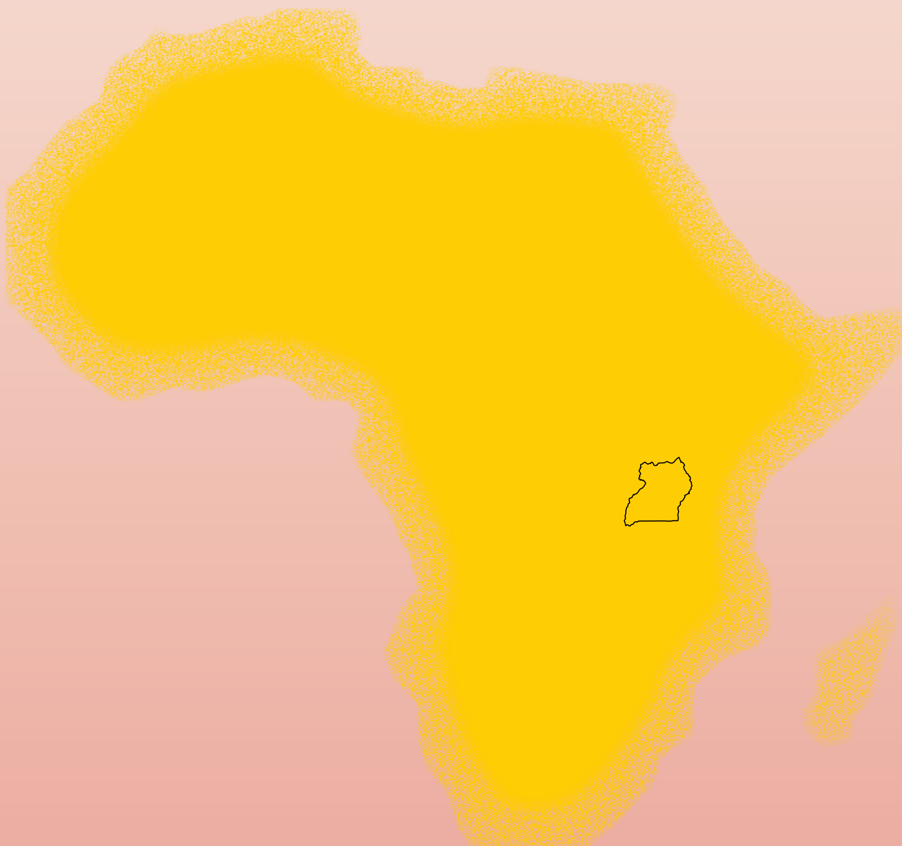
TAXATION STATE-BUILDING AND GOVERNANCE



BASELINE STUDY - UGANDA REPORT

EXECUTIVE SUMMARY

Taxation is the lifeblood of any economy and is vital for the functioning of the state and for the provision of public goods and services. If a nation fails to collect adequate tax revenue it not only dispenses with national sovereignty and independence, but also cannot provide socio-economic development and welfare for its citizens. Taxation therefore enables the country to meet its national socio-economic and political objectives, including determining state capacity and probably more importantly moulding the relationship between state and society and enables the country to meet the income re-distributional role[1]. It has been euphemistically stated that "Taxes are what we pay for civilised society."[2] Taxation is therefore presented as "the new frontier for those concerned with state building in developing countries"[3]. Taxation has a core role to play in attaining the global development agenda and sustainable elimination of global poverty, as defined by the Millennium Development Goals (MDGs)[4]. There is no doubt that MDGs cannot be met if a nation faces a challenge of mobilising domestic revenue. Taxation also plays a role in promoting democracy by raising domestic accountability and political participation at all levels of society since citizens who pay taxes would have the obligation to hold their governments accountable. An equally important contribution of taxation is the public expenditure management, shown by the way government uses and accounts for the revenue from taxation and other sources. Governments are expected to have transparent processes which would involve citizens' participation. The way public expenditure management is carried out has far reaching implications on government responsiveness and tax compliance and has the potential to transform the relationship between the citizen and the state into a social fiscal contract[5].

Uganda, as a developing country, has over time recognised this dictum, and has doubtly committed herself to ensuring that domestic revenue mobilisation is not simply a matter of priority, but has been understood to represent the real essence of nationhood. Collecting tax revenue presupposes that citizenry are engaging in economic activities or have in their hands revenue generating assets. The Government of Uganda accordingly interprets its cardinal duty to be delivery of sustainable economic growth that will ensure robust revenue performance[6].

SEATINI Uganda, Tax Justice Network Africa and Oxfam Novib commissioned a study on the matter of Taxation, State Building and Governance, with a view of producing a Uganda Country Report. The study had the following objectives: (a) Examine the history of the tax system in Uganda; (b) Identify major bottlenecks and challenges in tax collection; (c) Assess the administrative capacity for tax collection and management; (d) Assess the link between taxation and good governance; and (d) Generate recommendations for policy and advocacy work. A number of research methods were used including field interviews with stakeholders from the Government of Uganda, Uganda Revenue Authority, Uganda Manufactures Association, Civil Society Organizations, Tax Practitioners, Taxpayers and eminent academicians.

[1] Damme L, Mizrahi T & Orel S (2008).
[2] Oliver Wendell Holmes as cited in Attiya W (2007, pp. 272)
[3] Brautigam D, Fjeldstad O-H & Moore M P (2008)
[4] Teunissen J J & Akkerman A (Eds) (2005)
[5] Prichard W (2010)
[6] Background to the Budget, 2012-13

One of the key findings of the study was that Pay As You Earn (PAYE) contributes more direct tax revenue as compared to Corporate Tax in the ratio of 2:1. Furthermore, the effective PAYE rate of 40% is greater than the effective Corporate Tax rate of 30%. The argument and discussion here is that PAYE is easy to collect and it continues to contribute a bigger percentage to tax revenue.

The study recommends the following:

- Both Government of Uganda and the Civil Society Organisations need to focus on cultivating the citizen's civic responsibility towards tax payment, and in turn build the national framework towards good governance and accountability. This will not only be sustained through educating the citizenry to enable them appreciate the role of the different stakeholders in cultivating tax compliance and good governance but the education should also be structured in a manner that it enables the citizens to demand for their entitlements from the Government.
- Government needs to address the matter of low tax compliance as Ugandans are not enthusiastic about their tax obligation. This will require exploiting the symbiotic relationship between taxation and good governance
- Government also needs to review and limit the tax exemption regime, to pre-empt the tax exemption regime's adverse impact on the productivity and buoyancy of different sources of tax.
- Government should deliberately focus on incorporating and ingraining tax justice elements in the tax regime through for example making the tax rates and threshold sensitive to changes in the economy and mainstreaming issues affecting the poor and marginalized groups in the enactment of tax policies.
- Government needs to improve good governance in tax administration by improving accountability and providing information to stakeholders, improving the relationship between Central and local governments in tax collection, and strengthening the fiscal space or the ability of Government to fund social services without compromising the stability and sustainability of the economy.

ACKNOWLEDGMENTS

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2012

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ADB:	African Development Bank
BTTB:	Background to the Budget
CET:	Common External Tariff
CITPROD:	Corporate Income Tax Revenue Productivity (ratio)
COMESA:	Common Market for Eastern and Sothern Africa
CTL:	Commercial Transaction Levy
DRC:	Democratic Republic of Congo
EAC:	East African Community
EASCO:	East African Common Services Organisation
EAHC:	East African High Commission
EITI:	Extractive Industries Transparency Initiative
FY:	Financial Year
GDP:	Gross Domestic Product
GPT:	Graduated Personal Tax
IMF:	International Monetary Fund
LGFC:	Local Government Finance Commission
LTO:	Large Taxpayers' Office
MDGs:	Millennium Development Goals
MNC:	Multi National Corporations
MTEF:	Medium Term Expenditure Framework
NRM:	National Resistance Movement
PITPROD:	Personal Income Tax Revenue Productivity
SMU:	Small & Medium Taxpayers' Unit
UBOS:	Uganda Bureau of Statistics
UGX:	Uganda Shillings
URA:	Uganda Revenue Authority
USD:	United States Dollars
VATGCR:	Value Added Tax Gross Compliance Ratio
VAT:	Value Added Tax
PAYE:	Pay As You Earn
OECD:	Organization for Economic Cooperation and Development

CHAPTER 1: THE CONTEXT AND HISTORY OF TAXATION

"HOW PEOPLE ARE TAXED, WHO IS TAXED, AND WHAT IS TAXED TELL MORE ABOUT A SOCIETY THAN ANYTHING ELSE.
C. ADAMS (1993)[7]

Uganda is a landlocked country striding across the equator and located in the East African region and the (River) Nile Basin. It is bordered by the Democratic Republic of Congo in the West, Kenya in the East, the new Republic of South Sudan in the North, and Tanzania and Rwanda in the South. The country's total surface area is 241,038 km2 of which about 17% is water and marshland and 31% forest cover[8].

From independence in 1962 to 1970, Uganda's economy performed considerably well when the country experienced relative political stability. The economy's (real Gross Domestic Product or GDP) averagely grew by an annual rate of about 5%, the tax revenue as a ratio of GDP had grown to about 13% in 1970 and fiscal deficits rarely exceeded 2.5% with inflation maintained at an annual average rate of 3%. Though the period from 1966 to 1970 had some major political upheavals, including abrogation of the independence constitution and adoption of socialism through the Common Man's Charter, the economy largely remained stable. During the period of military rule, under General Idi Amin, from 1971 to 1979, the country's economy was seriously damaged by political turmoil and mismanagement. The economy contracted at an annual average rate of 1.6% per annum, and the rate of inflation averaged 30% per annum, reaching a 3-digit figure in 1979. In 1980-85, there was also civil strife and political instability that led to negative GDP growth rates[9].

In 1986, the National Resistance Movement (NRM) under President Yoweri Museveni, took power and ushered in a period of peace, political and economic reforms, and sustained social-economic development. Uganda engaged in the International Monetary Fund sponsored Structural Adjustment Programme that entailed a myriad of reforms across the economy which culminated into economic liberalisation, privatisation and government divestiture from public corporations with a view to attaining macroeconomic stability[10].

From 1987 to 2000, per capita GDP grew at an average annual rate of just over 3%, 4% in 2001, 10.8% in 2005/06 and 8.7% in 2007/08. In 2008/09, the GDP grew at a rate of 7.2% and 5.8% in 2009/10[11]. Given the global financial meltdown, it is estimated that Uganda's economy will expand by 3.2% in 2011/12, compared to a growth of 6.7% achieved in the year 2010/1112. The reduced rate of economic performance in the year 2011/12 is attributable to the remarkably volatile year, which included high global oil and commodity prices, drought in parts of the country and the wider region, power shortages, exchange rate volatility and weak external demand. Unusually high levels of inflation and exchange rate volatility had particularly severe implications for the real sector by undermining business confidence and investment in the industrial and services sectors[13].

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[7] Cited in the URA Corporate Plan 2011-2015
[8] Uganda Investment Authority & Kayaga L (2007)
[9] National Development Plan, 2010/11-2014/15
[10] African Forum and Network on Debt and Development (2007) and African Development Bank (2010):
[11] Background to the Budget, 2011/12
[12] Background to the Budget, 2012/13
[13] Background to the Budget, 2012/13

Though in the later parts of the year, straddling into the year 2012/13, the agricultural sector's performance drastically improved following the good rains from 0.7% in 2010/11 to 3.0% in 2011/12, the overall performance of the economy remained sluggish due to a dip in the industrial and from 7.9% in 2010/11 to 1.1% in 2011/12, and the services sector from 8.4% in 2010/11 to 3.1% in 2011/12. The performance of the economy and individual sectors is shown in Tables 1-2.

Table 1: Growth in the GDP for the Years 2005/06 to 2011/12

Sectors	Rate of Growth (%age) at 2002 Constant Prices						
	2005/06	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
Total GDP	10.8	8.4	8.7	7.3	5.9	6.7	3.2
Agriculture, forestry and fishing	0.5	0.1	1.3	2.9	2.4	0.7	3.0
Industry	14.7	9.6	8.8	5.8	6.5	7.9	1.1
Services	12.2	8.0	9.7	8.8	8.2	8.4	3.1
Adjustments	-	-	17.5	10.2	-2.7	3.0	10.2

Source: Background to the Budget, 2011/12 and 2012/13

The importance of GDP lies in the fact that it forms the base on which taxes are imposed, and the performance of a tax system depends on the proportion of GDP realized as tax revenue. The higher this proportion, the better for the economy.

Table 2: Actual GDP Figures for the Years 2005/06-2011/12

Item	Amount in UGX Billions						
	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
GDP at current market prices	18,172	21,212	24,497	30.101	34,908	39, 051	49,087
GDP at constant 2002 prices	15,396	16,688	18,145	19461	20,601	21,978	22,681
GDP growth rates (in percentage) based on constant 2002 values	10.8%	8.4%	8.7%	7.3%	5.9%	6.7%	3.2%

Source: Background to the Budget, 2011/12 and 2012/13

The GDP is composed of three principal sectors: (1) Agriculture, Forestry and Fishing, (2) Industry, and (3) Services[14]. The item 'Adjustments' includes two elements: Financial Intermediate Services indirectly measured (FISIM) and taxes paid by Government on products[15], which represent a non-resource item for tax purposes. FISIM is "the difference between the interest income received and interest paid by commercial banks. It captures, therefore, a performance of the net interest income of the commercial banks"[16]. The composition of GDP is shown in Figure 1, next page.

[14] A more detailed definition of the elements in each of the sectors is laid out in the Appendix 1.
[15] UBOS Statistical Abstract, June 2012.
[16] UBOS Statistical Abstract, June 2012, pp. 61.

Figure 1: Sectoral Composition of GDP (in Percentage and computed using 2002 constant Prices)

Source: Background to the Budget, 2011/12 and 2012/13, and UBOS Statistical Abstract, June 2012

Figure 1, confirms that the service sector is the biggest sector in the economy, comprising of about half of the economy. The Agriculture sector, though employing the biggest part of the population in the economy (about 70%), has largely been declining from 18% in 2005/06 to about 14% in 2011/12. The industry sector has also been largely constant, save for the year 2011/12 when there was a slight decline in its share of the economy.

The per capita GDP is the average amount of monetized economic activities attributable to an individual in the economy. It is determined by dividing the GDP with the total population in the country. This ultimately will influence the tax revenue that can be realized from the economy. The way GDP is actually spread or distributed in the economy will equally be important.

Table 3: Per Capita Figures for the Years 2005/06-2011/12

Item	Amount in UGX Billions						
	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Per Capita at current UGX market prices	657,708	742,159	827,823	981,725	1,118,218	1,206,866	1,463,961
Per Capita at constant 2002 UGX prices	557,235	583,780	613,162	634,701	659,924	679,222	676,422
Per Capita growth (percentage) rates based on constant 2002 values	7.2%	4.8%	5.0%	3.5%	4.0%	2.9%	-0.4%

Source: Extracted from Background to the Budget, 2011/12 and 2012/13, and the UBOS Statistical Abstract, June 2012

It is notable that for the years 2005/06 to 2010/11, Per Capita GDP has grown at a slower rate than the GDP, and in 2011/12 it actually declined by -0.4% despite the fact that real GDP grew by 3.2%. This actually implies that the country population (which is the denominator in the equation to determine Per Capita GDP) is growing at rate which imposes this subdued growth rate.

A related matter that has implication for the stability of the economy is the movement in the general price level or inflation. The rate of inflation has generally been high in the Sub-Saharan Africa region, but the East African Region had a more pronounced impact due to drought which led to high food prices. In December 2011, the inflation rate rose by 16 percentage point in the East African Countries. In Uganda the share of food on the total household expenditure ranges from 46-60%, and material changes of food prices greatly impact the welfare of the people[17]. Though the Government of Uganda has a policy objective of maintaining inflation at a rate of below 5%, this had largely not been attained. The rate of inflation for the past few years is as follows: 2007- 6.8%; 2008- 7.3%; 2009- 14.2%; 2010- 9.4%; 2011-16%. Government has however instituted a tight monetary and fiscal policy to address this matter[18].

Despite the fact that Uganda has recorded relatively high rates of economic growth in the past two or so decades, its economy has remained more reliant on subsistence agriculture and correspondingly less reliant on high-productivity manufacturing[19]. In 2011/12, agriculture contributed roughly one-half of the country's foreign exchange earnings, despite the fact that the low level of production denied Uganda the opportunity to take advantage of the high global prices[20]. Uganda is basically an agrarian economy with a total population in 2012 estimated to be 34.13 million, of which 85% live in rural areas[21] with about 66% of the labour force deriving their livelihood from the agricultural sector[22]. It is however notable that there has been a deliberate effort for the rural population to diversify into non-farm activities. The proportion of rural households that principally rely on subsistence agriculture has steadily declining. Compared to 1992, when only 24% of the rural households operated any non-farm enterprise to a proportion of 38% in 2005/06. The percentage of rural households primarily relying on subsistence agriculture has decreased from 64% in 2005/06 to 54% in 2009/10. The source of household income or employment is shown in table 4 below.

Table 4: Household Primary Sources of Income in 2005/06 and 2009/10

	2005/06	2009/10	2005/06	2009/10
	Rural		Urban	
Subsistence agriculture	64%	54%	15%	6%
Commercial agriculture	4%	5%	2%	2%
Wage employment	12%	17%	36%	45%
Non-farm enterprise	13%	18%	36%	37%
Other	7%	6%	11%	10%

Source: Adapted from the Uganda Poverty Status Report, May 2012, pp.45.

It is notable that wage employment is increasing and the impact of this development will be noticeable when considering taxation of employment.

17 The Poverty Status Report, 2012.
18 Background to the Budget 2011-12 & 2012-13; and the Poverty Status Report, 2012.
19 IMF (2009): and African Development Bank (2010):
20 Background to the Budget 2012/13
21 UBOS Statistical Abstract, June 2012, pp. 101.
22 Background to the Budget 2012/13

Uganda has one of the highest population growth rates on the African continent and the world of slightly over 3.3%, compared to the average growth rates of 2.6% for sub-Saharan Africa and 1.7% for low-income countries[23]. About 51% of the population is below 15 years; 56% is below 18 years and the potentially working population (18-64 years) is about 43%. In 2009/10, it was estimated that 5.9 million, or 19.3% of the population was between the ages of 15 and 24.[24] The country therefore faces the challenge of providing quality employment for this ever-bulging number of young people. This is vividly shown by Table 5.

Table 5: Selected Labour Force Indicators for persons aged 15-64 years

	2005/06	2009/10
Total National Population (millions)	27.2	30.7
Total employee force (aged 15-64) (millions)	10.6	12.9
Total employee force (aged 15-64) (as percentage of national population)	39%	42%
Activity Status of Workforce (in Percentage)		
• Self-employed	83.7%	79.3%
• Paid employment	16.3%	20.7%
Sector of Employment (in Percentage)		
• Agriculture, Mining & Quarrying	75%	67%
• Service	20.7%	24.5%
• Manufacturing	4.3%	5.5%

Source: Uganda Bureau of Statistics, 2012

It should be noted that given the intensity of activities and the poverty status figures, it is likely that most of these able-bodied individuals are under employed or having disguised employment.

Currently 7.5 million people or about 22% of the population lives under poverty[26]. Poverty is defined in terms of lack of adequate or sufficient income to meet essential or basic consumption needs[27]. It is accordingly a measure of absolute poverty, which was developed in the 1990s, and based on the price of an average food basket for the vulnerable population. It reflects the cost of an adult male consuming 3,000 calories per day based on the food basket of the poorest 50% of the population, plus some basic estimated non-food items. The definition has three classes[28]:(1) those who are absolutely poor and below the poverty line; these are people who live on less than US$ 1 per day; (2) the second class has those who are categorized as not poor, but whose situation is vulnerable in the sense that they can easily fall back into absolute poverty; (3) the third class is the middle class, and this is the group who are substantially well-off, with enough properties and assets that cannot fall back into absolute poverty. It is probable that the Government considers the number of people in the top class to be insignificant in the Ugandan population, and are therefore not provided for in the official report.

[23] Background to the Budget 2012/13
[24] African Economic Outlook, 2012
[25] Uganda Bureau of Statistics (2012)
[26] The Poverty Status Report, 2012
[27] The Poverty Status Report, 2012; Kabananukye K, Kabananukye A, Krishnamurty J & Owomugasho (2004)
[28] The Poverty Status Report, 2012

The number of 7.5 million people (or 24.5%) who are absolutely poor, when compared to the figures in the previous period such as 1992/93 when 56% of the population were absolutely poor shows a marked improvement. Of the 23 million Ugandans who are out of "absolute poverty", 10 million are classified as 'middle class', and are accordingly not so vulnerable to poverty as the remaining 13 million[29]. This can be contrasted with the situation in 1993, when the middle class numbered just 1.8 million[30]. It is also revealed that 60% of the poor were able to escape poverty between 2005/6 and 2009/10[31].

Table 6: The Poverty Status in Uganda[32]

		Population represented in Millions (and Percentages)				
Categorisation	Description	1992/93	1999/00	2002/03	2005/06	2009/10
Absolutely poor (below the poverty line)	Number (of people) in millions	9.9	7.4	9.3	8.5	7.5
Not poor, but insecure	Percentage of population	56.6%	33.8%	38.8%	31.1%	24.5%
	Number (of people) in millions	5.8	9.6	9.6	11.0	13.2
	Percentage of population	33.1%	43.9%	39.9%	40.2%	42.9%
Middle Class	Number (of people) in millions	1.8	4.9	5.1	7.8	10.0
	Percentage of population	10.3%	22.4%	21.2%	28.7%	32.6%
Total Population	Number in millions	17.5	21.9	24	27.3	30.7

Source: Poverty Status Report, May 2012, pp.ix.

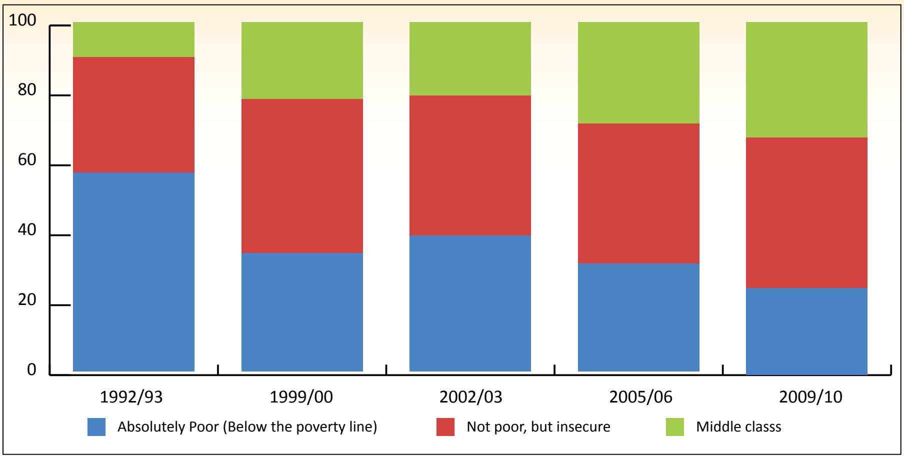
Figure 2 on the next page provides an impression of the movement in two extreme classes: as the class of 'absolutely poor' progressively dwindles, the 'middle class' is to about the same extent progressively bulging. The class of 'not poor, but vulnerable has, especially since 1999 largely remained unchanged in the range of 40-44%.

Using the criteria of US$1.25 per day indicates that up to 37.7% of Uganda population is under the poverty line[33]. This proportion compares with Tanzania 67.9%; Rwanda 76.8%; South Africa 17.4% and the Sub-Saharan Africa average of 47.5%. It is however notable that a strict and probably more universally acceptable definition of poverty that places any person living on less than US$2 per day to be poor shows that up to 55.3% of the urban population and 75.6% of total population in Uganda are poor[34].

The country has not made consistent investment in economic infrastructure. Of the total national road network estimated to be 78,100 km, only 4% is paved, while only 26% of rail network is functional . Freight cargo is transported by road to the extent of 96.4%, while the rail accounts for 3.5% . This has implications on the price level and profitability within the economy, as the cost of cargo freight by road is three times more than the cost of using rail.

[29] Background to the Budget 2012/13
[30] Background to the Budget 2012/13
[31] Background to the Budget 2012/13
[32] Poverty Status Report, May 2012
[33] UNDP: Africa Human Development Report, 2012, pp. 162
[34] Bertelsmann Stiftung, BTI 2012 — Uganda Country Report. Gütersloh: Bertelsmann Stiftung, 2012

Figure 2: Graphical Representation of Poverty Status in Uganda



Source: Graphical representation derived from the information in Table 6.

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Preceding statistics paint a picture that Uganda's socio economic development has largely progressed. A comparison to the state and performance of other global economies, however, does not give the same picture. It has, for example, been found that poverty, especially if one considered US$2 per day will be enveloping up to three-quarters of the population. Both poverty and income inequality are endemic in Uganda[41]. For example, households that constitute the richest 20% of the population own up to 71% of total national income; while households that constitute the poorest 20% have only 2% of the total national income. The Gini coefficient[42] shows that income inequality has actually been deteriorating in Uganda.

[36] National Development Plan 2010/11-2014/15, pp. 32
[37] National Development Plan 2010/11-2014/15, pp. 32
[38] National Development Plan 2010/11-2014/15, pp. 32
[39] National Development Plan 2010/11-2014/15, pp. 32
[40] Bertelsmann Stiftung, BTI 2012 — Uganda Country Report. Gütersloh: Bertelsmann Stiftung, 2012. pp.19.
[41] Income inequality is measured using the Gini Coefficient with zero showing perfect equality and one showing maximum or perfect inequality.
[42] Background to the Budget 2011/12; UNDP: Africa Human Development Report, 2012, pp. 162-163; Bertelsmann Stiftung, BTI 2012 — Uganda Country Report. Gütersloh: Bertelsmann Stiftung, 2012.

Table 7: The Status of Income Inequality in Uganda as Shown by Gini Coefficient

	1992/93	2002/03	2005/06	2009/10
National	0.365	0.428	0.408	0.426
Rural	0.328	0.363	0.363	0.375
Urban	0.396	0.483	0.432	0.447

Source: Poverty Status Report, May 2012, pp.ix.

Table 7 shows that the perception of income inequality has been increasing in Uganda, from 0.365 in 1992/93 to 0.426 in 2009/10. The comparable Gini Coefficient covering the period 2000-2010 for countries in the EAC are Burundi 0.333; Tanzania 0.376; Kenya 0.458, Rwanda 0.531 while Sub-Saharan Africa is at 0.498[43]. The UNDP sponsored Human Development Index[44] (HDI) ranks Uganda among the least developed countries as shown in table 8.

Table 8: The HDIs for Uganda and some selected Countries[45]

Country	Rank out of 187 in 2011	1990	2000	2005	2009	2010	2011
Uganda	161	0.299	0.372	0.401	0.438	0.442	0.446
Kenya	143	0.456	0.443	0.467	0.499	0.505	0.509
Burundi	185	0.250	0.245	0.267	0.308	0.313	0.316
Tanzania	152	0.352	0.364	0.420	0.454	0.461	0.466
Rwanda	166	0.232	0.313	0.376	0.419	0.425	0.429
Ghana	135	0.418	0.451	0.484	0.527	0.533	0.541
Republic of South Africa	123	0.564	0.615	0.616	0.599	0.615	0.619

Source: Extracted and based on Human Development Report, 2011, and Geo-Hive, 2000-12.

Uganda is in the 161st position out of 187 participating countries in the 2011 Human Development Report. It is also categorized as a low Human Development Group[46] given its score which is under 5. It is also notable that Uganda lags behind Kenya and Tanzania in the HDI ranking with the two countries positioned at 143rd and 152nd rank respectively. The oil discovered in the Albertine Graben has been estimated to range from 2 billion[47] to 6 billion[48] barrels, and the projected daily production is between 100,000 and 150,000 barrels per day[49]. If well managed and invested, the proceeds from oil will significantly increase revenue for the Government, eliminate poverty, and prop up economic growth and development. There is however no certainty that this will be so. Fear stems from the realisation that though Uganda has significant natural resource endowments, most communities living in close proximity to natural resources like minerals and wildlife, continue to suffer serious levels of poverty[50].

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[43] The HDI is an informative measure sponsored by the UNDP which is primarily determined on dimensions of socio-economic development and standard of living such as health, education, food security and income that describes the level of human development as an indication of development in African countries. It is used as a yardstick for comparison with other countries and regions in the world.

[44] Based on Human Development Report, 2011, and Geo-Hive, 2000-12.

[45] There are four classes of HDI Group: (1) Countries with an index over 0.800 are categorized as Very High Human Development group; (2) Countries with an index between 0.700 and 0.800 are categorized as High Human Development,(3) Countries with an index between 0.500 and 0.700 are categorized as Medium Human Development and (4) Countries with an index below 0.500 are categorized as Low Human Development group.

[46] International Alert, 2011.

[47] Wafula W (2010): & Veit P, Excell C & Zomer A (2011):

[48] Veit P, xcell C & Zomer A (2011):

[49] Muramira T & Manyindo J (2008):

[50] Moyini Y., Manyindo J., and Makumbi I. (2006) & Muramira T & Manyindo J (2008):

The country does not have a formal practice that recognises and fairly compensates the important stewardship function played by these communities in maintaining the natural resource base[51].
Unlike the United States where the land owners share in the oil revenues from their land, Uganda took a cue from most developing countries and oil wealth is a national asset[52].

Box 1: Uganda and the Resource Curse[53]

The discovery of oil in Uganda is exciting, but this is tempered by the realization that the country does not have a good record in resource management. History affirms that the country is enveloped by the resource curse. For example, areas like those next to the national game parks where there is wildlife that attract tourists, and minerals, like in Kasese District where copper was mined in the 1960s, do not have any noticeable well organized community programmes that have benefitted the country.

The resource curse refers to countries that have abundant natural resources, like oil, natural gas, minerals, wildlife and other resources; but whose level of socio-economic development do not reflect the endowment in resources, and the citizenry are denied the opportunity to enjoying the arising benefits. This state of affairs is more often attributable to inept and corrupt Government institutions.

Oil wells are in rural areas; the wells need to be managed responsibly and in an environmentally friendly manner so as to ensure that the extraction does not adversely affect the livelihood of the people in the vicinity and also ensure that the integrity of the eco-systems? and natural resources is sustainably maintained.

THE HISTORY OF TAXATION IN UGANDA

Prior to its constitution as a country by the British, Uganda was a heterogeneous area which had four closely related principal kingdoms and a string of communities with varied cultures, customs and political cultures.[54] Whereas the current pattern of taxation is closely tied to the country's socio-economic and political evolution, and colonial administration[55], the colonialists did not have the privilege of introducing taxation in Uganda. The monarchs and chiefs needed to meet the costs of administration and security for their different kingdoms and chieftains that dotted the current day Uganda. The Kingdom of Buganda, for example, had an elaborate system that at that time had at least four different taxes[56]: (a) tax on each married man, equivalent to twenty-one pieces of bark cloth and 100 cowry shells; (b) excise taxes on all food products from cattle, goats, and manufactured goods like pottery and handcrafts; (c) customs duties on salt and iron tools; and (d) compulsory military service. The economies were not monetised, and taxes in pre-colonial days were largely paid either in kind, or through labor contribution[57].

The British Government opted to control Uganda through a Protectorate model that ensured reliance on locally generated resources extracted using subtle compulsion attained through treaties with the indigenous communities without draining the British finances. This was partly precipitated by the considerable financial cost incurred in 1897 to transport to Uganda a

[52] Moncrieffe J (2004):
[53] Kasimbazi (2004): and Kayaga, L. (2007).
[54] M. Mamdani (1976): cited in Kayaga L (2007): and Bukenya I (1996):
[55] Bukenya (1996) (as cited in Kayaga, 2007)
[56] Sathyamurthy, T.V. (1986) &. Aldershoot, Vermont: Gower, as cited in Moncrieffe J (2004)
[57] Quoted verbatim from Attiya W (2004, pp. 296).

contingent of British Indian Army to quell a mutiny. On appointment as a Special Commissioner for the Uganda Protectorate in 1899, Sir Harry Johnston had an undisguised brief that entailed to ensure that:

'.....trade [was] established on a smooth basis; administration [was] placed on a permanent and satisfactory footing; control over taxation [was] exercised without arousing native suspicions; no effort [was] spared to preserve external appearances by which the collection of revenue and its expenditure took place within the formal structure of traditional authority; governance and development of Uganda [were] carried out with as little reliance as possible on metropolitan finances'[58].

In 1902, Sir Harry Johnston wrote attesting to the importance of getting the indigenous people in the Protectorate as to engage in trade, wage-employment or other economic activities so as to pay the required taxes:[59]

"...If every adult male native in these Protectorates paid 8s a year in taxation, there would be little, if any, need to resort to the Treasury of the United Kingdom for funds to supplement the cost of administration. There would also be no cause for the British taxpayer to complain if coffee or rubber, gold or ivory or all these substances combined, failed to provide a lucrative commerce for the British market. The Protectorate would then be administered purely in the interest of the black man. He at least, in the climate of the country wherein he was born, does not suffer from the diseases which afflict the European who attempts to settle in parts of tropical Africa; he at least is happy and content if he can maintain flocks and herds of cattle, sheep, and goats, and grow food-stuffs suited to his country and his palate... He can only earn money by working, say, for a month, or by collecting and selling rubber, coffee, or some other saleable substance, which he can acquire without robbing other people; or he may breed cattle for the provision market, or collect oil which is sufficiently valuable to meet the cost of transport to the European markets".

The Uganda Agreement of 1900 was designed to support the attainment of those objectives. In order to pay for the colonial Government administration costs, meet the operating costs of the Uganda Railway that had reached the shores of Lake Victoria in Kisumu (Kenya) and to ensure financial self-sufficiency for the Uganda Protectorate, taxation was identified as the principal vehicle that the colonialists had to use to draw the citizenry into the cash economy[60]. The 1900 Buganda Agreement introduced a hut tax of 3 rupees per annum for every man who had a homestead and was married , and a gun tax of 3 rupees; this was followed by poll tax in 1905[61]. All this revenue was reserved for the colonial government.

In 1917, Uganda and Kenya, established a Customs Union which obliged Ugandans to pay customs duty as an indirect tax; this was an ad valorem import duty at a rate of 5% on all goods entering East Africa, through the port of Mombasa and destined for Uganda. In 1927, German East Africa (then called Tanganyika) joined the Customs union and this led to imposition of similar duty to goods destined for Uganda that entered East Africa through the ports of Dar-es-Salaam and Tanga. The revenue collected at the coast in Kenya and Tanzania was remitted to Uganda. The revenue realised from hut and gun taxes and the customs duties was not sufficient for the Protectorate government to finance its programs. The Government enacted the first tax legislation in 1919 under the Local Authorities' Ordinance that led to the introduction of flat poll taxes, land taxes, and native administrative taxes on non-Africans[62].

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[58] Therkildsen O (2006):
[59] Attiya W (2010).
[60] Therkildsen O (2006):
[61] Bukenya (1996) (as cited in Kayaga, 2007); and Therkildsen O (2006).
[62] Therkildsen O (2006):

Native local authorities were first granted powers to tax in 1925, when they were allowed to commute work obligations or public works, such as road construction, building of administrative headquarters and schools, as well as forest clearance and other similar works (known as "luwalo") into cash[63]. These taxes widened the tax base by getting more indigenous Africans engaged in activities that would propel the growth of the monetary economy. This compelled Ugandans to enter the market sector of the economy through either selling their agricultural produce or hiring out their services. The tax burden was later increased by the introduction of an additional tax to finance local governments. In 1940, a Protectorate ordinance introduced a graduated personal tax for non-Africans (i.e. Europeans and Asians); and this was in 1945 substituted by income tax. In 1953, following recommendations by a committee headed by Mr. C.A.G Wallis, the colonial government progressively introduced Graduated Personal Tax across all districts between 1953 and 1960[64] as a universal source of revenue to finance local governments.

The Inter-territorial co-operation between the Kenya Colony, Uganda Protectorate and Tanganyika Territory was first formalised in 1948 through the establishment of the East African High Commission (EAHC). At this time all the three countries were administered by the British Government. This provided for a Customs Union, a Common External Tariff (CET), currency and postage; and also dealt with common services in transport and communications, research and education. In 1952, income tax ordinances in the three countries were replaced by the East African Income Tax Management Act, 1952, which laid down the basic legal provisions found in the East African income tax law[65]. Following the work done by a Commission of Enquiry chaired by Sir Erick Coates which sat in 1956 and published its report in 1957, the East African Income Tax Management Act of 1952 was repealed and replaced by the East African Income Tax Management Act of 1958. The 1958 Income Tax Act was in 1970 revised and renumbered East African Income Tax Management Act, CAP 24 of the Laws of the East African Community. Income Tax was administered under a regional or supranational body known as the East African Income Tax Department with its headquarters in Kampala, Uganda, but each of the three national governments of Kenya. Tanzania and Uganda retained the preserve to define and determine tax rates.

In 1961, as part of preparations for independence, the EAHC was reconstituted and replaced by the East African Common Services Organisation (EACSO), which many observers thought would lead to a political federation between the three territories. There were supranational or regional bodies responsible for income tax and customs administration. In 1967, the EACSO was superseded by the East African Community (EAC). This body was aimed at strengthening the ties between the members through a common market, a common customs tariff and a range of public services so as to achieve balanced economic growth within the region.

[63] Davey, K (1974) as cited in Ole Therkildsen (2006)
[64] Attiya (2010)
[65] Reith S & Boltz M (2011)

In 1977, the EAC collapsed after ten years with the three member states losing over sixty years of co-operation and the benefits of economies of scale. Each of the former member states had to embark, at great expense and at lower efficiency, upon the establishment of services and industries that had previously been provided at the EAC level. The Income tax department was actually closed on 31st December 1973, while Customs department dragged on until 1977. The collapse of the first EAC has been attributed to four main factors: (a) lack of steering functions; (b) unequal distribution of benefits; (c) purely intergovernmental or inter-statal structure; and, (d) irreconcilable differences of opinion between leading players, especially between the Ugandan dictator Idi Amin and the Tanzanian president Julius Nyerere[66]. The EAC was re-established in 2000 and is in process of reinstating some of the common services.

In line with the oft-quoted Edmund Burke dictum that *''to tax and to please, no more than to love and be wise, is not given to men,''*[67] colonial taxation was found to be inequitable by Africans. This was primarily because it could not be paid in kind, say through labour contribution, as it was in the pre-colonial days, and there was lack of a well-defined basis for determining the liability[68]. Non-Africans were taxed much lighter relative to their cash income. Native Ugandans, who had a less income, would end up paying a higher rate than the non-natives, who actually had higher incomes. For example, the tax burden for native Ugandans, jumped from about 23 percent of cash income in 1927 to an astonishing 55 percent in 1947[69]. These figures cover all taxes including the effects of marketing board deductions and export taxes. It has been indicated that non-compliance with tax payment during the colonial times would attract coercive measures for the Africans including imprisonment but such measures were not applied to non-Africans[70].

Uganda attained independence on 9th October 1962. There were major changes in the tax regime, with the most significant reform being the removal of discrimination in the way a taxpayer was treated based on race. This dispensed with the awkward practices of subjecting Africans to different types and rates of taxes than non-Africans. Secondly, the Government introduced Graduated Personal Tax which was based on ability to pay, and income tax. In order to ease collection of income tax on employment income, the Government introduced the Pay As You Earn (PAYE) tax which is income tax imposed on employment income but withheld at source by the employer and remitted to the tax collecting agency.

The take-over of the state power by the military in 1971 has been identified as the turning point leading to the citizenry's loss of sense of responsibility and readiness to contribute towards the state. General Idi Amin, expelled citizens of Asian origin, whose number is estimated to have been between 50,000-70,000, and expropriated their private property[71]. This action had great ramifications on the country. Firstly, the Asians had a material stake in a range of businesses from commerce, manufacturing and big agricultural estates; and they were the main stay of the private sector. This led to tax revenue, the national budget and the economy to plummete to their lowest point in the stay of Uganda as a country[72]. The economy tumbled by 40%[73], while tax revenue to GDP ratio declined from about 13% in 1970 to 6% in 1979[74], the

[66] Edmund Burke : Speech on American Taxation (1774) as cited in Cutler, Elmendorf & Zeckhauser R (1999):
[67] Kayaga L (2007):
[68] Jamal V (1978): as cited in Therkildsen (2006):;
[69] Mamdani, M. 1996. as cited in Therkildsen O (2006);
[70] Isachenko D & Schlichte K (2007); Jaimovich D & Kamuganga D (2008):
[71] Isachenko D & Schlichte K (2007):
[72] Jaimovich D & Kamuganga D (2008):
[73] IMF (2005)
[74] Isachenko D & Schlichte K (2007):

time when the military were removed from power. This state of affairs was both a cause and a consequence of the state's failure to deliver public and social services to the populace, leading to the institutions of state to fall into disrepair and ruin. The taxpaying culture therefore got stunted or in some instances seemed to have withered away. This lukewarm attitude towards taxation was strengthened by the fact that post-military governments in Uganda adopted economic liberalisation and privatisation of public entities. The services which would have been of a public nature such as education, transport and healthcare were either exclusively or partly offered to private operators[75]. Secondly, the Asians were a source of business skills and entrepreneurial management to the economy, and their departure significantly contributed to the decline of the private sector[76].

The post-Amin government under President Apollo Milton Obote that took over the reins of power after the 1980 national elections brought back some growth in GDP registering an average annual growth rate of about 5.6% between 1981-1983[77]. During this period, the Government also tackled the 3-digit inflation that had reached 111% and tamed it to a considerably lower value of 25%. The budget deficit was reduced from 2.8% of GDP in 1981 to 0.6 % in 1983. Subsequently, the country was engulfed in a guerrilla war stationed in the Central region that led to negative GDP growth rates during the period between 1984 to1986. The budget deficit that had been reduced to less than 1%, then spiraled to 11.9 % of GDP in 1984, and this political instability countered the socio-economic gains that the Government had achieved. The tax revenue to GDP ratio was hovering around 6-7% during this period. In real terms this period did not have much significant impact on the taxation trends in the country.

In 1986, when the National Resistance Movement, took the reins of power the economy was in a dire state and needed drastic measures and reforms. A minimum Economic Recovery Programme (ERP) which was augmented by various reforms that restored macroeconomic stability and provided a favourable environment for economic growth and private sector development was launched[78]. The key reforms included a currency reform, changes in tax and fiscal policy geared towards improving revenues and restraining expansion in Government expenditures, while maintaining a strong focus on economic recovery and growth. Tax reforms were intended to reduce reliance on donor funding; and is on course to achieve this objective. Table 8 and Figure 4 & 5 show both the trend in the past 5 or so years up to 2011/12, and the expected trend for the 5 or so years. In 2005/06, the external resource mobilisation contributed almost 30% of the national budgetary requirements. By 2011/12, the external resources were contributing up to about 16%. In the year 2016/17, this contribution is expected to significantly reduce a nominal contribution of 5-6% of the required funding[79].

Table 9 shows that the recent progressive increase in domestic revenue (which is up to 98% attributable to revenue collected by Uganda Revenue Authority) and a corresponding decrease in external funding will ultimately lead to increased capacity of government to be independent in making objective decisions and judgments for national development.

[75] Jaimovich D & Kamuganga D (2008):
[76] This is based on National Development Plan, 2011-2015
[77] National Development Plan, 2010/11-2014/15.
[78] Background to the Budget 2012/13.
[79] Background to the Budget, 2011/12 & 2012/13.

Table 9: The Actual and Projected Distribution of Revenue and Grants in the Government's Resource Envelope for the period 2005/06 to 2016/17[80]

Year	Total Revenue and Grants	Revenue		Grants	
	Amounts in Billion UGX	Amounts in Billion UGX		Amounts in Billion UGX	
		Amounts in Billion UGX	Percentage	Amounts in Billion UGX	Percentage
2005/06	3211.4	2313.9	72.05%	897.5	27.95%
2006/07	3809.9	2722.1	71.45%	1087.8	28.55%
2007/08	3985.3	3246.8	81.47%	738.5	18.53%
2008/09	4671.4	3786.6	81.06%	884.8	18.94%
2009/10	5,182.6	4,319.5	83.35%	863.1	16.65%
2010/11	7,326.6	6,119.1	83.52%	1,207.5	16.48%
2011/12	7,798.5	6,524.4	83.66%	1,274.1	16.34%
2012/13	8,522.5	7,332.6	86.04%	1,189.9	13.96%
2013/14	9,518.8	8,427.4	88.53%	1,091.4	11.47%
2014/15	10,603.4	9,731.5	91.78%	871.9	8.22%
2015/16	12,138.7	11,369.3	93.66%	769.4	6.34%
2016/17	13,987.8	13,230.2	94.58%	757.6	5.42%

Source: Extracted and based on Human Development Report, 2011, and Geo-Hive, 2000-12.

Government has been seeking external resources to fund major infrastructural developments. The increased domestic resources have however meant that progressively Government can fund the national programmes. The major tax reforms[81] implemented by the Government included: establishment of semi-autonomous revenue agency in 1991 called the Uganda Revenue Authority (URA); introduction of Value Added Tax (VAT) in 1996; enactment of a new Income Tax Act in 1997; and a range of other reforms spread over the years since 1992 that have entailed carrying out tariff reforms and abolishing export taxes; and the modernization of URA processes.

[80] Background to the Budget, 2011/12 & 2012/13.
[81] African Development Bank (2010)

FINDINGS OF THE STUDY

CHAPTER 2: THE UGANDAN TAX SYSTEM

Taxation is a sovereign and constitutional matter, and the tax system adopted by a sovereign state would normally be closely aligned to the political system adopted by the country. Article 152 of the 1995 Constitution of Uganda provides that taxation in Uganda shall only be imposed under an Act of Parliament[81]. The Constitution provides for decentralization and devolution of authority and accountability for service delivery to local governments. Article 176 of the Constitution provides that the district will be principal unit of the local government system in Uganda. Article 176(2) (d) requires that each local government should have a sound financial base with reliable sources of revenue. These provisions provide the context in which Articles 191 and 192 empower local governments to levy and collect fees and taxes. Article 193 provides for grants and subvention payments from the Central government to support local governments. There are accordingly two principal units that collect tax revenue in Uganda: the central government through the Uganda Revenue Authority, and local governments, through the city, municipality and district authorities.

Box 2: Article 152 of the Constitution

152. Taxation.

(1) No tax shall be imposed except under the authority of an Act of Parliament.

(2) Where a law enacted under clause (1) of this article confers powers on any person or authority to waive or vary a tax imposed by that law, that person or authority shall report to Parliament periodically on the exercise of those powers, as shall be determined by law.

(3) Parliament shall make laws to establish tax tribunals for the purposes of settling tax disputes.

Uganda's tax system is influenced by the national socio-economic status of the Country. This is one of the countries characterised as a weak state[82] with a current human development index[83] (HDI) of 0.45 which is slightly below the Sub-Saharan average score of 0.47[84], ranked as 161 out of 187 participating countries and far below the score for the developed countries which is above 0.85. The country has a life expectancy of 53 years. As highlighted earlier, Government statistics indicate that poverty levels have declined significantly from 1993 when 56% of the population lived under absolute (extreme) poverty and only 1.8 million out of about 20 million in the middle class income level. Uganda is currently not in a good financial position, and it shares most of the characteristics of sub-Saharan African states[85]. Currently, Uganda's public debt is about USD 5.5 billion of which 64% is external, and 36% is domestic[86]. This amounts to 25% of the GDP[87]. Interest payments amount to about USD 250 million, and for the year 2010/11 this was about 10 per cent of the state's domestic revenue. Some conventional economists maintain that (foreign) investment is dependent upon low taxes, and that a country like Uganda would therefore have a fiscal dilemma[88] to balance out two divergent and opposed aspects of fiscal policy, that is, revenue collection and encouraging investment.

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[81] Constitution of Republic of Uganda
[82] Isachenko D & Schlichte K (2007):
[83] The HDI is an informative measure which is primarily determined on three dimensions of health, education and income that describes the level of human development as an indication of development in African countries. It is used as a yardstick for comparison with other countries and regions in the world.
[84] United Nations Development Programme (2012):
[85] Isachenko D & Schlichte K (2007), ibid
[86] BTTB 2012/13, pp. 59
[87] BTTB 2012/13, pp. 59.
[88] Isachenko D & Schlichte K (2007), ibid
[89] Isachenko D & Schlichte K (2007), ibid

This creates a dichotomy[89] though there is no systematic empirical evidence to support this proposition. It has actually been espoused that income tax is a very weak stimulant of investment and is accordingly not a very influential factor to determine the flow of Foreign Direct Investment in any given country[90]. A survey on factors determining business location ranked taxation as number 13 out of 26 factors[91]. There are accordingly other factors other than taxes and tax rates which more often play a significant part in raising real investment, such as education of the workforce, availability and prices of inputs (energy, primary materials and intermediate products) and market size.

The Government of Uganda realized that the level of revenue recovery was neither adequate nor sustainable, and hence devised means for establishing a revenue collection and enforcement regime[92]. Government opted to set up a semi-autonomous revenue collecting agency as the institution to be used to improve revenue collection. This was the basis for the creation of the Uganda Revenue Authority (URA) in 1991, which was modeled on the Ghanaian Revenue Authority that had been created earlier in 1985. URA was established following the enactment of an Act of Parliament, the URA Statute of 1991, and the autonomy granted the Authority an independent Board of Directors to release it from undue political influence and ease the decision making process. This was therefore perceived as the appropriate institutional setup to sustained improvement of revenue collection[93]. The Government of Uganda invited Ghanaian expatriates to establish the URA, which was the second autonomous revenue agency established in Sub-Saharan Africa.

The government also considered avenues to ease, simplify and reduce the resource outlays on tax compliance by introducing taxes that would be easier to collect, and this involved replacement of Sales Tax and Commercial transaction Levy with Value Added Tax, and the introduction of a user-friendly Income Tax Act. There has also been a multiplicity of restructurings and modernisation of processes in URA to strengthen its capacity to collect the due tax[94]. These institutional changes account for the initial leap in a five year period of the revenue to GDP ratio from 7% in 1991/92 to about 12% in 1996/97. This ratio has since then been hovering around 12-13%. Figure 3, next page shows the growth trend and depicts the relationship between four elements: growth in revenue yield; growth or movement in the tax revenue to GDP ratio; growth in the GDP; growth in the Per Capita GDP.

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[90] Morisset J & Pirnia N (2000)

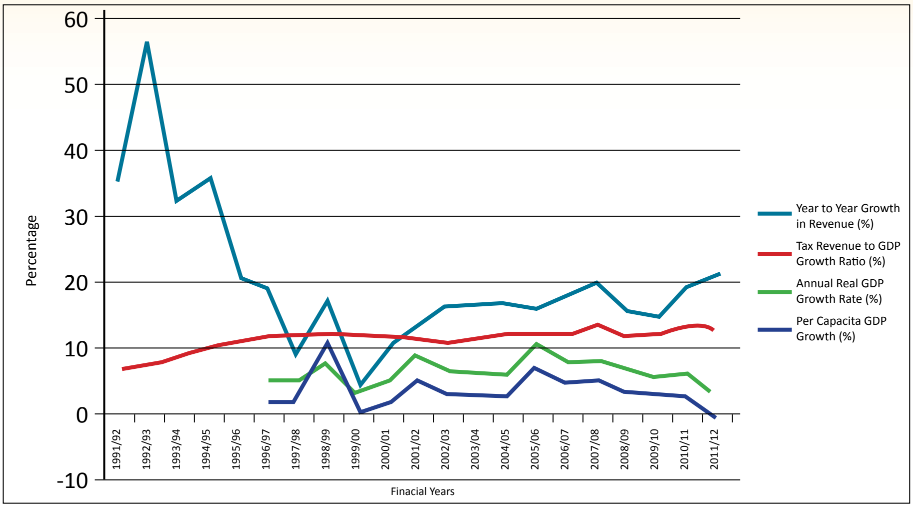
[91] Fortune/Deloitte & Touche, "1997 Business Location Study", 1997 as cited in Morisset J & Pirnia N (2000)

[92] Isachenko D & Schlichte K (2007), ibid

[93] Hadler S (2000):.

[94] Uganda Revenue Authority Modernisation Plan 2006/07 to 2008/09

Figure 3: The relationship between the Percentage Growth in Tax Revenue; the Tax Revenue-to-GDP Ratio; GDP and Per Capita GDP.



Source: *Background to the Budget 2001/02-2012/13; World Bank (2010) and UBOS Statistical Abstract, 2009-2012.*

Figure 3 confirms a general relationship between the three elements of growth in tax revenue, GDP and Per Capita GDP. The increase in GDP and Per Capita GDP should be directly related to improved revenue yield. The rate of growth in tax revenue is however considerably higher than the growth in GDP and Per Capita GDP. This is principally because revenue is stated in nominal values that would include inflation. It has also been submitted by URA that[95] the tax-to-GDP ratio is based on GDP at market prices and given the rising inflation this accounts for the stagnant ratio. This only flaw in this argument is that the revenue is also stated without adjusting it for inflation to a real or constant value.

It would be appropriate to consider the performance of URA for the past six years, as shown by the revenue collections and this will include the different types (or tax heads). The information is laid out in Table 10 next page.

[95] URA Revenue and Trade Report (2012, pp. 32).

Table 10: Revenue Performance for the years 2006/07 to 2011/12

Tax Heads	Collections for the Financial Years in Billions Uganda Shillings					
	2006/07	2007/08	'2008/09	'2009/10	'2010/11	'2011/12
Tax Revenue to GDP Ratio	12.39%	12.91%	12.17%	12.16%	13.1%	12.65%
Net URA collections (Excl. govt. taxes & Tax Refunds)	**2,625.20**	**3,161.10**	**3,662.30**	**4,205.70**	**5,114.20**	**6,208.50**
Domestic Taxes						
Income Taxes	**727.40**	**862.20**	**1,028.90**	**1,303.10**	**1,665.10**	**1,991.90**
• PAYE	368.60	451.40	555.70	657.90	825.60	996.90
• Corporate taxes	195.00	213.30	230.00	315.40	419.60	553.90
• Withholding Tax	116.10	128.20	158.70	212.80	274.80	328.90
• Others	47.70	69.30	84.50	117.00	145.20	112.20
Consumption Taxes (Domestic)	**597.40**	**698.30**	**768.60**	**945.50**	**1,039.80**	**1,296.10**
• Excise duty	184.70	217.00	242.60	274.10	315.60	372.80
• Value Added Tax	412.70	480.70	526.00	671.40	724.20	923.30
Taxes on International Trade	**1,314.20**	**1,633.70**	**1,891.70**	**1,960.70**	**2,441.70**	**2,937.20**
• Petroleum duty	403.00	513.60	566.20	638.20	821.20	920.90
• Import Duty	259.00	304.20	360.10	352.20	447.40	506.10
• Excise duty	64.80	80.30	112.50	112.80	93.30	182.10
• VAT on Imports	512.40	653.80	763.60	763.40	986.50	1,164.50
• Others	75.10	81.70	90.30	94.10	185.60	162.60
Tax Refunds	**(96.00)**	**(95.50)**	**(101.90)**	**(105.60)**	**(143.60)**	**(167.80)**
Fees and Licenses	**83.90**	**62.50**	**78.30**	**102.70**	**111.30**	**184.10**
Government Taxes	**29.80**	**45.90**	**80.90**	**57.50**	**55.30**	**76.10**
Non-Tax Revenue	**96.70**	**85.70**	**124.30**	**113.80**	**94.10**	**65.50**

Source: *Background to Budget 2011/12 & 2012/13*

Table 10 shows revenue collected for the years 2006/07 to 2011/12, and clearly confirms that revenue collected has been consistently rising. The only notable subdued performance is on tax revenue-to-GDP ratio and on the non-tax revenue item.

Secondly, in order to encourage production and investment, the government of Uganda chose to primarily tax income and consumption rather than production or trade.[96] This was part of a Government strategy that entailed selecting strategic export subsectors where it would deploy resources for promoting export earnings, creating employment and achieving economic transformation[97]. This strategy was translated into policies for deploying resources through express expenditure on a given sector or refraining to collect the due tax through tax incentives or exemptions. Particularly, export taxes which used to be a lucrative source of revenue, were reduced or totally scrapped. The principal sources of export taxes were the principal agricultural cash crops, such as coffee, cotton, cereals and tea.

[96] Isachenko D & Schlichte K (2007), ibid
[97] BTTB, 2001/02.

Table 11: Percentage contribution of different Taxes towards Government Revenue

Fiscal Year	Income Tax (%)	Export Tax (%)	Indirect Taxes (%)	Sub-Total (%)	Other Sources of Revenue (%)	Total Revenue (%)
1961/62	30	10	36	76	24	100
1969/70	16.5	13	41	70.5	29.5	100
1982/83	4.8	30.7	17.6	53.1	46.9	100
1991/92	10.7	2.3	58.6	71.6	28.4	100
2002/03	23.9	0	69.6	93.5	6.5	100
2006/07	27.7	0	69.2	96.9	3.1	100
2011/12	32.1	0	65.5	97.6	2.4	100

Source: *Extracted from relevant Background to the Budget pubblications by the Ministry of Finance & Isachenko D & Schlichte K (2007).*

Table 11 confirms that export taxes were eventually abandoned as a source of taxes and the focus for raising taxes shifted towards income and consumption taxes. The share of domestic direct taxes or income taxes was as low as 10% of the total revenue about 15-20 years ago. In the early 1990s, the contribution of income taxes in Uganda was below the Sub-Saharan African average share of taxes of about 20 per cent of the GDP[98], and IMF found this an untenable and hopeless position[99]. The country has accordingly moved on with income taxes currently contributing about 32% of the total revenue. In 2002/2003, after the liberalization of the coffee market, export taxes were no longer among the main sources of state income as was the case in the 1960s and 1970s. Indirect taxes however contribute twice as much as income taxes. The combined Direct and Indirect Domestic taxes have also ultimately overtaken taxes on international trade as the principal sources of income. For example, for the year 2011/12, if these domestic taxes are considered together with other sources of (domestic) revenue, then these locally generated revenue amounted to about 55% against 45% for the taxes on international trade. The trend over the past 5 or so years shows progressive increase both in quantum and proportion of domestic taxes against international taxes, moving from a contribution of 60% by taxes on international trade in 1990/91 to current position as indicated for the year 2011/12 to be 45%. This is indicated in Figure 4 on the next page

[98] Kasumba, Stephen R. 1996:

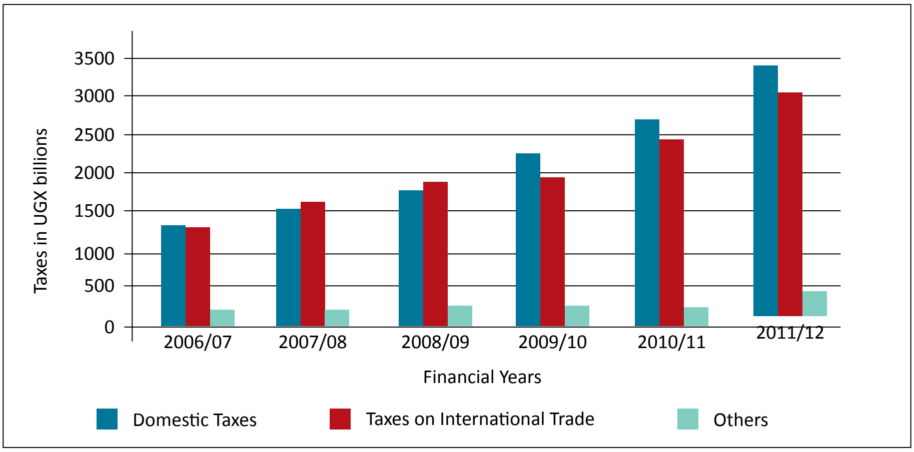
[99] Shaver R, DeZaysa H, McDonald C (1995):

Figure 4: Contribution of Domestic and International Trade Taxes for the year 2011/12

Source: *URA (2012): Revenue and Trade Performance Report, 2010/11, and Background to the Budget, 2012/13.*

The composition and relationship between domestic taxes (including both direct taxes and indirect taxes) and international trade taxes.

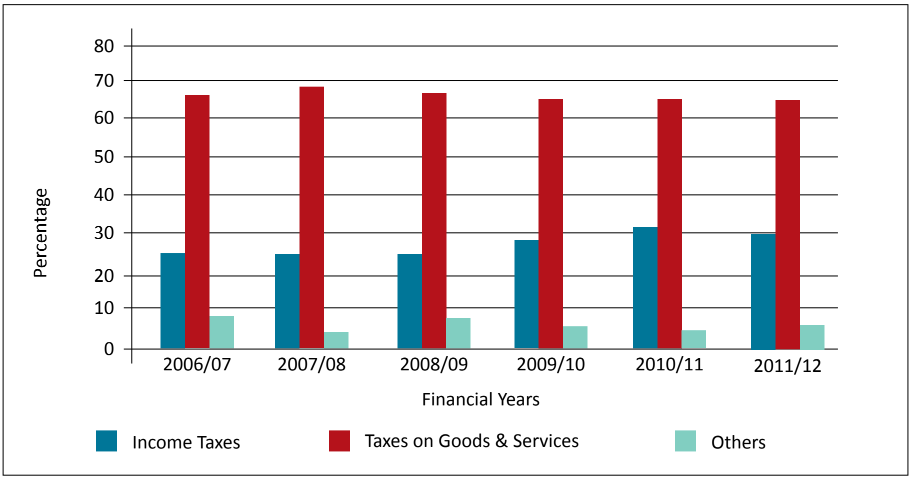
Figure 5: Domestic Taxes and Taxes on International Trade 2006/07 to 2011/12



Source: *URA (2012): Revenue and Trade Performance Report, 2010/11 and Background to the Budget, 2011/12 & 2012/13.*

There has therefore been a movement in the tax structure from the 1960-1970s when taxes on international trade were taking a lion's share of up to 60% to the current time when domestic taxes are making a bigger contribution. This is made pertinent by the re-establishment of the East African Community in 2000 and its progression to a Customs Union which introduced three key aspects: a Common External Tariff (CET) on imports from third party countries; duty-free trade between the member states; and common Customs procedures[100]. Notably for Uganda, the revival of the EAC, the progressive integration within the Common Market for Eastern and Southern Africa (COMESA) and world-wide trend towards trade liberalisation and reducing tariff structure have compelled the government to focus on the exploration of how domestic revenue could be mobilised. The importance of enhancing domestic revenue mobilisation for a country like Uganda is; to strengthen internal budget management as the country is insulated against the volatility and uncertainty associated with donor aid and grants; to give the country a free hand to define its spending in line with national priorities; to provide an alternative source of revenue due to entrenchment of globalisation, international trade liberalisation and regional economic integration which are progressively trimming down trade taxes; and to increase the participation of the citizenry in the political process and create a sustainable avenue for them to demand for accountability and better governance in managing of public expenditure[101].

Figure 6: Graphical representation of the Structure of Tax Revenues 2006/07 to 2011/12 shown in Percentage terms and based on Gross Revenue



Source: *Background to the Budget, 2011/12 & 2012/13.*

[100] East African Community Customs Management Act, 2005
[101] OECD (2008); Alabede, Ariffin & Idris (2011)

As highlighted, taxes can either be on goods and services or income. Ordinarily taxes on goods and services tend to be regressive in nature, yet in Uganda the ratio of taxes on goods and services to taxes on income is almost 2:1 as shown by the table 12 below.

Table 12: Structure of Tax Revenues 2006/07 to 2011/12 shown in Percentage terms and based on Gross Revenue[102]

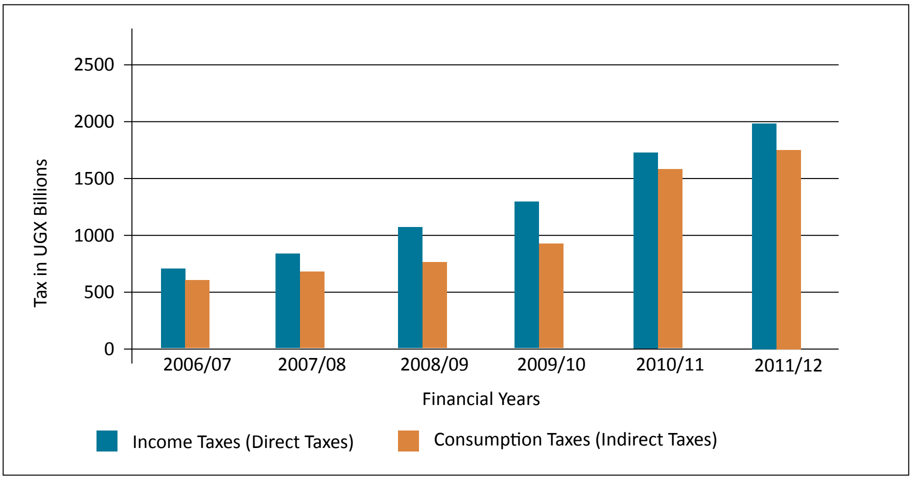
	2006/07	2007/08	'2008/09	'2009/10	'2010/11	'2011/12
Income Taxes	25.53	25.45	25.90	29.07	30.79	30.41
Taxes on Goods & Services	67.09	68.83	66.96	64.82	64.39	64.62
Others	7.38	5.73	7.14	6.11	4.82	4.97
	100.00	100.00	100.00	100.00	100.00	100.00

Source: *Background to the Budget 2012/2013*

There is however some sign of an increasing progressive nature of the tax structure when considering absolute figures in Table 12 (above). The figures also show that the tax on income is growing at faster rate than the tax on goods and services.

The different types of taxes or tax heads are constituted as follows:
The first category of taxes considered are Domestic taxes which have two broad sub-categories, that is, Direct taxes and Indirect taxes. Direct taxes include Corporate Tax and Income Tax, while indirect taxes are consumption-based taxes which include Value Added Tax and Excise Taxes. The distribution of Direct and Indirect Domestic Taxes is shown in Figure 7 hereunder:

Figure 7: Domestic Direct and Indirect Taxes



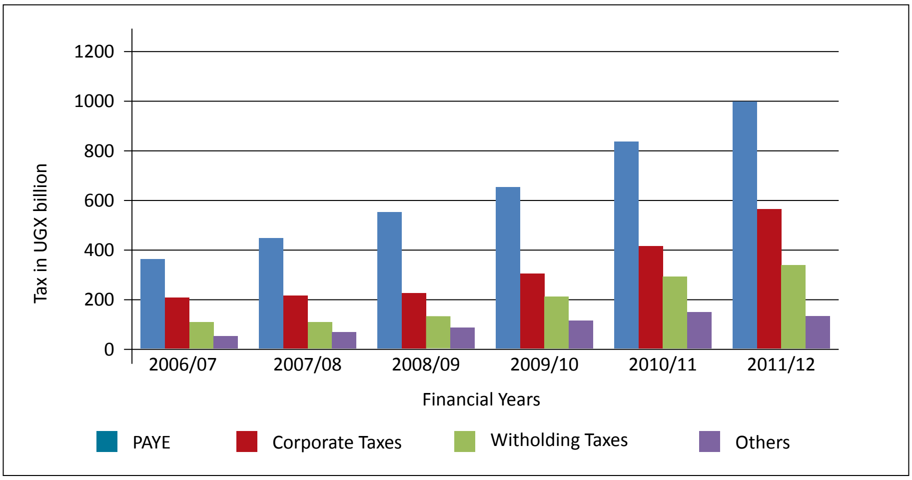
Source: *Background to the Budget, 2011/12 & 2012/13.*

[102] Computed from Background to the Budget, 2012/13

Figure 7 shows that whereas the yield of both direct taxes and indirect taxes have been increasing, it is notable that income-based taxes have been increasing at a faster rate and are now substantially contributing more revenue than consumption based revenue.

Direct Taxes have two principal taxes: Corporate Tax and Pay As You Earn (PAYE) tax. Tax on employment income which is collected under the PAYE system is the most significant source of revenue under Income Tax, contributing over 50% of the total revenue. PAYE tax is greater than Corporation tax in the ratio of 2:1. This may partly explain the Government's reluctance to vary the tax rate structure of individual income tax. The Corporate tax is principally paid by Multi National Companies, with top 5 companies paying UGX.203.2 Billions out of the total Corporation taxes realised of UGX. 553.9 Billions or about 37% of the tax. Figure 8 shows the constitution of Direct Taxes and confirms the consistent increase and growth in these taxes.

Figure 8: Constitution of Domestic Direct Taxes



Source: *URA (2012): Revenue and Trade Performance Report, 2010/11 & 2011/12 and Background to the Budget, 2011/12 & 2012/13.*

Figure 8 confirms the position of PAYE tax. It is important to account for this significant position of PAYE. Firstly, the Government has maintained the same tax rate structure since 1993/94 with an annual (tax free) threshold of UGX. 1,560,000[103] (USD 624) which has been increased in the 2012/13 budget to UGX. 2,820,000 (US$ 1,128). At the time the threshold was introduced in the financial year 1993/94, the annual threshold was equivalent to US$1,415. Given that this is at the first taxable level of 10%, the maximum monthly tax benefit to an employee who had to start paying tax at UGX 130,000 (US$52) which has been raised to UGX. 235,000 (US$94) is UGX. 10,500 (US$4.2).[104] Using Consumer Price Indices[105], and based on

[103] This is based on the Exchange Rate of US$ 1= UGX. 2,500. The Uganda Shilling has been fluctuating between UGX. 2,450-2550 against the US Dollar. Based on the 2004/05 BOU Annual Report, pp. 30, the Exchange rate in 1993/94 averaged US$1= UGX. 1,102.70

[104] The computation of the tax benefit from increasing the threshold is as follows: UGX ([235,000-130,000]*10%).

[105] The CPI measures the change over time in the general level of price of goods and services that households buy for consumption (UN, 2009). The CPI computation based on Year 1994 as 100 is derived from the UBOS Statistical Abstract, June 2012 and the BOU 200/05 Annual Report.

the CPI as at 30 June 2012, it shows that the general price level has changed by a factor of more than 332% since 1993/94. The threshold was introduced in Uganda's tax system in the 1980s to replace a multiplicity of Personal allowances[106] that were necessary as vehicles for societal welfare, and these were: (1) single allowance, (2) married allowance; (3) child allowance. The threshold was meant to enable a family (a taxpayer, spouse and four children) to live an acceptable standard of living. In real terms therefore the Government is overtaxing people paying individual income tax. Such imposition of taxes on labour or employment may discourage people from providing, and this leads to the operation of the tax wedge[107]. A Tax Wedge is the ratio of the total employment taxes to the total employment costs. This can be divided into two elements: (1) payroll taxes, which includes all taxes paid by the employer; and (2) general income taxes which are the taxes by the employer. The productivity and buoyancy of income taxes is a very pertinent matter. This is principally because world over the trend is towards trade liberalization and regional economic integration. This is inevitably reducing reliance on international trade taxes. Uganda currently belongs to the EAC and COMESA, and these two trading blocs contribute between 10-15% of the country's imports[108].

The country has so far negotiated and entered into fifteen Double Taxation Agreements[109], and this initiative further reduces immediate revenue yielding avenues. Box 3 shows that Uganda needs to improve its tax administrative efficiency to improve the revenue generated from both

Box 3: Buoyancy and Productivity of Income Taxes in Uganda

Considering the buoyancy and productivity of income taxes in the Uganda tax system will lead to judging how efficiently Uganda is generating revenue from income taxes. The two measures used are: (a) the Corporate Income Tax Revenue Productivity (CITPROD), and (b) the Personal Income Tax Revenue Productivity (PITPROD). These measures reflect efficiency of measures such as enforcement, auditing, taxpayer registration and compliance; and how their implementation is reflected in revenue generation. The measures can also be used to compare the efforts and quality of performance in different jurisdictions. The CITPROD signifies how well Corporate Income Tax performs in terms of generating revenue, given the prevailing tax rate. It is calculated by dividing total corporate income tax revenues by GDP and then dividing this by the general corporate income tax rate. The PITPROD signifies the performance of the personal income tax in terms of generating revenue. It is calculated by taking the actual revenue collected as a percentage of GDP, divided by the weighted average PIT rate. The computed measures for CITPROD and PITPROD amounted to measures of 0.11 and 0.03 respectively. This would imply Uganda uses these taxes less efficiently in generating revenue than World averages of 0.13 and 0.14, respectively. It has been submitted that the low levels of voluntary compliance account for these dismal revenue yields.

Source: This is based on African Development Bank (2010

Personal and Corporate Income Tax. Personal Income Tax is the tax collected under the PAYE Scheme. Uganda's performance on account of income tax buoyancy and productivity is not good and Government needs to address this matter urgently, as the comparison with other countries shows in Table 13 on the next page.

106 The (repealed) Income Tax Decree, 1974 and Ghai (1966).
107 Gray, Lane & Varoudakis (2007); Holm-Hadulla, Leiner-Killinger & Slaví (2007); World Bank (2005).
108 This is based on statistics from URA, with Kenya which also a member of both EAC and COMESA contributing 11-12%.
109 Uganda has entered into 15 Double Taxation Agreements with the following countries: Belgium, China, Denmark, EAC, Egypt, India, Italy, Mauritius, Netherlands, Norway, Seychelles, South Africa, United Arab Emirates, United Kingdom, Zambia

Table 13: Comparing the PITPROD and CITPROD Measures for Uganda and Different Jurisdictions

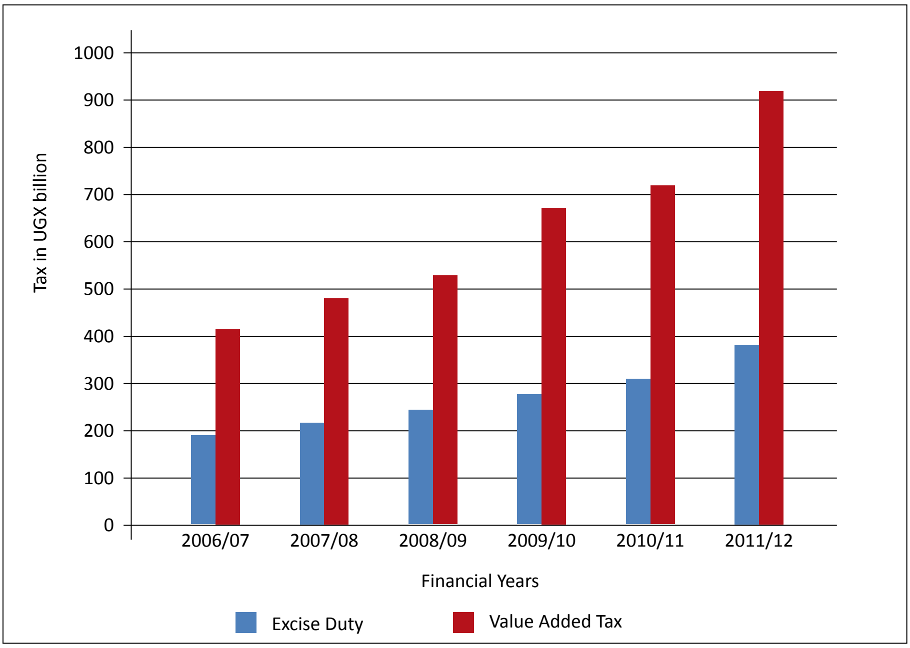
Country/Regions	PITPROD	CITPROD
Uganda	0.11	0.03
Rwanda	0.09	0.06
Kenya	0.11	0.15
Tanzania	0.08	0.05
South Africa	0.22	0.27
Sub-Saharan Africa	0.08	0.09
Low Income economies	0.07	0.08
World	0.14	0.13

Source: *Adopted from ADB (2010)*

Table 13 shows Uganda is only able to retain a respectable score on personal Income Tax of 0.11 which is above the Sub-Saharan Average of 0.08. This may be attributable by its high real tax rates than ample coverage of the potential taxpayers. The performance on Corporate Income Tax is, however, very poor. It is below the average for the Sub-Saharan Africa and Low Income Countries.

The Domestic Indirect Taxes have two forms, Excise duty and VAT. The contribution of VAT is more than twice as much as the contribution of excise duty. This is illustrated in Figure 9 below.

Figure 9: Composition of Domestic Indirect Taxes

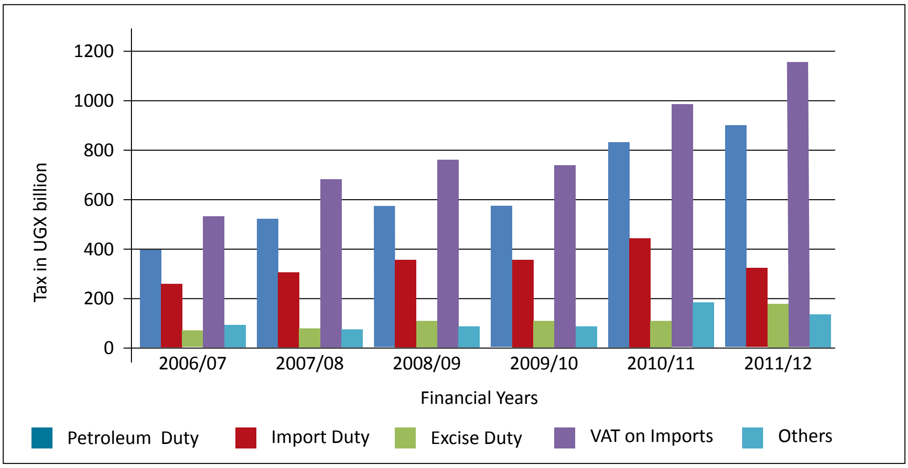


Source: *URA (2012): Revenue and Trade Performance Report, 2010/11 & 2011/12 and Background to the Budget, 2011/12 & 2012/13.*

Figure 9 shows that yield from Domestic VAT is more than double the yield from Excise duty. Considering the past five years, the growth in Domestic VAT averages 17.4% as opposed to 15% for the Local Excise Duty. This confirms the position of Services as a bigger Sector than Industry, and also may be a pointer to the relatively less robust growth of the manufacturing sector.

The Taxes on International trade have four principal tax heads: VAT on imports; Import Duty; Petroleum Duty and Excise duty on imports. The other taxes collected under this category include withholding tax and the environmental duty on some old motor vehicles.

Figure 10: International trade taxes



Source: *URA (2012): Revenue and Trade Performance Report, 2010/11 & 2011/12 and Background to the Budget, 2011/12 & 2012/13.*

Figure 10 shows that VAT on imports is the principal source of revenue under the International trade category, closely followed by petroleum duty. The petroleum duty regime is considerably high in Uganda and currently accounts for 35-40% of the pump prices of petroleum products. It is however likely that this will change with the discovery of oil in the country.
VAT is therefore an important source of revenue contributing up to 35% of the total revenue as indicated below:

Table 14: VAT as a Proportion of Net URA Revenue Collections

	Revenue Collections in UGX. Billions					
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Value Added Tax (Domestic)	413	481	526	671	724	923
VAT on Imports	512	654	764	763	987	1165
Total VAT Collections	**925**	**1,135**	**1,290**	**1,435**	**1,711**	**2,088**
Total URA Revenue Collections	**2,625**	**3,161**	**3,662**	**4,206**	**5,114**	**6,209**
Percentage	**35%**	**36%**	**35%**	**34%**	**33%**	**34%**

Source: *URA (2012): Revenue and Trade Performance Report, 2010/11 & 2011/12 and Background to the Budget, 2011/12 & 2012/13.*

This also affirms the importance of tax on goods and services, as VAT is an important aspect of these taxes.

TAX INCENTIVES AND EXEMPTIONS

As highlighted earlier on, Governments have to balance the need to collect revenue and also encourage productivity and investment if they are to spur economic growth. There is however no universal acceptance that the granting of generous tax incentives, exemptions and subsidies, which are collectively referred to as *tax expenditures,* is a prudent, viable and beneficial fiscal policy option. tax expenditures take the form of permanent exclusion from income tax, deductions, deferrals of tax liability, credits against tax, or special rates and normally favour a particular industry, activity, or class of persons[110] and constitute a relief given to a particular person, sector or activity which translates into taxes forfeited by government in order for a given policy objective to be realized. This is often justified on the grounds of attracting foreign investments and boosting the national economic productivity. The reasoning behind goes like this: The state postpones receipt of revenue on the presumption that laying a bait of future revenue and benefits which are far higher than the current tax revenue is a more prudent decision. This position is however not a *fait accompli* as the Hawaii Government Tax Review Commission, 2001-3[111], forthrightly indicated in their opinion on tax incentives:

"A tax incentive program is a potential 'black hole', because it is a future benefit of unknown proportions, which is determined by the favoured taxpayer's interpretation of what the tax credit should be, and is claimed on a tax return which is confidential."

In 1991, the Government enacted the Investment Code Act, 1991 (CAP 92 of the Laws of Uganda) that established the Uganda Investment Authority (UIA) and provided more favourable conditions for local and foreign investors[112]. The administrative challenges faced by UIA compelled government to transfer exemptions regimes to the different taxing statutes. The statutes also include provisions that accord to the Minister of Finance, Planning and Economic Development (MEPD) discretionary powers to give exemptions in defined circumstances and report such decisions to Parliament.

This position taken by Government on tax incentives and holidays is however against the standard and firm advice given by IMF. The gist of the IMF[113] advice is that: First, an instrument that waives the obligation to pay taxes is in direct conflict with the cardinal goal to increase revenue and puts undue pressure on the objective of broadening the tax base by encroaching on vulnerable sectors such as small and medium taxpayers. Second, the consideration of tax in making investment decisions is a second order matter relegated by stronger factors such as rule of law, security of property ownership, effective judicial system, quality of infrastructure and minimal bureaucracy in doing business. Third, most countries operate on (tax) residence basis which in any case would impose tax on such exempt income in a foreign country; the taxpayer would ultimately pay tax and the purported exemption only affects the area of tax jurisdiction in tax exemptions.

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110 Surrey S & McDaniel P (1985).
111 The 2005-2007 Hawaii Government Tax Review Commission
112 The Long title to the Investment Code Act,1991(CAP.92)
113 ADB (2010) pp. 229; IMF (2011).

Box 4: The Estimated Revenue Loss from Tax Incentives and Exemptions in Uganda and comparable examples from some EAC countries.

- *In the year 2009/10 Uganda lost about UGX 690 billion (US$ 272 million) in tax exemptions. The amount lost would amount to about 16% of the revenue or at least 2% of the GDP (ADB, 2010).*
- *A variant estimate is given by URA (URA, 2010):*
  - *Revenue foregone as a result of incentives and exemptions grew from UGX 481.98 Billion in 2005/06 to UGX 1,231.60 Billion in 2009/10.*
  - *For the year 2009/10, this would amount to 3.99 percentage points, and would accordingly have enabled the country to attain a Tax revenue to GDP ratio of 16.15% (up from the realized 12.2%) or alternatively this is almost 30% of the revenue realized (UGX. 1,231.6 billion as opposed to total revenue collection of UGX.4,205.69 billion); and yet external donor funding in the year amounted to about 38% of the collected revenue (UGX. 1622, spread almost evenly between foreign grants and debt financing) or 24% of the required national budget.*
- *The case of Tanzania: Tanzania Revenue Authority estimated that in 2008, through tax exemptions, the government lost revenue amounting to Tanzanian Shillings 1.8 trillion (US$1.23 billion) or 6% of GDP (ADB, 2010).*
- *Rwanda lost Rwf 94 billion (US$ 156 million) in 2008 and Rwf 141 billion (US$ 234 million) in 2009. These were the equivalent of 3.6% of GDP in 2008 and 4.7% of GDP in 2009 (ActionAid, 2011). The country lost at least 3% of GDP through tax incentives and exemptions (ADB, 2010).*
- *In 2006, Burundi had 60% of imports exempted from transaction tax, which were estimated to lead to a revenue loss of Burundi Francs 103.7 billion (US$84 million), or 10.7% of GDP (Chambas and Laporte, 2007, cited in ADB, 2010)*
- *Kenya loses as much as KShs. 100 billion (US$ 1.1 billion) a year; which amounts to around 3.1% of GDP. Secondly, on joining the EAC, Kenya was obliged to introduce exemptions of import to protect infant industries in the EAC region on the value of goods that qualified for such exemptions increased in 2006 by 71.2% to US$1,370.8 million, resulting in revenue loss of US$289.5 million, which was about 14.20% of total trade taxes (ADB, 2010)*

The impact of this fiscal policy option in Uganda is probably most typified on VAT. This tax was introduced in 1996 to replace Sales Tax and Commercial Transaction Levy (CTL) and had been projected to yield substantial revenue but its potential has been curtailed by the multiplicity of tax exemptions and zero-rated supplies[114].

Box 5: The Impact of Tax Exemptions on VAT Productivity

When introduced ten years ago, Uganda's value-added tax (VAT) reflected good international practice, with a single positive rate, a broad base, and limited exemptions. However, the introduction of numerous exemptions has undermined VAT effectiveness, and is a contributing factor to Uganda's disappointing domestic revenue effort. Uganda's VAT intake was 3.8 percent of GDP in FY2009/10, in comparison to 5.8, 4.6 and 4.1 percent for Kenya, Tanzania and Rwanda, respectively, despite all having a standard VAT rate of 18 percent (16 percent for Kenya). In particular, the lower intake is due to a large number of exemptions that have been adopted for intermediate goods, transforming the current VAT into something closer to an old-style manufacturer's turnover tax in some sectors. The exemption on petroleum products, for example, will pose a serious problem in the context of future oil production.

Source: *Extracted from IMF (2011), pp.14 (only considered aspects of VAT).*

[114] IMF (2011).

As part of intention to prop up economic growth and support some disadvantaged groups, the Government introduced a range of exemptions especially for intermediate goods[115] (which have instead led to an unintended effect of diluting the tax's robustness, making it regressive to appear like the Sales Tax it replaced). The zero-rated and exempt supplies have led to stagnating of revenue generation by VAT which had been expected to rise beyond the 35% ceiling shown in Box 6 below.

The October 2011 IMF mission to Uganda predicted that if the Government of Uganda implemented a battery of recommendations over the next three financial years (see Box 7, below), there would be increase in domestic revenues amounting to 0.6% of GDP leading to additional revenue of at least UGX. 300billion. The recommendations implemented in the year 2011/12 would generate annual revenue of UGX. 130 billion, which is about 0.25% of GDP, primarily through suspension of some existing VAT and corporate income tax exemptions and tax holidays[116].

Box 6: Measures Recommended by IMF to Enhance Revenue Performance

Revenue measures to become effective from the start of FY 2011/12:

- *Eliminate VAT exemption on supply of motor vehicles or trailers of a carrying capacity of 3.5 tons or more designed for the transport of goods;*
- *Streamline agricultural processing exemptions and 10-year export holiday under the CIT;*
- *Eliminate government incentives for construction materials for hotels;*
- *Eliminate investment trader regime under the VAT;*
- *URA to issue and begin to enforce proposed transfer pricing guidelines; and*
- *Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures.*

Revenue measures to become effective in FY 2012/13:

- *Introduce a capital gains tax on non-business assets of individuals;*
- *Eliminate VAT exemptions on the following intermediate products:*
- *Supply of petroleum fuels subject to excise duty, except for kerosene (motor spirit, gas oil, spirit type jet fuel, kerosene type jet fuel, as well as residual oils for use in thermal power generation to the national grid);*
- *Supply of any goods and services to the contractor and subcontractors of hydro-electric power projects;*
- *Supply of specialized vehicles, plant and machinery, feasibility studies, engineering designs, consultancy services and civil works related to hydro-electric power, roads and bridges construction, public water works, agriculture, education and health sectors; and*

Revenue measures to become effective in FY 2013/14:

Eliminate the following VAT exemptions:

- *Supply of machinery used for the processing of agricultural or dairy products;*
- *Supply of packaging material exclusively used by the milling industry for packing milled products or used by the dairy industry for packing milk; and*
- *Supply of feeds for poultry and livestock.*

- *Supply of computers, computer parts and accessories, computer software and software licenses, printers and accessories.*
- *URA to begin to pay VAT refunds directly, rather than through budgetary appropriation.*

Source: *Extracted from the IMF Country Report, October 2011.*

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[115] See Box 6 for some items of exemptions that have been identified to be scrapped.

[116] IMF Country Report, 2012.

The June 2012 IMF report[117] indicates that the Government is on course in implementing the proposed measures, though some of them which seem to be affecting the standard of living of the low income people such as removal of VAT from (household) water have not received Parliamentary approval.

A corollary angle of looking at the performance of VAT and the impact of several exempt and zero rated goods is looking at tax revenue performance measure called the VAT Gross Compliance Ratio (VATGCR). The ratio measures the productivity of revenue by VAT for the government. It recognises that VAT is mostly applied to final consumption by households and individuals, and is computed by dividing net VAT revenues by total private consumption in the economy and then dividing this by the VAT rate. VATGCR is the actual VAT collections divided by potential VAT collections, expressed as a percentage.

Box 7: Example of detremining VATCGR

For example, considering the year 2011/12:

- *The Gross VAT revenue is UGX. 2088 billion,*
- *The tax refunds are UGX.167.8 billion,*
- *The private/household consumption is UGX. 41,041 billion.*
- *VAT rate of 18%.*

VATGCR will be:

- *Potential VAT Collections= UGX. 41,041 billion * 18%*
  =UGX. 7,387.38 billion.
- *Net VAT collections= UGX. (2088- 167.8) billion= UGX.1920.2 billion.*
- *The VATCGR= Net VAT Collections/Potential VAT Collections*
  = 1920.2/7,387.38
  =25.99

Uganda's VATGCR for the year 2011/12 is about 26%

Source: *The primary figures have been derived from URA (2012): Revenue and Trade Performance Report, 2011/12 and Background to the Budget, 2012/13.*

The illustration for the year 2011/12 is in sync with the average VATCGR which has been computed to be 26.5. In Table 15, we explore the VATCGR from different jurisdictions to position Uganda compared to other countries.

Table 15: Comparing the VATCGR Measures for Uganda and different jurisdictions

Country/Regions	**VATGCR**
Uganda	26.5
Rwanda	30.3
Kenya	40.5
Tanzania	27
South Africa	86.9
Sub-Saharan Africa	42.3
Low Income economies	38.45
World	65.48

Source: *Adopted from ADB (2010)*

[117] IMF Country Report (2012)

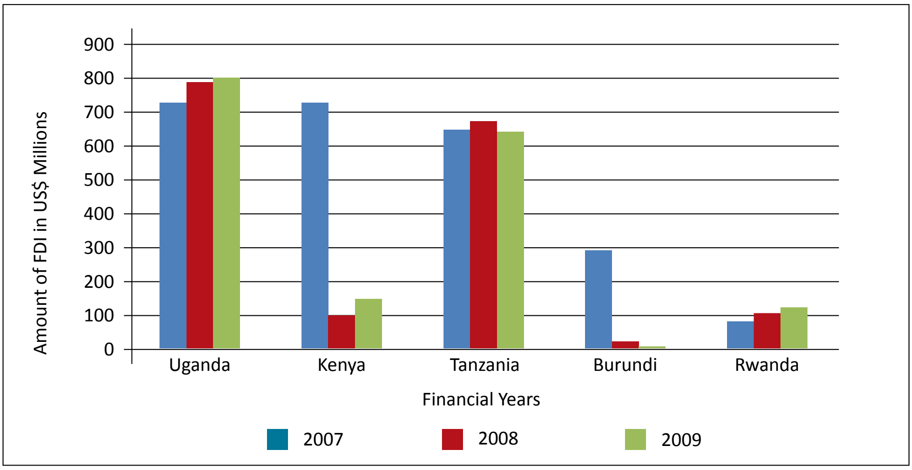
As shown in Table 15, Uganda has not been able to exploit the VAT revenue potential in the country. Uganda has a relatively high VAT rate of 18% but its VATGCR is 26.5% which unfavourably compares with the global and Sub-Saharan Africa average of 65.48% and 38.45 respectively.[118] Uganda's VAT yield was 3.8% of GDP in the financial year 2009/10, compared to Kenya with 5.8%,Tanzania with 4.6% and Rwanda with 4.1%, yet save for Kenya which uses a 16% VAT rate, all other countries have a similar rate of 18%.This shows the impact exemptions can have on the Country's tax effort. The VATGCR has not increased as had been anticipated due to administration capacity and compliance[119].

TAX COMPETITION AND TAX HARMONISATION

Tax competition can only subsist if there is a likelihood of a person to reduce tax burdens by shifting capital and/or labour from high-tax jurisdictions to low-tax jurisdictions[120]. Advocates of tax competition argue that low-tax jurisdictions receive real investments and labour that propel their growth and compels high-tax jurisdictions to lower tax rates and engage in pro-growth tax reform[121]. It has also been established that tax incentive schemes aimed at attracting investment, financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases[122].

Uganda has engaged in tax competition, but there is now more or less universal agreement that the alleged benefits from tax competition through generous tax incentives do not justify the revenue lost[123]. The figures of lost revenue hovering around UGX 690 billion (US$272 million) or 2% of the GDP cannot be justified by cases of additional Foreign Direct Investment[124].

Figure 11: Foreign Direct Investment in the EAC Countries



Source: *World Investment Report, 2010, UNCTAD as cited in BTTB, 2011/12, pp.69.*

118 African Development Bank (2010);
119 Cawley and Zake (2010)
120 Mitchell (2010)
121 Bénassy-Quéré A, Fontagné L & Lahrèche-Révil A (2003), and Mitchell (2010)
122 OECD(1998)
123 SEATINI (2012); IMF (2011; 2012).
124 IMF (2011); SEATINI (2011); ActionAid International (2011).

The amounts of the Foreign Direct Investment show Uganda receiving the highest FDI in excess of US$700 million. Yet the change in the FDI received by Kenya in 2008-2009 and that received by Burundi may signify that factors such as level of security (given the Kenyan Post-Election violence, and the continued insurgency in Burundi at the time) have a greater impact on FDI than tax incentives and exemptions. Uganda as a partner state in the East African Community (EAC) is obliged by Article 80(1)(f) of the Treaty establishing the EAC to:

"harmonise and rationalise investment incentives including those relating to taxation of industries particularly those that use local materials and labour with a view to promoting the Community as a single investment area"[125]

Tax harmonization is an antithetical of tax competition and subsists when taxpayers face a similar or identical tax regime. This is the objective of the EAC, not only to eliminate fiscal competition, but also ensure harmonious, balanced and equitable development within the EAC region[126].

CHALLENGES OF UGANDA'S TAX SYSTEM

One of the principal challenges in Uganda's tax system that partly accounts for the stagnant tax revenue to GDP ratio is the existence of a large informal sector in the economy[127]. The informal sector is often referred to as the shadow economy and is commonly defined to encompass all currently unregistered economic activities that contribute to the officially calculated (or observed) Gross Domestic Product[128]. Such economic activities would therefore not be exposed to government regulation, taxation or observation.

Table 16: The Taxonomy of Types of Underground Economic Activities

Type of Activity	**Monetary Transactions**		**Non-Monetary Transactions**	
Illegal Activities	Trade in stolen goods; drug dealing and manufacturing; prostitution; gambling; smuggling; fraud, human-,drug-, and weapon-trafficking		• Barter of drugs, stolen goods, smuggling etc. • Produce or growing drugs for own use. Theft for own use.	
	Tax Evasion	**Tax Avoidance**	**Tax Evasion**	**Tax Avoidance**
Legal Activities	Unreported income from self-employment; wages, salaries and assets from unreported work related to legal services and goods	Employee discounts, fringe benefits	Barter of legal services and goods	All do-it-yourself work and neighbour help

Source: *Adopted from Lippert and Walker (1997) as cited in Schneider (2010, pp.5)*

[125] EAC Treaty
[126] EAC Treaty
[127] Isachenko D & Schlichte K (2007):
[128] Schneider F, Buehn A & Montenegro C (2010):

Uganda's shadow economy is estimated to have been between 42-45% for the period 1999-2007[129]. The implications of the shadow economy would be non-monetisation of economic activities in different sectors, typified by the agricultural sector in Uganda. Administratively, many taxpayers would not be registered and the business transactions which would significantly impact on government revenues are not captured[130]. There is also high smuggling across the international borders[131]. The principal reasons advanced that justify taxing the informal sector are[132]: the need to increase revenue; the phenomenal size and growth of informal sector resulting from the implementation of Structural Adjustment Programmes that is pushing many formal businesses into the informal sector ; the perception of injustice by people in the formal sector for government not to pursue people with apparent taxable income in the informal sector; government need to preempt loss of legitimacy by incorporating informal sector activities into formal systems; people in informal sector would like to pay taxes as a price for legitimacy, access credit from financial institutions; stability and gaining protection from arbitrary harassment from state agents; paying taxes will ingrain the demand for accountability in the populace.

Another challenge is the limited compliance by the Multi-National Corporations (MNCs) through exploitation of the loopholes in the taxation laws through designing complex tax avoidance schemes and transfer pricing. Of recent, MNCs are coming to the emerging economies and developing countries to establish businesses in order to increase business opportunities and generate revenues to cover gaps resulting from current global financial meltdown and crisis depression. The MNCs including oil companies present complex economic and tax (avoidance) schemes and transactions that are beyond the competence of tax authorities like URA to handle. The limited capacity and exposure in the tax administration is therefore a major hindrance to domestic revenue mobilisation and maximisation in Uganda.

As a Country, Uganda faces the challenge of poor record and information management. Uganda lacks national identification system; there is no national identity card or social security number covering every citizen and the national electoral register has been a perennial source of dispute. There is also no reliable business, industrial or sector data. The lack of reliable data and poor information systems complicates tax administration and collection. This problem is partly overlapping with the lack of transparency and information management. For long URA as any other Ugandan public institution has also had a problem of record management with tax payments at times being hard to retrieve[133]. The Government of Uganda and its constituent institutions still hide behind notions such as 'sensitive' or 'classified' information to deny civil society important information. This notion was, for example, used to deny access to information on oil exploration agreements between the Government and various oil companies that are working in the Albertine Graben oilfields to the public.

Like other developing Countries, Uganda still faces challenges in tax administration due to lack of a strong mechanism to derive and develop policy prescriptions.[134] Without a firm research

[129] Schneider F, Buehn A & Montenegro C (2010):
[130] URA Corporate Plan, 2006-2010
[131] African Development Bank (2010);
[132] Ayee (2007)
[133] URA is in the process of computerising its Domestic Tax operations through the e-tax system; though given the considerable time URA has spent operating the Customs ASYCUDA++ System the existence of the new system cannot be a panacea for information management challenges bedevilling URA.
[134] (ADB, 2010).

function in both the tax administration and the legislative functions, the development of innovative tax policy is therefore a distant possibility and Uganda cannot be able to have a focused pursuance of objective for revenue maximisation[135]. Uganda has also faced the challenges of tax collection in low-income and post-war economies. The ratio of government revenue to gross domestic product in war economies is, on average, well below the average for non-war economies with similar levels of per capita income[136] In Uganda, similar to the Democratic Republic of the Congo (DRC) and Rwanda, for example, the tax base is relatively low, dependent to a large measure on trade taxes, and is extremely narrow where 'large' payers (which are generally in the range of 300) contribute between 40 and 70 per cent of domestic revenue collection[137] There is need to institute measures to widen the coverage of the tax base and to examine the political economy of large taxpayer offices in the government.

The other challenge facing tax administration in Uganda is the depletion of revenue potential through capital flight through illicit capital flows, abuse of transfer pricing which is done by MNCs, and the use of tax havens[138]. A research[139] produced in 2008 produced startling results covering the period from 1970-2004: that US$420 billion left some 40 Sub-Saharan African states and that for every one dollar that these got on loan, some 60 US cents left the country in the same year. The paper shows that the capital flight in the case of Uganda amounted to 73% of the GDP[140]. A more recent paper shows that from 1990 to 2008, a total of US$369bn left developing countries[141]. It is also indicated that in 2006, the inflow to the developing world amounted to US$857 billion, while the outflow from the developing world to the developed world was US$ 1,207 billion (of which US$619 billion is estimated to be illicit capital flight)[142]. There is no doubt that capital flight has negative impacts on the country. It has been submitted[143] that capital flight will lead to loss of resources that would otherwise have been available for taxation, and investment in infrastructure and social spending; this will be translated in reduced economic growth rates, unemployment and informalisation of economic activity and poverty. One of the vehicles used to effect capital flight by MNCs is establishing branches in low tax jurisdictions and then manipulatively arrange their profit determination and tax affairs in such a way that profits arise from and are taxed in the low tax country[144]. Tax administrations need to improve their tax auditing capacity to preempt such abusive practices and also use the legal and international cooperative arrangements to stem these excesses.

Another challenge related to capital flight is when nationals get money which they cannot account for, say through unscrupulous means such as corruption and drugs. The Income Tax law is clear that income received from what are essentially commercial activities *albeit* tainted with illegality such as corruption and drug trafficking will be chargeable to tax. This, of course, excludes proceeds of crime such as burglary and house breaking. Nevertheless, individuals engaged in such activities cannot legitimately declare such income, and accordingly seek crafty ways of concealing the income leading to money laundering. This involves the 'washing' of illegal or dirty money by putting it through a cycle of transactions so that it comes out the other end as legal, or clean, money; the source of illegally obtained funds is obscured through a succession of transfers and deals in order that those same funds can eventually be made

135 Tanzi and Zee, (2001; ADB, (2010).
136 Gupta S, Clements B, Pivovarsky A & Tingson R E (2004); and Addison & Allan Roe (2004).
137 Di John, (2006).
138 Byiers & Dalleau (2011):
139 Ndikumana & Boyce (2008) as cited in Byiers & Dalleau (2011)
140 Ndikumana & Boyce (2008) as cited in Froberg & Waris (2011).
141 Kar, (2011) as cited in Byiers & Dalleau (2011)
142 Froberg & Waris (2011). The estimate was based on information from Eurodad fact sheet "capital flight diverts developing finance", OECD and World Bank.
143 Di John (2009)
144 Byiers & Dalleau (2011)

to reappear as legitimate income[145]. There are many cases of corruption or embezzlement of public funds and there is ultimately no decision to recover what was unjustifiably taken away from the state. For example, it is indicated that each year up to UGX. 500 billion (US$ 200 million) or about 10% of the national resource envelope is lost in procurement related corruption. Uganda like all other African countries is a soft spot for drug traffickers. It is important that a sturdy legal and regulatory framework is put in place to bring these resources in the national coffers through either taxation or any other legally defensible means such as forfeiture of ill gotten wealth.

In light of its multiplicity of challenges, Uganda's relative performance as indicated by the tax gap and tax effort does not competitively compare with countries in the region and is evidencing prevalent tax evasion and leakages. These are shown by the level of tax gap and tax effort shown by a given country. A tax gap is the difference between estimated potential tax revenue and actual tax revenue collected by the country; while a tax effort is the actual tax revenue realised presented as a proportion or percentage of estimated potential tax revenue[146]

Table 17: Tax Gap and tax effort for select EAC countries & S.A (Select year)

Country	**Year**	**Tax revenue (A) Estimated**	**Potential Tax Revenue (B)**	**Tax Gap (B) – (A)**	**Tax Effort (A)/(B) as a %**
		As a % of GDP			
Kenya	2001	17.8	20.8	3.0	85.5
	2005	18.6	20.6	2.0	90.5
South Africa	2001	24.8	26.7	1.9	92.9
	2005	27.4	27.0	-0.4	101.4
Rwanda	2001	10.7	20.9	10.2	51.2
	2005	12.2	21.4	9.9	57.0
	2008	13.5	22.0	8.5	61.4
Tanzania	2001	9.7	20.0	10.3	48.5
	2005	11.2	20.5	9.3	54.4
	2008	15.0	20.9	5.9	71.6
Uganda	2001	10.4	19.2	8.8	54.3
	2005	11.8	19.5	7.8	60.3

Source: *Adopted from ADB (2010)*

THE LOCAL GOVERNMENT TAXATION SYSTEM

In respect to mobilisation of local government revenue, the Constitution is given effect through a number of legislation to support the proper management of local governments in Uganda. These include the Local Government Act, 2004, and the Local Government Financial and Accounting Regulations. One of the most important constitutional provisions in supporting revenue management in local governments is the setting up of the Local Government Finance Commission (LGFC) under Article 194 of the Constitution. LGFC is responsible for

[145] Robinson (1994) as cited in
[146] African Development Bank (2010);

advising Government on the distribution of revenue between central government and local governments; determining the allocation formula for conditional and equalization grants to local governments; and exploring potential sources of revenue and appropriate levels of taxation for local governments.

Currently local governments in Uganda derive the revenue to finance their activities and programmes from the following sources:

- Central government transfers which contribute more than 80% of the local government revenue;
- Revenue from local sources such as the sale of services;
- Non-tax revenues and user charges/fees;
- Local tax revenues, especially property taxes and,
- Some local governments receive donor funding or funding from Non-Governmental Organisations (NGOs) for long term investments or specified projects.

Typical Central Government funds transfers for local governments are unconditional, conditional and equalization grants. Unconditional grants are remitted to local governments to finance decentralized services, including both wage and non-wage expenditure, and amount to about 10-12% of Central Government transfers to local governments. Conditional grants are tied to funding specified programs and projects which are agreed upon between the central government and the local governments and amount to about 88-90% of central government funding to local government; the grants have conditionalities to ensure effective implementation of the programmes and projects. Equalization grants are remitted to some local governments that are lagging behind national average standards of particular services, and amount to about 0.5-1% of total transfers. Local government transfers amount to 20-30% of the national budget. In the financial year 2008/09, Government transferred to local governments UGX 1.2 trillion (US$ 700 million) as opposed to the national budget of UGX. 4.9 trillion (about US$2 billion). The local government revenue performance over the past eight years is as follows:

Table 18: Trend of Local Government Revenue Performance and Central Government Grants[147]

Source	Revenue Collected in UGX billions							
	2002/03	**2003/04**	**2004/05**	**05/06[148]**	**2006/07**	**2007/08**	**2008/09**	**2009/10**
Local Service Tax	-	-	-	-	-	-	3.84	9.19
LG Hotel Tax	-	-	-	-	-	-	0.98	1.50
Graduated Tax	51.78	36.53	60.04	10.87	4.43	-	-	-
Property Tax	13.55	6.79	3.54	26.72	37.82	28.59	24.94	45.60
User Fees	18.43	13.10	10.50	23.10	20.95	64.85	33.15	39.92
Licenses	3.54	5.80	4.09	12.21	11.78	13.48	9.17	13.37
Others	12.27	17.89	12.20	27.78	23.68	9.06	46.63	33.22
Total LG generated revenue	**99.57**	**80.11**	**90.37**	**100.67**	**98.65**	**115.98**	**118.71**	**142.80**
Grants from Central Government				**1,602**	**949**	**1,024**	**1,150**	**1,300**
Total Revenue				**1,702.67**	**1,047.65**	**1,139.98**	**1,268.71**	**1,442.80**
Proportion of LG revenue to Total Revenue				**6.28%**	**10.40%**	**11.33%**	**10.32%**	**10.98%**

Source: *These are aggregated figures for all the districts with their sub-counties, municipalities with their divisions and town councils extracted from the LGFC annual reports*

[147] Source: LGFC; These are aggregated figures for all the districts with their sub-counties, municipalities with their divisions and town councils
[148] The significant decline in GPT arose from politicizing the collection of this tax in run up to the 2005 national elections

As noted for the year 2008/09, local government revenue collected of UGX. 118 billion was against central government transfers of UGX. 1,150 billion. Currently the actual local revenues collected by individual local government average between 3-5%, with the rest coming from central government and other sources such as bilateral arrangements from NGOs. The causes identified[149] for poor performance in local governments include the following:

(a) Incompetent management of the procurement processes, which is marred with lack of standardized method of determining reserve prices, contractors over-pricing their quotations as a ploy to win tenders, and political interference.
(b) There is a challenge of politicizing the revenue collection process. This is more pronounced during election times when politicians tend to discourage payments of due taxes and fees.
(c) The poor infrastructure such as the road network makes some areas inaccessible especially during the rainy season.
(d) Local governments do not have strong supervision and monitoring systems.
(e) The management of outsourced revenue collection contracts has been affected by pitfalls such as giving contractors receipts for local revenue collection but with no clear mechanisms to monitor their use, and to pre-empt abuse; and lack of a clear definition of fees due to contractors. In some instances, the contractor may earn much more than what is remitted to the local government[150].
(f) Local governments are also challenged by the fact that many markets and other utilities are situated on private land. This has implications for access and control of these facilities, and claims to share of revenue.
(g) There are challenges of vendors operating from un-gazetted areas such as along the road sides where the local governments are not authorized to collect and thereby lose substantial amount of revenue.

Local government administration will only be effective when individual local government councils can raise a relatively large share of their revenues locally. The tendency to transfer responsibilities from the central to the local government which are not matched by the ability to finance their execution creates a largely fictional decentralization. Local governments have remained overly dependent on the goodwill of the central government to finance them. Since the central government sets the rules and generally takes the highest yielding taxes for its own use, local governments tend not to have access to tax revenue and sources that would effectively free them from dependence on transfers. Inter-governmental transfers are vital for local governments but they should not be used to prevent local governments from attaining an appropriately independent status. Without an adequate revenue source under the control of local government, a suitable degree of fiscal autonomy cannot be realized.

Local governments have opted to use public-private partnerships to mobilize revenue through tendering and contracting out local revenue collection as an avenue of enhancing the revenue yield. They have had the inherent problem of revenue generation which has hampered both the autonomy of local governments and their ability to finance development priorities and deliver better services. The hindrances include limited revenue sources, limited conditional

[149] Local Government Finance Commission (2006):
[150] A case in point is the Taxi Organisation in the Capital city, which was remitting about UGX 300 million, but collecting an amount estimated to be more than UGX 1 billion in the month. The amount was considered very low compared to the number of commuter taxis in the City.

grants from the central governments, inadequate capacity building in local tax administration, insufficient revenue management, poor planning and budgeting mechanisms, lack of citizen engagement and sensitization on their social obligations to pay taxes and flaws in the tax regimes and revenue collection practices.

It is also a good practice in public finance management that local governments raise revenue to finance the costs of proposed services from the beneficiaries of those services. Locally raised revenues that are spent locally for the benefit of local tax-payers illustrate the direct link of the tax to the benefits received by the community as a whole. This means that the local citizens should pay higher taxes if they want better services or if the local government is inefficient. This gives the right incentives to demand accountability from their leaders.

CHAPTER 3: ADMINISTRATIVE CAPACITY IN TAX COLLECTION

"THERE IS NEED TO MOBILIZE RESOURCES, AND THAT ROOM IS AVAILABLE THROUGH A PROGRESSIVE TAX REGIME. SOMETHING HAS TO GIVE WAY…."

THOMAS RICHARDSON, IMF RESIDENT REPRESENTATIVE UGANDA, 2011.

FORMATION OF URA AND INTRODUCTION OF TAX REFORMS

The irresponsible management of public affairs by General Idi Amin's military government from 1971 to 1979 led to total collapse and disintegration of all public institutions in the country, including taxation and revenue administration.[151] The revival of revenue administration was at the core of Government recovery programmes as there was immediate need for resources to finance Government and public expenditure. concerted efforts were launched soon after the overthrow of the Idi Amin government, and the next decade up to1990 witnessed at least two Government Commissions and three consultancy studies addressing the matter of improving revenue administration.[152] During this period, there were four Ministry of Finance departments responsible taxation policy and administration: three departments of Customs and Excise, Income Tax and Inland Revenue were responsible for (operational) tax revenue administration and collection, while the department of Taxation was concerned with taxation policy formulation and development.

Following guidance from IMF and the example of Ghana, in 1991 the Government of Uganda set up a semi-autonomous tax revenue collecting agency called Uganda Revenue Authority (URA) which was formed under the Uganda Revenue Authority Act[153]. The Revenue Authority model was preferred because it provides greater governance, financial and particularly human resource autonomy and was the best avenue of severing the organization from the Civil Service bureaucracies and rigidities that had hampered effective revenue administration in the country[154]. The Revenue Authority model was also expected to reduce political interference with the tax administration and to improve revenue performance[155]. The URA pioneered the combination of the both Domestic Taxes and Customs under one roof[156] on the African continent.

The formation of a statutory agency outside the Civil Service structures was accordingly envisaged to integrate central government taxes under one management, limit political interference in tax assessment and collection, enhance the use of automated systems, improve staff remuneration and hence attract quality staff[157]. It was also expected that this will concurrently stem vices such as corruption and poor work ethics that had bedeviled the tax collecting departments. At its launch in 1991, there was commitment to retain quality staff and the URA staff was paid salaries which were 8-9 times higher than those of other civil servants and comparable to the salaries received by employees of the private sector[158].

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151 von Soest (2008); Di John & Putzel, 2005.
152 von Soest (2008); Fjeldstad (2005)
153 The Uganda Revenue Authority Act(CAP.340)Laws of Uganda; von Soest (2008); Chen & Reinikka, 1999; Therkildsen 2004; De Wulf , (2004)..
154 Kloeden (2011); Kidd and Crandall, 2006
155 von Soest (2008);
156 von Soest (2008); Therkildsen (2004)
157 Kaweesa Kiwanuka (2000)
158 Di John / Putzel (2005); von Soest (2008); Fjeldstad (2003)

In addition to the establishment of a semi-autonomous revenue agency, in a bid to improve tax administration, stem corruption and enhance tax revenue collection, government introduced the following principal tax reforms:

- The introduction of Value Added Tax (VAT) in a bid to broaden the tax base. This tax replaced sales tax and commercial transaction levy; and was done against popular resistance.
- The enactment of a new Income Tax Act in 1997, with the objectives of consolidating all income tax laws into one simplified Legislation, remove Ministerial wide-ranging discretional powers in granting tax exemptions in the repealed Investment Code levying tax on a residence basis and promoting a flat tax rate scale.[159]
- In addition, presumptive income tax was introduced in 1998; it provides for a tax rate of one percent on turnover of small businesses whose turnover falls below UGX. 50 million per annum.[160]
- The carrying out of (international trade) tariff reform whose policy objectives evolved around simplification of the tax structure and abolishing export taxes.
- Government introduced major policy changes in the decade up to 2007/08 primarily around tax incentives and exemptions under income tax and widening items covered by the zero-rated and exempt schedules under VAT.
- In 1999, The Tax Appeals Tribunal Act was enacted to operationalise Article 152(3) of the Constitution, which provides for the setting up of the Tax Tribunals. The Act led to the establishment of the Tax Appeals Tribunal which is mandated to resolve tax disputes between the Uganda Revenue Authority and tax payers[161].
- The modernization of URA administrative systems, including carrying out re-engineering and crafting new processes, policies, practices and procedures in Customs and domestic tax; automating processes; the revising of the staff code of conduct and the crafting of a whistle blowing policy were developed in 2009.
- Other reforms included developing and circulating a taxpayers' charter with clear standards of service; translating tax publications into eight languages, and holding tax clinics to obtain feedback on taxpayers' needs. Other improvements were: the simplification and shortening of registration and payment processes, enhanced tax education in tax payers locations and the media, improving customs data capture systems, enhanced collaboration with neighboring states in information sharing, and the launching of an electronic tax system that is used to date. Compared to periods before its existence, there is a noticeable increase in revenues collected and the Government in 2005/6 mandated the Authority to collect some Non-Tax Revenues.[162] These are the Immigration and Passport fees under the Immigration Act[163], and Fines under the Traffic and Road Safety Act[164].

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[159] Income Tax Act, 1997 (CAP 340 of Laws of Uganda)
[160] Gray, J. & Chapman E (2001)
[161] The Tax Appeals Tribunal Act(CAP.345)Laws of Uganda
[162] Finance Act, 2005/6
[163] Immigration Act(CAP 63) Laws of Uganda
[164] Traffic and Road Safety Act(CAP360) Laws of Uganda.

In the aftermath of its establishment. It is important to note that at the time of establishment of URA, the tax to GDP ratio was 6.5%. URA was able to increase the tax to GDP ratio to 12%. This superlative improvement has largely been attributable to the operation of the Revenue Authority, though there is no doubt that there is interplay of other factors such as economic growth and changes in taxation policy[165]. However, the tax-to-GDP ratio fluctuated and remained stunted at about 11-13% since 1996/9[166]. Compared to other countries and jurisdictions within the region, Sub-Saharan Africa and Low Income Countries, Uganda's tax-to-GDP ratio is low. Currently the ratio is at 13.5%. Uganda's position cannot even be justified by the level of poverty (which has greatly reduced) and the dominance of the informal sector in the economy.

Table 19: Comparison of Tax-to-GDP Ratio (based on 2008 Figures)

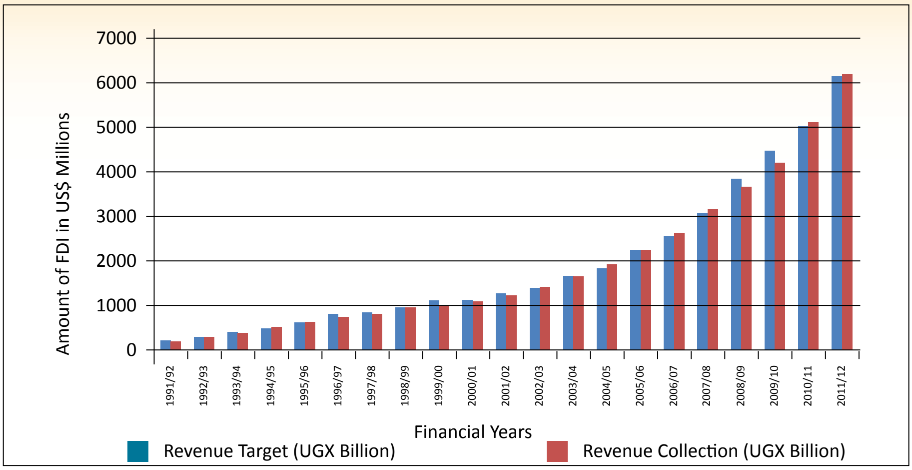
Country/Jurisdictions	Tax-to-GDP Ratio (%)
South Africa	**29.1**
OECD	**35.6**
Burundi	**18.5**
Kenya	**19**
Tanzania	**15**
Rwanda	**14.2**
Uganda	**12.9**

Source: *ADB (2010)*

The stagnation of the tax-to-GDP ratio is attributed to factors such as economic downturn, a low buoyancy in the tax system, a heavy dependence on agriculture, and the exhaustion of "easy" sources of revenue stemming from improved compliance of the formal economic sector, the continued application of tax exemptions, poor taxpaying culture and administrative capacity of URA, including revenue leakage due to lack of appropriate competences and corruption[167]. The performance of URA since its inception against Government set revenue targets is laid out in Figure 12 on the next page.

[165] von Soest (2008);IMF (2005)
[166] von Soest (2008);IMF (2005); URA Annual Revenue Bulletin Reports
[167] von Soest (2008);IMF (2005; 2011& 2012); Fjeldstad, & Rakner (2003); Clarke & Wood (2001)

Figure 12: URA's Performance against the Government Set Revenue target



Source: *URA Tax bulletins from Research &Planning Unit*

Figure 12 shows that whereas the revenue realized by URA is persistently increasing, the tax to GDP ratio is, as noted earlier, within the range of 12-13%, making Uganda one of the countries with the lowest ratio in the EAC and Sub-Saharan Africa. It also indicates that URA is meeting the Government set revenue targets and would accordingly in that respect seem to be performing well.

TAX COMPLIANCE

A revenue agency is set up with the primary responsibility of maximizing tax revenues within the boundaries of the law. This can only be done if the agency ensures that all people within its area of jurisdiction fully comply with the tax laws. The effective execution of this responsibility depends on a variety of factors some of which are out the control of the revenue authorities. These can be the state of the economy, the popularity of the government and the public support for the priorities of the government and the willingness of taxpayers to comply with tax rules[168]. No doubt that a revenue agency would focus on cultivating voluntary compliance and its achievement through the nature and content of interaction and dealings with the taxpayers and the public.

Tax compliance refers to the degree to which a taxpayer willingly meets the obligations and responsibilities imposed on him by the tax laws, rules and regulations. It shows the willingness of taxable entities to act in accordance with the spirit as well as the letter of tax law and administration without the revenue agency applying any enforcement activity[169].

[168] CGI Group (2007); OECD (1999)
[169] mes & Alley (2004); Alabede J, Ariffin Z & Idris K (2011

To an individual taxpayer, tax compliance will ordinarily involve four elements: filing a tax return and notices; submission of correct income; correct claim to deductions, expenditures, allowances and exemptions; and timely payment of due taxes[170]. Tax noncompliance is the failure of a taxpayer to meet tax obligations whether the act is done intentionally or unintentionally[171] Since a revenue agency exists to maximize revenue collection through cultivating taxpayer compliance through reliance, either on taxpayer voluntary compliance or enforced compliance, it follows that there must be continuous ways to measure its performance toward achieving these twin goals. Tax compliance may be measure using the indicators below:

TAXPAYER REGISTER

The taxpayer register indicates taxpayers' registration and deregistration details. The movement in the taxpayer register in the Domestic Taxes Department covering two fiscal years 2009/10 and 2010/11 is shown in Table 20. With the exception of Presumptive Tax, the table shows that for the fiscal year the tax register largely increased from the year 2009/10 to the subsequent year 2010/11. For example, individual taxpayers who registered improved from 5,767 in 2009/10 to 9,945 in 2010/11, while the entities that registered for Corporation Tax increased from 3,567 in 2009/10 to 4,306 in 2010/11. The figures for deregistration also shows a deliberate effort by URA to clean its register. This is especially so in respect to VAT and Corporate tax where 1,432 and 1600 taxpayer were deregistered respectively in the year 2009/10. The Tax register is clogged by speculative taxpayers who register in anticipation of winning tenders to supply goods and services to Government departments, especially in the myriad of local governments. The taxpayer register for the fiscal year 2010/11 had 53,172 taxpayers for Individual Tax, 36,563 taxpayers for Corporation Tax, 22,181 taxpayers for VAT and 8,520 taxpayers for PAYE. For a matter of comparison, it can be noted that in 1961, only 9,600 persons (or 0.14% of the total population) and 1,264 companies paid income tax[172].

Table 20: Taxpayer Register in Domestic Taxes for FY 2009/10- 2010/11

Tax Head	Opening Balance 2009/10	Regist-ration 2009/10	Deregis-tration 2009/10	Closing Balance 2009/10	Regist-ration 2010/11	Deregis-tration 2010/11	Closing Balance 2010/11
VAT	19,449	2,069	1,432	20,086	2,185	90	22,181
PAYE	8,043	551	862	7,732	895	107	8,520
Corporation Tax	30,321	3,567	1,600	32,288	4,306	31	36,563
Rental Tax	10,098	357	34	10,421	445	168	10,698
Individual Income Tax	37,548	5,767	65	43,250	9,945	23	53,172
Presumptive Tax	16,761	181	64	16,878	61	117	16,822

***Source:** URA (2012: Revenue and Trade Performance Report 2010/2011*
The figures in the Register reveal several tax administration inefficiencies discussed in the subsequent parts of this report.

[170] Alabede J, Ariffin Z & Idris K (2011
[171] James & Alley (2004); Alabede J, Ariffin Z & Idris K (2011
[172] Ghai (1966, pp.19)

The figures in the Register reveal several tax administration inefficiencies discussed in the subsequent parts of this report.

FILING RATIOS

This considers the proportion of taxpayers who duly submit their tax returns on time. The available URA statistics considers the taxpayers who are obliged to file monthly returns under the VAT and PAYE taxes. The taxpayers under the Large Taxpayers Office (LTO), who are big taxpayers in the formal sector have a respectable filing ratios which average 95%, while the taxpayers in the Small and Medium Taxpayers' Unit (SMU) had filing ratios as low as 58% for VAT. It is also notable that the filing ratios have largely declined over the two years considered with VAT for the SMU having a phenomenal drop of 21%.

Table 21: Average VAT and PAYE filing ratios (%) for the Years 2009/10-2010/11

Tax Unit	Tax Head	Filing Ratio(%)		Growth Rates
		2009/10	2010/11	
LTO	VAT	97	94	-3%
	PAYE	95	96	1%
SMU	VAT	73	58	-21%
	PAYE	80	68	-15%

Source: *Revenue and Trade Performance Report 2010/2011, URA (2012)*

DOMESTIC TAX AUDITS

Tax audits are an important vehicle through which URA cultivates tax compliance. They are used to check on whether the tax returns submitted have correct information with regard to income or the tax base, and claims for allowances and deductions.

Table 22: Overall Domestic Taxes Audits Performance for period July 2010 to June 2011

Type	Target 2010/11 422	Audited 2010/11	Proportion of Target Audited	Audited 2009/10	Growth Rate
Comprehensive	2,224	328	77.7%	355	-8%
Issue	2,646	614	27.61%	452	36%
Total		942	35.60%	807	17%

Source: *URA (2012): Revenue and Trade Performance Report, 2010/11*

It is notable that a total of 942 audits were completed during the Fiscal Year 2010/11 (328 comprehensive and 614 Issue audits) out of the 2,224 targeted cases. The audited cases registered a growth rate of 17% as compared to Fiscal Year 2009/10. The audit performance was accordingly only 36% of target.

Table23: Domestic Taxes Audit Collection Performance in UGX Billion for the Year 2010/11

	Amounts	Percentages
Number of Audited Cases (No)	942	100
Tax Assessed (in UGX Billion)	907.37	100
Tax Returned (in UGX Billion)	65.27	7
Tax out of Audit Effort (in UGX Billion)	842.10	93
Number of Objections	87	9.2
Amount Objected	213.87	24
Tax Paid After Audit (in UGX Billion)	67.95	7.5

Source: *URA (2012): Revenue and Trade Performance Report, 2010/11*

During the Financial Year 2010/11, total assessments out of 942 audits were UGX 907.37 Billion, out of which UGX 65.27 Billion (or 7%) is the normal flow which had been returned by the taxpayers, and UGX. 842.1 Billion (or 93%) was determined out of the auditing process. Out of the 942 cases audited in the Financial Year, 87 cases (or 9.2%) were objected to .Out of UGX 907.37 Billion that was assessed in the FY 2010/11, UGX 67.95 Billion (or 7.5%) was paid.

CUSTOMS ENFORCEMENT

Customs enforcement is used to establish tax that could have been lost through tax payer non-compliance. The statistics show the trend covering some six years with both the seizures and the realized revenue fluctuating. For example, a total of 4,842 notices of seizures were issued in the FY 2010/11, which is a drop of 27% compared to number of seizures issued in FY 2009/10.

Table 24: Customs Enforcement Recoveries for the Financial Years 2005/06-2010/11

Financial Years	Seizures	Amounts in UGX billions				
		Total Recovery	Outright Smuggling	Under Valuation	Under Declaration	Other Offences
FY 2010/11	4,814	11.082	2.88	2.87	4.00	1.34
FY 2009/10	6,619	9.90	2.20	3.31	2.85	1.54
FY 2008/09	5,848	6.83	1.68	2.03	2.59	0. 53
FY 2007/08	4,039	6.77	1.68	2.01	2.01	1.07
FY 2006/07	2,840	7.69	1.82	2.60	2.74	0.54
FY 2005/06	3,115	8.58	2.42	3.66	2.06	0.43

Source: *URA (2012): Revenue and Trade Performance Report, 2010/11*

TAX ARREARS

Tax Arrears are a core activity in Tax Compliance, as the revenue agency's ultimate test of performance is the amount of taxes paid in the state coffers. For Domestic Taxes, the uncollected taxes or the debt stock was UGX 158.18 Billion by the end of 2010/11, Of this debt, UGX 89.64Bn were debts over 12 months old. UGX 158.18 billion as at end of the year 2010/11 amounted to about 5.8% of the domestic taxes revenue for the year 2010/11.

Table 25: Customs Enforcement Recoveries for the Financial Years 2005/06-2010/11

Age	LTO	MTO	Other stations	All arrears
1-3 months	3.30	0.78	8.60	12.68
4-6 months	12.78	7.01	8.12	27.90
7-12 months	3.95	9.18	14.83	27.97
Over 12 months	24.81	19.98	44.85	89.64
Total	44.84	36.95	76.39	158.18

Source: *URA (2012): Revenue and Trade Performance Report, 2010/11*

The Customs Department arrears were categorized into private and Government arrears.

Table 26: Status of Private Arrears in UGX Billion for Year 2010/11[173]

Status of Private	Amount	Performance Rate (%)
Arrears	7.20	25.4
Paid	1.21	4.3
Closed	19.90	70.3
Outstanding	28.31	100
Total		

Source: *URA (2012): Revenue and Trade Performance Report, 2010/11*

Total private customs arrears for the FY 2010/11 amounted to UGX 28.31 Billion and arrears recovered were UGX 7.20 Billion. The outstanding arrears totaled to UGX 19.90 Billion of which UGX 15.08 Billion (79%) was under objection or dispute.

Table 27: Status of Government Arrears in UGX Billion at the close of the year 2010/11

Status of the Government Arrears	Amount (UGX Billion)	Performance Rate (%)
Paid	43.64	46%
Sent to Auditor General	9.27	10%
Auditor General Instructed BOU to pay	23.39	24%
Outstanding	19.31	20%
Total	95.61	100%

Source: *URA (2012): Revenue and Trade Performance Report, 2010/11*

General Government arrears for the period year 2010/11 were UGX 95.61Bn .The Auditor General instructed Bank of Uganda to pay UGX 23.39Bn. The outstanding general government arrears position as at end of the year 2010/11 is UGX 19.31Billion.

CHALLENGES IN REVENUE COLLECTION

Despite the implementation of the tax reforms that were introduced and buttressed by a number of other measures to strengthen the performance of the economy, a number of deep-seated challenges have inhibited the realization of the country's full revenue potential. This is marked by the stagnation in the Revenue to GDP ratios for the past 15 or so years in the range of 11.5-13%[174]. Some of the causal factors are discussed on the next page.

[173] URA (2012): Revenue and Trade Performance Report, 2010/11
[174] Background to the Budget

THE FISCAL ARCHITECTURE

The country's estimated population is to be 34.13 million by mid-year 2012[175] with more than 50% below the age of 15, and the actively working age group of 15-64 years estimated at 43%. Uganda has one of the fastest growing populations in the world at a rate of 3.2%. Over 75% of the population is engaged in agriculture and lives in the country side. The dependency rate is estimated at 117%. The poverty status report indicates that the middle class as at 2009/10 was about 10 million or 32.6% of the total population[176]. The population figures however seem out of sync with the tax register. The tax register had a total number of 147,956 taxpayers, if we were to presuppose that the same taxpayers are not registered for a multiplicity of taxes. Taxpayers register for VAT, PAYE and Corporate or individual income taxes[177]. Taking that fact into account brings down the actual number of taxpayers to a dismally low figure. Unfortunately, considering that there are only 53,172 registered individual income tax payers (which are not even 1% of the potential active part of the population) that show the gigantic responsibility that URA has to bring potential taxpayers into the tax net. It is very crucial that factors that underlie taxpayer behaviour and account for such tendency as voluntary compliance or non-compliance are studied by URA and the policy makers to fully innovatively bring on board measures that will stimulate the expansion of the tax register and growth of revenue.

STRUCTURE OF THE ECONOMY

Like other developing economies, Uganda's is characterized by a number of revenue inhibiting factors notably; a large share of total economic input and employment is based on agriculture; there is a relatively large informal sector; entrepreneurial units are numerous, small, and unstable, rarely surviving beyond a couple of years; wages form a relatively small share of total national income and a relatively small share of total consumer spending takes place in large modern establishments[178].

The above and other related factors affect the size of the both taxable base and population, complicate tax administration, impose limitations on avenues and extent of widening the tax base and also limit the scope for policy options.

THE INFORMAL SECTOR

Economists disagree on precise definition, extent and measurement of the informal sector or shadow economy. It is however indisputable that in all economies there is some informal sector though its size is hard to quantify. In Uganda's case, one study noted that it had increased in size from 43.1% in 1999/2000 to 45.4% in 2002/2003[179]. A 2007 survey revealed that the informal sector employed about 2.5million people in 1.8 million households (36%) of the households surveyed[180] and that it constituted 150,138 (87%) of the 160,883 businesses surveyed and its gross output was estimated at UGX. 175.6 billion. The sector has since grown in size, but little is known about it[181] Apart from this sector being hard to tax, the fact that its economy is unrecorded affects the official National Income Statistics which end up being

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[175] Uganda Bureau of Statistics (2012)
[176] Uganda Bureau of Statistics (2012); Background to Budget, 2012/13; Poverty Status Report (2012)
[177] Note that employers register for collection of PAYE tax, irrespective of their tax status.
[178] Samuel Famboni; (2006)
[179] Schneider :(2005)
[180] Uganda Bureau of Statistics (2003).
[181] Uganda Bureau Of Statistics (2001)

inaccurate and hence may lead to poor policy formulation and poor responses from the tax payers. The fact of the tax burden falling on a few taxpayers due to the size of the informal sector has been a common complaint at all levels. One IMF Official remarked that "the one complaint we have heard from tax payers consistently is that the informal sector is not captured so the tax burden is falling disproportionately on those few compliant tax payers"[182]. Informalization of an economy also leads to problems of regulation, difficulty in establishing support systems to such businesses and hence hinders technology transfer and dissemination of good business practices[183]. A 2009 research estimated that the top 35 highest taxpayers in the country alone accounted for 50% of all the tax revenue which is an indication of the narrow tax base in the Country[184].

TAX POLICY CONCERNS

The quality of the tax policies in place greatly impact the tax revenue realized by any revenue agency. It has been argued by tax researchers that Uganda's tax policies are not wholly derived from the economic environment in place. The Policy makers are said to be short on policy innovations and prescriptions and lack vigorous and comprehensive research and analysis of the tax policy environment which in part explains the minimal impact of the reforms on tax revenue as a percentage of the GDP, tax effort and the tax gap[185].

The reforms introduced are also described to have been administratively comprehensive but neither focused nor driven by specific performance outcomes such as improved tax enforcement or increasing the tax base but were mainly focused on meeting revenue targets and not enough was done to embed non-revenue performance objectives and indicators…".[186]

MASSIVE TAX EXEMPTIONS

One of the reasons for the enactment of the Income Tax Act, 1997 was to consolidate the Laws on Income Tax and to curb the discretion to grant exemptions laid out in the Investment Code Act[187]. The Constitution and the Act however retained provisions which still empower the Minister to grant tax waivers, exemptions and also make non-resource payments on behalf of tax payers. The only requirement is to report the amounts foregone to Parliament and this is dutifully done in every Budget Speech. The waivers granted by the Minister have the effect of eroding institutional autonomy, create market distortions and negate any efforts in Domestic Revenue Mobilization[188]. The use of political discretion to grant tax waivers and exemptions may also result into rent seeking and wide scale corruption in the tax sector. As indicated earlier on up to 2% of the GDP which would be revenue into the state coffers is thrown away through tax exemptions[189].

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182 Thomas Richardson (2011).
183 Muwonge, A, Obwona M & NambwaayoV;(2007)"
184 Senoga(2009)
185 African Development Bank (2010)
186 Cawley & Zake (2010)
187 The Investment Code Act,(CAP) Laws Of Uganda
188 IMF(2011)
189 IMF (2011); ADB (2010)

UNRELIABLE DATA AT NATIONAL AND TAX PAYER LEVELS

Data is part of the raw materials based on which tax policies and interventions must be framed hence its integrity must not be suspect. Uganda has no reliable statistics on the size of her population, lacks a national citizen identification system , has no reliable data on the numbers engaged in specific sectors of the economy and all these impact on the quality of some of the tax policies enacted.

Linked to this is the lack of digital methods of exchanging data across government departments which would be useful for matching and validation. For purposes of tax administration, the necessity for cross matching data cannot be underscored.

At the tax payer level, the culture of keeping records is not widely spread and where records are kept, they are not necessarily reliable. This raises collection costs in terms of extended audits and investigations, creates a necessity to invoke punitive provisions in the tax statutes and sometimes leads to tax litigation which has the potential of locking up tax revenue for long periods. The lack of reliable accounting also constrains the types of taxes that can be effectively employed by the tax administration.

LOW TAX MORALE

Voluntary compliance is key to effective tax administration and greatly reduces collection costs. Apart from process weaknesses within the tax collection agency itself, tax morale is affected by the quality of Government's accountability for the use of the collected revenue. In the case of Uganda, the government has been intermittently bedeviled with high profile cases of public expenditure and corruption scandals in the public service. As a result, the tax morale has been adversely affected and is a cause of tax evasion by some citizens.

INSTITUTIONAL WEAKNESSES

There are documented factors that contribute to a conducive environment for effective tax administration such as: the existence of a predominantly money economy; a high standard of literacy; prevalence of honest and reliable accounting the lack of which constrains the types of taxes that can effectively be employed; a large degree of voluntary compliance on the part of tax payers and the non existence of a political system dominated by wealthy groups acting arbitrarily in their own self interest[190]. The above factors affect the revenue collection efforts as observed in the preceding paragraphs.

STAFF COMPETENCIES

At the inception of URA the remuneration structure was attractive and the envy of many public sector employees .Over time, the salaries were eroded by inflation and private sector employers who constantly reviewed their employment terms started recruiting from the URA.

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[190] IMF(1988)

The targeted staff is the well trained and exposed professionals especially in the fields of auditing and Information Technology. The loss of skilled staff has the effect of stretching the remaining ones hence impacting on the quality of the output, strains the human capital development budgets and compromises the speed of work flow. Tax audits and post audit reviews require extended periods at the expense of the tax payers, refund audits take longer, cargo clearance takes longer and of course the general working morale of the staff body is affected. The other aspect is the lack of technical competence to unravel well crafted tax evasion schemes used by MNCs with the aid of top notch consultancy firms. Creative accounting, transfer mispricing schemes, E-commerce based transactions and other ICT based service industries like the telecommunication sector are hard to audit. The tax body lacks technical capacity to fully appreciate the nature of their operations and lots of tax revenue may remain uncollected. One of the reasons for the lack of revision of the staff remuneration was cited as the politicization of the staff remuneration by the main stream civil servants who would always argue that the pay was excellent compared to other employees in Government[191].

STAFF INTEGRITY

The effect of corruption on revenue collection is enormous and may take various forms including collusion with tax payers to under declare taxes, reduce tax liability, giving safe passage to smugglers, destruction of official records and manipulating electronic systems to compromise data. Whatever the form, revenue and other scarce resources are lost. The URA has carried out perception surveys and respondents have not shied away from reporting the fact of the existence of the vice within the organization. A Transparency International 2011 report on bribery in East Africa ranked the URA at number 5, a slight improvement from the Number 1 position it held in 2010[192]. Statistics on numbers of staff disengaged from the URA on disciplinary offences supports the assertions hereinabove.

Table 28: Staff Exit Trends for the Period 2005 - 2011

EXIT REASON	**2005/06**	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
Disciplinary Related Turnover	52	69	46	39	24	28
Other Turnover Causes	28	28	65	86	72	63
Total	**80**	**97**	**111**	**125**	96	**91**
Staff Turnover Rate	**4%**	**5.3%**	**6.1%**	**7%**	**5.3%**	**5.7%**

Source: *URA (2011): URA Corporate Plan, 2011-2015*

PHYSICAL RESOURCES CONSTRAINTS

Much as the URA is an autonomous statutory body, financing for its capital and operational expenditure comes from the central government. Government expenditure follows the largely inflexible Medium Term Expenditure Framework (MTEF) and on this count URA's funding requirements are only met to the extent that they are compatible with MTEF and Government budgetary priorities. This leads to constraints in the procurement of required items necessary for fulfilling its mandate. URA's capacity to acquire equipment to facilitate its operations like

191 AfDB (2010).
192 Transparency International Kenya. (2011).

computers, vehicles, appropriate office space and other requirements necessary for effective revenue collection has not been consistent[193]. This hinders operations and affects the staff working morale.

[193] URA Corporate Plan 2006-2010 & 2010-2015

CHAPTER 4: TAXATION AND THE GOOD GOVERNANCE AGENDA: KEY CONCERNS AND ADVOCACY ISSUES.

"THE PURSE OF THE PEOPLE IS THE REAL SEAT OF SENSIBILITY. LET IT BE DRAWN UPON LARGELY, AND THEY WILL THEN LISTEN TO TRUTHS WHICH COULD NOT EXCITE THEM THROUGH ANY OTHER ORGAN." – THOMAS JEFFERSON.

Studies on taxation have revealed that governments that derive a greater proportion of taxes from local sources tend to be more accountable, responsive and democratic[194]. In other words, if citizens do not witness Government expending tax revenue on development programmes that support their development and social welfare requirements, it is likely that this will be a major cause of weak, unresponsive governance in many poor countries[195]. This is based on the logic that the collection of tax revenue relies on both coercion and a degree of willingness to comply by the Citizens hence governments should allow for some concessions to secure the compliance. The other aspect of this reasoning is that citizens who pay taxes tend to develop a sense of ownership of the state and therefore demand accountability for the use of the public resources and are likely to mobilize politically[196]. Other scholars opine that states that rely more on revenue from donors or natural resources are less responsive to citizen demands and are less accountable[197]. There is however strong evidence to suggest that taxation in Sub-Saharan Africa has often been coercive and ineffective and that taxation is only likely to be an effective catalyst for change in the presence of organizations or individuals that can aid in crystallizing public demands[198].

Box 8: Measures Recommended by IMF to Enhance Revenue Performance

When governments depend on a large number of taxpayers for revenue they have incentives to promote broad prosperity, and to develop bureaucracies capable of collecting and administering taxes effectively. This makes governments more responsive to their citizens and helps build state capacity.
Bargaining with citizens over tax makes governments more accountable, as taxpayers mobilise to resist or negotiate tax demands, monitor how tax is collected and used, and insist on having a greater say in public policy in exchange for compliance with tax demands. As tax compliance increases, state capacity improves and the taxation process becomes more efficient and predictable. Better public policy results from debate and negotiation with citizens.

Source: *OECD Fact Sheet (2008, pp. 1).*

194 Moore & Mick (1998); Robinson & White (1998).
195 OECD (2008).
196 Levi, Margaret, 1988.
197 Ross, Michael (2001).
198 Prichard (2009)

In a discussion paper[199], the Commonwealth Secretariat lays down a number of well-articulated considerations why developing countries need to link Taxation, Governance and Development, and these are re-stated hereunder:

- A well designed tax system (and taxes) will buttress the standard of living of the citizens and especially the poor and vulnerable through their contribution towards advancing economic growth, decreasing extreme income and other social inequalities, dealing with climate change and funding the delivery of the Millennium Development Goals (MDGs).
- Tax is acknowledged as a core part of state effectiveness, state-building and the most outward and visible sign of the social contract between citizens and the state. Fair and transparent tax collection would therefore demonstrate good governance and shape government legitimacy by promoting accountability to tax-paying citizens. This will in turn stimulate effective state administration and good public financial management.
- Tax revenues that increase with economic growth ensure sustainable funding of essential public services ('public goods') such as security, health and education on which economic growth and social development depend.
- Rising tax revenues together with sustainable economic growth are the basis of an exit strategy to get developing countries out of aid dependency.

Uganda has registered progressive increase in domestic revenue collections compared to trade taxes. This is partly due to the deepening integration in the East African Community, and also as a result of reforms in tax administration and notably use of the electronic systems of tax payer registration, payment and tracking. Processes were shortened and made more accessible to tax payers though there are still complaints about frequent breakdowns which call for alternative systems to be available as a stop gap measure.

The flipside of Uganda's improved domestic resource mobilisation is that it relies heavily on a limited number of large tax payers, including Multi-National Corporations (MNCs), which makes it inherently difficult to create a valid social contract with the poor. The five biggest taxpayers on this front though are actually MNCs with excusive foreign ownership. The MNCs' interest will be influencing policies that improves the environment to suit and benefit their business ends. The MNCs would have no interest in pressing for good governance like individual citizens would do. The MNCs are more often wary of engaging in local politics, lest they fall prey to the resultant intrigues and purges.

In discussing governance and taxation, it would be prudent to use a working definition of the term governance that will show the bounds of the matter. The most appropriate reference point for Uganda is contained in the National Development Plan (2010-2015), where [good] governance is defined as:

"the positive exercise of authority characterized by citizens' transformation and participation in governance, control of corruption, political stability, respect for the rule of Law, government effectiveness, regulatory quality and effective knowledge management." [200]

[199] Discussion Paper No. 11, July 2011.
[200] National Development Plan 2010/11-2014/15

It is appropriate to consider the individual elements in the understanding of Governance and how it is related to taxation.

CITIZEN'S TRANSFORMATION AND PARTICIPATION IN GOVERNANCE

Transformation of societies is a subjective process with a number of variables the realization of which is determined by the change agent, a role that can in this case be ably performed the government. Taxes have been used to increase school enrollment levels through the introduction of subsidized education, extension of health services, improvement of infrastructure, provision of clean water and enhancement of economic activities to provide income to households. All these and a lot unmentioned are blocks to transformation. Participation in the election of local leaders and representatives to Parliament too is part of the process.

The question, however, remains whether these per se translate into a society with a degree of national consciousness that will always task government to account for the misuse of national resources? The levels of citizens' participation in determining the tax agenda and revenue utilization are minimal. Parliament which is supposedly comprised of the elite is occasionally compromised into making slanted decisions to favor government, the oversight role especially in the area of granting tax incentives is not well spelt out, partisan interests sometimes override national interests in important debates and such weaknesses in governance are key issues for advocacy .Another clear aspect of poor governance is the non-adherence to Budgets passed by government and diversion of funds from planned investment projects to other areas that sustain the presidency[201]

It is thus argued that positive political will is key to governments' openness and accountability for the use of national resources and overrides the citizen's consciousness.

CONTROL OF CORRUPTION

Corruption is a malaise that has bedeviled many countries in Sub-Saharan Africa including Uganda. Corruption is an antithetical to the core objectives of government and maximizing revenue and it is closely linked to tax evasion. Fighting corruption is therefore a major challenge for any revenue agency because it substantially reduces overall tax collections. Studies have shown that at least half of the revenue that should be collected can be lost by government treasuries through corruption and tax evasion[202], thereby decreasing the funding available for public service provision. Corruption and tax evasion reduce voluntary compliance with tax laws and regulations, demoralize honest taxpayers, and create an atmosphere of cynicism. Corruption also induces tax officials to resist reform of tax structures, which over the long term leads to an erosion of public trust and confidence in government institutions and undermines the legitimacy of government.

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201 National Development Plan
202 Fjeldstad (1996)

It is crucial to define the term corruption. Probably, the simplest and broadest definition of the concept of corruption is *"the misuse of public or private position for direct or indirect personal gain"*[203] The World Bank (2000) categorizes corruption into three broad types and defines them as follows:

(a) *Bureaucratic or Administrative corruption* which refers to the intentional imposition of distortions in the prescribed implementation of existing laws, rules and regulations to provide advantages to individuals in and or outside government through illicit, non-transparent means. Bribes to tax collectors to reduce one's tax liabilities are a classic example.
(b) *Patronage* and its close cousin nepotism refer to favoritism shown to narrowly targeted interests by those in power in return for political support. The examples include the granting of personal favours, awarding "sole-source" contracts or making (unmerited) appointments to public offices.
(c) *State Capture* refers to the actions of individuals, groups or firms both in the public and private sectors to influence the formation of laws, regulations, decrees and other government policies to their own advantage. The granting of a monopoly franchise to the highest bidder and the consequent protection of the beneficiary from competition is a typical example of this more subtle, and possibly, most venal form of corruption.

The three keys that would determine whether a transaction is corrupt are: the discretional power that an individual has over the allocation of resources; higher rents associated with misuse of resources and the high probability of evading regulations or penalties associated with the wrongdoing[204].

Surveys in developing and transition countries indicate that revenue administration agencies are typically ranked among the most corrupt public institutions. Corruption in tax and customs administrations leads to both efficiency and equity problems[205]. It is one of the leading causes for revenue leakage. Empirical studies have shown that:

(a) Countries with a high incidence of corruption tend to have a larger shadow economy, which implies a depleted tax base and thus a serious loss of revenues[206]. Corruption provokes unfair treatment of honest taxpayers and hurts their competitiveness, consequently driving more businesses out of the formal sector and generates a vicious circle that retards the development of the formal economy. In the case of Customs, corruption may even compromise the national security by becoming a conduit for the transit of drugs and arms.
(b) That the magnitude of the impact of corruption varies by the type of tax, with a larger negative impact on direct taxes than on indirect taxes[207]. Corruption exacerbates the imbalances in the tax take from direct and indirect taxes; it reduces the tax collection from a certain group of taxpayers (normally those well-to-do businesses that have the ability to bribe tax officials) and increases the relative tax burden of the poorer groups of taxpayers.

[203] Grey and Kaufman (2000).
[204] Jain, 2001; Klitgaard, 1988; Schneider and Enste, 2000; Bardhan, 1996
[205] Martinez-Vazquez, Arze, and Boex (2004)
[206] Schneider and Enste (2000); Johnson, Kaufmann, and Zoido-Lobaton (1998).
[207] Tanzi and Davoodi (2000).

Uganda has an official policy against corruption and has in place a number of institutions to fight corruption. These include the Police, Parliament, the Ombudsman (Inspectorate of Government) and Special Anti-Corruption Courts. Institutions like URA have an official 'zero-tolerance for corruption' policy. The anti-corruption efforts can only succeed in Uganda if there are holistic, multi-pronged and with express and active political support. Factors such as the poor facilitation of the anti-corruption agencies to do their work, corrupt individuals within the agencies, weak enforcement structures, lack of political will and outright impunity have slowed down the fight against the malaise. The World Bank estimates that Uganda loses at least UGX. 500 billion to procurement related corruption annually[208] and in 2004 Transparency International ranked Uganda at number 102 out of 133 countries with a raw corruption index of 2.6 among the most corrupt countries[209]. In Uganda today corruption is recognized a major impediment to attaining further achievements in the country's development[210].

POLITICAL STABILITY AND RESPECT FOR THE RULE OF LAW

Political stability and respect for the Rule of Law are key aspects of good governance that are relatively observed in Uganda. Uganda has for example for the past two decades maintained relative political stability with the institutions of democratic governance having national acceptance. The separation of powers is in place with the institutions of the legislature, executive and judiciary largely functional and accepted in the country. Court decisions are therefore largely observed by individuals and government. Delays in government meeting her decretal obligations, use of government machinery and resources to favour individuals in elections, under funding of the judiciary and other law enforcement agencies however demean government's commitment to the observation of those key parameters of good governance. Citizens' unrest manifested through incessant demonstrations and riots are partly attributed to the above inadequacies.

GOVERNMENT EFFECTIVENESS

As a measure of good governance, government scores low on this aspect. Key policies and programs that are planned for execution are not executed. The execution of those that are implemented is not effectively monitored to ensure that the desired outcomes are realized. Efficient utilization of public resources is wanting, evaluation of policy and project benefits are sometimes not done and resources are lost to corrupt individuals at the expense of all tax payers. A 2012 report on the performance of government towards the realization of the key pillars in the National Development Plan reveals that 48% of the final targets are either on course to be missed or data for performance assessment is not yet available[211]. On the positive side though, government has through policy measures committed to gazette and publish on the internet the names of beneficiaries of all tax expenditure[212].

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[208] Fjeldstad (2005)
[209] Schneider (2006)
[210] BTI (2012)
[211] IMF (2012) pp. 13
[212] IMF (2012) pp. 15.

REGULATORY QUALITY AND EFFECTIVE KNOWLEDGE MANAGEMENT

The major challenge is not in the quality of laws, regulations or absence of regulatory agencies in Uganda. The issues are lack of facilitation of the implementation processes, lack of political will in some instances, ineffective monitoring and evaluation, corruption and misuse of office at times with political backing. This is manifested in the civil service and public sector service delivery functions.

Knowledge management is still another challenge in government since systems are not electronically interlinked. Data is not shared and duplication of activities is not uncommon as a result.

In conclusion, it has been realized that domestic revenue from sources other than natural resources may influence government's responsiveness and accountability, but the effectiveness of the structures in place, the independence of people structures, political will, and level of belief in democratic principles by the sitting government play a crucial role too. Some sections of the Civil Society postulate that the more government weans itself from donor aid, the more it becomes less tolerant to alternative views and becomes less accountable since the donor countries hold on it is lessened.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

This study has in many respects been stretching from the introduction of taxation by the British colonialists at the turn of the 20th century and how that compulsive and inequitable run of events was ingrained in the Ugandan taxation psychic and fabric and is to date affecting the attitude towards taxation. This is revealed through the low level of tax compliance, and the lack of accountability by government towards the citizenry over taxation matters. The study also explored the last two decades with an array of tax reforms that culminated in the phenomenal and monumental increase of the tax-to-GDP ratio over a year period from 1991/92 to 1996/96 when it rose from 7% to 12%. The study has made the following observations:

(a) The introduction of taxation was ingrained in injustice and discrimination by the British colonial government and did not involve the population in majorly taxation and expenditure decision. The subsequent post-independence Uganda governments took a cue from this and has essentially sustained the framework.
(b) Though Uganda has had a two decade period of high economic growth figures, this has not rubbed off or translated into substantively improved standards of living for the people, as evidenced by the fact that up to three-quarters of the population survive on less than US$ 2 per day. The country's Per Capita GDP is not only nominally growing partly due to the high growth in population, but there is also increased income inequality with the rich becoming richer, while the poor become poorer. There is excitement and expectations that the exploitation of the recently discovered of oil will change this situation.
(c) Whereas the institution responsible for Local Government taxation, the LGFC, is constitutionally provided for with such well-defined constitutional guarantees, URA is not a constitutional body and this implies that its autonomy is not adequately ring-fenced in cases where it may have tough challenges and decisions to take.
(d) There has also been a marked shift from international taxes to domestic taxes. International trade taxes used to contribute 60% of the national revenue but this has reduced to 45%, with domestic taxes now accounting for 55%. This movement is logical and important especially in light of the fact that Uganda is pursuing further economic integration under both EAC and COMESA, and the continued trend towards trade liberalization that is leading to reducing international trade tax rates and tempered with the volatility in global trade.
(e) Government relies on a few MNCs to realize corporate income tax, with the top five companies accounting for 40% of the tax, and this tax head contributes about only 6-8% of the total national revenue, as compared to 24% for South Africa and 16% for Rwanda. Personal Income tax (PAYE) is double the tax amount realized from Corporate Income Tax.
(f) The administration of PAYE tax is a matter of concern. Government has dragged the decision on changing the threshold of UGX. 1,560,000 that was established in 1993/94 and has only changed to UGX. 2,820,000 in 2012/13. Considering the CPI factor of 3.32 and US dollar equivalence, the new threshold is in real terms lower than what it was in 1993/94.
(g) Government and URA have not accorded adequate attention to policy development and this may account for the stagnant growth in the tax-to-GDP ratio.
(h) Government has to take the responsibility to ensure that as a matter of accountability it avails important and required information to the stakeholders. It is important to explore issues like identification through the national identity card and social security numbers. Using Tax Identification Numbers will not avail adequate information as having one national identifier for all transactions.

(i) So much potential tax revenue is lost through illicit capital flight, money laundering and the shadow or black economy. Government needs to institute strong legal and institutional measures to stem these factors that are depleting away national resources.

(j) Given the fact that up to 30% of the national budget is deployed in Local Governments, and that local governments contributes less than 5% of their budgets is a matter that needs urgent attention. Government would need to explore whether service delivery and spiraling public administration expenditure through creating districts are complementary ventures.

(k) The Tax Register does not muster up to even 1% of the population. The challenge for government on this account is to task URA to move away from concentrating on low lying fruits and soft targets and seriously plan on how it will innovatively tackle the matter of growing the tax register and the related matter of low filing ratios by taxpayers.

(l) The audit function is also crucial in addressing the MNCs' abusive tax planning and evasion practices. The statistics from auditing operations for the year 2010/11 shows that out of the tax assessed as a result of auditing, 24% has been objected to and only 7.5% has been collected. Auditing effort that does not contribute to revenue yield cannot be an ultimate goal for a tax administration.

(m) Government needs to address the matter of low tax compliance as Ugandans are not enthusiastic about their tax obligation. This will require exploiting the symbiotic relationship between taxation and good governance. Government of Uganda needs to institute an explicit fiscal contract or a tax bargain with its citizenry by defining the minimum acceptable standards for service delivery and use them as a basis for negotiating full compliance with their tax obligations by the citizenry. Civil Society Organisations and URA need to champion the process of educating the citizenry to understand their civic and political responsibility to pay taxes. One constraint to improved tax compliance and good governance is corruption. Many citizens would rather avoid and evade taxes because of the loss of tax payers money through corruption and embezzlement.

(n) Whereas it is fully agreed that agriculture occupies up to 70% of the country's population, the proportional expenditure on this sector is declining. There is need to review the budget priorities to ensure that the expenditures are line with the national priorities, and geared to supporting the majority of the citizens.

(o) Probably the most important aspect of the expenditure management is the concept of fiscal space: the ability of Government to fund social services without compromising the stability and sustainability of the economy.

RECOMMENDATIONS

The study accordingly makes the following recommendations:

a) There is urgent need to educate the citizens to gain appropriate knowledge and understand their stake in taxation and revenue management and this can only have effect if it is done by both Government and the Civil Society Organisations.
b) URA needs to consider how it will grow the Tax Register and filing ratios. This will require innovative policy changes and Government efforts to inculcate into the citizenry the civic duty to pay taxes. This is matter where Government will have to partner with Civil Society organizations.
c) It is pertinent to explore whether the URA does require a constitutional back up to strengthen its autonomy and be self-accounting as a national tax revenue administration.
d) The tax exemption regime adopted by Government is neither sustainable nor proven to be as beneficial as has been touted by its proponents. WE can agree with the position taken by the IMF to fully review the tax exemption structure. Receipt of more revenue by the fiscally squeezed Treasury is a better course of action.
f) Government would require to afford justice to individual income tax payers by review the threshold for PAYE tax to a fair level that would in real terms that would be equivalent to the 1993/94 level.
g) There is a need to carry out a detailed research to establish the basis for the dismal performance of Corporate Income Tax.
h) There should be a deliberate and firm effort to develop the capacity to carry out policy formulation and development in the tax administration.
i) The Tax Appeals Tribunal and the Judiciary should work out a system of prioritizing and fast tracking tax cases so as to stem the practice of taxpayers using litigation to delay collection of tax revenue.
j) Much as increased reliance on Domestic Revenues is positive and a solution to the decreasing tax take from International Trade Taxes, there is great need to mainstream issues affecting the poor and marginalized groups in the enactment of tax policies as a way of ensuring tax justice.
k) The Government should explore the use of one national universal identifier for all transaction than having a multiplicity of identifiers such as TIN, Passport Number, elections number etc. Such an identifier would make it easier to track and trail transactions in different institutions.
l) Government should review its relationship with local governments, consider the process of creating new districts, strengthen their revenue collecting capacity, explore reintroduction of graduated tax or a similar citizens tax, and assure service delivery to the populace.

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Appendix 1: Composition of the Different Sectors in the Economy[213].

Sectors	Subsectors
Agriculture, forestry and fishing	• Cash crops • Food crops • Livestock • Forestry • Fishing
Industry	• Mining and quarrying • Manufacturing • Formal • Informal • Electricity supply • Water supply • Construction • Wholesale and retail trade; • Repairs
Services	• Hotels and restaurants • Transport and communications • Road, rail and water transport • Air transport and support services • Posts and telecommunication • Financial services • Real estate activities • Other business services • Public administration and defence • Education • Health • Other personal and community services

[233] Based on information from BTTB, 2012/13.

BASELINE STUDY - UGANDA REPORT

SEATINI

Strengthening Africa in World Trade

MAKE TAX FAIR