Research Brief

Uganda's Tax Regime;

Missed Opportunities and Critical Challenges

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1. Introduction

The Uganda Vision 2040, states that "A transformed Uganda Society from a peasant to a modern and prosperous country within 30 years". In addition, according to the National Development Plan (NDPII), Uganda's target is to attain a lower middle income status by 2020. Resources will be required by government to achieve these aspirations. The government intends to make extra effort to increase domestic tax revenue as the main mode of financing development through the provision of essential public services, infrastructure and for reinvestment. There is no doubt that taxation plays an important role in fulfilling vision 2040 and the NDPII goals. Mobilizing domestic revenue enables government to create fiscal space, and reduce dependency on foreign aid and loans. [1]

Despite the sustained growth of Uganda's economy, trends in tax revenue collection show a stagnation of performance. Tax revenue as a percentage of GDP, oscillated between 11.7 per cent and 13.1 per cent between 2005/06 and 2014/15. Compared to other EAC countries, Uganda's Tax to GDP ratio is one of the lowest; Kenya's stood at 20.0 per cent, Rwanda's at 14.7 per cent and Tanzania's at 21.0 per cent in 2013/14 (URA,2017). In its efforts to raise tax revenue from 13.9 per cent of GDP in FY 2015/16 to 16.3 per cent of GDP by FY 2020/21, government has put in place several mechanisms to widen the tax base (OXFAM, SEATINI Uganda 2015). However, at only 13.8% of GDP, Uganda's tax revenues are inadequate to finance its development needs.[2] Therefore, in order to finance these projects, the government of Uganda has had to greatly rely on external and domestic debt hence increasing its indebtedness which currently stands at 27% of GDP (Budget Speech 2017/18). This has greatly compromised Uganda's ability to achieve and provide adequate social services and infrastructure; and the prospects of achieving the aspirations as stated in the Vision 2040 and in the NDPII. This brief seeks to analyse Uganda's current tax regime; its challenges and prospects. Specifically, the paper examines the trends in Uganda's tax revenue collection from FY 2014/15-2016/17 and, the implications of these trends

1 *Taxation in Uganda, a review and analysis on national and local government performance, opportunities and challenges. Research report; February 2017, pg 1.*

2 *Uganda Budget Speech FY 2017/18*

on the budget and on service delivery. The last section of the paper provides recommendations on how to improve Uganda's tax revenue collection.

2. Uganda's Current Tax Regime

Uganda's current tax regime comprises of national and local level tax systems. Uganda's tax administration system is split between the central government and local governments regimes. The central government tax regime is implemented by the Uganda Revenue Authority (URA), which was established by the URA Act 1991 (Cap 1996).

It serves as a central body for the assessment and collection of specified tax revenues. The URA identifies, informs and assesses taxpayers. The URA is headed by a Commissioner General who is appointed by the Minister of Finance, Planning and Economic Development. The organisation comprises seven departments (each headed by a Commissioner): corporate affairs, domestic taxes, tax investigations, customs, internal audit and compliance, legal services and board affairs, and the commissioner-general's office. Although the URA is a quasi-autonomous institution, for budgetary purposes, it is regarded as a department under MoFPED, and is subject to the same financial rules and discipline as other departments (SEATINI, TJNA & Oxfam, 2016).

On the other hand, the Constitution of the Republic of Uganda under Article 191 (1) and (2), empowers Local Governments (LGs) to levy, charge, collect and appropriate fees and taxes such as rents, rates, royalties, stamp duties, fees on registration and licensing and any other fees and taxes that Parliament may prescribe. Section 77 (1) of the LGA (Ch 243) empowers LGs to formulate, approve and execute their budgets and plans and to collect revenue and spend it.

The major tax policy changes over the last decade primarily evolved around Value Added Tax (VAT) and income tax. For instance, the standard rate of VAT was increased from 17% to 18% in 2005/06. Attempts to protect the poor have been through zero-rating[3] and exemptions[4] of foods under VAT, and by raising the threshold of personal income; Pay as you Earn (PAYE) threshold was raised from UGX 130,000 to UGX 235,000 in 2012. In 2014, Government of Uganda (GoU) enacted a Tax Procedures Code Act to guide and harmonise the administrative procedures of the current tax laws hence easing the compliance process for tax payer.

3. Trends in Uganda's Tax Revenue Collections and Implications

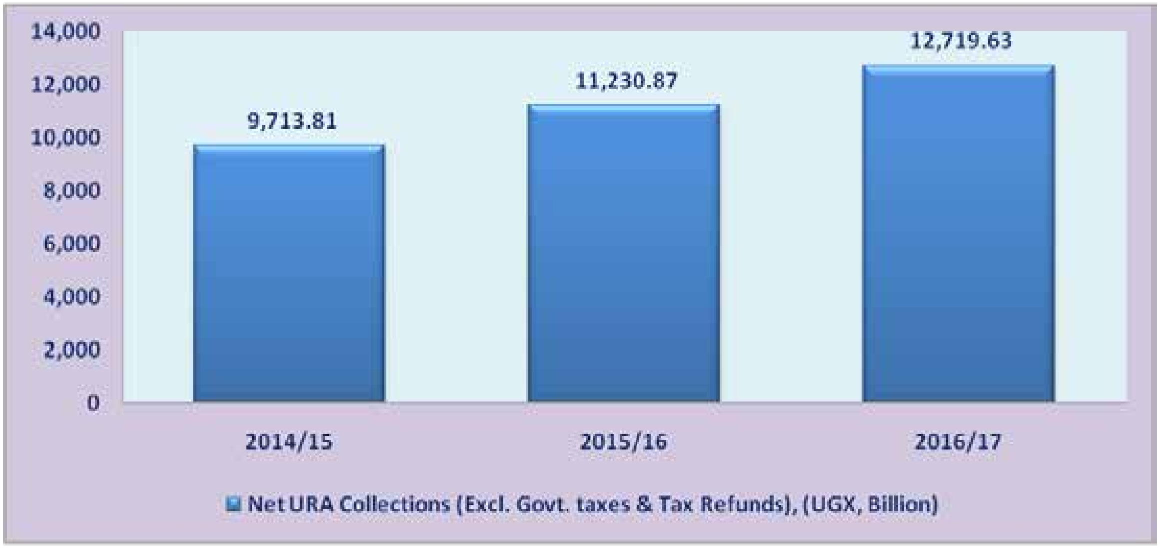
(FY2014/15- FY2016/17)

Over the past three years, Uganda has realized a tremendous increase in its revenue collections from UGX 9,713.81 bn in FY2014/15 to UGX 12,719.63 bn in FY2016/17(see figure below). However despite the increase in tax collections, there is a decline in the percentage growth rate of the revenue collections registering 20.95%, 16.62 and 13.26% in FY2014/15, FY2015/16 and FY2016/17 respectively.

3 Government doesn't tax its retail sale, but allows credits for the VAT paid on inputs.

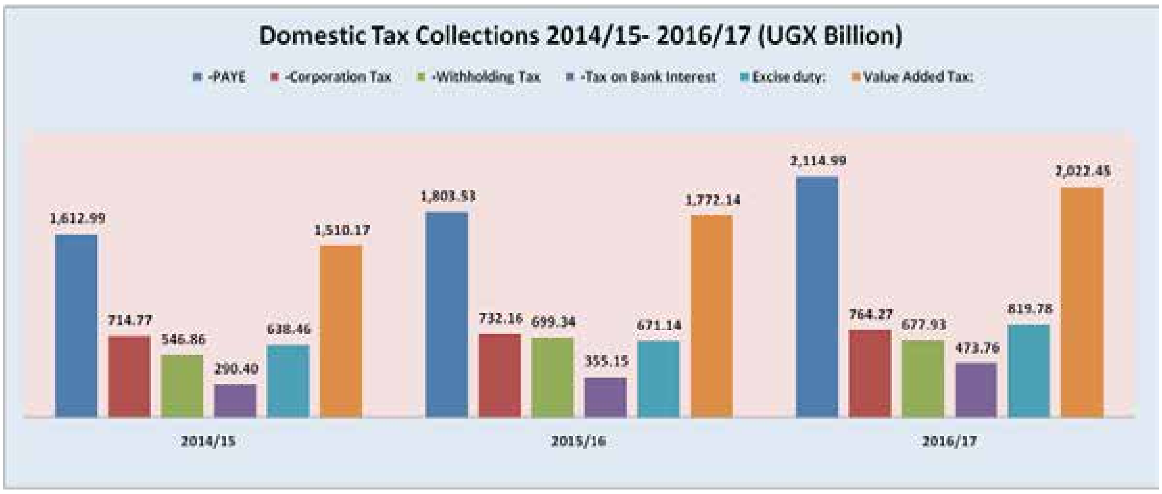
4 Government doesn't tax the sale of the good, but producers cannot claim a credit for the VAT they pay on inputs to produce it.

Figure 1: Total URA Tax Collections 2014/15-2016/17



Source: Author's calculations based on URA's statistics

Figure 2: Selected Domestic Tax Collections 2014/15-2016/17



Source: Author's calculations based on URA's statistics

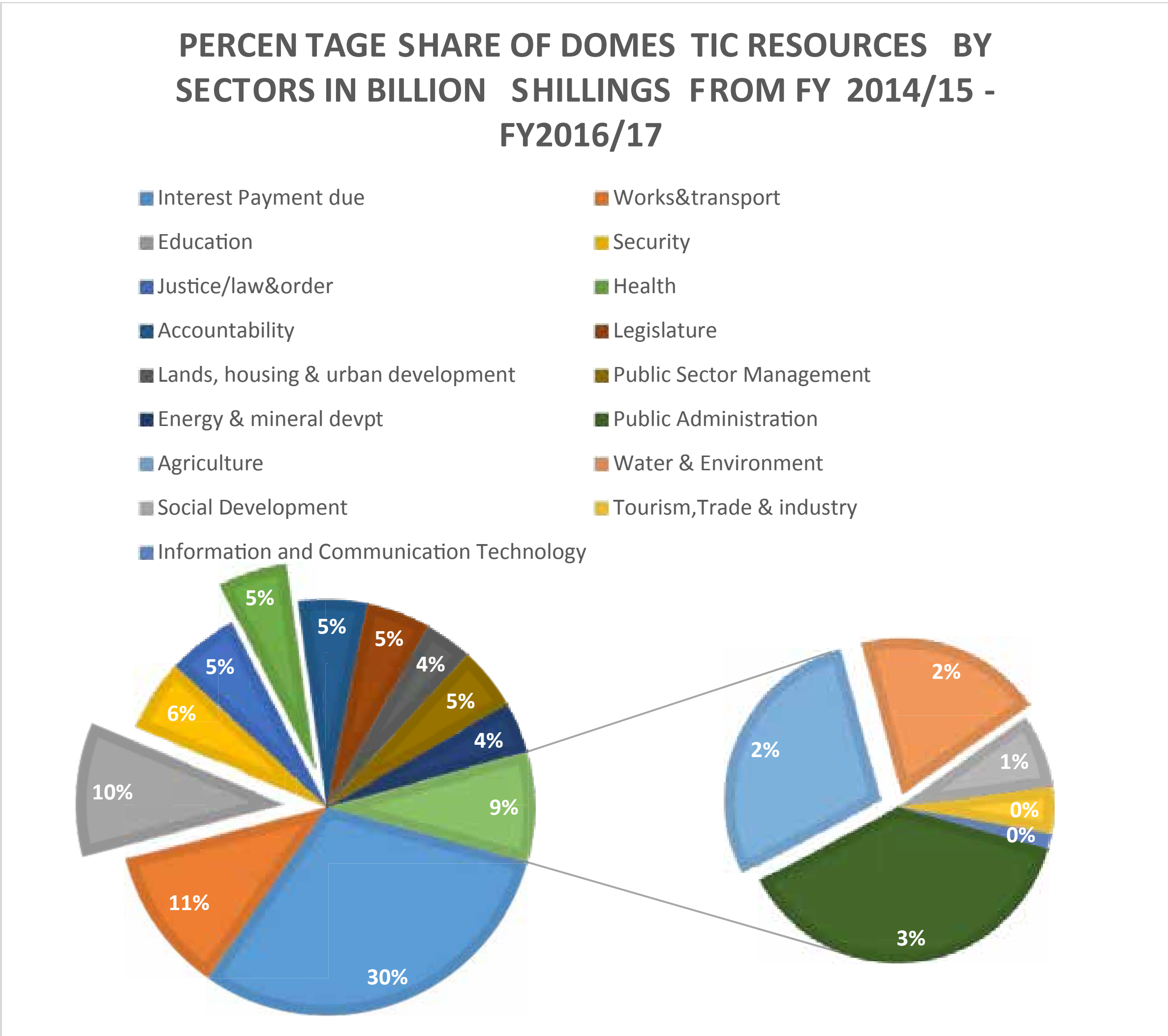
The graph above shows selected taxes collected by URA. There has been an increase in the contribution of Pay as You Earn (PAYE) which increased by 17.3% in FY 2016/2017. On the other hand, Collections from corporation tax have stalled at an average of UGX 737 billion in the past three FY 2014/15-2016/17. This is partly attributed to the fact that many of the multi-national companies have often avoided and evaded tax by taking advantage of loopholes within the domestic tax laws and tax treaties that have been signed by Uganda with other countries. In 2015 Finance Uncovered, a global network of investigative reporters, revealed how Africa's biggest cellphone company, MTN, was shifting billions of dollars from its subsidiaries in Ghana, Nigeria and Uganda to Mauritius. Mauritius is a tax haven, which means that taxes are levied at a very low rate. This has been worsened by the tax incentives regime in Uganda. In the financial year 2015/16, the revenue forgone in the form of tax holidays was UGX 999.8 billion that constituted 1.1% of GDP. This however was more than sufficient to cover the shortfall in the budget which amounted to over shs. 404.5 billion by the end of the financial year.

The contribution of the indirect taxes includes collections from excise duty and Value Added Tax. In FY 2016/17, collections from excise duty amounted to 819.78 billion reflecting an increase from 671.14 billion in the previous financial year. VAT collections hit a mark of 2,022.5 billion in FY 2016/17 up from 1772.14 billion in FY 2015/16 and 1510.17 billion in FY 2014/15.

Furthermore, statistics reflect that indirect taxes have registered a higher growth rate from 13.7% to 16.3% in 2015/16 and 2016/17 respectively as compared to direct taxes whose growth rate declined to 12.7% in 2016/17 from 14.1% in 2015/16. This is due to the fact that indirect taxes especially VAT are easier to collect since they're mostly charged on consumption. As a result, some scholars have been thought of it as a rather regressive tax which limits consumption of basic commodities by the most vulnerable groups especially women and youth who have most of their income on these. This has been thought to broaden the inequality gap.

3.1: Comparison of the Contribution of Domestic Revenue to Social Sectors

The Pie chart below shows the average contribution of the domestic revenue to the key social sectors.



Author's computation from the Background to the Budgets

In the pie chart above, between FY 2014/15- 2016/17, 30% of domestic revenue was allocated to interest payments. The education sector was allocated only 10% despite its many challenges which include: low quality of education at all levels due to, shortage of critical infrastructure especially classrooms and sanitation facilities, inadequate school feeding programs and poor sanitary facilities in primary school among others. The 5% allocation to the health sector is inadequate to meet the maternal, infant and child mortality rates as well as the under-nutrition among children below 5 years and women of reproductive age which has remained high. On the other hand, the agriculture sector is still grappling with a number of challenges including limited access to land and agricultural finance, a weak agricultural extension system, with access to extension services lowest among women, slow technological innovations and adoption particularly amongst women farmers despite being the majority labour force; Therefore it is evident that the 2% share of the domestic revenue to agriculture sector is insufficient to mitigate the challenges above.

There is need for Government of Uganda to rethink its spending priorities by balancing development programmes with key social sectors that aim at addressing the challenges facing the citizens and redirect investment to the productive sectors. Allocation of the tax revenue does not necessarily mean that it will be spent as planned. There is thus need to track the utilisation of funds in order to achieve the set objectives.

Efforts put in place;

A number of efforts have been put in place to increase the tax base. Uganda Revenue Authority (URA) in collaboration with Uganda Registration Services Bureau (URSB), Kampala Capital City Authority (KCCA) and LGs rolled out the Taxpayer Register Expansion Project (TREP) and is earmarked to expand URA's tax register by 103,570 value clients (clients who submit returns and pay income tax) and generate revenue worth UGX 12.9 billion (URA, 2014). Other proposed measures include: development and implementation of a policy on mandatory association membership for informal sector players; streamlining the non-standard VAT tax exemptions; strengthening Inter-Agency collaboration among agencies i.e. Uganda Investment Authority (UIA), KCCA, LGs, Uganda Revenue Authority (URA) and URBS; combating international tax evasion schemes; strengthening the capacity of relevant URA staff in critical functions; strengthening local tax administration; and exploring new sources to widen and deepen local revenue bases (Republic of Uganda, 2015).

Despite these efforts by government, Uganda's current Tax-to-GDP ratio has stagnated between 12.5% to 13% over the past 3 years, which accounts for an average annual tax collection between 11.36 and 11.82 trillion shillings. Uganda still faces a number of challenges in domestic revenue mobilization. These include, among others:

1. Large Informal Sector

A large informal sector that contributes 43 per cent of GDP; the informal sector comprises of Informal businesses that are normally characterized by an absence of final accounts, having few employees and no fixed location, being unregistered, and often operational for less than a year. The 2009/10 Uganda National Household Survey showed that, out of the estimated 6.2m households covered, 1.2m (21%), had an informal business. The majority of these were in the agricultural sector (27%), followed by trade and services (24%), with only few in mining and quarrying (1 %) and fishing (1%) (Fair Tax Monitor, 2016).

2. Inadequate Tax Payers' Registers at local and national level

A tax payers' registers are an important asset in revenue generation. As of August 2017, Uganda Revenue Authority has a tax payers' register of 1,052,661 against a taxable population of 9,000,000. Similar challenges of under developed tax payers registers are faced by local governments. In general, good quality national databases, including company, property and vehicle registries, as well as enabling legislation, would allow URA and local governments to use third party information for improving tax compliance and enforcement. URA currently issues taxpayers Tax Identification Numbers (TIN) that are not linked to the National Biometric Identification Cards. This complicates compliance management and increases the risk of tax evasion and avoidance.

3. Tax incentives and exemptions

The GoU is providing a wide range of tax incentives to attract greater levels of foreign direct investment, as part of the wider tax competition among the members of the EAC, following its re-establishment in 1999. This has created a larger regional market, and means that firms can be located in any EAC country to service the whole market (SEATINI, 2013). A study by the African Development Bank estimated that Uganda was losing at least 2% of GDP in revenues due to tax incentives (AfDB, 2010). In 2015, URA reported total revenues foregone as a result of tax exemptions in FY 2013/14 amounted to UGX 1.6 trillion, which is equivalent to 2 percent of GDP (SEATINI, TJNA & Oxfam, 2016). In the financial year 2015/16, the revenue forgone in the form of tax holidays was UGX 999.8 billion that constituted 1.1% of GDP. Such revenues foregone each year collectively are a lot of money. Furthermore, in 2016, MPs exempted themselves from paying taxes on their allowances. This alone led to a loss of more than 53billion annually. In the current FY 2016/17, Saving and Credit institutions (SACCOs) are exempted from paying income tax which has seen the revenue foregone increase by Ugshs. 553.56 Billion to almost Ugshs. 1, 639.89. Tax collections for the financial year now ending 2017 were projected to amount to Shs 12,882.3 billion, against a budgeted figure of Shs. 13,259.32, reflecting a shortfall of Shs. 377.02 billion. It is possible that part of this deficit could be covered with a surplus of the foregone revenue in form of tax holidays or exemptions.

Uganda does not have a clear policy about how tax incentives and exemptions should be awarded or measured (SEATINI, 2013). Uganda's finance minister has the power to grant tax and non-tax incentives, as well as waive the tax due depending on the reasons and evidence provided by the URA Commissioner-General. Although Uganda's Constitution (Article 152(2)) obliges the Minister of Finance to provide information on how much tax the government directly paid on behalf of some taxpayers. This information is usually provided after the incentives have been given away.

4. Double Taxation Treaties

Double Taxation Treaties (DTTs) or Double Taxation Agreements (DTAs) are agreements entered into between states to regulate matters of taxation of income and capital, arising in the context of transnational business or investment. DTTs are predominantly between two states (bilateral). In limited cases, DTTs may be entered into on a multilateral basis (i.e., between and among several states). An example of a multilateral DTT is the East African Community Double Taxation Treaty, between Member States of the East African Community. The government of Uganda is a signatory to a number of DTTs, having agreements with developing countries like Zambia, transition countries like Mauritius and India, and developed countries such as the Netherlands, Italy, Norway and the United Kingdom. Uganda also has other DTTs pending ratification or final negotiation, including with secrecy jurisdictions or tax havens such as the Seychelles and Cayman Islands. Although there are progressive provisions in a number of DTTs, there are key provisions in some of them that pose risk to revenue generation including certain provisions that unduly restrict taxing rights of the source state. (SEATINI&AAIU, 2018).

5. Implications of the Low Revenue Collection on the Budget

Due to the ever increasing debt from US$ 7.2 billion in FY 2014/15 to US$ 8.7 billion by the end of December 2016. In FY 2017/18 Uganda will spend up to UGX 2.6 trillion on interest payments. Debt servicing reduces the resources that would have been useful in critical sectors of the economy such as trade, health, education, water and environment. The net revenue collections for FY 2016/17 were UGX 12,719.63 billion, indicating a 13.26% growth compared to the same period last financial year. However, this was UGX 457.51Bn below the FY 2016/17 target registering a performance of 96.53%. The year to year net revenue collection decreased by 2.34% percentage points from 15.60% in FY 2015/16 to 13.26% in FY 2016/7. (URA annual report 2016/17)

Policy and practice Recommendations

Government

1. Government should establish a multi-stakeholder monitoring panel including policy makers and civil society to evaluate the relevance of awarded tax incentives, exemptions and holidays that reports to parliament. Parliament, with the assistance of the Auditor General, needs to conduct routine cost-benefit and opportunity-cost analyses of all tax exemption, incentives and holidays that have so far been awarded and the subsequent ones to justify their continued existence.

2. The re-negotiation of tax treaties should be expedited to close loopholes that can be taken advantage of by scrupulous investors and individuals.

3. There is need to invest in agriculture and trade sector, increasing financing in such sectors has the potential of facilitating creation of jobs and industrialization. The current financing of the trade sector stands at 0.4% of the 28, 252.5 trillion National budget of the FY 2017/18. This is not sufficient enough to strengthen the sector to meet the NDP II objectives.

Civil Society Organisations

There is need to critically invest in building public awareness and knowledge of tax payers. Civil society should work closely with various government agencies like Uganda Revenue Authority, Local Government Finance Commission, Ministry of Finance, Planning and Economic Development, Ministry of Local Government. Through public awareness and accountability forums, citizens will appreciate the importance of tax and strengthen compliance.

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