

**VALUE ADDED TAX POLICY AND BUSINESS  
PERFORMANCE. A CASE STUDY: CENTRAL  
TRADING COMPANY LTD. KAMPALA  
CENTRAL DIVISION, UGANDA**

**BY**

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### DECLARATION

I declare that this research report is my original work and has never been published or submitted before to Kampala International university or any other institution of higher learning for the award of any degree or diploma.

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### APPROVAL

This is to certify that this research report has been done under my supervision and submitted to Kampala International University school of business and management in partial fulfillment for the award of a Bachelors degree of Business Administration of Kampala International University under my supervision.

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## **DEDICATION**

I dedicate this work with love and gratitude, to my parents Mr/Mrs.Wilson Toroitich.

## **ACKNOWLEDGEMENT**

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## **DEFINITION OF TERMS**

### **Threshold person**

This refers to the level of turnover for taxable supplies prescribed by the law at or below which a “person” must register for VAT.

### **Exempt supplies**

Are supplies on which VAT is not charged either the standard or zero rate ( schedule II of the VAT statute).

### **Taxable supplies**

These are business transactions, which are liable for VAT at zero or standard rate.

### **VAT**

Is also referred to as a broadly based consumption tax under which it is imposed at each point of consumption with recognized stages being manufacturing, whole selling and retailing up to the final consumer ( URA Act 1996).

### **TAX**

A tax is a compulsory payment levied by the central government or local authorities payable by a person ( Mulindwa, 2000).

### **Fiscal policy**

Is a tool of government, which uses taxation, public borrowing and expenditure to achieve economic stability and development ( Mulindwa 2000).

### **A commercial enterprise**

Refers to any business of whatever nature and include; ordinary business e.g shops, contractors, manufacturers, wholesalers e.t.c.

**Taxable person**

Is a person registered under section 8 of the VAT statute as a taxable person from the time registration takes effect.

**Input tax**

This is a tax that is charged by suppliers on business purchases and expenses both in Uganda and imported.

## **LIST OF ACRONYMS**

VAT- Value Added Tax

CTL- Central Trading Company

URA- Uganda Revenue Authority

UMA- Uganda Manufacturers Association

COMESA- Common Market for East and Central Africa.

BOE- Bills Of Entry

TIN- Tax Identification Number.

SEC- Section

No.- Number

CIF- Cost, Insurance and Freight.

FREQ- Frequency

## **ABSTRACT**

The study was designed to establish the effect of Value Added Tax policy on business performance of Central Trading Company Ltd. The researcher was triggered to undertake this study by the fact that the company meets with the failure to increase sales and this has a big impact on organizational performance in terms of sales revenue maximization and profitability. The study was conducted to find out the way VAT is imposed and administered, to establish the factors affecting business performance of the company, and the relationship between VAT policy and business performance. The researcher employed a longitudinal and analytical researcher design to analyse Value Added Tax policy and its effect on business performance. The data was collected from both secondary and primary sources through use of interviews and questionnaires. Respondents were selected by use of purposive sampling and simple random sampling. The findings from the study revealed that the company uses accrual accounting method when accounting for VAT. Also findings showed that VAT is charged on the registered persons with a turnover of 50 million shillings in three consecutive calendar months and that VAT is charged on the 15th day of the following month and remitted to URA. It was also discovered that factors like low purchasing power, competition and economic changes affect business performance of the company. Finally, findings indicated an inverse relationship between Value Added Tax and business performance. In line with the findings, the following recommendations were made; the standard rate for VAT of 18 percent should be reduced to say 12 percent. URA also should be able to consider problems facing taxpayers and try to design tax policies accordingly to reduce on the taxpayer's burden.

## **CHAPTER ONE**

### **1.0 INTRODUCTION**

This chapter concentrates mainly on the background of the study, objectives, research questions, scope and significance of the study.

### **1.1 BACKGROUND TO THE STUDY**

In recent years, a lot of efforts and attention in most developing countries have been directed to policies that may stimulate economic growth and development (Tumutegyereize, 1999). Among these policies is the tax policy especially the specific taxes like Value Added Tax (VAT). Before its introduction, domestic indirect taxes were typically limited to narrowly defined products (exercise on alcohol and tobacco for example) and notably, sales turnover taxes. The distortions created by the last kind of tax liabilities, combined using revenue requirements, provided an incentive to seek an alternative less distortionary taxes. Intellectually, the basic idea of VAT appears to have originated with a German businessman, Vio Siemens, writing in the 1920s. There were other developments in the 1920s including the suggestions of the invoice-credit method by Adams (1921).

In recent years, a lot of efforts and attention in most developing countries have been directed to policies that may stimulate economic growth and development (Tumutegyereize 1999). Among these policies is the tax policy.

The role of government is to raise revenue for establishing a conducive environment for private sector, so as to provide the public with goods and services. Tax policy is a component of fiscal policy that looks at taxation (Mulindwa 2000). The goal of this tax policy is to provide revenue to produce social/public goods and services and accelerate economic growth and development of the country (Tumuhimbise 2000). Specific tax policies in Uganda include; income tax, Value Added Tax (VAT) and other taxes such as Import duty, Excise duty, Withdrawal duty and



Comesa duty (Mulindwa 2000). However, this study concentrates specifically on one policy, Value Added Tax (VAT).

In 1996, the Value Added Tax (VAT) was introduced in Uganda to replace the Commercial Transaction Levy (CTL) and the Sales Tax (CT) (Sejjaka 1997). The VAT was considered necessary for broadening the tax base. The CTL was selective, applicable only to service sector and there were problems of valuation and enforcement of this tax. Also, while the sales tax applied to the general spectrum of exports, for domestic production, this tax was limited to the manufacturing sector, thus letting the burden of taxation fall on this sector. Introduction of VAT that applied fairly to both imports and exports was, thus, necessary to promote neutrality and at the same time raise more revenue.

The reforms undertaken by the Ugandan government registered an initial success with tax revenue rising from 7 percent of GDP in 1991 to more than 10 percent of GDP in 1997. Since then, however, tax revenue contributions to GDP have stagnated. This percentage is very low compared to the sub-Saharan African average of 20 percent. Many explanations have been given for the low revenues. For one thing, existence of large-agro based economy means a large part of the population goes untaxed.

Large informal sector which is hard to tax since transactions conducted in this sector are cash-based and not recorded, thereby making it hard to track them. Also the fact that Uganda depends highly on donor funds may lead to laxity in strengthening tax policy and administration since the country has another source of funding.

In 1994/95 Budget Speech, a policy change was announced in Uganda converting sales tax and CTL to VAT which was effected on July 2, 1996 using a standard rate of 17 percent on taxable supplies. However, the National Budget Speech of 2005/06 increased the standard rate to 18 percent is now in application to VAT registered companies. The VAT statute number of 8 of 1996 provides for the imposition and collection of VAT, the responsible body being Uganda Revenue Authority (URA).

Unfortunately, businesses do not have much control over Government policies regarding these issues that affect their competitiveness and ability to survive the economic downturn.

VAT introduction in Uganda created several disruptions in the economic life of the country, most significant of which was the collapse of several businesses during the period 30<sup>th</sup> September 1996 and 7<sup>th</sup> October 1996, which led to a VAT strike (New Vision 1<sup>st</sup> October 1996). Private firms argued that the then 17 percent tax rate was too high, thus would affect their activities, of say importation of material (UMA Budget Report, 1997/98). A company such as Central Trading Company has been in existence for more than 11 years with business units like stationery, imported office furniture and printing. The company pays VAT both on imported finished goods and raw materials as well as spare parts for use in its machines for local production (Kigudde 2005).

Ever since 1998, the company has been paying VAT on its utilities such as electricity, water charges and telephone bills and on the transportation of its imported commodities. Proclamations have been made in the company that VAT among other taxes has reduced the company's sales due to increased prices. This has severely brought about a substantial effect on the company through loss of customers and delayed deliveries as well as low profit margins.

## **1.2 STATEMENT OF THE PROBLEM**

Despite the fact that currently the economic growth rate of Uganda is 7 percent with the highest Value Added Tax in the region of 18 percent, still most companies or businesses perform poorly and others collapsing due to this policy. The introduction of VAT led to collapse of most businesses and nationwide VAT strike (New Vision 1, Oct 1996) of businesses during the period of 30<sup>th</sup> Sept and 7<sup>th</sup> Oct due to diminishing sales volume and profitability levels. Furthermore, failures and delays in filing VAT returns and eventual payment of VAT results in harsh penalties and fines which are often levied by the VAT authorities in the event of non compliance all impacting on the company's activities.

Further still, proclamations have been made on the Value Added Tax policy but refund process is still low, and the period of two years before writing off a bad debt is also long. So the researcher seeks to establish the extent to which VAT affects business performance.

### **1.3PURPOSE OF THE STUDY**

The purpose of the study was to establish the effect of Value Added Tax (VAT) on the performance of businesses in Uganda.

### **1.4OBJECTIVES OF THE STUDY**

- To find out how VAT is imposed and administered on companies.
- To establish the factors affecting business performance in the company.
- To establish the relationship between VAT policy and business performance.

### **1.5 RESEARCH QUESTIONS**

- How is Value Added Tax policy imposed and administered on companies?
- What are the factors affecting business performance in the company?
- What is the relationship between Value Added Tax policy and business performance?

### **1.6 SCOPE OF THE STUDY**

#### **1.6.1 Subject scope**

The study concentrated on VAT policy and business performance. With VAT policy being the independent variable that influences business performance as the dependent variable. There were many measures of business performance such as sales volume, profitability, market share e.t.c but for the purpose of this study, the research concentrated on the sales volume as the major indicator of business performance.

#### **1.6.2 Geographical scope**

The study was carried out in Kampala City on Nkrumah road in Central Division where the company offices are located.

### **1.6.3 Time Scope**

The study covered a period of five years that is from 2006 to 2010. Since the inception of 18 percent Value Added Tax

## **1.7 SIGNIFICANCE OF THE STUDY**

- The study will add to the available literature on taxation and benefits other researchers who might make use of it in future. It will also assist managers in the business arena in identifying the critical factors influencing the competitiveness in business performance and the role of taxes in a competitive environment.
- The study will also help the policy makers in designing policies that are appropriate that is, those that do not discourage production and private investments. In addition, the study will also enable both local and foreign investors to carry out evaluation of VAT on their firms before thorough establishment and investment.

## CHAPTER TWO

### LITERATURE REVIEW.

#### 2.0 INTRODUCTION.

This chapter gives a researcher the ability to analyse and give a critical review of the existing literature on Value Added Tax (VAT) and business performance.

#### 2.1 VALUE ADDED TAX.

Sukumar Mukhopadhtay (2000) cited that, recently Value Added Tax (VAT) has gained the status of one of the most discussed subjects in the media. This is because the decision of the union government to introduce VAT in the states from April 1, 2002. Before that, alot of preparations is necessary which is reportedly in the process. Even then it is necessary to properly appreciate the theoritical and practical aspects of VAT so that an unduly commitment approach does not lead the country up the wrong path. Examining the theoritical side first we find that the fiscal economists justify VAT on three theoritical grounds, which are claimed to be the following;

Weidenbaum (1997) argued that the theory of tax should be neutral (a) between labour and capital, (b) between choices for consumers, and (c) between different allocations of resources. It should not cause distortion in consumer choice or investor's choice. It should not favour capital intensive against labour intensive investments. On the consumption side a neutral tax does not distort consumer choice. It means that a general VAT that does not distinguish between all goods and services leaves consumer with the choice of unbought ( so untaxed) and bought (so taxed) equally.

Sjjebren Cnossen (1996) stressed that cascading occurs when taxable goods are produced using taxed inputs. The cascading effect leads to distortions in allocation of resources. In any case the mechanism to remove cascading is to give credit of input tax alraedy paid which is precisely what VAT is. In any case, the neutrality between bought and unbought is highly ephemeral concept which can only satisfy a philosopher but hardly a consumer in the bigger context. Efficiency in resource allocation and by extension the neutrality advantage of VAT cannot be



attained if prices continue to be controlled by the government and enterprises continue to be subject to proactive fiscal direction.

According to Angelo Faria (1985) it is claimed that zero-rating of exports by making inputs shorn of tax leads to boosting of exports. This has been proved wrong by study of exports in Italy, Sweden, the UK and the Federal Republic of Germany. Introduction of VAT did not have any significant effect on exports. It is the customs union that drives international trade and not VAT. Moreover, VAT is not the only method for zero-rating.

## **2.2 TAX POLICY**

Mohammed (2006) state that, Tax policy can affect entrepreneurial activity in various ways. First, small business income is taxed differently from wage earnings on a paid job. If the business is incorporated, profits are taxed under the corporate income tax system. If a business is unincorporated, profits are often (but not necessarily) taxed as individuals, income under the personal income tax system. Consequently, tax policy influences not only the choice of whether or not to create a new-business, but also how the new firm should be organized, and how profitable it can be. Further, it is well known that various business expenses are tax-deductible, including the cost of certain things that might also provide non-business related consumption benefits. Tax policy also influences the cost of capital, thereby affecting hiring and investment practices among small business owners.

In many ways, small business (and self-employed individuals specifically) are relatively tax favored vis-à-vis wage workers and even larger business in the US. In addition to the deductibility of many business expenses, no third party exists to withhold taxes on behalf of self employed workers. The more normative question of whether tax policy should affect entrepreneurship is perhaps more puzzling. Those in favor of small business tax subsidies use the popular argument that entrepreneurial ventures fuel economic growth and create jobs.

## **2.3 BUSINESS PERFORMANCE**

Buzzel and Gale (1987) argue that while some differences exist in their modeling approach, the numerous studies assessing empirically the effect of strategic factors on profitability essentially



regress profitability measure e.g. Return On Investment (ROI), on observed strategic factors. ROI of a business should be considering its marketing environment, competitive position, and marketing strategy. Variables selected for the equation are based upon four criteria; (1) consistency with economic theory (2) consistency with the beliefs of knowledgeable businessmen (3) statistical significance and (4) controllability by management. Each variable must have at least three of the four criteria to be included in the model. The variables in the model reflect the major categories of environmental attractiveness, competitive position, competitive differentiation, investment effectiveness, and discretionary budget expenditure.

Itam (1985) notes that analysts have tended to define assets too narrowly, identifying only those that can be measured such as plant and equipment. He feels that "invisible assets" e.g. a particular technology, accumulated consumer information, brand name, reputation, corporate culture, management skill, are the real sources of comparative advantage. How strategies affect and are affected by these invisible assets influences a firm's competitive success.

Performance of a business refers to the ability to meet standards, increase market share, and improve facilities. Ensuring returns on profitability and total waste reduction thus once these are achieved a business is believed to be performing effectively Balunywa (1998).

Performance management integrates the situation leadership concept. The three major steps in implementing performance management are performance planning, coaching to reinforce performance plans and develop followers and conducting the formal performance review.

## **2.4 MEASURES OF BUSINESS PERFORMANCE**

The relationship between market share and firm performance has been of considerable interest to researchers and business strategists for several decades. One view holds that the nature of this relationship is causal, and emerges from the structure-performance paradigm (Bain 1995). Specifically it holds that market share causes higher prices and lower costs, thus yielding greater profitability. In the marketing area the work of Buzzell et al (1975) is most typically identified with this view. A different view is espoused by the work of Demsetz (1973, 1974). This view suggests that reverse causality between share and performance; that is, greater efficiency leads to lower costs, which then leads to greater market share yet a third view acknowledges a strong

correlation between market share and performance, but attributes this to skill, luck, or other unobserved stochastic factors. As an example, although the hypothesized effects of market share typically operate through prices and costs, most cross firm market share models employ ROI, not prices and/or costs, as the dependent variable.

Incapacitated production systems it is known to find instances when the demand placed on the system exceeds its productive capacity. Traditionally, the product-mix planning problem has focused on the maximization of the contribution to overall profitability without a consideration for detailed level inventory related setup and holding costs, and setup (times Johnson and Motgomery 1974). By definition, bottleneck facilities cannot meet all the demand placed upon them; hence, the focus here should be on what products to produce and in what quantities, as well as on how inventory related to setup and holding cost minimization.

Grauer, Hakansson and Shen (1990) examined the firm where the investment universe consisted of twelve- value or equal-weighted industry group. They refined the EPAA to generating probability assessments by including an inflation adapter and applied it to the problem of ‘timing the market’ i.e. to the problem of choosing between the value-weighted (IRSP) market portfolio and cash or borrowing. The approach is noteworthy for two reasons. First, the only information provided to the model was realized, past (joint) returns. Second, it sometimes generated statistically significant positive abnormal returns.

Findings on appropriate ethical standards for public relation practitioners are not an easy task (Mc Elreath, 1996). The situational environment is complicated, and opinions are competing most of time. An issue of ethical relativism exists for each situation. Public Relations Society of America (PRSA’s) new code of ethics still contains this complex problem of ethical relativism. PRSA recommends (1) avoiding ‘real, potential, or perceived conflicts of interests’ in order to build ‘the trust of clients, employers, and the public’s’, and (2) to protect confidential and private information of clients.

## 2.5 FACTORS AFFECTING BUSINESS PERFORMANCE

Competition comes in existence from situations where two or more business organizations produce similar products, share the same market. Many economists believe that competition is a fact of life, which must be considered if the business is to prosper. In order to match increasing competition, most companies will produce products that can be bought at relatively low prices. However, this may compromise quality in that customers may purchase infrequently hence performance Drucker (1989).

David and Houston (2000) argued that the most important factors that impact any organization's operations strategy are those set by the customers. The purpose of any operations function is to manage value adding activities inside the business in such a way that customer requirements are met in full. For each element of a product or service that is of concern to the customer, organizations will have an internal response that facilitates the satisfaction of the customers concern thus performance. The most successful businesses are those that can most effectively configure their operations to meet the customer requirements.

Dunne (1999) stresses the importance of financial planning in the business as could help a business to prosper successfully. A retailer or any business owner invests money in merchandise for profitable re-sale to others but this will be impossible if the choice of merchandise is made without effective planning, and as a result is always low profits or loss. Therefore, any business to be successful an individual must have a plan of what to be accomplished.

A business operator should be in a position to decide well the proper strategic place where the products of business can be easily identified by potential customers.

Dunne (1999) asserts that one wise executive's three elements or decisions in retailing are 'locations, location and location' location determines the market share of a business, assuming other factors remain constant. Therefore, a company with a strategic location can easily increase its sales revenue hence performance.

Adock (1995) cited marketing function as one major weapon to be used for the better results of business operations. All business organizations have continuously encouraged their potential customers to buy their products and they must achieve this as efficiently as possible. And this should only be arrived at through implementing marketing functions.

Dennise (1995) advises business organizations with no formal marketing department, in order to succeed to use specialists or managers who initiatively understand market requirements.

Bramble (1990) advises business operators or owners to acknowledge that, a business which carries out advertising as part of marketing function increases its marketing share, which is good news as far as business performance is concerned.

In situations where high currency rates are charged, businesses are forced to increase prices for sustainability of the business hence affecting their performance. This can be as a result of importation in periods for example, when the currency rate is high. Other economic changes like inflation also causes prices to increase eventually cost of production increases as a result supply reduces hence affecting performance (Brown 1990)

**2.6 EFFECT OF IMPOSITION OF A TAX ON BUSINESS PERFORMANCE**

This sub-section explains the effect of imposition of a tax on sales, raw materials, profits and thus total cost of production in the performance of the business.

Musgrave, 1973 maintains that VAT for instance is imposed at each stage of production and that at each stage the value of products is increased and sales prices rises accordingly. Each increment in price reflects the value added at that stage with the value or price of the final product equal to the sum of increments of value added at various stages.

This increment in price will discourage customers and eventually sales reduce accordingly. This is because the total VAT is ultimately incorporated in the price paid by the customers.

In one of the discussion papers presented by Onyach-Olaa, 1992, he argues that high tax rates are some of the major causes of inefficiency and smuggling both of which lead to poor performance and hence a reduction in industrial operations as well as government's revenue. This has brought

about much concern to the extent that some people and even local manufacturers organized under Uganda Manufacturers Association (UMA) Annual Report, 2004

In case of VAT, the basic principal is that it is borne by the final customer. At each stage of production or service delivery the net tax paid is on the value at that stage. Therefore, the total VAT is ultimately incorporated in the price paid by the consumer. Thus the buyer pays a higher price than he would have paid without VAT. Hence customers end buying less due to increase in price hence reduction in sales (Tumuhimbise 2000).

Critics of VAT doubt that it induces efficiency. They claim that in a shortages economy like Uganda, speculative hoarding, non competitive price rise and similar practices are quite common. This impacts on sales revenue negatively in that, in a seller's market producers and sellers have no increase in their efficiency (Indirect Taxation Enquiry Committee Report, 1997)

Much of this literature relates to what is taking place in Uganda in tax regime. The Ugandan scholars, from their literature, shows all what is taking place on the ground especially when it comes to implementation and the effects of the tax policy. Other scholars with no knowledge of Ugandan tax policy still highlight the policies that generally affect taxation worldwide.

All in all, these lay the framework for the tax structure like canons of taxation, but which can now be customized to the local needs/ application to fulfill the objectives of the tax policy.

## CHAPTER THREE METHODOLOGY

### 3.0 INTRODUCTION

This chapter provides the operational framework within which the data is collected and analyzed. It describes the research design, study population, sampling techniques, data collection methods and instruments used in data processing and analysis as well as the study limitations.

### 3.1 RESEARCH DESIGN

The study used both cross sectional and analytical research design to obtain data ranging from 2006-2010. These were further centered on operations within the organization as a unit of analysis.

### 3.2 STUDY POPULATION

The research used 3 senior officials in the company; that is the accountant and the Managing Director to fill in the questionnaire. The researcher also used URA officials, company officials and other employees of central Trading Company. The researcher used a study population of 40 respondents.

### 3.3 SAMPLE SIZE

The study used a sample of 36 consisting of 2 senior managers, 5 URA officials, 5 marketing executives, 3 cashiers and 21 other employees who were categorized accordingly and then simple random sampling was used to select the respondents.

**Table 3.4 showing actual number of Respondents**

Population	Sample size	Percentages
Managing Director	2	6
Marketing Officials	5	14
Cashiers	3	8
URA officials	5	14
Other Employees	21	58
<b>Total</b>	<b>36</b>	<b>100</b>

*Source: primary source*



### **3.4 SAMPLING DESIGN**

In this research, the researcher used purposive sample selection design. This kind of sampling was directly to be made on the important officials in the company such as the Managing director, Marketing Executives, Cashiers, other employees and URA Officials. The selection was done irrespective of the contribution he/she makes to the company in a given period.

### **3.5 DATA COLLECTION METHODS**

#### **3.5.1 Questionnaires**

The research/ study used the structured questionnaires with questions for the respondents to answer. The types of questions used were free choice, multiple questions and a few open-ended questions. The questionnaires were used because of its effectiveness to elicit information from a large sample in the shortest time possible through written responses.

#### **3.5.2 Interviews**

The researcher used formal interviews as the major method of data collection which enabled the researcher to deal with respondents directly to get first hand information, explain some hard questions and at the same time have a direct interaction with the officials of the company, employees and authority implementers.

### **3.6 sources of data**

In an attempt to establish the effect of VAT policy on business performance, the sources from which data was extracted include both primary and secondary data sources.

#### **3.6.1 Primary sources of data.**

The study used questionnaires and face to face interviews to collect primary data with the aid of an interview guide. Structured questionnaires were administered to enable the researcher to analyze the effect of Value Added Tax (VAT) policy on business performance.

#### **3.6.2 Secondary sources of data.**

The secondary sources of data consisted of company's records, particularly from annual reports in the accountants departments as well as the sales department. The researcher also used relevant documents such as textbooks, publications and journals.

### **3.7 DATA PROCESSING AND ANALYSIS**

The data was processed manually. This involved the use of frequency tables from the questionnaires. After the fieldwork, questionnaires were scrutinized, edited, classified and data

analyzed. Correlation was used to measure the relationship effect between VAT policy and business performance.

## CHAPTER FOUR

### PRESENTATION, INTERPRETATION, DISCUSSION AND ANALYSIS OF FINDINGS

#### 4.0 INTRODUCTION

This chapter concentrates mainly on presentations, interpretation, analysis and discussion of findings. These findings are in line with the objectives and answer the research questions stipulated in chapter one. In the presentation and analysis, the researcher used frequencies (freq), percentages (%ages) and correlation coefficient.

#### 4.1 FINDINGS ON BACKGROUND INFORMATION

##### 4.1.1 Response rate

From the analysis of the questionnaires used, the response rate is summarized in the table below;

**Table 4.1.1 showing actual response rate**

Category	Actual no. of respondents	%ages
Managing Director	2	6
Marketing executives	5	14
Cashiers	3	8
URA officials	5	14
Other employees	21	58
<b>Total</b>	<b>36</b>	<b>100</b>

*Source: primary data*

From the table above, most of the respondents were employees shown by 58 percent, URA officials were 14 percent, marketing executives 14 percent, cashiers were 8 percent, and Managing Director 6 percent. Anticipated number of respondents was 40 and the actual number of respondents was 36. This represented 90 percent of the expected responses. It can therefore be concluded that, the researcher reached almost every respondent and necessary data was obtained.

4.1.2 Gender respondents

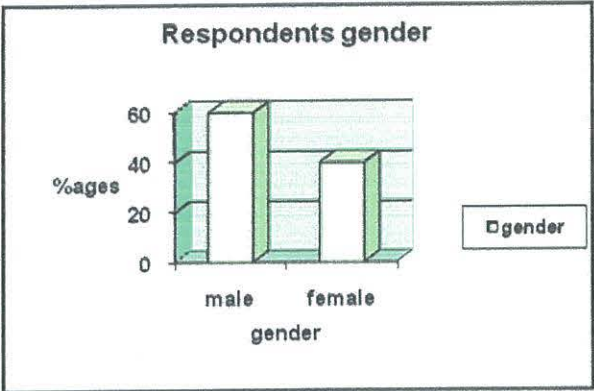
Findings on the gender of respondents showed that 20 of respondents were male and 16 of them were female. The researcher was therefore gender sensitive. This is illustrated below;

Table 4.1.2 showing respondent's gender

Response	Frequency	%ages
Male	20	60
Female	16	40
Total	36	100

Source: primary data

Figure 1 showing respondent's gender



Source: primary data

From the figure above, it is shown that 60 percent of the respondents were male and 40 percent were female. This gave the researcher unbiased information in addition to random sampling.

4.1.3 level of education

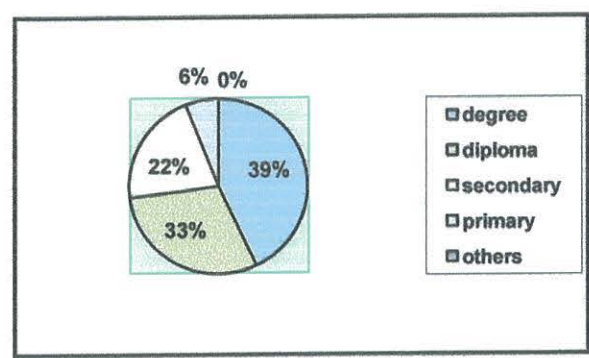
Findings on the level of education were obtained from the questionnaires and this is illustrated below;

**Table 4.1.3 showing respondents level of education**

Level	Frequency	%ages
Degree	14	39
Diploma	12	33
Secondary	8	22
Primary	2	6
Others	0	0
<b>Total</b>	<b>36</b>	<b>100</b>

*Source: primary data*

**Figure 2 showing respondents level of education**



*Source: primary data*

The figure above shows that most of the respondents were degree holders represented by 39 percent, diploma holders were 33 percent, 22 percent were holders of secondary certificate, 6 percent were primary leavers and non were other educational levels, this therefore enabled the researcher to obtain accurate and concrete data from respondents with knowledge, experience and skills in business management and administration as well as taxation issues.

This implies that, respondents could prepare books of accounts in compliance with International Financial Reporting Standards (IFRS) therefore, the data provided could be deemed accurate and reliable. In conclusion, respondents were aware of the taxation issues whereby taxation laws were complied with. This therefore means that correct amounts of VAT are paid and losses

inform of fine, penalties, interests that accrued from delays in filing of VAT returns, misrepresentation are minimized

When asked about how long the company has been in existence, the researcher found out that the company has been in operation for more than 10 years. The researcher further discovered that the company deals in products like; office furniture, stationery and printing. This shows that the company deals in both standard and zero-rated supplies and as such paid VAT at a rate of 18 percent for the years 2006 to 2010.

Response from the company officials indicated that, 18 percent rate was too high constraining their sales performances. It was also found out that most of these products are imported and a few bought and made within. However, these imports carry an input VAT subsequently forcing the company to increase its prices in order to recover the costs of sales and this resulted into a decrease in demand for the company products. This is in agreement with Musgrave (1973).

**4.2 VALUE ADDED TAX POLICY ADMINISTRATION**

In relation to the first objective of the study, the researcher had to find out the way VAT is imposed and administered on companies. The study found out the following;

**4.2.1 VAT Registration**

Findings got from the questionnaires revealed that for a company to register for VAT it must have a taxable turnover of not less than shs.50 million for three consecutive calendar months as of July 2010. When asked whether a company can be registered if its turnover is below the shs.50m, the following responses were got as illustrated below;

**Table 4.2.1 showing whether a company with turnover of sales less than 50m can register**

Category	Frequency	%ages
Strongly Agree	-	-
Agree	3	8
Not sure	10	28
Disagree	14	39
Strongly Disagree	9	25
Total	36	100

*Source: primary data*

From the table 4.3.1 above, it is shown that 39 percent of the respondents disagree that a company can be registered if its turnover is below 50m in three consecutive months, 25 percent strongly disagreed, 8 percent agreed, and 28 percent were not sure.

This implies that company respondents seemed not to be aware of the minimum requirements for official VAT registration. If a company is liable to register and does not apply to register at the proper time, it commits an offence under VAT law and hence liable for a financial penalty. This penalty becomes an expense to the company which reduces profits hence performance. In this case Central Trading Company ltd was liable to register for VAT due to the fact that, it makes a gross taxable turnover of more than 50m in three consecutive months. This justifies the company's obligation to pay VAT on its taxable supplies. However, the VAT paid increases price and leads to reduced sales revenue hence performance.

#### **4.2.2 VAT collection method**

When respondents were asked the VAT collection method used, they gave the following responses as illustrated below;

**Table 4.2.2 showing method of VAT collection used**

<b>Method</b>	<b>Frequency</b>	<b>%ages</b>
Accounts method	25	69
Invoice method	-	-
Not sure	11	31
<b>Total</b>	<b>36</b>	<b>100</b>

*Source: primary data*

From table 4.2.2 above, it is shown that 69 percent of the respondents agree that the company uses accounts method of VAT collection where the tax authority asks the company to pay its tax on the base determined by the tax authority. However, 21 percent of them were not sure as to the method of VAT collection used.



This required the company to file its returns applying 18 percent and 0 percent rates on their taxable supplies and payment made on the 15<sup>th</sup> day of the following month. The VAT that the company charges on its goods and services is the output VAT incorporated in the price charged to customers, hence a burden pushed to customers in form of high prices. This is in agreement with Tumuhimbise (2000) that VAT is borne by the final consumer who pays a higher price and may end up buying less hence affecting the performance of the company.

#### 4.2.3 Rates of VAT used by URA

The researcher found out that during the years 2006 to 2010 a standard rate of 18 percent and 0 percent were used by the company. The response is illustrated below;

**Table 4.2.3 showing the rates of VAT**

Rates	Frequency	%ages
Standard	20	56
Zero	16	44
Not sure	-	-
Others	-	-
Total	36	100

*Source: primary data*

According to the table 4.2.3 above, findings gathered reveal that, 56 percent of the respondents agreed that there is a standard rate of 18 percent. Whereas, 44 percent agreed that there is also a zero rate of 0 percent. The company was then required by law to use the two rates when and where applicable.

The standard rate (18 percent) applied to all goods and services except those currently specified in schedule II (exempt goods and services) and schedule III (zero-rated goods and services) of the VAT law. Yet the zero rate applies to zero-rated supplies of the VAT statute 1996.

In this case, Central Trading Company Ltd, according to the accountant used both 18 percent and 0 percent rates. The zero rate is applied on supply of educational materials like books, files,

photocopying papers, printing papers and printing services for educational purposes. This means that price of such zero-rated products and services may be low. However, prices of other products with VAT of 18 percent were high and as a result scared away customers hence impacting on sales performance. If this rate is not reduced, the company is bound to have a continuous trend of poor performance in terms of reduced sales revenue and profitability.

#### 4.2.4 Findings on how often VAT is charged

The study established that VAT is charged on the 15<sup>th</sup> day of the following month. This is illustrated below;

**Table 4.2.4 showing how often VAT is charged**

Response	Frequency	%ages
Annually	-	-
Once a month	-	-
15 <sup>th</sup> day of the month	26	72
Not sure	10	28
Others	-	-
<b>Total</b>	<b>36</b>	<b>100</b>

*Source: primary data*

From table 4.3.4 above, it is shown that 72 percent of the respondents agree that VAT is often charged on the 15<sup>th</sup> day of the following month while 28 percent of them were not sure as to when VAT is charged.

This is in conformity with VAT statute; section 32(1), 1996 which states that failure to submit the VAT returns by the 15<sup>th</sup> day of the following month is tantamount to a penalty on top of incurring an interest. The implication is that, the company incurs an expense in form of a penalty and interest charge which in turn reduces profits of the company hence performance.

#### 4.2.5 Findings on calculations of VAT

The researcher established that in calculating the amount of VAT to remit to URA, the taxpayer should first of all add the margin on the CIF value and thereafter apply the VAT rate applicable.

Under the statute, the formulae for computing VAT are;

Tax Payable = Output tax – Input tax (Output tax exceeds Input tax for a tax period).

Tax Claimable = Output tax – Input tax (Input tax exceeds Output tax for a tax period).

Where invoice/receipt value;

- a) Excludes VAT, 18 percent is applied on the invoice value.
- b) Includes VAT, 18/118 is applied on the invoice value.

Where 18 percent is the current standard rate (National Budget, 2005/06)

The implication of this is that VAT leads to an increase in the selling price which in turn minimizes customer demand for the company products.

#### **4.2.6 Accounting for VAT**

On an interview with the URA officials, the researcher found out that, every registered person is required to account for VAT at the end of each tax period. The tax period for VAT is the calendar month. The company thus compiles the totals of input tax and output tax for the tax period.

There are basically two main ways in which VAT is accounted for by companies. This includes the cash and/or accrual accounting methods, which are stipulated under section 27 of the VAT statute, 1996.

The cash accounting method is where VAT is paid instantly at the time of purchase of goods in cash. With accrual accounting method on the other hand, the company meets the VAT in the goods purchased by the consumers.

In other words, the VAT is paid before the sale of the product. This normally takes place when the company offers credit facilities to its consumers. The researcher established Central Trading Company Ltd uses accrual accounting method whereby its VAT liability is paid before the purchase of the products. In other words, VAT is paid in advance and the implication is that, the company's working capital is reduced and hence crippling its performance.

### 4.3 BUSINESS PERFORMANCE

The researcher sought to measure business performance basing on its sales revenue over a period of 10 years from 2006-2010. The response is illustrated below;

#### 4.3.1 Total sales performance in the corresponding years (2006-2010) in millions

**Table 4.3.1 showing sales in millions**

Years	Sales (performance
2006	2,015
2007	2,089
2008	1,698
2009	1,457
2010	1,227

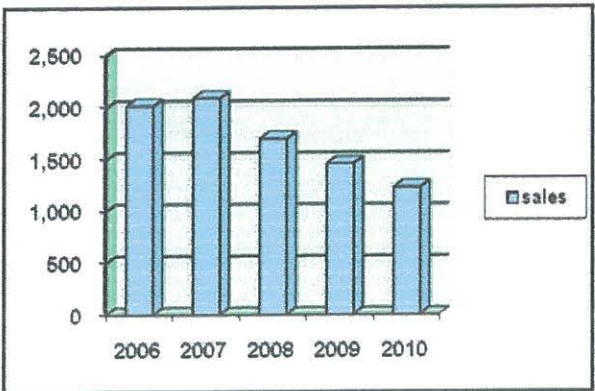
*Source: central trading company ltd*

From table 4.4.1 above, it is shown that the company's sales performance has been declining over the years since 2006. This decline is due to the fact that high prices reduce customers' number and making the company's products lowly demanded. The reason for the high prices is Value Added Tax component added to the price charged.

This is in agreement with Musgrave (1973), who indicated that VAT is incorporated; in the price charged to the customer and that the consumer pays a higher price than he would have paid without VAT. This leads to a reduction in the consumption of company's products hence affecting their performance.

This can be further illustrated in the figure below;

**Figure 3 showing sales performance**



*Source: primary data*

According to the company officials, the sales trend in figure 3 above was attributed to the increase in prices charged per item. Customers shifted from purchasing the company’s products, the reason being that prices were high. Thus affecting the rate at which customers frequent the premise to trade, this in turn reduces their performance in terms of sales.

From the analysis of the questionnaires, the researcher discovered that, on average the company serves between 20-100 customers per month. According to the Managing Director, this was not a good performance and if the tax rate is not reduced, it may hinder the company’s success hence collapses.

This was also emphasized by Hardwick et al (1990) that, VAT leads to distortions in relative price and may impose a burden on both the producer and the consumer implying that consumers will not buy hence reducing sales which may translate into poor performance.

**4.3.2 Findings on how often customers buy goods and services**

The findings from the study indicated that most of the customers buy infrequently and others occasionally. This is illustrated in the table below;

**Table 4.3.2 showing how often customers purchase goods and services from the company**

Response	Frequency	%ages
Regularly	-	-
Occasionally	16	44
Infrequently	20	56
Others	-	-
<b>Total</b>	<b>36</b>	<b>100</b>

*Source: primary data*

It is shown from table 4.3.2 that 56 percent of the respondents said that most of the customers purchase infrequently and 44 percent occasionally. The reason given was that the company charges higher prices compared to other firms in the industry.

This therefore makes the customer to shift to other companies where prices are affordable thus reducing the company's sales volume hence affecting performance.

#### **4.4 Testing for the relationship between VAT and business performance.**

Findings got from the company officials showed that there was a strong inverse relationship between VAT and business performance.

It was said that such performance originates from the fact that relatively high prices are charged in which VAT is inclusive. This negatively affects the overall performance of the business. The above relationship can further be emphasized using the correlation analysis as shown below;

**Table 4.4.1 showing total sales in the corresponding years (2006-2010) million**

Years	Sales (performance)	VAT (millions)
2006	2,015	0
2007	2,089	16
2008	1,698	182
2009	1,457	152
2010	1,227	231



Source: central trading company ltd

To confirm the inverse relationship that existed within the period ranging from 2006-2010, the researcher used Pearson's correlation coefficient to find out the relationship between VAT and performance.

Assuming VAT is represented by X and business performance is represented by Y.

The above data can be tabulated as shown below;

**Table 4.4.2 Pearson correlation coefficient**

X	Y	XY	X <sup>2</sup>	Y <sup>2</sup>
0	2,015	0	0	4,431,025
16	2,089	33,424	256	4,363,921
182	1,698	309,036	33,124	2,883,204
152	1,457	221,464	23,104	2,122,849
231	1,227	283,437	53,361	1,505,529
581	8,576	847,361	109,845	15,306,528

The correlation coefficient  $r = \frac{N\sum XY - \sum X \sum Y}{\sqrt{[N\sum X^2 - (\sum X)^2][N\sum Y^2 - (\sum Y)^2]}}$

$$\sqrt{[N\sum X^2 - (\sum X)^2][N\sum Y^2 - (\sum Y)^2]}$$

Therefore,

$$r = \frac{5(847,361) - (581)(8,576)}{\sqrt{[5(109,845) - (581)^2][5(15,306,528) - (8,576)^2]}}$$

$$r = -0.938$$

$$r = -0.94$$

This shows that there is a very strong negative relationship between VAT and performance of business and this is because the relationship is tending to -1 (negative one).

## **CHAPTER FIVE**

### **SUMMARY OF MAJOR FINDINGS, CONCLUSION AND RECOMMENDATIONS**

#### **5.0 INTRODUCTION**

This chapter gives the summary of major findings, conclusion drawn from discussion of findings, recommendations and areas for further research. Having carried out the study, presented data, as well as analysis of findings, this chapter then reviews the outcome of the study in line with the objectives.

#### **5.1 SUMMARY OF FINDINGS**

In relation to the findings on VAT administration and imposition, the researcher found out that the company uses accrual method to account for VAT. This is whereby VAT is paid before the sale of the product. It was further established that URA used two rates of VAT i.e. the standard rate of 18 percent and a zero rate of 0 %.

However, prices of other products with VAT of 18 percent were high as a result scared away customers hence affecting business performance. If this rate is not reduced, the company is bound to have a continuous trend of poor performance in terms of reduced sales performance and profitability.

Findings further showed that for a company to register for VAT it must have a taxable turnover of not less than 50million shillings for three consecutive calendar months. This implies that if a company is liable to register and does not apply to register at the proper time, it commits an offence under the VAT law and hence liable for a financial penalty. This penalty becomes an expense to the company which reduces profits hence performance.

VAT is often charged on the 15<sup>th</sup> day of the following month and paid to Uganda Revenue Authority through authorized Banks like Standard Chartered Bank, Stanbic Bank, Centenary Rural Development Bank and Orient Bank.

The findings also showed that other than VAT, there are other factors that affect the performance of the business and this mainly included, low purchasing power, competition, lack of trained manpower and economic changes (dollar prices).

According to researcher's findings, this was an inverse relationship between VAT policy and business performance. In fact, VAT led to a decrease in customers demand for the company's products. Therefore as the value of VAT increases, performance reduces at a relatively higher rate.

## **5.2 CONCLUSION**

In conclusion, the researcher noted that Central Trading Company ltd is a VAT registered company which paid VAT on its taxable supplies at rates of 18 percent and 0 percent. It was observed further that on the point of administration of Value Added Tax, the URA had relatively administered tax poorly.

However, it was further found out that, sales of the company have been continuously declining since 2006 due to other factors other than VAT. These other factors include competition, low purchasing power, economic changes and inadequate trained man power. It can thus be concluded that VAT and those factors outlined above led to the poor performance of Central Trading company ltd over the five years period from 2006 to 2010.

Therefore, for the company to survive in this current economic situation, it has to increase its prices and cut on its costs. For the company to be charged a relatively lower value of VAT, it should be able to defend itself in the 'eyes' of the authority implementers; URA. That is by having clear books and also having properly imported goods with proper documentation such as the bills of entry (BOE).

## **5.3 RECOMMENDATIONS**

In light of the findings the effect of VAT policy on business performance can be reduced if some measures are considered;

- In order to encourage payment of VAT, the URA officials should ensure that there is sound administration of taxes.
- Companies should also try to adjust to other factors that affect business performance other than tax in order to compete effectively.
- URA should also try to put up committees, which will be able to forward problems which tax payers face in order to reduce on their burden. And in a way be able to incorporate such problems when designing the tax policies.
- Companies should try their level best to employ highly skilled man power. Accountants who understand how VAT policy is supposed to be carried out and accounted.
- Both the companies and the Uganda Revenue Authority should come together and align their differences so as to harmonize their relationship.
- URA should embark on tax awareness activities through tax education, seminars, workshops and conferences. This will actually lower the costs of administration and implementation.

## **5.4 AREAS OF FURTHER RESEARCH**

Most research needs to be done in the following areas;

- The contribution of VAT collection on government revenue.
- Effects of VAT on the cost of production.
- VAT and revenue collection.

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APPENDIX A: RESEARCH INSTRUMENTS  
**RESEARCH QUESTIONNAIRE: FOR URA OFFICIALS.**

Dear Respondents,

I am a student of Kampala International University conducting a research on “Value Added Tax policy and Business performance”. A case study of the Central Trading Company Ltd. This is part of the requirement for the award of the degree of Bachelor of Business Administration of Kampala International University.

Your response will be treated confidentially and all the information provided will be published only for statistical operations. Your cooperation will be highly appreciated.

**PART I General information**

Department .....

Position in URA.....

Sex      Male      ☐      Female      ☐

Age of respondents

- |                |                          |                  |                          |
|----------------|--------------------------|------------------|--------------------------|
| a) 20-29 years | <input type="checkbox"/> | c) 40-50years    | <input type="checkbox"/> |
| b) 30-39 years | <input type="checkbox"/> | d) Over 50 years | <input type="checkbox"/> |

**PART II VAT policy and Administration**

1. What are the rates of VAT?

- |                  |                          |             |                          |
|------------------|--------------------------|-------------|--------------------------|
| a) Standard rate | <input type="checkbox"/> | c) Not sure | <input type="checkbox"/> |
| b) Zero rate     | <input type="checkbox"/> |             |                          |

2. How often is VAT charged?

- a) Annually ☐ c) 15<sup>th</sup> day of the following month ☐  
 b) Once a month ☐ d) others (specify).....

3. How is VAT charged?.....  
 .....

4. Who are the persons liable for VAT?.....  
 .....

5. What factors are considered for the company to register?

- a) Creditable input ☐ d) Obligation ☐  
 b) Principle trading ☐ e) others (specify).....  
 c) Taxable supplies ☐

6. A company/individual can register for VAT before commencement of business.

Strongly Agree	Agree	Not sure	Disagree	Strongly Disagree

7. A company can be registered if its turnover is below the limit i.e. 50m?

Strongly Agree	Agree	Not sure	Disagree	Strongly Disagree

8. What are the taxpayer's responses towards VAT policy?

Positive	Negative	Not sure

9. Give reasons for your answer in (8) above.....

.....

10. a) Do you encounter problems in the administration of VAT?

Strongly Agree	Agree	Not sure	Disagree	Strongly Disagree

b) If you strongly agree or agree give any reasons.....

.....

## RESEACH QUESTIONARE: FOR CENTRAL TRADING COMPANY

Dear respondent,

Iam a student of Kampala Intenational university conducting a research on “Value Added Tax Policy and business performance”. A case study of Cental Trading Company as part of the requirement for the award of the degree of Bachelor of Kampala International University.

Your responce will be treated confidencially and all the information provided will be published only on statistical operations.

Your cooperation will be highly appreciated.

### PART I: ( General information)

(please tick or fill in when appropriate)

Department .....

Position in the company.....

SEX:    male        ☐                      Female                ☐

#### 1. Age of respondents

- |   |   |
|---|---|
| a) 20-29 years <input type="checkbox"/> | c)40-50 years <input type="checkbox"/>    |
| b) 30-39 years <input type="checkbox"/> | d) over 50 years <input type="checkbox"/> |

#### Education levels

- |                                     |                                       |
|-------------------------------------|---------------------------------------|
| a) Degree <input type="checkbox"/>  | c) Secondary <input type="checkbox"/> |
| b) Diploma <input type="checkbox"/> |                                       |

## PART II (product information)

2. Which product materials does the company deal in?.....  
.....
3. What are the products liable for VAT payment?.....  
.....
4. What are the sources of products/materials produced or sold by the company?
- a) locally produced ☐ c) both ☐  
b) imported ☐

## PART III (VAT policy)

4. Which VAT collection method do you use?
- a) Accounts method ☐ c) Not sure ☐  
b) Invoiced method ☐
6. How do you calculate your VAT liability?.....  
.....
7. Which books of accounts does your company prepare for VAT purposes?.....  
.....

## PART IV Business performance

8. On average, how many customers do you serve per month?
- a) Between 20-100 ☐ c) Between 500-1500  
b) Between 100-500 ☐ d) others (specify).....
9. How often do your customers purchase goods from the company?
- a) Regularly ☐ c) Infrequently  
b) Occasionally ☐ d) others (specify) .....

10. How are products bought in the company fairing in the market?

- a) Highly demanded ☐ c) Lowly demanded ☐  
b) Fairly demanded ☐ d) Not demanded ☐

11. i) How have customers responded to your products?

- a) Positively ☐ b) Negatively ☐ c) Not sure ☐

ii) Give reasons for such response.....

.....

#### **PART V Relationship between VAT policy and business performance**

12. a) VAT affects your business substantially

Strongly agree	Agree	Not sure	Disagree	Strongly disagree

b) If you agree, how does it affect your business?.....



## **APPENDIX B: INTERVIEW GUIDE**

### **FOR CENTRAL TRADING COMPANY LTD**

1. Does your company pay VAT?
2. How often do you pay VAT?
3. Briefly comment on the performance of the company as far as VAT is concerned.
4. Does your file VAT RETURNS?
5. How often do your customers purchase goods from you company?
6. In comparison with other companies, are the prices charged on the company's Products higher than those charged in other companies?
7. What problems are you facing with Administration of VAT policy?
8. Are you satisfied with the way VAT is administered in Uganda?
9. How do you calculate VAT that is remitted to URA?
10. In your opinion, what factors are affecting your business performance?

### APPENDIX C: TIME FRAME

The research study lasted for a period of September to October 2011 in this period the researcher listed and interviewed respondents, analyzing and interpretation of acquired data, collected questionnaires, data coding, cleaning and entry, analyzing and interpretation of acquired data.

Activity	Time in month			
	1	2	3	4
Dissertation writing				
Data collection				
Data analysis				
Submission				

## APPENDIX D: THE BUDGET

The plan below shows the expenses that were encountered during the course of my research. The expenditures are shown in the table below

Descriptions for various expenditures	Expenditure in Uganda shillings
Telephone calls	20.000
Transport	10.000
Internet usage	15.000
Typing and printing	20.000
Research bag	10.000
Total	75.000