TAX POLICY CHALLENGES FACING DEVELOPING COUNTRIES:

A CASE STUDY OF UGANDA

by

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ABSTRACT

Developed countries have had commendable success in improving their taxation policy systems over the years. However, developing countries face numerous tax policy challenges when they attempt to establish efficient tax systems. Uganda's tax structure has been greatly improved in recent years, and it appears to mirror the tax system in other Sub-Saharan Africa countries, in terms of the types of taxes and rates. Nevertheless, growth in domestic revenue mobilization after various reforms has not significantly improved as demonstrated by the increase in overall budget deficits. The persistence of budget deficits makes it clear that Uganda's tax policies urgently need to be reviewed to increase tax revenues. This thesis reviews the pros and cons of changes made to the tax system and assesses the extent to which they can solve the deficit dilemma. In particular, this thesis demonstrates that Uganda's approach to tax policy does not take into consideration prevailing domestic social phenomena like the HIV/AIDS epidemic, the ongoing civil war in Northern Uganda, the expanding informal sector, and barriers to effective tax administration, all of which are rapidly eroding the tax base. Policy solutions that address these systemic problems are suggested.

DEDICATION

To my mother, Berti Kawooya, whose courage inspires me to dream big

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Notwithstanding input from various individuals to this thesis, I remain fully responsible for any mistakes that may be contained herein.

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ACRONYMS

ART	Anti-Retroviral Therapy
CCTB	Canada Child Tax Benefit
CIT	Company Income Tax
CTL	Commercial Transaction Levy
EITC	Earned Income Tax Credit
EPRC	Economic Policy Research Center.
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GPRTU	Ghana Private Road Transport Union
GST	Goods and Services Tax
HIV/AIDS	Human Immune Deficiency/Acquired Immune Deficiency Syndrome
IDP	Internally Displaced Peoples' Camps
IMF	International Monetary Fund
LRA	Lord's Resistance Army
MAT	Minimum Alternate Tax
OECD	Organization for Economic Co-operation and Development
PAYE	Pay As You Earn
PIT	Personal Income Tax
USh	Shilling
TIN	Tax Identification Number
UN	United Nations
UNAIDS	United Nations Programme on AIDS
UNFPA	United Nations Population Fund
UPE	Uganda Primary Education
URA	Uganda Revenue Authority
VAT	Value Added Tax

CHAPTER ONE

TAX POLICY AND DEVELOPING COUNTRIES

In this age of globalization, most developing countries want to become integrated with the international economy. However, they face significant challenges in this pursuit, including the need to increase tax revenues. Hence tax policy makers have to analyze the prevailing conditions in the country and determine the relevant mix of taxes that can raise sufficient revenue. Many developing countries, Uganda included, have increasingly begun to restructure their tax systems for this specific purpose. Despite numerous tax reforms that were intended to improve the economic and social situation by supporting infrastructure and increasing the quality of public goods provided by the government, the situation in Uganda remains fragile, and the country remains among the poorest in the world. Based on the current approved budget for the financial year 2005/2006, a widening budget deficit of 9.2% compared to the previous financial year of 8.6% was reported.[1] The persistence of budget deficits on this scale makes the case for a review of the existing mix and structure of Uganda's main taxes.

One of the most flexible ways to raise per capita incomes and to support increases in real GDP growth rates is through taxation. Taxation is a sovereign right of the state used to transfer resources from private to public use in order to achieve the economic and

[1] Uganda, Ministry of Finance, Planning and Economic Development, *Background to the Budget for Financial Year 2005/06* (Kampala: New Vision Publication), online: New Vision <http://www.enteruganda.com/brochures/strategy_intro.html>, [hereafter referred to as *Background to Budget 2006*].

political goals of society.[2] Taxation is not the only means through which governments can develop resources to finance public expenditure.[3] Governments can and do "commandeer resources" directly from the people. This method would be practicable only in war times, however, and would be rejected by the masses in peaceful times. Governments sometimes print the money they need to function,[4] although it is recognized that this method drives inflation. Developing countries make heavy use of domestic and foreign borrowing, but this is not an adequate alternative to increasing tax revenues.[5] The majority of the people in developing countries receive very low incomes, if any, from which the government cannot borrow. And it may not be constructive for a government to rely on foreign aid as there are many deleterious consequences flowing from aid dependency. Thus taxation emerges as one of the most effective domestic tools that governments have direct control over to develop the resources needed to meet their social, economic, and political goals.

The problem faced by all developing countries -- and this of course includes Uganda -- is that developing countries face many generic and specific obstacles in implementing tax systems that can meet their unique needs and that will also finance the necessary level of public spending in the most efficient way.[6] Developing countries would like to increase

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[2] Richard M. Bird, *Tax Policy and Economic Development* (Baltimore: John Hopkins Press, 1992) at 3-4 [hereafter referred to as 'Bird, 1992'].
[3] Bird, 1992.
[4] *Ibid*.
[5] *Ibid*.
[6] Vito Tanzi and Howell H. Zee, *Tax Policy for Emerging Markets: Developing Countries* (Washington D.C.: IMF, Fiscal Affairs Department, 2000) (Working Paper WP/00/35) [hereafter referred to as 'Tanzi and Zee, 2000'].

their tax-to-GDP ratios in order to reduce budget deficits, improve the services they provide, and optimize the effectiveness of their tax structures. Like most developing countries, the government of Uganda has embarked on numerous tax reforms over the last several decades: it has created a revenue agency, the Uganda Revenue Authority; it has harmonized the tariff code, restructured the tax system, minimized tax exemptions, and updated tax laws such as the Income Tax Act of 1997; and it has established a strong tax investigation and litigation system.[7]

Although Uganda's revenue performance has improved remarkably in nominal terms from 1986 to 2006 as a result of these changes, it is still comparatively low and clearly does not meet Uganda's needs as measured against optimal levels of public expenditure for the country.[8] It is therefore accurate to conclude that the government must improve its tax policy to increase government revenues, but in a way that takes the realities of Uganda's social and economic structures into consideration. The challenge of inefficient domestic revenue mobilization carries important policy implications for Uganda (among which are included bad public services and increased debt), because domestic revenue production has not improved significantly despite the many changes the government has made. While several piecemeal efforts have been implemented in Uganda, concrete ideas on how the overall tax system can be improved remain scarce.

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[7] Torgny Holmgren, *et al.*, *Aid and Reform in Uganda -- Country Case Study* (Washington, D.C.: World Bank, 1999), online: World Bank <www.worldbank.org/research/aid/africa/papers.html> [hereafter referred to as 'Holmgren'].
[8] Holmgren.

This thesis focuses on finding ways to improve Uganda's tax policy that take into consideration the impact on the country of specific prevailing events such as the HIV/AIDS epidemic and the civil war in Northern Uganda, as well as the expanding informal sector and emerging barriers to effective tax administration. There is no such thing as perfect tax policy, because economic situations and society's needs are constantly changing. However, it remains important for the Government of Uganda to review its fiscal policies continuously in order to ensure that each tax instrument operates as well as it can under existing conditions.

While considering the advice of international experts on fiscal policy and the experiences of other developing countries, this thesis focuses on Uganda's tax policy. Chapter One outlines challenges facing tax policy in Sub-Saharan Africa and reviews selected major taxes in Sub-Saharan Africa. Due to the limited amount of literature dealing specifically with tax policy in Uganda, most of this background work draws on more general studies of taxation in Sub-Saharan Africa. However, these studies deal with tax policy issues that are known to be of concern in Uganda, and thus they provide the background against which Uganda's revenue strategies and options are examined in Chapter Two. In addition to identifying tax policy concepts relevant to developing countries, Chapter Two also outlines the history of taxation in Uganda, current Ugandan tax reforms, and the specific challenges that complicate Uganda tax law. Chapter Three discusses in particular how revenue collection in Uganda must take into account HIV/AIDS, the ongoing civil war in Northern Uganda, the expanding informal sector, and the barriers to effective tax administration such as lack of statistical data and lack of reliable resources. This detailed analysis is crucial to formulating policy to improve revenue effort. Chapter Four explores both the policy issues related to selected major taxes and how they operate in Uganda. This is done by examining the advantages and disadvantages of various tax policy options as well as their possible solutions in light of contemporary conditions and reform experiences in other developing countries. The final chapter provides specific recommendations on how the tax policy process in Uganda should be improved, so that tax policy makers in Uganda can take the country's tax laws to the next level and enable it to meet all its policy objectives as effectively as possible.

CHAPTER TWO

TAX POLICY IN DEVELOPING COUNTRIES AND UGANDA'S POLICY CHALLENGES

I UNDERSTANDING TAX POLICY

Tax policy is concerned with the reasoning behind how much revenue the government is collecting, what the revenue is being used for, and whether the government is collecting revenue in the most appropriate way. Tax policy analysis follows a two-step process: the first step identifies the purposes of specific tax instruments, and the second step evaluates how well those instruments achieve their purposes.[9] Tax policy analysis necessarily examines the nature and role of the state**,** for most of the purposes of tax instruments are identical to the function of government itself. In a sense, taxes are a necessary evil in private property regimes; we have taxes in order to give government entities access to cash and productive resources.[10] From this derives the old maxim that "taxation is one of the few things that one can be certain about." [11]

A Purposes of Taxation

Viewed in this light, the imposition and collection of taxes is simply one of the fundamental policy instruments used to achieve governmental social and economic goals. The objectives of tax policy are similar to those of public policy in developing countries, and overlap with the purposes of the tax system or the purpose of most governments.

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[9] Tim Edgar and Daniel Sandler, *Materials on Canadian Income Tax* (Toronto: Thomson Canada, 2005) at 45-49 [hereafter referred to as 'Edgar and Sandler'].
[10] Edgar and Sandler at 46.
[11] Herbert Stein, *Tax Policy in the Twenty-First Century* (N.Y.: John Willey and Sons, 1988).

There are five purposes for collecting revenue through taxes: to give government power to allocate resources; to enable government to provide/support social development; to stabilize the economy; to constitute and define the market place; and to encourage optimal economic growth.[12] In his book *Tax Policy and Economic Development,*[13] Richard Bird has concluded that three of these are of greatest urgency in developing countries: economic growth; internal and external stability; and ensuring that incomes are distributed appropriately.

(1) Economic Growth

Most developing countries are extremely focused on economic growth in both the private and public sectors. Even in primarily market-based economies, governments need to acquire assets for public sector capital formation and development-related expenditures.[14] There appears to be no limit to the tax gadgetry used in different countries to stimulate economic growth. Most developing countries encourage foreign direct investment to stimulate economic growth through the use of tax incentives,[15] and many developing countries impose higher taxes on retained profits than on distributed profits in order to encourage distribution.[16] However, the effectiveness of some policies -- especially of

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[12] Edgar and Sandler at 64.
[13] Edgar and Sandler at 8.
[14] Bird, 1992 at 8.
[15] Ibrahim F.I. Shihata, "Promotion of Foreign Direct Investment -- A General Account with Particular Reference to the Role of the World Bank Group" (1991), 6:2 *ICSID Review Foreign Investment Law Journal*, 484 [hereafter referred to as 'Shihata'].
[16] Bird, 1992 at 8.

incentives -- remains uncertain because there is still insufficient data to link such policies with growth performance.[17]

(2) Stabilization

The use of tax instruments to enhance economic stability is important in developing countries because this enables them to ensure elasticity with respect to changes in the value of money and income levels. If tax yields rise when national income rises,[18] governments have less need to rely on deficit financing to maintain and expand the level of public-sector activity in a growing economy.[19]

(3) Distribution of Income

The distributional role of taxes in developing countries is another important purpose of the tax system. Disparities in income can block development and increase demands for government social spending. The main explicitly redistributive tax in most tax systems is the personal income tax (PIT).[20] In practice, the personal income tax in developing countries is far from being progressive due to large disparities in incomes. These disparities are compounded by the influence of the rich, who may end up paying fewer taxes due to numerous exemptions or favors from the government.[21]

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[17] Shihata at 484-486.
[18] Bird,1992 at 8.
[19] *Ibid*.
[20] Howell H. Zee, *Personal Income Tax Reform: Concepts, Issues and Comparative Country Developments* (Washington D.C: IMF, Fiscal Affairs Department, 2005) (Working Paper WP/05/87), online: IMF <www.imf.org/external/pubs/ft/wp/2005/wp0587.pdf> [hereafter referred to as 'Zee, 2005'].
[21] Zee, 2005.

B Evaluative Criteria

The tax criteria of equity, neutrality, and simplicity are used to evaluate the extent to which substantive governmental goals are being pursued in a fair and just manner.[22]

(1) Equity

There are three main types of tax equity: horizontal, vertical, and, in the international context, inter-nation.[23] Horizontal equity expresses the principal that similarly situated taxpayers should pay the same amounts of taxes because they have the same ability to pay.[24] Vertical equity expresses the principal that those who are "better off" should bear a larger proportion of the tax burden while those who are "worse off" should bear less.[25] Inter-nation equity centers on whether a tax system promotes a fair sharing of the international tax base, particularly among developing countries.[26]

(2) Neutrality

The neutrality criterion requires that tax rules are drafted to minimize the excess burden of taxation whenever feasible. Tax neutrality looks to whether tax laws cause taxpayers to engage in fundamentally different activities just to avoid paying taxes.[27] A tax measure is considered to be neutral when it does not distort individual choices. If taxes are not neutral, they encourage tax avoidance. In an international context, it is important

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[22] This discussion of these criteria is based on Edgar and Sandler at 65.
[23] *Ibid*.
[24] *Ibid*.
[25] *Ibid*.
[26] *Ibid*.
[27] Richard M. Bird, *Tax Policy and Economic Development* (Baltimore: John Hopkins Press, 1992) at 8.

to consider whether tax systems promote capital export neutrality or capital import neutrality.[28] Capital export neutrality is realized if a taxpayer's choice between investing at home or in a foreign country is not influenced by taxes, while capital import neutrality is realized if a company operating abroad is in the same tax position as a local competitor.[29]

(3) Simplicity and accessibility

The simplicity criterion means that tax rules should be understandable, accessible, and uncomplicated. [30] "Simplicity" is a general term that encompasses the following:

Comprehensibility:	The tax system should be understandable to the people to whom it applies.[31]
Certainty:	The application of the tax system to particular transactions should be determinable, predictable, and reasonably certain.[32]
Administrative convenience:	Taxpayers should not have to devote undue time or incur undue costs in complying with the tax system.[33]
Difficult to avoid:	The tax system should offer minimal opportunity for noncompliance.

II CHALLENGES FACED BY DEVELOPING COUNTRIES

Developing countries face formidable challenges in trying to establish effective and efficient tax systems.[34] As summarized by Vito Tanzi, the leading authority on these

[28] Bird, 1992 at 8.
[29] *Ibid*.
[30] Edgar and Sandler at 70-72.
[31] *Ibid*.
[32] *Ibid*.
[33] *Ibid*.

issues, all developing countries have to address four basic problems: (1) the structure of the economy, which makes it difficult to impose and collect taxes; (2) the limited capacity for tax administration; (3) the poor quality of basic data and; (4) in many developing countries, the fact that the political setup is less amenable to rational tax policy than it is in advanced countries. Each of these basic challenges is discussed further below.

A Structure of Developing Economies

Developing countries have well-known economic characteristics: large shares of total economic output and employment are based in agriculture; they have relatively large informal sectors; entrepreneurial units are small and numerous; 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. The size of the informal sector plays a significant role. Not only does it reduce the possibility of relying on certain modern taxes, such as personal income taxes at the individual level, or value-added taxes at the wholesale, retail, and consumer levels, but it also makes it much more difficult to reach those with the economic ability to pay taxes.[35]

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[34] Vito Tanzi and Howell H. Zee, *Tax Policy for Emerging Markets: Developing Countries* (Washington, D.C.: IMF, 2000) (Working Paper WP/00/35) [hereafter referred to as ‘Tanzi and Zee, 2000’].

[35] Samuel Fambon, “Taxation in Developing Countries: Case Study of Cameroon” (Helsinki: World Institute for Development Economics Research, 2004) (Research Paper No. 2006/02), online: United Nations University <www.wider.unv.edu/publications/rps/rps2006/rp2006-02.pdf-> [hereafter referred to as ‘Fambon, 2006’].

The bulk of literature on tax policy in developing countries tends to focus on large taxpaying units, countering tax avoidance and evasion, and the formal economy.[36] While those policy analysts who discuss the particular problems caused by relatively large informal sectors of the economy[37] differ in their views as to exactly what should be done about this gap in developing countries' tax bases, they do agree that the informal sectors need to be brought into the documentary process, and that some form of presumptive taxation may be the best way to begin collecting revenues from the best-documented sectors.

Bonjean and Chambas argue that the tax potential of the informal sector activities is at least partially exploited through direct and indirect taxation.[38] Despite their large contribution to production, informal activities are characterized by small profits, they are usually geographically dispersed, and they may not keep accurate accounts or file returns. Hence the administrative costs of direct taxation in such circumstances are prohibitive.[39] Shome[40] further criticized simplified tax regimes established to cater for small taxpayers. These regimes require less revenue from the taxpayers in comparison to their revenue potential and do not mobilize as much revenue.

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[36] Parthasarathi Shome, "Tax Administration and the Small Tax Payer", (Tax Policy Paper 04/02) (2004) [hereafter referred to as 'Shome, 2004'].
[37] Catherine Araujo Bonjean and Gerard Chambas, "Taxing the Urban Unrecorded Economy in Sub-Saharan Africa," Communication for the "Hard to Tax" Conference (Atlanta, GA: 2003) [hereafter referred to as 'Bonjean and Chambas']; Shome, 2004; World Bank, *Tax Compliance and the Informal Sector in Ghana*, online: World Bank <http://www.worldbank.org/wbiep/fiscalpolicy/case5.pdf> [hereafter referred to as 'World Bank, *Tax Compliance*']; Amardeep Dhillon and Jan G. Bower, "Reform of Tax Administration in Developing Nations" (2005), 1 *Tax* [hereafter referred to as 'Dhillon and Bower, 2005'].
[38] Bonjean and Chambas.
[39] *Ibid*.
[40] Shome, 2004.

Bonjean and Chambas[41] suggest implementation of a unified business tax on the informal sector as a strategy for collecting taxes from the informal sector. In this system, the scale of tax is determined according to objective indicators. These can be the nature of the activity, its geographical situation, or the equipment used. In the case of a restaurant, the number of tables and chairs could be used as tax indicators. The anticipated result would be reduction in the financial and administrative burden of ensuring taxpayer compliance as the need for bookkeeping and filing returns would be eliminated.[42] Despite these apparent advantages, Shome has criticized the single business tax for increasing vertical and horizontal inequity and encouraging the unwillingness of small taxpayers to graduate from the single tax to the conventional tax system.[43] Shome recommends a Minimum Alternate Tax (MAT) based on both gross assets and turnover, which yields higher tax revenue. The tax rate of MAT should be set to equivalence with the lower marginal income tax rate under the assumption of a reasonable rate of return on capital.[44] VAT thresholds could be set below which small taxpayers would be allowed to opt into the conventional VAT system.[45]

The World Bank study on the informal sector in Ghana[46] examines how the Ghanaian government had tried to tax the informal sector. The government used the Standard Assessment method, which uses a single tax. Under the Standard Assessment Act 1963,

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[41] Bonjean and Chambas.
[42] *Ibid*.
[43] Shome, 2004.
[44] *Ibid*.
[45] *Ibid*.
[46] World Bank, *Tax Compliance*.

a fixed lump sum tax was levied on individuals or businesses on the basis of occupation or the business activity in which they were engaged. Levies were calculated from the average income level presumed to be earned by members of any particular occupation. Persons liable to tax were to obtain tax clearance certificates. Of course, this system was criticized as being regressive. However, the scheme was later reintroduced as 'Occupational Grouping Taxation' in an attempt to capture informal sector activity. The pilot scheme began with the large informal transport sector. The law decreed that every person who owned a specified vehicle was to pay a specified rate. Transport operators in the informal sector were thus required to file returns and accounts at the end of the year of assessment. The scheme enhanced horizontal equity to the extent that the levy captured small businesses and the self-employed, who had previously escaped taxation. Nonetheless, numerous problems arose -- embezzlement by tax officials in charge of collecting tax returns, poor record keeping, and other problems associated with high levels of illiteracy.

Another characteristic of developing economies that is an obstacle to tax policy is the low registration rate of taxpayers. Taxpayers register in low numbers either because they do not understand their obligations or because they are deliberately evading tax. Dhillan and Bouwer[47] recommend that one of the main objectives of tax administration should be to identify and bring tax evading entities into the system. They further explain that each taxpayer should be assigned a unique number and contact details should be noted and validated. Other government agencies like the police, land registrars, and

[47] Dhillon and Bower, 2005.

licensing departments should also be involved in finding tax evaders. The writers do not elaborate exactly how the registration should be achieved, but at least they provide a starting point. Private companies such as mobile companies that cater to a wide range of the population could be enlisted in the search for tax evaders. It might be expensive, but there is a dire need for the government to identify all absentee taxpayers.

B Tax Administration and Data

The second challenge facing tax policy in developing countries is the lack of efficient tax administration. Administrations face major problems: a large proportion of the economy is at a subsistence level; many taxpayers do not keep records, and even where records are kept, they are not necessarily reliable. Taxpayer cooperation is also low because of chronic shortages of trained officials, traditions of corruption, and lack of visible improvements in government services.[48] As a consequence, countries often develop tax systems that exploit whatever obvious revenue-generating options they have rather than develop modern and efficient tax systems that create wide tax bases from which to draw revenue. Hence many developing countries often end up with too many small tax sources, too heavy a reliance on foreign trade taxes, and a relatively small use of personal income taxes.[49]

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[48] IMF, Fiscal Affairs Department, *Tax Administration in Developing Countries: Strategies and Tools of Implementation* (Washington: IMF, 1988) online: World Bank <http://www-ds.worldbank.org/servlet/WDSContentServer/WDSP/IB/1989/08/01/000009265_3960928033505/Rendered/PDF/multi_page.pdf> [hereafter referred to as ‘IMF, 1988’].

[49] Tanzi and Zee, 2000.

The challenges faced by developing countries are made painfully clear by comparing the administrative recommendations made by the International Monetary Fund (IMF) with the realities in developing countries. As outlined in 1988,[50] the IMF concluded that effective tax administration depends on the existence of these factors:

- The existence of a predominantly money economy;
- A high standard of literacy; although literacy is not a necessary condition for taxation, the lack of a literate population reduces the options for policy makers;
- Prevalence of honest and reliable accounting; lack of reliable accounting constrains the types of taxes that can be effectively employed;
- A large degree of voluntary compliance on the part of taxpayers; modern taxation involving self-assessment depends heavily on voluntary co-operation by taxpayers;
- A political system not dominated by wealthy groups acting arbitrarily in their own self-interest.

Some of the strategies that have been suggested to deal with the problems are: use of withholding taxes; increased reliance on indirect taxes; use of presumptive taxes; and increased computerization of the tax system. The pros and cons of these and other reform strategies are discussed in detail in later chapters, so for now a brief overview will suffice.

(1) Withholding taxes

The IMF strongly recommends use of withholding taxes as a way to improve the administration of the tax systems of developing countries.[51] The idea is that the tax is withheld by the payor and turned over to the government directly before it reaches the

[50] IMF, 1988.
[51] *Ibid*.

taxpayer.[52] This method is effective when taxing wages, but it requires that taxpayers be easily identifiable. However, in developing countries in which a majority of the population operates in the informal sector, a withholding system would not reach them.

(2) Indirect taxes

Most developing countries have realized that direct taxes – especially personal income taxes – are relatively difficult to administer. This is because direct taxes require a sophisticated taxpayer population that is easily identifiable, highly literate, able to keep records, and willing to file self-assessments. [53] These characteristics are nonexistent in most developing countries, with the result that heavier reliance is placed on consumption taxes that cannot be evaded even by those in the informal sector. One of the most popular consumption taxes is value added taxation (the VAT). The VAT uses a principle of withholding and is in fact characterized as a "form of withholding."[54] Value added taxation can be successfully administered by implementing a single rate and reducing the number of exemptions.[55]

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[52] *Ibid*.
[53] Jalia Kangave, "Improving Tax Administration: A Case Study of the Uganda Revenue Authority" (2005), 49:2 *Journal of African Law* at 145-176 [hereafter referred to as 'Kangave'].
[54] Richard M. Bird and Pierre-Pascal Gendron, "Is VAT the Best Way to Impose a General Consumption Tax in Developing Countries?" International Tax Program Paper 0602 (Toronto: University of Toronto, 2006), online: University of Toronto <http://www.rotman.utoronto.ca/iib/> [hereafter referred to as 'Bird and Gendron, 2006'].
[55] Bird and Gendron, 2006.

(3) Computerization

Computer technology can be used to perform more rapidly such routine tasks as processing forms, compiling statistics, and using available data to forecast tax revenues.[56] Computerization of the tax collection process enables easy detection of defaulters, and also helps to reduce corruption by reducing personal interaction between tax officials and taxpayers that is necessitated by inefficient manual systems.[57] However, use of technology does not necessarily increase revenue collections. Computer technology must be combined with political will and effective organization if it is to yield its potential for greater revenue.

(4) Presumptive taxation

This form of taxation refers to the use of simplified methods of assessing complicated taxes. Presumptive assessment methods are designed as administrative expedients, but they can also be used to promote efficiency and equity goals.[58] Presumptive taxes are a good way to tax hard-to-tax groups, as will be discussed later in detail.[59] A number of countries have adapted the Israeli "*tachshiv*."[60] The *tachshiv* is a system of presumptive taxation that uses objective factors and indices to estimate the income of

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[56] IMF, 1988.
[57] Kangave at 145-176.
[58] Gunther Taube and Helaway Tadesse, *Presumptive Taxation in Sub-Saharan Africa: Experiences and Prospects* (Washington, D.C.: IMF, 1996) (African Department Working Paper WP/96/5), online: IMF <http://www.imf.org/external/pubs/cat/longres.cfm?sk=1993www.fiscalreform.net/library/pdfs/> [hereafter referred to as 'Taube and Tadesse'].
[59] Presumptive taxation is discussed in greater detail in Chapter Four.
[60] R. Christian and H. Jaramillo, "Presumptive Income Taxation and Costly Tax Compliance" (Ann Arbor: University of Michigan, Department of Economics, 2004), at 1-2, online: University of Michigan <www.fiscalreform.net/library/pdfs/presumptive%20income%20tax--jaramillo.pdf> [hereafter referred to as 'Christian and Jaramillo'].

taxpayers who do not keep records of physical inputs; these factors include the number of employees, the different kind of services provided, and the equipment used in the establishment.[61] Presumptive taxes are not accurate, but they are preferable to totally exempting hard-to-tax groups from complex tax systems.

C Political and Social Factors

Political and social factors create additional challenges in devising tax policies for developing countries. Lack of political will to support tax reforms in developing countries has oftentimes led to unsuccessful reforms. Lessons learned from successful reform programs suggest that the key factor is strong political will, demonstrated by a commitment from leaders at all levels of government.[62] Additionally, most developing countries suffer from military dictatorships, corruption, civil wars, underdevelopment, deep poverty, disease, and famine. All these challenges have inevitably led to low tax revenue yields in developing countries.

Another developmental challenge facing the world and particularly Africa is the HIV/AIDS epidemic. [63] The epidemic has become much more than a health problem as it encompasses economic, social, political, psychological, and cultural dimensions.[64]

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[61] Christian and Jaramillo.
[62] Sahr J. Kpunden, "Political Will in Fighting Corruption," online: UNDP <http;//mirror.undp.org/magnet/Docs/efa/corruption/chapters06.pdf>.
[63] George Saitoti, *The Challenges of Economic Institutional Reforms in Africa* (England: Ashgate Publishing Ltd, 2002) at 155 [hereafter referred to as Saitoti].
[64] Saitoti, at 155.

Sub-Saharan Africa continues to be the most severely affected by HIV/AIDS.[65] In 2006, it was reported that almost two-thirds (63%) of all persons infected with HIV are living in Sub-Saharan Africa -- approximately 24.7 million people in total.[66] An estimated 2.8 million adults and children in Sub-Saharan Africa became infected with HIV in 2006 -- more than in the rest of the world combined.[67] The scale of the epidemic's impact greatly varies from place to place. In countries with high levels of HIV/AIDS, the epidemic is having a serious impact on public services.[68] At the same time that productivity and tax bases are being constrained by the deaths of adults in their productive prime, AIDS is placing increasing demands on public sector services, such as health and education, and on public administration.[69] Thus AIDS has started to reverse the economic gains that had been achieved by many developing countries.

III BACKGROUND ON UGANDA

Uganda is a small land-locked country located in the heart of Sub-Saharan Africa. The total area of the country is about 241,039 square kilometers of which about 17% is water and marshland and 31.1% forest cover.[70] Uganda is located in East Africa astride the equator. Uganda's neighbors' are Sudan to the north, the Democratic Republic of Congo

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[65] UNAIDS/WHO, *2006 Report on the Global AIDS Epidemic* (Geneva: UNAIDS, 2006) at 10, online UNAIDS <http://unaids.org/en/HIV_data/2006GlobalReport/default.asp> [hereafter referred to as 'UNAIDS Report, 2006']

[66] UNAIDS Report, 2006.

[67] *Ibid*.

[68] Markus Haacker, *The Macroeconomics of HIV/AIDS* (Washington: IMF, 2004) at 80 [hereafter referred to as 'Haacker'].

[69] Haacker, at 93.

[70] Uganda Investment Authority, "Guide to Uganda," online: UIA <http://www.ugandainvest.com/guide.htm> [hereafter referred to as 'Guide to Uganda'].

to the West, Kenya to the East, and Tanzania and Rwanda to the South.[71] In 2007, the population of Uganda was estimated at 30.9 million.[72] This is an increase of 3 million compared to the previous year, making Uganda one of the fastest growing populations in the world. To solve communication problems among 52 different ethnic groups with almost an equal number of local dialects,[73] English was designated as the official language.[74] The eastern and northern regions of Uganda are characterized by vast plains with occasional hills, while the central region is dominated by Lake Victoria (the second largest fresh water body in the world), the River Nile basin, numerous hills, and swamps.[75] The west is dominated by beautiful volcanic highlands and rolling hills.[76] Uganda's climate and vegetation vary widely in two climatic regions as the result of differences in altitude and water bodies.[77] There are two major climatic regions. The north and east form one region that has two seasons each year, one rainy and one dry.[78] The western, central, and some parts of Northern Uganda form the other climatic region that experiences two dry seasons each year.[79]

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[71] Kangave at 145-176.
[72] "Uganda Population now 31 million," *The New Vision* (June 26, 2007), online: The New Vision <http://www.newvision.co.ug/D18/12/572716>.
[73] Rujumba George Williams, "Uganda," online: Keio University http://www.ic.keio.ac.jp/en/pdf/jjwbgsp/1999/1999_5uganda.pdf> [hereafter referred to as 'Rujumba'].
[74] Rujumba.
[75] *Ibid*.
[76] Guide to Uganda.
[77] *Ibid*.
[78] *Ibid*.
[79] Rujumba.

The Ugandan national economy relies heavily on agriculture, which accounts for 42% of GDP.[80] Uganda's main exports include coffee, fish and fish products, tea, tobacco, cotton, corn, beans, and sesame.[81] The average annual income in 2006 was 280 US dollars.[82] Since the late 1980s, Uganda has begun to rebound from the abyss of civil war and economic catastrophe to achieve relative success politically, socially, and economically.

During the 1970s and 1980s, Uganda was notorious for its human rights abuses, first during Idi Amin's military dictatorship from 1971-1979, and then during the reign of Milton Obote from 1980-1985. During this time, up to half a million people were killed in state-sponsored violence.[83] Under the firm leadership of President Yoweri Museveni, President since 1986, Uganda has become relatively peaceful, stable, and prosperous. Museveni has introduced democratic reforms and has been credited with substantially improving respect for human rights, from the most notorious rights abuses of the Amin period, notably by reducing abuses by the army and police.[84] The rule of law is entrenched and has prevailed for over twelve years, and Uganda now has a strong popularly elected parliament and an independent judiciary to check the executive.

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[80] Guide to Uganda.
[81] BBC, "Uganda's Country Profile," online: BBC <http://news.bbc.co.uk/2/hi/africa/country_profile/1069166.stm> [hereafter referred to as 'BBC, Uganda's Profile'].
[82] BBC, Uganda's Profile.
[83] Kaweesa Kiwanuka Christopher, "Taxation and Investment in Uganda Structure and Trends," online: Uganda Revenue Authority <http:// www.ugrevenue.com/pdfs/UK%20TAXATION%20PAPER.pdf> [hereafter referred to as 'Kaweesa'].
[84] Kaweesa. However, international human rights monitors continue to report on abuses such as incommunicando detention and torture. See, *e.g.* Amnesty International, *Report on Uganda*, AI Index: AFR 59/006/2007.

Together, these institutions have been able to guarantee stability, thereby providing investors with a high degree of certainty for future planning.

Uganda's social achievements are reflected in the improvement of the education system and its ongoing AIDS campaign. The government has made tremendous improvements in education beginning in 1997, with the implementation of the Universal Primary Education (UPE) program, which entitles up to four children per family to free primary education.[85] To ensure that funds allocated for this program were not misappropriated, a public expenditure tracking system was established. With the advent of UPE, enrolment in primary schools rose from 55% in 1994/95 to 98% in 2001/2002. The primary school dropout rate has declined from 70% to 6.6%. [86] In spite of the progress made in primary education enrolment, rates in secondary and tertiary education remain low with the average net secondary enrolment in 2002 being noted at 16.5%, up from 8.1%.[87] There has been a notable deterioration in the quality of post-secondary education; thus the government still needs more resources to improve the education system in order to further increase the literacy rates.

These improvements in education are mirrored by a decline in the rate of HIV/AIDS in Uganda, which has been hailed as a rare success story in the battle against this epidemic.

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[85] UNECA, "Uganda: A Tale of Two Economies?" online: UNECA <http://www.uneca.org/era> 2003 at 84, cited in Jalia Kangave, *Improving Tax Administration: A Case Study of the Uganda Revenue Authority* (LLM Thesis, Queen's University, Faculty of Law, 2004) at 21 [hereafter referred to as UNECA].
[86] UNECA at 84.
[87]OECD, "Africa Economic Outlook 2005-2006, Uganda" at 517, online: OECD <www.oecd.org/dev/publications/african>.

The prevalence of HIV/AIDS in Uganda has declined from around 18% in 1992 to 6.14% in 2005.[88] This has been attributed to the strong political support from the President, who established the AIDS Control Program (ACP) within the Ministry of Health. In 1992, after the government realized that HIV/AIDS was more than a "health" issue, a multi-sectoral AIDS control approach was established. One prong of this approach has been the emphasis on HIV/AIDS education, which ranges from the promotion of condom use to abstinence.[89] Despite such concerted efforts in Uganda, HIV/AIDS remains at epidemic proportions, and a number of research studies indicate that the rates of new infections per year are still high.[90]

The economic reforms implemented by the present government in Uganda since 1987, coupled with political stability, have contributed to economic growth rates averaging 6% per annum in the last decade.[91] This is a great accomplishment for a new government, which inherited a shattered economy when it came to power in 1986.[92] The social, moral, and economic fabric of society had broken down, due to years of political turmoil.[93] During Amin's dictatorship, the nation's economy virtually vanished,[94] mainly because Amin expelled the Asian population, which had commanded the majority of the

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[88] Uganda AIDS Commission and Ministry of Health, "Accelerating HIV Prevention in Uganda" (Kampala: Uganda AIDS Commission, 2006) at 4.
[89] Uganda, AIDS Commission, *And Banana Trees Provided Shade: The Study of AIDS in Uganda* (Kampala: Uganda AIDS Commission, 2003).
[90] UNAIDS, "Uganda Country Profile," online: UNAIDS <http://www.unaids.org/en/Regions_Countries/Countries/Uganda.asp.>.
[91] Guide to Uganda.
[92] Holmgren.
[93] *Ibid*.
[94] Vali Jamal, "Asians in Uganda, 1880-1972: Inequity and Expulsion" (1976), 29:4 *Economic History Review*, *New Series* at 602-616 [hereafter referred to as 'Jamal, 1976'].

wealth in the country.[95] Asians, who were experienced business-owners, kept proper books of account and ran profitable businesses, and thus were easily taxed. The Africans who replaced them lacked business experience and consequently ran the businesses down.[96] By the mid-1970s, almost every manufacturing industry had closed down due to shortage of foreign exchange, mismanagement, and lack of raw materials.[97] The growing and manufacturing of coffee, the main export and backbone of the economy, had come to a halt and was replaced by smuggling coffee.[98] As the economy disintegrated, tax revenues declined. Hence the biggest challenge for Museveni's government has been economic rehabilitation. With the help of international financial institutions, the government has embraced reforms that have helped revamp the economy.

As the result of these changes, the country's infrastructure, notably its transport and communications systems, which had been destroyed by war, have been rebuilt. Inflation is under control, having remained below 10% per annum for the last four years. Most economic sectors are fully liberalized and open to foreign investment.[99] A number of tax reforms, such as the establishment of the Uganda Revenue Agency and enactment of new tax laws, have increased revenues.[100] Nevertheless, Uganda remains one of the poorest

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[95] Jamal, 1976.
[96] *Ibid*.
[97] Holmgren.
[98] *Ibid*.
[99] Claire Akamanzi, *Resolution of Tax Disputes in Uganda: A Case Study of the Tax Appeals Tribunal* (LLB Thesis, Makerere University, Faculty of Law, 2002) at 24 [hereafter referred to as 'Akamanzi'].
[100] Kangave at 145-176.

countries in the world: 38% of the population still lives below the poverty line, and per capita income remains around US 280 dollars per annum.[101]

The challenge for Uganda now is to revise reforms already underway and to prevent their reversal. For this reason, the tax system remains one of the areas of governance that cannot be ignored. The Ugandan government has to prioritize tax reform to ensure that all potential sources of revenue are targeted, while ensuring that tax policies reflect contemporary social realities. Uganda has worked hard at improving the administration of its tax system, but is still not collecting sufficient revenue, debt loads continue to rise, and budget deficits continue to mount.

IV HISTORICAL OVERVIEW OF TAXATION IN UGANDA

The history of modern taxation in Uganda dates back to the onset of the colonial era in 1894. However some form of taxation in Uganda existed even before the coming of the British.[102] Ramkrishe Mukherjee[103] points out that the people of Buganda (central Uganda) had to pay taxes to their monarchs and chiefs in the form of tribute. Tribute was paid in various forms: it might consist of cattle, trade products such as ivory, or even forced labour.[104] Mamdani[105] found that Buganda collected four different kinds of taxes:

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[101] DFID, "Country Profile-Uganda," online: DFID <http://www.dfid.gov.uk/countries/africa/uganda.asp>.
[102] Iga Bukenya, *Taxation and Development: The Case for Value Added Tax in Uganda* (LLM Thesis, Makerere University, Faculty of Law, 1996) at 150 [hereafter referred to as 'Bukenya'].
[103] Bukenya at 156.
[104] Bukenya at 150.
[105] Mahmood Mamdani, *Politics and Class Formation in Uganda* (Dar es Salam: 1976) at 31, [hereafter referred to as Mamdani], cited in Bukenya at 150.

(1) an obligatory tax on each married man, who was required to pay twenty-one pieces of bark cloth and 100 cowry shells; (2) excise taxes on all food products from cattle, goats, and manufactured goods like pottery and handcrafts; (3) customs duties on salt and iron tools; and (4) compulsory military service. The major reasons advanced for imposing these taxes were governmental administration costs and defense from hostile neighbours.[106] Taxation ultimately benefited the king, and ordinary people bore the full burden of paying those taxes.

Uganda was declared a British protectorate in 1894. In order to raise money to meet their expenses, the British introduced cash-based taxes in Uganda.[107] According to Bukenya, the British included stipulations concerning for tax payments in the very first agreement they signed with the African rulers.[108] The 1900 Buganda Agreement imposed a hut tax of 3 rupees per annum and a gun tax of 3 rupees. Later poll taxes, land taxes, and native administrative taxes were also instituted.[109] Bukenya[110] argues that taxes were used to impose a cash-based economy in Uganda. Although taxes prior to colonialism could be paid in kind, for example, by labour contribution, with the advent of colonialism, the payment of taxes had to be in cash. According to Bukenya, colonial taxation was detested by the Africans due to its oppressive nature.[111] The colonial taxes were discriminatory and inequitable. For example, the poll tax was regressive in that the black Ugandans, who

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[106] Vali Jamal, "Taxation and Inequity in Uganda, 1990-1964" (1978), 38:2 *Journal of Economic History* at 418-438 [hereafter referred to as 'Jamal,1978'].
[107] Jamal,1978 at 420.
[108] Bukenya at 150.
[109] *Ibid*.
[110] *Ibid*.
[111] Bukenya, at 150.

had a much lower income, paid a higher rate than the non-natives, who had higher incomes.[112] Even amongst natives, the system was discriminatory as some favored tribes paid less than unfavored ones.[113] Discriminatory and exploitative colonial taxation is the root cause of the negative attitude that Ugandans continue to have toward taxation today.

Uganda gained independence on October 9th 1962. At that time, most colonial laws were continued -- including tax laws -- although they underwent several reforms over the years. Following World Bank recommendations, Uganda appointed a commission to recommend measures to overhaul its tax system.[114] In 1965, withholding taxes on wages and East African income tax rules were issued.[115] The East African Income Tax Management Act, which from its passage in 1970 governed all tax systems in East Africa, collapsed in the 1970s, at which time each country had to take care of its own tax system.[116] Not surprisingly, in the 1980s, many Sub-Saharan African countries experienced fiscal crises that led to the decline or collapse of their revenue bases. In Uganda, this period was one was not only of civil disorder but also of economic chaos as businesses shut down and entrepreneurs fled.

It was not until after President Museveni came to power in 1986 that Uganda started reforming its tax policy. Because these efforts were backed by Western guidance, Uganda, like many other African countries, undertook economic structuring agreements

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[112] Mamdani at 31.
[113] *Ibid*.
[114] Akamanzi at 23.
[115] *Ibid*.
[116] *Ibid*.

with international financial institutions.[117] These agreements all emphasized the need for tax reform. Both the administration and the nature of Uganda tax law underwent significant changes. In 1991, a semi-autonomous revenue authority responsible for collecting central government taxes was established. Revenue collection was removed from the Ministry of Finance, a move which limited political interference in tax matters.[118] In 1996, the value added tax (VAT) was introduced to replace the commercial transaction levy (CTL) and the sales tax.[119] A flat VAT rate of 17% was applied on both imports and local products. In addition, the 1997 Income Tax Act was introduced to replace the inadequate, vague, and difficult to understand 1974 Income Tax Decree.[120] The purpose of the new law was to simplify tax administration and boost taxpayer compliance.[121]

Although these measures went some ways towards improving Uganda's basis for taxation, problems remained, so in 2001/2002, further amendments were made to the Income Tax Act, including the introduction of a 4% withholding tax on revenue received by professional certification bodies, abolition of the tax exempt status for Treasury Bills and Bank of Uganda bills, and elimination of double taxation on housing allowances made to employees. The government realized that export taxes were a major disincentive to the agricultural sector, and abolished them.[122] The corporate income tax rate was

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[117] Holmgren.
[118] Kangave at 145-176.
[119] *Ibid.*
[120] *Ibid*.
[121] *Ibid*.
[122] Kaweesa.

lowered from 60% in 1987 to 30% in 1997 and the maximum individual income tax rate was reduced from 60% in 1987/1988 to 30% in 1993/1994. Finally to further rationalize the tax structure, the Tax Appeals Tribunal was established in 1998 to handle complaints and appeals from taxpayers.[123]

In the short term, these reforms were successful, with tax revenues rising from 7% of GDP in 1991 to more than 10% of GDP in 1997. However, since then tax revenue has stagnated at 10% GDP.[124] This percentage is very low compared to the Sub-Saharan Africa average, which is approximately 20% of GDP. Although Uganda has achieved macroeconomic stability, low tax revenues are a major constraint on its governments' ability to promote economic and social development.

V RECENT TAX POLICY TRENDS IN UGANDA

Taxes can broadly be divided into two categories: direct and indirect taxes.[125] The major direct taxes for 2005/2006 in Uganda were: Pay As You Earn (PAYE), corporate taxes, and withholding taxes.[126] Indirect taxes include the Value Added Tax (VAT), which is a consumption tax,[127] as well as import duties and excise taxes imposed on international trade and locally manufactured goods.[128] Kaweesa[129] states that these taxes were

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[123] *Ibid*.
[124] Holmgren.
[125] Guide to Uganda.
[126] Uganda Revenue Authority, *Revenue Performance Report, July to June 2005/2006* (Kampala: URA Corporate Services Department, 2006), online: URA <http://www.ugrevenue.com> [hereafter referred to as '*Revenue Report 2005/06*'].
[127] *Revenue Report 2005/06.*
[128] Rujumba.

introduced to meet Uganda's broad tax policy objectives that include: establishment of a semi-autonomous revenue authority, enacting new laws, and rationalizing the overall tax structure. These reforms are briefly discussed here.

A Establishment of a Semi-Autonomous Revenue Agency

In September 1991, the Uganda Revenue Agency (URA) was formed as a semi-autonomous authority responsible for collecting tax revenue to take over from the Ministry of Finance.[130] It was hoped that an independent revenue authority would limit political interference in the tax assessment and collection process. It was also expected that the URA's semi-autonomy would allow it to offer better remuneration to its employees, enabling it to attract competent staff and reduce the corruption that has been associated with URA officials.[131]

B Introduction of New Taxes

To ensure increased efficiency of the new revenue agency, new tax laws were enacted. In 1996, the value added tax (VAT) was introduced to replace the commercial transaction levy (CTL) and sales tax.[132] A flat VAT rate of 17% was applied to both imports and local products.[133] The VAT was considered necessary for broadening the tax base. The

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[129] Kaweesa.
[130] Kangave.
[131] Kaweesa.
[132] Ayoki Milton, Marios Obwana and Moses Ogwapus, "Tax Reforms and Domestic Revenue Mobliization in Uganda" (Washington D.C.: Global Development Network, 2005), online: Global Development Network <www.gdnet.org/middle.php?oid=361> [hereafter referred to as 'Ayoki, 2005'].
[133] Ayoki, 2005.

sales tax had been discriminatory because it applied only to the manufacturing sector; thus the introduction of the VAT was intended to increase fairness in both the export and import sectors.[134] The Income Tax Act was introduced in 1997 to consolidate the existing income tax law, which had undergone several amendments, and to simplify the law.[135] For a long time, the tax system lacked a mechanism for redress in the event of tax disputes, but in 1997, the Government established the Tax Appeals Tribunal under the Tax Appeals Tribunal Act.[136] This tribunal was intended to address the dissatisfaction of aggrieved taxpayers, complementing the substantive reforms.

C Rationalizing the Tax Structure

After the 1980s economic crisis, Uganda, like other Sub-Saharan countries, recognized the need to rationalize and harmonize the tax rates. The objectives were to attract and promote investment in Uganda, increase revenue yields, and simplify tax administration. Table 1 outlines these reforms, showing the rates of each major tax before and after the reforms:

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[134] *Ibid*.
[135] Kangave.
[136] Akamanzi.

TABLE 1

Changes in tax rates and tariffs, Uganda, 1993-present

Type of Tax	Previously	Currently	Since
Income Tax			
Company	60%	30%	1994
Mining Corporations	60%	24%-45%	1997
Individual	10%-70%	10%-30%	1994
Import Duty	Maximum 20%	0%, 7%, 15% (Comesa 0%, 4%, 6%)	1998 1998
Excise Duty	Maximum 50%	0%, 10%	1999
Sales Tax	Maximum 50%	Abolished	1996
CTL	Maximum 15%	Abolished	1996
Value Added Tax		0%, 17%	1996
Export Tax	Coffee Stabilization Tax 30%	Abolished	1993

Source: Christopher Kawesa Kiwanuka, "Taxation and Investment in Uganda Structure and Trends" (2004)

As shown in Table 1, the corporate income tax was lowered from 60% to 30% in 1997, and the maximum individual tax rate was reduced from 60% in 1987/88 to 30% in 1993/94.[137] The many wide-ranging exemptions that have been granted to special sectors over the years -- including a number of Minister's powers to exempt -- have been abolished. They include provisions granting tax holidays under the Investment Code of 1991, which were repealed in 1997, and a provision in the Customs Management Act

[137] Kaweesa.

empowering the Minister to grant specific waiver of taxes and duties on imports, which was repealed in 2001.[138]

A scheme of capital deductions and allowances was introduced in 1997 through the Income Tax Act of 1997 to replace the abolished tax holidays. Other allowances include deductions or exemptions for ordinary business expenses, meals, refreshments, and entertainment expenditures, interest payments, and business obligations. Carry-forward losses were also introduced so that an assessed loss arising out of company operations, including losses legally resulting from investment incentives, are allowed as deductions in determining the taxpayer's chargeable income in subsequent tax years.[139]

Tax exemptions on industrial inputs and specialized inputs were enacted. The government extended tax exemptions to imports of industrial inputs such as raw materials, industrial machinery, computers, printers and accessories, machinery used for processing agriculture or dairy products, dental, medical, and veterinary equipment. [140] Uganda now offers a tax-free export policy to promote production for export. All exports are tax free and zero-rated, while at the same time, a duty drawback system is in place under which a producer or exporter can claim back the taxes paid on certain inputs during the production of the goods declared for being exported.[141]

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[138] *Ibid*.
[139] *Ibid*.
[140] *Ibid*.
[141] *Ibid*.

The fiscal year 2005/2006 saw the implementation of additional key tax policy measures which were aimed at boosting revenue collections, and these measures and their effects are outlined in Table 2, below.

TABLE 2
Evaluation of Ugandan Tax Policy Measures, 2005-2006

Policy measure	Intended objective	Performance July to June 2005/2006
Petroleum products • Excise Duty on PMS increased from USh660 to USh720/ltr. • Excise duty on AGO increased from USh400 to USh450/ltr.	To generate USh28 billion in Revenue.	The gross gain resulting from the increment generated USh35.96 billion as at end June 2006. This is USh7.96 billion more than projected. However, diesel tax refunds amounted to USh8.41 billions. This implies that the policy generated a net of USh27.55 billion.
Mobile Phone Airtime • Excise duty on Airtime increased from 10% to 12%.	To generate USh5.2 billion in Revenue	Overall surplus from the sub sector of USh1.82 billion has been recorded. USh5.91 billion was realized from the policy increase which was well above the USh5.2 billion projected by USh0.69 billion.
Excise duty on cigarettes • 10% increase in excise duty	To generate USh0.5 billion in Revenue	Policy implementation was suspended. Note that there was no subsequent reduction in the overall target for 2005/06.
Sugar • Introduced a specific duty rate of USh50 per kg on locally produced or imported sugar.	To generate USh16.0 billion in revenue.	Excise duty on sugar registered a shortfall of USh5.76 billion. Out of the projected policy yield of USh16 billion only USh10.24 billion was realized. Average monthly sugar production has been about 15,846 metric tones as compared to 26,666 metric tones projected for the realization of the policy measure. During the fiscal year sugar imports were 14,586.87 tones.
Value Added Tax • The Standard VAT rate was raised from 17% to 18%.	To generate USh38.6 billion in revenue • USh2.70 billion to be collected from excisable local goods. • USh6.18 billion to be collected from non-excisable local goods. • USh8.49 billion to be collected from	A gross surplus of USh13.93 was recorded for both VAT on local supplies and imports. However, government VAT payments of USh20.36 billion leave a net shortfall of USh6.43 billion. **Excisable goods**: A deficit of USh5.19 billion has been registered from excisable local goods. **Non-excisable goods**: A surplus of USh14.56 billion was registered by the end

Policy measure	Intended objective	Performance July to June 2005/2006
	Services. • USh21.23 billion to be collected from Imports.	of 2005/06. **<u>Services:</u>** A shortfall of USh19.56 billion was recorded. **<u>Imports</u>**: The 18% VAT has generated about USh24.87 billion as at end June 2006, which is above the target level by 3.64 billion.
Traffic Act • Various fees on motor vehicles and motor cycles licenses were adjusted upwards.	To generate USh10.2 billion in revenue. • Buses and Lorries are not affected.	General fees and licenses under the traffic Act have posted a shortfall of USh5.11 billion.
Pharmaceutical Products • The duty rate on medicaments was abolished.	Promote Pharmaceutical Industry	Pharmaceutical products whose CIF value was USh266.39 billions, registered a growth a rate of 62.02%.
Solar Equipment and Accessories • Duty on deep cycle batteries was remitted to 0%.	To develop alternative sources of energy.	Solar equipments whose CIF value was USh4.73 billion registered a growth rate of 60.86%.
Paper for Printing Textbooks, Examination Paper and Covers • Duty remitted to 0%.	To enhance literacy in community.	Classification of these goods has remained a great challenge
Speed Governors • Duty remitted to 0%	To reduce carnage on the roads.	Speed Governor imports CIF value of USh1.54 billion fell by 13.76%.
Worn (second hand) Clothing • CET rate on second hand clothes reduced from 70% or U$ 0.5 cents to 40% or U$.0.3 cents per kilogram.	Partly to address concerns of the stakeholders at the time.	The CIF values of USh44.94 billion grew by 5.51%. Import duty of USh16.28 billions grew by 181.16%.
Credit to Agriculture • Interest earned by financial institutions on loans exempted	To encourage lending to the agriculture sector.	The study is not yet complete.

Source: Uganda Revenue Authority, *Revenue Performance Report 2005/2006.*

VI CONCLUSION

Although President Museveni is much admired by policy makers and members of international organizations for his economic stewardship, Uganda’s total tax revenues bring a very small share of the GDP into the hands of the government, even by African standards. To date, the ratio of tax revenue to GDP has only risen to 13%, while the Sub-Saharan average remains at 18% to 20% of GDP.[142] While 13% is high when compared to the miserable low of 4% in 1989,[143] it is still dangerously low for a country with significant development, social, health, and political needs. The realities of life in Uganda, including the continued existence of a large informal sector, the impact of the HIV/AIDS epidemic, ongoing civil war, and the limitations of the tax administration system have all led to a host of other problems such as increased debt, poor or nonexistent public services, and evasion of taxes among some classes with impunity. These characteristics make it all the more urgent that the tax system be strengthened, and in a manner that takes all these realities into account.

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[142] Uganda, Ministry of Finance, *Background to the Budget for Financial Year 2005/06* (Kampala: New Vision Publication, 2006), online: New Vision <http://www.enteruganda.com/brochures/strategy_intro.html>.
[143] Kaweesa.

CHAPTER THREE

TAX POLICY CHALLENGES IN UGANDA

I INTRODUCTION

The government of President Yoweri Museveni has made enormous strides in reforming the tax system in Uganda, both in terms of tax administration and substantive tax policy. The tax policy reforms enacted by the government and implemented by the URA have led to the rise of revenue from 7% of GDP in 1991, when the URA was first established, to more than 11% by the mid 1990s.[144] These increased revenues have enabled the government to expand its expenditures on key issues such as providing free primary education and infrastructure rehabilitation, which are crucial to poverty reduction and broad-based economic growth. [145]

Despite these achievements, Uganda still faces numerous unique challenges which impede the government's attempts to raise tax revenue to levels required to support government expenditures on a sustainable basis. These challenges include the HIV/AIDS epidemic, the ongoing civil war in Northern Uganda, the expanding informal sector, and continuing barriers to tax administration such as lack of resources, corruption, and lack of technology. The HIV/AIDS epidemic threatens to set in motion processes that will profoundly and negatively transform the economic achievements in the tax system. The

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[144] Torgny Holmgren *et al*., "Aid and Reform in Uganda Country Case Study" (Washington, D.C.: World Bank, 1999), online: World Bank <www.worldbank.org/research/aid/africa/papers.html> [hereafter referred to as 'Holmgren'].
[145] Holmgren.

epidemic is creating new patterns of social and economic activity marked by extreme poverty, low levels of education, and disintegration of existing social structures. The ongoing civil war in the north has had similar impact, with death of potential taxpayers, destruction of infrastructure, and low levels of investment in affected areas. The expansion of the informal sector and continuing barrier to effective tax administration such as lack of resources, lack of modern technology, and lack of statistical data make it all the more difficult to overcome the effects of the HIV/AIDS epidemic and civil war.

This chapter examines these phenomena and how they impact tax policy in terms of mobilization of tax revenue. The chapter does not seek to cover each of these aspects in detail; rather, it examines at a general level the impact of these problems on tax revenue performance. It is hoped that policy makers will recognize the effects of these problems when making further tax policy decisions.

II THE HIV/AIDS EPIDEMIC

By the time the HIV/AIDS epidemic was recognized in 1986, Uganda was already weakened by poverty, civil war, debt, drought, and famine. The HIV/AIDS epidemic poses a real threat to Uganda's very existence. This is because the effects of the epidemic touch on virtually all aspects of a country's social, economic, demographic, and political development.[146] The impact of HIV/AIDS on mortality, morbidity, and the resulting demographic changes has the potential of eroding the economic benefits which Uganda

[146] Lori Bollinger, John Stover and Vastha Kibirige, "The Economic Impact of AIDS in Uganda" (1999), online: The Policy Project www.policyproject.com/pubs/SEImpact/Uganda.pdf. [hereafter referred to as 'Bollinger and Kibirige'].

has achieved since 1986. This section explores the different ways in which HIV/AIDS affects economic growth, and thus the functioning of its tax system. Some of the key channels explored are the impact of HIV/AIDS on individuals and households, small and large businesses, and governmental activities.[147]

Uganda is not the only country facing the huge fiscal and revenue impact of the HIV/AIDS epidemic. According to estimates by the Joint United Nations Programmes on AIDS (UNAIDS), as of the end of 2003, over 20 million people are estimated to be living with HIV/AIDS, and over 90% of those live in developing countries.[148] Sub-Saharan Africa has just over 10% of the world's population, but it is home to more than 60% of all the people living with HIV/AIDS.[149] An estimated 2.8 million adults and children became infected with HIV in Sub-Saharan Africa in 2006, more than in all other regions.[150] The magnitude of the epidemic and its devastating impact on every sector of the economy has led several developing countries to declare HIV/AIDS as a national disaster.[151]

Uganda remains one of the notable HIV/AIDS success stories in Sub-Saharan Africa. After a dramatic rise in HIV/AIDS to 30% of the population in the 1990s, the rate

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[147] Markus Haacker, ed., *The Macroeconomics of HIV/AIDS* (Washington, D.C.: IMF, 2004) at 63 [hereafter referred to as 'Haacker'].
[148] UNAIDS, *Report on the Global AIDS Epidemic 2006* at 10, online: UNAIDS <www.unaids.org/en/HIV_data/2006GlobalReport/default.asp> [hereafter referred to as 'UNAIDS, Report, 2006'].
[149] UNAIDS, Report, 2006.
[150] UNAIDS, *December 2006 AIDS Epidemic Update* at 2-6 (Geneva: UNAIDS and WHO, 2006) [hereafter referred to as 'UNAIDS, Epidemic Update, 2006'].
[151] UNAIDS, Report, 2006.

declined to 11% in 2000 and by 2005 had fallen to 6.7%.[152] This decline was attributed to concerted efforts such as a successful public education campaign supported by the President.[153] However, HIV/AIDS remains at epidemic proportions, and recent data from the Uganda Sero-Behavioral Survey in 2005 provide cause for concern, as they show these gains are being eroded.[154] Due to failure to maintain behavioral changes and other reasons, the survey found condom use was erratic (only about half the men and women surveyed reported using a condom the last time they had sex with a casual partner), and almost one in three men said they had had more than one sexual partner in the previous year.[155] Estimates from UNAIDS and Ministry of Health indicate that over 130,000 people have become infected every year since 2003, nearly doubling the rate in 2002 (70,000 per year).[156]

From this survey, it is apparent that the ages of those affected are rising with the highest prevalence being concentrated in the age range of 30-34 and 35-38 for women and men respectively.[157] This shift in the ages of new infections is alarming, because they are striking mainly adults, the most economically productive segment of the population and the sector of the population forming the majority of Uganda's taxpaying population. At

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[152] World Bank, "Uganda Country Brief," online: World Bank <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/UGANDAEXTN/0,,menuPK:374947~pagePK:141132~piPK:141107~theSitePK:374864,00.html> [hereafter referred to as World Bank, Uganda's Profile'].
[153] UNAIDS, Report, 2006.
[154] UNAIDS, "Uganda Country Profile," online: UNAIDS <http://www.unaids.org/en/Regions_Countries/Countries/Uganda.asp.> [hereafter referred to as 'UNAIDS, Uganda's Profile'].
[155] UNAIDS, Uganda's Profile.
[156] *Ibid*.
[157] *Ibid*.

this point in time, there is little agreement on what the long-term economic impact of AIDS on the country's economy will be, let alone on tax revenues. What is clear is that HIV/AIDS through its impact on mortality, morbidity, and resulting demographic changes has an adverse impact on the domestic tax base and thus on government revenue. It is against this background that this chapter highlights the impact of the epidemic on Uganda's population, and thus on attempts to increase government revenues.

A Impact of HIV/AIDS on Individuals and Households

The most direct impact of HIV/AIDs is the unprecedented rates of morbidity and mortality among adults. According to the UNAIDS report of 2006, about 1,000,000 people in Uganda are living with HIV/AIDS.[158] Worse still, estimates from UNAIDS and the Ministry of Health indicate that since 2003, another 130,000 become infected every year.[159] In 2006, there were 91,000 deaths due to HIV/AIDS.[160] The economic impact of AIDS-related deaths was observed to be stronger than other types of deaths because households lost much of their savings in order to pay for healthcare and funeral expenses.[161]

According to Bollinger's study, AIDs is predicated to reduce both the size and the rate of growth of Uganda's labour force so that by the year 2010, there will be approximately 2

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158 *Ibid*.
159 *Ibid*.
160 *Ibid*.
161 World Bank, Uganda's Profile.

million fewer people, or about 12% less, due to the impact of AIDS.[162] The detailed implications of this epidemic on tax revenues have not been documented yet. However, what is clear is that the already small tax bases are being eroded by the epidemic. HIV/AIDS also has profound effects on the economic situation of households, which also inevitably affects tax revenue production. Incomes decline as breadwinners fall ill and die and as other household members are obliged to take time off from other productive activities to care for the sick relatives.[163] Households have to reallocate their spending to devote a much greater share to health care, including not only drugs and, doctor's fees but also supplies for home care.[164] A study of three countries (Burkina Faso, Rwanda, and Uganda) has found that AIDS will increase the percentage of people living in extreme poverty from 45% in 2000 to 51% in 2015.[165] In the case of Uganda, where the majority of the population is already living below the poverty line, the expenses incurred due to HIV/AIDS will prevent most people from being able to pay taxes.[166]

The HIV/AIDS impact extends beyond households directly affected to other households that step in to offer assistance to the extended family. For example, when a household affected by HIV/AIDS dissolves, members of the extended family step in to take care of the surviving members. This of course puts a strain on their incomes,[167] affects their ability to pay taxes, and reduces their ability to consume goods and pay for health care.

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[162] Bollinger and Kibirige.
[163] Haacker, at 45.
[164] *Ibid*.
[165] World Bank, Uganda's Profile.
[166] Haacker.
[167] *Ibid*.

Loss of consumption power results in low demand for goods and services generally and hence impairs production and investment.[168] All these factors make it more difficult for the state to produce sufficient revenues for ordinary governmental operations and development purposes.

The long-term effects of HIV/AIDS also pose a tremendous challenge to tax policy because this epidemic creates much higher levels of economic disadvantage and dependency, often across generations, and thus compounds the need for social assistance. The death of parents has resulted in the rising number of orphans who are educationally and economically disadvantaged. According to UNAIDS, there are approximately one million orphans in Uganda.[169] It is reported that children from HIV/AIDS-affected households are withdrawn from school, both because of the lack of finances to pay tuition and because the children are needed as labourers when their parents cannot work.[170] One early survey of 1,133 households in Kampala found that 47% of households with orphans did not have enough money to send the children to school, compared to 10% of households with parents.[171] The increasing number of orphans means that a growing

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[168] Maureen Were and Nancy N. Nafula, "An Assessment of the Impact of HIV/AIDS on Economic Growth: The Case of Kenya," (2003) CESifo Working Paper Series No. 1034, online: Kenya Institute for Public Policy Research and Analysis <papers.ssrn.com/sol3/papers.cfm?abstract_id=449241 - 30k> [hereafter referred to as 'Were and Nafula'].
[169] UNAIDS, Uganda's Profile.
[170] Bollinger and Kibirige.
[171] *Ibid*.

proportion of the population is unable to acquire skills that would enable them to be economically productive citizens,[172] thus reducing the amount of tax revenue collected.

The HIV/AIDS epidemic has created a crisis in the family structure. In Uganda, there has been a role reversal where the elderly have been turned into the providers in families.[173] According to a study carried out in Uganda, there were HIV/AIDS-related deaths in 82.3% of the surveyed households. In almost 34% of the households, the caregivers of HIV/AIDS orphans were older people over 50 years.[174] Care, treatment, and support of patients with AIDS-related illness have been placed on the elderly relatives -- especially on the women.[175] However, little attention has been given to how elderly caregivers are affected. According to a recent study in Uganda, the elderly experience economic devastation due to being overburdened with the effects of HIV/AIDS.[176] The elderly -- usually the orphans' grandparents -- have to make up for the loss of income of the sick or deceased, pay for funeral expenses, school fees and supplies, medical bills, clothing, and home repairs, all of which were beyond their financial capabilities.[177] The situation is worsened by the lack of support or even recognition from government and policy makers

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[172] Haacker, at 50.
[173] Kakooza James and Kimuna Sitawa, "HIV/AIDS Orphan's Education in Uganda, The Changing Role of Older People" (2006), 3:4 *Journal of Intergenerational Relationships* at 63-81 [hereafter referred to as 'Kakooza and Sitawa'].
[174] Kakooza and Sitawa.
[175] *Ibid*.
[176] Ssengonzi R., "The Impact of AIDS Epidemic on the Living Arrangements and Well-Being of Elderly Caregivers in Sub-Saharan Africa" Paper presented to the International Conference, 11-16 July 2004), online: <http://gateway.nlm.nih.gov/MeetingAbstracts/102279285.html > [hereafter referred to as 'Ssengonzi'].
[177] Ssengonzi.

of the impact of poverty in these homes. Therefore the need for relevant tax policy that supports these new crisis-driven family structures cannot be over-emphasized.

B HIV/AIDS Impact on the Private Sector

Increased mortality means that the economy is left with fewer workers, both in total and across different occupations and skill levels. According to UNAIDS, AIDS will reduce both the size and growth of Uganda's labour force so that by the year 2010, there will be approximately 2 million fewer workers.[178] As private employees and public servants fall ill and eventually die, the efficiency of production and administrative processes is diminished with this widespread destruction of human capital.[179] By increasing morbidity and mortality, HIV/AIDS affects both the productivity of employees living with the disease and productivity in general as the retirement or death of these employees disrupts companies' operations. For most companies, the most important costs associated with HIV/AIDS are monetary, including medical and death-related benefits, all of which add to personnel expenses.[180] Most firms pay for burial-related items such as coffins, transportation of the body, a number of mourners, and 6 to 12 months payment as a death benefit or gratuity.[181] One sugar company in Uganda estimates this cost to total US$500 per employee, which greatly reduces the funds they have available for investment.[182] The Uganda Railway Corporation has reported an increase in its annual hospital bill by 1992 to US$77,000, while the cost per patient had increased from US$69 in 1988 to US$300 in

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[178] UNAIDS, Uganda's Profile.
[179] Haacker at 41.
[180] Haacker at 51.
[181] Bollinger and Kibirige.
[182] *Ibid*.

1992.[183] As the costs of death-related, disability, and medical benefits increase, companies have to invest in measures to contain the adverse impact of HIV/AIDS. This diverts resources that could have been used in investment in physical or human capital, and instead are used on containing the epidemic, hence reducing potential tax bases.

The loss of skilled labour professionals as well as of managerial expertise and experienced workers due to the epidemic has also had an impact on businesses. In one banking institution in Kampala, five senior staff died from AIDS in one year.[184] Between 1989 and 1993, out of 250 government officials sent abroad for further studies on government sponsorship, 12 died; at least ten of these deaths were AIDS-related.[185] This reflects a substantial loss of investment in human capital by the government, mirroring losses in the private sector.

C Impact of HIV/AIDS on Government

The impact of HIV/AIDS on the government is pervasive, because the government is not only a major employee, but also seeks to provide for those in dire need. As an employer, the government’s personnel costs, through increased medical, death-related benefits, training, and recruitment costs, are being pushed up as the epidemic continues. Employment benefits in the public sector are more comprehensive than in the private sector. Public servants are more likely to be permanently employed, a condition that is also associated with higher benefit levels, and governments may refrain for political

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[183] *Ibid*.
[184] *Ibid*.
[185] *Ibid*.

reasons from cutting benefit levels as a way of containing costs. Thus personnel costs are likely to increase in all areas of the public service.[186]

At the same time, the HIV/AIDS epidemic has created unprecedented need for healthcare, care for orphaned children, and support for single or elderly caregivers, and community infrastructure. The HIV scourge has exerted enormous strain on the health budget. Demand for public health services has increased sharply, and this is exacerbated by cost-sharing policies, which makes health care services unaffordable for the poor.[187] By 1993, over 50% of admissions in Rubaga hospital, the third largest hospital in Kampala, were HIV-related.[188] Hence the government has to intervene to provide antiretroviral treatment, which consumes already-scarce government resources. UNAIDS reports that the government of Uganda has spent about US$18 million from domestic sources on HIV/AIDS.

At the same time that the HIV/AIDS epidemic has caused severe economic deterioration in the economic conditions of Uganda, it has also increased the need for basic health care and human services. Thus the government is faced with falling revenues and growing health, educational, and social needs. The Uganda AIDS Commission stated that it required US$1.2 billion annually to accelerate the search for the AIDS vaccine, but only

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[186] Haacker at 63.
[187] Were and Nafula.
[188] Bollinger and Kibirige.

US$650 million of that funding was in place by 2006.[189] The UN estimates that between US$9.6billion and US$11.3billion will be required for low- and middle-income countries in 2005, rising to between US$14.1 billion and US$18.8 billion by 2007, to mount an appropriate response to fight the HIV/AIDS epidemic.[190] In the case of Uganda, the World Health Organization estimated that the government would need between US$69.2 million and US$131.7 million to support scaling up HIV/AIDS treatment to reach 55,000 people by the end of 2005.[191] This target was missed, and by 2006, only 47,000 of the 75,000 HIV/AIDS patients had received anti-retroviral treatment.[192] These increased demands for health services emphasizes the government's urgent need to increase tax revenues.

III THE CIVIL WAR IN NORTHERN UGANDA

Civil war is a devastating phenomenon, both to the population and to economic activity. Uganda, which has experienced a twenty-year period of intermittent civil war, has been affected on both these levels. Although no studies have been carried out linking the civil war in Uganda to its poor tax performance, studies carried out in other developing countries suggest that this link is unavoidable. Since President Yoweri Museveni came into power, the southern two-thirds or more of the country have been at peace, and much

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[189] "Round up: Budgets cuts to affect HIV/AIDS Patients in Uganda," *People's Daily* (29 May 2006), online: People's Daily <http://english.peopledaily.com.on/200605/29/eng20060529-269364.html> [hereafter referred to as "Uganda budget cuts"].
[190] Maureen Lewis, "A War Chest for Fighting HIV/AIDS" (2005), 42 *Finance and Development Quarterly Magazine* 42 at 4, online: IMF <http://imf.org/external/pubs/ft/fandd/2005/12/lewis.htm>.
[191] WHO, "Uganda Summary Country Profile" (2005).
[192] "Uganda budget cuts."

has been done in reconstructing the political and the economic systems, while the northern part has continued to suffer from war for almost two decades.[193] Uganda being one of the poorest countries in the world, with low per capita income,[194] the existence of conflict inevitably affects the country's revenue collections, increases demands for government assistance and investment, and places further pressure on the government to meet increased revenue needs.

The civil war in Northern Uganda is one of extreme brutality and callousness. Characterized as "one of the world's forgotten crises," it has escalated since the 1980s to engulf huge parts of the countryside, trapping tens of thousands of innocent people in a seemingly endless cycle of violence and suffering.[195] The Lord's Resistance Army (LRA) led by Joseph Kony started as a small group in the 1980s and has been fighting the Ugandan government ever since.[196] The LRA's principal tactic has been to target the civilian population of Acholi land, terrorizing the community and creating paralyzing despondency. In its attacks, the rebel group characteristically kills, maims, chopping off lips, legs and arms of innocent civilians,[197] rapes, loots, burns homes, destroys crops, and, most traumatically, abducts civilians -- especially children. The boys are

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[193] Oliver Furley, ed., *Ending Africa'sWars* (England: Ashgate Publishing Ltd, 2006) at 115 [hereafter referred to as 'Furley'].
[194] World Bank; Uganda's Profile.
[195] Justine Nannyonjo, "Conflicts, Poverty and Human Development in Northern Uganda" (2004), online: UN University Wider < www.wider.unu.edu/conference/conference-2004-1/conference%202004-1-papers/Nannyonjo-3105.pdf > [hereafter referred to as 'Nannyonjo']
[196] BBC News, "Country Profile: Uganda" (August 16, 2007), online: BBC <http://news.bbc.co.uk/2/hi/africa/country_profiles/1069166.stm> [hereafter referred to as 'BBC, Uganda's Profile'].
[197] Human Rights Watch, "Uganda: No Amnesty for Atrocities" (July 2006), online: HRW <http://hrw.org/english/docs/2006/07/27/uganda13863.htm>.

subsequently indoctrinated and trained as LRA fighters, and the girls are turned into sex slaves for the older fighters. [198]

As the conflict between the Government of Uganda forces and the armed insurgent groups intensified in 1996, a Presidential order declared that people living especially in Acholi land were to move into concentration camps (Internally Displaced Camps), where they would be protected from the rebels' attacks.[199] Since then, the violence has displaced over 1.6 million people, and the UN estimates that the group has abducted about 20,000 children.[200] The government has made numerous efforts to end the war, the latest being a truce signed between the government and the rebels in August 2006 aimed at ending the war.[201] Nevertheless, these efforts have not been fruitful, and the war continues to rage on. The extended interlude of insurgency, counter-insurgency, displacement, and disruption that began in 1986 and that has persisted since then has devastated the local economy and has isolated Acholi land from the very substantial economic and social progress elsewhere in the country.[202] At the same time, the long term costs associated with sustained violence are innumerable. The ensuing discussion will examine the effects posed by the civil war on Uganda's fiscal and revenue needs.

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[198] Willet Weeks, "Pushing the Envelope: Moving Beyond 'Protected Villages' in Northern Uganda" (Paper submitted to the United Nations Office for the Co-ordination of Humanitarian Affairs, March 2002) [hereafter referred to as 'Weeks'].
[199] Weeks.
[200] BBC, Uganda's Profile.
[201] *Ibid*.
[202] Weeks.

Most obviously, the civil war has damaged the economy through the destruction of human and physical resources and increasing human needs for bare subsistence. Uganda has lost numerous potential taxpayers in this war through premature deaths and abductions, and continues to lose many more. It has been reported that the violent death rate for Uganda is currently at 146 deaths per week (0.17 violent deaths per 10,000 people per day) -- three times higher than the rate of death in Iraq, where the incidence of violent death in the period following the allied invasion was estimated to be 0.052 per 10,000 people per day.[203] The increased death rate destroys human capital and potential taxpayers. The 1.6 million who are currently in camps are of course immune from taxation because they are unable to carry out income-generating activities like agriculture in the camps. A government study noted that 70% of the population in Northern Uganda live in absolute poverty, with each adult's consumption expenditure at less than US$1 a day and about US$11 per month.[204] This is worsened by the fact that half the working-age population in the camps is redundant anyway, because there are no job opportunities in the camps.[205] By making household's investment and diversification into business impossible, these people have become wholly dependent on the government to provide them with food and services.[206] This affects government revenues and increases government's expenditures.

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[203] Oxfam International, "Uganda: Rate of Death in Northern Uganda Is Three Times Higher Than in Iraq" (Press Release, 30 March 2006), online: Oxfam International <http://allafrica.com/stories/200603300533.html>.
[204] "Uganda: Survey reveals grinding poverty in war-affected North," online: IRIN Humanitarian News and Analysis <http://www.irinnews.org/report.aspx?reportid=58691> [hereafter referred to as "Survey on war-affected North"].
[205] "Survey on war-affected North."
[206] *Ibid*.

The long-term effect of civil war on education is particularly serious, especially when the education system has literally broken down. Since the rebels have targeted young children through systemic abductions, a whole generation is illiterate without skills that will enable them to participate in more productive activities that can help them support themselves and their families, and become taxpayers. In Pader, one of the most affected districts in Northern Uganda, 38 primary schools have been completely destroyed over the last two decades.[207] In Kitgum district, 63 primary schools with 31,000 children had been displaced.[208] It is not surprising that the literacy rate in Northern Uganda stands at 54% compared to the national average of 64%.[209] Even when the war does end, the government will be faced with a generation that itself has been left out of Uganda's development, and will need more government assistance because of these circumstances.

Direct destruction of infrastructure by civil war has similar effects. During the war, the rebels have targeted physical infrastructure as part of their military strategy. The main targets have been telecommunication lines, railroads, bridges, and roads. In addition to this, the rebels have looted and destroyed housing, schools, and health facilities. A survey carried out of households in Northern Uganda found that 90% of the respondents from Acholi and Langi districts had lost all their assets.[210] Their houses were bombed, their household belongings such as bicycles and furniture had been looted, and their cattle had

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[207] Nannyonjo.
[208] *Ibid*.
[209] "Survey on war-affected North."
[210] "A Third of Adults Abducted in the North," *The New Vision* (August 13, 2007), online: New Vision <http://www.newvision.co.ug/detail.php?mainNewsCategoryId=8andnewsCategoryId=12andnewsId=581204>.

been stolen by soldiers. With the sale of cattle being the principal source of income,[211] this looting has directly depleted the tax base from which revenue for local and national government could be collected. The pre-war transport system had been a large foreign income earner that was lost once the war intensified.[212] Infrastructure is an important determinant of economic growth, and so its destruction on such a large scale has become significant impediment to investment.[213]

Diversion of scarce resources from more productive activities, such as education or provision of infrastructure to directly enhance the economy, in order to fund the war, in turn reduces the size of trading networks. As the government of Uganda has increased its military expenditure to fund opposition to the rebels, this spending has directly reduced economic growth. Research has shown that during peacetime, the average developing country spends about 2.8% of its GDP on the military. However, during civil war, on average this increases to 5.0%.[214] The cost of Uganda's civil war has been estimated at US$1.7 billion over the course of the last two decades.[215] The average annual cost of the war was estimated to be US$85 million.[216]

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[211] Anke Hoeffler, "Measuring the Costs of Conflict" (March 2003), online: Graduate Institute of International Studies, Geneva <heisun1.unige.ch/sas/files/portal/issueareas/victims/Victims_pdf/2003_Hoeffler_Reynal.pdf> [hereafter referred to as 'Hoeffler'].
[212] Hoeffler.
[213] Klaus Deininger, "Causes ad Consequences of Civil Strife: Micro-level Evidence from Uganda," online: Oxford Economic Papers <http://www.econ.brown.edufac/Herschel_Grossman/Courses/182,222papers/Deininger.pdf> [hereafter referred to as 'Deininger'].
[214] Hoeffler.
[215] Civil Society Organisation For Peace in Northern Uganda,"Counting the Cost: 20 Years of War in Northern Uganda," online: Oxfam International
Footnote continues on next page

The instability that violence inevitably generates also impairs economic growth, incomes, and tax revenues. The localized collapse of order extends impunity to criminal and other anti-social behavior.[217] Frightened people flee from their homes, leaving behind the few assets they once owned.[218] This inevitably increases poverty levels and puts people in a position where they cannot afford to pay taxes. Also, in response to heightened uncertainty, people invest less and retreat into those activities that are less vulnerable, even though they may not generate as much revenue. The insecurity that follows civil strife leads to disinvestment or diversion and expatriation of assets by private investors to sectors less vulnerable to war.[219] The effect of this is to increase poverty in the area as business firms and trade activities are closed down, leaving people with no means of earning income. Also, the government which relies on businesses and corporations for tax revenues has lost taxpayers who have moved to more stable countries.

IV THE INFORMAL SECTOR

One of the challenges facing African countries in this decade is mastering the dynamics of the informal sector, which is now emerging as a significant element in African development.[220] The informal sector forms an important segment of the African

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www.oxfam.org/en/policy/briefingnotes/report_CSOPNU_nuganda_060330/sendto_form [hereafter referred to as “20 Years of War”] .

[216] “20 Years of War.”

[217] *Ibid*.

[218] Deininger.

[219] *Ibid*.

[220] United Nations, *Informal Sector Development in Africa* (New York: United Nations, 1996) at 1 [hereafter referred to as ‘UN, *Informal Sector’*].

economies and cannot be ignored in attempts to further economic recovery, especially through improved tax policies. Uganda is no exception.

Researchers who are concerned with the shadow economy not only face difficulties in measuring it, but also in defining it. This is reflected in the variety of names used to identify it: shadow, informal, hidden, black, underground, gray, clandestine, illegal, unreported, non-cash, and parallel.[221] The best definition is 'all currently unregistered economic activities that contribute to the officially calculated (or observed) Gross National Product.'[222] Smith defines this sector as market-based production of goods and services, whether legal or illegal, which escapes detection in the official estimates of GDP.[223] It has also been broadly defined as those economic activities and the income derived from them that circumvent or otherwise escape government regulation, taxation, or observation.[224]

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[221] Matthew H. Flemming, John Roman and Graham Farrell, "The Shadow Economy," (2000), 53:2 *Journal of International Affairs* at 387, online: Columbia University < http://www-staff.iboro.ac.uk/~ssgf/PDFs/shawow%20Economy.pdf> [hereafter referred to as 'Flemming'].

[222] Friedrich Schneider and Enste Hernando de Soto, *The Other Path: The Invisible Revolution in the Third World* (N.Y. Harper and Row, 1989) [hereafter referred to as Schneider al de Soto 1989], cited in UN, *Informal Sector* at 389.

[223] Philip Smith, "Assessing the Size of the Underground Economy: The Canadian Statistical Perspectives" (1994), 11:110 *Canadian Economic Observer* at 3, 16-33, cited in Flemming at 389.

[224] Friedrich Schneider, *Shadow economies of 145 countries all over the world: What do we really know?* (Durham: Durham Univ., 2005) (Working Paper No. 4), online: Durham University <www.dur.ac.uk/john.ashworth/EPCS/Papers/Schneider.pdf> [hereafter referred to as 'Schneider, *Shadow Economies*'].

An alternative approach posits that shadow economic activities are best defined with respect to the particular behavioral characteristics of the activities in question.[225] In most developing countries like Uganda, activities that are classified as comprising the shadow economy include small enterprises and businesses that operate outside the formal economy, utilize lower levels investment, require less demanding skills, and produce relatively simple products.[226] In terms of workforce, small enterprises may employ from one or two persons to ten or more employees or working family members.[227] In urban areas, they range from street vendors to small manufacturing entities, while in rural areas, small enterprises engage in the production and sale of farm products, handicrafts, and services.[228] It is important to note that the informal sector as understood here does not include illegitimate activities such as smuggling, drug dealing, or armed robbery; those illegal activities may provide an income to those who engage in them, but add little value to the society and the economy.[229]

Estimating the size of the informal economy is very difficult because the essence of this area of economic activity is that people who engage in these activities do their best to avoid detection. However, studies show that the shadow economy in developing countries appears in many cases to be much larger than in transitional or developed

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[225] Flemming.
[226] UN, *Informal Sector*.
[227] *Ibid*.
[228] Samuel Fambon, "Taxation in Developing Countries: Case Study of Cameroon" (Helsinki: World Institute for Development Economic Research, 2004) (Research Paper No. 2006/02) online: United Nations University Wider <www.wider.unu.edu/publications/rps/rps2006/rp2006-02.pdf > [hereafter referred to as 'Fambon, 2006'].
[229] Fambon, 2006.

economies.[230] A study of African countries from 1999 to 2003 concluded that the shadow economies in these African economies had increased steadily during those four years.[231] On average, the size of these 37 African shadow economies was 41.3% of official GDP in 1999/2000, and had increased to 43.2% of GDP in 2002/2003. This is an average annual increase of 0.9 % in each of four years.[232] In Uganda's case, the average size of the shadow economy was found to have steadily increased from 43.1% in 1999/2000 to 45.4% in 2002/2003.[233] Obviously, policy makers ought to be concerned about the ever-expanding shadow economy. As Tanzi noted in his study, "there cannot be any question that the underground economy is a real phenomenon with important implications that deserve attention and study." [234] From the point of view of assessing the fiscal needs of the state and optimizing tax revenues, the informal or unreported sector in Uganda is of great importance.

A The Main Causes of Shadow Economies

The fact that the informal sector is being ignored by policy makers does not erase the fact that it is steadily growing and will continue to negatively affect state functioning and tax policy if it is not addressed. There are a number of factors that explain the growth of the informal sector in Uganda as well as other developing countries. The growth of population and hence of the labour force has been rapid, despite major demographic

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[230] Schneider, *Shadow Economies*.
[231] *Ibid*.
[232] *Ibid*.
[233] *Ibid*.
[234] Vito Tanzi, "Uses and Abuses of Estimates of the Underground Economy" (1999), 109 *Economic Journal* at 388 [hereafter referred to as Tanzi, 1999].

dislocations caused by the HIV/AIDS epidemic and the civil war in Northern Uganda. Although agricultural output has increased, employment in agriculture has not increased significantly but has been stagnant or falling, creating pressure to create additional jobs outside agriculture.[235] In the 1990s, Uganda was one of the low- income countries advised to adopt the structural adjustment programs (SAPs) by the international financial institutions in an effort to contain the debt crisis.[236] SAPs introduced a number of policies such as retrenchment of the civil service, privatization of public enterprises, and anti-inflationary monetary policies. The retrenchment policy sought to reduce government's budgetary expenditures by reducing the number of employees in government service.[237] The civil service staff level fell from 320,000 civil servants in 1990 to 150,000 by 1995.[238] Additionally, about 30,000 staff were made redundant through privatization.[239] This has contributed to the expansion of the informal sector, because those employees had to find work elsewhere.[240]

At the same time, tax and social security rules place pressure on small enterprises to operate informally and outside the official reporting system.[241] The bigger the difference between the total cost of labour in the official economy and the after-tax earnings from

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[235] UN, *Informal Sector* at 1.
[236] Moses Kiggundu, "Retrenchment Programs in Sub-Saharan Africa: Lessons for Demobilisation" (2007), online: Bonn International Center for Conversion <www.smallarmssurvey.org/files/portal/spotlight/disarmament/disarm_pdf/1997_Kiggundu.pdf> [hereafter referred to as 'Kiggundu, 2007'].
[237] Kiggundu, 2007.
[238] Matthew Baird, "The Global Influence of New Public Management: Case Studies of Africa," online: Villanova University [hereafter referred to as 'Baird'].
[239] Baird.
[240] UN, *Informal Sector*, 1996.
[241] Schneider and de Soto, 1989.

work, the greater the incentive to avoid incurring labour costs by working in the shadow economy.[242] Similarly, increase in the number and nature of government regulations, often measured in the numbers of laws and regulations like licenses, is another factor that reduces the economic benefit of participating in the official economy. Regulations lead to a substantial increase in labour costs in the official economy. But since most of these costs can be shifted to employees, these costs provide another incentive to work in the shadow economy, where they can be avoided.[243] Structural factors such as sparse infrastructure, low levels of education, lack of systems in place to detect taxpayers, and weak and arbitrary enforcement of tax laws are exacerbated by weak and inefficient tax institutions, all of which contribute to the growth of the informal sector.[244]

The existence of refugees from other countries affected by political tension, such as Rwanda, Kenya, Sudan, Somalia and Ethiopia, has fuelled the growth of the informal sector. Even as Uganda's refugee policy had been praised by the international community for providing refugee assistance, refugees are facing discrimination when enrolling in schools or applying for jobs.[245] This forces them to look for employment or create their own income-generating activities in the informal sector.

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[242] UN, *Informal Sector*, 1996, at 389

[243] Schneider, *Shadow Economies.*

[244] Friedrich Schneider and Dominik Enste, "Hiding in the Shadows: The Growth of the Underground Economy" (2002), 30 *Economic Issues*, online: IMF <http://www.imf.org/external/pubs/ft/issues/issues30/index.htm> [hereafter referred to as 'Schneider and Enste, 2002 '].

[245] The Advocacy Project, "Uganda and UN Deny Assistance to Urban Refugees in Kampala, Charges Ugandan Advocacy Group." (Washington D.C.: The Advocacy Project, 2005), online: <http://www.advocacynet.org/resource/582>.

Like the substitution of unpaid and untaxed household work and childcare for paid work, those who have been moving into the informal economy in Uganda are responding to the inability of the state to meet basic human needs, and, in the case of those avoiding reporting requirements, are willing to risk detection and punishment to bypass the state.

B Tax Implications of the Informal Economy

The shadow economy is essentially unrecorded; therefore a number of people who earn incomes are not taxed, creating significant gaps in the tax base. Informal urban employment absorbs as much as 61% of the urban labour force in Africa.[246] Substantial proportions of total urban incomes in many countries are typically found in the informal sector -- 30% in Burundi, 44% in Madagascar, 58% in Senegal, and 68% in Mali.[247] The inability of governments to establish systems to detect incomes in the informal sector has resulted in overburdening those in the official sector with high tax rates to make up for revenue shortfalls.

Due to the unrecorded nature of the informal economy, official national income statistics cannot accurately represent the true state of a nation's economy.[248] Given that these statistics are employed to generate economic policies, inaccurate figures may lead to inappropriate or inefficient policy responses. Aggressive tax and regulatory regimes drive economic agents from the official sector into the shadow economy, further eroding the

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[246] Flemming.
[247] ILO, "World Employment Review" (Geneva: ILO, 1988) at 15, cited in UN, *Informal Sector* at 13.
[248] Schneider and Enste, 2002.

already small tax base.[249] Loayza notes that rational actors move to the shadow economy to escape the entry costs to legality, such as license fees and registration requirements, as well as the high costs of remaining legal rules, such as payment of taxes, governmental reporting requirements, and environmental regulations.[250] Growth of the shadow economy reduces state revenues, which in turn reduce the quality and quantity of publicly provided goods and services.[251] Due to revenue shortfalls, firms and people in the official economy will have to pay higher tax rates. These higher tax rates, combined with deteriorating public services, provide further incentives to join the shadow economy.

The shadow economy is an active component of Uganda's economy. People engage in the shadow economy for a variety of reasons, the most important of which is to avoid taxation. Hence the government has to approach tax policy reform with a view to decreasing the growth of the shadow economy. Also for the already-existing shadow economy, tax policy makers have to analyze how best to bring taxpayers into the assessment process on a long-term basis.

V BARRIERS TO EFFICIENT TAX ADMINISTRATION

While tax laws impose obligations on taxpayers to contribute to government revenues, the actual amount of revenues flowing into the hands of any government depends on the

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[249] Flemming.
[250] Flemming.
[251] Fambon, 2006.

effectiveness of its revenue administration.[252] Weakness in revenue collections leads to inadequate tax collections. For a number of reasons, efficient tax administration is a major problem in developing countries. Not only do developing governments face an uphill battle in bringing individuals and businesses into the taxation process, as discussed above, but governments face insufficient administrative staff with no skills, high levels of illiteracy among taxpayers and tax collectors, lack of sufficient computer equipment and facilities, and lack of reliable statistical data.[253]

Uganda has definitely made improvements in tax policy over the years, but it still lacks sufficient administrative capacity. This has been attributed to numerous barriers to efficient tax administration. Thus to improve revenue performance, Uganda has to depend highly on improving tax administration.[254] This is because good tax policy depends on effective tax administration to raise the revenue.[255] The Uganda Revenue Agency has to formulate a way to address each of these problems.

A major constraint in tax administration is the lack of adequate resources to sustain and facilitate the operation of tax authorities. Resources to administer a tax can generally be divided into two categories: human resources and physical resources. Human resources

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[252] Richard M. Bird, "Administrative Dimensions of Tax Reform" (2003), *International Tax Program Paper* 0302, online: University of Toronto < http://www.rotman.utoronto.ca/iib>. [hereafter referred to as 'Bird, 2003'].
[253] Jalia Kangave, "Improving Tax Administration: A Case Study of the Uganda Revenue Authority" (2005), 49 *Journal of Africa Law* at 145-176 [hereafter referred to as Kangave].
[254] Kangave.
[255] Jit B.S. Gill, "The Nuts and Bolts of Revenue Administration Reform," online: World Bank Group <http://www1.worldbank.org/publicsector/tax/NutsBolts.pdf>[hereafter referred to as 'Gill, "Nuts and Bolts"'].

include not only the number of tax officials but also the quality of tax officials.[256] Physical resources cover a wider dimension, ranging from office buildings and office equipment to vehicles and communication systems.[257] These are the resources required by the human resources in order to ensure compliance with tax laws. Due to financial constraints, many tax officials who are hired lack understanding of the tax laws they are administering, and the concepts of accounting that are essential to analyzing returns. The problem of inexperienced and unqualified personnel is worsened by lack of adequate training facilities and opportunities.[258] Most training undertaken in developing countries is general in nature, and certainly does not correspond with the particular reform strategies that are being undertaken by tax authorities.[259]

Lack of modern technology, especially computers, to facilitate the taxation process is another impediment to effective tax administration. Until recently, Uganda, like most developing countries, had to rely on manually entering taxpayer data into record books, and keeping a voluminous amount of tax information in print. Even with the advent of modern technology, the lack of resources to purchase equipment means that a number of tax offices still use highly ineffective manual systems of recording tax information. [260]

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[256] Gill, "Nuts and Bolts."
[257] *Ibid*.
[258] Vito Tanzi and Howell H. Zee, *Tax Policy for Emerging Markets: Developing Countries* (Washington, D.C.: IMF, 2000) (Working Paper WP/00/35), online: IMF < http://www.imf.org/external/pubs/ft/wp/2000/wp0035.pdf> [hereafter referred to as 'Tanzi and Zee, 2000'].
[259] Tanzi and Zee, 2000.
[260] Bird, 2003.

The effectiveness of tax administration is further hindered by the high levels of illiteracy in Uganda, especially in rural areas. According to the World Bank, 67% of the adult population in Uganda was literate in 2004, with literacy rates of 77% for the male population and 58% for the female population. The Ugandan National Household Survey found a much higher rate of literacy in urban areas (87%) compared to rural areas (65%) in 2003. This same survey found the literacy rate in Kampala for the population aged 18 and over to be as high as 93% in 2006. [261] The prevalence of illiteracy inevitably affects tax administration, because taxpayers are unable to file returns or record their income sources and expenditures. Hence tax authorities are usually unable to collect taxes from such people.

Despite these challenges, the Uganda government nonetheless has a duty to provide public goods and services, and promote economic development. This leaves the government in a position where they have to come up with measures to increase tax revenues. According to the 2006/07 financial year budget, the total amount of resources available is estimated at shillings 4,255 billion, representing an increase of 18% over the 2005/06 financial year.[262] Approximately 59% of the budget in the financial year 2006/07 is projected to be financed by domestic revenues, whilst the balance will be provided through the support from donor partners.[263] This represents a decline on the

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[261] Kangave at 145-176.
[262] Uganda, Ministry of Finance, *Background to the Budget for Financial Year 2005/06* (Kampala: New Vision Publication, 2006), online: New Vision < http://www.enteruganda.com/brochures/strategy_intro.html> [hereafter referred to as 'Uganda; *Background to Budget 2006*'].
[263] Uganda; *Background to Budget 2006*.

current financial year, when 60% of the budget was estimated to have been financed by domestic resources. Hence there is dire need for the government to increase revenue collections. This will necessitate policy makers to take into consideration the different social realities as they seek to improve existing tax instruments or as they come up with completely new tax instruments, if Uganda is to start raising more revenue.

VI CONCLUSION

This chapter has outlined the specific challenges tax policy in Uganda faces. It is undisputable that the far-reaching impact of the HIV/AIDS epidemic, the civil war in Northern Uganda, the expanding informal sector, and the government's limited capacity for effective tax administration all threaten the productivity and competiveness of the economy, and reduce the amount of revenue the government can collect. The government has to make itself more fiscally relevant to everyone in Uganda, and needs to find creative ways to do so. Appropriate policies must be sensitive to economic, social, and political realities. For example, the government could introduce tax policies aimed at assisting those affected by HIV/AIDS, civil war, and poverty. These could include health insurance benefits that entail free access to anti-retroviral treatment, and special care programs for the elderly or war victims. Tax exemptions and deductions on essential goods and services benefiting the low-income population could be introduced. These tax benefits would not only benefit those with low incomes, but would enable the government to give some of the potential taxpayers who have been hiding in the unrecorded economy incentives to join the recorded economy. The pros and cons of specific tax policy options and policy practices that can address these complex goals are discussed in the final two chapters of this thesis.

CHAPTER FOUR

POLICY ISSUES IN SELECTED MAJOR TAXES

I INTRODUCTION

The primary economic goal of developing countries is to increase the rate of economic growth, in order to bring them to levels of *per capita* real income comparable to those of developed countries.[264] Attaining this goal depends on the developing government's ability to provide additional basic government services, particularly in education, public health, and transport, and on achieving higher rates of capital formation in production facilities, whether undertaken in governmental or private sectors.[265] The key to economic growth is, of course, the transfer and better utilization of resources, not merely the shift in the location of money. Taxation is a primary instrument for the transfer of funds to the government in order to facilitate transfer of resources.[266] Complicating this process in developing countries is the difficulty of mobilizing sufficient revenue to satisfy overall revenue objectives while taking into consideration the unique conditions in each country.

Translating these general principles of development economics and governance into concrete tax and spending proposals for Uganda is complicated by the factors outlined in this thesis. Uganda is one of the poorest countries in existence, and the many challenges it faces have made it much more difficult for it to increase its tax revenue even at the pace

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[264] Milton C. Taylor, "Taxation for African Economic Development" (1970) 13:2 *African Studies Review* at 311-314 [hereafter referred to as 'Milton'].
[265] Milton.
[266] *Ibid*.

of other countries in Sub-Saharan Africa, which on average collect revenues equal to about 23% of GDP.[267] For the 2005/2006 fiscal year, Uganda reported a widening budget deficit of 9.2% compared to the previous financial year of 8.6%.[268] The need for the government to review its tax policies and come up with strategies to increase tax revenue is crucial.

Also very fundamentally, the challenges discussed in chapter three make it difficult to solve Uganda's revenue problems by simply implementing classical developed-country revenue-increasing strategies such as broadening tax bases, raising tax rates, and tightening up the enforcement systems. The impact of the HIV/AIDS epidemic and the ongoing civil war in Northern Uganda have affected the demographic profile of the country in a way that has decreased the number of adult workers, reduced literacy, increased the need for subsistence support in housing, water, food, health, and literacy, increased the burden of caregiving for children and ill people on older adults, predominantly women, and destroyed formal enterprises, thus pushing more workers into the informal economy. All of these effects make it much more difficult to collect traditional taxes like income taxes, value-added taxes, excise, and property taxes. These specific problems are exacerbated, from a revenue-generation perspective, by the size of the large and growing informal sector and the Ugandan government's inefficient tax

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[267] Torgny Holmgren, *et al*: *Aid and Reform in Uganda* -- *Country Case Study* (Washington, D.C.: World Bank) (1999), online: World Bank <www.worldbank.org/research/aid/africa/papers.html> [hereafter referred to as 'Holmgren'].
[268] Uganda, Ministry of Finance, Planning and Economic Development, *Background to the Budget for Financial Year 2005/06* (Kampala: New Vision Publication, 2006), online: New Vision < http://www.enteruganda.com/brochures/strategy_intro.html> [hereafter referred to as Uganda, *Background to Budget 2006*].

administration. In the face of such a combination of circumstances, simply increasing tax rates or tightening up penalties for tax avoidance creates the risk of overburdening those already devastated by the HIV/AIDS epidemic and/or civil war, and, at the same time, of driving productive workers and enterprises further into the unreported economy.

This chapter surveys the standard suggestions for improving the taxation process in developing countries with a view to highlighting strategies and reform measures that could potentially reach past these challenges to begin bringing people in Uganda into closer contact with the government. The critical perspective used in this discussion posits that just as governments should be selected by the people of Uganda, so too should all of the government's functions be designed to meet the needs of people in Uganda. This is an idealistic perspective, but as the discussion in this chapter demonstrates, it is a view that is beginning to influence the creation of new tax policies in developing countries.

II PERSONAL INCOME TAX

A Advantages of the Personal Income Tax

In developing countries, income taxation is widely accepted as the most suitable primary source of revenue[269]and remains the most effective way of reaching above-subsistence incomes.[270] A large portion of the revenues raised with personal income taxation is

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[269] Vito Tanzi and Howell H. Zee, *Tax Policy for Emerging Markets: Developing Countries* (Washington, D.C.: IMF, 2000) (Working Paper WP/00/35), online: IMF <http://www.imf.org/external/pubs/ft/wp/2000/wp0035.pdf> [hereafter referred to as 'Tanzi and Zee, 2000'].

[270] Vito Tanzi and Howell Zee, *Tax Policy for Developing Countries* (Washington, D.C.: IMF, 2001) (Economic Issues No. 27), online: IMF

Footnote continues on next page

obtained from civil servants, business executives, employees, and professional people. [271] The direct burden of the tax has the advantage of making people aware of their responsibilities to the government. Furthermore, the yield is more stable because it can be collected by employers, making it much more difficult for employees to evade it.[272] The personal income tax (PIT) conforms to widely accepted standards of equity, and can be used to improve distribution of income, although this is difficult to achieve.[273]

Current statistics from the Uganda Revenue Authority (URA) reflect these advantages. For the month of June 2006, domestic tax collections amounted to USh175.65 billion, against a target of USh161.31 billions, leaving a surplus of USh14.34 billions.[274] For the same period of time, indirect taxes left a shortfall of USh7.43 billions. [275] The personal income tax, also known as PAYE (Pay as You Earn), was the most productive direct tax, which actually produced a surplus of USh20.65 billion and easily offset the USh10.29 billion and USh3.53 billion shortfalls in corporate and withholding taxes. [276] The growth

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<www.imf.org/external/pubs/ft/issues/issues27/index.htm> [hereafter referred to as 'Tanzi and Zee, 2001'].

[271] Tanzi and Zee, 2001.

[272] Howell H. Zee, *Personal Income Tax Reform: Concepts, Issues and Comparative Country Developments* (Washington, D.C.: IMF, 2005) (Working Paper WP/05/87), online: IMF <www.imf.org/external/pubs/ft/wp/2005/wp0587.pdf> [hereafter referred to as 'Zee, 2005'] .

[273] Richard M. Bird and Eric M. Zolt, "Redistribution Via Taxation: The Limited Role of the Personal Income Tax in Developing Countries," International Tax Program paper 508 (Toronto: University of Toronto, 2005), online: University of Toronto <http://rotman.utoronto.ca/iib/ITP0508.pdf> [hereafter referred to as 'Bird and Zolt, 2005'].

[274] Uganda Revenue Authority, *Revenue Performance Report July to June 2005/2006* (Kampala: URA Corporate Services Department, 2006), online: URA <http://www.ugrevenue.com> [hereafter referred to as *Revenue Report 2005/06'*].

[275] *Revenue Report 2005/06*.

[276] *Ibid*.

in PAYE was attributed to growth in salaries, increased collection efforts, and increased terminal benefits due to restructuring of private organizations and government bodies.[277]

B Limitations of the PIT

Despite the fact that the PIT is generally very successful in mobilizing revenue when compared with other tax instruments, it suffers from obvious limitations in the context of developing countries. According to Tanzi,[278] the PIT has yielded relatively little revenue in most developing countries not only because of ineffective tax administration, but also because of the inherent narrowness of the tax base and the effect of graduated rate structures on taxpayer behavior.

(1) The rate structure

The graduated rate structures used in income taxation are often the most convenient and visible way for governments in developing countries to show their commitment to social justice and hence to gain political support for their policies.[279] However, the effectiveness of nominal rate progressivity in delivering effective rate progressitivity is usually undermined by the effects of very high marginal tax rates on high incomes. The number of individuals actually affected by the highest marginal tax rate is very small.[280] According to Tanzi, in a number of developing countries, a taxpayer's income must be hundreds of times the average *per capita* income before it enters the highest rate

[277] *Ibid.*
[278] Tanzi and Zee, 2001.
[279] *Ibid*. at 15.
[280] Bird and Zolt, 2005.

brackets.[281] At the same time, high tax rates may discourage savings and encourage evasion. This is of greater concern when the top marginal PIT rate exceeds the corporate income tax rate by a significant margin, because such a differential inevitably provides strong incentives for taxpayers to choose the corporate form of doing business purely for tax reasons.[282]

At the other end of the income range, even the lowest marginal income tax rates can discourage taxpayer compliance when liability for taxes impairs subsistence. In developed countries with stable and effective social assistance programs, this aspect of the PIT may not cause substantial compliance problems. But developing countries which provide the poorest members of society with limited or no social assistance leave potential taxpayers with little choice but to avoid the PIT completely.

In Uganda, entire sections of the population have been pushed into bare subsistence mode by the HIV/AIDS epidemic, civil war, and the slow rate of economic and governance development. In such circumstances, attempts to enforce payment of the PIT can drive people away from the taxation process even though they might be the beneficiaries of the lowest PIT rates.

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[281] Tanzi and Zee, 2000.
[282] *Ibid.*

(2) The tax base

The effectiveness of the PIT in Uganda is also undercut by the numerous personal exemptions and deductions that benefit those with high incomes, but that do nothing for those with average or subsistence incomes. (For example, the exemption of capital gains from the PIT and generous deductions for medical and educational expenses are completely irrelevant to those living on low or survival incomes).[283] The Ugandan Income Tax Act also provides numerous tax exemptions for salaries of potential taxpayers such as members of the armed forces, the police, prison service, and expatriate staff.[284] These exemptions and deductions further reduce the already narrow tax base, and thus reduce the amount of revenue collected.

Government interventions on behalf of taxpayers also reduce the revenue that can be raised by income taxes. Although graduated tax rates impose higher rates on the rich than on the poor, the economic and political power of the rich enables them to avoid paying taxes not only by lobbying against fiscal reforms that would increase their tax burdens, but also by obtaining government interventions.[285] This was evidenced in Uganda in the financial year 2005/2006, in which the government actually paid out USh20.36 billion in taxes on behalf of selected taxpayers. The Ministry of Finance instructed the Uganda Revenue Authority (URA) to consider these payments as non-resource, which drastically

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283 Joweria M. Teera, "Could Do Better: An Appraisal of Uganda's Tax Performance Relative to Sub-Saharan Africa," online: University of Bath <www.bath.ac.uk/cpe/workingpapers/Uganda-tax-performance.pdf> [hereafter referred to as 'Teera, Uganda's Tax Performance'] .
284 Republic of Uganda, *Income Tax Act*.
285 Tanzi and Zee, 2000.

reduced net government revenue collections by the same margin.[286] It is important to note that there is no defined policy as to who should benefit from such government interventions; they are completely discretionary. If the government continues to pay taxes on behalf of politically-favored taxpayers, then the URA's efforts to increase tax revenues will continue to be undermined.[287]

The expansion of the informal sector is another factor that radically negates the effectiveness of the PIT. As the informal sector grows, it literally erases substantial portions of the tax base. The informal sector contains high, middle, and low incomes, all of which are immune from taxes due to the simple fact that developing governments do not have the administrative capacities to identify these taxpayers, let alone assess and collect taxes from them. Tax authorities experience major problems in identifying informal sector activities, not only because they sometimes include illicit activities, but also because even legitimate activities are difficult to identify when they are mobile (e.g., traders), small-scale (e.g., basic services), or elusive (e.g., craftsmen carrying out small jobs for cash). These difficulties severely limit the personal and business income tax base that is known by and reported to the tax authorities. Usually only a fraction of small businesses in Uganda register with the tax authorities. Moreover, only a small share of the overall population is on the payroll of formal sector enterprises or the government, where recorded wages and salaries are readily observable and easily taxable through

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[286] *Revenue Report 2005/06*.
[287] *Ibid*.

employer withholding schemes.[288] Hence only a few people in the growing informal sectors pay personal income taxes, which leads to negative state growth factors in revenues.

(3) Ineffective tax administration

Ineffective income tax administration also limits the ability of developing countries to raise sufficient revenue through the PIT. Uganda suffers from a severe shortage of trained personnel for administrative work of all kinds, including income tax audits. Existing personnel are mainly employed to deal with the top income and wage earner groups, and standards of literacy and record keeping are such that accurate determination of income is virtually impossible.[289] Application of tax laws to subsistence farming income is particularly difficult because of the problems of determining the amounts and values of this income.[290] Tax administration is generally severely constrained in terms of resources and skills, and the government must often choose whether to go after the larger firms and individuals already in the tax net, where the potential tax revenue payback may be higher, or to pursue instead the less lucrative small taxpayers who are largely outside the tax net.[291]

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[288] Gunther Taube and Helaway Tadesse, *Presumptive Taxation in Sub-Saharan Africa: Experiences and Prospects* (Washington, D.C.: IMF, 1996) (African Department Working Paper WP/96/5), online: IMF <http://www.imf.org/external/pubs/cat/longres.cfm?sk=1993www.fiscalreform.net/library/pdfs/> [hereafter referred to as 'Taube and Tadesse, 1996'].
[289] Taube and Tadesse, 1996.
[290] Milton, at 182.
[291] Richard M. Bird and Sally Wallace, "Is it really Hard to Tax the Hard-to-Tax? The Context and Role of Presumptive Taxes," International Tax Program Paper 307 (Toronto: University of Toronto, 2003) [hereafter referred to as 'Bird and Wallace, 2003'].

C Possible Solutions

Several creative solutions have been devised in response to these problems: (1) use of presumptive taxation to create incentives for tax reporting and disincentives for not reporting; (2) changing the tax rates imposed on subsistence and low incomes; (3) creating positive benefits for entering the taxation process. Given the specific tax policy problems that have emerged in Uganda, each of these solutions would enhance the overall functioning of Uganda's PIT.

(1) Presumptive taxation

A number of countries have attempted to broaden their PIT tax base and increase revenues by applying various forms of presumptive taxation.[292] Presumptive taxation is designed to capture income that frequently escapes conventional taxation by presuming receipts of certain levels of income. Some presumptive PIT systems impose lump sum levies on small-scale businesses and activities, while others assess taxes by applying indicators or proxies to estimate a taxpayer's income (estimated assessments) or collect minimum taxes irrespective of a taxpayer's actual level of business activity (presumptive minimum taxes). [293] The positive incentive effects of a presumptive levy were elaborated decades ago by Italian economist Luigi Einaudi,[294] who noted that when all taxpayers are taxed on the basis of a presumptive "average" income and not on their actual income, they have an incentive to produce above the average, because this excess income is

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[292] Taube and Tadesse, 1996.
[293] *Ibid*.
[294] Vito Tanzi and Milka Casangera de Jantscher, *Presumptive Income Taxation: Administrative, Efficiency, and Equity Aspects* (Washington, D.C.: IMF, 1987) (Working Paper WP/87/54) [hereafter referred to as 'Tanzi and de Jantscher, 1987'].

essentially tax exempt. At the same time, a person with less than “average” income has an incentive to file a tax return that entitles them to a reduction in the amount of tax payable. Taxes based on "average" or "normal" incomes can thus have both positive and negative incentive effects if they are designed well.[295]

Presumptive taxation does have a number of shortcomings. A person on the margin between subsistence and market economy production may be driven back to the subsistence economy entirely by presumptive taxation.[296] Presumptive taxation is a crude tool that does not take account of taxpayer-specific conditions such as family size or exceptional losses in a given year that would normally be accounted for in conventional tax methods.[297] Many enterprises in the small but “modern” business sector are unable or unwilling to keep proper accounting records.[298] Unless fixed assessments are used, estimated assessments involve some degree of discretion on the part of tax assessors, who presume incomes and assess tax liabilities. This clearly is an invitation to corruption and favoritism, considering the generally low level of civil service salaries and the fact that tax administrations often lack adequate budgetary support and effective management. Discretion can also lead to inconsistencies, with taxpayers at similar income levels ending up with substantially different tax burdens, or taxpayers at very different income levels having to pay similar tax liabilities. In such cases, rather than

[295] Tanzi and de Jantscher, 1987.
[296] Milton at 312-314.
[297] Taube and Tadesse, 1996.
[298] Tanzi and de Jantscher, 1987.

enhancing horizontal equity, presumptive assessments may end up worsening it.[299] The intensified use of presumptive taxation is commendable, given the persistence and significance of the hard-to-tax groups, the considerable scope of tax evasion, and weak tax administration. However, intensified presumptive taxation does strengthen a government's ability to collect PIT and other revenues.[300]

Some of these shortcomings can be overcome by building incentives into presumptive taxation. For example, taxpayers who provide formal books of accounts and records documenting their actual PIT liability can be offered a bonus or tax credit. If a taxpayer could obtain forgiveness of say, 25% of their PIT return, the incentive to opt for actual PIT taxes instead of presumptive PIT taxes would be strengthened. More generous tax forgiveness programs could be used to "wipe the slate clean" as individuals and enterprises leave the informal sector and come forward to join the tax-paying economy.

A variation on presumptive taxation has been developed around industry and professional groupings, in which community groups support non-reporting groups in moving into the PIT process.[301] Whether structured around unions, neighbourhoods, or work activities, these identifiable groupings can be used to distribute educational information on the mechanics and benefits of paying the PIT, and can also help support new taxpayers

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[299] *Ibid*.
[300] Taube and Tadesse, 1996.
[301] Anuradha Joshi and Joseph Ayee, "Taxing for the State? Revenue and the Informal Sector in Ghana" (2002), online: Institute of Development Studies Sussex <http://www.ids.ac.uk/gdr/cfs/drc-pubs/summaries/summary%2014-JoshiAyee-taxingforthestate.pdf> [hereafter referred to as 'Joshi and Ayee, 2002'].

through the process of coming into the formal economy through any amnesty or forgiveness programs that might be offered.

The experience in Ghana, in which the Ghana Private Road Transport Union (GPRTU) has been used to collect taxes from the informal sector on behalf of the government,[302] offers an example of administrative innovation that could be used in Uganda to tax the informal sector through existing PIT mechanisms. In an effort to increase revenue and broaden the tax base in the 1980s, the government of Ghana negotiated with the GPRTU and other unions to act as tax agents on behalf of the government.[303] The new scheme, known as 'Identifiable Grouping Taxation,' was seen by union members as an improvement over the earlier scheme of presumptive taxation.[304] The earlier schemes of presumptive taxation required members to pay a lump sum whether or not they were working; the arrangement was time-consuming; and members were subjected to harassment if they did not pay.[305] In contrast, the new scheme involves daily collection of taxes, making payments small and affordable, and drivers do not pay this tax unless they are actually working.[306] The unions are entitled to retain 2.5% of all revenues collected, which give them incentives to maximize collection and also supports their development.[307] This program demonstrates that non-governmental organizations in the informal sector can be used to collect taxes effectively.

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[302] Joshi and Ayee, 2002.
[303] *Ibid*.
[304] *Ibid*.
[305] *Ibid*.
[306] *Ibid*.
[307] *Ibid*.

(2) **Changes to the rate structure**

Experiences with PIT reforms in developing countries suggest that the progressivity of effective tax rates could be improved by reducing the degree of nominal rate progressivity and the number of rate brackets, and exemptions, and deductions.[308] The use of tax credits instead of deductions and exemptions could be used to avoid inequalities in income they create.[309] The effectiveness of high marginal rates is known to be reduced by the fact that they do not produce much revenue, because relatively few taxpayers in developing countries have high incomes.[310] In addition, it is important to keep the top PIT rate roughly at the same level as the corporate income tax rate, because high PIT rates inevitably provide strong incentives for taxpayers to choose the corporate form of doing business purely for tax reasons.[311]

Changing tax rates is particularly important at the lower income levels, especially if the PIT is also being amended to provide positive cash benefits for entering into the taxation process. Creating a realistic zero-rated subsistence PIT tax bracket would send the message that low incomes are not subject to PIT. Keeping PIT tax rates low for low-middle and middle incomes would also reassure potential taxpayers that entering into the reporting process will not destroy their economic viability. Identifiable industry or taxpayer groupings can be invited to make recommendations on the rates of PIT that they could contemplate. While such a process of self-disclosure could be intimidating, serious

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[308] Tanzi and Zee, 2000.
[309] *Ibid*.
[310] Bird and Zolt, 2005.
[311] *Ibid.*

dialogue with government officials, especially if combined with an amnesty or tax forgiveness program, could overcome the fear factor.

(3) Integrating social benefits with the PIT

The use of tax expenditures to deliver social benefits normally delivered directly by the state to needy individuals is often criticized for lack of transparency, fiscal accountability, and universality.[312] Often criticized as being 'hidden expenditures,' tax benefits such as refundable child care or health care tax credits are not viewed with great favour in developed country PIT tax systems.

As outlined in chapter three, however, the very structure of impoverished and developing economies like that in Uganda creates very different considerations. No impoverished and poor households, individuals, and enterprises are utterly without means of subsistence, and, with effective resources, many can develop greater economic and income-earning capacities. Thus the use of the PIT to deliver much-needed social, development, and health assistance could create incentives to sign up for the PIT, and, over time, could simultaneously create the administrative machinery needed for the operation of the PIT. A number of programs carried out in other countries delivering earned income credits, health insurance benefits, and child tax benefits will be discussed below. These tax policy strategies can be used to deliver welfare to HIV/AIDS victims,

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[312] OECD, "Economic Survey of Turkey 2006: Enhancing competitiveness and growth and reducing incentives to operate in the informal economy," online: OECD <www.oecd.org/document/35/0,3343,en_2649_34327_37524707_1_1_1_1,00.html> [hereafter referred to as 'OECD, 2006'].

those caring for ill people and orphans, those displaced by civil wars, those seeking micro credit or small business development, and those seeking to move into the reporting economy.

(a) earned income tax credits (EITC)

Earned income tax credits (EITC) are used to reduce income inequalities. This is a special tax credit for low-income families that can reduce the amount of tax they owe and/or increase their tax refunds.[313] The objective of earned income tax credits is to encourage social assistance recipients to engage in paid employment through the provision of an earned income supplement that is designed to offset the loss of benefits and/or increased taxation and other costs associated with employment.[314] Versions of this tax credit have been enacted in a number of countries, including Canada, the United States, and the UK.[315] While the details of earned income tax credits vary substantially among jurisdictions, certain features are common to all versions of this credit: individuals are eligible if they have worked during the tax year; they must have incomes that are at or near the poverty line; and tax returns must have been filed in order to obtain the credit. If necessary, earned income credits can be structured to provide cash payments to taxpayers in transition. They can also be adapted to use for small businesses and agricultural

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[313] "Taxes and Growth," online: Monetary Policy, Fiscal Policy, and the Macro Economy <http://taxes and growth.ncpa.org/news/are-the-poor-staying-poor>.

[314] Sheena Starky, *Scaling the Welfare Wall: Earned Income Tax Credits* (Ottawa: Library of Parliament, 2006), online: Library of Parliament <http://www.parl.gc.ca/information/library/prppubs/prb0598-e.html> [hereafter referred to as 'Starky, 2006'].

[315] Starky, 2006.

enterprises.[316] Provision of this benefit would also create incentives for registering people from the informal sector who would want to benefit from it.[317] The tax credit is an incentive for people to join the paid work force, where they can learn skills that will enable them to increase their incomes with time, and thus, over time, increase the amount of revenues collectable by the government.

(b) health insurance benefits

Provision of health insurance to low income groups is another tax policy option that can be integrated into Uganda's tax system. This benefit will enable the government to deal with its main social problems: HIV/AIDS, poverty, and the informal sector. If managed and governed well this benefit can increase access to healthcare and increase the number of reporting taxpayers.[318] Community-based health care insurance might be important devices in extending coverage to those in rural areas and in the informal economy.[319] Community-based organizations can help sensitize the people about health tax benefits and support them in filing returns.[320] Ghana is the first African country to put health insurance into the legal framework, requiring subsidized health care for the people.[321]

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[316] *Ibid*.
[317] Caledon Institute of Social Policy, "A Working Income Tax Benefit that Works" (2005), online: Caledon Institute of Social Policy <www.caledoninst.org>.
[318] Karine Lamiraud, Frikkie Booysen and Xenia Scheil-Adlung, "The Impact of Social Health Protection on Access to Health Care, Health Expenditure and Impoverishment: A Case Study of South Africa" (2005), online: International Labour Organization <http://www.Geneva:ilo.org/public/english/protection/secsoc/projects/africa.htm> [hereafter referred to as 'Lamiraud and Adlund, 2005'].
[319] Lamiraud and Adlund, 2005.
[320] Mark V. Pauly, *et al*., "Private Health Insurance in Developing Countries" (2006), 25:2 *Policy Journal of the Health Sphere* at 369-379 [hereafter referred to as 'Pauly, 2006'].
[321] Lamiraud and Adlund, 2005.

The method of social assistance in Ghana is being used as a way of indirectly taxing the informal economy and thus a step forward to 'formalization' of the informal economy.[322]

(c) child tax benefits

Child tax benefits can be used to extend tax credits to poor families with children. Such tax benefits are delivered through the PIT in Canada, and will be used to illustrate how these credits work. Child tax benefits could be used in Uganda to assist elderly caregivers looking after orphans in absolute poverty due to the HIV/AIDS epidemic and the civil war, and would also be available to those people with low incomes. Under the Canada Child Tax Benefit (CCTB), all families with children whose income is below a low-income threshold receive this benefit regardless of the source of that income.[323] The benefit begins to decline as income rises above the threshold.[324] The CCTB is available to taxpayers with children below 18 years and who are employed.[325] The CCTB is adjusted each year to keep pace with inflation. Depending on how poor the parents are, the CCTB currently provides an annual tax exempt cash benefit of approximately $1,500 to $3,500 for a child under 7, $1,300 to $3,200 for a child over 7, and slightly smaller amounts for each additional child.[326] This provides horizontal equity by recognizing the

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322 *Ibid*.
323 Cindy Wiggins, *The Canada Child Tax Benefit* (Ottawa: Canadian Labour Congress, 1997) (Research Paper No. 8) at 1-5 [hereafter referred to as 'Wiggins, 1997'].
324 Wiggins, 1997 at 2.
325 *Ibid*.
326 Gordon Ternowetsky and Jane Pulkingham, *The New Canada Child Tax Benefit: A Critical Commentary* (Child Welfare Research Centre, University of Northern British Columbia, 1997) [hereafter referred to as 'Ternowetsky and Pulkingham, 1997'].

number of children in a family, and vertical equity because it is based on the economic situation of families.[327]

The CCTB has been criticized for reinforcing discrimination because it requires some lowest-recipients to participate in workfare programs.[328] Those negatively affected by this requirement are the poorest of the poor, usually single mothers, who are on income assistance and have no alternative way of supporting themselves.[329] This could be a problem in Uganda, because the majority of the people who would benefit from such child tax benefits are unemployed. Therefore it is crucial for the Ugandan government to take into consideration the people that the benefit is targeting while designing it to ensure they are not placed at further disadvantage by such requirements. In particular, older caregivers and those who are themselves ill, disabled, or denied access to workfare by social dislocation should be exempt from such requirements.

III CORPORATE INCOME TAX

A Advantages of Corporate Income Taxation

The popular rationale for corporate taxes is ability to pay. Since corporations are separate legal 'persons' and most of them have a lot of money, they must have substantial 'ability to pay' their taxes.[330] In developing countries, most of the large taxpayers are

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[327] Ternowetsky and Pulkingham, 1997.
[328] Wiggins, 1997 at 2.
[329] Ternowetsky and Pulkingham, 1997.
[330] Richard M. Bird, *Why Tax Corporations?* (Ottawa: Finance Canada, 1996) (Working Paper 96-2), online: Department of Finance Canada <www.fin.gc.ca/taxstudy/wp96-2e.pdf> [hereafter referred to as 'Bird, 1996'].

easily identifiable; hence they are easily taxed. It is convenient to utilize corporations as agents to collect taxes from customers (sales tax), employees' payroll and personal income taxes, and owners (dividend and withholding taxes).[331] The incidence of corporate income taxes (CIT) is progressive, to the extent that corporate taxes reduce the income of the shareholders who, compared to non-shareholders, are, on average, rich.[332]

B Limitations of the CIT

Corporation taxes in developing countries tend to be fairly inefficient. Provisions that make sense in more developed economies tend to narrow the CIT tax base without having any noticeable incentive effects. For example, multiple rates differentiated along sectoral lines, exemption from tax of certain sectors, and allowable depreciation of physical assets for tax purposes tends to narrow the tax base.[333] In Uganda, CIT revenues are in decline.[334] The 2005/2006 Revenue Performance Report reveals that the annual corporate tax collections posted a cumulative deficit of USh10.29 billion.[335]

This section will not attempt to discuss all the above problems with the CIT. Instead the focus will be on the challenges faced by small businesses in Uganda as they attempt to enter the formal sector. The conventional practice in developing countries has been to devote scarce administrative and collection resources to large taxpayers, and to ignore

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[331] Bird, 1996.
[332] *Ibid*.
[333] Tanzi and Zee, 2001.
[334] *Revenue Report 2005/06.*
[335] *Revenue Report 2005/06.*

small businesses that generally do not generate substantial levels of tax revenues. [336] Failure to target small businesses leads to missing a potentially large source of growth in the economy. In Uganda, like other developing cities, much of the economy is made up of small businesses, most of which are informal. By neglecting this large sector of the economy, the government ignores future sources of sustainable, domestically-generated economic growth.[337] It also ignores the opportunity to assist women in joining the formal economy and thus accessing resources to support the growth of their enterprises.[338] There is extensive evidence that small businesses in the informal sector in developing countries are capable of considerable growth and can generate substantial incomes.[339] Hence there is need for government to encourage small firms to enter the formal sector and in the long run reduce the burden on the existing narrow tax base in the formal sector.

Uganda has a flexible regime for small businesses; they can either pay corporate income taxes at the rate of 30%, or can pay presumptive taxes of 41% on turnover. Most small businesses opt for presumptive taxation, although due to their difficulty in maintaining proper accounting records, they have great incentive to under-report turnover.[340] In instances when informed and profitable small businesses opt for the corporate income option, in practice there is considerable confusion about the nature of expenses that

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[336] Richard E. Stern and Paul A. Barbour, "Designing a Small Business Tax System that Enhances Growth: Lessons from Africa" (2005), online: World Bank Group <www.fias.net/.../$FILE/Taxing+SMEs+in+Africa_Richard+Stern+and+Paul+Barbour.pdf> [hereafter referred to as Stern and Barbour, 2005].
[337] Signe-Mary Mckernan and Mark M. Pitt, "Use of the Formal and Informal Sector: Does Gender Matter?" (Washington D.C.: World Bank, 2005) (Paper 3491) [hereafter referred to as Mckernan and Pitt, 2005].
[338] Mckernan and Pitt, 2005.
[339] Stern and Barbour, 2005.
[340] Teera, "Uganda's Tax Performance."

qualify for deduction from taxable income. This results in small businesses opting for presumptive taxation, which does not contribute to crediting or strengthening a culture of compliance among small businesses. [341]

C Possible Solutions

Small businesses in Uganda exhibit high levels of informality against a backdrop of poverty and lack of access to education. Under these conditions, it would be wise of the government to invest in tax programs that will move firms from the informal sector to the formal sector, thus bringing small firms into the tax net. Such programs could be designed to ease the process of small businesses opting into the formal sector, and could include the use of incentives, development grants, training programs, and tax amnesties to make the move from the informal to formal economy worthwhile.

The CIT should be designed to encourage small businesses to join the formal sector. Firms should be assured of receiving benefits for joining the culture of compliance which at least neutralize the financial cost of paying taxes.[342] Small firms should be offered amnesty so that they do not have to pay taxes on incomes earned while they were operating in the shadow economy. Small firm owners should be offered free training on how to comply with the law, basic accounting skills, business management skills, and opportunities to access finances, markets, and cooperatives. The actual tax burden on small firms should be reduced by establishing exemptions, credits, and deductions

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[341] Stern and Barbour, 2005.
[342] *Ibid*.

targeting small businesses.[343] These types of provisions would produce short-and long-run results. In the short run, the number of small firms in the tax system would rise, and capacity-building would occur. In the long run, many of these firms will grow and become larger taxpayers, which will enhance revenue production through the CIT.

IV VALUE ADDED TAX

The introduction of value-added taxation (VAT) in 1996 to replace the sales tax and the commercial transaction levy (CTL) was one of the reforms carried out by the government of Uganda in order to improve revenue administration.[344] The remarkable growth in tax revenue from 7.8% of GDP in 1990/1991 to 12.6% in 2003/04 was the result of the introduction of the VAT.[345] It was observed that the existing patterns of sales taxes and the commercial transaction levy at the time were ineffective in collecting revenue, worsened by the fact that the taxes met a lot of public resistance because they were selective and based on too narrow a range of transactions.[346] Sales taxation on domestic production was limited to the manufacturing sector, which put a disproportionate tax burden on their operations, while the CTL applied to the service sector.[347] Hence it was suggested that instead of relying on a system which taxes some forms of consumer spending but not others, it would be better to replace them with a general consumption tax that falls more evenly on a much wider range of consumer spending in the domestic

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343 *Ibid*.
344 Ayoki Milton, Marios Obwana and Moses Ogwapus, “Tax Reforms and Domestic Revenue Mobilization in Uganda” (2005), online: Global Development Network <www.gdnet.org/middle.php?oid=361> [hereafter referred to as ‘Ayoki and Ogwapus, 2005’].
345 Ayoki and Ogwapus, 2005.
346 Teera, “Uganda’s Tax Performance.”
347 *Ibid*.

economy, because low income people pay disproportionately high taxes under the current scheme.[348]

The VAT has provided a valuable alternative tax source, especially because of its buoyant revenue base.[349] A recent IMF study has concluded that the VAT can be a good way to increase tax revenues and modernize the overall tax system.[350] According to Uganda's June 2005/2006 revenue report, the government has raised the standard VAT rate from 17% to 18% in order to generate an additional USh38.6 billion in revenue.[351] A gross surplus of USh13.93 billion was recorded for VAT from local suppliers and imports.[352]

A Advantages of the VAT

The VAT is generally believed to be non-distortionary, provided there are few exemptions and little zero-rating. However, it is increasingly accepted that zero-rating is necessary to achieve social justice and security in harsh economic conditions.[353] When the VAT on investment is fully credited, it is an improvement over older taxes on capital

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[348] *Ibid*.
[349] Ayoki and Ogwapus, 2005.
[350] Liam Ebrill, *et al*., "The Allure of the Value Added Tax" (2002), *Finance and Development Quarterly Magazine* 39:2 online: IMF <http://www.imf.org/external/pubs/ft/fando/2002/06/ebrill.htm> [hereafter referred to as 'Ebrill, 2002'].
[351] *Revenue Report 2005/06*.
[352] *Ibid*.
[353] Richard M. Bird and Pierre-Pascal Gendron, "Is VAT the Best Way to Impose a General Consumption Tax in Developing Countries?" (Toronto University, Toronto, 2006) (ITP Paper 0602) [hereafter referred to as 'Bird and Gendron, 2006'].

goods.[354] The VAT generally replaces inefficient, distortionary, and badly administered taxes that cascade liabilities, use many tax rates, tax capital goods and exports, favour imported goods, reduce the base, and frequently involve an antiquated and corrupt administration.[355]

With the introduction of the VAT, the economic costs and risks of collecting revenue will decline as the entire production and distribution chain becomes involved in collecting this tax, because this spreads the costs and risks of collection over a much larger number of transactions.[356] The VAT has also helped to facilitate trade by exempting exports, removing hidden subsidies, and placing the taxation of imports and domestic production on the same level playing field.[357] On the whole, the VAT's effects on trade have been considered to be largely beneficial, with economists applauding the level playing field for imports and governments generally paying more attention to the removal of barriers to exports.[358]

Studies of the impact of the VAT in developing countries are still few, but there is growing evidence that the VAT is not an especially regressive tax.[359] For example, studies in Cote d'Ivoire, Guinea, Madagascar, and Tanzania all show that the poor pay

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[354] Bird and Gendron, 2006.
[355] Tanzi and Zee, 2000.
[356] Richard M. Bird, "Value Added Taxes in Developing and Transitional Countries: Lessons and Questions" (Rome: International Tax Dialogue Conference on VAT, 2005) [hereafter referred to as 'Bird, VAT, 2005']
[357] Bird, VAT, 2005.
[358] Bird, VAT, 2005.
[359] Ebrill, 2002.

less than their share of total VAT revenues, when measured against their share of consumption. Hence the VAT has proved to be more progressive than the trade taxes it often replaced.[360] In terms of simplicity, the VAT can facilitate substantial improvements in overall tax administration, particularly the establishment of more integrated tax administrative systems and the development of modern procedures based on voluntary compliance. In many countries, activities taking place in the informal sector of the economy generally escape the direct tax system. However, an indirect tax such as the VAT can be used to tax invisible taxpayers such as non-reporting plumbers and other home repair enterprises that buy supplies from registered taxpayers.[361]

B Limitations of the VAT

As in many developing countries, VAT has become the workhorse of the revenue system in Uganda because direct taxation continues to be relatively ineffective. However, Uganda's VAT has clearly become less efficient as a revenue-producer. The revenue yield of VAT as a share of GDP has declined since it came into full effect in 1996. Such a prolonged decline is attributed to a number of shortcomings, such as an incomplete design of the VAT; the complexity of VAT assessments; the existence of numerous exemptions; the presence of the informal sector; and the use of multiple VAT rates.

The success of the VAT cannot be taken for granted; it requires good design and implementation. In many developing countries like Uganda, VAT suffers from being

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[360] *Ibid*.
[361] Bird and Gendron, 2006.

incomplete in one aspect or another, leading to less revenue being collected. In the June 2006 Revenue Performance Report it was noted that government VAT payments of USh20.3 billion left a net shortfall of USh6.43 million.[362]

VAT is often thought to be an intrinsically complicated tax, cumbersome for both taxpayers and authorities. In developing countries, where even basic record-keeping abilities may be limited, it can be especially difficult to implement a VAT.[363] The effectiveness of the VAT is further undermined by the difficulty of implementing workable self-assessment systems, under which taxpayers declare and pay taxes on the basis of their own calculations, subject to the possibility of later audit by tax authorities.[364] Government's inability to give prompt refunds of excess credits to certain taxpayers, particularly exporters, reduces the effectiveness of VAT because exports are zero-rated, exporters have no output tax liability, and are entitled to a refund of the tax paid on their purchases.[365] Failure to provide prompt refunds detracts from the merits of the tax.[366]

Uganda provides for a wide range of zero-rated and exempt goods under its VAT. However, the threshold income for compulsory registration for VAT in Uganda is annual turnover of about US $27,000.[367] This threshold is much lower than in Kenya

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[362] *Revenue Report 2005/06*.
[363] Ebrill, 2002.
[364] Bird, VAT, 2005.
[365] *Ibid.*
[366] Ebrill, 2002.
[367] Teera, "Uganda's Tax Performance."

[US$47,000], Botswana [US$50,000], Lesotho [US$39,000], Ghana [US$75,000], Mauritius [US$71,400], and South Africa [US$40,000].[368] Uganda's low threshold presents compliance and equity problems. For example, in Uganda, which has a substantial agricultural sector,[369] the VAT from agriculture accounts for nearly 40% of GDP in Uganda, compared to less than 20% in Kenya, 6% in Mauritius, 11% in Namibia, and 16% average of Sub-Saharan Africa.[370] Although Uganda's agricultural sector is predominantly made up of small land holdings that usually only provide subsistence, agriculture still bears a heavy VAT burden overall, because many important sectors, most notably services, wholesale sales, and retail sales, are all exempt from the VAT.[371]

Some analysts suggest that in the presence of a substantial informal sector, a tax like the VAT that falls on the formal sector impedes economic growth and development.[372] Indeed, a recent study concludes that increasing consumption taxes definitely fosters the expansion of the hidden economy if the labour intensity of the production in that sector is greater than in the formal sector.[373] The right way to implement VAT is through self-assessment. However, potential taxpayers have many ways to escape being taxed. They may flee abroad; they may remain hidden in the informal economy; or they may secure some form of favorable treatment by exerting influence to have changes made in law.

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[368] *Ibid*.
[369] Holmgren.
[370] Ayoki and Ogwapus, 2005. These countries were used for comparative purposes based on availability of data.
[371] *Ibid*.
[372] Bird, VAT, 2005.
[373] *Ibid*.

This has resulted in the erosion of the base of the VAT through concessions at many levels as well as through general administrative weakness.[374]

Many developing countries have adopted multiple VAT rates. Multiple rates are politically attractive, but they are not administratively effective, because they tend to be regressive.[375] The conventional argument that there is unlikely to be much point in imposing differential ‘luxury’ rates under a VAT given the efficiency and administrative costs to which such differentiation gives rise, seems convincing.[376] But the conventional case for imposing VAT at a uniform standard rate and on as broad a base as possible in more developed countries seems less convincing in developing countries like Uganda. A uniform VAT is likely to be regressive because it will necessarily increase the price of many goods essential to the poor, even though the poor will consume relatively small amounts of such products and much of the benefit of special exemptions or low rates may go to the non-poor.[377]

Despite these criticisms of the VAT, the VAT is still the best form of general consumption tax for developing countries. However, the VAT could be designed better to fit the circumstances of Uganda, and it could certainly be administered better. Therefore the government of Uganda has to rethink the design of its VAT and work at implementing it.

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[374] *Ibid*.
[375] Tanzi and Zee, 2000.
[376] *Ibid*.
[377] Bird and Gendron, 2006.

C Possible Solutions

Uganda can solve most of the technical problems outlined above in ways that improve revenue production through value-added taxation. There are ways to remove inequities from the VAT and turn it into a mechanism for improving equity among taxpayers and improving the overall administration of the tax system.

(1) Technical adjustments

The targeting of zero rating can be improved by carefully analyzing the level and form of relief that is best suited to the particular circumstance of Uganda. At the same time, the extension of the VAT to services must be considered. This must be an ongoing process, with these issues being revisited as circumstances change.[378]

In general terms, the list of VAT exemptions should be kept to a minimum in order to broaden the tax base, facilitate compliance by taxpayers, and improve tax administration.[379] The use of zero rates should be discouraged unless required by international agreements, because extending zero rates results in more difficult control systems, an increased number of refund claims, and heavier administrative burdens.[380] A more systematic approach to assembling and analyzing data would improve the administration of the VAT.[381] Even when data is available, considerable effort is required to put such data to any useful purpose, whether to analyze and improve the

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[378] Bird, VAT, 2005.
[379] Tanzi and Zee, 2001.
[380] *Ibid*.
[381] Ayoki and Ogwapus, 2005 at 17.

effects of the VAT structure or to monitor and improve its administration. The exemptions for small and seasonal enterprises should be increased in order to bring them more into line with those in neighboring countries, but businesses should have the option to opt into the VAT if they want, or could be permitted to deduct VAT taxes paid under the PIT.[382] Technical assistance in teaching people how to file returns should be carried by using identifiable organizations such as unions, neighborhoods, community-based organizations, and microfinance institutions. Systematic assembly and analysis of data would enable the government to monitor trends and changes in taxpayer behaviour in order to develop appropriate rates and exempt ranges.[383]

(2) Equity considerations

The overall levels of poverty in Uganda, the devastating impact of the HIV/AIDS epidemic on individual and household incomes, the workforce, and business, and the literal disappearance of existing social and governance structures in Northern Uganda all point to the unfairness of treating those with little or no income as if they can pay VAT at the same rates as everyone else. While the great advantage of a VAT is that it can potentially reach every cash-based transaction and many in-kind exchanges as well, this also makes it very difficult for those facing subsistence issues to meet their basic survival needs.

[382] Tanzi and Zee, 2000.
[383] Ayoki and Ogwapus, 2005 at 19.

The obvious solution to this is to implement a generous VAT tax credit or refund scheme that reaches all those in this category. The Canadian Goods and Services Tax Credit (GST credit) illustrates this type of adjustment. The GST credit is carefully designed to benefit low-income people.[384] The government of Canada introduced the GST along with the GST credit in 1991 to help low-and modest-income individuals and families purchase goods and services that had become more expensive overnight because end-point consumers pay the full price of the VAT.[385] The Canada Customs and Revenue Agency pays the GST credit quarterly to individuals and families with low and modest incomes to help offset some or all of the GST they pay. This tax credit is fully refundable in the form of cash, and it is tax exempt.[386] The GST credit is structured as a tax credit for each qualifying adult and child, which means that claimants have an incentive to file income tax returns in order to receive the credit.[387]

In the context of Uganda, such a credit mechanism would help overcome longstanding distrust of government officials and would offer people a positive reason to begin documenting their incomes and existence with the tax authorities. Such a tax credit system would genuinely ameliorate poverty and show people that tax systems are designed to enable the state to better meet their needs. Thus they would be given an

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[384] Poverty Primer: *A Comprehensive Strategy to Reduce Poverty and Inequality in Canada* (Ottawa: Canada Centre for Policy Alternatives, 2007), online: Canada Centre for Policy Alternatives
<http://www.policyalternatives.ca/documents/National_Office_Pubs/2007/AFB2007_Poverty_Primer.pdf > [hereafter referred to as ‘Poverty Primer, 2007’].
[385] Government of Canada, “The GST and the Poor” (January 1990).
[386] *Ibid*. The GST credit has been criticized for offsetting less and less of the GST burden on low-income families.
[387] Government of Canada, *Report on Activities and Expenditures 2000-2001*, online: Social Union <http://www.socialunion.ca/ecd/ch1_3_e.htm>.

incentive to become taxpayers instead of being punished for avoiding taxes. Over time, people who grow up receiving tax benefits from the government will already be on the tax rolls when they become adults, and thus will be less likely to disappear into the informal economy as they become income-earners.

V EXCISE TAXES

Excise taxes are an important source of revenue in most developing countries.[388] Excise taxes are usually imposed on the consumption of goods and services that bear some externalities or are considered to be luxuries.[389] The most important of these taxes are the traditional excise taxes on tobacco, alcoholic, and petroleum products.[390] In Africa, since 1973, excises have yielded 1.9% of GDP, which amounted to 11% of all tax revenue.[391] These proportions are similar to those in other developing countries, but they are substantially lower than those found in OECD countries, where excise taxes raise revenue equivalent to 3% of GDP.[392] Developing countries need to review their excise taxes to enable then to raise more revenue.

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388 Bruce Bolnick and Jonathan Haughton, "Tax policy in Sub-Saharan Africa: Examining the Role of Excise Taxation" (1998), online: UNPAN <unpan1.un.org/intradoc/groups/public/documents/UNPAN/UNPAN002514.pdf> [hereafter referred to as 'Bolnick and Haughton, 1998'].

389 United Nations, *An Investment Guide to Uganda Opportunities and Conditions* (New York: UN International Chamber of Commerce, 2004) [hereafter referred to as 'UN, *Guide to Uganda*'].

390 John F. Due, "Excise Taxes" (Washington, D.C.: World Bank, 1994) (Research Working Paper 1251), online: World Bank <ideas.repec.org/s/wbk/wbrwps15.html > [hereafter referred 'Due, 1994']

391 Bolnick and Haughton, 1998.

392 *Ibid*.

Currently in Uganda, all excise taxes are *ad valorem* (taxes according to the value of the good) ranging from 5% to 100%.[393] Excise taxes in Uganda are imposed on the following goods: alcohol, tobacco, soft drinks, mobile phone services, and petroleum products. Below is a table of the tax rates applied to each category of goods.

TABLE 3
Current Excise Tax Rates in Uganda

Product	Duty Rate (%)
Beer	**60**
Spirits	**45**
Soft Drinks	**15**
Cigarettes	**130**
Airtime/Service fees	**7**

Source: Uganda Revenue Authority databases, as at July 10, 2007

Excise taxes are also levied on a selected list of imports generally as a way of protecting local producers of similar goods or import substitutes, and on imports that are considered to be luxuries such as sugar, beverages, cosmetics, certain textiles, and garments.[394] The 2005/2006 Revenue Performance Report revealed a decline in the revenue collected from excise taxes,[395] especially in relation to petroleum products (expected revenue USh28 billion; actual revenue only USh27.55 billion), imported sugar (USh16 billion expected, only USh10.24 billion raised), and cigarettes (USh28.31 billion received, USh31.69 billion expected).[396]

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[393] UN, *Guide to Uganda*.
[394] *Revenue Report 2005/06*.
[395] *Ibid*.
[396] *Ibid*.

A Advantages of Excise Taxes

Traditional excise taxes are quite simple to administer. This is because taxpayer units are easily identifiable and generally operate in the formal sector, which makes it much easier to collect revenue.[397] Selective taxes on luxury goods may be more effective in reaching high-income groups than poorly-enforced direct taxes on income.[398] This is usually the case in most developing countries, where substitute goods for the taxed goods are produced in the informal sector, which escape taxation, and are consumed disproportionately by the poor.[399]

B Limitations of Excise Taxes

The major limitation on the use of excise taxation in developing countries is their inappropriately broad coverage of products, which is often driven by the search for revenue. According to Tanzi, the economic rationale for imposing excises is very different from that of imposing general consumption taxes such as the VAT. While VATs should be broad-based to maximize revenue with minimum distortion, excise taxes should be highly selective, narrowly targeting a few goods mostly on grounds that their consumption entails negative externalities on society, such as tobacco, alcohol, petroleum products, and motor vehicles.[400] Even if the poor do not consume excisable goods such as petroleum directly, they may do so indirectly when they pay transport costs.[401]

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[397] Bolnick and Haughton, 1998.
[398] *Ibid*.
[399] Due, 1994.
[400] *Ibid*.
[401] *Ibid*.

However, due to lack of sufficient information in Uganda, it is not possible to trace the effects of excise tax on the poor.

Ad valorem taxes require tax administrators to be skilled, and to have solid knowledge of accounting.[402] Such skills are relatively scarce in Uganda, where weak administration already makes it difficult to raise sufficient revenues. Uganda has recently resorted to taxing mobile phone services at very high rates to make up for deficient revenues. This is justified by the high profits being made by phone companies, which benefit from the increase in business prospects due to improved communication. The negative effects of the high excise taxes on phone services is they will discriminate against small businesses that might not be able to afford phone services. This is another example of taxes that should not be applied to the poorest, perhaps by extending credits and exemptions.

C Possible Solutions

In order to overcome the inappropriately broad coverage of excise taxes, they should be confined to the traditional excises (that is tobacco, alcohol spirits, and fuel) and a limited number of luxury goods.[403] Luxury excises leave a lot to be desired, except for a few obvious items such as soft drinks. The government can be creative in designating luxury goods by taxing very expensive large houses, valuable pieces of land purchased for recreation, and environmental pollutants. In the case of fuel excises, which have increased transport costs and the prices of goods consumed by the poor, the government

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[402] Bolnick and Haughton, 1998.
[403] Due, 1994.

could shift the tax to the producers and providers and make it part of the cost of doing business. The effects of the change in price will not be as alarming as they are when the tax is fixed at the pump.

Some authors have been of the view that increased reliance on excise taxes is consistent with an equitable system in which the burden of the taxes falls on the rich.[404] However, in developing countries like Uganda, excise taxes on items such as kerosene are often thought to be regressive. A tax on kerosene (or paraffin) may have high social costs, because kerosene is often very important in poor households, which use it for lighting and cooking, but is not widely used by the rich.[405] Hence some of the items that are used by the poor ought to be exempted from more general excise taxes to improve equity without encouraging inefficient substitutes.

In Uganda's case, the government has consistently increased taxes on mobile phone services, which has in turn increased the price of services, to the disadvantage of those with low incomes. Small enterprises need to communicate in all aspects of their business operations. High communication costs therefore represent a substantial burden and incur a major penalty in terms of economic growth. The government could lower the excise tax on mobile phone services, or simply exempt them from excise and tax them only under VAT -- but it certainly should not impose both VAT and excise taxes on mobile phone services.

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[404] Bolnick and Haughton, 1998.
[405] Due, 1994.

VI TAX INCENTIVES

The gap between rich and the poor countries is very much a function of investment capital.[406] Developed economies possess more investment capital than developing ones, and what they have usually incorporates more advanced technologies.[407] Thus developing countries traditionally place heavy emphasis on increasing their financial and physical assets. This is usually done by increasing their foreign exchange in order to import both consumer and capital goods, bridge the savings-investment gap, meet budget deficits, and pay interest and principal on loans.[408] The main sources of foreign exchange are exports, foreign direct investment, and aid.[409] Exports suffer from deteriorating terms of trade, falling world prices, and falling world demand for primary products, and aid entails conditionalities and repayment of both interest and capital.[410] This leaves foreign investment as the main source of foreign capital, and attracting foreign direct investment has assumed a prominent place in the strategies for economic renewal being advocated by policymakers at national, regional, and international levels.[411]

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[406] Ibrahim F.I. Shihata, "Promotion of Foreign Direct Investment -- A General Account with Particular Reference to the Role of the World Bank Group" (1991) 6 *ICSID Review Foreign Investment law Journal* at 484 [hereafter referred to as 'Shihata, 1991'].
[407] Ahil Kumar, "Does Foreign Direct Investment Help Emerging Economies?" (2007), online: Federal Reserve Bank of Dallas <http://www.dallasfed.org/research/eclett/2007/d070/.html/> [hereafter referred to as 'Kumar, 2007'].
[408] Kumar, 2007.
[409] Marios B. Obwana, "Determinants of FDI and Their Impact on Economic Growth in Uganda" (1996), online: International Development Research Centre <www.idrc.ca/uploads/user-S/10330689810WP_Obwona_1998-1.pdf> [hereafter referred to as 'Obwana, 1996'].
[410] Obwana, 1996.
[411] Shihata, 1991 at 39.

Africa's share of foreign direct investment (FDI) flows to developing countries dropped from 11% in 1986-1990 to 6% in 1991-1993, and then to 4% in 1994.[412] Like other African countries, Uganda has not been very successful in attracting foreign direct investment (FDI) over the past few decades.[413] Currently Uganda is said to have only 39 FDI projects, while Zambia has 44, Sudan, 43, Kenya, 58, Ghana, 51, Angola, 72, Algeria, 161, Egypt, 216, and South Africa, 299.[414] African countries that have attracted the most FDI have been those with the largest tangible assets, such as natural and mineral resources, as well as domestic markets, which are non-existent in Uganda.

To reverse the downward trend in FDI inflows, the government of Uganda has taken steps to enhance Uganda's appeal as an investment location. These efforts include the introduction of wide-ranging economic policy reforms such as reform of foreign exchange rates, liberalization of existing trade policies, and the enactment of the Investment Code in 1991.[415] Despite the fact that Uganda has gone ahead to introduce and extend a variety of special tax incentives to foreign investors, experience suggests that non-tax factors such as sound macroeconomic policies, political stability, good infrastructure, and a sound judicial system are more important factors than tax benefits.[416] In addition, the economy is faced with a number of social phenomena such as the political instability in Northern Uganda, the effects of the ongoing HIV/AIDS

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412 Obwana, 1996.
413 Jacques Morisset, "Foreign Direct Investment in Africa Policies Also Matter" (2000), online: World Bank <wbln0018.worldbank.org/research/workpapers.nsf/0/224dc23f67e3412a8525698b005c3872/$FILE/wps2481.pdf> [hereafter referred to as 'Morisset, 2000'].
414 Morisset, 2000. These countries were selected based simply on availability of data.
415 Obwana, 1996.
416 Morisset, 2000.

epidemic, the expanding informal sector, and barriers to effective tax administration. Therefore even before the government goes on a campaign to attract FDI, it must improve the investment climate if the country is to target FDI as a way to enhance economic growth and thus tax sources of revenue for the long term.

A Advantages of Tax Incentives

Tax incentives are crucial to a poor country like Uganda because under appropriate conditions, FDI can be a powerful engine of private sector development. FDI facilitates transfer of technology.[417] It usually brings in new knowledge on processing techniques, product design, packaging, communications technology, market development, and business strategies.[418] These inputs are generally injected during the life of the investment, enabling the project to keep apace with technical innovations and developments in world markets.[419] Developing countries are aware that these benefits are crucial for economic growth. Foreign investors also provide training to their local employees and introduce industrial discipline, thus developing host countries' human resources.[420] Foreign investors usually have a more profound knowledge of international markets and frequently command worldwide distribution channels for local products.[421] These advantages enable them to introduce local products on the international market, hence helping developing countries to gain access to international markets and, over time, increasing their tax revenues.

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[417] Shihata, 1991 at 484.
[418] *Ibid*.
[419] *Ibid*.
[420] Morisset, 2000.
[421] Shihata, 1991 at 484.

B Limitations of Tax Incentives

Despite efforts of African governments to enhance domestic growth by attracting foreign direct investment (FDI), tax incentives for FDI have cost implications in terms of tax revenue foregone. Uganda's Investment Code provides an array of incentives in the form of credits, incentives for exporters, first arrival privileges, exemption from corporation taxes, and assistance in importing plant, machinery, and construction materials.[422] All of these benefits and tax concessions have seriously eroded Uganda's tax base. The main weakness is that these incentive schemes are too generous; besides giving exemptions on building materials which are not given in any other country, the scheme also gives foreign investors extravagant depreciation allowances.[423]

It is possible that tax incentives are being given to investors who would have invested exactly the same amount of money in Uganda even without the incentives, thus rendering the scheme wasteful.[424] The effectiveness of such incentives in attracting incremental investments is questionable, especially when their revenue costs are so high.[425] For foreign investors, the primary target of most tax incentives in developing countries, the decision to enter a country would normally depend on a whole host of factors, among which the availability of tax incentives is only one. Other factors include the availability and existence of natural resources, political and economic stability, transparency of the legal and regulatory systems, adequacy of supporting institutes (e.g., banking,

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[422] Morisset, 2000.
[423] Obwana, 1996.
[424] *Ibid*.
[425] Tanzi and Zee, 2000.

transportation, and communication), ease of profit repatriation, and the availability of a skilled workforce. [426]

It is also doubtful whether, in the absence of the other factors, tax incentives would be enough to attract foreign investors. The effectiveness of tax incentives is also questionable when the beneficiary of the incentives may be the treasury of the foreign investor's home country. According to Tanzi, this comes about because any income that is spared from taxation by the host country will be taxed by the investor's home country when the home country bases its tax jurisdiction on the residence principle.[427] Tax incentives have proved ineffective as many developing countries have similar and competing schemes, and in the long term, these exemptions appear to have little impact on distribution of private investment among low-income countries.[428] Incentives are inefficient, because countries with better general economic policies could attract the same amount of investment at a lower cost.

One of the most controversial types of tax incentives to foreign direct investment is the offer of tax holidays. While tax holidays are simple to administer, they have numerous shortcomings: (1) By exempting profits irrespective of their amount, tax holidays tend to benefit an investor who expects high profits and would have undertaken the investment even if there are no such incentives. (2) Tax holidays provide strong incentives for tax avoidance, as taxed enterprises could enter into economic relationships with exempt ones

[426] *Ibid.*
[427] Shihata, 1991 at 484.
[428] Shihata, 1991 at 484.

to shift their profits to the latter through transfer pricing. (3) The duration of tax holidays, even if formally time bound, is prone to abuse and extension by investors through creative re-designation of existing investment as new investment. (4) Time-bound tax holidays tend to attract short-run projects, which typically are not as beneficial to the economy as longer term ones.[429]

C Possible Solutions

It is advisable to limit the duration of special incentives, both to reduce constraints affecting revenue and to allow for possible changes in the circumstances that made the incentives desirable. There may be a case for limiting the amount of benefits in relation to invested capital, particularly to prevent industries that quickly became highly profitable from enjoying excessive and unnecessary concessions. In the meantime, as a minimum, governments that offer these incentives must obtain full information on revenue forgone, exemption base, and other relevant particulars from the beneficiaries; this is the only way governments can evaluate the impact of such incentives and monitor compliance with the conditions for granting the exemptions. [430]

To realize the potential for increased revenue from FDI projects, Uganda needs to revisit some of its treaty conditions with foreign countries and to be more cautious when signing on new trade and economic treaties. This is to ensure that Uganda is not disadvantaged by unfair treaty conditions that hinder the tax authorities from taxing foreign firms that may

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[429] Tanzi and Zee, 2000.
[430] *Ibid*.

start up businesses. For example, in 1983, Uganda signed a treaty on Economic Co-operation with Canada, Article VII of which states that the Government of Uganda will exempt Canadian firms and Canadian personnel, including their dependents, from all resident and local taxes imposed on personal income regardless of whether the source of income was from Uganda.[431] Article VII also exempts Canadian firms and Canadian personnel from import duties, customs tariffs, purchase taxes, and all other duties.[432] Even if Uganda were to attract FDI from Canada, these firms would be exempt from most Ugandan taxes. At the same time, the Canadian government would benefit as Canadian companies and individuals are taxed on their world-wide income.

VII CONCLUSION

Despite concerted efforts to reform the Ugandan tax systems, Uganda still cannot raise sufficient tax revenues, even when measured against its own modest expectations. The basic conclusion of this chapter is that the tax system in Uganda is in need of reform. However, the reform of the existing tax system will have to take into consideration the prevailing social conditions such as HIV/AIDS, the civil war in Northern Uganda, the large informal economy, and barriers to ineffective tax administration when considering how to raise sufficient revenue for economic growth and a minimum social safety net for the many extremely poor people in Uganda, and how to use these tax provisions in a genuinely progressive and equitable manner.

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[431] Treaty Series 1983, No. 5 Economic Co-operation
[432] *Ibid*.

As demonstrated in this chapter, tax policies can be used to create incentives for poor and unrecorded people to turn to the government to get tax benefits such as the child tax benefits, earned income tax credits, and other anti-poverty measures that help make the overall tax system fairer. When combined with simplification of the tax system, greater use of the PIT and the VAT, and limitations of tax incentives, Uganda could better meet these complex needs.

CHAPTER FIVE

DIRECTIONS FOR TAX REFORM IN UGANDA

I INTRODUCTION

Uganda experienced reasonable economic growth rates between 1986 and 1998.[433] The growth record can be roughly divided into two periods, the period of post war recovery, and the subsequent period of economic reforms.[434] From 1971 to 1986, Uganda was subject to severe economic mismanagement, political instability, civil war, mass murder, and mass emigration of skilled workers.[435] During these periods, much of its infrastructure was destroyed, and the economy virtually collapsed.[436] All this changed when the current President, Yoweri Museveni, came into office in 1986.[437] Under his leadership, Uganda made the transition from political instability to a stable, democratic system of government, and the collapsed economy was revived through a series of economic reforms.[438]

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433 Torgny Holmgren, *et al*., *Aid and Reform in Uganda* -- *Country Case Study* (Washington, D.C.: World Bank, 1999), online: World Bank <www.worldbank.org/research/aid/africa/papers.html> [hereafter referred to as 'Holmgren'].

434 Robert Kappel, Jann Lay and Susan Steiner, "The Missing Links: Uganda's Economic Reforms and Pro-Poor Growth" (Capetown: Macro-Micro Linkage Forum, October 2004), online: German Institute of Global and Area Studies <www.gigahamburg.de/.../content/publikationen/archiv/wiss_aufsaetze/kappel-etal_05_abstract.pdf -> [hereafter referred to as 'Kappel']

435 African Development Bank and African Development Fund, *Republic of Uganda : Country Assistance Evaluation Report* (2004), online: OECD <www.oecd.org/dataoecd/28/46/37900515.pdf> [hereafter referred to as *Uganda Evaluation Report*].

436 *Uganda Evaluation Report*.

437 *Ibid*.

438 Helen Bullock, Juliet Mountford and Rebecca Stanley, "Better Policy-Making" (2001) Centre for Management and Policy Studies, online: Policy Hub <www.policyhub.gov.uk/better_policy_making/ > at 13-15 [hereafter referred to as 'Bullock'].

One of the most important areas of economic reform has been the reformation of Uganda's tax system, both in terms of tax administration and tax policy. These reforms have ranged from restructuring tax rates and establishing the Uganda Revenue Authority to enacting new tax laws and establishing a tax court. The increase in tax revenue from 7% of GDP in 1991 to over 11% of GDP has been largely attributed to these changes in the tax system.

The tax policy reforms enacted by the government and implemented by the URA have transformed the tax system. The tax base has been broadened. Tax rules are now more uniform so that tax-induced distortions to resource allocation have been reduced. The excessive rates of taxation levied on some taxpayers, such as on exporters and importers, which acted as disincentives for production and investment, have been removed. The economy thus stands on the threshold of sustainable economic growth due to the success of the tax policy reforms.

Unfortunately, these achievements are in danger of being undermined by continuing social and economic problems. The HIV/AIDS epidemic remains a major obstacle to economic and social development, and has created a huge health, demographic, and poverty crisis. The ongoing civil war in Northern Uganda not only continues to divert scarce government resources away from economic development, making it difficult to embark on development activities in that part of the country, but has also destroyed social structure, the quality of life, and generations of people. The existence of the informal sector has eroded the tax base, and deficient tax administration compromises the effectiveness of tax policy. The HIV/AIDS epidemic and the ongoing civil war in Uganda are of particular concern because they have exacerbated the levels of poverty in the country through the loss of lives of the productive members of families, and, in the case of war, destruction of property. Given these circumstances, it is not surprising that the government has been unable to collect sufficient tax revenues despite numerous reforms. Thus Uganda remains locked into unending dependence on foreign aid, constrained government operations, and weakened economic management. It is therefore important for the government to look creatively for changes it can make in its tax laws that would enable it not only to increase tax revenues but also to promote sustainable economic growth and combat poverty, disease, and other structural barriers to development.

Given Uganda's deep poverty overall, and given the very unique problems posed by the HIVS/AIDS epidemic, civil war, the large informal economy, and deficient tax administration, the case for fundamental rethinking of tax policy is very clear. The types of changes that would enable Uganda to overcome these problems are discussed in this chapter, under four main themes that emerge from these discussions in earlier chapters. These include: (1) the need for better tax policy making; (2) the need to improve the administration of the tax system; (3) the importance of integrating pro-poor incentives into the tax system to bring the poor and unrecorded people and enterprises into contact with the government; and (4) addressing gender issues involved in these problems. Each of these recommendations will be discussed below in greater detail.

II RECOMMENDATION ONE: BETTER POLICY MAKING

As demonstrated in this thesis, tax policy is complex, and each type of tax that goes into the tax mix has its own strengths and weaknesses. The full nature of the problems faced by developing countries is only now becoming more visible as researchers and policy analysts from specific countries are developing the capacity to examine the traditional recipes for tax reform given to them by foreign experts and international organizations like the IMF. This is particularly true for tax policy in Uganda, which remains one of the poorest countries in the world and faces intractable barriers to revenue production. Uganda must approach the tax system not just with its traditional focus on revenue raised, but must reconceive tax policy analysis to encompass assessment of the effects of taxation on efficiency, fairness, incentives, and competiveness as well as on compliance and administrative costs.[439] Policy-making is the process by which governments translate their political visions into programs and actions to deliver desired changes in the real world.[440]Good policy making is a fluid process that is forward and outward looking; innovative, flexible and creative; evidence-based, inclusive, and interdisciplinary; and continually self-critical.[441]

A Forward and Outward-Looking Policy Analysis

The policy process ought to clearly define the outcomes that the policy is designed to achieve, and, where appropriate, to take a long-term view based on statistical data and informed predictions of social, political, economic, and cultural trends. The government

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[439] Bullock.
[440] *Ibid.*
[441] *Ibid.*

of Uganda needs to make statements of intended outcomes of tax policy instruments that can then be used to evaluate the effectiveness of existing and new tax policies. At the same time, creative reference to the experiences of other countries, their similarities and differences, and factors influencing the national, regional, and international arena is crucial. This process draws on experiences in other countries, and considers how policy will be communicated to the public.

From the discussion in previous chapters of this thesis, it is evident that policy makers in Uganda have not yet addressed the impact the HIV/AIDS epidemic, the civil war, and the large growing informal sector on the tax reform process. This has resulted in unrealistic policies that are increasingly failing to raise sufficient revenue because Uganda's tax bases and tax-paying population are being eroded by these conditions. The government has to draw on the experiences of other countries and figure out the best to improve its tax policies. For example, the experience in Ghana, where the Ghana Private Road Transport Union has been collecting taxes from the informal sector on behalf of the government,[442] offers an example of administrative innovation which could be of wider interest in taxing informal sectors, and opening up discussions of how to bring government into closer and more positive contact with those in the unrecorded economy.

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[442] Anuradha Joshi and Joseph Ayee, "Taxing for the State? Revenue and the Informal Sector in Ghana" (2002), online: Institute of Development Studies Sussex <http://www.ids.ac.uk/gdr/cfs/drc-pubs/summaries/summary%2014-JoshiAyee-taxingforthestate.pdf >.

B Policy-Making should be Innovative, Flexible, and Creative

Good policy-making involves a process that is flexible and innovative, questions established ways of dealing with issues, encourages new and creative ideas, and, where appropriate, fine-tunes established policies.[443] To date, policy-makers in Uganda have followed heavily “western” ideas on the best ways to raise revenue, and have not even demonstrated as much creativity and flexibility as other African states such as Ghana. Nor has Uganda begun to examine how the tax and social existence systems can be integrated in order to develop trust, the relevance of government to people’s ordinary lives, or registration systems that give government benefits instead of penalties to those who come forward. Tax amnesties, tax holidays for Ugandans, and tax benefits designed to offer at least some support to the people of Uganda could build infrastructure that can then support a more expansive role for government.[444]

C Inclusive, Evidence-Based, and Interdisciplinary Policy Analysis

The advice and decisions of policy makers should be made based upon the best available evidence from a wide range of sources.[445] All relevant evidence, including that from specialists in all pertinent areas of study, should be available in an accessible and meaningful form to policy makers.[446] This element is clearly missing in Uganda’s tax policy process. One of the major limitations in writing this thesis was the lack of data on the different tax instruments in relation to prevailing social phenomena. The government

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[443] Bullock.
[444] Holmgren.
[445] Richard M. Bird, *Tax Policy and Economic Development* (Baltimore: Johns Hopkins University Press, 1992) [hereafter referred to as ‘Bird, 1992’].
[446] Bird, 1992.

needs to invest in the development of knowledge tools to provide a centre of expertise and advice in research and to ensure that government researchers are equipped to provide high quality research and analysis to support policy making. As a minimum, the government should develop Uganda's capacity to review existing evidence, commission new tax research through universities, and set up pilot initiatives and programs.

Development of pertinent data and analysis must be inclusive, should take account of the needs of all people directly or indirectly affected by policy, and must involve all stakeholders directly.[447] Including the general public in the policy process would secure their confidence in the tax system and help overcome the culture of tax evasion in Uganda. This process should also be designed to take a holistic view, looking beyond institutional boundaries as well as working together with other departments to meet the government's strategic objectives.[448] Tax policy in Uganda lacks a holistic view, and this could be rectified by encouraging the Ministry of Finance, the government department that is responsible for tax policy, to consult with other agencies or departments working with vulnerable groups such as women and children, HIV/AIDS victims, and war victims on how best the tax system could be improved without having negative effects on these most vulnerable groups.

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[447] Bullock.
[448] *Ibid*.

D Continuing Critical Policy Analysis

Good tax policy is grounded in the social, economic, and political realities of the society it affects. Because society continually changes, tax policy must be constantly reviewed to ensure that it is really dealing with problems it was designed to solve, and takes account of associated effects elsewhere.[449] As a minimum, this would require putting an ongoing review program in place with a range of meaningful performance measures, and mechanisms to allow service deliveries/customers to provide feedback to policy makers.[450] This would enable the government to evaluate the effectiveness of the tax system and identify problems.

In addition, formal evaluation and assessment of tax policies and continued reference to the experiences of other countries would institutionalize the expectation that policy makers will continually identify good practices that have potential for wider application in the design and implementation of policies.[451] Several developing countries, including some African countries, have been very creative in their domestic tax policies, and Uganda would benefit from studying some of these success stories. For example, the case in Ghana where the informal sector is taxed through organized unions that are within the informal sector is a great relevance to conditions in Uganda.[452]

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[449] Bullock.
[450] *Ibid*.
[451] *Ibid*.
[452] *Ibid*.

In conclusion, it is important that the government of Uganda realizes that tax policy making involves continuous learning and is not just a one-off initiative. The society in which taxes are implemented is constantly changing, and so should its tax system.

III RECOMMENDATION TWO: IMPROVING TAX ADMINISTRATION

The best tax policies in the world are worth little if they cannot be implemented effectively. Therefore tax policy design must take into account the administrative dimension of taxation at every step of the process.[453] Even though reform of tax policy and tax administration entails fiscal and political costs, there is no other way to develop a sustainable tax system.[454] At the very least, Uganda needs to move to computerized tax processes not only to improve administrative functioning, but to reduce the contact between taxpayers and tax officials in order to counter corruption.[455]

However, new technology alone is not sufficient if the government does not recognize the need for skilled tax officials.[456] Effective tax administration requires qualified tax officials with requisite skills to maintain these systems and operate them to their fullest potential.[457] A computer-based revenue administration would have different skill needs than a system based on manual processes. Human resources as in the form computer

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[453] Jit B. S. Gill, "The Nuts and Bolts of Revenue Administration Reform" (2003), online: World Bank <siteresources.worldbank.org/NTTPA/Resources/NutsBolts.pdf>.
[454] Richard M. Bird, "Administrative Dimensions of Tax Reform" (2003) International Tax Program Paper 0302, online: Toronto, University of Toronto <http://www.rotman.utoronto.ca/iib> [hereafter referred to as 'Bird'].
[455] Bird, 2003.
[456] *Ibid*.
[457] Bird, 2003.

professionals, researchers, tax lawyers, and auditors are necessary. Since the market value of these professionals is high, mechanisms to pay them competitive salaries need to be developed as well.[458]

The role of tax education on a large scale cannot be underestimated. Uganda has first-hand experience of the benefits of investing in public sensitization. The Ugandan government was able to reduce the prevalence of HIV/AIDS from 30% in the 1990s to 6.7% in 2005 by using public campaigns to educate the public about the disease.[459] A number of media outlets like radio stations, TV programs, newspapers, magazines, and billboards were used to educate the public and spread awareness. [460] The school curriculum was also used to educate students who indirectly would educate their parents. All this information was disseminated in different languages. Government officials, cultural leaders, religious leaders, and entertainers were all involved in the campaign of spreading awareness of HIV/AIDS, and the results were tremendous. The government needs to take this same large-scale intensified approach to educating people about why the state needs taxes and how it helps them. The Uganda Revenue Authority should provide adequate taxpayer services in the form of information, pamphlets, and advice agencies to ensure taxpayers get a better understanding of tax matters. It is also important that the task of improving tax administration is periodically reviewed to ensure that best

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[458] Jalia Kangave, "Improving Tax Administration: A Case Study of the Uganda Revenue Authority" (2005), 49:2 *Journal of Africa Law* at 145-176.
[459] Lori Bollinger, John Stover and Vastha Kibirige, "The Economic Impact of AIDS in Uganda" (1999), online: Policy Project <www.policyproject.com/pubs/SEImpact/uganda.pdf>.
[460] UNAIDS, "Uganda Country Profile," online: UNAIDS <http://www.unaids.org/en/Regions_Countries/Countries/Uganda.asp.>.

practices from other countries are adopted or integrated into Uganda’s tax administrative system.

IV RECOMMENDATION THREE: INTEGRATING PRO-POOR POLICIES INTO THE TAX SYSTEM

In spite of numerous economic reforms, Uganda, like most of the African countries, has continued to experience extremely low *per capita* incomes and daunting levels of poverty.[461] However, Uganda has not yet explored how the tax system can be used to implement pro-poor measures.[462]

“Pro-poor growth” refers to policy strategies that are designed to enable the poor to actively participate in and significantly benefit from economic activity.[463] According to Kappel,[464] there are two possible ways to achieve pro-poor growth: through direct methods, and with indirect methods. Direct methods are used to immediately raise incomes of the poor by ensuring that economic growth occurs in those sectors or regions in which the poor are employed, and focuses on using the factors of production they already possess.[465] Indirect methods redistribute income and capital to the poor through tax provisions and targeted government spending.[466] This spending can take the form of direct financial transfers, investment in the assets of the poor, or provision of basic social

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[461] Kappel.
[462] Arne Bigsten and Augustin Kwasi Fusu, “Growth and Poverty in Africa: An Overview” (2004), 13 supplement 1 *Journal of African Economics* at 11-115 [hereafter referred to as ‘Bigsten and Fusu’].
[463] Bigsten and Fusu.
[464] *Ibid*.
[465] *Ibid*.
[466] *Ibid*.

services.[467] Indirect pro-poor methods include heavy reliance on progressive taxes as well as direct spending on the poor by the government.[468] Financial transfers can immediately benefit the poor by increasing their disposable incomes, while public services increase the welfare of the poor by improving their living conditions.[469] Both types of measures can be considered to be investments in the assets of the poor, because they provide opportunities to increase their earning capacities, enhance health and knowledge, and change the distribution of incomes in the medium to long run.[470]

Between 1992 and 2002/03, the Ugandan population experienced important welfare gains as consumption increases were broad-based, inflation was reduced, trade liberalization was encouraged, and restructuring of public administration was enforced.[471] However, after 2000, this growth slowed down, poverty began to increase again, and the situation has not since improved. This setback seriously reduced Uganda's chances to achieve its goal of reaching a poverty level of 10% or less by 2017. The tax system can be used to foster pro-poor growth in Uganda, as discussed below.

Pro-poor growth requires that taxes be designed to burden the rich more than the poor and alleviate the worst effects of poverty regardless of cause. In Uganda, the only assistance provided to the poor by the tax system consists of exemptions in the PIT. However, these exemptions really only help those who have enough income to take

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[467] *Ibid*.
[468] *Ibid*.
[469] Bigsten and Fusu.
[470] *Ibid*.
[471] Kappel.

advantage of them, and are of no assistance to any of the many low-and no-income people in the informal economy. Only civil servants and any officials qualify for government pension payments,[472] and the National Social Security Fund (NSSF) offers pensions, invalidity, and survivor's benefits only to qualified private sector employees.[473] Even though the NSSF is open to informal sector workers, the vast majority of members, if not all, are employed in the formal sector because the benefits of this fund are not worth the other costs of leaving the informal economy.[474] The main pro-poor assistance from the government is in the form of the provision of public services such as primary education and health care.[475] But in practice, these services are severely limited by low quality, and end up not being beneficial.

The government of Uganda could encourage pro-poor growth by integrating direct assistance into some of PIT and VAT tax systems. Such assistance could include the extension of child tax benefits, earned income benefits, and VAT credits for poor and low-income individuals. These benefits would not only assist the poor, but would also create vehicles for bringing those individuals into the recorded economy. Examples of these types of benefits as used in Canada are outlined here: The Canadian child tax benefit aims at assisting poor families and children by making them eligible for a sum of money per child.[476] This benefit would assist the elderly caregivers looking after

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[472] *Ibid*.
[473] *Ibid*.
[474] *Ibid*.
[475] *Ibid*.
[476] Cindy Wiggins, *The Canada Child Tax Benefit* (Ottawa: Canadian Labour Congress, 1997) (Research Paper No. 8) at 1-5.

HIV/AIDS orphans as well as families affected by civil war. It can be structured as a deemed income tax credit that is fully refundable to those who register for it. Earned income tax credits lower the amount of income taxes low-income taxpayers owe, and increases their tax refunds.[477] The importance of this credit is to encourage welfare recipients to engage in paid employment, which increases their skills and their revenue over time. The explanation for the limited access to health care is poverty, and the situation is worsened by the prevalence of HIV/AIDS whose treatment is very expensive. Hence, a health insurance benefit for the poor would increase access to health care while increasing the tax base when people have to register with the tax authorities to become eligible for the benefit. In conclusion, by encouraging pro-poor growth through taxation, the government can take steps that can reduce the levels of poverty, support growth in levels of income and the size of the recorded economy, and hence increase tax revenues.

V RECOMMENDATION FOUR: INTEGRATING GENDER ISSUES INTO THE TAX SYSTEM

The widespread poverty in Uganda and the impact of HIV/AIDS, civil war, and under development affects men, women, and children in Uganda. However, there are gender differences in how each factor affects people depending on their gender, age, and other considerations. Women are particularly hard hit. For example, throughout the HIV/AIDS epidemic, women are still expected to care for the ill, orphaned children, and fractured families in their communities. Over a decade ago, Uganda agreed to incorporate gender

[477] Sheena Starky, "Scaling the Welfare Wall: Earned Income Tax Credits" (2006) Economics Division, online: Library of Parliament <http://www.parl.gc.ca/information/library/prppubs/prb0598-e.html>.

perspectives into budget processing, including tax policy, when it committed to the Beijing Platform for Action in 1995.[478] The Platform for Action is an agenda for women's empowerment that aims at advancing goals of equality, development, and peace for all women everywhere in the interest of all humanity.[479] In an effort to achieve the objectives of equality for women, the Ugandan Government has included provisions for equality in the Constitution, other national laws, and policy processes to provide motivation for engendering tax policy.[480]

Despite these reforms, the inferior position of women in Ugandan society has not changed. The vast majority of women (60% of all women) work in agricultural subsistence work, as compared with only 49% of all men.[481] Women account for 80% of all unpaid workers.[482] Worse still, in nonfarm production, men predominate in the formal economy, where they represent 61% of employees, while most women workers are self-employed or work as unpaid family workers.[483] Women also face greater vulnerability to HIV/AIDS due to economic, social-cultural, and legal factors. They carry the burden of looking after the sick and fending for the families on little or no income.
Gender inequality is a serious obstacle to sustainable poverty reduction, and hence affects the amounts of revenue collected from women as a group. A recent World Bank study

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[478] Uganda Revenue Authority, *Report on Gender Budget Analysis of Taxation in Uganda*, online: IDRC <www.idrc.ca/uploads/user-S/11279461961Gender_Analysis_of_Uganda's_Budget.doc> [hereafter referred to as '*Uganda Report on Gender and Taxation*'].
[479] United Nations, Fourth World Conference on Women (Beijing: UN, 1995), online: United Nations <www.un.org/womenwatch/daw/beijing/platform/plat1.htm >.
[480] *Uganda Report on Gender and Taxation*.
[481] *Ibid*.
[482] *Ibid*.
[483] *Ibid*.

suggests that Uganda could gain as much as 2% of GDP growth a year by eliminating gender inequality.[484] The Ugandan government pledged long ago to implement a gender-based analysis in all policy processes, including the formulation of tax policies. It is high time for the government to rally support for gender sensitive taxation so that policy makers and politicians appreciate the need for gender-sensitive tax policy impact assessment and evaluation. This can be done by initiating research to projects to inform policy makers of the many links between gender inequality and tax policy.[485]

VI CONCLUSION

Over the last two decades, the government of Uganda has made tremendous improvements in its tax system. However, it is clear that more work has to be done if Uganda is to increase its tax revenues. Due to the low levels of development in Uganda, it will take a number of years before a fully-fledged and operational tax system is set in place. Nevertheless, the government has to continue adapting the tax system to meet the evolving needs of people and enterprises in Uganda.

One of the major challenges of tax reform in Uganda is to enlarge the tax bases that have been eroded by the HIV/AIDS epidemic, the conflict in Northern Uganda, the growth of the informal sector, and deficiencies in tax administrative capacities. This thesis concludes that the government should focus tax policy on promoting equity, participation, and growth for all sectors of the population. In particular, it is time for the

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[484] Amanda Ellis, Claire Manuel and C. Mark Blackden, *Gender and Economic Growth in Uganda* (Washington: World Bank, 2006) [hereafter referred to as 'Ellis and Blackden']
[485] Ellis and Blackden.

government of Uganda to invest in providing social security for the poor and those in the unrecorded economy so as to enable them to enter the formal economy as the government broadens its tax bases.

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