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An Investigation of the Effect of Tax Incentives on the FDIs: A Case of EPZs in Athi River Kenya

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Abstract

The study sought to investigate tax incentives, exclusively tax holiday and capital deductions and how they influence the attraction and retention of the Foreign Direct Investments in Export Processing Zones. A sample size of 72 employees of the firms operating under EPZs was selected for the study using stratified method for the firms and purposive method for the respondents. The study utilized descriptive survey design using self administered questionnaires to solicit information from sampled senior of Export Processing Zones firms. The study found that the use of tax holiday greatly influences the attraction and retention of Foreign Direct Investments. Arguably, the manufacturing sector seems greatly favored by the tax incentives compared to other sectors due to extended capital allowances. The research concludes that tax incentives should be enhanced towards boosting the growth and expansion of the foreign director investors and that the government should be willing to extend the tax holiday beyond ten years for the firms depending on capital injected on long term basis.

Introduction

Background of the study

Granting of tax incentives to attract more FDI is received with mixed feelings among different stakeholders. First, the tax incentives must lead to an increased flow of FDI into that country by attracting FDI that would not come without the presence of the incentives. Second, these FDI should contribute to the country's development by offering returns to the country that offset (the returns) the foregone tax revenue in the form of tax incentives granted to the investors (Ngowi , 2000).

Tax incentives play a minor role in making investment decisions as governments uses them as a means to an end (UNCTAD, 2005). Following the establishment of EAC in 1999 Kenya, Tanzania and Uganda created a custom union i.e. a duty-free trade area with a common external tariff in 2005. The aim was to create a larger regional market that will enable firms to set operation in any of the East Africa nations. In a number of situations the EAC countries have made attempts to increase the tax incentives in order to attract FDI and eventually increase jobs and exports. The more prominent incentives offered to the firms operating in Export Processing Zone include; tax holiday where a firm is exempted from the corporate income tax for 10years, exemption from import duty on machinery, raw materials and input meant for export production (Action aid, 2012).

Tax incentives

Fletcher (2002) defines tax incentives as any tax provision granted to a qualified investment project that represents a favorable deviation from the provisions applicable to investment projects in general. Morisset (2000) argues that numerous surveys of international investors have shown that tax incentives are not the most influential factor in the selection of the investment destination but there are tax policies which are capable of affecting the volume and location of FDI, as higher tax rates reduces the after-tax returns ((Morisset & Neda, 2001).

The Government of Kenya has not lagged behind in the global competition for FDI as measures on tax policies have been formulated and implemented to this effect .There are various tax incentives available in Kenya both targeted and non-targeted (KRA, 2010). These tax incentives include; initial 10 year tax holiday for companies operating in the Export processing Zone and subsequent reduction of corporate tax rate to 20% for the next 10 years, tax loss carry forward for the next four years from the year of income the tax loss was first incurred, investment deduction of 150% for investment of more than

Kshs.200million outside the cities of Mombasa, Kisumu and Nairobi. These Investment deductions are 100% claimable in case the firm is set in Nairobi, Mombasa or Kisumu (Kenya Income Tax ACT, CAP 470 and 517 Laws of Kenya).

Foreign direct investment (FDI)

FDI inflows in Kenya in the year 2001 reflected new investments by mobile phone companies (involving mergers and acquisitions of $3 million) and accelerated offshore borrowing by private companies to finance electricity generation activities which became necessary because of the drought that prevailed that year. The stock of net FDI inflows increased from Kshs 3.624 million in 2000 to 10,867millions in 2010 (Economic survey, 2010-2000). Although Kenya was leading as a destination of FDI to the East Africa Community in the 1970 and 1980, the relative level of inflows was 7.5% of GDP in 2003 compared to 25.3% for Africa and 31.5% for developing countries (UNCTAD, 2005).

Despite the numerous tax incentives, the Kenyan EPZs have not achieved much in terms of job creation and inflows whereby in 2010 Kenya was lagging behind with only US$ 133 compared with Tanzania and Uganda which had massive inflows of US$700 and US$848 respectively (Action aid, 2012). Kenya has had a long history with foreign firms whereby in the 1970s it was one of the most favored destinations for FDI in East Africa. However over the years, Kenya lost its appeal to foreign firms a phenomenon that has continued to date (Kinuthia, 2010).

Over the last decade to 2001 analysis shows that Kenya lost its competitiveness in attracting FDI as well as retaining the stocks investments. This has been attributed to many interrelated factors such as negative perception by investors about political instability, poor governance, corruption, inadequate infrastructure, insecurity, crime and theft (Nyamwange, 2009). According to a report released in 2012 by the bureau of economic and business affairs shows that Kenya has enjoyed a long history of economic leadership in East Africa as the largest and most advanced economy in the region. However, post-election violence in January-February 2008 caused many to reassess Kenya's investment climate.

Export processing zones programme in Kenya

The Export Processing Zones Program came into being in November 1990 following the enactment of the EPZ Act (Cap 517) of the Laws of Kenya by Parliament. The EPZ programme is managed by the Export Processing Zones Authority which has the role of initiating, promoting and providing attractive investment opportunities for exportoriented business ventures in the country (EZPA, 2012). In the year 2008, the gazetted zones were 38 compared to 52 in 2014. In 2015 the gazetted zones stood at 57; out of which 55 are privately owned and operated while two are public (EPZA,2016).

Statement of the problem

Research on the effectiveness of tax incentives in attracting FDI has yielded conflicting results in that it affect the net return on capital and should, at least in the mind of numerous policymakers, influence the capital movements between countries (Tung & Cho, 2000). There has been a growing attention to the costs associated with tax incentives –and not only to their possible benefits. Tax incentives are likely not only to have a direct negative impact on fiscal revenues but also, and frequently, create significant possibilities for suspicious behaviors from tax administrations and companies (Morisset & Neda, 2001).

According to Morisset (2000) tax incentives have a more apparent effect on the composition of Foreign Direct Investment. Most governments use tax policies to attract particular type of investment rather than to increase the overall level of investment. A recent study found out that foreign companies such as those in the automobile sector are generally in a better position to negotiate special tax regimes thus extracting a rent from the host government (Oman, 2000). The two main questions held by the researchers are: What kind of tax incentives is likely to have the greatest impact on the investment location decision of the multinational? And which type of investment is likely to be most sensitive to tax changes?

Kenya's productivity levels are among the lowest in the world in spite of the many tax holidays offered by the government (Kimuyu, 2005). Potential benefits of tax holidays are eliminated by poor infrastructure and other barriers of investment. It is yet to be confirmed if the tax holidays available in Kenya are considered by firms investing in the country as an incentive in light of the existing poor infrastructure (Robert et al. 2004). Overall, despite the various tax incentives extended by the Government of Kenya, most manufacturing firms' especially operating under EPZ close after 10 years of operation (KAM, 2010). There are various determinants of FDI performance in Kenya where few studies on tax incentive as key determinant in attracting FDI has been carried out. This study therefore aims at investigating the tax incentives and foreign direct investments in Kenya, with EPZs in Athi River serving as a case study.

Research questions

(i) Does tax holiday influence the attraction and retention of foreign direct investments in the EPZs in Kenya?

(ii) Does capital allowance/deductions influence the attraction and retention of foreign direct investments in the EPZs in Kenya?

Literature Review

There are widely known arguments favoring use of tax incentives as a tool for investment. Bruce (2004) argue that tax incentive increase returns on investment and are justifiable by the positive effects arising from investment including ease of directing them to specific target group, ease of fine-tuning them and they demonstrate openness to capitalism. Further they are necessary in order to compete in other tax jurisdiction as they make up for other insufficiencies in the investment environment. Morisset & Neda (2001) argued that tax incentives are still widely used by developing countries especially those that deem themselves to be in stiff competition for FDIs since they are located near other countries that have equally attractive investment climate.

Tax incentives are often provided with attached conditions since their objective is to encourage investment in specific sectors or topographical areas (Nephil et al., 2006). Most tax incentives designed indicate the related benefits as well as impose certain restrictions. For example, there may be a requirement to have the facility set up in a specific region, have a certain turnover threshold, require use of specific technology and have a certain number of employees. China, for example extend a 40% tax refund to firms by foreign investors on reinvested profits aimed at increasing the firm's capital or intended to establish another firm (Fung et al., 2010). The profits are supposed to be reinvested for a period of five years failure to which the firm will have to pay the taxes. India, on the other hand provides tax exemptions to firms in tourism or travel sectors provided the foreign currency received is convertible (Robert et al., 2004).

When a government offers tax incentives to investors or its citizens it foregoes some income in form of taxes. Since tax incentives appears to have some effect on location of the multinational firms, especially within the regional markets, there is a risk that Government will 'race to the bottom' with competitive tax incentives. This kind of competition has already been noted in some regions like Asia (Ambrose & Mosioma, 2012). The major concern is that the countries may end up in a bidding war, favoring multinational firms at the expense of the state and the welfare of the citizens/economy.

Also, scholars try to establish the need for tax incentives in relation to a Government's economic policies in terms of infant-industry protection. When a foreign firm invests progressively in an infant-industry where local firms enjoy Government protection, the investment benefits are less reflected in the investing firm's return than in the growing industry. Tax reduction and grants thus need to be offered to these firms to compensate foreign investors for the lack of returns due to the host country's industrial policy (Blankenau, 2005).

Tax incentives also offer political advantages over direct expenditure programs to stimulate investment (Bruce, 2004). Evidence has shown that small enterprises generally respond more to tax incentives than large enterprises. Taxes are an important cost factor for the small firms since they do not have the human and financial capacity to structure strategies for avoiding tax. Domestic enterprises play a key role in facilitating the transfer of technology and constructing local infrastructure. Even where the fiscal incentives are available it is mostly the large firms which participate (Coyne, 1994). In a survey of Taiwanese firms, only 8% of firms rated tax incentives as the single most effective government policy for promoting technological development: last, after educating more R&D personnel (18.8%), coordinating firms to conduct joint research (18.6%), introducing new technology from abroad (17.2%) and transferring technology through government-sponsored research institutions (Lall, 2000).

According to OECD, a tax incentive tends to reduce government revenue by 12% of the GDP. Therefore the investment incentive should be well targeted and narrowly on the activities they seek to promote if they (tax incentives) have to be of any benefits. Tax holiday strongly favor transitory rather than sustainable investment and create glaring opportunities for aggressive tax avoidance (Ambrose & Mosioma, 2012). In a joint report conducted by IMF, UN, OECD and World Bank comes to a conclusion that where governance is poor, corporate income exemption does little to attract FDI and in case they do, then it is at the expense of the domestic investment.

Wells and Allen (2001) studied effectiveness of tax incentives in attracting FDIs. They argued that tax incentives offered to investors result to an increase in the number of FDIs in the developing countries and should the first argument not hold, the resultant effects is spatial distribution of investment. The benefits of FDIs are usually shared among many income groups since the resultant increase in productivity is not completely used by the investor. Domestic labour force will benefit by receiving higher real wages which means more taxes for the government while consumers get quality goods at low prices. All factors held constant, FDIs increases a country's ability to import by availing foreign exchange, provision of managerial skills such as organizational and accessibility to foreign markets which makes possible the shift of technology from developed countries and provision of a variety of goods and services to people of the recipient country are some of the other benefits of FDI (Morisset & Neda, 2001).

UNCTAD (2000) highlights that other rationales are factored when governments are choosing incentives to use. In cases of institutional failure, the return on investment to the investor varies from the value to the economy. Institutional failures are either natural or sometimes caused by certain policies of the government. Natural causes arise from effects of factors like adoption of new technology whereby the benefits to the investor is less than the overall benefit to the economy, pollution and congestions resulting from the project in which case the cost to the economy exceed the cost to the investor, as well as other instances where there is a variance between returns and cost to the investor and to the economy (UNCTAD, 2000).

Theoretical Framework

"Eclectic theory" of foreign direct investment

Eclectic theory also known as the "OLI'' -Ownership, Location, and Internalization- was developed by Professor Dunning. The theory has a mix of three theories namely:-

(i)"O" for ownership advantage

According to Dunning for any transnational company to enter a foreign market then it is expected that it will have certain characteristics that will triumph over operating cost on a foreign market. The advantages are property competences or specific benefits of the company. The fact that the company has a monopoly over its own specific advantage then when used abroad will yield higher marginal profits and less marginal costs. Dunning further explains that the specific advantages are monopoly over privileges like access to market, technology and economies of scales.

(ii)''L'' for location

Location is a key factor in determining who will host the countries for the activities of transnational corporations. The specific advantages include economic, political and social advantage (Dunning, 1988).

(iii) ''I'' for internalization

It is a situation whereby the corporation can use some factors outside the country of origin. Internalization offers a framework in which the company will be able to exploit its powers from sale of goods and services to various agreements to be signed between the companies. In case the internal benefit is higher than the firm will want to engage in foreign production and not produce under license and franchise

Dunning concludes that foreign countries that attract investment by multinational firms have a large and growing market, a high gross domestic product, low production costs, and political stability. In additional locational advantage of the host economies e.g. market size, income skills, infrastructure, political and macroeconomic stability that determines cross-country patterns of FDI (Dunning, 2000). In this study the theory applies in that the FDI evaluates a number of factors in order to make investment decision .Tax incentive is one of the factors though other factors like economic, political and social factors are key determinant in making investment decision.

Normative theory

The theory describes how the development of the institutional structure of government creates a set of incentives as well as constraints within which governments and other actors operate (Cochran, 1999). These incentives shape the path of development, and different governments may evolve in different ways, not all of which are efficient. Tax policy-making and tax administrative reform therefore evolve simultaneously and symbiotically. The institutional theory developed here provides a generalized framework that can be used to better understand the development of tax policy and administration across time and cultures. It offers an attractive model for description, explanation and prediction. Richard and Oliver (1990) recommended division of fiscal functions where they stated that the fiscal federalism lies in the proposition that the policies of the allocation should be permitted to differ between states in references to the preferences of its citizens. The theory applies in this study in the sense that FDI has economic benefit on the host country in terms of revenues from taxes and better government policies as a strategy for FDI attraction and retention. In conclusion FDIs create an environment that triggers improvement in terms of infrastructure development and employment opportunities for the locals.

Conceptual framework

Intervening Variables

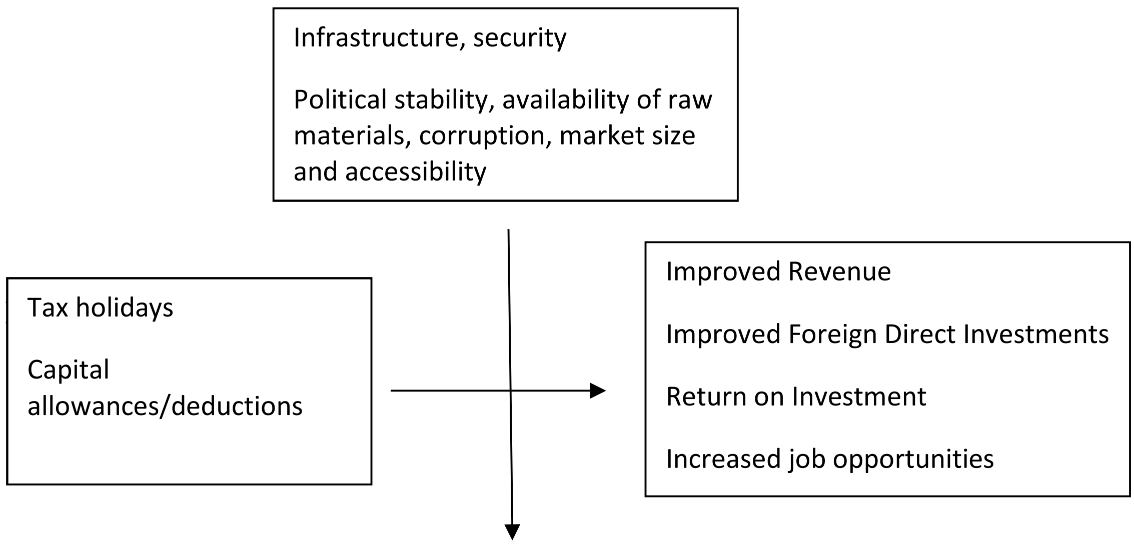

Figure 2.1: Conceptual Framework
(Source; Author, 2013)

Empirical literature review

According to a study carried out by Nguyen et.al (2004) in Vietnam, Corporate Income Tax (CIT) was a major incentive meant to attract FDI and boast the local industries. Out of 70 firms that were interviewed only 7 firms were situated in the export processing zone and could enjoy the incentive representing only 10% of the firms interviewed. With regard to incentive capital size, the firms receiving the CIT were 7.5% larger than those not receiving the CIT. The study further found out that CIT does not play a major role in investment decision on the part of the firm. Other factors:-good infrastructure and good human resource were the highest ranking with 4.23 and 4.11 out of 5.00. There was no significant difference in the response between the companies receiving CIT and those not receiving CIT. Access to raw materials, access to port facilitates, access to domestic market and local regulations scored 3.76, 3.75, 3.74 and 3.63 respectively out of 5.00. The study concluded that 84% of the firms argued that they would have still carried out the investment decision even without extension of CIT while 6% no and 10% were indifferent. Therefore CIT is not an efficient tool that the government should rely on in attracting the investors (Nguyen et al., 2004).

In a survey carried out by Sebastian in 2009 in four different countries on the importance of tax incentive as a tool for investment decision, three parameters were studied i.e. duty free-imports, tax incentives and consideration of another location. Out of 60 firms in Mozambique 27% considered duty free-imports, 17% tax incentives while 12% considered relocating to another area. In Jordan the firms in consideration were 61, 36% duty free-imports, 38% tax incentives and 33% relocation, Serbia 61 firms were used, 16% invested due to duty free imports, 29% tax incentives while 30% considered relocation and finally Nicaragua 93% duty free-imports, 76% tax incentives and 40% considered another location. All the survey found out that factors related to investment climate such as ease of imports and exports, availability of local suppliers, regulatory framework, infrastructure and countries geographical location related higher than tax incentive as a primary motivation for investment. Whenever the government wants to offer incentive tax should ensure that they are: - affordable; simple, targeted and reviewed periodically. In addition, it should take initiative to encourage lobbying, transparency on the cost associated with the incentives as a way of ensuring that firms get the benefit of the tax incentive to help frame the future policy (Sebastian, 2009).

According to a survey conducted by World Bank in 1999-2000, on over 10,000 firms of all sizes in 80 countries to obtain data on variable of investments and the perception on the investment climates, 15 were from sub-Saharan with 6 from Southern African Development Community, 33% of the respondent viewed tax and regulation as a major or moderate concern for investment while 60% viewed financing, inflation, corruption and infrastructure as a serious constraint. The econometric tests showed that influence of taxes on investment after controlling for the effect of non-tax factors and international investment involve two steps namely:-assessment of the fundamental viability of operating in different locations and thus the business pay less attention on tax system whether too good or too bad. The other step is the selection of a particular host country from a shortlist of viable location and attention is given when they are similar and eventually tax consideration is decisive at this stage. Therefore, the conclusion of the survey showed that respondents place low weight on tax factors in making an investment decision even though tax variable can have a significant effect on the final decision (Nathan-MS-Group, 2004).

In 2002, Foreign Investment Advisory Services (FIAS), of the World Bank conducted a study on the role of the fiscal and financial investments in promoting the private investments in Tunisia. The survey targeted the private investments whereby it was found out that between 1996-2001 private investments increased by 10% higher than other countries in the African region. In addition a reduction of corporate tax from 35% to 15%, lack of coherence between the multiple systems of incentives and other aspects of economic policy were cited to have reduced the effectiveness of the incentives by 35% during 1996-2001. The study recommended the abolition of exonerations despite findings that fiscal and financial incentive spearhead development and growth of private investment particularly in exports sectors. The study concluded that the cost derived from incentives systems in terms of complexity, neutrality and revenue exceeds their benefits. Therefore the broadening of the tax base by diminishing the tax incentives, simplified tax system and elimination of many distortions associated with the tax system will be a success in promoting of private investments without losing tax revenue (OECD, 2007).

Knowledge gap

From the literature review, it emerges that there exist a knowledge gap that need to be filled by this study. First there is lack of knowledge on the relationship that exist between the tax incentives and FDIs in Kenya. Most of the studies conducted by scholars tends to lay more emphasis on the developed countries. From the numerous empirical studies, tax incentives do not contribute much to FDI attraction and retention but other factors such as insecurity, infrastructure, government policies, political stability and a friendly business environment (Nathan-MS-Group, 2004; Nguyen et al, 2004). .

First, tax holiday deprives off the government much of the revenue through exemption of corporate income tax for a period of 10 years. At the same time the government of Kenya, have shown concern to abolish the tax holiday. Not much of the agenda have been implemented despite the disadvantages of offering tax holiday outweighing its advantages (Action aid, 2012). The study will fill the research gap through identifying whether the government use tax holiday as a tool to attract and retain FDIs in the zones, putting into consideration other costs associated with establishment of an EPZ.

Secondly, the study seeks to advance knowledge on the capital allowances/deductions available to the firms in the zones. Furthermore not all firms import heavy machinery to qualify for the allowance. The study will fill the research gap through identifying the types of capital allowances for the firms operating in the zone and whether it is an effective tool to attract and retain the FDIs.

Research Methodology

Mugenda and Mugenda (2003) define descriptive study as process of collecting data in order to test hypotheses or to answer questions concerning the current status of the subject under study. This type of study portrays an accurate profile of persons, events or situation. They further claim that the descriptive research design is one of the best methods for conducting research in human contexts because of portraying accurate current facts through data collection for testing hypothesis or answering questions to conclude the study. Therefore; this study used descriptive research design to be able to answer the research questions under investigation on the influence of tax incentives on foreign direct investment for the firms operating under EPZ in Athi River, Kenya.

Table 3.1: Population of EPZs

Type of Industry	Total Population	Target Population
Manufacturing	71	30
Commercial	22	8
Services	17	8
Total	110	46

Source: EPZA (2012)

Table 3. 2: Sample Size

Type of Industry	Target Population	Sampled Firms(40% of target population)	Respondents per firm	Sample size
Manufacturing	30	12	4	48
Commercial	8	3	4	12
Services	8	3	4	12
Total	46	18	12	72

Source: Author (2013)

Sampling design

For this study stratified random sampling was used in the selection of the EPZ firms while purposive sampling was applied to select the individual respondents whereby 4 respondents **(**that is top managers, finance manager and two accountants**)** were selected for the study.

Types of data

In this study both the primary and secondary data was used. Secondary data has been used for literature review while primary data on the influence of tax incentives on FDIs operating in the EPZ, Athi River Kenya was gathered by use of questionnaires.

Data collection instruments

The study used questionnaires where the researcher used predetermined questions which were modified in such a way that both the researcher and the respondent gave and got feedback accordingly.

Data Analysis, Findinsg and Discussions

A total of 72 respondents were being targeted by the researcher. The researcher divided the sample into three industries, namely manufacturing with a sample of 48 respondents, commercial with a sample of 12 respondents, and service industry with a sample of 12 respondents.

Table 3. 3: Response rate

Response rate of the research instrument

	Frequency	Percentage
Distributed questionnaires	72	100.00
Filled and collected questionnaires	62	86.11
Uncollected questionnaires	10	13.89

Table 3.4: To establish the influence of tax holiday on the attraction and retention of FDIs in Athi River, Kenya

	Very great extent%		Great extent %		Moderate%		Little extent%		Very little extent%	
To what extend does tax holiday affect the foreign investors retention	5	8	3	5	8	13	16	26	48	48
To what extend does tax holiday affect the foreign investors attraction	30	48	20	32	4	7	5	8	5	5

According to Coyne (1994) tax holidays are often extended by the governments in developing countries to labor intensive investments. Whereas barriers to trade are a cost to the investor since they increase the cost of acquiring capital equipment and other inputs thereby raising the cost of production, they are not a cost to a country. Removing the barriers of trade would be the best solution. However this would lower tax revenue and remove protection for domestic industries. The incentive for reducing the tariff can be targeted to exporters.

Tax holidays are only beneficial when a company begins earning income, while the benefits of a lower corporate tax rate accrue more slowly and over a longer time. Tax holidays benefit primarily short-term investments, typical of "footloose" industries in which companies can move quickly from one jurisdiction to another (Morisset, 2003). They also tend to reward the founding of a company rather than investment in existing companies, and to discriminate against investments that rely on long-lived depreciable capital. Tax holidays can lead to erosion of the tax base as taxpayers learn how to evade taxation of income from other sources. For all these reasons fiscal experts have generally been highly critical of tax holidays (Morisset, 2003).

About 48% of the respondents cited that tax holidays affects foreign investors retention at a very little extent while 48% of the respondents said that tax holiday affects foreign investors attraction to a very great extent. This is because, majority of the investors come in the country with anticipation that the tax holiday will benefit them to recoup the capital outlay but due to other expenses like energy, salaries and wages and transportation then it turns out that a period of ten years is inadequate thus a number of investors quit after the 10th year. The findings of the research study indicates that tax holiday does not favor the retention of investors but used as a tool to market Kenya as an investment destination.

Table 3.5: To what extent capital allowance/deductions influence the attraction and retention of EPZ firms in Athi River, Kenya.

	Very great extent%		Great extent %		Moderate%		Little extent%		Very little extent%	
	F	%	F	%	F	%	F	%	F	%
To what extent does capital allowance affect the foreign investors retention	4	7	12	19	24	39	10	16	12	19
To what extent does capital allowance affect the foreign investors attraction	22	36	16	26	8	13	10	16	6	10

Capital Allowance

	Frequency	Percent
Production allowance	18	29.03
Infrastructure allowance	15	24.19
Manufacturing allowance	9	14.52
Import allowance	7	11.29
Transport allowance	7	11.29
Energy consumption allowance	5	8.07
No Response	1	1.61
Total	62	100.0

Many countries especially in the industrial world, allow fast write-offs for investment expenditures as either all the investments or through tax allowance or credits. The extinct advantage of the investment tax allowance is that it is targeted at the desired activity as the firm will only receive the benefit of lower corporate tax only if it makes the capital investments (rather than formation of new company).This encourage companies to take a long-term view when planning investment (Morisset & Pirna, 2001). Countries are lead to a downward pressure on the tax-rate as one way of allocating investment among the countries where studies are mainly on the host country corporate tax (Axarloglou, 2005).

Investment tax allowance have limitation in that if it is not refunded, existing companies reap that full benefit (i.e. supporting expansion) while start-up companies must first earn enough income before they can take allowance (Morisset & Pirna, 2001). When inflation is high, the allowance aggravates the tax system's uneven impact on the investment behavior of companies thus these companies benefit from more borrowing to finance capital, because tax deductions for capital expenditure are more valuable. This is opposite of tax holidays and a lower corporate tax rate as this reduces the advantage of interest cost deductions for tax purposes during high inflation.

In relation to the findings 7% of the respondents said that capital allowances does influence investors retention while 36% of the respondents gave their responses that capital allowances is a tool used by the government to attract the investors. The absence of capital allowances will subject the investor to high revenue which leads to high corporate taxes thus low profitability. Investors definitely look forward to maximizing profit and any indication into this direction is greatly welcomed. The fact the majority of the firms in the EPZ fall under manufacturing sector then this is a key decision for potential investors to invest on heavy machineries that aids in production of goods.

Conclusions

From the questionnaires distributed to and received from the respondents, taxes are not the only incentives that the investors consider in making the investments decision. Other factors like infrastructure, availability of local suppliers, countries geographical location, corruption, inflation, human resources, access to market and local regulation also influence the foreign direct investments.

Recommendations

Tax holiday

To begin with, there is need by the government to regulate and adjust the duration of the tax holiday especially for the new firms which have just entered the market. Tax holiday should be extended beyond ten years especially for firms which have invested more capital outlay to enable them fully recover the investment capital.

Capital allowance/deductions

The government should increase the number of capital allowances especially the one meant for machinery as way of boosting the output. There is need for the government to enlighten the general public of the capital allowance given to FDIs and those extended to local firms. An incentive should be a short term strategy designed for specific firms to attract FDIs while long term strategy should be to improve infrastructure, security and minimize strict policies and regulations.

Areas for further Research

Further research should be carried out on the other tax incentives apart from the two discussed in this paper. In addition other factor apart from tax incentives that influence the attraction and retention of FDIs in Kenya should be addressed in order to make Kenya an attractive investment destination for FDIs.

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List of Abbreviations and Acronyms

CIT	Corporate Income Tax
EAC	East Africa Community
EPZs	Export Processing Zones
EPZA	Export Processing Zone Authority
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Services
GDP	Gross Domestic Product
IMF	International Monetary Fund
KIPPRA	Kenya Institute of Public Policy Research and Analysis
KRA	Kenya Revenue Authority
KAM	Kenya Association Manufacturers
KIA	Kenya Investment Authority
OECD	Organization for Economic Co-operation and Development
OLI	Ownership-Location-Internalization
TI	Tax Incentives
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme