

**EFFECT OF TAX INCENTIVES ON FINANCIAL PERFORMANCE OF  
DOMESTIC AIRLINES IN KENYA**

**BY**

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## DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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## ABSTRACT

Performance of domestic airlines in the past it is not encouraging and through the introduction of tax incentives, they started experiencing some sort of relief, which were based on motivation to invest which enhanced their growth. It is therefore for this reason that the researcher sought to establish on how tax incentives had affected performance of domestic airlines in Kenya. The specific research objective was based on determining the on how corporate tax income incentives had had an effect on domestic airline financial performance, to determine the effect of tax holiday incentives on domestic airline performance, and to analyze the effect of capital allowance incentives on domestic airline performance. The study employed a descriptive research design, with the target population being the 15 domestic airlines in Kenya. The sampling technique used was census technique due to the fact that the target population was manageable. Secondary data was used in this study which was collected from the financial reports of the airlines within a period of 5 years from 2015-2019. The data was analyzed with the help of SPSS version 26 whereby diagnostic test was done through multicollinearity, heteroscedasticity as well as normal test from the regression model which was used to analysis the panel data collected and the presentation was through the help of figures and tables. The study after data analysis revealed that their corporate income tax and tax holiday which were the independent variables were found to be satisfactory in explaining the financial performance (return on asset) of Kenyan domestic airlines. Because the p-values of the tax holiday and capital allowance are statistically significant. p-value of corporate income tax which was statistically insignificant b based financial results. As a result, the study recommended that because corporate income tax has an impact on return on asset of an entity, the management of Kenya's domestic airlines should make better use of other tax breaks. They should also use the tax holiday to seek additional tax relief in their investments so that they can be protected from the negative risk of operation when the corporate income tax is highly induced without taking the tax incentive perspective into account. Tax holidays in terms of aggressiveness and adverse tax shielding in order to protect themselves from harsh taxation bases. As a result, management should consider pursuing additional tax breaks in order to boost their return on asset. Kenya's domestic airline management should make better use of capital allowance when given this type of incentive. The study also recommends that the Kenyan government improve existing policies to enhance ease of undertaking business activities through reduction of bureaucracy in obtaining share and debt financing for domestic airlines.

**Keywords:** tax incentives, corporate income tax, tax holidays, capital allowances and performance.

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## **DEDICATION**

I wish to dedicate this research project to my family who have been so instrumental by ensuring they financially supported me as much as they can. More also I would also dedicate it to my friends and colleagues who offered me support when I did not get the necessary research materials. May God abundantly increase you through his blessings.

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## **ACRONYMS AND ABBREVIATIONS**

EPZ	:	Export Processing Zones
FDI	:	Foreign Direct Investment
GDP	:	Gross Domestic Product
VAT	:	Value Added Tax

## OPERATIONAL DEFINITION OF TERMS

**Tax Incentives** - Tax incentives are a booster for local organization to invest.

This

means that it is kind of a relief that if offered to businesses in terms of tax relief so that they can invest more with encourages their growth (Kaplan, 2011).

**Capital Allowance** - It refers to the amount that can be deducted from a business from its overall reduction of tax in corporate entities based on the profit attained (Kuria, 2016)

**Corporate Income Tax-** Refers to reduction of income tax on any income that qualifies to a particular type of activities especially in manufacturing activities or locations. The rate may be verse and may be applied to domestic income sources or foreign source (Ohaka and Agundu, 2012)

**Tax Holidays** - are periods when taxes are reduced or eliminated on seasonal basis (Chege, 2020).

**Performance** - Refers to an overall achievement after a business has been able to achieve its mandate through meeting the operational objectives and goals whereby in previous literature, different factors contributed to performance of different entities which is not an exclusive of

airlines

(Kamunge,2014).

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Both wealthy and poor nations have governments that levy taxes to pay for public services. According to Marina and Danijela (2012), taxes are the only known viable way to raise money to pay for government expenditure on the commodities and services that all citizens use. Technically speaking, though, this is incorrect because developing nations also receive funding from non-tax sources, such as user fees and licenses levied for services provided by departments, agencies, and ministries, as well as cash gained from the privatization and sale of public assets. In addition, a lot of developing nations depend on foreign help as a source of cash (Barnett & Grown, 2014).

In wealthy nations, tax incentives take many different forms, including deductions for asset investments, rapid depreciation, and inventive strategies to offset R&D costs. Tax breaks for businesses that use creative work might come in the form of venture duty credits, accelerated devaluation, and advantageous expense provisions in industrialized nations. According to Tembur (2016), Kenyan conditions call for tax exemptions, tax holidays, allowances and subsidies for investments, special zones, faster depreciation, and lower tax rates. The corporate tax rate for a resident firm is 30%, whereas the rate for a non-resident company is higher at 37.5%.

Tax incentives acts a booster for local organization to invest. In this, it implies that the governments all over the world use it to ensure that they motivate their source of incomes (entities) in their economic endeavors (Kaplan, 2011). The peripheral tax incentives are based on boosting investment of companies in order to enable them report high growth rate which induces performance (Ngure, 2018). The use of tax incentives by the government is used to attract private investment which has not been encouraged previously and therefore through embankments of tax incentives, they enroll in the sector (Agundu, 2012). They are mostly

offered to offset actual or perceived differences which are incurred during the process of doing businesses in different operational context. These differences might arise from tax difference or in the process of transportation, labor sector or any other cost which are a result of utilization (Agundu, 2012).

In their part Harb and Shaqqour, (2016) noted that a tax incentive is a government-provided exemption, reduction also a deduction related liability from tax which is offered to investors so as to promote their trade engagement which is based on the variation of their returns. A tax incentive, according to Feyitimi, Temitope, Akeem, and Oladele (2016), is a provision in the tax code that provides preferential tax treatment to certain activities over time, such as manufacturing versus nonmanufacturing industries and certain organizational forms of business over others, such as incorporated versus unincorporated organizations. Tax incentives include special exclusions, exemptions, special credits, preferred tax rates, and tax liability deferral (Ohaka & Dagogo, 2015). Tax breaks include tax exemptions, the deductibility of certain expenses, and lower import tariffs or customs duties (Gebremedhin & Saporna, 2016).

Tax incentives are available all over the world and are constantly improving. They are tax breaks that allow for more favorable duty treatment of specific exercises or segments than is granted to the general industry. Tax incentives are effective in ensuring that there is smooth flow of the operations of an organization. They more to ensure that the operations of an organization are not lamed by taxes which causes the firms to have crisis of operations. The Institute of Economic Affairs (2012) defines a tax incentive as any arrangement that provides any individual or action with favorable conditions that differ from the standard provisions of excise legislation.

According to Ohaka and Agundu, tax-advantaged businesses frequently produce higher returns (2012). Tax benefits can increase investment attraction, which improves a

company's capacity to turn a profit. Tax incentives increase employment and encourage independent contractors to form limited companies, which improves the financial performance of businesses because limited corporations outperform sole proprietorships because they can evaluate outside sources of funding (Philips, 2011). Due to fewer costs, businesses will report larger net profits, resulting in strong financial success. This is especially true when the government offers financial aid to businesses, grants, low interest rates on loans, lower labor costs, and improved transportation infrastructure to cut down on transportation costs.

The financial performance of a company's policies and operations can be assessed with the help of economic growth. The amount of profit a firm generates from its assets, investments, and long-term value growth can be used to evaluate its performance (Barth, 2014). Financial development also enables us to assess how effectively a company is using its resources to generate higher profits. Examples of well-known economic growths include asset net worth, operating revenue, gains before taxes and interest, and others. It is crucial to keep in mind that no single interpretation of monetary expansion should be taken into account independently (Adam, 2014). When assessing a company's performance and growth, all growth indicators are carefully taken into account. The ability of a business to use its property rights from key sources to generate large amounts of money is a key factor in determining economic growth. Financial performance is essential when comparing businesses in the same industry or even when comparing large organizations since it may be used to convey general judgments of a company's financial health over a certain period (Almazari, 2011).

By focusing on financial management and the overall economic environment, aviation companies could retain long-term profitability while maintaining effective and well-managed internal operations. Since it influences both short-term and long-term decisions, the financial success of aviation firms is essential. Operational rather than financial success was prioritized

in earlier research on the performance of airlines (Barth, 2014). Because it measures statistics like available seat kilometers, load factor, and income per kilometer, operation performance has become more and more popular. The significance of analyzing an airline's financial performance in terms of profitability, liquidity, and solvency is still stressed by Feng & Wang.

It is typically given to individuals who participate in activities that the government wishes to promote. A step that has a positive impact on the person, for that individual or action, or any measure that allows for a more cost-effective treatment of specific exercises or segments than what is available to the general business. It is a strategy for increasing and expanding foreign investment through lower tax rates, as well as energizing private sector investment in monetary and social projects in which the government plays a key role (Waris et al., 2008).when the organizations are faced off which crisis of tax, they always seeks for tax relief and these in large corporates is based on the incentives they are being granted to ensure that they do not fall short of their operations as long as they can be able to complement their value addition to the general economy of a country

This offsetting of certain costs improves performance of an entity due to its speeding up of operations (Phillip, 2010). Incentives are mostly used to raise the return on asset which thereafter makes investment to be more attractive as an entity is assured of experiencing growth. There exist different types of incentives especially fiscal one which are provided by the government. Ohaka and Agundu (2012) revealed that when an entity has performed well in terms of increasing its return on investment, that kind of incentive is considered to be least discriminatory as it reduces the corporate and personal tax rate. This therefore implies that different incentives have adverse effects either positively or negatively on the outcome of an entity.

The incentives in Kenya are categorized based on where it's applicable and the

timeliness. Those in the 10 years' corporate income tax holiday, then they are those that which are within the rates of 25% compared to the standard 30% in the period of 10years and 10 years' exclusion based on all the tax withholdings especially those that are mostly exempted from duties, materials especially those raw materials inputs in accordance to the study by Network-Africa, & Action Aid International (2012). This implies that the rate which the exemption is articulated ensures there is effective outcome from the entities performance. In conjunction to this, incentives in Kenya based on their category have different implication towards the overall performance of that entity and therefore their articulation are based on certain effects of operation

According to James (2013), a tax incentive is the process of reducing the tax liability that is available on various investments by deviating from the system's unnecessary taxes. It is a tax provision made available to SACCOs in order to reduce their tax liability. Accelerated depreciation, tax credits, and reductions in tax rates/exemptions and capital allowance are all examples of tax incentives. In finance and accounting, depreciation refers to assets losing their value over time or having their useful life reduced.

Koowattanatianchai, Charles, and Eddie (2009) noted that an accelerated depreciation incentive is the reduction in the useful life, or deterioration, of a firm's asset cost in its early years rather than later years. The benefit of this incentive is limited to tax deferral. Because firms pay taxes on their profits after deducting their expenses, accelerated depreciation, as an expense, defers a firm's taxes, particularly in the early years of an asset's life, and increases them in later years. This incentive increases the after-tax present value of net returns by increasing the present value of depreciation deductions. It's similar to a no-interest loan given to taxpayers in exchange for a deferred tax payment. Lower or reduced tax rates encourage and enable investors and businesses to operate and launch new ventures.

The Kenya airways corporation, which was established in the middle of the 1990s,

offers freight services to governmental and non-governmental groups as well as to nearby nations including Tanzania, Uganda, and Ethiopia. It just started providing private industry freight services as well as passenger transportation. 11 prop aircraft are owned by 748 Air Services (World Airline Directory, 2016). This airline was one of Kenya's first. Its main hub, Wilson Airport, was created after Sunbird Aviation and Air Kenya merged.

Kenyan airlines have continued to perform poorly in recent years as a result of globalization, market liberalization, and market consolidation throughout Africa, for instance. Kenyan airlines have generally been less profitable than their competitors in the region. Due to excess capacity, optimal asset usage, high fixed costs, a sluggish response time to changes, and extremely uncertain revenue streams, local airlines in particular in Kenya are currently facing difficulties.

A declining market, rising fuel prices, subpar safety records, and excessive taxes are all issues that the airlines must contend with (Bosire, 2015). To promote domestic travel, the government periodically announces laws and offers tax breaks to domestic carriers. The current study tries to determine how tax incentives affect Kenyan local airlines' financial results.

A tax incentive provision in a nation's tax code promotes or supports a specific economic activity. Tax incentives can impact the economy in a positive or negative way. Tax incentives, in accordance with Fletcher (2015), are specific exclusions, exemptions, or deductions that offer specialized credits, advantageous tax rates, or tax deferrals.

Others are exempted from VAT such as raw materials in the manufacturing and processing firms. Those investing in capital projects are also granted capital allowances on basis of reducing balance (Njuguna, 2015). These may include, deductions on capital expenditures especially those incurred during constructions of industrial buildings as well as those deductions involvement during investments. These deductions are applied to encourage

development in mostly shipping investments and manufacturing sector which are rated at 40% deductions on capital expenditure. In so doing, the promote the well-being of the entities through encouraging them to be more vigorous in their undertaking. This signifies that capital projects thereby need effective consideration especially when they are enshrined to the entity endeavors.

When an entity is found out that its profits are declining especially based on the projects, they invest in they are offered allowances which are based on the capital invested thereby reducing their prone to risk of desolation. These include the investment deduction, which is given to encourage the growth of manufacturing industries, the industrial building allowance, which is given on capital expenses incurred when constructing an industrial building, and the shipping investment deductions, which are given at a rate of 40% on capital expenses and only one of them can be applied to the same ship. In any case when the effect of the tax reduction is evaluated and found to be inducing the outcome of an entity, its therefore enhanced through competitive implementation to that entity. Tax incentives significantly affect the value we place on organizational performance. These capital investment allowances improve these businesses' performance, making them more productive and having a substantial impact on their overall development when they are well employed. In this it means that they are well armed to ensure that they are not adversely affected by the externals which implies that they are not faced off with operational crisis being induced by high rates taxes.

In global context, the tax incentives enhance the performance of organizations in different percepts. Study by Bart (2014) in the case of European countries, he stated that the utilization capacity of available resource by any organization is mostly dependent on the profits earned by the organizations as a result of how they invest on its properties and the general outcome as a result of resource exploitation. In his study, Alhulail (2014) revealed

that tax incentives in Japan on sales of eco-friendly vehicles influenced their performance due to the fact that it reduced some kind of external burdens which influenced their efficiency and effectiveness in operations. These are thereby implications that tax incentives play a critical role in the overseas to factor the overall outcome of an entity.

In regional perspective, Agundu and Ohaka (2012) noted that in Nigeria the entities which have a higher return are the one that are eligible for tax incentives. This is based on the fact that when firms are granted tax incentives, they are more flexible to operate due to the fact that they experience a relief and this implies that they are attracted to invest more which enhances their performance. In relation to this there is creation of more employment as on the fact that there is the room for abolishing of sole traders to form limited companies which are large corporates which requires extensive labor which means absorption of more personnel in the labor sector which is also attributed to availability of external source of funds (Philips, 2011). The boost that comes as a result of their imposition of the tax incentives, leads to polarity of employment creation through an enabling environment of business operation.

Chukwumerije and Akinyomi (2011) revealed that tax incentives available in Nigeria enhanced the overall outcome of the small-scale entities which are registered in the country which implied that it induced utilization of any available opportunities by the sector thereby the growth and development. Study by Barbour (2005) on how tax incentives regime had affected the performance of manufacturing sector revealed that they had increased performing compared to previous when there were no tax incentives granted by the government. Mayende (2013) while studying on how reduction of tax has impacted on the outcome of Ugandan entities revealed that it increased the gross sales compared to their counterparts.

In local perspective, Githaiga (2013) noted that incentives which are tax based had affected FDI inflows of organizations which are listed in the Nairobi Security Exchange due to the fact that they acknowledged the essence of wear and tear. This is similarly echoed by

Njuru, Ombuki, Wawire, and Susan (2013) while investigating effect of taxation on the performance of private sector in Kenya whereby the revealed that when the sector is not granted any tax incentives, it tends to experience difficulties in its operations. In his study, Murage (2012) argued that there is increase in performance in terms of sales because of availability of tax incentives of firms in the EPZ. This is because the main role of government providing incentives is to reduce the operational costs of organizations mostly when the government offers subsidies and other forms of incentives, such as grants and low interest rates, are examples of such measures. According to the above context that are used in the measures of the performance of different entities, this study will apply the use of growth as the measures of performance.

Dhaliwal and Erickson (2018) investigated market reactions to intangible asset amortization court rulings. Lower courts have ruled that depreciation on certain intangible assets is not allowable. The lower court's decision was later overturned by the Supreme Court. The price reaction was negative in the case of the lower courts' decision, but positive in the case of the Supreme Court's decision. Another study on how the market reacts to tax news that affects share prices.

### **1.1.1 Tax incentives**

Tax incentives or reductions in the tax burden are given as a result of investing in certain businesses, which are mostly manufacturing, mining, oil, gas, export, agriculture, and other sectors that will stimulate development or reduce the burden on compatriots. Personal allowance, capital allowance, investment allowance, loss relief, roll over relief, annual allowance, pioneer relief, tax free dividend, export processing zone relief, research and development, and tax-free holiday are examples of tax breaks (FIRS, 2018).

Tembur (2016) asserted that tax incentives vary based on the set stipulation from the tax man such as tax breaks, allowances, and subsidies from investments, special zones with lower tax rates, tax exemptions, and so on has increased depreciation value of assets. This

eases the burden of operation of either the individuals or corporates which induces performance. From this context, it is therefore of significant to understand that corporate tax which is charged on companies within the borders of Kenya enjoys the 30% rate whereby those companies that are non-residents are charged at 37.5% which signifies that those within are encouraged to continue with their operations at reduced corporate tax.

### **1.1.2 Financial Performance**

Financial performance can be termed an overall achievement after a business has been able to achieve its mandate through meeting the operational objectives and goals whereby in previous literature, different factors contributed to financial performance of different entities which is not an exclusive of airlines (Kamunge, 2014). Financial performance of airlines can also be attributed by output as a quantified role or growth in terms of profitability gained (Martin 2010). It can also be measure through how employees are able to meet the operations requirements in terms of delivering intended services and their success will attribute to performance while failure to meet the obligations will be termed as poor performance. (Wanjiku 2015). In other scenario, financial performance, which is measured through profitability increase in sales volume and the non-financial measures, may be attributed to increase in labor force the level of satisfaction of customers.

Loyalism of customers as well as brand awareness might also be used in as a measure in which an entity performs. Many studies have been carried out in defining what performance is all about whereby they have indicated finance as the key indicator of performance (Gichuki 2014). Other researcher depicts that the size of the entity also contributes towards its performance due to either being undercapitalized or effectively capitalized as many businesses operates under the influence of the owner's capitalization in terms of savings which therefore leads to the fact that finance is the key challenge on performance (Mutira 2017).

Previous research has found that production or operations performance elements like speed, quality, flexibility, and cost efficiency are strongly related to firm performance in administrative, process, and product innovations (Edwards et al., 2015). According to Coad and Rao, continuous efforts and higher performance in innovations, for example, foster organizational learning and increase the speed and quality of operations (2018). As a result, advancements in innovation can be implemented more easily, and any design or quality flaws can be corrected more quickly, resulting in improved performance.

Firms are deemed to introduce new products and services to customers which are based on efficiency and effectiveness compared to the current products so that they are able to ensure there is an aspect of loyalty. Product quality can be improved through innovation, which improves firm performance and, eventually, a firm's competitive advantage (Tufano, 2019). According to Becheikh et al. (2016), product innovation can protect a company from market threats and competitors. Product innovation and financial performance have a significant and positive relationship (Susman et al., 2016).

Study by Wadongo, Odhuno, Kambona, and Othman (2010) noted that performance of an organization has been determined by the level of revenue to which an organization has been experienced at the end of a certain operational period through the use of key operational study ratios. On his part, Jaworski and Kohli (1996), revealed that an organization outcome which is a multidimensional, is constituted by revenue and cost-based performance, innovativeness related outcomes as well as growth. This implies that performance is not evidently self-evident nor catch them all terms, as it's an overall contributory aspect based on how an entity is able to utilize its resources to induce an outcome that is generally accepted.

Most governments entice their stakeholders especially investors through reduction of tax in their operations all over to stimulate economic activity and firm investment. They use this type of incentive to direct some effective operations in their jurisprudence toward key

sectors of the economy where they are either unnoticed or do not exist (Kaplan, 2001). Kenyan businesses, including domestic airlines, benefit from substantial tax breaks, particularly capital allowances such as IBD, ID, and W&T allowances, which enable them to report higher gains after various deductions are made thereby enhancing their operational outcomes.

Reduction of tax to entities that are in operation are created with the intention of promoting and enhancing business and investment activity. They are fiscal measures taken by the government with the goal of reviving, repairing, and stabilizing people and businesses. Additionally, the government employs tax exemptions to channel certain economic activity toward crucial economic areas where it is not noticeable or does not exist (Kaplan, 2001).

Tax incentives, according to Philips (2010), will encourage self-employed people to form limited liability firms in addition to producing jobs. The company will become more profitable as a result. Okelle (1995) noted that by giving large tax advantages to corporate tax payers for projects whose profitability might not be recognized for three to five years, a strong economy can be attained. Reduction of taxes are mostly used by different authorities in different nations in order to entice private investment into their industries which they target to be more productive in generating income per capita especially the tourism sector. Whether the cost disparities are the consequence of different taxing or different transportation, labor, or other costs, incentives are frequently given to ensure that the actuality or the difference in undertaking certain projects in terms of businesses are not affiliated to any political temperature especially in their operationalization.

The result is an acceleration in performance (Philips, 2010). Incentives boost return on investment, which increases the allure of investing in a place and raises the profitability of the company. Different types of financial incentives exist. These include direct transfers of land and facilities, tax relief in the form of credits, deductions, or abatements, direct loans

from the government at below-market interest rates, and taxpayer-funded workforce training for certain businesses and industries (Bronos and Mc Donald, 2008).

Companies benefit from a plethora of tax breaks. The most important tax breaks for hotels such as ID, IBD, and Wear and Tear are examples of capital allowances. Capital allowances are used in Kenya which are mostly earned during the fiscal year and are deducted from the total corporate tax liability. As a result of the tax breaks, hotels can report higher after-tax profits. Thus, tax breaks aid in the recovery of capital expenditures incurred by hotels, particularly during this period of poor performance by domestic airlines.

Companies that qualify for tax breaks pay less tax, resulting in higher returns on equity and return on assets from tax profits (Ohaka and Agundu, 2012). Tax breaks increase the attractiveness of investments, increasing a company's profitability. Tax breaks generate jobs and encourage self-employed individuals to form limited companies, which improves business financial performance because limited companies outperform sole proprietors when evaluating external sources of capital (Philips, 2011). Incentives lower firm costs, particularly when the government provides Subsidies and other forms of firm incentives, such as low interest rates and grants, lower labour costs, and improving transportation networks to lower transportation costs. As a result of lower costs, firms' net profits will be high, resulting in strong monetary outcome.

### **1.1.3 Tax incentives and financial performance**

Many different companies, including the airline industry, can benefit greatly from tax incentives. Airlines benefit greatly from capital allowances like ID, IBD, and wear and tear. The total amount of Kenyan corporate tax due is reduced by the amount of capital allowances that were permitted for the specific year. As a result of the tax advantages, hotels can declare bigger after-tax profits. Tax incentives help hotels recover their capital costs in this way, which is especially important given the current slump in the tourism industry's hospitality

sector. Tax reductions are meant to promote and boost business and investment activity. To stabilize, rehab, and revitalize people and businesses, the state created financial plans.

The government also uses tax incentives to direct some specific economic activity toward crucial economic sectors that are either nonexistent or have not yet been felt (Kaplan, 2001). According to Philips, tax incentives would encourage the self-employed to form limited liability corporations and create jobs (2010). As a result, the company will become more profitable. According to Okello (1995), a strong economy can be attained by offering significant tax benefits to business taxpayers for activities whose profitability will likely not be apparent for three to five years. 5 Governments all across the world routinely employ tax incentives to entice private investment in particular sectors, including the tourism industry.

Whether the cost disparities are caused by tax variations, differences in transportation, labor, or other factors, incentives are frequently offered to balance out actual or perceived differences in the cost of doing business in other political jurisdictions. This promotes performance enhancement (Philips, 2010). By increasing the return on investment, incentives make investing in a region more alluring and thus increase the profitability of the business. Money rewards come in a wide range of forms and dimensions. Some of these include direct transfers of land and buildings, tax relief through the use of credits, deductions, or abatements, and taxpayer-funded labor force training for certain businesses and industries (Broncos & McDonald, 2018)

#### **1.1.4 Domestic Airlines in Kenya**

Kenya is one of the developing countries in the world, which enjoys the vastness of its domestic airlines. These airlines are mostly operated in the Jomo Kenyatta International Airport. This implies that these airlines are not only operating domestically but they also operate internationally. These airlines are 15 in number which includes, Blue bird aviation, capital airlines, Air Kenya express, airlink, air traffic Africa, fly 540, fly Sax, phoenix

aviation, safari express cargo, Ribway cargo airlines, air service, skytrail air safaris, KQ, African Express as well as air direct connect (World Airline Directory, 2017). Kenya airways (KQ) is obliged to operate within and in international level which has more than 39 airlines which constitutes to Boeing aircraft (Okulo, 2012).

The airlines which operate domestically have continued to experience low performance due to the globalization aspect and the context of internationalization as the service they offer are limited as many clients prefers traversing over the world therefore making the domestic operations sterile. This has more also been attributed to the idle capacity context whereby most of the time they are not in operation, optimal asset uses with heavy fixed costs slow pace to change and more to those experiencing revenues with are prone to change at any particular time (Chege, 2020).

The performance decline of these domestic airlines is as a result of high inflation rate which has affected the fuel prices, stringent safety records requirements, low market potential due to their increase in number and the high levied taxies from the government (Bosire, 2015). In order to motivate the operations of domestic airlines, Kenyans' government has been putting in measures such as tax incentives to the airlines so as to encourage internal travels with them and this has been facilitating their performance. This therefore induced the aspect of carrying out a study on how tax incentives have affected the performance of the domestic airlines.

These incentives are designed by the government of Kenya so as to encourage a particular economic activity of the organizations which are operating within the boundaries of the country. When considering the effects of these tax incentives, they can trigger an outcome of either positive outcome or negative one and that's the reason behind this study based on the overall outcome to the economy (Chege, 2020). These kind of tax incentives are offered by the government through Kenya Revenue Authority in order to encourage more investment

which its intention is to ensure there is increased growth of firms. They may be in form of capital allowances which in itself is based on wear and tear, deductions as a result of investment industrial deductions as well as farm works. KRA might also decide to offer tax holidays especially to those firms under export processing zones exemption on VAT insurance tax relief among many others. It is therefore for this reason that this study will concentrate on effect of corporate income tax incentives, tax holidays incentives as well as capital allowance incentives on performance of domestic airlines.

### **1.1 Statement of the Problem**

Tax incentives are a common strategy used by many nations, especially those with developing economies, to entice investment, generate jobs, and boost their competitiveness on the international stage (Klemm & Van Parys, 2012). Reduced corporate income tax rates, tax holidays, capital allowances, tax credits, rapid depreciation, tax exemptions, and other incentives are implemented by governmental regimes. The performance and economic expansion of the company are consequently enhanced. Tax benefits give businesses the freedom to set aside cash and reinvest it, boosting their profitability. Market liberalization, market consolidation, and globalization are a few ways that Kenya has struggled in recent years. Kenyan airlines have generally been less profitable than their competitors in the region. Kenya's domestic airline sector faces a number of difficulties. The State of the Kenyan Airline Business, a 2016 report by Mutema, states that the business need assistance due to a falling market potential, high fuel prices, poor safety records, a loss of qualified personnel to other foreign airlines, and excessive taxation.

Businesses like Kenya Airways have been losing money over the previous few years. When analyzing how tax incentives affect the financial performance of firms in Kenya, prior studies have mainly used a generic approach. Because each sector of the Kenyan economy is unique in a variety of ways, such generalizations could not be considered accurate

representations of those sectors. The research's findings on the subject might be more accurate and consistent.

For instance, Kamau (2018) investigated the effects of tax advantages on the success of publicly traded agricultural companies in Kenya. According to the study's findings, there is little to no correlation between an enterprise's financial success and its effective tax rate. The implications of tax incentives for foreign direct investments (FDI) in Kenya were examined by Gumo (2013). However, it disregarded financial results. His research showed that industrial allowance has a detrimental effect on FDI, whereas investment deductions and mining operation deductions incentives policies have a beneficial impact.

In their 2013 study on taxes on private investment, Njuru, Ombuki, Wawire, and Okeri found that while VAT, income tax, and the creation of the Kenya Revenue Authority (KRA) had negative effects on private investment, excise tax, import tax, and tax amnesty had positive benefits. The objective of Muthari (2016) was to determine the tax advantages and operational efficiency of particular industrial firms in Kenya. According to the study, custom duty incentives had a favorable and significant impact on the performance of the enterprises, although having the least amount of an impact. It was discovered that the performance of the firms was significantly and favorably affected by excise tax incentives.

A significant gap in the literature on this subject is the management's failure to correlate the impact of tax incentives on commercial performance in Kenya's domestic aviation industry. The analysis indicates that there is no perfect combination of tax incentives. Different tax incentives are used depending on the situation because different nations face different economic issues at different periods. In order to close this gap, the current study will focus on the following problem. What impact do tax incentives have on Kenyan local aviation enterprises' financial results?

### **1.3 Objectives of the study**

#### **1.3.1 General objective**

The main objective of the study was to examine the effect of tax incentives on financial performance of domestic airlines in Kenya.

#### **1.3.2 Specific Objectives.**

- i. To analyze the effect of corporate income tax incentives on financial performance of domestic airlines
- ii. To examine the effect of tax holidays incentives on financial performance of domestic airlines
- iii. To determine the effect of capital allowances incentives on financial performance of domestic airlines.

### **1.4 Research Questions**

- i. How do corporate income tax incentives affect financial performance of domestic airlines?
- ii. How do tax holidays incentives affect financial performance of domestic airlines?
- iii. What is the effect of capital allowances incentives on financial performance of domestic airlines?

### **1.5 Justification of the study**

Tax incentives offers a sign of relief to many organizations which implies that they are able to effectively induce their performance. The availability of different incentives within the operations of the organization acts as a remedy for some challenges especially those related to their incomes and source of raw materials.

The aim of this study therefore was to examine on how tax deductions had any impact on financial outcome of Kenya's domestic airlines. This will be based on extrapolating how different tax incentives have influenced or affected the performance of the airlines as they

play a major role in creation of employment through poverty alleviation in form of creating a well-established economic base. This more also enhances the performance of the airlines through growth which is attributed by significance of the tax incentives offered to them. With this study, the incorporation of how the airlines operates with different kinds of tax incentives, they are therefore deemed to either perform positively or experience loses and therefore this study will seek to investigate more on how capital allowances, tax holidays incentives as well as tax based on co-operations based on how it affects the outcome of the domestic airlines therefore being of great significance to the economic development sources in the country.

## **1.6 Significance of the study**

These study findings are pivotal to different parties as explained below:

### **1.6.1 Government and Policy makers**

The findings of this study help the government and the policy maker to understand what they are expected do what it comes to stabilizing on the overall activities of domestic airlines especially when they are considering on the kind of tax incentives to continue offering. This implies that, this implies that they are able to come up with different policies which benefits the airlines as the source of their revenue and income so as to have a stabilized flow.

### **1.6.2 Management of the domestic airlines**

The managers of the airlines and the shareholders' benefits form these study findings in that they are able to understand the basic principles of performance, which are evaluated in this study. They are able to counter-check when they experience gain or loses as a result of tax incentives and what they ought to do in order to seek more relief from different taxes which are imposed to them in the future in order to curb operational harshness.

### **1.6.3 Academic and research**

These study findings instill a sense of acknowledging the source for the study for the academician and future researchers in that through understanding of how tax incentives influence performance of airlines or any organizations, they embrace stipulated measures which are required in an academic field. The study findings also are crucial to this group of individuals in that it helps them to be very conversant on how different tax incentives creates an enabling environment of operations.

### **1.7 Scope of the Study**

The issue based on how tax breaks had affected the outcome of Kenya's domestic airlines was the key area for this study. Therefore, it was based on trying to understand what are the effects that different tax incentives have on domestic airlines performance. Domestic airlines were the area of study so as to understand whether they have been embracing the tax incentives in their operations and if so, how have it impacted on their performance. It therefore extrapolates data from the 15 Kenya airlines whereby secondary data is used in the period of 5 years from 2015-2019.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter is all about reviewing literature based on the current study concept. It therefore entails consideration of past research based on how tax incentives have affected financial performance of different sectors of the economic development. This shed more lights in understanding an overall aspect of tax incentives. This entailed consideration of theoretical review, empirical review and the conceptual framework.

#### **2.2 Theoretical Review**

In this section, relevant theories were looked at which are aligned to the study objectives, these theories included, optimal tax theory, The Q Theory of Investment and agency Theory.

##### **2.2.1 Optimal Tax Theory**

This theory was developed by Ramsey (1927) and is based on how there is the need for commodities to be levied at optimum level especially when it comes to sales tax. In this Ramsey asserted that the demand curve slopes downwards and intersect with the supply curve which slopes upwards when there is surplus production as well as surplus consumption. As a result of this when there is imposition of sales tax, it triggers a reduction in the output

which definitely affects the overall performance. When there is no uniform tax rate applied to any commodity, it causes inelasticity of demand which means that there is always a reduction on how the commodity flows in the market. In this it means that when there is elasticity of supply especially when there is assumption of perfect elasticity regarding their response to tax changes, they expose an entity to operational distortion as tax levied on those commodities will experience a more inelastic consumer demand.

A tax system should be chosen to maximize a social welfare function within a set of constraints, according to standard optimal taxation theory. In the literature on optimal taxation, the social planner is typically treated as a utilitarian: that is, the social welfare function is based on the utilities of individuals in society. In its most general analyses, this literature employs a social welfare function that is a nonlinear function of individual utilities. Nonlinearity, for example, enables a social planner who prefers more equal utility distributions (Ngure, 2014). However, some studies in the literature assume that the social planner is only concerned with average utility, implying a linear social welfare function in individual utilities. For the purposes of this essay, these distinctions are of secondary importance, and the social planner can be thought of as a classic "linear" utilitarian.

While economics, as a social science, is concerned with finding possible solutions to the fundamental problem of reconciling individuals' unlimited desires with scarce resources, numerous approaches have revealed specific objectives of the subject, such as economic growth, balance of payments stability, income redistribution, price stability, full employment, and many others (Alhulaili,2014). Alternatively, economics can be defined as the art of distributing limited resources in an optimal way that maximizes the utility of every single participant in an economy in order to achieve the highest level of prosperity in society, while all individuals are focused on behaving rationally in order to gain greater satisfaction from life, or in economic language, maximizing their utility.

From the perspective of microeconomics, generally, an individual maximizes his utility by consuming preferable variety of goods and services in an optimal quantity subject to the prices of commodities and his/her income, which is determined by individual's labor supply who tries to optimally balance his/her working and non-working (leisure) time (Kwamboka,2010). However, from a macroeconomic standpoint, where all indicators are measured at the aggregate level, societal welfare could be increased by optimally allocating aggregate income into consumption and saving, which eventually leads to the highest level of prosperity through its effect on capital accumulation.

While optimal tax theory and various growth models have long embarrassed economic policymakers and intrigued economic theorists, this paper focuses on the role of taxation in the process of achieving economic growth. It specifically attempts to launch a mathematical model aimed at calculating optimal rates of various types of taxes in order to achieve long-run economic growth based on the basic Solow model of economic growth (Ngumo,2013).

Government has an obligation to provide public goods and services to the population, such as education and healthcare, the legal system and defense, and infrastructure such as roads, by controlling and monitoring the economy. To cover these costs, the government must acquire some financial assets (Njeru & Ndimitu, 2015). Despite other sources of revenue, such as income from certain public goods and services, or sales of government assets and bonds, and possibly even the possibility of borrowing from international organizations such as the World Bank or the International Monetary Fund, taxation remains the primary source of government revenue. As a result, taxation is required to fund government spending.

Current research focuses primarily on the government's first function, economic stabilization, by attempting to identify the optimal level of various types of tax rates, such as

personal income tax and consumption tax, that can eventually lead to the long run steady state level of economic growth. Furthermore, as previously stated, the model attempts to balance the rates of various types of taxes by calculating their optimal levels. However, according to standard optimal taxation theory, an optimal tax system should be designed to maximize social welfare while taking into account the utility function and household consumption decisions in the economy (Mankiw, Weinzierd, Yagan, 2009).

As previously stated, the research model is based on the basic Solow model of economic growth and is thought to calculate the optimal level of different tax rates that can lead to the optimal level of long run economic growth. It is critical to emphasize that in 1956, great scientist and economist Robert Merton Solow examined a possible theoretical way of achieving optimal level economic growth that maximizes the share of consumption in income in the long run. According to his research, aggregate consumption of a nation reaches its maximum level when the national saving rate in the economy equals the share of aggregate capital stock in the production process (Mankiv,2009). Because of its flexibility, the tax system can influence household consumption and saving decisions.

To be more specific, it is an undeniable fact that almost all modern tax systems are a mixture of various types of taxes, allowing different types of taxes to impact the economy in different ways, in order to increase the tax system's influential power over the economy. As a result, the role of taxation in the process of reaching the maximum level of aggregate consumption will be the focus of this study (Weinzierd, 2009). The mathematical model will precisely answer the question of what the rates of various taxes should be in order to achieve the golden rate of economic growth in the long run. Furthermore, the model attempts to balance the rates of various types of taxes in the economy for economic stability.

Mirrlees (1976) factored in on how revenue is supposed to be raised in order to reduce the aspect of inefficiency and distortion encompassed through distortionary taxation whereby

he revealed the aspect of optimal tax. This implied that there is the need to have a neutral tax which is supposed to be charged in order to avoid the variance level of tax inefficiency once and for all. This in accordance to Kuria (2016) implied that when tax is distorted, there is high risk of operations and therefore people intend seek for income tax liability on their pay in order to consume them in either leisure or household production outside their intended purpose as they are not taxable in that context. This is attributed more also to the fact that when individuals consume especially food made from their homes after buying products in a supermarket, they feel that they are not taxed as already the commodities have been taxed in the entity. And while they are in the restaurants, they feel taxed signifying that there is aspect of distortion.

The essence of tax discrimination therefore in this case occurs through when there is expose of favor of households compared to the task that can be easily done in the marketplace which can thereafter leads to gross inefficiency in operations of tax.

This theory will be of great significance to this study in that it is based on the fact that when it comes to issue of corporate tax incentive, it should consider that there is the attribution charge of VAT incentive as well as exercise tax incentive which is based on corporate operationalization. This can also relate to study from Ohaka and Agundu (2012) who found out that the eligibility of EPZs firms on VAT taxes and exercise tax incentives influenced the firms to pay less tax, which on the other hand influenced their performance and therefore in relation to these corporate tax incentives is critical in inducing the performance of organizations.

### **2.2.2 The Tobin Q Theory of Investment**

Summer (1984) developed this model which was all about investment equations aligned to Tobin's concepts. In this theory, its main aim is to extrapolate the impacts of tax policies on the stock market investment. From Tobin's theory when there is less tax induced to in any

arena, there is a direct relation in terms of more investment over a long period as every income is ploughed back to purchase more which leads to increase in market value by over the income spent previously.

In Tobin's assumption, it reveals that the value of a good market is estimated through having an increase of components of capital is equivalent to the average market value which is based on capital stock within the firm. From Tobin's point of view, it is of importance to understand that the average approximated the marginal  $q$  comes as a result of the additional value on dollars invested in any operation. In this he referred it as the value of the market of capital stock to the cost incurred in replacing it. To understand what is all about investment rate, as a result, it implies that it is the increasing function of marginal returns approximated by  $q$ .

According to Blanchard and Summers (2010), the application of Tobin's theory is an uneconomical theory of investment behavior because it is based on the aspect of  $q$  in the series being the representation of a fraction of the market value of already existing shares of a given entity that has the ability to show off the firm's cost in terms of physical assets. This means that when the value of  $q$  is greater than one, it always indicates that there will be additional investment in the organization as the firm assets will always outnumber the profits generated, the organization will have a significant impact. When the  $q$  is less than one, the firm will be a notch higher when selling their assets rather than using them. In this context, the ideal state is when  $q$  equals one, implying that the company is in equilibrium (Bond, 2009).

At parity level in relation to Tobin's model, the business is able to determine what is their net marginal products of the capital they are using based on the cost of the capital. This implies that whether there are tax holidays by an entity there will be a major steady state as the change of withholding would lead to obsolete cost of the firm mostly at times of acquiring

new investment opportunities. This theory based on the current study was used to help to understand how tax holidays influence the performance of corporates with the essence of accumulating capital during the period.

### **2.2.3 Agency Theory**

Jensen and Meckling (1976) developed this theory whereby the theory was all about the ownership of the business who are the key shareholders and therefore they delegate the mandate to their managers to ensure there is maximization of the shareholders' wealth. This implies that in there is ownership delegation to the third part to be an overseer of the business operations. In this, proprietors are the principals while the managers act as the agents and they are the transcend of ensuring that they handled the business misfortune (Jensen & Meckling, 1976).

One or more people (the principal(s)) hire another person (the agent) to perform some service on their behalf, which includes delegating some decision-making authority to the agent. Jensen and Meckling (1976) developed agency theory where agency costs are defined as the sum of the monitoring expenditures by the principal, bonding costs by the agent, and a residual loss. Conflicts between managers and shareholders (agency cost of equity) or between shareholders and debt holders will result in the existence of an agency problem (agency costs of debt) (agency costs of debt).

This theory factors in the aspects of losses which may occur as a result of agency dormancy and therefore the management ensures that the incentives which are available compensate them in terms of monetary value in order to catalyze the interest of the shareholders (Chege, 2020). This ensures that the directors of the organization do not experience the shocks of nay deformity of the entity exposing them to risk hence they get their shares through a calculated move of possibly lowering the charge through embracing of balancing off the investor's funds to those of the managers.

The aspect to which there exist that separation of the business possession and control, makes it hard to control between the managers and the shareholders due to the rising need of ensuring that there is wealth maximization of the shareholders. This creates a coherence between agent and the principal in order to help fully utilization of the available resources which its reflection is purported in the audit reports.

A study by Pincus (2009), argued that in audit committees, there is whereby the essence of utilization of the resource are experienced due to the fact that the costs of agency are fundamentally utilized and exposit high level so as to ease the way in which the data streams from the agent to the principal.

This theory is useful in this study because it explains how capital allowances, which are endorsed by any entity, can be a predictive factor, especially when it comes to the operations of the agents, and thus they lead to positive and critical accommodation between the reliability of financial statements and the availability of audit committees (Rutherford & Springer, 2005).

## **2.3 Empirical Review**

Domestic airlines mostly can experience financial performance when there is conducive environment of operations. In this availability of tax incentives creates of enabling environment whereby they can be able to utilize their resource effectively. Through literature review, this study will identify various effects that are attributed by tax incentives towards the performance of airlines.

### **2.3.1 Corporate Income Tax Incentives and financial Performance**

A study by Olaleye, Riro, and Memba (2016) while examining on how income tax had affected performance of listed manufacturing firms in Nigeria established of an existence of a strong positive linear relationship between foreign direct investment and reduced company

income tax incentives. These findings were arrived at after exposition of descriptive research design and the use of 174 listed manufacturing firms in Nigeria as the target population. In their study they used primary data whereby questionnaires were distributed to the respondents through use of trained research assistance. They also used snowball method to arrive at the findings. Emails and phone calls facilitated in understanding how the respondents were fairing on in relation to filling in the questionnaires. In this study there existed a research gap in that they carried a study on how company income tax incentives affect performance of listed manufacturing firm whereby current study will deal with how tax incentives affect financial outcome of an entity with the case of domestic airlines.

Study by Njeru and Ndimitu (2015) found out that investments in EPZ firms experienced increase when they had increase in sales volume which increase their profits coupled with incentivized arising from tax beam. More also tax incentives impacts entity outcome in the zone is insignificant. More also from their findings they indicated that the firms in the zone had also benefited from grants or loans reduced tax rates investment allowances as tax incentives. This is as a result of their study on assessing how tax incentives had influenced performance of firms in EPZ. These findings were as a result of using descriptive research design and the data is analyzed using SPSS version 20. This clearly indicated that there were some tax incentives which contributed to the performance of the firms in the EPZ while others were not such as unhealthy competition and conflictive administration which caused operational mayhem. This study exposed a research gap as it dealt with manufacturing firms in EPZ which the current study will deal with domestic airlines performance based on tax incentives. This more to relate to the finding of Devereux, Maffini and Xing (2015) on how corporate tax incentives had influenced performance of companies in UK found out that corporate tax incentives affected external leverage of local and multinational companies.

In order to increase the value of their company, managers frequently try to avoid paying corporate taxes. In other words, the company is at its most aggressive. Marketers can substantiate this claim with marketing effort data banks and tax shelter reports (Fama & French, 2018). Aside from cost savings, aggressive tax strategies increase the value of a company's stock. Tax evasion and stock performance have a positive correlation. In some tax courts, tax evasion is treated as noncompliance, resulting in penalties and disallowable expenses. Because the goal of any business is to maximize profits, investors will react negatively to any information about potential increased cash outlays, such as increased tax payments (Hanlon & Slemrod, 2013).

Ojochogwu and Ojeka (2012) in their study which was based on establishing whether there existed any relationship amongst tax strategy and the increase in size of small and medium entities in Nigeria applied use of different research techniques. The working population for the study was SMEs in Zaria, North Central Nigeria, and data were collected using a structured questionnaire for selected samples obtained through judgmental sampling. To test the study hypothesis, the collected data were analysed using Spearman's Rank Correlation. The study discovered a negative relationship between tax and the survival of the sampled SMEs. As a result, stakeholders must engage in vibrant and bold sensitization in order to spur growth in the sector and the economy as a whole.

In accordance to the study by Adejare (2015), found out that the reduction in corporate tax led to increase in labor force. This is based on the study on how tax related to corporates affected revenue profile of Nigerian organizations whereby secondary data was collected from central bank of Nigeria through statistical bulletin which were from 1993-2013. The variables used were rated to inflation, infrastructural improvement which led to growth of the gross domestic product. The study established that the reduction in corporate tax incentives led to increase in economic growth as the dependent variable under study was

gross domestic product while independent variable in this case is income tax and value added tax. This study concentrated on revenue profiles of firms in Nigeria and was based on effect of corporate tax towards revenue profiling thereby exposing a research gap which this study will seek to fill by studying on how tax related to corporates impact on the financial outcome of Kenya's domestic airlines.

While studying on corporate tax and corporate profits and job growth in the US, Linger and McFate (2013) determined the existence of no relationship between tax rates reduction based on corporate profits. They concentrated on how low taxes affected the corporate profits. The study analysis revealed that out of 30 corporations being examined between 2008-2010, 22 of them had paid higher tax rates, which is higher by 30% and created more jobs amounting to 200000 within a period of 4 years between 2008-2012 while the rest of the other 8 companies recorded employment reduction though they were paying higher taxes in the same period.

Musyoka (2012) examined the about the mutual benefits amongst foreign direct investment and tax break. The variables of the study were gathered from published annual data on investments, trade incentives, import duty exemption, and FDI inflows for the study period. To determine the degree of association between the study variables, the collected data were analyzed using correlation and regression techniques. Contrary to popular belief, firm incentives resulted in a reduction in government generated revenue because the company used such avenues to evade and avoid tax, according to the study. This finding is only concerned with the revenue aspect of taxation, whereas providing such incentives will encourage new business, which will pay employees and pay taxes to the government.

John (2013) did a study on how corporate income tax affected the financial performance of Ghanaian manufacturing firms and discovered a negative significant level between corporate income tax and financial performance of the firms. This is based on the

fact that the study utilized panel data which covered 10 listed manufacturing firms in Ghana whereby the secondary data of a those which had been in operation for a period of 7 years were used. Gemmell, Kneller, McGowan and Sanz (2012) investigated on how higher rates of corporation taxation influenced the firm's performance in 11 European countries whereby in their study they found out that there is an increase in corporate ta which led to reduction in productivity growth of the small-scale firms. This is after the study utilized panel data techniques. Rapuluchukwu et al. (2016) discovered that a variety of fiscal incentives, including import duty exemptions, profit tax exemptions, and export financing, had a positive effect on firm productivity.

Jens and Schwellnus (2008) used stratified sampling to examine the effects of corporate income taxes on two of the main drivers of firm growth, profitability, and investment in European OECD member countries from 1996 to 2004. They discovered that this is true across firms of various size and age classes, with the exception of young and small firms. Corporate income taxes, according to the findings, reduce investment by increasing the user cost of capital. This could be explained in part by the negative effects of corporate income taxes on profitability if the corporate tax rate is raised.

In a study on corporate income taxes, Rohaya, Nor'Azem, and Bardai (2010) discovered a link between corporate profitability and income tax. The study looked at how corporate income tax liabilities affected various firm variables like gross profit, cost of sales, and expenses, among others. For the fiscal years 1995 to 2000, a sample of 7,306 hotels and restaurants was drawn, including 6,594 in business services and 1,484 in transportation manufacturing. Based on the study outcomes, corporate income tax impacted negatively on corporate profitability but has a positive relationship with firm size and company age. Apart from these authors, De Mooij et al. (2001) and Meg (2008) discovered a link between corporate taxation and financial performance, so the following hypothesis is reasonable: 1.

Corporate taxation has a negative relationship with firm financial performance.

### **2.3.2 Tax Holidays Incentives and Financial Performance**

Different studies have been undertaken in relation to how tax holiday incentives have impacted on different entities outcome. Wachira (2011) found out that Kenya airways grasp all the tax the advantage of tax deduction. More also the study found out that tax incentives were effective to the performance of the Kenya Airways. This were as a result of the study based on establishing the impact of reduction of taxes as key component of evading schemes by Kenya Airways whereby the study used a semi structure questionnaire which had both close and open-ended questions which was used in collecting primary data. This study used SPSS tool for data analysis.

Study by Baghebo (2012) noted that tax holiday was a government scheme which was based at reducing tax rate required by businesses to remit. This kind of tax incentive was mostly based on reducing sales tax especially by domestic government although they depend on external finance to influence on their outcomes especially from the developing countries context. This signifies that they are used to encourage purchase power of different items in both local market engagement and foreign market engagement within a temporary period which is based on reducing certain taxes or else remove them completely. This happens whereby a government can intends to reduce sales taxes when schools are about to re-open in order to lower the burden of parents or guardians when shopping for the school items (Philips, 2010).

According to Bolnick (2014), tax holidays are a common type of tax incentive used by developing and transition countries to attract investment in specific sectors. Registered venture capital funds have benefited from significant tax breaks, including up to ten-year tax holidays on fund income. For a set period of time, a tax holiday exempts qualifying newly established businesses from paying corporate tax (Gebremedhin & Saporna, 2016). EPZs in

Kenya benefit from a period of ten years of entity-based tax leave, followed by a 25% tax rate on profits; a 10-year withholding tax holiday duty; VAT exemption on inputs and zero-rating on exports; and Stamp Duty exemption.

Tirimba, Muturi, and Sifunjo (2016) investigated the relationship between tax breaks and firm profitability. Their study included the 61 NSE-listed companies, of which 150 were chosen as a working sample. The necessary study data were gathered primarily from primary and secondary sources, and the data were analyzed using descriptive statistics, correlation, and multiple regression. They discovered that tax breaks have no effect on cooperative performance. This finding suggests that tax breaks do not play a significant role in improving the performance of the businesses studied.

Klemm and Parys (2019) investigated the effects of tax breaks on encouraging investment and as a tax competition tool. Between 2005 and 2014, the study was conducted in over 40 Caribbean and Latin American countries. The study discovered that tax holidays had strategic interactions, but no evidence of tax credit competition was found. Longer tax holidays, according to the study, attract FDI. A study was conducted to determine why policymakers value tax breaks. It was determined that they should only be used to correct firms that have experienced market failures, and that investments can only be recovered faster if the preferred form of tax incentives is implemented (Zee et al., 2012)

While studying on tax holidays form, Effiok, Tapang, and Eton (2011) asserted that tax incentives which are taken as a form of tax holidays are mostly deducted within a limited timeliness based on certain expenses especially on imports tariffs which eventually leads to enhancement of financial performance of different entities. These tax incentives act as boosters for the wellbeing of organizations in order to shield them from harsh conditions which are brought about by economic toughness. They are therefore implemented to enhance undertaking of economic activities which leads to the organization's growth. This boost the

gross domestic product which is brought about by economic growth. This more also is attributed by government imposing tax holiday to encourage foreign investors to establish different companies in a country's jurisprudence. They are therefore put in place in certain economic sectors to induce their growth or else to induce aspect of diversification. On other hand, upcoming businesses are offered tax holidays in order to encourage their settling up to induce their growth through increased revenue in a fiscal policy concept which may encourage more businesses to be raised up.

In their study, Ohaka and Agundu (2012) noted that tax incentives are induced to enhance performance especially through gross sales and value addition on different products in comparison to what their counterparts are doing. This helps to invest more within the set timeliness and this leads to profitability of the entities which accrues to financial stability. In relation to fiscal policy which is mostly introduced by governments, Ifueko (2015) noted that when the tax rates are high, they to some extent leads to growth of certain businesses which signifies that taxation hinders growth of many businesses hence when offered tax holidays they induce growth with is attributed to different components of performance indicators.

### **2.3.3 Capital Allowances Incentives and financial Performance**

The study by Maffini, Xing and Devereux (2016) on the influence of incentives in the form of depreciation allowances provided new evidence by employing confidential corporation tax returns in the UK. A difference-in-difference analysis have been conducted by exploring an exogenous change in the qualifying threshold for the first-year allowances (FYAs) that was recorded in the year 2004. The findings of the study depicted an increase in the investment rate during the period when the firms qualified for FYAs by a percentage increase of between 2.1-2.6 when compared to the firms that did not qualify for the FYAs. There was thus a mean increase of about 11%. The study established that the large effect was not a result of an increase in the available cash after exogenous variation in the timing of payments of tax had

been exploited but rather it was a cost of capital effect. It was also found that firms showed a rapid response to the FYAs within the period 12-18 months. It was also found out in the study that the salience of the FYAs was enhanced due to the cost of the capital created by the qualifying thresholds being just below the notches. The main result was however not driven by this behavior.

Amendola, Boccia, Mele, and Sensini (2018) used company-level data from 2006 to 2015 to investigate the impact of tax breaks on cooperative profitability in the Dominican Republic. The study's collected data was analysed using panel data analytical techniques to determine the type of association that exists among the study variables. The study confirmed that corporate income tax exemptions improve corporate profitability of the Dominican Republic's listed companies; however, the irregular tax assessment between corporate entities misrepresents competition in most sectors, particularly in the area of industries, resulting in the incentives having an overall negative impact on economic efficiency.

Mayende (2013) examined the effect of tax incentives on sampled firms' value added taxes and gross sales in Uganda, he discovered that streamlining the tax-incentive structure would improve firms' overall performance. However, despite their importance in terms of job creation and food security, most of these studies did not include manufacturing firms, particularly in developing economies such as Nigeria. A study was conducted in Tunisia to investigate the effect of corporate income tax breaks on financial performance of listed and non-listed firms (Assidi, Aliani and Omri, 2016). The descriptive research design was used on a sample of 35 Tunisian listed and non-listed firms. The data used in the study ranged from 2000 to 2010. The data for the listed firms came from their published financial statements, while the data for the non-listed firms came from their accounting services. The dependent variable in the study was firm value, which was measured by return on assets (ROA).

According to Lassala (2017), the most efficient measure of firm value is ROA. The study's independent variable was tax optimization. Tax optimization, according to Capietz (1994), is defined as the reduction of income tax in order to improve the firm's financial performance. A multiple linear regression model was developed by the research team. According to the study's findings, corporate tax has a negative impact on Tunisian firms' financial performance. This demonstrated that lowering corporate tax rates improves firm financial performance. According to the study, lowering corporate tax rates improves firm financial performance. Assidi, Aliani, and Omri (2016) discovered agreement with the research of Gadzo and Kpportorgb (2013) on the impact of Corporate Income Tax on the Financial Performance of Ghanaian Listed Manufacturing Firms.

It is given to businesses that invest in both building construction and the purchase and installation of new machinery, and the owner of that machinery, who is also the owner or lessee of the building, uses it for manufacturing or one of the following ancillary purposes: electricity generation, transformation, and distribution; effluent and other waste product cleanup and disposal; environmental damage reduction; water supply or disposal. Qualifying expenditures include the construction of a manufacturing building, the purchase and installation of manufacturing machinery, and the construction of a hotel building certified by the commissioner. Companies are currently claiming ID at 100%, while those investing for Kshs200 million or more outside of the three cities are claiming ID at 150%. (ITA, 2010).

According to ITA (2010), a resident carrying on a trade who incurs capital expenditure on the purchase of a new ship for the purpose of trade may claim 40% in the first year and 10% over the next six years for expenditures on the purchase of a new and unused power-driven ship weighing more than 495 tones gross, or the purchase and subsequent fitting of a used power-driven ship weighing more than 495 tones used for business.

The mining industry necessitates significant investment. For persons incurring

expenditure on the mining business, the ITA (2010) provides a deduction of 40% in the first year and 10% in each of the following six years. The act includes costs for searching for or discovering and testing mineral deposits, providing mining machinery, and constructing a mine-specific building or works, as well as costs for development, general administration, and management prior to or during a period of non-production.

Study by Zwick and Mahon (2016) estimated the effect of temporary tax incentives on firm equipment performance. This study used two episodes of investment stimulus and a difference-in-differences methodology to study the effect of taxes on investment and how it varied across firms. The policy studied, -bonus, depreciation, accelerated the schedule for when firms could deduct from taxable income the cost of investment purchases. Bonus altered the timing of deductions but not their amount, so the economic incentive created by bonus worked because future deductions were worth less than current deductions.

Analyzing data for over 120,000 firms it was found that bonus depreciation had a substantial effect on investment. Across firms with differential exposure to bonus, we find a relative investment response of 10.4 percent on average between 2001 and 2004 and 16.9 percent between 2008 and 2010. The study indicated methodological research gaps which suited the choice of the methodology in the current study. The study by Zwick and Mahon (2016) used a difference-in-differences methodology to achieve its objectives. The study also focused on temporary tax incentives and the performance of equipment. The current study deviated from the choice of those variables and focused on a number of tax incentives versus performance of the firm. This was in an attempt to fill the existing conceptual knowledge gap from this study by Zwick and Mahon (2016).

Burggraeve, Jeanfils, Van Cauter, and Van Meensel (2015) investigated the risk capital allowance's macroeconomic and fiscal implications. The study's specific goal was to assess the extent to which the objectives of the law enacting a risk capital tax allowance on

June 22, 2005 had been met. As a result, it was decided to assess the range of the measure's net fiscal impact for the 2007 tax year. Because the data were still too fragmented to attempt any disaggregated quantification of the risk capital allowance's secondary effects on employment, investment, or the public finances, the sectoral approach had to be limited to estimating the risk capital allowance's gross fiscal impact. The implementation of the risk capital allowance resulted in a structural change in corporate financial behaviour, as it was in their best interests to modify their financial structure in order to fully benefit from the tax break. As a result, establishing a subsidiary or conducting business through finance companies may be advantageous. The tax reform aimed to improve the solvency of Belgian-based businesses. In this regard, shareholder equity and authorized capital increased significantly in 2006 and 2007.

This increase was the result of contributions from both Belgian and foreign capital. Depreciation and capital allowances, according to UNCTAD's Uganda IPR (2015), were preferable to general tax breaks because they specifically encouraged new investment. Capital allowance, according to CITA (2014), is a tax break given to anyone who incurred qualifying capital expenditure on assets used for business or trade at the end of the basis period during the basis period. Investment allowances and tax-deductible R&D expenditures, according to Lall (2013), did not elicit a significant response from Ghana's business community.

Using an equilibrium model, Trela and Whailey (2017) investigate the impact of direct and indirect tax rebates on exports, investment allowance, tax holidays, and investment tax credits on Korean growth performance. According to the findings, tax policy contributed less than one-tenth of Korean economic growth between 1962 and 1982. In Korea, there was no statistically significant relationship between investment allowance and foreign direct investment.

The tax law in Nigeria governing the grant of capital allowances is contained in the

Fifth Schedule of the Personal Income Tax Act (PITA) 2004. For tax purposes, capital allowances are granted to amortize qualified capital expenditures incurred over the asset's life span. Capital allowances are statutory depreciation that is deducted from a taxpayer's total assessable income/profit, and such reduction is given on capital expenditure that is recognized as qualifying expenditure in order to calculate the taxpayer's chargeable profit. The Fifth Schedule specifies, among other things, qualified plant expenditure, qualified building expenditure, qualified ranching expenditure and plantation (agriculture), and qualified mining exploration expenditure.

According to Abdullahi (2014), capital allowances are granted to all companies in place of depreciation at specified rates in order to spread capital expenditure over the useful life of the asset and ensure tax uniformity. The grant of capital allowances is subject to conditions, such as 1) the taxpayer must submit a written claim to the revenue authority in order to claim the capital allowances. 2) Qualified capital expenditures must be incurred and used during the fiscal year.

Ngure (2018) investigated the impact of tax breaks on Kenyan manufacturing firms. The target audience included 725 businesses. The sample size was 90 companies. The study applied the use of secondary data which was collected in between 2011-2016. The study variables were confined to custom duty, and capital allowance incentives were found to improve company performance. The findings of the study advocated for the need for and expansion of tax breaks. Capital allowance is the deduction of a specified percentage of an investment from the taxable surplus; it is typically granted to cover the use of assets in the business (Daniel & Faustin, 2019). It is typically granted on capital expenditures incurred in the course of doing business. Tax credits are traditional methods of stimulating investment and innovation, but they differ in relation to small businesses depending on the country in which they are used.

A study by Rosenberg and Marron (2015) focused on startup as well as innovative businesses in order to examine the alterations by tax policies on investment incentives. The study concurred with other past studies and established that widely varying tax rates were imposed by existing policies on the investments that were carried out in different industries as well as different activities that favored debt over equity. It was equally noted that the existing policies also imposed the effective tax rates by favoring pass through entities over corporations. The cost of capital was well lowered by the targeted tax incentives for some specific businesses such as those that invested in intellectual property, startup businesses as well as small businesses. Two factors were found to weaken the advantages in some cases while in others the advantages were reversed.

The first factor explained how firms that relied more on tangible investment were found not to rely heavily on higher-taxed equity in contrast to those firms that invested heavily in new materials. The second factor established that initial losses suffered by startups made them face limits that were confined to their ability to realize the full extent of the value of tax deductions as well as credits. The advantages that come as a result of tax incentives were therefore found to be offset by these limits. The effects of the tax reforms that would result to the achievement of more equal tax treatment across various business investment forms apart from enhancing a reduction in the corporate income rate of tax were also examined by the study.

In Kenya, a similar study was conducted by Gumo (2013) to determine the impact of tax breaks on the performance of Kenyan manufacturing firms. The study was descriptive, and the research design was descriptive. Secondary sources, such as the Kenya Revenue Authority, were used to collect secondary data on (tax incentives and Foreign Direct Investment). The data was also collected from the Kenya National Bureau of Statistics to enhance depth. The study further collected primary data through structured questionnaires to

capture quantitative data. The study established that Kenya had various tax incentives including capital investment allowances offered to resident companies such as Industrial Building Allowance (IBA).

Capital investment allowances were offered on the expenditure on capital which is incurred on an industrial building construction. The government of Kenya also has an allowance on investments made where by some deductions are made on each investment made and that was aimed to spur the growth of the manufacturing sector. There were other incentives levied on farm works in the tune of up to fifty percent per year for a duration spanning twenty-four months. Other incentives involved were reductions on investment on shipping and that was charged at a tune of up to forty percent on the total expenditure on capital shipping.

## **2.4 Summary of the literature**

The study examined the impact of tax breaks on the performance of Kenyan domestic airlines. The key concepts were based on how corporate income tax incentives, tax holidays incentives as well as capital allowances influenced financial performance. The theories to be used in helping to explain this effect will be agency theory, optimal tax theory as well as the q theory of investment. The concepts will be derived from empirical review which will supports the objective of the study on the impact of tax breaks on the financial performance of domestic airlines.

## **2.5 Research Gap**

Many researchers have been carried out in both global, regional and local contexts in before on analyzing the effect of tax incentives on performance of different organizations. Majority of the researchers mostly concentrated on manufacturing firms especially in vehicles manufacturing, EPZ, firms listed in NSE and dealt with specific objectives. Only one study that has dealt with tax incentives on domestic airlines and therefore this study will seek to fill

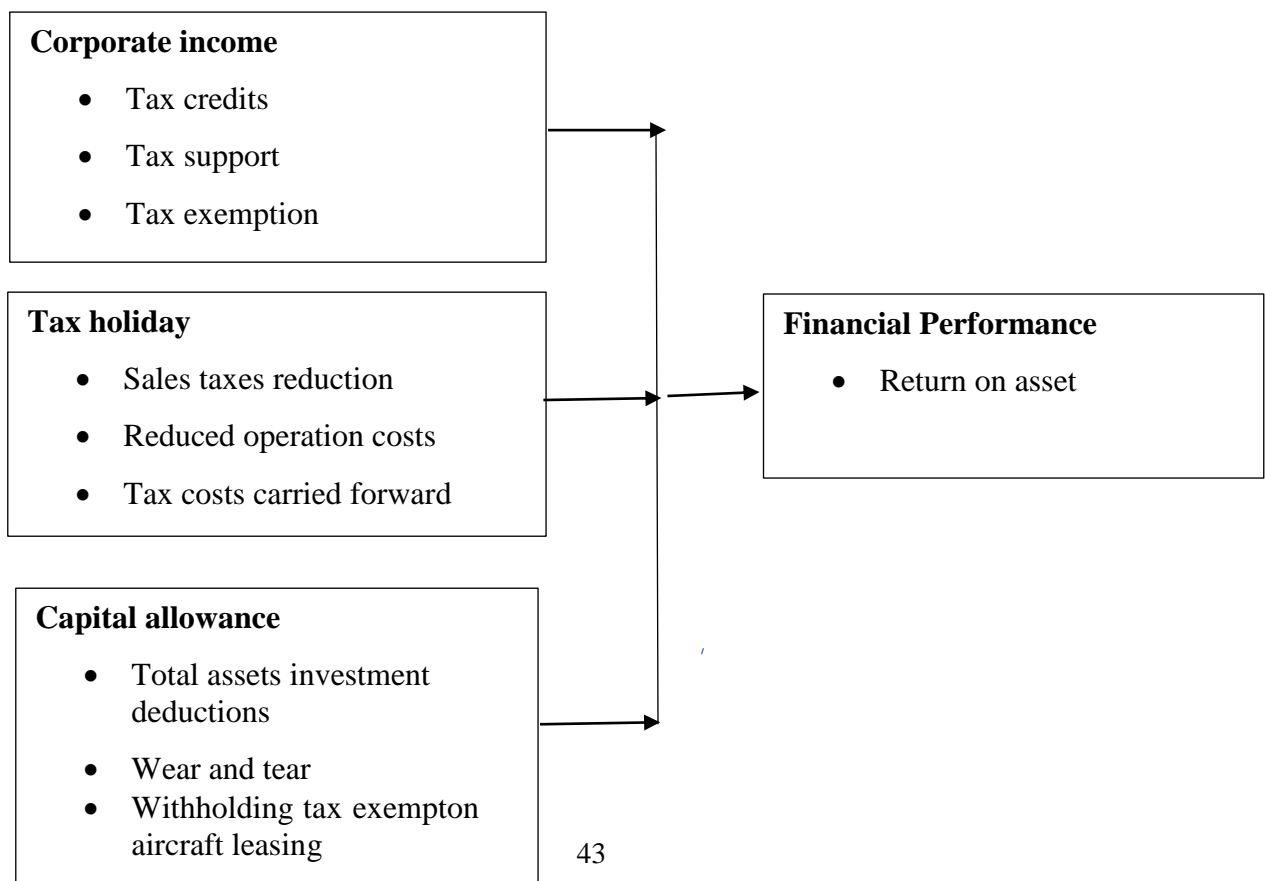
the study gap by studying on how tax breaks have impacted on financial outcome of Kenya's domestic airlines. Other studies have been research on but have concentrated on factors influencing implementation of tax incentives to different organizations especially fiancé issues. Others dealt with production issues. This study will therefore aim at filling in the research gap by analyzing the effect of corporate income tax incentives, tax holidays incentives as well as well as capital deductions on monetary outcome of domestic airlines in Kenya,

## 2.6 Conceptual Framework

This is a diagrammatical presentation of ideas and principles which are collected from accepted fields of study (Kombo and Tromp 2011). It is therefore present the relationship between study variables in a diagrammatical format to show the link between independent and dependent variables under study (Mugenda & Mugenda 2012). This is presented as shown in figure, 2.1

### Independent Variables

### Dependent Variable



## Figure 2. 1: Conceptual Framework

### 2.7 Operationalization of variables

The table below presents the operationalization of variables and which clearly elaborates ways in which each study variable was measured.

*Table 2. 1: Operationalization of variables*

Variables	orientation	Objectives	Indicators	Scale of measurements	Tool of analysis
Financial Performance	Dependent variable		-Return on Asset	Ratio scale	Descriptive regression analysis
Corporate income tax	Independent variable	To evaluate on how corporate income tax affects performance of domestic airlines	-Tax credit -Tax exemptions -Tax support	Likert scale	Descriptive regression analysis
Tax holidays	Independent variable	To investigate oh how tax holidays affect performance of domestic airlines.	-Sales taxes reduction -Reduced operation costs -Tax costs carried forward	Likert scale	Descriptive regression analysis
Capital allowances	Independent variable	To analyze on how capital allowances incentives affects	-Total assets investment deductions -Wear and tear	Likert scale	Descriptive regression analysis

		performance of domestic airlines.	-Withholding tax exemption aircraft leasing		
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## **CHAPTER THREE RESEARCH METHODOLOGY**

### **3.1 Introduction**

In research methodology, the study sought to describe on how the data was collected whereby the areas under consideration was research design, target population, sample and sampling technique, data collection and instrumentation, diagnostic testing, multicollinearity heteroscedasticity, normality Test as well as data processing and analysis.

### **3.2 Research Design**

A research design is a blue print in a study, which helps to guide on how the researcher collected appropriate data which was used to answer questions which are as a result to stipulating the research problem (Creswell & Clark, 2007). The qualities of a good research design provide the solutions of the research problem through provision of maximum findings especially from other aspect related to the study (Kothari, 2004).

The context within the research design used helps to determine the kind of research in which the researcher intends to utilize. For the purpose of this study, the researcher adopted the use of descriptive research design which helped to define the occurrence of phenomena which are simply the events that leads to the happening of something and in this case, it helped to understand how tax incentives affects the performance of domestic airlines in Kenya. In accordance to Mugenda and Mugenda (2012) descriptive research design is used to describe the features of the population the researcher intends to use in a study. The utilization of this design helped to extrapolate the features of the population in order to find out what really is associated with its variability through quantification and therefore the suitability of the research design.

### **3.3 Target Population**

Mugenda and Mugenda (2012) defined population refers to total elements to be used in a study which exposit features which are designed to bring out the relevance of the study in wholeness. On the other hand, target population refers to set of events in a diem which is

composed of real set of events, objects or people whereby the study findings are generalized. The target population of this study therefore was all the registered 15 domestic airlines in Kenya whereby the data will be retrieved from world airline directory (2017). This was presented in Appendix I.

### **3.4 Sample and Sampling Technique**

A subset of a population in its small quantity or amount to target population which exhibit features which are associated to that of the target population is what is known as a study sample. The sample therefore it's a subsection of the target population whereby the researcher wishes to make reference to in his/her researcher compared to using the whole target population. In this it means that sampling design helps to describe the sample units sample frame sampling procedures to be used as well as sample size to be used in research study. In according to Cooper and Schindler (2006), the sampling frame describes the entire population list of units from which the sample is drawn. This signified that this study was in need of understanding more on basic principle of how these airlines operates. This study utilized the use of census sampling technique whereby all the 15 domestic airlines were used. In accordance to Mugenda and Mugenda (2012) census sampling technique is used whereby the target population is small and manageable and exhibit features which are similar and identifiable which implies that every unit has the capacity to be used in the study hence a complete count. In census sampling, the study basically uses of principle of homogeneity which simply signifies that the sample being used based on the target population is small and manageable.

### **3.5 Data Collection Methods and instrumentation**

Data collection is a process in which the researcher uses to gather the relevant data which are to be used in a study. This study utilized the secondary data which was collected from the reports of the airlines which are 15 in number and operates domestically. The study

extrapolated financial data within a period of 5 years from 2015-2019 which will help to analysis how the performance inform of growth, has been influenced by tax incentives. This was based on corporate income tax incentives effect, tax holidays incentive effect as well as capital allowances incentives. The data after being collected was evaluated for completeness and consistency so that there was minimization of errors during analysis. Due to the data being quantitative in nature, and it was analyzed and presented using descriptive and inferential statistics with the aid of tables and charts. The use of these parameters was to easily conceptualize on the factorability and simplifying the value of the study for ease of interpretation. The analysis was facilitated through the use of regression model so as to understand the effects associated amongst dependent and independent variables. The following model was used,

The study applied the following regression model

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Whereby;

Y = Financial performance

X<sub>1</sub> = corporate income tax

X<sub>2</sub> = Tax holidays

X<sub>3</sub> = capital allowances

B<sub>0</sub> = Constant term

β<sub>1</sub> - β<sub>3</sub> = regression coefficients

ε = error term

### **3.6 Diagnostic Tests**

This is a test based on statistical assumption whereby the regression test was assumed and used statistically. These assumptions from regression context were met through conducting a

diagnostic test. The tests conducted was multicollinearity, heteroscedasticity as well as normal test from the model:

### **3.6.1 Multicollinearity**

In a study multicollinearity, exist whereby there is a relationship between two variables under study, which are moderately related, or they have a high degree of multiple existence in the regression model. They exhibit the variance inflation factor is mostly used to determine the level of multicollinearity severity. If the independent variables have any correlation with the dependent variable, the variance of the coefficient estimates is measured using the variance inflation factor, which is 1 if there is no multicollinearity. When there is an existence of a moderating correlation which is exposed by the independent variable, the variance inflation factor is above 1 which signifies that there is existence of a problematic multicollinearity which is posited between the values of between 5-10 VIF

### **3.6.2 Heteroscedasticity**

This study employed the use of Levene test which will help to assess the quality of variance amongst the study variables which are capital allowance, corporate income tax and Tax Holidays incentive. In order for heteroscedasticity to occur, there must be an exposition of error term which is aligned to observations not having the same variation. This implies that the error term variation is assumed to be uniform across all observations in the regression analysis. When the model is unbiased, residuals in the minimum variance violate the variance equality assumption. The Breusch-Pagan test was used for this study to ensure that all observations have a constant variation residual with a null hypothesis to be tested (Chege, 2020). If the study variance was less than 0.005 level of significant p-value, the study variance violated the study assumption based on the inference.

### **3.6.3 Normality Test**

In normal test, the level of significance in this study was collated to the computed significant value through the use of skewness and kurtosis in order to have an effective conclusion through the use of the test. In any case there exist a residual in the analysis, it was normally distributed only if the significant level is below the computed significant value (Kariuki, 2018). Then from this context, the data was assumed to have departed from the normal distribution if the significant level was below the computed significant value.

### **3.7 Data presentation and analysis**

Data analysis is the process in which raw data after being collected is converted and summarized in a more comprehensive manner which is understandable in their qualitative and quantitative nature. The secondary data collected was analyzed through the use of statistical package for social science version 26. The data was computed and analyzed based on the regression model whereby after computation, it was presented through the use of figures and table for ease of understanding. This helped to show the existence of any relationship amongst the study variables which was effective in this study concept in alignment of the effects of tax incentives towards the performance of domestic airlines in Kenya.

## CHAPTER FOUR

### DATA ANALYSIS, INTERPRETATIONS AND FINDINGS

#### 4.1 Introduction

This chapter's focus was on summarizing the data analysis in regard to the recommended technique. As a result, it was inferred that the study's core idea, which was to determine whether there was a connection between tax incentives and domestic airlines' financial success, was extrapolated. The analyzed data was presented in relation to correlation analysis, inferential statistics, and through the idea of descriptive statistics. Based on their main findings, other literature materials were then compared to the study's conclusions.

#### 4.2 Descriptive Statistics

This component concerned descriptive study findings that were based on the variables being investigated and tabulated in the table as indicated.

**Table 4. 1: Descriptive Analysis**

Descriptive Statistics					
Variable	Obs	Mean	Std. Dev.	Min.	Max.
Corporate income tax	68	8.14428	1.50803	9.03	9.59
Tax holiday	68	11.25341	1.61130	9.46	10.79
Capital allowance	68	7.55566	1.85050	9.95	11.08
Return on asset	68	94.40999	10.79375	-10.40	2.40

Table 4.1 above findings reveal that domestic airlines in Kenya's domestic market experienced very poor average financial performance as indicated by return on assets from 2015 to 2019. The minimal return on asset of -10.40 indicates that the airlines sustained large losses over the course of the five-year period, suggesting a greater risk of operational crises

based on unfavorable results from their level of operationalization. Financial performance based on return on asset measures had a relatively high standard deviation, which showed that performance varied greatly throughout the given time frame. This suggested that internal operations were efficient, which led to a greater rate of return in terms of asset utilization.

The minimum was 9.03 and the maximum was 9.59 for corporate income tax, demonstrating that the airlines sought an average corporate income tax benefit through complete agreements throughout the period. Additionally, the standard deviation was quite small, demonstrating that the variation in corporate income throughout the given time period was minimal. This was in line with Adejare's (2015) research, which showed that decreasing business taxes increased the labor force. The largest tax holiday request was 10.79, while the average tax holiday request over the time was 9.46 (measured by sales tax reduction, reduced operation costs, and tax costs carried forward). Furthermore, the standard deviation was quite small, demonstrating that there was very little variation in the tax holiday during the designated time.

The overall mean of capital allowance, calculated as the total assets investment deductions, wear and tear, and withholding tax exemption on aircraft leasing, was 7.556, with a maximum of 11.08, indicating that it was the most frequently requested source of tax incentive by Kenyan domestic airlines throughout the period. This suggests that it is the favored tax incentive for the aviation sector. Because the standard deviation was so small, the capital allowance varied very little over the time period indicated.

#### **4.4 Correlation Analysis**

Karl Pearson's coefficient of correlation was used in the study's correlation analysis to compare the independent and dependent study variables. Based on the correlation, which was conducted at a 95% confidence level whereby the outcome was as shown in the table below to

show the magnitude

**Table 4. 2: Correlation Coefficient**

	Return on Asset	Corporate income tax	Tax holiday	Capital allowance
Return on asset	1.000			
Corporate income	0.197 0.054	1.000		
Tax holiday	0.354 0.006	.306 -.055	1.000	
Capital allowance	0.327 0.003	0.176 0.070	0.225 0.059	1.000

The above analysis revealed that Corporate income tax and financial success (return on asset) are positively and strongly correlated, as shown in table 4.2 ( $r= 0.197$ ,  $p=0.054$ ). The results corroborate Salam Olaleye, Riro, and Memba's (2016) research, which found a substantial positive linear association between foreign direct investment and fewer corporate income tax advantages.

The results also demonstrate a favorable and substantial mutual coexistence amongst tax holiday and financial outcome which is based on return on asset ( $r= 0.354$ ,  $p=0.006$ ). The results are consistent with Ifueko's (2015) assertion that high tax rates cause some businesses to grow, implying that taxation prevents the growth of many businesses. Accordingly, when tax holidays are offered, this induces growth, which is attributed to various performance indicator components.

Financial performance (net profit return on asset) and capital allowances were discovered to be positively and strongly correlated ( $r= 0.327$ ,  $p=0.003$ ). The results support those of Zwick and Mahon (2016), who found that bonus depreciation significantly affected investment.

#### 4.5 Diagnostic tests

Before forcing the use of panel regression analysis, the study used diagnostic checks to prevent false results. In this instance, the tests for normality, multicollinearity, and heteroscedasticity were run.

##### 4.5.1 Multicollinearity Test

The table below is based on analysis of multicollinearity test with the use of VIF aspect of analysis.

**Table 4. 3: Multicollinearity test results**

Variable	VIF	1/VIF
Corporate income tax	1.056	0.947
Tax holiday	1.120	0.893
Capital allowance	1.162	0.861

**Mean VIF= 1.113**

The Shapiro-Wilk test was developed to check for normality and make sure the residuals in the model behaved properly. The Shapiro-Wilk test was used to verify the assumption that the residual distribution was normal. The results are shown in the table below.

##### 4.5.2 Normality Test

Table 4.4 shows that the return on asset regression model has a p-value of 0.794. Normality is implied because the p-value is greater than 0.05. The study concluded that the residuals behaved normally as a result, and it was unable to demonstrate that they are not normally distributed.

**Table 4. 4: Shapiro-Wilk Test for Normality**

Models	Obs.	Statistic	Df	Sig.
Financial performance	68	0.969	67	0.794

Table 4.4 indicate the p-value of 0.794 for return on asset regression model. Since the p-value is higher than 0.05, normality is implied. As a result, the study came to the conclusion that

the residuals behaved normally and did not successfully reject the null hypothesis that they are normally distributed.

#### 4.5.3 Heteroscedasticity Test

Due to the heteroscedasticity that many variables display, evaluation results from cross-sectional and time-series data are ineffectual (Baltagi, 2005). The Breusch-Pagan test was used to assess heteroscedasticity in this study. The residuals were homoscedastic, according to the null hypothesis. Heteroscedasticity existed if the F statistics rejected the null hypothesis at least 90% or 95% of the time. The variance remains constant if the p-value is greater than 0.05. With a return on asset of 0.1085, the model's reported value indicated that the null hypothesis was not rejected. As shown in Table 4.5, the data did not exhibit heteroscedasticity.

**Table 4. 5: Breusch-Pagan Test for Heteroscedasticity**

ROA		
chi2 (1)	=	2.59
Prob>chi2	=	0.1085

#### 4.6 Regression Analysis

The study used the General Least Square (GLS) regression model because the hausman test suggested that the specified regression model is the random effect estimator. The regression model was used to demonstrate the relationship between the independent variables and the dependent variable asset return (financial performance) (corporate income tax, tax holiday and capital allowance). The General Least Squares (GLS) regression model was used in the study because the hausman test indicated that it is the random effect estimator. relationship between independent variables and dependent variables variable return on asset (financial performance) was demonstrated using regression modelling (corporate income tax, tax holiday and capital allowance). The study's findings are presented in the tables below.

### 4.6.1 Model Summary

Using the regression model summary, the R and R square values between the independent variables and the dependent variable, return on asset, were displayed (corporate income tax, tax holiday and capital allowance). The relationship between the dependent variable (financial performance) and the independent variable (tax incentives) is shown in Table 4.9.

**Table 4. 6: Regression Model Summary**

<b>Model Summary</b>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.335 <sup>a</sup>	.112	.071	10.41

a. Predictors: (Constant), Tax Holiday, Corporate income tax, Capital allowance

b. Dependent variable: return on asset

The strength that exists between the study dependent and independent variable is shown by the coefficient of determination (R<sup>2</sup>) and correlation coefficient (r). Tax incentives and financial performance are strongly and positively correlated, as shown by the R value (0.335). (Return on asset). The domestic airlines of Kenya's explain 7.1% of changes in financial performance, according to the adjusted R<sup>2</sup> (return on asset).

### 4.6.2 Variance Analysis (ANOVA)

To ascertain whether there were any variations in tax incentives that could account for variations in financial performance, the Analysis of Variance (ANOVA) method was used.

The tables below present the return on asset results.

**Table 4. 7: ANOVA Results for ROA Model**

		ANOVA <sup>a</sup>				
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	876.099	3	292.033	2.697	.053 <sup>b</sup>
	Residual	6929.751	64	108.277		
	Total	7805.849	67			

a. Dependent Variable: Return on Asset

b. Predictors: (Constant), Tax Holiday, Corporate income tax, Capital allowance

Table 4.7's findings indicated that the model is a good fit at ( $p=0.053$ ), which was supported by the data. Tax incentives thus help to explain one aspect of Kenyan domestic airlines' financial performance.

#### 4.6.3 Coefficients of Regression

The regression coefficient was used to assess whether there was a relationship between the independent variables and the dependent variable, which was financial performance (corporate income tax, tax holiday and capital allowance). This was condensed in table 4.8, as shown below.

**Table 4. 8: Regression Coefficients**

		Coefficients <sup>a</sup>				
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	86.594	11.645		7.436	.000
	Corporate income tax	-.362	.866	-.051	-.418	.678
	Capital allowance	2.080	.740	.357	2.809	.007
	Tax Holiday	-.440	.835	-.066	-.527	.600

a. Dependent Variable: Return on Asset

$$\text{Financial performance} = 86.594 - .362 + 2.080X_2 - 0.440 X_3$$

Where: Financial performance

X<sub>1</sub> = corporate income tax for airline,

X<sub>2</sub> = for Tax Holiday for airline.

X<sub>3</sub> = capital allowance for airline

The outcome presented in the table above demonstrated that the independent variables of corporate income tax and tax holiday were successful in adequately explaining the financial performance (return on asset) of Kenyan domestic airlines. The capital allowance was statistically significant because the p-value was lower than 5%. However, the study discovered that the corporate income taxes and tax holiday p-values were higher than 5%, indicating that it was statistically unimportant based on financial performance. The results corroborated those of John (2013), who looked into how corporate income tax affected the financial health of Ghanaian manufacturing firms. He found a negative, statistically significant relationship between corporate income tax and firm financial health.

The findings also demonstrate an insignificant relationship between tax holidays and domestic airline financial performance (ROA) in Kenya ( $=-.440$ ,  $p=0.600$ ). Accordingly, an increase in the tax holiday incentive of one unit would result in decrease in the return on asset of 0.440 units. The results are in contrary with Ifueko's (2015) observation that high tax rates, to a certain extent, contribute to the expansion of some businesses. This implies that taxation restricts the expansion of many businesses, so when tax holidays are provided, growth is reduced, which is attributed to various performance indicator components.

Additionally, the results demonstrate a strong correlation ( $r=2.080$ ,  $p=0.007$ ) between capital allowance and the financial success (return on asset) of Kenyan domestic airlines. This means that for Kenyan domestic airlines, a one-unit increase in capital allowance would translate into a 2.080-unit increase in return on asset.

## **4.7 Hypotheses Testing**

### **4.7.1 Corporate income tax and financial performance**

H01: The financial performance of Kenyan domestic airlines is not significantly impacted by corporate income tax.

The hypothesis was tested using panel regression analysis, and the p-value was calculated. To rule out the null hypothesis, the p-value must be less than 0.05. The panel regression analysis results show that the p-values ( $p=0.678$ ) are greater than 0.05. The alternative hypothesis held that corporate income taxation had a significant impact on Kenyan financial performance. In relation to domestic airlines. The findings backed up the null hypothesis. The premise was that income tax has little to no impact on Kenyan domestic airlines' financial health. The findings support Linger and McFate's (2013) conclusion that there is no relationship between tax rate reductions based on business profits.

### **4.7.2 Tax holiday and Financial Performance**

The following hypothesis was tested:

H02: The financial stability of Kenyan domestic airlines is unaffected by the tax holiday.

The hypothesis was tested using panel regression analysis, and the p-value was calculated. To rule out the null hypothesis, the p-value must be less than 0.05. The null hypothesis was held because the p-values for the panel regression analysis ( $p=0.600$ ) was greater than 0.05. According to the opposing theory, share funding has a significant financial impact on Kenyan domestic commercial airlines.

### **4.7.3 Capital allowances and Financial Performance**

The third hypothesis that needed to be tested was:

H03: The financial performance of Kenyan Airlines is not significantly related by capital allowance.

The hypothesis was tested using panel regression analysis, and the p-value was calculated. To rule out the null hypothesis, the p-value must be less than 0.05. Because the p-values ( $p=0.007$ ) are less than 0.05, the null hypothesis was rejected by the panel regression

analysis. According to the opposing theory, capital allowance has a significant negative impact on Kenyan domestic airlines' financial performance.

**Table 4. 9: Summary of hypothesis**

No	Objective	Hypothesis	Rule	P-Value	Comment
1	To analyze the effect of corporate income tax incentives on financial performance of domestic airlines commercial airlines in Kenya.	$H_{01}$ : corporate income tax does not significantly affect financial performance of domestic airlines in Kenya.	Reject $H_{01}$ If pValue < 0.05	P>0.05	Corporate income tax had a positive but insignificant effect on financial performance of domestic airlines in Kenya
2	To examine the effect of tax holidays incentives on financial performance of domestic airlines	$H_{02}$ : tax holiday does not significantly affect financial performance of domestic airlines in Kenya	Reject $H_{02}$ If pValue < 0.05	P<0.05	Tax holiday has a significant effect on financial performance of domestic airlines in Kenya

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

Based on the idea of data analysis, the study considered summarizing its findings in this chapter. As a result, this affected how the data were interpreted and related to various empirical and theoretical investigations. From then, in order to improve a thorough comprehension of the study's concepts, conclusions and recommendations were formed. The chapter went on to discuss its conclusions in more detail and summarized it with ideas for additional research.

#### **5.2 Summary**

The study's main goal was to determine how tax breaks affected the financial results of Kenyan local airlines. The study's goal was to look into the effects of corporate income tax breaks, tax holidays, and capital allowances on the financial performance of domestic airlines. The target population consisted of 15 domestic Kenyan airlines that flew between 2015 and 2019.

##### **5.2.1 Effect of corporate income tax incentives on financial performance of domestic airlines**

The study's primary goal was to determine how corporate income tax cuts affected the financial results of domestic airlines. The correlation results show a positive and significant relationship between corporate income tax and Kenyan domestic airlines' financial performance (return on asset). The coefficients reveal that corporate income tax and the financial success (return on asset) of Kenyan domestic airlines are unrelated. As a result, the analysis was based on the finding that corporate income tax had no effect on the financial performance of Kenyan domestic airlines.

### **5.2.2 Effect of tax holidays incentives on financial performance of domestic airlines**

The second goal of the study was to look into how tax holidays affected the profitability of domestic airlines. The correlation analysis reveals a strong relationship between the tax holiday and Kenyan domestic airlines' financial performance (return on asset). The coefficient regression analysis also revealed a strong link between the tax holiday and the financial success of Kenyan local carriers (return on asset). As a result, the research looked into whether a tax holiday has a significant impact on the financial performance of Kenyan domestic airlines.

### **5.2.3 Effect of capital allowances incentives on financial performance of domestic airlines.**

The third goal of the study was to determine how capital allowances incentives affected domestic airline financial performance. Capital allowance and financial success (return on asset) are both positively and strongly correlated, according to the correlation data. Using coefficient regression analysis, a positive and significant correlation between capital allowance and financial performance (return on asset) of Kenyan domestic commercial airlines was discovered. As a result, the study discovered that capital allowance has a significant impact on Kenyan domestic airlines' financial performance.

## **5.3 Conclusions**

### **5.3.1 Effect of corporate income tax incentives on financial performance of domestic airlines**

According to the study's findings, corporate income tax has little to no effect on the financial results of Kenyan domestic airlines. As a result, corporate income tax has no effect on domestic commercial airlines' financial health. The study also discovered that corporate income tax had a significant negative impact on Kenyan domestic airlines' financial performance. Kenyan domestic airlines, as a result, use corporate income tax to reduce their

tax obligations and improve their financial performance. The study also discovered that, when compared to other tax breaks, corporate income tax breaks had the greatest impact on performance. Similarly, the study discovered that when given incentives for capital allowances and custom duty payments, certain manufacturing businesses in Kenya performed better.

### **5.3.2 Effect of tax holidays incentives on financial performance of domestic airlines**

According to the study's findings, the tax holiday has a significant impact on the financial success of Kenyan domestic airlines. Kenyan domestic airlines seek tax breaks to increase capital, retain ownership, and reduce risk, thereby increasing return on assets. The data led the researchers to the additional conclusion that the tax holiday has a variety of effects on domestic airlines' financial health.

### **5.2.3 Effect of capital allowances incentives on financial performance of domestic airlines.**

According to the study, capital allowance has a significant impact on the financial performance of Kenyan domestic airlines. Kenyan domestic airlines use capital allowance because it is easily accessible and the government assists in lowering additional operating costs, which improves their overall financial performance.

## **5.4 Recommendations**

The management of Kenya's domestic airlines should make better use of other tax exemptions, the report claims, because corporate income tax has an effect on financial performance. In order to shield themselves against the risk of operating when the corporate income tax is heavily incentivized without taking the tax incentive perspective into consideration, they should also use the tax holiday to seek out extra tax relief in their investments. The report also offers management of Kenyan domestic airlines advice on how to more aggressively and effectively exploit tax vacations in order to insulate themselves from onerous taxation bases. As a result, management have to think about looking into more

tax incentives to raise their return on assets.

The study also suggests that Kenya's domestic airline management should use capital allowance more effectively when provided this kind of incentive because it affects financial performance. The benefit of capital allowance tax incentives is that they protect businesses from the adverse impacts of tax remittance to the tax corporation by assisting in the reduction of internal expenses brought on by wear and tear on operational instruments and tools.

In order to direct airline management in Kenya, the research also recommends that the Kenya Airports Authority and the Kenya Civil Aviation Authority adopt economic norms and policies. This will help airlines become more profitable while also helping the revenue authority decide what kind of tax incentive to offer. The study also suggests that Kenya's government strengthen current regulations to facilitate commercial operations and cut red tape in the acquisition of equity and debt funding for domestic airlines.

### **5.5 Limitation of the study**

It's important to note the study's shortcomings. It's possible that some errors were missed. The constraints were controlled to reduce the expected inaccuracies by making extensive clarifications and reviewing the data numerous times. Data mining enabled the study to ensure that all of the data used in the analysis was based on inscription despite the lack of data that was anticipated for the current state of the investigation. The study also had to deal with data encryption-related information tampering.

### **5.6 Areas for further research.**

The results of this study are anticipated to advance understanding and lay the groundwork for additional investigation. The following areas have been determined to need more research as a consequence of this study. The current study first looked at tax benefits and their elements. Take into account the effect on Kenya's local airlines' financial performance. Future analysis

should determine whether the same capital allowance, tax holiday, and corporate income tax components apply to other businesses in Kenya and abroad.

Second, as mentioned in the first topic for further study, the focus of this investigation was limited to three elements. To ascertain how other factors that are not currently included in the study's scope may affect financial performance, more research is required. The study's time frame was also constrained to a five-year span, from 2015 to 2019. Additional research should be carried out over a longer time period of more than 5 years for outcomes that are more trustworthy and conclusive. The study also found that corporate income tax had no discernible influence on Kenyan domestic airlines' financial results. As a result, additional research should be done to ascertain whether this is accurate for other historical periods.

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## APPENDICES

### Appendix I: List of domestic airlines in Kenya

No	Name of Airline
1.	African Express Airways
2.	KQ
3.	Air Direct-Connect
4.	Air Kenya Express
5.	Airlink (Kenya)
6.	Air Traffic Africa
7.	Blue Bird Aviation (Kenya)
8.	Capital Airlines (Kenya)
9.	Fly540
10.	Fly-SAX
11.	Phoenix Aviation (Kenya)
12.	Queensway Air Services
13.	Ribway Cargo Airlines
14.	Safari Express Cargo
15.	Skytrail Air Safaris

Source: World airline directory (2017)

## APPENDIX II: DATA COLLECTION TOOL

No.	Tax incentives	2015	2016	2017	2018	2019
1.	Corporate income tax					
2.	Tax holiday					
3.	Capital allowance					
4.	Financial performance (Return on asset)					