, 2018, 19.

subsequent period of taxation at a reduced rate.[187] A ten-year tax holiday is given to an EPZ enterprise in Kenya that does not participate in any business activities that begin with the year in which production, sales, or receipts identifying with the activities for which that undertaking has been authorised as an EPZ enterprise.[188] Tax holidays are viewed as a simple incentive with a generally low compliance burden.[189]

Investment allowances and tax credits are types of tax reliefs that depend on the estimation of consumptions on qualifying investments as they accommodate tax benefits over the depreciation allowed for the resource.[190] Investment allowances tend to lower the effective price of acquiring capital. A tax allowance is utilised to decrease the taxable income of the firm and a tax credit is utilised to straightforwardly deduct the measure of expenses to be paid.[191] They both are given as a specified percentage of qualifying investment expenditures.[192] Tax rate reductions can be given for money from explicit sources or to firms satisfying certain guidelines.[193] This varies from tax holidays in that the expense obligation in this example is not wiped out, the benefit is stretched out past new enterprises to incorporate pay from existing activities, and the benefit is not time-restricted. It is a decrease in tax rate, commonly the corporate income tax rate.[194]

In Kenya, newly listed companies listed in an approved securities exchange are qualified for decreased expense tax rates for a period depending on the percentage of share capital as per the Third Schedule in the *Income Tax Act*. If a company has at least 20% of its issued share capital listed, 27% for three years beginning immediately after the year of income. If a company has at least 30% of its issued share capital listed, 25% for five years commencing immediately after the year of income.[195] However, these Sections were repealed as per the *Tax Laws Amendment Act*,

[187] Holland D and Vann RJ, 'Income Tax Incentives for Investment' in Thuronyi V, *Tax Law Design and Drafting, Volume 2*, International Monetary Fund, 1998, 4.
[188] Elizabeth NM, 'The Law on Tax Incentives of Medium Enterprises: A Case Study of Kenya and the Republic of Korea' Unpublished LLM Thesis, University of Nairobi, Nairobi, 2014, 54.
[189] United Nations, Design and Assessment of Tax Incentives in Developing Countries: Selected Issues and a Country Experience, 2018, 20.
[190] Holland D and Vann RJ, 'Income Tax Incentives for Investment', 6.
[191] Klemm A, 'Causes, Benefits, and Risks of Business Tax Incentives', 4.
[192] United Nations, Design and Assessment of Tax Incentives in Developing Countries: Selected Issues and a Country Experience, 2018, 20.
[193] Holland D and Vann RJ, 'Income Tax Incentives for Investment', 9.
[194] Klemm A, 'Causes, Benefits, and Risks of Business Tax Incentives', 4.
[195] Third Schedule, *Income Tax Act* (CAP 470).

2020. If a company has at any rate 40% of its issued share capital listed, 20% for five years beginning immediately after the year of income.[196]

There are also the tax deductions that are deducted from the gross pay to compute the taxable income. No deductions should be made in computing the increases and benefit of an individual if it is of a capital nature.[197] In Kenya, the *Income Tax Act* provides for capital deductions as found in the Second Schedule to encourage new industrial enterprises. There is the industrial building deduction which is an allowance that is conceded to an investor who brings about capital expenditure on a structure utilised as an industrial building at the rate of 10% of the expense. There is additionally the wear and tear allowances which are charged on capital consumption on machinery and equipment which is divided into four classes with different rates ranging from 37.5% to 12.5%. Furthermore, there is the investment deduction whereby an investor who incurs capital consumption on building and/or machinery used for manufacture is qualified to an investment deduction equivalent to 100% of the expense.[198]

For the EPZs they have a 10-year corporate income tax holiday due to the activities they undertake that consist of assembling of merchandise for trades under the EPZs and a 25% tax rate for a further 10 years.[199] This is the EPZ incentive. In addition, there are also the SEZs incentives whereby they are not required to register for VAT as it is subject to VAT at 0%.[200] The corporation tax rate for SEZs is at a rate of 10% for the first 10 years or 15% for the next 10 years.[201]

3.7 CONCLUSION

From the above, it is evident that the government put a lot of effort to define strategies to help the establishment of SMEs in Kenya. An enormous number of SMEs, their high turnover rates and their variety presents difficulties to all administrations.[202] By analysing the above tax incentives,

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[196] Third Schedule, *Income Tax Act* (CAP 470).

[197] Elizabeth NM, 'The Law on Tax Incentives of Medium Enterprises: A Case Study of Kenya and the Republic of Korea' Unpublished LLM Thesis, University of Nairobi, Nairobi, 2014, 49.

[198] --<https://www.kra.go.ke/en/ngos/incentives-investors-certificate/investing-in-kenya/incentives-investors>-- on 28 November 2020.

[199] --<https://www.kra.go.ke/en/ngos/incentives-investors-certificate/investing-in-kenya/incentives-investors>-- on 28 November 2020.

[200] PWC, Corporate: Tax Credits and Incentives --<https://taxsummaries.pwc.com/kenya/corporate/tax-credits-and-incentives>-- 03 August 2020 on 28 November 2020.

[201] --<https://www.kra.go.ke/en/ngos/incentives-investors-certificate/investing-in-kenya/incentives-investors>-- on 28 November 2020.

[202] Institute of Economic Affairs, The Budget Focus: Informal Sector and Taxation in Kenya, Issue No. 29, 2012, 2.

none of them are specific to SMEs but they can take advantage of incentives that are enjoyed across the board.[203] SMEs need tax incentives as has been seen from the advantages that they are effective and efficient and hence, will lead to profits and investments, and this increases the economic growth of a country. However, the recent Building Bridges Initiatives (BBI) report hopes to award at least seven year's tax holiday for youth-owned businesses.[204] They can take advantage of the capital deductions or the reduced tax rates for newly listed companies that are approved in the securities exchange. The challenges facing the SMEs are evident, especially taxation, and these enterprises not having tax incentives for their survival, which in turn, would promote youth employment in Kenya. This shows that Kenya needs to have a tax policy on the informal sector so that it can enjoy tax incentives.

[203] Elizabeth NM, 'The Law on Tax Incentives of Medium Enterprises: A Case Study of Kenya and the Republic of Korea' Unpublished LLM Thesis, University of Nairobi, Nairobi, 2014, 48.
[204] Republic of Kenya, *Report of the Steering Committee on the Implementation of the Building Bridges to a United Kenya Taskforce Report,* October 2020, 13.

CHAPTER 4: A COMPARATIVE STUDY OF THE REGULATION OF SMEs IN SOUTH AFRICA

This chapter provides a comparative analysis of South Africa's regulation of SMEs as Kenya and South Africa are similar in terms of demographics. The chapter first addresses youth and unemployment in South Africa and then analyses the taxation of SMEs and micro-businesses. It further assesses the tax incentives that are available to small businesses in South Africa.

4.1 YOUTH AND UNEMPLOYMENT

In South Africa, the labour report indicates that the first quarter of 2020 shows that employment had decreased by 38,000 to 16.4 million, and the number of jobless people expanded by 344,000 making the number 7.1 million.[205] The rate of unemployment has been high over time with the youth aged 15-34 years being the most affected. The youth represented 63.3% of the total number of jobless people and the rate of unemployment within the youth in the first quarter of 2020 was 43.2%.[206] Some of the youth that seek jobs do not have the requisite skills or are not well educated for them to be employed in the labour market, as the economy demands skilled and experienced work-searchers. This makes it troublesome for the youth to secure jobs.

In addition, the youth have disengaged with the labour market as they are Not in Employment, Education, or Training (NEET). Other factors that affect the youth NEET are lack of experience and having unspecified or limited contract duration and not having employee benefits such as medical aid and pension fund.[207] There are many reasons for youth unemployment such as population growth, inappropriate ways of searching for a job, and lack of guidance in choosing a career in school.[208] The connection between joblessness and destitution is depicted as bi-directional causality since joblessness causes poverty and poverty adds to joblessness and its

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[205] Statistics South Africa, *Quarterly Labour Force Survey: Quarter 1: 2020*, 2020, 2.

[206] Statistics South Africa, Vulnerability of Youth in the South African Labour Market --<http://www.statssa.gov.za/?p=13379#:~:text=The%20youth%20aged%2015%E2%80%9324,1st%20quarter%20of%202020.>-- on 28 November 2020.

[207] Statistics South Africa, Vulnerability of Youth in the South African Labour Market --<http://www.statssa.gov.za/?p=13379#:~:text=The%20youth%20aged%2015%E2%80%9324,1st%20quarter%20of%202020.>-- on 28 November 2020.

[208] Cloete A, Youth Unemployment in South Africa: A Theological Reflection Through the Lens of Human Dignity, 2015, 514.

consistency.[209] The issue of youth unemployment extends beyond the young people themselves as it as well impacts businesses, the government, and society.[210]

However, the South African government has put in skills and training programs to try to alleviate poverty through various Technical and Vocational Education and Training that are publicly funded. Publicly funded programs have been implemented by the government to offer employment to vulnerable South Africans in the provision of essential basic services and deployment in programs that can provide income as well as developing additional skills which then, improve the chance of one being employed in the future. There is the Community Works Program (CWP) which was planned as an employment safety net whereby one's current occupation is enhanced by offering an essential degree of pay through work.

The public deployment programs through the National Youth Development Agency had a year training program for the youth to furnish them with the qualification credits. Another training program is the National Rural Youth Service Corps which comprised a comprehensive two-year skills and incubation program whereby the members would then be associated with local area advancement projects and the Sector Education and Training Authorities which had a leadership program.[211] The Department of Labour additionally passed the *Employment Services Act* to promote employment by providing the youth with specialised services to get work with the government. The other significant intervention is South Africa's Jobs Fund which gives public financing in enterprise advancement, infrastructure investment, support for work searchers, and institutional limit and it has made almost 100,000 job positions.[212]

Similarly, South Africa also has an informal sector comprised of SMEs. SMEs create opportunities for the youth who are less skilled and less experienced to enter the labour force. Small businesses account for an estimated 60% of South Africa's employment as they are grounds for

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[209] Fourie FCvN, 'The South African Unemployment Debate: Three Words, Three Discourses? REDI3X3, Working paper 1, 2012 18 --<https://www.researchgate.net/publication/275715297_The_South_African_unemployment_debate_Three_words_three_discourses>-- on 28 November 2020.

[210] Shankar V, Cooper A and Koh H, Reducing Youth Unemployment in South Africa, 2016.

[211] Cassim A and Oosthuizen M, The State of Youth Unemployment in South Africa --<https://www.brookings.edu/blog/africa-in-focus/2014/08/15/the-state-of-youth-unemployment-in-south-africa/>-- 15 August 2014, on 28 November 2020.

[212] Cassim A and Oosthuizen M, The State of Youth Unemployment in South Africa --<https://www.brookings.edu/blog/africa-in-focus/2014/08/15/the-state-of-youth-unemployment-in-south-africa/>-- 15 August 2014, on 28 November 2020.

entrepreneurship and innovation.[213] Creating jobs is important to ensure that young people can access economic opportunities. The government established the Small Business Development Ministry in 2014 to facilitate the improvement and development of small businesses. The SMEs in South Africa also battle to survive in the tough economy and the hostile regulatory environment.[214] This is because the government has not created an entirely enabling environment for the SME sector to flourish. A study found about 250,000 SMEs in South Africa in 2018 by the Small Business Institute, however, they face a 70% to 80% failure during the first five years of business.[215] SMEs lack support, and this is a challenge as identified by the Global Entrepreneurship Monitor 2016/17.[216] SMEs in South Africa are provided for in the *National Small Enterprise Act* and it characterises businesses into micro, very small, small, and medium enterprises. The National Treasury in South Africa recognises the importance of SMEs and has granted them many tax incentives to improve the cash flows of growing SMEs and to enable them to create jobs.[217] In addition the *ETI Act* was enacted to provide for incentives to improve the unemployment situation in South Africa.

The National Development Plan identifies three categories of businesses within SMEs, and these are the survivalist businesses, lifestyle businesses, and entrepreneurial businesses. The survivalist business is either home-based or one that operates on the streets, for example, hawkers and gardeners. A lifestyle business means a business that is either home-based or operates in a single office which is in middle or upper-class areas. Examples of lifestyle businesses are doctors, engineers, and accountants. Lastly, entrepreneurial businesses are those businesses that aim at expansion and have the potential to attract venture capitalists to invest and are considered successful in creating employment opportunities.[218] A small business corporation is defined as a close corporation or any company enlisted as a privately owned business in terms of the *Companies*

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[213] Rungani EC and Potgieter M, The Impact of Financial Support on the Success of Small, Medium and Micro Enterprises in the Eastern Cape Province, 2018, 2.
[214] SBP Alert, Bulletin 3: Small Firms can be the Drivers of Youth Employment in South Africa, 2015, 2.
[215] Small Business Institute, The number of formal micro, small & medium businesses in South Africa, Preliminary findings of stage 1 of the Baseline Study of Small Businesses in South Africa, 4.
[216] Herrington M, Kew P and Mwanga A, South Africa Report, Can Small Businesses Survive in South Africa? 2016/2017.
[217] Qabaka V, Does Our Current Tax System Really Support Small Business? --<Does Our Current Tax System Really Support Small Business? - The SA Institute of Tax Professionals (thesait.org.za)>-- 06 May 2011 on 28 November 2020.
[218] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 6.

Act.[219] It is a separate and distinct business entity that includes co-operative enterprises and non-governmental organisations that are overseen by one or more proprietors, including its branches or subsidiaries, if any, is carried on in any area or sub-area of the economy.[220]

4.2 TAXATION OF SMEs AND MICRO BUSINESSES IN SOUTH AFRICA

They are taxed according to the structure of the entity, for example, if it is a sole proprietorship, partnership, Small Business Corporation (SBC), or micro-businesses. SBCs are taxed at a progressive tax rate as seen in table 1.[221] Table 1 shows the rate of taxes for monetary years that end on any date between 1 April 2020 and 31 March 2021. They additionally meet all requirements for a 100% discount on new machinery utilised in a cycle of production.[222]

Taxable Income (R)	**Rate of Tax (R)**
1 – 83,100	0% of taxable income
83,101 – 365,000	7% of taxable income above 83,100
365,001 – 550,000	19,733 + 21% of taxable income above 365,000
550,001 and above	58,583 + 28% of the amount above 550,000

Table 1.

Micro-businesses in South Africa are taxed a turnover tax depending on the number of turnover sales the enterprise makes. The rates of turnover tax applicable for any year are in Table 2.[223] To be classified as a micro-business, the enterprise should register with the South African Service Revenue (SARS). Only incorporated bodies such as companies, close enterprises, and co-operatives, and natural persons that are either sole dealers or associations can enroll as a micro-business if they have a turnover that does not surpass R1 million.[224] However, if a business does

[219] Section 12E (4), *Income Tax Act* (Act No 58 of 1962) (South Africa).
[220] Section 1, *National Small Business Act* (Act No 102 of 1996) (South Africa).
[221] --<https://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Companies-Trusts-and-Small-Business-Corporations.aspx>-- on 28 November 2020.
[222] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 16.
[223] --<https://www.sars.gov.za/TaxTypes/TT/Pages/default.aspx>-- on 28 November 2020.
[224] Naicker Y and Rajaram R, The Effectiveness of Tax Relief Initiatives on SMEs in South Africa, 15 *ŒCONOMICA* 4, 2019, 129.

not register for turnover tax, they will be subjected to income tax and dividends tax rules.[225] They also pay income tax, VAT, and employee taxes like PAYE.[226]

Turnover (R)	**Rate of Tax (R)**
0 – 335,000	0%
335,001 – 500,000	1% of each R1 above 335,000
500,001 – 750,000	1,650 + 2% of the amount above 500,000
750,001 and above	6,650 + 3% of the amount above 750,000

Table 2.

4.3 TAX INCENTIVES FOR SMALL BUSINESSES IN SOUTH AFRICA

4.3.1 SMALL BUSINESS CORPORATIONS (SBCs)

Companies are normally charged at a fixed rate of 28% but SBCs are taxed based on a progressive rate for income tax which means that the tax depends on the amount of taxable income.[227] The higher the available pay, the higher the rate of tax, and a low taxable income will have a low rate of tax.[228] Table 1 above shows the tax rates for SBCs. The other tax incentive related to SBCs is according to Section 12E (1) of the *Income Tax Act* which states that two sets of accelerated capital allowance rates apply to the plant and machinery, which are assets of an SBC. The assets may qualify for a 100% write-off if they are utilised directly in a cycle of manufacture or a cycle of a comparative sort.[229] The plant or machinery should be brought into utilisation for the first time by the taxpayer that owns the asset or acquired it as a purchaser under an installment sale agreement and it should be for the taxpayer's trade other than farming and mining.[230]

The other tax incentive available for SBCs is the venture capital company allowance that is provided for in Section 12J of the *Income Tax Act* which provides for a deduction for investors in Venture Capital Companies (VCCs). An investor may claim a deduction for expenditure that was

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[225] Makgalemele M, 'Do Tax Incentives Promote Development of Small Medium Enterprises That Ultimately Yield Economic Growth' Unpublished MCom Research, University of Witwatersrand, Johannesburg, 2017, 15.
[226] Pillay C, Tax Guide for Your SME --<https://smesouthafrica.co.za/Tax-guide-for-your-SME/>-- 17 October 2014 on 28 November 2020.
[227] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 15.
[228] Ssennyonjo P, 'A Comparative Study of Tax Incentives for Small Business in South Africa, Australia, India and the United Kingdom' Unpublished Master of Philosophy in Accounting Sciences, University of South Africa, South Africa, 2019, 52.
[229] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 16.
[230] Section 12E (1), *Income Tax Act* (Act No 58 of 1962) (South Africa).

incurred to acquire shares, given to the investor by an affirmed VCC and not on the acquisition of VCC shares from another investor.[231] It was introduced to encourage investors to invest through and this, in turn, enables small businesses to obtain finance.

4.3.2 MICRO-BUSINESSES

A micro-business is a natural person or a company that has a turnover that does not surpass R1 million for the year of assessment.[232] The turnover tax for micro-businesses has been simplified in a way that the tax payable is calculated based on annual taxable turnover and there are no deductions whatsoever. This turnover tax structure replaces income tax, VAT, capital gains tax, provisional tax, and dividends tax for micro-businesses that have a yearly turnover of R1 million or less. However, the turnover tax is optional, and this means that it still has the alternative to use the general income tax system.[233] From table 2 above, it shows that the turnover tax is progressive.

4.3.3 EMPLOYMENT TAX INCENTIVE (ETI)

This is a South African wage subsidy programme that was introduced in 2014 to curb youth unemployment by accelerating creation. It is a form of tax relief for firms that hire workers between the ages of 18 – 29 years and that earn less than R6,000 a month.[234] This is a cost-sharing instrument between employers and the government that is pointed toward decreasing the liability of employers for employees' tax after they meet certain requirements of the *ETI Act*[235] while leaving the employee's wage unaffected. This Act was implemented by the government as a response to the high rate of youth joblessness.[236] The Act provides for an ETI as a sum by which worker's tax may be reduced and to allow for a claim and payment of an amount where the tax of the employees cannot be reduced.[237] It indicates that there is a need for the government to support the growth of employment by supporting labour market activation by hiring young people looking for jobs.[238] The aim is at urging employers to employ the youth and less experienced occupation

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[231] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 16.
[232] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 26.
[233] Ssennyonjo P, 'A Comparative Study of Tax Incentives for Small Business in South Africa, Australia, India and the United Kingdom' Unpublished Master of Philosophy in Accounting Sciences, University of South Africa, South Africa, 2019, 76.
[234] Bhorat H, Hill R, Khan S, Lilenstein K and Stanwix B, 'The Employment Tax Incentive Scheme in South Africa: An Impact Assessment' DPRU, Working Paper 202007, 2020, 1 --<https://media.africaportal.org/documents/The_employment_tax_incentive_scheme.pdf>-- on 28 November 2020.
[235] --<https://www.sars.gov.za/TaxTypes/PAYE/ETI/Pages/default.aspx>-- on 29 November 2020.
[236] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 37.
[237] *Employment Tax Incentive Act* (Act No 26 of 2013) (South Africa).
[238] Preamble, *Employment Tax Incentive Act* (Act No 26 of 2013) (South Africa).

searchers and it only applies to employees employed on or after 1st October 2013 and has to be claimed within the first two years of employment of an employee. This incentive will supplement the existing government programmes with similar objectives such as the CWP.[239] This incentive will also apply to SEZs.

The employer is qualified to guarantee ETI if the employer is registered for employees' tax (PAYE), or should be eligible to register for PAYE, is not in the national, provincial, or local sphere of government, is not a public entity listed in Schedule 2 or 3 of the *Public Finance Management Act*, is not a municipal entity and is not excluded by the Minister of Finance.[240] The employer guarantees the tax incentive by decreasing the measure of PAYE charge that should be paid to SARS monthly, in light of the number of workers that are supported by the tax incentive and the important salaries of those employees.[241] The employees must be between 18 – 29 years, have a South African identity card, and must receive an income between the minimum wage for that particular sector and R6,000 per month.[242] In addition, the employee cannot be associated or connected to the employer in any capacity and homegrown labourers will not be qualified for the incentive.[243] To determine the value of the incentive for a month, the employer must; recognise all qualifying workers in regard to that month, determine the applicable employment period for each qualifying worker, determine each worker's monthly salary, figure the measure of the incentive per qualifying worker and lastly total the outcome.[244]

In 2014, there was an increase in job creation as 23,500 employers had guaranteed the ETI for at least 209,000 employees.[245] The ETI is progressing very well in South Africa as R2 billion had been guaranteed by 29,000 employers who had guaranteed for at least 270,000 young people and that job positions in South Africa developed by 203,000.[246] The ETI has enabled many jobs to be

[239] --<https://www.sars.gov.za/TaxTypes/PAYE/ETI/Pages/default.aspx>-- on 29 November 2020.
[240] --<https://www.sars.gov.za/TaxTypes/PAYE/ETI/Pages/default.aspx>-- on 29 November 2020.
[241] Ranchhod V and Finn A, 'Estimating the Short Run Effects of South Africa's Employment Tax Incentive on Youth Employment Probabilities Using a Difference-In-Differences Approach' 84 *South African Journal of Economics* 2, 2016, 202.
[242] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 37.
[243] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 38.
[244] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 39.
[245] Gordhan P, Minister of Finance, Budget Speech, 2014 by Deputy Minister Nene.
[246] President Jacob Zuma: State of the Nation Address 2015 --<https://www.gov.za/president-jacob-zuma-state-nation-address-2015>-- 12 February 2015, on 29 November 2020.

supported and grown rapidly since 2014, reaching over 1 million in 2016.[247] Firms that claimed the ETI hired more subsidy-eligible youth than firms that had not claimed the ETI. A total of 35,333 jobs were saved between 2014 and 2016 due to the implementation of the ETI.[248] Small businesses have reaped the greatest benefits from the ETI, with growth rates ranging from 0.888 to 0.928 percentage points higher than non-ETI firms, demonstrating a small but statistically significant effect of the ETI policy.[249] The ETI has reaped fruits,[250] such as the SME sector being urged to comply with basic wage levels and general work guidelines.[251]

4.4 CONCLUSION

In this chapter, the relationship between the youth and unemployment was identified in South Africa. The definition of SMEs and the taxation framework of SMEs have been discussed extensively. The tax incentives for SBCs and micro-businesses were also analysed together with the employment tax incentive. From the above analysis, it is evident that South Africa has ensured economic growth through its tax policies. This South African regime for tax incentives can be adopted in Kenya to alleviate poverty and curb youth unemployment.

[247] Bhorat H, Hill R, Khan S, Lilenstein K and Stanwix B, 'The Employment Tax Incentive Scheme in South Africa: An Impact Assessment', 23.

[248]Bhorat H, Hill R, Khan S, Lilenstein K and Stanwix B, 'The Employment Tax Incentive Scheme in South Africa: An Impact Assessment', 23.

[249] Bhorat H, Hill R, Khan S, Lilenstein K and Stanwix B, 'The Employment Tax Incentive Scheme in South Africa: An Impact Assessment' DPRU, Working Paper 202007, 2020.

[250] Ebrahim A, Leibbrandt M and Ranchod V, 'The Effects of the Employment Tax Incentive on South African employment' WIDER Working Paper 2017/5, --<wider.unu.edu/sites/default/files/wp2017-5.pdf>--, 2017.

[251] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 41.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

This chapter is the final chapter of the research, and it will give a summary of the main findings, conclusion, and recommendations. The summary of the findings will show a short presentation of the main findings and the chapter will end with recommendations that are based on the lessons of the main findings.

5.1 SUMMARY OF MAIN FINDINGS

The purpose of this research was to identify the tax incentives that are available to SMEs to curb youth unemployment in Kenya. The research also addressed the following questions: what the impact of SMEs are on the establishment of youth employment in Kenya, how SMEs are taxed and what the impact of their taxation is on youth unemployment in Kenya, and whether any tax incentives are given to SMEs to promote youth employment. This research relied on statistical data and doctrinal methodology that analysed the relevant primary and secondary sources. This study, additionally, used South Africa's case study as a comparative analysis to draw lessons that will help Kenya's situation on lack of tax incentives for SMEs specifically.

Based on the outcomes of the study, the youth in Kenya form a large number of the economy and most of them are unemployed. This unemployment does not benefit Kenya's economy in that it undercuts productivity and lowers the economic growth of the country. Kenya's economy is dual as it has both the formal and informal sectors and from the analysis in chapter 3, the youth are seen to get more work opportunities from the informal sector as most of them have not attained high levels of education. SMEs are classified under the informal sector, and they contribute to the economic growth of a country. As seen in chapter 3, SMEs contribute greatly by generating employment for the youth and alleviating poverty. However, these SMEs face problems such as taxes and this hinders their survival. Therefore, there is a need for SMEs to have tax incentives to facilitate their development and enhance their survival. This, in turn, will curb the high level of youth unemployment in Kenya.

5.2 RECOMMENDATIONS OF THE STUDY

This research investigated whether there were tax incentives available for SMEs in Kenya. It also investigated whether any tax incentives are available for SMEs in South Africa that are not available in Kenya which could be introduced to improve Kenya's economy. The research addressed Kenya's tax incentives; however, they were not specific to SMEs, and it also addressed the tax incentives that are available for SMEs in South Africa. Consequently, the research found that South Africa had tax incentives that were specific to SMEs as opposed to Kenya's situation. The following recommendations were made considering the findings of the study with a view that they could enhance the situation of SMEs in Kenya.

The first recommendation is that there should be an elaborate legislative framework. Firstly, they should expand the definition of SMEs to also include a definition of medium enterprises. The *Micro and Small Enterprise Act* has defined micro and small enterprises, but no legislation defines what medium enterprises are. The definitions of medium enterprises given relate to a number of employees, but it would be better to have it written down in legislation. This legislation should also be revised regularly to ensure that it is consistent with the economic growth of the country.

The second recommendation that SMEs in Kenya can use is borrowing from the incentives of SBCs in South Africa. SBCs can claim the cost of their assets over a shorter period as compared to normal deduction periods as found in Sections 12C and 11(e) of the South African *Income Tax Act*. Section 12E (1) of the *Income Tax Act* states that two sets of accelerated capital allowance rates apply to the plant and machinery. The assets may qualify for a 100% write-off if they are utilised directly in a cycle of manufacture or a cycle of a comparative sort.[252] The plant or machinery should be brought into utilisation for the first time by the taxpayer that owns the asset or acquired it as a purchaser under an installment sale agreement and it should be for the taxpayer's trade other than farming and mining.[253] However, there are some criteria to meet to qualify as an SBC in South Africa. These are provided for in Section 12E (4); all the holders of shares in the corporation or individuals should be natural persons throughout the year[254] and they ought not to hold any shares or have any interest in equity of some other corporation other than those

[252] Davis Tax Committee, *Small and Medium Enterprises: Taxation Considerations*, Interim Report, 2014, 16.
[253] Section 12E (1), *Income Tax Act* (Act No 58 of 1962) (South Africa).
[254] Section 12E(4)(a), *Income Tax Act* (Act No 58 of 1962) (South Africa).

corporations that are explicitly excluded,[255] the gross pay of the entity for the year of assessment does not surpass R20 million,[256] the total revenue receipts, accruals and capital gains of the entity may not be more than 20% of investment pay or pay from delivering a personal service[257] and the entity may not be an employment corporation.[258] The SMEs in Kenya can qualify to be SBCs to be able to enjoy the 100% write-off on assets that are brought into utilisation for the first time. Similarly to South Africa, Kenya should adopt the same criteria to enjoy the incentives as this would be specific to SMEs.

The third recommendation is adopting the *South African Employment Tax Incentive Act* in Kenya. From the findings in chapter 4, the ETI has born fruits as there was an increase in jobs in the market for the youth. Kenya could adopt such an Act to ensure that jobs are created and thus, youth employment will be promoted. Kenya could have similar conditions for both employers and employees as South Africa when implementing this tax incentive. Thus, there is a need for the ETI Act as legislation in Kenya.

The fourth recommendation is that the government should give tax reliefs to SMEs. This is seen in the BBI report which recommends that a seven-year tax holiday should be given to businesses owned by the youth.[259] The report states that the youth are to be given technical support to start up their businesses. The government should adopt the recommendations made by the BBI report and incorporate it in the *Income Tax Act*. County governments can also give tax incentives to new businesses that are starting up in their counties by giving funds to enable the business to grow in the first years.

The tax policy reform will help the SMEs to survive despite the taxes that choke them as seen in chapter 3, which will, in turn, grow the economy. When drafting the tax policy, it should contain Adam Smith's principles of equity, certainty, convenience, and simplicity as viewed in chapter 2. Tax incentives work well if they are well designed and implemented. There should be conditions for the effective implementation of tax incentives as viewed in Keynes' analysis in chapter 2.

[255] Section 12E(4)(a)(ii), *Income Tax Act* (Act No 58 of 1962) (South Africa).
[256] Section 12E(4)(a)(i), *Income Tax Act* (Act No 58 of 1962) (South Africa).
[257] Section 12E(4)(a)(iii), *Income Tax Act* (Act No 58 of 1962) (South Africa).
[258] Section 12E(4)(a)(iv), *Income Tax Act* (Act No 58 of 1962) (South Africa).
[259] Republic of Kenya, *Report of the Steering Committee on the Implementation of the Building Bridges to a United Kenya Taskforce Report*, October 2020, 13.

These conditions should be stipulated in legislation as seen in the *Income Tax Act* for SBCs and the *ETI Act*. As seen in the ability to pay theory in chapter 2, the tax policies towards SMEs ought to be adequately accommodating to encourage their financial performance, profitability, and most importantly their survival. Incentives can also be utilised to elevate access to services in Kenya as accommodated in Article 6 of the 2010 *Kenyan Constitution* which provides that the national State organ is to make sure that there is reasonable access to its services in all parts of Kenya. Investors can be persuaded through the tax incentives by the national government to invest in areas that are not popular.

5.3 CONCLUSION OF THE STUDY

The above research has shown that SMEs form a great part of the Kenyan economy in that they create jobs and generate revenue for the economy. Therefore, there is need to have a legislative framework that will provide for tax incentives for the survival of SMEs as seen in South Africa's case study in chapter 4. Chapter 1 provided the problem statement, the research questions, objectives, hypotheses of the study, and literature review which showed us how important SMEs are in the Kenyan economy. Chapter 2 showed us the theoretical framework of Adam Smith and John Keynes which supports the study. This chapter was relevant to this study as it showed how these theories support the study. Chapter 3 tackled the specific study's objectives in that it addressed the establishment of SMEs and their importance in Kenya as they contribute to the economic growth of Kenya and impacts on youth employment. The taxation regime and the challenges facing SMEs were also analysed to show how taxation impacts youth unemployment. In addition, there was an extensive discussion of tax incentives under this chapter. Chapter 4 gave us the comparative study that Kenya can borrow from the South African tax regime of SMEs. This study has shown the importance of incentives to SMEs and that the implementation of the above recommendations will result in economic growth as SMEs will continue to grow without taxes hindering their operations.

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