



African Journal of Commercial Studies

Publisher's Home Page: <https://ijcsacademia.com/>



Review Paper

Open Access

Relationship between Income Tax and Profitability of the Hotel Sector in Kenya

Jackline Nkatha Gitonga*

¹Department of Accounting and Finance, Technical University of Mombasa, Kenya. E-mail: jackiegitonga013@gmail.com

Article Info

Volume 3, Issue 2, September 2023

Accepted : 2 October 2023

Published : 10 October 2023

doi: [10.59413/ajocs/v3.i2.4](https://doi.org/10.59413/ajocs/v3.i2.4)

Ark: ark:/69431/AJoCS.v3i2.4

Abstract

Taxation is a global economic phenomenon of paramount importance, serving as a shared fiscal responsibility between citizens and governments. This comprehensive review explores the intricate relationship between income tax and profitability, focusing on corporate tax, Pay as You Earn (PAYE), withholding tax, and their impact on businesses, particularly star-rated hotels in Kenya. The theoretical frameworks of Tax Incidence Theory and Labor Market Theory provide valuable insights into understanding the complex interplay between taxation and profitability in the hospitality industry. Drawing from empirical literature, this review explores studies from Nigeria, Kenya, and Romania, shedding light on the complex relationship between income tax and profitability. It discusses how corporate tax rates, employee income taxes, and other tax-related factors can influence a company's financial performance. This study concludes that there is an intricate negative relationship between income tax and profitability in the context of Kenyan star-rated hotels, considering corporate tax, PAYE, and their implications. The study aims to contribute to effective tax policies that support the industry's sustainable growth in Kenya and potentially other similar industries globally.

Keywords: *Income tax, Profitability, Corporation tax, PAYE, Withholding tax, Hotels*

© 2023 Jackline Nkatha Gitonga This is an open access article under the CC BY license (<https://creativecommons.org/licenses/by/4.0/>), which permits unrestricted use, distribution, and reproduction in any medium, provided you give appropriate credit to the original author(s) and the source, provide a link to the Creative Commons license, and indicate if changes were made.

1. Introduction

The concept of taxation has been a global topic for a relatively long period owing to the economic importance attached to it by every nation. [Aguolu \(2018\)](#) and [Nwezeaku \(2005\)](#) believe that taxes are a shared fiscal responsibility between citizens and their government, necessary for the government to fulfill its functions and obligations. [Anyafu \(1996\)](#) and [Buhari \(2002\)](#) describe taxation as the mandatory transfer of goods, services, or payments from individuals, institutions, or groups to the government. It is seen as a financial burden imposed on individuals or property to support government expenditures. [Ojo \(2009\)](#) argues that taxation is a scientific process of imposing taxes

on citizens. Its purpose is to generate income that can be used to provide essential social amenities, ensure security, and promote the overall economic well-being of the citizenry. [Adams \(2018\)](#) emphasizes that taxation is the primary and most significant source of revenue for modern governments, often constituting a large portion of their total income. The relationship between taxation and governance is closely intertwined, as highlighted by [Moore \(2007\)](#).

Generally, tax levels tend to increase as the gross domestic product (GDP) grows, suggesting that populations governed more effectively are typically more willing to pay higher taxes. However, higher tax burdens do not automatically equate to greater legitimacy for states. As taxation becomes

a larger portion of a nation's economic output, the likelihood of conflicts decreases (Hendrix, 2008). The issue of taxation has emerged as a notable challenge due to high tax rates, multiple taxations, complex tax regulations, a lack of coordination between different levels of government regarding tax payments, and insufficient awareness or education on tax-related matters. For instance, an increase in corporation tax on business profits produces the same effect as an increase in cost. Similarly, a rise in interest rates amplifies the costs associated with borrowing money, compelling consumers to curtail their spending, subsequently resulting in a decline in business sales. Hence, while corporate tax hikes may not be imposed directly on employees, they still have an indirect impact on workers by diminishing their wages, as evidenced by Gordon and Slemrod (1998). Additionally, these tax increases affect consumers by causing a rise in the prices of goods and services they purchase. The resultant price surge may subsequently lead to decreased consumption, which can adversely impact the sales of companies that offer various goods and services to customers. The hospitality industry, being a service sector that is crucial to national growth, is also susceptible to these effects.

The hotel industry is one of the most developed industries in the world and is sensitive to tax (Ampofo, 2020). The hospitality industry plays a critical role in the economic development of nations, contributing to job creation, foreign exchange earnings, and overall economic growth. Within the hospitality industry, hotels are significant contributors, providing accommodation, dining, and other services to both domestic and international guests. However, hotels face various challenges in maintaining profitability, and one of the significant factors influencing their financial performance is tax. It is subjected to a range of specific taxes, fees, and charges. According to Geringer (2021), when an income is subjected to more than one tax treatment, it leads to multiple taxation. Income tax is defined as a form of direct tax that is levied on individuals or entities based on the income or profits, they have earned (Kadenge, 2021). This tax is typically calculated by multiplying the taxable income by a specified tax rate. The tax rate can vary depending on the taxable income, and this is often referred to as a graduated or progressive tax rate. Corporate tax, which is applicable to companies, is usually imposed at a fixed or flat rate. When it comes to individual income, progressive tax rates are commonly used, meaning that the tax rate increases as the income level rises. For example, the first portion of income may be taxed at a lower rate, while higher income brackets face higher tax rates. Hotels in Kenya, like other businesses, are subject to income tax on their profits. The scope and specifics of income tax regulations vary from country to country, with each nation having its own set of tax laws. Generally, countries levy taxes on income derived from various sources, including wages, salaries, interest, dividends, and rental income. There is disparity in the levels of taxation across different countries.

The variations in income tax rates and regulations directly impact the profitability of businesses. The level of taxation can significantly influence the overall profitability of an entity, as higher tax burdens reduce net earnings and available resources for investment, expansion, and innovation.

The success of a company is heavily dependent on its financial performance, which is essential for its overall health and sustainability. Scholars across diverse disciplines within business and strategic management have devoted substantial focus to studying profitability as it directly influences the overall well-being and long-term viability of the organization. Researchers have utilized various profit indicators in their studies, and among the most commonly used measures are those that combine stock market and accounting data, such as Tobin's Q or the market-to-book value ratio. Stock market measures like cumulative abnormal returns (CAR) and accounting-based measures, including financial statement figures and ratios like return-on-equity (ROE) and return-on-assets (ROA), are also commonly employed.

Accounting metrics such as sales, earnings per share, and the growth rate of a company are commonly used to evaluate the firm's profitability. Return on assets (ROA), return on equity (ROE), and return on capital employed (ROCE) provide insights into the profitability and efficiency of a company. According to the studies conducted by Dyreng et al. (2019), Oeta et al. (2019), Laffitte et al. (2020), and Jaffar et al. (2021), it is argued that a firm's profitability serves as an intuitive indicator that can influence the effective tax rate. When profitability is measured based on pre-tax income, the expectation is that more profitable firms will have higher earnings and, as a result, pay more taxes. The rationale behind this argument is that as a company's profitability increases, its taxable income also tends to rise. Higher profitability leads to a larger tax base, resulting in a higher amount of tax owed to the government.

2. Literature Review

This section provides a comprehensive review of the existing literature related to the study in a bid to position it within a pertinent theoretical framework. Thus, it discussed the findings of related research to this study as well as what research has already been done and how the findings relate to the problem at hand. In addition, a critique of the existing literature will be provided to identify gaps and limitations that this research aims to address.

2.1. Theoretical framework

Theories are analytical tools for understanding, explaining, and making predictions about a given subject matter. Various theories explain the theories of taxation and its effects on profitability;

2.1.1 Tax Incidence Theory

Tax Incidence Theory, initially advanced by British economist Richard Musgrave in 1939, is a fundamental economic theory that explores the distribution of tax burdens among various stakeholders within an economy. It examines how the imposition of taxes, in this case, corporation tax, affects not only the entity legally responsible for paying the tax but also how the burden is shared among consumers, employees, and shareholders. Applying this theory to the effect of corporation tax on the profitability of star-rated hotels in Kenya reveals valuable insights.

One key aspect of Tax Incidence Theory is the concept of tax shifting, which refers to the ability of firms to pass on the burden of taxes to other economic agents. In the context of star-rated hotels in Kenya, this theory suggests that when the government imposes or increases corporation tax, hotels may respond by adjusting their pricing strategies. Research by [Burman and Randolph \(1994\)](#) found that businesses, including hotels, often attempt to shift the tax burden to consumers by raising prices. Therefore, when corporation tax is levied on hotels, it may result in higher room rates or charges for services, impacting the cost structure for guests.

Moreover, the incidence of corporation tax also depends on the elasticity of demand for hotel services. If the demand for accommodation in Kenyan hotels is relatively inelastic, meaning that consumers are less responsive to price changes, hotels may have greater latitude to pass on the tax burden. Research by [Saelim \(2019\)](#) supports this concept by emphasizing that inelastic demand can result in a larger portion of the tax burden being borne by consumers. In such cases, the profitability of hotels could be adversely affected, as higher prices might deter potential guests.

Additionally, Tax Incidence Theory highlights that the distribution of the tax burden can extend to employees and shareholders. If the imposition of corporation tax places financial pressure on hotels, they may seek to mitigate the impact by adjusting employee compensation or reducing dividends paid to shareholders. Research by [Wawire \(2020\)](#) notes that when corporations face higher tax costs, they may reduce employee wages or slow down wage growth. This potential reduction in employee compensation could affect workforce morale and retention in Kenya, potentially impacting service quality and, in turn, profitability.

Tax Incidence Theory provides a valuable framework for understanding how the imposition of corporation tax can affect the profitability of star-rated hotels in Kenya. By considering how hotels may attempt to shift the tax burden to consumers, adjust pricing strategies based on demand elasticity, and potentially make internal adjustments to labor costs and shareholder payouts, this theory sheds light on the complex dynamics of tax incidence in the hospitality industry. Further empirical research and data analysis are essential to assessing the precise impact of corporation tax on profitability in this specific context.

2.1.2 Labor Market Theory

Labor Market Theory, originally formulated by British economist Alfred Marshall in the late 19th century and further developed by subsequent scholars, provides a foundational framework for understanding the dynamics of labor supply and demand in an economy. When examining the effects of Pay as You Earn (PAYE) on the profitability of star-rated hotels in Kenya, this theory becomes relevant in elucidating how labor market conditions can influence the financial sustainability of these establishments.

Alfred Marshall's Labor Market Theory posits that the price of labor (wages) and the quantity of labor supplied are determined by the interaction of supply and demand for labor in a competitive labor market. In the context of PAYE, the theory suggests that changes in labor costs, driven by tax deductions, can have direct implications for both employers (star-rated hotels) and employees. Research by [Borjas \(2019\)](#) emphasizes the significance of this relationship, noting that labor market conditions and tax policies can interact to shape wage structures and labor market outcomes.

The impact of PAYE on the profitability of star-rated hotels in Kenya can be understood through the lens of labor supply and demand elasticity. If the labor supply is relatively inelastic, meaning that it is not very responsive to changes in wages, hotels may find it challenging to adjust to higher labor costs due to PAYE deductions. Empirical evidence from research by [Card et al. \(2020\)](#) suggests that an inelastic labor supply can lead to wage increases being absorbed by employers, potentially reducing profitability. In such a scenario, hotels may face higher labor expenses without being able to pass them on to consumers through price increases.

Furthermore, labor market theory also highlights the role of labor market institutions and regulations in shaping labor market outcomes. In the case of PAYE, government regulations dictate the tax deductions from employee salaries. The impact of these regulations on hotel profitability can vary based on how effectively they balance the interests of employers and employees. Research by [Neumark \(2019\)](#) underscores the importance of understanding the regulatory environment in labor markets and how it can affect the distribution of labor costs and profitability.

Additionally, the seasonality and volatility of the tourism industry in Kenya can exacerbate the effects of PAYE on star-rated hotels. The theory suggests that when labor supply is highly responsive to changes in wages, as may occur in seasonal industries, the impact of tax policies like PAYE can be particularly pronounced. Research by [Ehrenberg and Smith \(2013\)](#) highlights that in seasonal labor markets, employers may face more challenges in adjusting labor costs, and the burden of PAYE may be more evident during peak tourism seasons, affecting profitability fluctuations.

Labor Market Theory offers a valuable perspective on

how the effects of PAYE on the profitability of star-rated hotels in Kenya can be understood within the context of labor supply and demand dynamics. The theory underscores the importance of considering labor market elasticity, regulations, and the unique characteristics of the tourism industry when assessing the impact of PAYE on hotel profitability. Empirical research that accounts for these factors is essential for a comprehensive analysis of the relationship between PAYE and hotel financial sustainability in the region.

2.2. Income tax and Profitability

2.2.1 Corporate tax

Corporation tax, as defined by Oladele and Agbaje (2017), is a form of direct taxation imposed on companies. Governments levy this tax on various sources of revenue generated by corporations and companies, including sales and investments. It serves as a crucial revenue source for governments, facilitating funding for public services and infrastructure development.

In the context of star-rated hotels in Kenya, the taxable income comprises the proceeds from hotel operations, encompassing elements such as room revenue, food and beverage sales, and other income sources. The computation of this tax is based on the net profits of the company, calculated after deducting allowable expenses, allowances, and tax credits. The actual corporate tax rate applied varies depending on the specific tax laws and regulations of the country.

The term "tax rate" denotes the percentage of income or a specific monetary amount that an entity must remit as taxes. Tax rates can exhibit variation based on the characteristics of the taxpayer and the nature of the income involved. In some cases, tax rates are graduated or progressive, meaning they increase as taxable income rises. Consequently, larger and more profitable companies often face higher tax rates in contrast to their smaller counterparts.

In the Kenyan context, the Income Tax Act governs income taxation, particularly corporate tax, which is imposed at a flat rate (Kamau et al., 2021). For hotels operating as corporate entities, such as limited liability companies in Nairobi, they are subject to corporate income tax. As of 2023, the standard corporate tax rate stands at 30% of the taxable income.

The imposition of a higher corporate tax rate, like the 30% rate in Nairobi, has implications for hotels. They are compelled to allocate a more substantial portion of their profits to taxes, which, in turn, diminishes their net income available for covering operational expenses, investment in improvements, or expansion of services. This reduction in profitability can significantly influence the financial decisions and growth trajectory of hotels.

According to Hicks, as cited in Oladele and Agbaje (2017), the introduction of an additional tax on profits can fundamentally alter the expected return curve. This alteration entails a shift to the left without changing its fundamental shape or the likelihood of incurring losses. This shift signifies a reduction in the potential for exceptionally high gains that, in the past, balanced the inherent investment risk. Consequently, high-risk investments become less attractive, favoring safer investment options. Introducing a high-profit tax can thus disadvantage venture capital and pose substantial challenges for a country aspiring to keep pace with modern development trends.

2.2.2 Pay as You Earn (PAYE)

Hotels often have employees who are subject to individual income tax, a levy based on their respective salary levels. Individual income tax rates exhibit variability based on an employee's earnings, with distinct tax bands and corresponding rates applied, as highlighted by Peter et al. (2010). This tax framework operates under the Pay-As-You-Earn (PAYE) system, wherein the responsibility for deducting and remitting income tax on behalf of employees' rests with the employers.

In the context of PAYE, taxable income refers to the portion of an employee's earnings that is subject to income tax. This encompasses the entirety of income derived from employment, comprising basic salary, allowances, bonuses, commissions, and non-monetary benefits. Deductions and allowances, such as pension contributions, medical insurance premiums, and approved donations, are factored in to calculate the taxable income.

The PAYE system streamlines the taxation process for employees and enhances tax collection efficiency for the government. Typically, individual taxpayers need not engage in separate income tax return filings, as their employers undertake the task of deducting and forwarding the requisite taxes on their behalf. Nevertheless, there are situations wherein individuals may still be required to file annual tax returns, primarily to report supplementary income, assert deductions, or seek tax refunds. Employers bear the onus of ensuring accurate tax deductions and punctual remittances to the tax authorities to remain compliant with PAYE regulations.

In Kenya, the personal income tax framework targets the income earned by individuals, adhering to a progressive tax structure. This implies that tax rates increase with rising income levels. As of September 2021, the applicable tax rates were as follows: 10% on the initial KES 24,000 of annual income, 15% on income ranging from KES 24,001 to KES 40,000, 20% on income within the KES 40,001 to KES 60,000 bracket, 25% on income spanning KES 60,001 to KES 80,000, and 30% on income exceeding KES 80,001.

The payment of individual income tax on employee salaries contributes to the hotel's labor costs. Elevated tax

rates translate to increased salary expenses for the hotel, thereby affecting its overall operational outlays and profitability.

2.2.3 Withholding tax

Withholding tax is a form of income tax paid to the government by the entity responsible for disbursing income, rather than the recipient (Wawire, 2020). This means that the tax is deducted from the income owed to the recipient, serving as a pre-emptive measure against tax evasion. It is worth noting that governments employ withholding tax as a tool to combat tax evasion, and in certain cases, they may impose additional withholding tax requirements, especially when recipients have been non-compliant in filing tax returns or in industries where tax evasion is prevalent.

Typically, the withheld tax is considered an advance payment towards the final tax liability of the recipient. It can be refunded if, upon filing a tax return, it is determined that the recipient's actual tax liability is less than the amount withheld. Conversely, additional tax may be owed if the recipient's tax liability exceeds the withheld amount. In specific instances, the withheld tax serves as the complete discharge of the recipient's tax liability, obviating the need for a tax return or supplementary tax payments. This form of withholding is commonly referred to as final withholding.

For hotels in Kenya, interest income is subject to a withholding tax rate of 15%. In practical terms, if a hotel earns interest from bank deposits or other financial instruments, the financial institution disbursing the interest will deduct 15% of the interest sum before transferring it to the hotel. The withheld tax is subsequently remitted to the Kenya Revenue Authority (KRA) on behalf of the hotel. Additionally, royalties earned by hotels in Kenya are subject to a withholding tax rate of 20%. In cases where a hotel receives royalties for the utilization of intellectual property, such as trademarks or logos, the entity making the royalty payment will withhold 20% of the royalty amount and forward it to the KRA. Furthermore, the Kenya Revenue Authority mandates that dividends distributed to shareholders of hotels be subjected to a withholding tax rate of 5%. When a hotel declares and disburses dividends to its shareholders, it is obligated to retain 5% of the dividend total and remit it to the KRA on behalf of the shareholders.

The impact of withholding tax is directly felt in the profitability of hotels in Kenya. It diminishes the income derived from interest, royalties, and dividends, ultimately reducing the net income. For instance, if a hotel earns Ksh 100,000 in interest income and is subject to a 15% withholding tax rate, Ksh 15,000 will be deducted and remitted to tax authorities, leaving the hotel with Ksh 85,000. This decreased cash flow can constrain the hotel's capacity to undertake projects, address working capital requirements, and influence its competitive positioning. Moreover, complying with withholding tax regulations

necessitates additional administrative efforts and costs. Higher withholding tax rates on dividends can also impact shareholder returns, potentially affecting investor confidence and foreign investments. For hotels earning royalties from intellectual property, elevated withholding tax rates can significantly reduce overall revenue from these arrangements. Consequently, the influence of withholding tax can be substantial, directly affecting the financial well-being and competitive stance of hotels in Kenya.

2.2.4 Profitability

In their comprehensive study, Diana and Maria (2020) delved into a spectrum of key profitability measures essential for evaluating a company's financial performance. Among these metrics, Return on Assets (ROA) emerges as a pivotal indicator, shedding light on an enterprise's efficiency and effectiveness in harnessing its assets to generate income. ROA effectively gauges management's proficiency in deploying capital to yield profits. ROA elucidates the relationship between income generated and the entirety of assets engaged by the company. This ratio serves as a valuable gauge of how proficiently a company's assets are mobilized to produce profits. A higher ROA signifies an efficient utilization of assets in income generation, while a lower ROA suggests suboptimal asset utilization. Notably, ROA transcends mere financial efficiency; it also encapsulates management's prowess in capital allocation.

In her study on Challenges Affecting Financial Performance of Small and Medium Sized Firms in Kenya, Murori (2022) explicated that the concept of financial performance encompasses a wide range of elements and can be understood as the measure of the degree to which a firm has achieved its financial goals and objectives. Even if a company demonstrates adeptness in income generation, it might not be making the most judicious use of its capital, resulting in a diminished ROA. ROA, therefore, stands out as a holistic measure of a company's operational performance, considering both profit outcomes and the resources channelled (total assets) to achieve these outcomes.

ROA's straightforwardness renders it readily interpretable. A higher ROA is generally coveted, signifying a company's ability to generate greater income per unit of assets employed. It's a key indicator of financial prowess. The interplay of Return on Assets (ROA), Operating Income (OPM), and Total Revenue (ATR) underscores the multifaceted evaluation of financial performance. Enhancing profitability by optimizing resource utilization can transpire in two ways. Firstly, companies can bolster revenue per unit of output, with Operating Income serving as a metric for income per production unit. Hence, a company exhibiting higher productivity is a low-cost producer.

In the context of agricultural resources or sizable farms, managerial influence over business operations and property

management proves pivotal in enhancing financial performance. The act of incorporating the evaluation of environmental factors into the process of analyzing the financial viability and making decisions regarding new investments has proven to have a positive impact on the overall sustainability of the environment. This integration of environmental considerations and financial appraisals has been found to contribute towards the creation of an eco-friendlier environment where the effects of human activities are taken into account and minimized (Mbalu & Kamau, 2022). An elevation in either or both factors augments ROA, typically signifying commendable financial performance. Debt, when employed judiciously, can prove advantageous, enabling a firm to unlock its potential for profitability. By leveraging equity capital with borrowed funds, businesses can amplify their financial capacity, embarking on projects with the potential for superior returns. To gauge the efficacy of debt in the capital structure, the rate of return on equity (ROE) comes into play. ROE is computed by dividing net income by shareholder's equity.

Taxes, with their inherent financial implications and economic significance, assume a paramount position and exert a substantial impact on the development and enhancement of infrastructure, which are pivotal and indispensable for the optimization and advancement of firms' operational efficacy, productivity, and overall performance (Orodi, 2022). For businesses reliant on borrowed capital, ROE should surpass the rate of return on assets (ROA). If ROE falls short of ROA, it suggests that borrowed capital isn't generating adequate income to cover its costs, signalling suboptimal debt utilization. Conversely, a substantial ROE exceeding ROA implies further opportunities for gains from additional investments. This reflects that the firm's equity capital generates returns surpassing borrowing costs, indicative of favourable performance and growth potential.

ROE also serves as a valuable yardstick for investors weighing alternative investment options. It aids in assessing the attractiveness of investing in the firm's operations vis-à-vis other opportunities. However, it's imperative to recognize that ROE lacks risk adjustment. Therefore, when making direct comparisons, adjustments for differences in perceived investment riskiness should be considered. Furthermore, ROE maintains a close relationship with and is influenced by ROA. Taking management actions to enhance operating profit margin and/or asset turnover can elevate ROA, thereby positively impacting ROE. Augmenting overall business profitability through these strategic measures can result in a more appealing ROE, thus attracting potential investors.

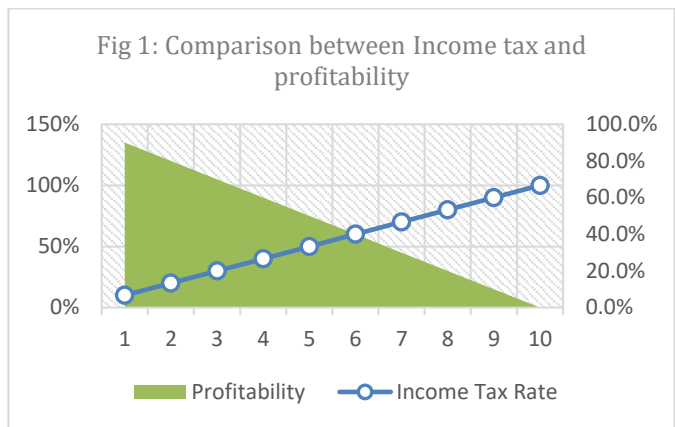


Figure 1 illustrates a clear negative correlation between income tax and profitability. As income tax increases, profitability decreases. This negative correlation suggests that higher levels of income tax have a detrimental effect on the profitability of the entities being studied. In other words, as the tax burden on income grows, it leads to reduced profits for the entities, such as star-rated hotels in Kenya, and potentially affects their financial well-being and decision-making processes. This finding highlights the significance of understanding the impact of income tax on profitability, especially in industries like hospitality, where profitability is a key driver of sustainability and growth.

2.3. Empirical literature review

In their research, Ezugwu and Akubo (2014) conducted a comprehensive examination of the impact of elevated corporate tax rates in Nigeria on firm profitability. Their study employed a survey method and incorporated multiple retrospective approaches to analyze secondary data sourced from the Federal National Revenue Service (FIRS). The dataset encompassed information from 45 commercial establishments situated in Lagos, with a selected sample of 41 participants subjected to rigorous analysis. The primary focus of their investigation centered on two pivotal variables: business profitability (the dependent variable) and the value of taxpayers (the independent variable). The collected data underwent meticulous scrutiny via statistical selection methods. The research findings unveiled a robust correlation between corporate tax rates and corporate profits. This discovery underscores the profound influence that country-specific tax rates can exert on the intricate relationship between income and profitability.

Chude and Chude (2015) delved into the impact of employee income tax on firm income, with their analysis grounded in secondary data derived from annual financial reports of brewers. Their study's focal point was earnings per share (EPS) as the variable of interest, with income tax (corporate tax) serving as the explanatory variable. To assess the effect of Corporate Income Tax (CIT) on EPS, they conducted an Augmented Dickey-Fuller (ADF) unit test at a 5% significance level. The results pointed to a long-term relationship and revealed that CIT exhibited a positive effect

on EPS (P value $0.000 < 0.05$). This investigation underscores the notion that corporate income tax plays a constructive role in enhancing the profitability of Nigerian breweries, thus hinting at potential variations in the income tax-profitability relationship across industries.

In their study on the financial performance of companies listed on the Nairobi Stock Exchange in Kenya, [Otwani, Namusonge, and Makokha \(2017\)](#) employed a mixed research design. They combined secondary data analysis with a sample comprising 59 companies listed on the Kenya Stock Exchange (KSE). The research considered various independent variables such as size, productivity, investment, and age/debt, while the variable of interest was the company's income and return on investment (ROI). Their findings illuminated a positive correlation between corporate tax and the performance of these companies. In essence, the results suggested that higher income taxes yield a positive impact on the financial performance of the research companies. This empirical evidence underscores the notion that tax revenues can wield a substantial influence on profitability within the specific context of Kenya.

[Pitulice et al. \(2019\)](#) embarked on an exploration of the impact of Romanian corporate tax on the financial performance of companies. Their dataset encompassed financial statistics spanning three years, specifically from 2019 to 2021, and involved a sample of 20 companies traded on the Bucharest Stock Exchange. Employing multiple regression analysis, the researchers focused on two critical metrics: revenue and financial return (return on assets). The analytical process took into account several independent variables, including the effective tax rate, size, assets, long-term debt to total assets, and financial leverage. Notably, cases with no discernible effect were excluded from the study. The findings illuminated the influence of corporate tax not only through effective tax rates but also its bearing on the economic performance of companies. In essence, higher taxes were associated with diminished economic performance.

[Nwaorgu, Oyekezie, and Abiahu \(2020\)](#) undertook an examination of the impact of corporate tax rates on the profitability of manufacturing companies in Nigeria. Their study was predicated on post-hoc design data and was analyzed through horizontal linear regression. The findings of their research indicated that corporate tax rates did not exert a significant effect on the return on equity of these enterprises. This suggests that factors beyond income tax should be considered when interpreting the results.

Finally, [Olatunji and Oluwatoyin \(2019\)](#) delved into the effect of corporate income tax on the profitability of companies in Nigeria. Their study leveraged the Ordinary Least Square (OLS) technique and drew on secondary data from various sectors including banks, construction, insurance, petroleum, breweries, food and beverage companies, and other establishments. Their study spanned the period between 2019 and 2018, with data sourced from

firms trading on the Nigeria Stock Exchange (NSE). The dependent variables encompassed Annual dividend payments, Annual corporate tax expenses, earnings per share, and returns on earnings per share. The study's findings suggested that corporate tax did not significantly influence a company's policies or dividend distribution. Consequently, the study recommended the formulation of an appropriate tax structure that would encourage public investment and economic development, including the hotel sector, without adversely affecting regular income.

3. Summary and Conclusion

The existing body of literature offers valuable insights into the impact of income tax on financial performance, particularly within the manufacturing and brewery sectors in Nigeria. However, there exists a notable research gap when it comes to studies that specifically delve into how income tax influences the profitability of hotels in Kenya. While the reviewed studies provide a broader perspective on the intricate relationship between income tax and profitability across various settings, they may not directly address the distinct characteristics and dynamics inherent to the hotel industry in Kenya.

Furthermore, while some of these studies do shed light on tax-related constraints affecting profitability, they often fall short of thoroughly exploring the specific mechanisms through which income tax exerts its influence on hotel profitability. These mechanisms could encompass aspects such as the impact of tax rates on investment decision-making, pricing strategies, or the allocation of resources. A comprehensive understanding of these mechanisms holds the potential to provide invaluable insights for both hotel managers and policymakers.

The literature review unequivocally highlights the need for specialized investigations into the specific ramifications of income tax on the profitability of hotels situated in Kenya. Despite the existence of studies that have explored the effects of income tax on financial viability in a general sense or within diverse industries, there remains a glaring lack of research that hones in on the hotel industry within Kenya. The objective of this research is to fill this void by providing empirical evidence regarding the impact of income tax on hotel profitability within this distinct and particular setting.

The literature review underscores the paramount importance of comprehending how income tax affects the profitability of star-rated hotels in Kenya. While existing research yields mixed findings, indicating that income tax can have both positive and negative repercussions on profitability, the absence of dedicated studies centered on Kenya necessitates a more extensive examination of the existing literature. This research endeavors to bridge these gaps and contribute novel insights into how income tax influences hotel profitability within the unique context of Kenya.

this study delves into the intricate relationship between taxation, particularly corporation tax and PAYE, and the profitability of star-rated hotels in Kenya. The background of the study provided a comprehensive overview of taxation's economic significance and its role in supporting government functions and obligations. It highlighted the importance of taxation as a major source of government revenue and its connection to effective governance.

Furthermore, the study emphasized the unique challenges faced by the hospitality industry, particularly hotels, in maintaining profitability, with a focus on the impact of income tax and labor taxes. These challenges are exacerbated by complex tax regulations, multiple taxation points, and varying tax rates across different countries.

The literature review examined two key economic theories, Tax Incidence Theory and Labor Market Theory, to provide theoretical frameworks for understanding the impact of taxation on hotel profitability. Tax Incidence Theory shed light on how corporations, including hotels, may attempt to shift tax burdens to consumers, adjust pricing strategies, and make internal labor cost adjustments when faced with corporation tax. On the other hand, Labor Market Theory offered insights into how labor market conditions and tax policies, such as PAYE, can influence wage structures and labor market outcomes, with potential repercussions for hotel profitability. In light of the theories

and the specific tax challenges faced by hotels in Kenya, empirical research becomes essential to provide a deeper understanding of the precise impact of taxation on hotel profitability. This research will not only contribute to the existing body of knowledge but also offer practical insights for policymakers, hotel operators, and other stakeholders in the hospitality industry. Ultimately, a nuanced understanding of how taxation affects hotel profitability can inform more effective tax policies and strategies to promote the sustainable growth of the hotel sector in Kenya and potentially serve as a valuable reference for similar industries worldwide.

In conclusion, taxation, including corporate tax, PAYE, and withholding tax, has a substantial impact on the profitability of businesses, including star-rated hotels in Kenya. Effective tax management and planning are essential for optimizing profitability while fulfilling tax obligations. Additionally, the relationship between taxation and profitability is influenced by various contextual factors, making it imperative for policymakers and businesses to consider the unique economic and industry-specific dynamics of the region. Further research and empirical analysis are necessary to gain a more comprehensive understanding of the intricate interplay between taxation and profitability in the specific context of Kenya's hospitality industry.

Acknowledgment

We would like to express our gratitude to the journal editor and the anonymous reviewers for their valuable comments and suggestions that significantly improved the quality of this manuscript.

References

- Adams, C. (1993). *For good and evil: The impact of taxes on the course of civilization*. Rowman & Littlefield.
- Aguolu, O. (2018). *'Taxation and Tax Management in Nigeria,' 3 Edition*, Enugu; Meridan Associates.
- Ampofo, J. A. (2020). Contributions of The hospitality industry (Hotels) in the development of Wa municipality in Ghana. *International Journal of Advanced Economics*, 2(2), 21-38.
- Anyafu, A. M. (1996). *Public finance in a developing economy: The Nigerian case*. Department of Banking.
- Borjas, G. J. (2019). *Immigration and economic growth*.
- Buhari, A. L. (2002). *Staight to the Point Ican/Polytechnic Public Finance*. Ilorin.
- Burman, Leonard E, and William C Randolph. 1994. "Measuring permanent responses to capital-gains tax changes in panel data." *The American Economic Review*, 794-809.
- Card, D., Cardoso, A. R., Heining, J., and Kline, P. (2018), 'Firms and Labor Market Inequality: Evidence and Some Theory', *Journal of Labor Economics*, 36 (S1), S13-S70.
- Chude, D. I. & Chude, N. P. (2015). Impact of company income taxation on the profitability of companies in Nigeria: A study of Nigerian Breweries. *European Journal of Accounting, Auditing and Finance Research*, 3(8), 1-11.
- Diana, H. I., & Maria, M. M. (2020). The importance Of profitability indicators In assessing The financial performance

Of economic entities. The Annals of the University of Oradea, 29(2020), 219.

- Dyreg, S. D., Hanlon, M., & Maydew, E. L. (2008). "Long-run corporate tax avoidance", Accounting Review, 83(1), 61-82.
- Ehrenberg, R., and R.S. Smith. 2013. Modern Labour Economics: Theory and Public Policy, Chapter 5. 11th ed. Upper Saddle River: Prentice Hall.
- Ezugwu, C.I, & Akubo, D. (2014). Analysis of the effect of high corporate tax rate on the profitability of corporate organisations in nigeria - A study of some selected corporate organisations. Mediterranean Journal of Social Sciences, 5(20), 310.
- Geringer, S. (2021). National digital taxes-Lessons from Europe. South African Journal of Accounting Research, 35(1), 1-19.
- Gordon, R. H., & Slemrod, J. (1998). Are" real" responses to taxes simply income shifting between corporate and personal tax bases?.
- Hendrix, C. S. (2008). Leviathan in the tropics? Environment, state capacity, and civil conflict in the developing world. University of California, San Diego.
- Jaffar, R., Derashid, C., & Taha, R. (2021). Determinants of tax aggressiveness: Empirical evidence from Malaysia. The Journal of Asian Finance, Economics and Business, 8(5), 179-188.
- Kadenge, J. M. (2021). Effect of Taxation on Economic Performance: A Case of Kenya.
- Kamau, C. G., Mutiso, A. N., & Ngui, D. M. (2012). Tax Avoidance and Evasion as a Factor Influencing'Creative Accounting Practice'Among Companies in Kenya. Journal of Business Studies Quarterly, 77-84.
- Laffitte, S., Martin, J., Parenti, M., Souillard, B., & Toubal, F. (2020). International corporate taxation after COVID-19: Minimum taxation as the new normal. CEPII Policy Briefs, 30, 1-6.
- Mbalu, P., & Kamau, C. G. (2022). Corporate Sustainability Accounting and Reporting in Kenya. Available at SSRN 4000715. <https://dx.doi.org/10.2139/ssrn.4000715>
- Moore, M. (2007). How does taxation affect the quality of governance?.
- Murori, C. K. (2022). Challenges Affecting Financial Performance of Small and Medium Sized Firms in Kenya. African Journal of Commercial Studies, 1(1), 9-17
- Neumark, David. 2019. "The Econometrics and Economics of the Employment Effects of Minimum Wages: Getting from Known Unknowns to Known Knowns." German Economic Review 20 (3): 293-329.
- Nwaorgu, I. A., & Abiahu, M. F. C. (2020). Effect of corporate tax on sustainable financial performance of listed firms in Nigeria. Abiahu, MC & Nwaorgu, IA (2020). Effect of Corporate Tax on Sustainable Financial Performance of Listed Firms in Nigeria. Journal of Taxation and Economic Development, 19(1), 50-63.
- Nwezeaku, C.N.(2005). Taxation in Nigeria: Principles and Practice, Owerri
- Oeta, S., Kiai, R., & Muchiri, J. (2019). Influence of tax planning on financial performance of manufacturing companies listed at Nairobi Securities Exchange. International Journal of Research in Business and Social Science (2147-4478), 8(6), 262-270.
- Ojo, S. (2009). Fundamental principles of Nigerian tax. Sagriba Tax Publication.
- Oladele, R. & Agbaje, W. H. (2017). Corporate taxes and performance in manufacturing firms in Nigeria. International Journal of Economic and Business Review, 5(4), 1-11 Olatunji, O. C., & Oluwatoyin, A. E. (2019). Effect of corporate taxation on the profitability of firms in Nigeria. Journal of economics and behavioral studies, 11(1 (J)), 191-201.
- Olatunji, O. C., & Oluwatoyin, A. E. (2019). Effect of corporate taxation on the profitability of firms in Nigeria. Journal of economics and behavioral studies, 11(1 (J)), 191-201.
- Orodi, S. (2022). The Effects of Fiscal Policy on the Performance of Commercial Banks in Kenya. African Journal of Commercial Studies, 1(1), 18-27

- Otwani, M. N., Simiyu, G. N., & Makokha, E. N. (2017). Impact of capital adequacy on the financial performance of companies listed on the Nairobi Securities Exchange in Kenya. *International Journal of Social Sciences and Information Technology*, 3(9), 2506-2513.
- Peter, K. S., Buttrick, S., & Duncan, D. (2010). Global reform of personal income taxation, 1981-2005: Evidence from 189 countries. *National Tax Journal*, 63(3), 447-478.
- Pitulice, I., Stefanescu, A., Minzu, V., Popa, A., & Niculescu, A. (2016). Research of corporate tax impact on financial performance. Case of companies listed on Bucharest Stock Exchange. *Management and Economics Review*, 1(2), 203-216.
- Saelim, S. (2019). Carbon tax incidence on household demand: effects on welfare, income inequality and poverty incidence in Thailand. *Journal of Cleaner Production*, 234, 521-533.
- Wawire, N. (2020). Constraints to enhanced revenue mobilization and spending quality in Kenya. Policy Paper.

Cite this article as: Jackline Nkatha Gitonga (2023). [Relationship between Income Tax and Profitability of the Hotel Sector in Kenya](#). *Africa Journal of Commercial Studies*. 3(2),108-117. doi: 10.59413/ajocs/v3.i2.4