

UGANDA'S TAXATION POLICY:

**Implications for Poverty Reduction
and Economic Growth**

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List of Abbreviations

BDV	Brussels Definition of Value
BOU	Bank of Uganda
BRO	Baltics, Russia and Other
CFPED	Committee on Finance, Planning and Economic Development
COMESA	Common Market for Eastern Southern Africa Countries
CPI	Consumer Price Index
CSOs	Civil Society Organisations
CTL	Commercial Transaction Levy
FDI	Foreign Direct Investment
GATT	General Agreement of Trade and Tariffs
GDP	Gross Domestic Product
GOU	Government of Uganda
IMF	International Monetary Fund
LPAC	Local Public Accounts Committee
MFPED	Ministry of Finance, Planning and Economic Development
OECD	Organisation of Economic Co-operation and Development
PAC	Public Accounts Committee
PAYE	Pay As You Earn
PEAP	Poverty Eradication Action Plan
PMA	Modernisation of Agriculture
POU	Parliament of Uganda
R&D	Research and Development
TROU	The Republic of Uganda
UBOS	Uganda Bureau of Statistics
UDN	Uganda Debt Network
URA	Uganda Revenue Authority
VAT	Value Added Tax

Executive Summary

Tax policy refers to the choice of tax instruments, the rates at which taxes are set, the nature of exemptions and the assignment of taxes to different levels of government. A good tax system should be defined so as to meet the requirements of equity in burden distribution, efficiency in resource use, the goal of macro policy and ease of administration. It should also allow the country's authorities to implement tax policy in the most efficient way. The main objective of this study was to review and analyse the current taxation policy and its implications for poverty reduction and economic growth in Uganda. The study applies comparative, trend and correlation analysis to identify key issues for discussion. The data used in the study was obtained from the publications of major Government of Uganda (GOU) ministries and agencies including Uganda Revenue Authority (URA), Ministry of Finance, Planning and Economic Development (MFPED), and Bank of Uganda (BOU), supplemented by key informant interviews.

Social, Economic, Political and Fiscal contexts for Taxation Policies in Uganda

- **Macroeconomic Environment**

Uganda's primary macroeconomic objective is to promote rapid broad-based and sustainable private sector-led economic growth that is adequate to reduce poverty. The economy has achieved macroeconomic stability with growth rates averaging more than six per cent since 1985/86 and average inflation at single-digit levels since 1992/93. Growth in monetary agriculture was low, averaging only 1.3 per cent in the last five years,

while the transport and communication sector has experienced the highest levels of growth (i.e. averaging 15.8 per cent). As a result, the telecommunications sector has become a major source of tax revenue for the Treasury. The Government, with varying degrees of success, has pursued the following policies to ensure increased growth rates:

- ◆ **Privatisation:** This has resulted in increased government revenue generation with enterprises that were formerly a burden to the Treasury now contributing taxes.
- ◆ **Export competitiveness:** This still requires more deliberate national policies to foster a systematic upgrading of domestic productive capabilities.
- ◆ **Agricultural modernisation:** The Plan for Modernisation of Agriculture (PMA) has not fostered robust agricultural output, yet the numbers of people depending on the sector have increased.
- ◆ **Foreign Direct Investment (FDI):** There has been steady growth in FDI inflows credited to political and macroeconomic stability.

- **Fiscal Context of Tax Policy in Uganda**

Fiscal policy focuses on stimulating economic growth, strengthening tax administration and raising tax revenue. A flexible fiscal regime has been maintained to respond to volatile movements in the foreign exchange market, unrealized revenue performance and shortfalls in the external budgetary support. Fiscal policy has experienced problems of supplementary expenditures which often exceeded the regulatory level of three per cent of the total approved budget. Fiscal deficits have been an important aspect of fiscal policy as a result of the tax system not being revenue-productive. In a number of budget speeches since 1995, Government has emphasized that the central aim of the tax policy was to increase the ratio of revenue to GDP, simplify the tax system, lower rates

and equity considerations. There have been concerns about the sustainability of the fiscal stance as a result of the failure of Uganda's own resources to cover almost one half of its spending.

- **Uganda's taxation policy in relation to the PEAP objectives**

The national planning framework which guides public action to reduce poverty is contained in the Poverty Eradication Action Plan (PEAP). The PEAP was formulated in 1997 aimed at reducing the population living in absolute poverty to 10 per cent by 2017. Tax policies support poverty reduction through creating more growth and reducing the cost of goods mainly consumed by the poor. Tax policy actions have been in line with the PEAP objectives through supporting increased production, minimizing distortions, promoting human development and generally exempting the poor from paying certain taxes.

Headcount poverty as a percentage of the total population has reduced significantly from 56 per cent in 1992 to 31.1 percent in 2006. Income per capita has increased from U Shs 285,860 in 1995/96 to U Shs 824,742 in 2007/08. On the other hand, the disparities in income levels have remained wide as measured by the gini coefficient indicator. There is a strong regional dimension to poverty with much of the chronic poverty and descent into poverty occurring in the northern region. Poverty is still more prevalent in the rural areas. The tax system does not have any special mechanism specifically targeting the poor.

The impressive growth in GDP appears to have benefited the masses through translating into a significant reduction in headcount poverty. Yet the dramatic decline in coffee prices partly reversed the positive poverty reduction trends evident until 2000. Land shortage owing to population pressure is also a contributing factor to poverty incidence in Uganda.

Lack of material opportunities such as jobs, credit, and public services like schools and health services is a direct cause of poverty. Metered water, electricity and telecommunication services are variable and, in addition, telecommunication services attract excise tax. This implies that the urban poor are disproportionately burdened.

On moving into and out of poverty, one of the factors underlying the improvements could have been the recovery of coffee prices from an average of U Shs 970 per kg in 2002/03 to U Shs 2,508 per kg in 2005/06. Coffee export receipts are estimated to increase by 32 per cent from US\$ 228.5 million in 2006/07 to about US\$ 301.6 million in 2007/08 as a result of a 19 per cent increase in the international coffee prices. In Uganda, direct taxes do not affect the poor directly because of the low income levels. Complex and non-transparent tax laws drive up compliance costs and invite tax evasion and tax avoidance which are not pro-poor. The broad-based VAT is not generally regressive, partly because of the use of exemptions and zero rating. Thus, lack of off-farm opportunities may contribute to keeping poor households in a poverty and land degradation trap.

- **Political Context of Tax Policy in Uganda**

Democracy and its underlying principles are crucial for the wellbeing of all Ugandans because of the turbulent history that the country has gone through. In the last two decades, the country has held three successful general elections, with the last one in 2006, under a multiparty setting. In the 2001 elections, graduated tax was one of the campaign issues. Tax policy has had a strong component of development partner perspectives and the current tax policies have been closely intertwined with trends in international development assistance. In Parliament of Uganda (POU), tax proposals are usually passed with minimal amendments or rejections.

There has also been an element of semi-military operations to prevent smuggling and tax evasion.

The politics of taxation is generally limited to involve a few specialized interest groups, and tend to take place in non-public arenas. The peasants and elites are not represented in tax policy formulation but the elites have the alternative of airing views through the media. One such organized group is the Uganda Manufacturers Association (UMA) which has been very vocal in protecting local industries. The issue of participation could best be undertaken by the Civil Society Organizations (CSOs) that in most cases are in close contact with the local communities.

- **Revenue Performance in Uganda**

Uganda's tax reforms have had a marginal increase in revenue collection as a percentage of GDP (i.e. from 11.3 per cent of GDP in 1995/96 to 13.1 per cent of GDP in 2007/08) and they have not widened the tax base. Uganda's revenue collection is among the lowest in the East African region. The low revenue performance has been attributed to the structure of Uganda's economy. Uganda has a significantly large agricultural sector, accounting for 21.4 per cent of GDP in 2007/09. The phenomenal increase of the service sector may not be significantly contributing to revenue mobilization (i.e. real estate activities which have overtaken the posts and telecommunications sector). The inputs and outputs in the sector do not attract taxes.

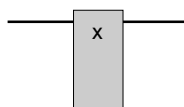
The tax system is dominated by indirect taxes which depend on goods and services consumed. Direct domestic sources of revenue contributed 29 per cent in 2005/06 while indirect taxes accounted for 71 per cent. The share of international trade taxes in total domestic revenue has declined from 61 per cent in 1996/97 to 51 per cent in 2007/08. While Pay-As-You-Earn (PAYE) has had the highest increase from one percent of

total revenue in 1988/89 to 14 per cent in 2007/08. Non tax revenues have almost remained constant at around three percent or less since the early 1990s.

Developing countries face formidable challenges generating revenue because workers in these countries are typically employed in agriculture or in small and informal enterprises. In a similar vein, the modern means of raising revenue such as income taxes and consumption taxes, play a diminished role in Uganda's economy. Uganda also has a small mining and quarrying sector accounting for about one per cent in total output. Low revenue collections are also attributed to low compliance levels, difficulties in enforcement, political interference, poor revenue management and administration. There is also the problem of revenue fraud in the form of smuggling, undervaluation, underdeclaration of income and taxable goods, and misclassification of goods. There is also a problem of tax evasion and avoidance. There is also the problem of importation of second-hand commodities which is bound to adversely affect the environment, employment, local production, household incomes and investments which are important for revenue generation.

Legal and Institutional Framework for Taxation in Uganda

The broad legal framework as laid out in the Constitution of the Republic of Uganda mandates Parliament of Uganda to impose taxes but this may be subject to a presidential veto. Parliament's powers are restricted in financial matters. The amendment power of Parliament on taxation policy depends on the effectiveness of the Committee of Finance, Planning and Economic Development (CFPED) which suggests amendments to the House. This Committee's oversight and scrutiny function on taxation is not well developed and in most cases it is performed on ad hoc basis.



The URA is the central body for the assessment and collection of specified tax revenue, administering and enforcing the laws. In 1998, a Large Taxpayer Unit (LTU) was established within the tax administration to monitor the activities of 100 taxpayers and their subsidiaries that pay a significant share of total taxes to ensure compliance among the largest taxpayers. Tax disputes that arise between URA and the taxpayers are handled by the Tax Appeals Tribunal (TAT). The tax disputes are large and are projected to increase which is a reflection of the problems in tax management. URA and TAT have been in conflict for the most part of 2007/08 which could be a sign that the activities of TAT should be reviewed.

On the other hand, the MFPED is responsible for the formulation of tax and non-tax policies aimed at generating domestic revenue and promoting investment, consumption and savings. The broad tax policy objectives are contained in the budget speeches, followed by the details in tax-related laws like the Finance Act, 2003. It was established that Uganda's tax laws are structured in a manner that is not easy to understand. There are several cross amendments, annual changes, description of items is too detailed, and the coding cannot be understood by non-tax experts. At the same time, the MFPED announces the figures of how much incentives and waivers but not how they have performed in terms of achieving the stated objectives. On participation, apart from Uganda Manufacturers Association (UMA), CSOs have not been involved in tax policy issues especially at the legislative level. Civil society organizations could compliment both the URA in tax education and Parliamentary staff in providing technical information.

Impact of the Current Taxation Policy on Economic Growth in Uganda

Taxes create distortions in the choices made by producers and consumers. Tax policy should neither be too restrictive to discourage private investment and growth, nor too accommodative to create high inflation and crowd out private investment. Government has supported increased output through exemption of taxes on agriculture and exports, tax incentives, low tax rates, emphasis on consumption taxes and generation of high revenues.

This study found a strong relationship between international trade taxes and GDP at market prices. There was virtually no correlation between changes in gross revenues over time and changes in GDP at market prices. The international trade tax reforms could have had a positive impact on growth. Uganda's tax regime does not appear to affect growth which may be attributed to the structure of Uganda's economy which has a significantly large agricultural sector. This implies that wide, overriding tax policy changes may not generate increased outputs; which calls for selective policy interventions.

The tax system was also found to have elements of pro-poor and non pro-poor growth. Low domestic revenue generation, high exemptions and imposing taxes on goods consumed by the poor do not support the notion of pro-poor growth. However, the introduction of broad-based taxes, zero rating of education and health services and taxes on consumption are a characteristic of a pro-poor tax system.

Uganda's Taxation Policy on Poverty Reduction

Tax policy has implications on the poor through the principles of fairness and equity, economic growth and efficiency, and raising appropriate

government revenues. Taxes consistently found to be regressive or at least not progressive are those on exports and on kerosene. Direct taxes in Uganda do not directly affect the poor because of their low levels of income. The threshold for PAYE is above the poverty line and the other direct taxes are not paid by the poor. Most of the commodities consumed by the poor in Uganda are taxed - sugar, soap, matchboxes and paraffin attract different taxes. Import and VAT/Sales taxes in Uganda have also been found to be progressive.

Value-Added Tax in Uganda and the Poor

Value Added Tax is an important component of Uganda's tax system contributing around 36 per cent of the total domestic revenue. A recent study by Ssewanyana & Okidi (2007) found that increasing VAT while other taxes remained constant would increase the tax burden of the poor but the non-poor households would continue paying more taxes relative to their expenditures than the poor households. Commodities like sugar, soap and matchboxes consumed by the poor in Uganda are taxable. Earlier studies had also found VAT/sales tax in Uganda to be progressive.

The 2007/08 National Budget Tax proposals and the Poor

In 2007/08, the major proposed changes in the budget were the introduction of the Local Service Tax and Local Hotel Tax which may have been in response to the abolition of Graduated Tax (GT) in 2005/06. In 2008/09, government is proposing tax breaks and incentives, introducing taxes on the extractive Industry (Oil), excise duty to raise revenue and strengthen measures that protect the environment. There are still fears that Local Service Tax and Local Hotel Tax may encounter problems during implementation similar to those that were faced by GT before it was abolished and the problem of creating small nuisance taxes.

The proposed increase of the environmental levy on used vehicles and goods, exemption from import duty on garbage trucks plus the earlier environmental tax on polythene bags and plastic containers are good for environmental protection. The proposals for revenue generation including the reviewing of excise duty and non-tax revenues are important for the poor. In the 2008 tax proposals stated tax expenditures amount U Shs 24 billion against the stated revenue that will be generated from the new sources of U Shs 53.1 billion.

Investment incentives have continued to be a constant feature in Uganda's budgets with them being either introduced or abolished. Like in the past, the budget also proposes investment incentives to enhance investments, employment, competitiveness and growth. The 2008/09 tax proposals have nine tax breaks and incentives for business, investors and consumers. The tax breaks and incentives are likely to affect revenue mobilization efforts

Another important revenue proposal in 2008/09 is one that relates to payments in the extractive industry. This proposal is important because the extraction of oil and gas generates a large portion of government revenues and there is need to avoid plunging into the "resource curse". There has been substantial activity in petroleum exploration and development. Uganda has signed production-sharing contracts (PSCs) with a number of companies. Government expects under the early production scheme (EPS) to start oil production in mid-2009. The much-needed transparency in oil activities is inadequate or even lacking. The legal framework does not exist and a number of stakeholders have not been taken on board on this new development.

The 2008/09 Tax proposals do not directly address the problems of poverty reduction but are aimed at boosting output. However, the tax policies in existence that affect the livelihoods of the poor directly like agricultural inputs and outputs, health and educational materials have remained zero-rated or exempt.

Allocation of Tax Revenue to Government Programmes

There has been a decrease in the amount of public expenditure as percentage of GDP from 26 per cent in the mid 1990s to around 21 per cent of GDP in the last five financial years. The Budget in Uganda is divided between Poverty Action Fund (PAF) protected areas and non-PAF areas, responding to PEAP priorities. The allocations to PAF were 27 per cent of the total budget in 2006/07. The local revenue is allocated to both recurrent and development expenditure. The local revenue only covers recurrent expenditure

The report makes the following **policy recommendations**:

- Government should carry out limited tax policy reforms and any more reforms should take an incremental process of change targeted at increasing economic growth and tax efficiency. The other policy actions include:
 - ◆ maintaining a single VAT rate with minimal exemptions for commodities mainly consumed by the poor;
 - ◆ introduction of taxes on minerals like gold and in future on oil;
 - ◆ reviewing and raising the minimum threshold of PAYE to U Shs 235,000 to cater for the losses in welfare that have resulted from price increases;
 - ◆ increasing efforts for presumptive taxation through detailed 'sectoral studies' of informal sector firms.

- There should be renewed efforts aimed at simplifying the tax system and educating taxpayers. This may call for the involvement of CSOs like Uganda Debt Network (UDN).
- Government should undertake more simplification of the taxation approaches including markedly reducing tax exemptions, deductions and privileges that cause losses to the Treasury as well as breeding corruption tendencies. A comprehensive document on tax policies and administrative measures undertaken by government should be published to improve on tax administration and also encourage voluntary compliance.
- The MFPED should carry out more technical reviews on the proposed Local Service Tax, Local Hotel Tax, VAT on sale of residential properties and tax investment incentives for international carriers with the idea of dropping these proposals. This would help in avoiding the problems of reliance on small nuisance taxes and abuse of tax incentives.
- Tax policy should be made more pro-poor through the exemptions on commodities like paraffin and matchboxes without incurring large tax expenditures.
- Government should expeditiously define the legal and regulatory framework and this should precede the introduction of taxes on petroleum exploration, processing and development. A framework should be developed for regular publication of all material oil, gas, and mining payments and revenues received by governments. There should be deliberate effort by the Government and Oil companies to bring all stakeholders on board. Studies should be conducted to assess the expected impact of the production of oil.
- Government should reduce on tax expenditures through improvements in transparency and governance especially by making tax laws, regulations, and other documents including explanatory materials available to taxpayers.

- Government should continue to improve expenditure allocations especially through increased allocation to productive sectors like agriculture.
- More comprehensive reviews on tax policies should be conducted aimed at identifying ways of achieving the objectives of adequate revenue, economic efficiency, and provision of equity, simplicity and effective tax administration.

1.0 Introduction

Tax policy refers to the choice of tax instruments, the rates at which taxes are set, the nature of exemptions and the assignment of taxes to different levels of government. Taxation has four main purposes or effects: revenue, redistribution, repricing and representation. A good tax system should be defined so as to meet the requirements of equity in burden distribution, efficiency in resource use, the goal of macro policy and ease administration (Musgrave & Musgrave, 2004). The system should allow the country's authorities to implement tax policy in the most efficient way. Vigorous, open debate on tax policies is ultimately an essential ingredient for the development of a country's "fiscal social contract", whereby citizens are willing to pay taxes because they are confident that the tax system is fair and is raising revenue for valued programmes and services (Moore & Schneider, 2004).

Tanzi & Zee (2001) note that both efficiency (whether the tax enhances or diminishes the overall welfare of those who are taxed) and equity (whether the tax is fair to everybody) are central to the analysis. Another concern is that the choice between taxing income or consumption involves their relative impact on equity. Taxing consumption has traditionally been thought to be inherently more regressive than taxing income. Rarely would increasing income taxes be considered a viable option on the grounds of both policy (because of their perceived negative impact on investment) and administration (because their revenue yield is less certain and less timely than that from consumption tax changes).

Like many other developing countries, Uganda has undertaken comprehensive tax reforms encompassing most of the important revenue sources. Even with these tax reforms, there has been only an increase of about three per cent in the revenue to GDP ratio from around 11 per cent in 1995/96 to 13.1 per cent in 2006/07. Uganda's revenue collection is the lowest in the East African region and this has been attributed to the structure of Uganda's economy. The rate of increase in revenue has not been matched with the overall growth rates in output and increases in people's incomes. The GDP growth rates have averaged more than six per cent since early 1990s and income per capita has more than doubled. Income per capita has increased from U Shs 285,860 in 1995/96 to U Shs 824,742 in 2007/08, while poverty has declined from 56 percent in 1992 to 31.1 percent in 2006.

The purpose of the study was to review and analyse the current taxation policy and its implications for poverty reduction and economic growth in Uganda. Uganda Debt Network sought to contribute to the debate of making Uganda's taxation policy pro-poor by carrying out a comprehensive review and analysis of the policy and its management, and its impact on growth and poverty reduction..

Tax policy has a substantial impact on many of the core concerns of civil society groups, from ensuring the availability of funds for important social programmes to narrowing the gap between rich and poor. In many countries, tax debates are dominated by business people and wealthy individuals, who often do not have the same concerns as civil society groups (Friedman, 2008). Civil society groups can help broaden the debate and bring a new focus on fairness and the needs of the disadvantaged to the discussion of tax policy.

The rest of the report is arranged in three main sections. The next section looks at methodology, sources of data and scope of the study. This is followed by the presentation, review and discussion of results in relation to tax policy, growth and poverty. The last section gives conclusions and policy recommendations.

1.1 Objectives of the study

The main objective of the study was to review and analyse the current taxation policy and its implications for poverty reduction and economic growth in Uganda.

The specific objectives of the study were to:

- a) Provide an understanding of the social, economic, political and fiscal contexts within which the taxation policies are made;
- b) Provide an understanding of the implications of Uganda's revenue policy, revenue collection strategies and management for the overall macro-economic policy environment;
- c) Provide a detailed understanding of Uganda's taxation policy as a tool for equitable, fair and transparent distribution of wealth;
- d) Highlight the key macro-economic policy issues that impede or facilitate effective collection and management of revenues in Uganda; and
- e) Understand the efficiency in allocation of tax revenues towards achievement of economic growth and poverty reduction.

2.0 Methodology

2.1 Research Design

The study employed the descriptive approach. Descriptive approaches collect and analyse a large body of information about the nature of policy, the way reforms are implemented, and changes in the welfare of different groups within the country (McCulloch, Winters & Cirera, 2001). These kinds of studies seek to construct a plausible account of the extent to which policy changes have been responsible for observed changes in welfare.

The study applied comparative, trend and correlation analysis to identify key issues for discussion. To further assess the influence of taxation on growth, correlations between savings, investment and growth were established. Inference from similar studies, especially in developing countries, was also employed. The impact of VAT on poverty using inference from similar studies was undertaken. VAT was selected based on the fact that the introduction of VAT reforms were a major component of tax reforms in Uganda, as it significantly contributed to the resource envelope (17 per cent of total revenue) before the reforms and the general public had reacted negatively to its introduction.

2.2 Data type

The study used both primary and secondary data. Macroeconomic secondary annual time series data was used. The key variables used were: GDP at market prices; revenue, grants and total expenditure; national population and poverty.

2.3 Data Sources

The secondary data used in the study was obtained from the major GOU publications. The publications were got from the Uganda Bureau of Statistics (UBOS), Documentation Unit at UDN, URA, MFPED, BOU, Economic Policy Research Centre and the Parliament of Uganda library. The MFPED publications used included copies of the Budget Speech and the Background to the Budget issued over several years. In addition, internet sources were used to access data that was not available in hard copy form.

To supplement the empirical findings, interviews with key informants were conducted. However, the problem of non-response was encountered from the MFPED, CSOs and Members of Parliament.

2.4 Data analysis

Annual time series data collected was analysed using spreadsheets. The nominal data collected was expressed as a ratio of GDP. A number of averages, percentages and rates of change were worked out for use in the study and calculation of correlations. The information was tabulated and graphs created. To supplement this, qualitative information was gathered, coded and summarized in themes and message content.

2.5 Scope of the study

The study covered the period 1985 to 2008 with more emphasis on the last 10 years. The key areas covered included tax policy, revenue collection, poverty, and GDP growth rates. The taxes were classified into direct and indirect taxes and subsequently subdivided into major tax heads such as VAT, excise tax, corporate income tax and PAYE.

3.0 Presentation and Discussion of Results

3.1 The Social, Economic, Political and Fiscal contexts within which the taxation policies are made

3.1.1 Macroeconomic Environment

The Government's primary macroeconomic objective is to promote rapid broad-based and sustainable private sector-led economic growth that is adequate to reduce poverty (MFPED, 2007). In line with this objective, the economy has achieved macroeconomic stability with growth rates averaging about 7.8 per cent since 2000/01 and average inflation at single digit levels since 1992/93. The economy is projected to grow at 8.1 per cent during the financial year 2008/09 (MFPED, 2007). Similarly, government has maintained a competitive real exchange rate that supports export growth. The foreign reserves have increased from negative in the 1980s to the current level where they can cover about 6.9 months of imports of goods and services (MFPED, 2008).

In the last five years, the transport and communication sector has experienced the highest levels of growth. Output in the sector increased from U Shs 700 billion in 2003/04 to U Shs 1,258 billion in 2007/08. The sector had double-digit growth rates; growth has averaged 15.8 per cent in the last five years. The other sectors with the exception of monetary agriculture have had impressive growth rates. The sectors of manufacturing, wholesale and retail trade, and hotels and restaurants grew at five, seven, and nine per cent respectively. Growth in monetary

agriculture has been extremely low, averaging only 1.0 per cent in the last five years. However, the most puzzling and disturbing issue is the inability of the agricultural sector, which employs 73 per cent of Ugandans, to effectively contribute towards the country's GDP. This indicates the need for incentives and investments to enhance agricultural production and productivity, agro-processing and marketing.

The policies pursued by government to ensure increased output include:

- **Privatization**

The Government in the early 1990s adopted a programme to divest itself of the majority of the 107 public enterprises that were in existence at the time. The public enterprises were inefficient and unable to generate enough resources to finance their operations and save for re-investment. They were increasing the public debt through indirect and direct subsidies which amounted to U Shs 0.208 billion in 1994 (MFPED, 2000a).

As result, GOU has reduced its direct role in the economy especially in the production of goods and services. The process had led to the reduction of subsidies from U Shs 208 billion in 1994 to only U Shs 51 billion in 2001 (with direct subsidies reducing by 50 per cent and indirect subsidies by 78 per cent. However, the problem of subsidies is re-emerging as evidence shows that subsidies amounted to U Shs 207.6 billion in 2006/07. The recent resurgence of subsidies in the energy sector has resulted in more than the pre-privatization subsidy levels. The economy has benefited in terms of expanded tax base, improved productivity and competitiveness and job creation. The privatisation process has resulted in increased government revenue generation. Enterprises that were formerly a burden to the Treasury now contribute taxes, as examples in Table 1 below indicate.

However, the major concern in the divestiture process was the corruption, for example, during the sale of the former Uganda Commercial Bank, Nile Bank and Apollo Hotel. Secondly, the public as major stakeholders have never known how the divestiture proceeds were utilized (MFPED, 2000a). There was also little or no pre-post layoff support including counselling, retraining and redeployment programmes that would have helped laid off workers reintegrate into the labour market. The treatment of employment liabilities has been on an ad hoc basis and lacked clear retrenchment benefits policy.

Table 1: Tax Remittance for Selected Companies (U Shs, millions)

Tax Payer	Before divestiture	2005/06	% change
Kampala Sheraton Hotel (Apollo Hotel)	408	3,356	722.5
Uganda Telecom Limited	8,644	30,632	254.4
MTN Uganda Limited	0	120,014	-
Celtel (U) Limited	0	11,764	-
Nile Breweries Ltd	6,875	49,593	621.4
Uganda Clays	861	2,037	136.6
Tororo Cement Industries Limited	0	35,258	-

Source: Privatization & Utility Sector Reform Project, 2004

- **Export competitiveness**

Government's intention is to become a leader in Sub-Saharan Africa in terms of competitiveness and ease of doing businesses (MFPED, 2007). Government intends to ease the regulatory burden on doing business through reduced cost of registering and transferring property, to improve access to credit and reduce the cost of trading across borders. However, improving competitiveness still requires more deliberate national policies

to foster a systematic upgrading of domestic productive capabilities. Such policies cover a range of areas, including investment, enterprise development, technology, R&D, intellectual property, skill formation and infrastructure development. Attainment of competitiveness would result in increased exports, growth in output, more revenues and lowering of poverty levels. This would further improve on the export earnings of goods and services that have increased from US \$ 1,014 million in 2003/04 to US \$ 2,293 million in 2007/08.

- **Agricultural modernisation**

The Plan for Modernisation of Agriculture (PMA) - a central element of Uganda's poverty eradication strategy - is key to enabling the rural population to improve their livelihood and ensure food security through changing subsistence agriculture to doing farming as a business. About 70 per cent of the working population is self-employed in agriculture. In 2006, about half of the households in Uganda depended on subsistence farming as their major source of earnings. The proportion was higher in rural areas (58 per cent) compared to urban areas (10 per cent) (UBOS, 2006).

However, even with the PMA output in the agricultural sector has not been robust and the number of people leaving industry and service sectors to agriculture has increased. Employment in the agriculture and hunting sector increased from 65.5 per cent in 2002/03 to 73.3 per cent in 2005/06. The percentage of those self employed in agriculture increased by 11.2 per cent between 2002/03 and 2005/06. This may be partially due to the failure to get non-agricultural work, as explained by a negative growth rate for those persons who are self-employed in non- agricultural activities (9.4 per cent) per annum. These facts show that the country is still far from modernizing agriculture.

- **Foreign direct investment**

Government enacted The Investment Code, 1991 to provide more favourable conditions for investment and establish the Uganda Investment Authority to promote, facilitate and supervise investments in Uganda. Government will continue efforts to improve the business environment by the enactment of additional commercial laws including the Counterfeit bill, the Mortgage Bill, the Free Zones Bill, the Company Bill, the Insolvency Bill, and amendment of the Investment Code. There has been steady growth in Foreign Direct Investment (FDI) inflows credited to the remarkable macroeconomic and political stability. In the last five years, FDI has averaged to US \$ 335.2 million (i.e. from US \$ 204.7 million in 2003/04 to US \$ 536.6 million in 2007/08). High FDI levels are important for generating more output, employment, generation of government revenues and poverty reduction.

3.1.2 Fiscal Context of Tax Policy in Uganda

Fiscal policy is related to government's taxation and spending programmes with the goal of achieving full employment, price stability and economic growth. Medium-term fiscal programmes geared towards sustaining financial sustainability and high rates of economic growth as well as supporting the PEAP have succeeded in achieving low and stable inflation, adequate level of foreign reserves and relatively favourable outlook for balance of payments and availability of donor support. A flexible fiscal regime has been maintained to ensure that it responds to volatile movements in the foreign exchange market, unrealized revenue performance and shortfalls in the external budgetary support. Notable examples of the flexibility are the surrendering of the Treasury Bill instrument to the monetary authorities, the imposition of a coffee stabilization tax during the 1994-95 coffee price boom and expenditure

cuts whenever there are shortfalls in programmed revenues as was the case in 1998/99. The coffee stabilization tax raised U Shs 14.3 billion and U Shs12.9 billion in 1994/95 and 1995/96 respectively.

The other tool that government has applied has been the introduction of a cash budget in 1992 where expenditure is based on revenue available. This was further followed by the Government Commitment Control System that expressly details Accounting Officers not to commit GOU where there are no matching funds (MFPED, 1999). This did not stop the accumulation of arrears requiring funding for domestic arrears of U Shs 280 billion in 2007/08 (MFPED, 2007).

However, there is evidence that the problem of arrears is being solved as expenditure on arrears was U Shs. 280 billion in 2007/08 and there is a further provision of Shs. 300 billion for arrears in Financial Year 2008/09. The arrears and supplementary expenditures that further increase the deficits and debts are an obstacle to any future tax reform involving revenue losses uncompensated by expenditure restraint.

In addition, there has been a problem of supplementary expenditure. The supplementary appropriations for 2000/2001, 2001/2002, and 2003/2004 were U Shs 109.02 billion, U Shs 121.53 billion and U Shs 126.22 billion respectively,¹ and arbitrary budget cuts have almost become chronic. Supplementary expenditures for 2003/04 represented 4.2 per cent of the total budget. This contravenes the regulations that say supplementary expenditures requiring resources over and above what was appropriated are not expected to exceed three per cent of the total approved budget for that Financial Year without the prior approval of Parliament.

As a result, fiscal deficits have been an important aspect of fiscal policy in Uganda. Fiscal deficits are important because of their macroeconomic

consequences and the economic wisdom that public debt results from the need to finance budget deficits. The deficits have been heavily funded by donors as the local revenue collections have remained low. In the last decade, grants and concessional borrowing have financed fiscal deficits. Fiscal policy has been heavily influenced by donors whose strong support from multilateral and bilateral donors has entirely financed the fiscal deficit since 1992/93. This failure by Uganda to cover almost one half of its spending by own resources raises concern about the sustainability of the fiscal stance. This calls for answers to the question: what will happen in case of donor fatigue or just a change in donor policy that could result in the cutting of aid?

The existing persistent budget deficits suggest that the tax system is not revenue productive, and in such situations increasing revenue should be the main objective of tax policy. The overriding objective has been increased revenue collection coupled with increased production through attraction of investments and maintaining macroeconomic stability. Revenue enhancement has been a key element of fiscal sustainability. This has been through improvement in tax and customs administration, enhanced tax compliance, and committed effort to combat fraud and smuggling. Fiscal policy has also been used in the management of the environment. In this respect, Government imposes relatively high taxes on petroleum products, cigarettes, and second hand commodities (cars) and has an environmental levy. Examples of tax proposals in support of sustainable environmental management are:

- Imposed excise duty of 20 per cent on polythene bags for environmental reasons in 2002/03.
- 2007/08- Introduced a 10 per cent environmental levy on used motor vehicle spare parts;
- 2007/08- Introduced an excise duty of 120 per cent on polythene and plastic bags of more than 30 microns;

- 2008/09- Increase the environmental levy on used cars that are 8 years and above to 20 per cent.;
- 2001/02-Increased excise duty on cigarettes from 122 per cent to 130 per cent .

On the other hand, in the past, Uganda's emphasis on public borrowing was on concessional terms i.e. averaging a 40-year period with 10-year grace period at interest rates not exceeding 0.75 per cent. The legal framework is such that government cannot incur public debt or guarantee/ raise any loan without the approval of Parliament. The new framework for borrowing emphasises external debt sustainability, priority sectors for external borrowing, giving priority to grants over loans, minimizing cost and risks associated and setting rules (i.e. borrowing cap). However, despite these earlier attempts, by 2006 Uganda's external debt stock had reached US\$ 4.3 billion. The Multilateral Debt Relief Initiative (MDRI) has dramatically brought down the external debt to US \$ 1,899.93 million in 2008 while domestic debt was U Shs 2.063 trillion in June 2007. The public debt structure has been strengthened by a reduction of foreign indebtedness as a result of debt forgiveness. The study found out that past parliamentary loan scrutiny has not resulted in any significant changes.

Table 2: Top Fifteen Taxpayers, 2005/06 - 2006/07

Taxpayer	2005/06 Amount	Rank	2006/07 Amount	Rank
MTN Uganda Limited	120,014,563,759	1	173,930,571,973	1
Shell Uganda Ltd.	105,505,602,349	2	140,860,199,542	2
Uganda Breweries Ltd	70,055,233,294	3	101,942,117,894	3
Nile Breweries Ltd	49,593,222,491	4	60,344,338,243	4
Caltex Oil (U) Ltd	47,460,645,952	5	49,965,750,750	5
Total Uganda Limited	46,207,073,913	6	49,231,552,402	7
BAT Uganda 1984 Limited.	45,407,569,783	7	49,837,329,100	6
Century Bottling Co. Ltd.	43,737,951,033	8	43,338,452,378	9
Tororo Cement Industries Ltd	35,258,707,394	9	45,747,498,058	8
Stanbic Bank (U) Ltd.	33,206,283,732	10	-	
Aggreko International Project Ltd			37,770,681,879	10
Total	596,446,853,700		752,968,492,219	

Source: Uganda Revenue Authority

The tax regime is oriented more towards consumption taxes rather than income taxes. Income taxes account for only 27 per cent of net URA collections. The top ten taxpayers contributed 27 per cent and 29 per cent of the local resource envelope in 2005/06 and 2006/07 respectively with most of the revenue coming from excise duties. For 2005/06, corporation tax paid by 100 top taxpayers, who are mostly business companies constituted 10.75 per cent. This means that the tax incidence does not actually fall on these organizations, as they are simply acting as tax collection centres. For instance, taxes on petroleum duty (27.1 per cent) VAT on imports (15.95 per cent), local VAT (15.23 per cent), local excise (11.49 per cent), P.A.Y.E (8.42 per cent), import duty (5.18 per

cent) and Local Withholding Tax (4.66 per cent). The telecommunication sector has had the leading taxpayer (MTN Uganda Limited) for the financial years 2005/06 and 2006/07(see Table 2). These companies are important in raising revenue that is needed for economic growth and poverty reduction.

3.1.3 Overview of Poverty Eradication Action Plan

The key programmes aimed at improving the socio-economic welfare of all Ugandans are contained in the PEAP which is Uganda's national planning framework that guides public action to reduce poverty. The PEAP which was formulated in 1997 aimed at reducing the population living in absolute poverty to 10 per cent by 2017. The revised PEAP priorities are to be implemented in the medium term through five pillars:

- **Pillar 1: Economic management**

Government's aim is to maintain a growth rate of eight per cent in the medium term through, among other things, the removal of barriers to investment, tax incentives, improvement in transport infrastructure and utility services and security in Northern Uganda. The objectives of macroeconomic management are inflation control and private sector-led growth. Inflation is to be kept at five per cent by controlling monetary growth.

- **Pillar 2: Enhancing production, competitiveness and incomes**

Agriculture remains a critical sector to restore growth in rural incomes and provide employment to the majority. Actions will include promotion of production, competitiveness and incomes.

- **Pillar 3: Security, conflict-resolution and disaster management**

Government will continue to use security forces to protect the population. The search for peaceful methods of conflict-resolution will continue; Government will cooperate with CSOs, faith-based groups and traditional leaders. Peace in the northern region will lead to people in the Internally Displaced Peoples (IDPs) camps returning home to engage in active production contributing to their incomes, revenue generation and poverty reduction. It is predicted that peace would result in an increase in the demand and supply for goods and services, including infrastructure, and an increase in GDP.

- **Pillar 4: Good Governance**

Government conducted elections at all levels in 2006 under a multiparty system. Enabling laws will be strengthened to discourage malpractices and enacted in good time. It will also involve maintaining high standards of human rights, reducing and curbing mismanagement of government funds/corruption, and controlling crime because it discourages investment.

- **Pillar 5: Human development**

A healthy and well-educated population is both a necessary condition for development and one of the central objectives of development. Government will focus resources on those who would not have had access to education, particularly secondary and tertiary. In health, Government will prioritize preventive care. It will be the responsibility of Government to assume most of the costs of rural water supply while the supply of urban water will be managed on a commercial basis. Government will also strengthen social protection for vulnerable groups using community-based approaches. Human resource development is essential for creating the working class which would contribute to income taxes (i.e. PAYE).

3.1.4 Nature, Causes and Poverty Trends in Uganda

There is general agreement that poverty is *a lack of basic needs and services such as food, clothing, bedding, shelter, basic health care and education* (MFPED, 2002). People also emphasize that poverty is *powerlessness* which means a lack of ability to express one's views both at home, in the case of women, and to government. Individual or household poverty is seen as a situation of perpetual need for daily necessities of life (MFPED, 2000b). The 'poverty line' in Uganda relates to the cost of obtaining the basic requirements which was estimated at U Shs 39,746 per month per person in 2006. In addition, food, beverages and tobacco still dominate the household budget (UBOS, 2006).

Meanwhile, Uganda's impressive growth in GDP appears to have benefited the masses through translating into a significant reduction in headcount poverty. Headcount poverty as a percentage of the total population has reduced significantly, from 56 per cent in 1992, through 44 percent in 1997, 34 per cent in 2000, 38.8 per cent in 2002/03 to 31.1 per cent in 2006 (see Table 3). The poverty levels in Uganda are projected to reduce at a rate of 3.5 per cent annually (see Graph 1; UBOS, 2006). These changes were mainly driven by increases in average income rather than by the distribution.

The growth between 2002/03 and 2005/06 seems to have benefited the majority of Ugandans resulting in the proportion of people living in poverty declining and so has, in absolute terms, the number of poor persons. There were significant improvements in living standards and in distribution of income, but marked with spatial unevenness in the improvements. The results also suggest that the poverty reduction in rural areas contributed to the overall reduction in poverty by 7.7 per cent observed at the national level.

The trendline on graph 1 shows over time (X) that poverty (Y)- (P0)- which is the percentage of Ugandans estimated to live in households which spend less than what is necessary to meet their calorie requirements and to afford them a mark-up for non-food needs would periodically decline by -3.5 per cent. The decrease in poverty levels has not been smooth as shown on Graph 1. The successive trends in poverty reduction that had been achieved since 1992 were reversed in 2003. Poverty increased in both urban and rural areas. This was attributed to poor terms of trade mainly as a result of a decline in coffee prices (MFPED, 2006).

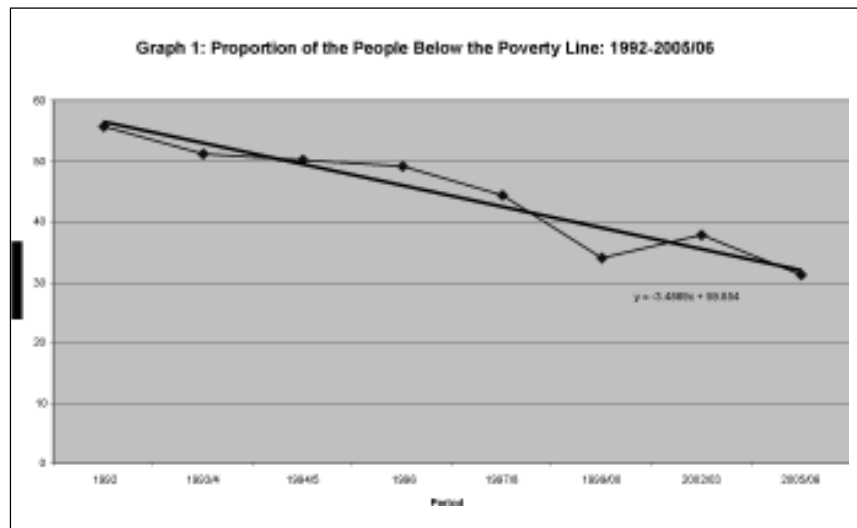
In absolute numbers, the poor have not significantly changed. The people below the poverty line were 8.5 million in 2006. In 2002/03, out of the 24.9 million people about 9.4 million Ugandans were living below the poverty line (see Table 3). In the period 1992-2006, only 1.2 million Ugandans have moved out of poverty. In absolute numbers, the decrease in the number of the poor people is projected at only 0.2 percent annually.

As a result of the civil war, Northern Uganda remains the poorest region in the country with 3.7 million poor people in 2006 (UBOS, 2006). The region has had the highest incidence of poverty. The percentage of the poor in the northern region dropped marginally from 72 per cent in 1992 to 60.7 per cent in 2006 (Table 3). Poverty levels in the eastern region have also remained high compared to western and central regions. The Central and Western regions have had the greatest decrease in poverty levels from 46 per cent and 53 per cent in 1992 to 16 per cent and 21 per cent in 2006 respectively.

Poverty is still more prevalent in the rural areas. Eighty five per cent of Ugandans live in rural areas. The number of poor people living in rural areas has declined from 60 per cent in 1992 to 34 per cent in 2006, while

the poor in urban areas have decreased from 28 per cent in 1992 to 14 per cent in 2006.

The Uganda National Household Survey (UNHS) 2005/2006, using the main industry in which the household head works reveals that the percentage of Ugandans living on incomes below the minimum required to meet the basic needs dropped in all sectors. Poverty declined markedly amongst crop farming households, with the headcount declining from 48.9 per cent to 36.8 per cent. The headcount for non-crop agriculture, construction and mining, and manufacturing was 28.1 per cent, 27.1 per cent and 21.8 per cent respectively. The lowest incidence of poverty of 8.5 per cent was under those engaged in public services. The inactive households had the highest poverty levels of 37.2 per cent.



On the contrary, while there was significant progress in poverty reduction in Uganda, the disparities in income levels have remained wide as measured by the gini coefficient indicator. A gini coefficient is a measure of inequality, which is a number between zero (0) and one (1); where zero corresponds with perfect equality and one corresponds with perfect inequality. The income inequality rose markedly from 0.36 in 1992 to 0.41 in 2005/06. This implies that the increase in income was not distributed proportionately among Ugandans. However, there was a reversal on the observed trend in income disparity in 2005/06 compared to 2002/03 when income inequality was widening; inequality dropped from 0.43 to 0.41 (see Table 3).

Table 3: Poverty and Income Inequality Trends in Uganda

Years/Residence	1992	1993/4	1994/5	1996	1997/8	1999/00	2002/3	2005/6
National	55.7	51.2	50.2	49.1	44.4	33.8	38.8	31.1
Rural	59.7	55.6	54.3	53.7	48.7	37.4	41.1	34.2
Urban	27.8	21	21.5	19.8	16.7	9.6	12.2	13.7
Central	46	-	-	-	28	19.7	22.3	16.4
Western	53	-	-	-	43	26.2	31.4	20.5
Eastern	59	-	-	-	54	35.0	46.0	35.9
Northern	72	-	-	-	60	63.7	63.6	60.7
National (Gini Coefficients)	0.36	0.35	0.36	0.37	0.35	0.39	0.43	0.41
People Below the Poverty Line (millions)	9.7	9.5	9.7	9.8	9.4	7.6	9.4	8.5
Total Population(millions)	17.5	18.6	19.2	19.9	21.2	22.6	24.9	27.4

Source: Uganda Bureau of Statistics & MFPED (2007a)

With regard to moving into and out of poverty, one of the factors underlying the improvements could have been the recovery of coffee prices from an average of US \$ 0.56 (U Shs 970) per kg in 2002/03 to US \$ 1.38 (U Shs 2,508) per kg in 2005/06.² The coffee sector is showing signs of recovery due to improved international prices. Coffee export receipts are estimated to increase by 32 per cent from US\$ 228.5 million in Financial Year 2006/07 to about US\$ 301.6 million in Financial Year 2007/08 as a result of a 19 per cent increase in the international coffee prices.

A study by Bigsten and Shimeles (2004) had also found that the positive distributional outcome was largely driven by the recovery in cash-crop agriculture. They observed that dramatic decline in coffee prices partly have reversed the positive picture evident until 2000. Similarly, Okidi and Mugambe (2002) found that households that experienced persistent poverty for at least five years in the 1990s were engaged in agricultural self-employment as the main economic activity. This evidence underscores the importance of off-farm opportunities in poverty reduction.

The other factor is the lack of human and technical skills to exploit available income-generating and life-improving opportunities. With the bulk of Uganda's population in the subsistence sector utilizing unskilled labour, it is essential that for growth to be pro-poor it should focus on labour-intensive techniques. Today's labour intensive production of goods and services in a competitive world requires abundant skills. There is also lack of affordable comprehensive insurance mechanisms to enable people to ward off economic, health and other related shocks that can lead to slippage into poverty at their occurrence. Furthermore, poverty has been exacerbated and perpetuated by insecurity of life and property.

Land shortages owing to population pressures are also a contributing factor to poverty incidence. According to the 2002 Population Census, Uganda has a population growth rate of 3.5 per cent per annum and a fertility rate estimated at 6.9. Population pressure directly contributes to deforestation and environmental degradation and in the end, trapping farmers in a vicious state of low productivity and low incomes.

The other causes are the lack of material opportunities such as jobs, credit, and public services, schools and health services. The major factors for moving into poverty included alcoholism, polygamy, and insecurity in the North and large families/dependants. Other influential factors included lack of access to markets and limited access to land, unfair taxation/high market dues, ill-health (Ssewanyana & Muwonge, 2004).

3.1.5 Uganda's taxation policy in relation to the PEAP objectives

Tax policies can have an impact on a country's economy by influencing incentives to work, save, and invest. Tax policy influences the distribution of income and wealth in a country. Knowing how the tax burden is borne by these different groups—rich or poor, male or female, urban or rural, employers or workers—can help advocate new, fairer tax policies. It is a question of who bears the burden of a tax often depends on the tax base—for instance, whether a tax is levied on the income a person earns, or the goods and services a person consumes. Because poor people must spend a large share of their income simply to purchase basic necessities, taxing consumption can impose a heavier burden on the poor than the well-off. In contrast, income taxes are often structured in such a way that the tax burden rises as income rises. They tend to impose a heavier burden on those with the greatest ability to pay the tax and so have the potential to reduce income inequality.

Tax policies mainly support poverty reduction through creating more growth and reducing the cost of goods mainly consumed by the poor. Many poor countries are characterised by both high levels of income and wealth inequality, and taxation regimes that are simultaneously inefficient and regressive. More efficient and equitable taxation regimes would change the distribution of income in favour of poorer people and permit governments to raise more financial resources to address poverty (Toye, 2000). Tax policy in Uganda has mainly concentrated on simplifying the tax system, revenue generation and restricting people from consuming certain commodities rather than directly protecting the poor. The key tax policy proposals are contained in the budget speeches delivered at meetings of the Parliament of Uganda. The details of tax policy changes are then drafted into a bill for consideration by Parliament.

Emphasis on revenue generation and tax incentives to attract investor is in line with the pillar of Economic Management, and the revenue generated is important in funding activities under the pillars of Good Governance, and Security, Conflict-resolution and Disaster Management. At the same time, tax policy through tax exemptions, incentives and zero rating of commodities has been more supportive to the pillars of human development and enhancing production, competitiveness and incomes.

The removal of taxes on agricultural inputs and outputs is in line with enhancing production, competitiveness and incomes. Fertilizers, insecticides, fungicides and herbicides attract no taxes, while implements like picks, mattocks, hoes and rakes are not taxable. Loans to the agricultural sector were exempted from taxes in 2006. Government has gradually removed most taxes in the sectors of health and education, which sectors are vital for human capital development. Government abolished duty rates on medicaments in 2006. Antibiotics, pharmaceuticals

and X-ray materials do not attract taxes ((Laws of the Republic of Uganda, 2000 Chapter 340& 349).

In all, government tax policy actions support PEAP through focusing on increased production, minimizing distortions, promoting human development and generally exempting the poor from paying certain taxes. However, a number of commodities (i.e. soap, matchboxes and sugar) consumed by the poor are not exempted or zero-rated. More still, the tax policy reforms were undertaken at the early stages of formulating and implementing the PEAP which implies some of the reforms that are in line with the PEAP goals could have been by coincidence.

3.1.6 Tax Reforms in Uganda

Taxes are frequently distinguished as 'direct' and 'indirect'. Personal taxes, such as the individual income tax, are direct and most in rem (taxes on things)³ such as sales and excise taxes are indirect (Musgrave 1989). Uganda relies on both direct and indirect⁴ taxes. Under direct taxes we have PAYE, withholding tax and corporate tax; and indirect taxes include excise duty, sales tax and VAT. Non-tax revenues comprise collections like dividends from BOU (and other Public Enterprises like Kinyara Sugar Works Ltd.), collections by ministries and foreign missions, collections from fees and licenses. Uganda heavily relies on indirect taxes but the share of direct taxes has been growing.

At any given point of time, however, the important tax policy issue for developing countries is not so much to determine the optimal tax mix but to spell out clearly the objectives to be achieved by any contemplated shift in the mix, to assess the economic consequences (for efficiency and equity) of such a shift, and to implement compensatory measures if the

poor are made worse off by the shift. The effectiveness of tax systems depends not only on the design of tax policies but also on effectiveness of tax administration (Stepanyan, 2003). Once governments have their tax policies appropriately designed, the tax administration plays the main role by securing the effective implementation of the policies.

The American Institute of Certified Public Accountants (2001) lists 10 guiding principles of good tax policy as: equity and fairness; certainty; convenience of payment; simplicity; neutrality; economic growth and efficiency; transparency and visibility; minimum tax gap; and appropriate Government revenues. The guiding principles are commonly cited and used as indicators of good tax policy. All the guiding principles have been selectively emphasized in Uganda. At the same time, the International Monetary Fund (IMF) has provided input into the design of tax reforms in many transition and developing countries and generally recommended that tax systems have the following characteristics:

- Heavy reliance on broadly-based sales taxes, such as VAT , preferably with a single rate and minimal exemptions, and excise taxes levied on petroleum products, alcohol, tobacco and a few items that are considered luxurious.
- No reliance on export duties, which inhibit international competition, or on small nuisance taxes, administration of which is not effective.
- Import taxation at as low levels as possible, with limited dispersion of rates to minimize effective rates of protection.
- An administratively simple form of personal income tax, with limited deductions , a moderate top marginal rate, an exemption limit large enough to exclude persons with modest incomes, and substantial reliance on withholding tax
- A corporate income tax levied at only one moderate-to-low rate

aligned with the top personal income tax rate, with depreciation and other non-cash expenditure provisions uniform across sectors and minimal recourse to sector or activity-specific incentive schemes.

A tax system should also address issues of transparency and governance. Tax laws, regulations, and other documents, including explanatory materials, should be accessible to the general public and be kept up-to-date. Changes to tax legislation should be given sufficient publicity so that tax-payers understand how they might be affected and there should be a mechanism in place whereby taxpayers can have their queries answered. In most cases, changes in tax legislation in Uganda are not given sufficient publicity. Also, administrative discretion in applying tax laws must be limited (Stepanyan, 2003). In addition, the IMF (2007) urges that tax expenditures which are revenues forgone as a result of selective provisions in the tax code should be compared with policy purposes to assess their relative effectiveness. They include exemptions from the tax base, allowances deducted from gross income, tax credits deducted from tax liability, tax rate reductions, and tax deferrals (such as accelerated depreciation).

On the other hand, the scope of tax reform may be comprehensive in the sense that it is intended to encompass most of the important revenue sources and often involves adoption of new tax codes, or it may be partial, confined to one or two significant components of the tax system. Regarding the breadth of reform, it may focus on the entire tax system, including institutions for tax administration and compliance, or may be concerned only with changes in tax policy that focus on tax base and rate structure. The impact of reform upon the revenue-generating capacity of the tax system is probably the most serviceable measure of the tax reform's success (Stepanyan, 2003).

The goals of tax reforms in Uganda have been fourfold: broaden tax base; increase efficiency of collection; create incentives for the private sector; and ensure equity of taxation. The tax reforms undertaken were comprehensive and intended to encompass most of the important revenue sources and involved the adoption of new tax codes. The reforms were directed at rationalizing the tax structure and tax rates, widening the tax base, reducing exemptions, and simplifying procedures (see Table 4; Appendix 1). A semi-autonomous URA headed by a Commissioner General was established in 1991 with the view of improving tax administration. The Commissioner General's independence and powers were enhanced in the URA Amendment Act, 2007. Numbers to identify taxpayers were introduced and a new coding system was introduced. The tax proposals in the last five years have targeted boosting investment, increased production; raising revenue and promoting the consumption of certain commodities (see Appendix 1).

Tax reforms in Uganda have generally been in line with the IMF's recommendations. A broadly-based VAT with a standard rate of 17 and minimal exemptions plus tax incentives was introduced in 1996. Sales tax before reforms was structured as 0 per cent, 10 per cent, 30 per cent, 70 per cent and 150 per cent (MFPED, 1991). Excise taxes are levied on petroleum products, alcohol, tobacco and airtime in line with the general practise in most countries. In addition, export taxes were abolished with exception of duty on hides and skins. Import duties have been reduced from 70 per cent in 1991 to 25 per cent 2006. As a result of the coming into effect of the East African Community Customs Union in 2005, a Common External Tariff (CEF) with a three-band structure was adopted for all imports in the East African Community.

The CEF is generally applied as follows:

- Zero (0) per cent for raw materials and capital goods;
- Ten (10) per cent for semi-processed and intermediate goods;
- Twenty five (25) per cent for finished products.

Elsewhere, Stepanyan (2003) notes that there seems to be little evidence in the Baltics, Russia and other (BRO) countries of a substantial improvement in income tax revenues resulting from reforms of simply reducing the top marginal tax rates. Also in BRO countries, the elasticity of the behaviour of economic agents, in terms of labour supply, savings and investment, with respect to income tax rates is not large, and a reduction of income tax rates is unlikely to lead to a notable expansion of economic activity. Therefore, aggregate savings will not increase much when personal income tax rates are reduced. Uganda differs significantly from the BRO countries; income taxes have grown significantly since the reforms were undertaken.

With the exception of Tajikistan, Ukraine and Uzbekistan, most BRO countries of the former Soviet Union charge enterprise profit tax below 30 per cent. These countries charge a lower rate compared to that of Uganda where corporate income tax is charged at 30 per cent. On the side of personal income tax system, the BRO countries widely differ from Uganda's practice with a top tax rate of 30 per cent and four brackets. In Uzbekistan, the personal income tax in 1998 was raised to 45 per cent and the number of brackets increased to five. Ukraine in 1996 reduced the top marginal tax rate to 40 per cent and the number of brackets to six. In 1997, Latvia introduced a single 25 per cent rate. While Armenia has two brackets with a top rate at 20 per cent and in 2001 it broadened the tax base by including interest income. Uganda's corporate income tax is in line with the IMF guidance of

levying only one moderate-to-low rate aligned with the top personal income tax rate.

In addition, Uganda's personal income tax (i.e. PAYE) is administratively simple, with four income brackets and a monthly threshold of U Shs 130,000 which excludes persons with modest incomes. In 1997, the tax brackets were reduced and widened from five to the current four and salaries were consolidated into a single unit for the calculation of PAYE by abolishing lunch and transport allowances or making them part of the salary. Employers are required on behalf of URA to deduct PAYE when effecting payment to employees. The tax rates for PAYE as stipulated in the Income Tax Act 1997, third Schedule Part 1 are specified as nil, 10 per cent, 20 per cent, 30 per cent. The nil rate applies to income earnings of up to U Shs 130,000 per month or U Shs 1,560,000 per annum.

As result, revenue generation from PAYE has increased from only U Shs 0.5 billion in 1988/89 before the reforms to U Shs 440.7 billion in 2007/08 equivalent to 14 per cent of URA collections (see Table 6; MFPED, 2008). However, there have been continuous calls from the general public and Parliament for an increase in the PAYE threshold to U Shs 235,000 to cater for the changes in welfare as a result of inflation (Parliament of Uganda, 2006). Especially with the current price increases, inflation has eroded the value of the standard exemption, and this has had a particularly harsh effect on people with low incomes. The Government has resisted adjusting the tax code for inflation in order to bolster revenue collections. Such "backdoor" kind of revenue increases should be monitored closely and avoided.

Table 4: Major Tax Reforms in Uganda 1989-2007

1990/91	<ul style="list-style-type: none"> • Taxes on government imports - abolished • Payment of taxes through commercial banks introduced, to minimize fraud and increase efficiency in revenue collection
1991/92	<ul style="list-style-type: none"> • Uganda Revenue Authority (URA) set up with the view of improving tax administration • The National Customs Tariff System based on the Customs Cooperation Council Nomenclature was replaced with the Harmonized Commodity Description and Coding System
1992/93	<ul style="list-style-type: none"> • Export duty on coffee
1994/95	<ul style="list-style-type: none"> • Coffee stabilization tax introduced • Introduction of withholding tax • Introduction of Tax Identification Numbers (TIN) and computerization of income tax department
1996/97	<ul style="list-style-type: none"> • Introduction of VAT at a standard rate of 17% to replace Commercial Transaction Levy (CTL) and Sales tax. 1996/97
1997/98	<ul style="list-style-type: none"> • Introduction of a new Income Tax Act 1997/98
2000/01	<ul style="list-style-type: none"> • Introduced GATT valuation method in place BDV and abolished pre-shipment inspection • Abolished discretionary powers under Section 4 of the Tariff Management Act 1970 for the Minister of Finance to remit import duty and excise duty under the Customs and Excise Law
2002/03	<ul style="list-style-type: none"> • All government contracts awarded only to VAT registered persons
2005/06	<ul style="list-style-type: none"> • Loans to agriculturalists exempted from tax • Graduated Tax abolished • Increased the rate of Value Added Tax (VAT) from 17 per cent to 18 per cent

2007/08	<ul style="list-style-type: none">• Introduction of Local Service Tax• VAT on sale of Residential Properties reduced from 18% to 5%• Road License Fees except for charges on first registration abolished• 10 year tax holiday to companies engaged in value exports• Local Hotel tax on all Hotels and Lodge Occupants• Environmental Levy
2008/09	<ul style="list-style-type: none">• Exempted of duty and tax payments on construction materials• Exempted income tax on new agro processing investments• Reduced the excise duty on beer made from local raw materials• Exempted Heavy Fuel Oil from VAT• Exempted VAT on trucks of loading capacity of 3.5 tons and above• Exempted VAT on table salt• Aligned the Income Tax Act with the Production Sharing Agreements• Tax imports and other supplies for companies undertaking petroleum exploration, development and production• Schools and tertiary institutions exempted from income tax

Source: TROU (Various); MFPED (Various); Ayoki, Obwona & Ogwapus (2004)

The executive has rejected this on grounds that the budget pressures are even greater and they leave no room for action. For example, raising the threshold of PAYE to U Shs 235,000 would exclude primary school teachers from paying the tax (Parliament Research Service, 2006; Table 5). It would result in loss of revenue estimated at U Shs 10.6 billion. On the other hand, health workers would continue paying lower amounts of the tax because health workers salaries are slightly higher compared to those of primary teachers. Health workers salaries would be above the new threshold.

Table 5: Estimated Amount of PAYE from Primary Teachers-2004

Qualification	Number of teachers	Average Salary	Annual PAYE	Total Amount of PAYE
At least Grade IV	22,066	232,570	123,084	2,715,971,544
Grade III	93,831	200,000	84,000	7,881,804,000
Licensed	22,756	121,366	0	0
Others	661	91,042	0	0
Total	139,314			10,597,775,544

Source: <http://www.education.go.ug/factbooklet .htm> & UDN's Calculations

Developed countries (like the USA) index exemptions, standard deductions and brackets limits thereby making the wage earners income tax inflation-proof (Musgrave et al, 1989). One of the reasons for increasing the threshold has been over time because of persistent increases in prices (inflation) the cost of living changes. The composite Consumer Price Index (CPI) has risen by more that 67 per cent since 1997/98 (i.e. CPI was 100 in 1997/98 and has increased to 167.0 in April 2008). As a result, a person who was earning U Shs 130,000 in 1997 would require about U Shs 217,084 in 2008 to remain at the same welfare level. This figure is close to the proposed U Shs 235,000.

3.1.7 Political Context of Tax Policy in Uganda

The way states raise revenue has major implications for state formation. In contemporary Organisation of Economic Co-operation and Development (OECD) countries, issues of taxation remain central and important - especially around elections (Fjeldstad & Rakner, 2003). On the contrary, issues of taxation have not entered the political agenda in most sub-

Saharan African countries because only a minority of citizens pay direct taxes and low revenue-raising countries receive large amounts of aid. In Uganda, the political goal of tax policy has been mainly a preserve of the MFPEP. On the other hand, with the exception of URA, the other key informants perceive politics, and not economics, to be the driver of tax policies.

Hale (2002) describes tax systems as the political constitution that defines the powers and limits of governments and the rights of citizens. The principles of the tax system reflect a loose and evolving political consensus on social and economic priorities. The politics of taxation demand that governments strive for a system that seems fair to most people.

Uganda is a very diverse society with a multiplicity of divisions, based in particular on ethnicity, region and religion. Following independence in 1962, Uganda has been blighted by long periods of violence and political instability. In Uganda, democracy and its underlying principles are seen as crucial for the wellbeing of all Ugandans because of the turbulent history that the country has gone through. In 1986, the National Resistance Army (NRM) took power and brought peace to most parts of Uganda.

The recent manifestation of democracy and political governance in Uganda includes the move from the Movement System of governance to a Multi-Party dispensation; the constitutional review process; conducting of electoral politics; and the question of gender in electoral politics. Decentralization has also been an important policy long before the tax reforms but the Movement and central priority-setting processes have remained in control of tax policy.

On the other hand, Daunton (2001) urges Parliaments to transcend conditions in which competing interests negotiated their share of taxation

and become auditors of expenditure. The strength of the Parliament's oversight role are claimed to be contingent upon the size of the governing party's majority of seats. According to Dubrow (2002), party domination can filter to committees and limit their effectiveness as well as the effectiveness of Parliament in general. Good governance is also gauged by the performance of the Justice, Law and Order sectors in any country.

In the case of Uganda, the Speaker of Parliament is from the ruling NRM organization and the CFPED which handles tax policy issues is dominated by members from the ruling party. This has not, however, stopped the committee from rejecting policy proposals from the executive. The Committee called on the executive to always ensure that the recommendations of Parliament are adhered to (POU, 2006a). For example, it reminded Government to think seriously of increasing the threshold of PAYE from U Shs 130,000 to U Shs 235,000. Contrary to the Committee's recommendation in 2006 the august House voted against increasing the threshold to U Shs 250,000 (POU, 2006a). In most cases, the House passes tax proposals with minimal amendments or rejections.

Secondly, under the Excise Tariff (Amendment) Bills, 2006, Parliament voted against the proposals to:

- to impose Shs 500 per 50-kilogramme bag of cement;
- increase of excise tariff on beer whose raw material content, excluding water at 75 per cent of its constituent from 20per cent to 30 per cent;
- impose excise duty on landline and public pay phones 5 per cent.

The house objected to these proposals on grounds that they would be detrimental and affect the construction industry and the poor. In accordance with Article 91(3) (b) of the Constitution the assent copies of the Excise Tariff (Amendment) Bill, 2006 were returned for reconsideration

by Parliament. The President explained that the imposition of excise duty on landlines and public pay phones and cement were designed to widen the tax base (POU, 2006b). Parliament reconsidered and passed the Excise Tariff (Amendment) Bills, 2006 without any changes (POU, 2007).

The President has also in the past given tax policy reforms political backing to ensure Uganda avoids overdependence on donors and generates revenues for the PEAP while controlling the political system. Tax policy has had a strong component of development partners' perspectives and the current tax policies have been closely intertwined with current international development assistance trends (Mackinnon & Reinikka, 1999). The revenue authorities concentrate on meeting the targets set by the IMF and MFPED; they have focused on increasing collection and compliance from existing taxpayers rather than attempting the more complicated task of widening the tax base. This may be a reflection that tax policy has limited effects on Uganda's political development without one clear overall trend.

There has also been an element of semi-military operations to prevent smuggling and tax evasion in Uganda. Coercion has been accepted as an integral part of tax collection, thus it is unlikely that state-society relations can become more accountable and democratic. In the 2001 general elections, graduated tax was one of the campaign issues. Some tax policy changes like the introduction of VAT in 1996, removal of Graduated Tax in 2005 and the proposed introduction of Local Service Tax in 2007 have taken place before or after the elections.

On the side of the peasants, they do not participate and are not represented in the tax policy- making process. The elite also do not directly participate in the tax policy formulation but usually air out their views through the

media. For example, the two leading daily newspapers (*Daily Monitor & New Vision*) carried 22 articles on taxation in the month of July 2007. Most of these articles were urging government to reconsider some of the 2007/08 tax proposals especially those that they anticipated would increase the burden on those in the formal sector. The issue of participation could best be undertaken by the CSOs who in most cases are in close contact with the local communities.

On the other hand, small lobby groups pressure for exemptions, for rate reductions on imports, or bargain with officials or ministers about tax liabilities (Fjeldstad & Rakner, 2003). The politics of taxation is in general limited to involving a few specialized interest groups, and tends to take place in non-public arenas. Political power is particularly important when it comes to special-interest politics: concentration of public policy (Persson & Tabellini, 2002). The groups benefiting most from policy have strong incentives to get organized and build political power, at the expense of everyone else. One such organized group is the UMA which has been very vocal in protecting local industries. The UMA has been the dominant interest group on tax policy issues. However, voices and organized responses to new revenue policies have been developing within the business community recently, especially from the Kampala City Traders Association. Examples are the strike against the introduction on VAT and radio debates on tax policy. Civil society organizations, especially churches, have also been calling for exemptions against certain taxes.

3.1.8 Revenue Performance in Uganda

Developing countries face formidable challenges in raising revenue because workers in these countries are typically employed in agriculture or in small and informal enterprises. They are seldom paid a regular fixed wage,

their earnings fluctuate, and many are paid in cash, “off the books”. The base for an income tax is therefore hard to calculate. Tanzi et al (2001) concluded that modern means of raising revenue, such as income taxes and consumer taxes, play a diminished role in these economies.

In the case of Uganda, revenue collection as a percentage of GDP has increased slightly from 11.3 per cent of GDP in 1995/96 to 13.1 per cent of GDP in 2007/08. Uganda’s revenue collection is among the lowest in the East African region; Kenya’s revenue collection as percentage of GDP averaged 21.2 per cent in the financial year 2003/04. The average tax-to-GDP ratio in Sub-Saharan Africa was around 21 per cent in 1999 and that of OECD countries averaged about 32 per cent (Fjeldstad & Rakner, 2003).

In nominal terms, revenue collection has more than doubled. Net URA collections increased from U Shs 797.43 billion in 1997/98 to U Shs 3,159.0 billion in 2007/08 (see Table 6). Revenue collection from all the major sources has more than doubled since 1997/98. The highest growth in nominal revenue of 810 per cent was in PAYE. This was followed by corporate income tax with an increase of 689 per cent and the least amount of change was observed in excise tax (159 per cent). The low nominal change in excise tax may be a reflection of the constant share of industry in GDP in the last five years.

The current ratio of 13.1 per cent of GDP (Financial Year 2007/08) is the highest level of collections in the last two decades. The annual changes in revenue collections as percentage of GDP have been minimal over the years. The changes in revenue collection as a percentage of GDP since 1999/00 have amounted to less than 3 per cent (i.e. revenue has not gone below 10 per cent nor increased beyond 14 per cent). The revenue

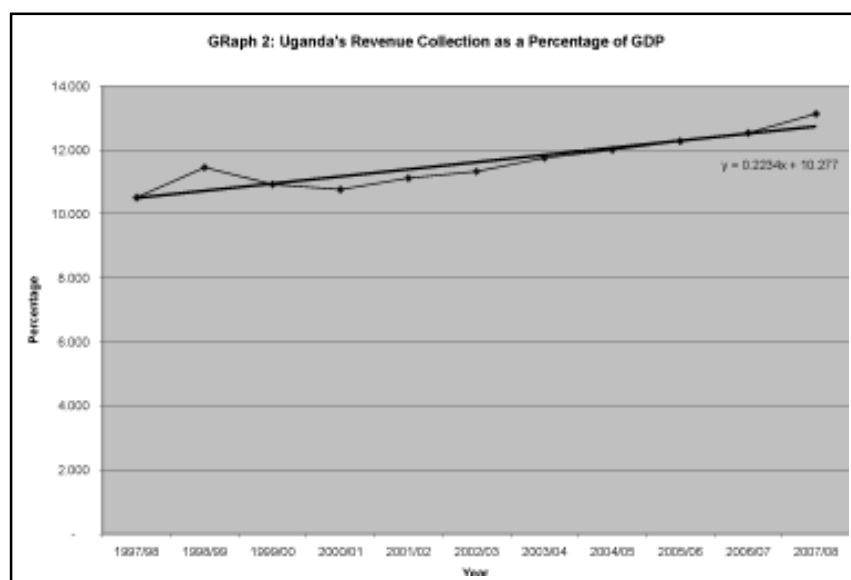
collection as percentage of GDP is projected to grow at a rate of only 0.2 per cent annually as shown by the trend line (See Graph 2). The rate of increase in revenue has not been in line with the overall growth rates in output and increases in people's incomes. Income per capita has almost doubled in the last eight years increasing from U Shs 441,713 in 2000/01 to U Shs 824,742 in 2007/08.

On the other hand, Mintz (2003) notes taxes on consumption are a better source of revenue for developing countries, they are easier to collect and more consistent with achieving economic growth objectives. Uganda's tax system is dominated by indirect taxes which depend on goods and services consumed. Direct domestic sources of revenue contributed 29 per cent in 2007/08 while indirect taxes accounted for 71 per cent. The share of international trade taxes in total domestic revenue has declined from 61 per cent in 1996/97 to 51 per cent in 2007/08. While the share of VAT as a percentage of total revenue has increased slightly from 33 per cent in 1997/98 to around 36 per cent in 2007/08. Non tax revenues have almost remained constant at around three per cent or below since the early 1990s.

Uganda's low revenue performance has been attributed to the structure of the economy. Uganda has a significantly large agriculture sector, accounting for 21.4 per cent of GDP in 2007/08. The services and Industry sector contributed 49 per cent and 24 per cent to GDP in 2006/07 respectively⁵. The contribution of industry to GDP has changed slightly from 22 per cent to about 24 per cent of GDP in the last decade (MFPED, 2006). In addition, there has been no shift in the sectoral composition of employment as agriculture remained the major sector with employment in the sector increasing from 66 per cent in 2002/03 to 73 per cent in 2005/06. About 70 per cent of the working population is self-employed in

agriculture (including hunting) (UBOS, 2006). The outputs and inputs in the agricultural sector do not attract taxes. The question to be answered is what is the contribution of the high growth rate service sector to revenue generation?

Uganda also has small mining and quarrying sector accounting for about 0.3 per cent in total output. This sector also contributes little to tax revenue. However, there are indications that the sector may emerge as one of the key sources of revenue from the mining of gold and oil. The export of gold has steadily grown over the years from a US \$ 34 million in 1999/00 to US \$ 118 million in 2006/07 (MFPED, 2007a). Currently, mining companies are supposed to pay only income tax. There was no easily accessible evidence to show that gold activities contribute to domestic revenue. For example, a levy of three per cent on gold activities would generate an estimated U Shs 6.4 billion annually.



At the same time, URA attributes low revenue collections to the big informal sector and inadequate tax education. The Uganda National Household Survey (UNHS) 2002/03 showed that Uganda's labour force stood at 9.8 million persons, of whom 2.6 million were in non-agriculture informal sector. Of the 9.8 million persons in the labour force, 3.5 million persons were the working poor. The unemployment rate is 3.5 per cent, while the underemployment rate is 17 per cent. These do not pay income tax apart from the Graduated Tax which was abolished.

Table 6: Revenue Performance in Uganda: 1997/98-2007/08 (U Shs millions)

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Net URA Collections*	797.43	935.56	978.00	1,075.15	1,212.47	1,409.25	1,642.06	1,923.52	2,231.05	2,625.20	3,159.0
Direct Domestic Taxes + Fees & Licences**	131.62	170.07	180.52	223.06	288.32	359.02	453.76	576.58	679.97	811.30	915.00
Indirect Taxes	680.68	788.2	827.48	887.09	962.94	1,080.8	1,230.8	1,393.34	1,639.86	2,011.61	2,328.30
Indirect Domestic Taxes	214.50	244.65	272.03	276.02	329.68	357.65	369.49	435.12	512.02	697.40	712.80
International Trade Taxes	466.18	543.55	555.45	611.07	633.26	722.45	861.31	958.22	1,127.84	1,314.21	1,615.50
Government Taxes	9.29	11.30	23.27	15.24	13.05	12.73	11.93	15.36	16.69	29.80	53.80
Direct Domestic Taxes	107.88	148.43	158.79	200.12	259.48	319.94	402.50	513.32	604.62	727.40	853.70
PAYE	48.41	57.65	83.47	103.55	137.31	168.27	200.27	245.33	307.57	368.63	440.70
Corporate Tax	29.25	44.31	40.47	54.27	69.41	84.27	121.58	160.03	182.17	195.01	230.80
Excise Duty	115.78	129.65	131.38	125.57	139.27	148.07	177.40	186.38	183.90	249.50	299.70
Value Added Tax	260.93	321.26	343.13	374.20	431.80	495.47	573.52	664.54	781.92	925.10	1,138.30
Tax Refunds	-14.87	-22.72	-30.00	-35.00	-38.78	-29.87	-42.51	-46.41	-60.01	-96.00	-100.20
Fees and Licences	23.73	21.65	21.73	22.94	28.84	39.08	51.27	63.27	75.35	83.9	61.30

Source: Uganda Revenue Authority & Ministry of Finance Planning and Economic Development

* Excluding Government Taxes and tax refunds

** The same as Direct axes

Uganda also has a large but declining non-monetary sector of the economy; the sector declined from around 15.1 per cent in 2001/02 to 13.5 per cent of GDP in 2006/07(MFPED, 2007a). The non-monetary sector is hard to tax people in the sector do not pay taxes and some of them cannot afford the basic needs. Another significant area are the Small to Medium Enterprises (SMEs), they constitute 75 per cent of all companies in Uganda and employ over 60 per cent of the total workforce. The direct tax these enterprises can appropriately pay is presumptive tax (i.e. estimates of taxes payable used in dealing with incomes or activities that are hard to tax). Presumptive taxation involves simple and cost-effective techniques to capture domestic transactions and sources of income that frequently escape taxation under conventional norms (Taube & Tadesse, 1996). In 2005/06, presumptive tax collections amounted to only U Shs 3.6 billion.

The other problem has been importation of secondhand commodities (like cars, clothing, household utensils etc) that adversely affected the environment, employment, local production, household incomes and investment. For example, the secondhand clothing that started entering the textile market around 1985 have currently flooded the country. The demand for all types of textile fabrics in Uganda was 210 million square metres per year (CFPED, 2004). The importation of secondhand clothes constituted 170 million square metres (81 per cent), importation of new fabrics 21 million square metres (12 per cent) and domestic production 15 million square metres (7 per cent) of the total demand. The secondhand clothes have effectively killed the textile industry, and have as a result affected the revenue raised from the textile sector.

It is usually said that high levels of aid may diminish a government's incentive to make full use of its domestic resources for revenue generation (Brautigam & Botchwey, 1999). Based on past studies in other developing

countries, one is compelled to say Uganda's poor revenue performance cannot be blamed on aid. In support of more aid, Jones & Arndt (2007) have argued aid in developing countries provides essential fiscal space to implement a tax system that is conducive to growth and builds a more positive social-fiscal compact. Collier (1997) argues that high taxation retards the growth process and induces tax evasion. Studies in Pakistan and the Thailand have associated aid with both investment and consumption expenditure and no final impact on taxation (Mcgillivray, 2002; Khan, 2002).

There is also a problem of tax evasion and avoidance. The MFPED (2006) attributed the decrease in contribution of VAT to the total collections by URA to low compliance levels, and difficulties in enforcement. In support of the MFPED argument, The Auditor General's Reports (2003; 2006) highlight a number of cases of wastefulness in revenue management. Among the many cases highlighted was: U Shs 4.2 billion not supported by receipts: URA retained U Shs 20 billion without authority; U Shs 1.5 billion not acknowledged by URA; U Shs 3.7 billion uncollected by Uganda Police; U Shs 2.3 billion not remitted by the New York mission; U Shs 1.1 billion by MFPED not supported by customs documents; and, U Shs 0.2 billion not collected by the Parliamentary Commission.

The problems of evasion and avoidance have occasioned armed security personnel to deploy to enforce compliance in revenue collection (this being a crude method of revenue collection). Revenue fraud has also been in the form of smuggling, undervaluation, and underdeclaration of income and taxable goods, misclassification of goods - all of which have been rising. A study by Fjeldstad & Rakner (2003) reported that after the initial success in the 1990s, revenue as percentage of GDP stagnated or declined and the level of fiscal corruption seems to have increased.

More so, the establishment of a proclaimed autonomous revenue authority has not protected the authority from political interference. The study also found out that corruption had continued to thrive in the URA even with relatively high wages and good working conditions due to the lucrative enticements dangled by those who pressurise staff to circumvent the rules. Third, hiring and firing procedures may lead to more corruption. These corruption networks also seem to have been strengthened because many of those fired are recruited to the private sector as 'tax experts'. In all, the taxes in Uganda are not structured to minimize non-compliance (i.e. they do not meet the principle of minimum tax gap).

Revenue management and administration have also been sources of problems as reflected in the complaints raised against URA and the MFPED. In 2003, four companies petitioned Parliament: Uganda Baati Ltd, Road master (U) Ltd, British American Tobacco (U) Ltd and Oil and Soap Manufacturers (CFPED, 2003). Uganda Baati Ltd petitioned parliamentary committee on grounds of discrimination in some sectors of the economy in which some manufacturers import nearly finished products and treat them as raw materials. In the Steel sub sector, the raw material for iron sheets (cold rolled coils) and the semi-finished galvanized sheets are treated as raw materials. The Committee recommended that import and COMESA duty should be imposed on importation of galvanised iron sheets to encourage investments in the sector and generate revenue and employment for the country.

Consequently, Uganda's tax system does not satisfy the principles of certainty, simplicity and neutrality. The tax law is not simple so that taxpayers understand the rules and the effect on tax-payer's decisions as to how to carry out particular transactions have not been kept to a minimum. The tax rules are also not clearly specified for an ordinary

taxpayer to know when the tax is to be paid, how it is to be paid and how the amount to be paid is to be determined. In addition, there are normally many annual tax changes which create uncertainty.

In all, agreeing with Tanzi et al (2001), modern means of raising revenue, such as income taxes and consumer taxes, play a diminished role in Uganda. The reforms have not achieved increased revenue to GDP ratio and the widening of the tax base. The tax system does not adequately satisfy the principle of appropriate Government revenues. The agricultural, non-monetized and informal sectors combined reinforce each other to limit the amount of revenue generated. About 70 per cent of Uganda's working population employed in the agriculture and those in the service sector who earn U Shs 50,000 cannot pay any form of income tax. Low revenue collections by URA are also attributed to low compliance levels, difficulties in enforcement, political interference, poor revenue management and administration.

3.2 Legal and Institutional Framework for Taxation in Uganda

The laws that govern the administration of Uganda's tax system include: The Constitution of the Republic of Uganda; The Public Finance Act Cap 149; The Contingencies Fund Act Cap 150; The Budget Act, 2001; The Income Tax Act, 1997; The Stamp Duty Act, (Cap 172) as amended; The Finance Statute 1998 (Statute No. 4 of 1998) as amended; The Customs Tariff Act, 1970 (Act No. 17 of 1970) as amended; The East African Customs Management Act, 2004; The Value Added Tax Statute, 1996 as amended; The Traffic and Road Safety Act, 1998 (Act No. 15 of 1998) and Regulations; The Excise Tax Act (Cap 174) as amended ; and The East African Excise Management (EAC Cap. 26) as amended.

These laws spell out the duties and responsibilities of the institutions responsible for regulating, policy development, planning, assessment, collection, administration, enforcement and accounting for all the revenue. These laws define the tariffs, for example, they define the imposition and collection of road users' tax. Similarly, all provisions for the collection of license fees, fines, levies and other fees (other than fines imposed by courts) are spelt out.

The Constitution of Republic of 1995 Uganda under Article 152 states:

- (1) No tax shall be imposed except under the authority of an Act of Parliament.
- (2) Where a law enacted under clause (1) of this article confers powers on any person or authority to waive or vary a tax imposed by that law, that person or authority shall report to Parliament periodically on the exercise of those powers, as shall be determined by law.
- (3) Parliament shall make laws to establish tax tribunals for the purposes of settling tax disputes.

Article 153(1) of the Constitution also provides that all revenues and other monies raised or received by the Government be paid to the Consolidated Fund. Parliament has a wide mandate to call Government officials, CSOs and the general public during the budget process. However, Parliament's amendment powers are subject to a presidential veto^{***}. Parliament of Uganda's powers are restricted in financial matters. Parliament shall not, unless the bill or motion is introduced on behalf of the Government:

- (a) proceed upon a bill, including an amendment bill, that makes provision for any of the following:
 - I. The imposition of taxation or the alteration of taxation otherwise than by reduction.
 - II. The imposition of a charge on the Consolidated Fund or

other public fund of Uganda or the alteration of any such charge otherwise than by reduction.

*** Article 91 (3) © of the onstitution of the Republic of Uganda

Parliament works through committees to allow for proper scrutiny, analysis and consultations on matters laid on table. In Uganda, the Parliamentary Committees responsible for tax-related issues are those responsible for: Budget, Finance, Planning and Economic Development, National Economy, Public Accounts and Local Government Public Accounts. The CFPED oversees, monitors and evaluates the performance of the MFPED and URA. The Bills mostly considered by the CFPED are revenue collection ones (like the Finance Bill, Income Tax bills) and any others related to the institutions and sectors under the Committees mandate. The amendment power of Parliament on taxation policy depends on the effective role of the CFPED which suggests amendments to the House. The Committee's oversight and scrutiny function on taxation is not well developed and in most cases has been performed on ad hoc basis. The Committees do not carry out detailed analysis of gender and equity concerns on the tax proposals. However, two other committees (LPAC and PAC) on accountability are rated highly in the oversight function (Kabakumba, 2007).

Some of the key milestones relating to taxation and revenue in the Budget Act, 2001 include:

- February 15th, submission to the President of preliminary Estimates of Revenue and Expenditure for the next Financial Year.
- April 1st, Three-Year Macroeconomic Plan and Programmes for Economic and Social Development in preparation for final submission. Indicative Preliminary Revenue and Expenditure Framework.

- Budget Committee scrutinizes the estimates and the reports of the Sessional Committees and submits its recommendations to the Speaker. The Speaker sends the recommendations to the President by May 15th.
- By June 15th, estimates of Revenue and Expenditure of Government are laid before Parliament. The Budget Speech is read.
- Quarterly reports on exemptions of tax are made to Parliament on or before March 31st, June 30th, September 30th and December 31st in each financial year.

The MFPED is responsible for the formulation of tax and non-tax policies aimed at generating domestic revenue and promoting investment, consumption and savings. Accordingly, the Ministry plays a pivotal role in the co-ordination of development planning, mobilisation of public resources, and ensuring effective accountability for the use of such resources for the benefit of all Ugandans. Tax policy formulation is limited to a few technocrats without the involvement of other stakeholders. The broad tax policy objectives are contained in the budget speeches, followed by the details in tax-related legislations like the Finance Act, 2003 and Income Tax Act, 1997.

In practice, the report on exemptions has been made annually and submitted to Parliament during the reading of the national budget. The requirement to submit quarterly reports on exemptions may not be quite realistic because it may be time-consuming and the resources needed to prepare and scrutinize it may not be readily available. The MFPED does report on the performance of incentives. The MFPED should not stop at announcing figures on incentives and waivers but it should report on their performance in terms of achieving the stated objectives.

The Parliamentary Budget Office and Research Division within the Parliamentary Service provide the technical background needed in discussing revenue and tax-related bills. The information required under the Budget Act (2001) is very technical in nature, yet all the key players in the budget process are expected to provide it at different stages. The Finance Act is structured in a manner that is not easy to understand. There are several cross amendments which are provided for, there are changes annually, and the volume of the act itself is large.

The description of items is too detailed and the coding cannot be understood by non-tax experts. The Act also includes amendments from different tax laws (i.e. fees payable under the Traffic and Road safety Act 1998, Act No. 15 1998 were included) (The Republic of Uganda, 2002). Thus in order for a person to understand the Finance Act, one needs to read several pieces of legislation. All respondents agreed that very few taxpayers understand the tax system and there was a lot to be done for taxpayers to understand the system. This has necessitated the URA Public and Corporate Affairs department to increase tax education activities through the media, booklets, hotlines, plays, tax education workshops and seminars. Civil society organisations could compliment both the URA in tax education and Parliamentary staff in providing technical information.

While URA which was established on 5 September 1991 by URA Statute No. 6 of 1991 is a central body for the assessment and collection of specified tax revenue, administration and enforcing the laws relating to such revenue and accounting for all the revenue to which those laws apply. The URA is required to advise the Government on matters of policy relating to all revenue. Uganda Revenue Authority is managed and administered by a Board of Directors, which is the policy-making body and has general oversight power. The management of URA is headed by the Commissioner-General.

More typical was the creation of an independent revenue agency with considerable autonomy. In 1998, a Large Taxpayer Unit (LTU) was established within the tax administration to monitor the activities of 100 taxpayers and their subsidiaries that pay a significant share of total taxes. The creation of an LTU may help the tax administration target its resources effectively and demonstrate its commitment to ensuring compliance among the largest taxpayers.

Uganda Revenue Authority identifies, informs and assesses tax payers with regard to those taxes relevant to them. It also collects and accounts for the taxes collected and enforces collection where default has occurred. The study found URA revenue generation was inadequate on the basis of the low revenue/GDP ratio compared to the other Sub-Saharan countries.

Disputes between URA and taxpayers are handled by the Tax Appeals Tribunal (TAT). The tribunal was set up by an Act of Parliament (Cap 345) as a specialized court to provide the taxpayer with easily accessible, efficient and independent arbitration. In the financial year 2006/07, 120 tax disputes were registered by the tribunal valued at U Shs 120 billion and out of which 105 disputes were resolved valued at U Shs 68.48 billion. The tribunal targets to resolve 100 disputes valued U Shs 130 billion (MFPED, 2007c). The tax disputes are large and are projected to increase which is a reflection of the problems in tax management. Unfortunately, URA and TAT have been in conflict for the most part of 2007/08 which could be a sign that the activities of TAT should be reviewed.

On the other hand, CSOs have been involved in the budgeting process in Uganda at the invitation of the MFPED. Uganda Debt Network, Forum for Women in Democracy and Uganda Manufacturers' Association (UMA) have been the lead CSOs involved in the budgeting process. UMA submits

proposals to MFPED during the drafting stage of the budget. Some of UMA's proposals are in the areas of tax policies, tax administration and infrastructure development. Apart from UMA, CSOs have not been involved in tax policy issues especially at the legislative level. Greater civil society involvement on this budgetary issue would help in compensating for limited capacity for fiscal analysis.

3.3 Impact of the current taxation policy on economic growth in Uganda

An effective state is able to mobilize revenue and spend it on infrastructure, services and public goods that enhance human capital and the well-being of communities, as well as stimulating investment and employment creation by the private sector. Engen & Skinner (1996) reported that output is determined by the economy's resources that include the size and skills of the workforce and the size and productivity of the capital stock. The United Nations University (2006) urges states to ensure policy on public finance is neither too restrictive to discourage private investment and growth, nor too accommodative to create high inflation and crowd out private investment.

Taxes create distortions in the choices made by producers and consumers. The component of income tax levied on wages distorts the choice between work and leisure and may affect labour supply (Stepanyan, 2003; Engen & Skinner, 1996). The component imposed on capital income received by individuals distorts their choice between consumption and saving, while the component imposed on enterprises affects investment decisions and may alter the allocation of capital among different sectors of the economy.

Studies on the impact of taxation on growth are ambiguous and numerous. Lucas (1990) claims that a tax reform involving a fiscally neutral change eliminating capital taxes would increase growth rates negligibly. Jones, Manuelli & Rossi (1993) found eliminating all distortionary taxes would increase the growth rate by four per cent to eight per cent, while Engen & Skinner (1996) predicted that a balanced budget increase in government spending and taxation by 10 per cent would decrease long-term growth rates by 1.4 per cent. Alesina, Ardagna, Perotti & Schiantarelli (1999) showed that an increase of one percentage point of GDP of taxes on labour leads to a reduction of investment over GDP ratio by 0.17 and a cumulative effect of about 0.7 in five years. Rohàè (2004) concluded that even with empirical studies giving conflicting results, smaller tax burdens create lesser distortions in the economy and lead to smaller losses in growth rates.

Uganda's tax system has not raised sufficient revenues to finance essential government expenditure and the level of donor support has been significant. The approved budget estimates for the five sectors of Works and Transport, Agriculture, Education, Health, and Water and Environment show that out of the U Shs 853.4 billion in 2006/07 allocated to these sectors, domestic contribution was U Shs 283.6 billion (see Table 7). The percentage share of contributions by domestic sources and donors in the five sectors was 33 per cent and 67 per cent respectively. On the contrary, the key informant from the URA believes tax policy supports economic growth through availing of revenue, infrastructure, incentives and exemptions.

Table 7: Share of Domestic and Donor Funding in Development Expenditure FY 2006/07 (U Shs Billion)

Sector/Vote	Domestic Development ⁶	Domestic Development (%)	Donor Project	Donor Project (%)	Total
Works and Transport	76.27	21.03	286.35	78.97	362.62
Agriculture	66.75	54.49	55.76	45.51	122.51
Education	47.05	55.84	37.21	44.16	84.26
Health	29.47	17.47	139.23	82.53	168.7
Water and Environment	64.04	55.55	51.24	44.45	115.28
Total	283.58	33.23	569.79	66.77	853.37

Source: MFPED, Budget Speech for Financial Year 2007/08 & Authors Calculations

On the other hand, Uganda has over time lowered the tax rates which are good for pro-poor growth. It has also reduced taxes or exempted intermediate inputs which are both output efficiency-enhancing and pro-poor. The exemptions have been in the areas of agriculture and exports, tax incentives to investors, emphasis on consumption taxes and generation of high revenues all in support of higher growth rates.

There has been an increase in exports, but this has been matched by the growth in imports and thus a negative trade balance. Exports increased from US \$ 459.9 million in 1999/00 to US \$ 1,752.33 million in 2006/07. The major exports in 2005 were coffee, fish and fish products, gold, cotton, base metals and products, flowers, tea, petroleum products and

tobacco. The seven major exports accounted for 73 per cent of the total exports. In the last five years, the exports have been growing at 22 per cent compared to 20 per cent growth in imports.

Table 8: Correlation Matrix of Output between Revenue in Uganda

	Change in GDP at Market Prices	Change in Fixed Capital Formation	Change in Savings	Change in Private Consumption
Change in Gross Revenue	0.12	0.01	0.06	0.15
Change in Taxes on International Trade	0.70	0.69	-0.28	0.71
Change in PAYE	-0.53	-0.36	0.26	-0.54

Source: Authors Calculations

Using correlations, Table 8, show that there is a strong relationship between change in international trade taxes and change in GDP at market prices. There is a positive correlation coefficient of 0.7 between change in international trade taxes for the three variables of GDP at market prices, fixed capital formation and private consumption. This may imply that the reforms on international trade taxes have had a positive impact on growth.

There is virtually no correlation between gross revenues over time and GDP at market prices. This could be interpreted as denoting that the tax system as a whole does not affect growth which ties in with the fact that there were no dramatic changes in growth after the major tax policies were initiated. There is a modest negative correlation between change in PAYE and change in private consumption with a coefficient of -0.54. This

indicates the importance of selective tax policy interventions relevant for increased growth. The tax system does not impede or reduce the productive capacity of the economy (i.e. it satisfies the principle of economic growth and efficiency). However, it should be noted that regression and correlation analyses alone cannot prove cause-and-effect relationships, and not all effects can be captured.

3.4 Impact of the current taxation policy on poverty reduction

Gemmell & Morrissey (2005) agree that few studies have actually looked at the impact on the poor of specific tax structure changes in developing countries, and there are no direct studies on the impact on poverty. They concluded that one would expect that taxes on foods, especially staple foods would have an adverse effect on the poor. Results by Ahmed & Stern (1991) using Marginal Social Cost (MSC) on kerosene or paraffin supported the idea that taxes on such fuels are regressive and have a high social cost. Also Davis (2007) found that poorer taxpayers are disproportionately burdened by excise taxes imposed on “necessities”, such as gasoline, utilities and telephone services. In Uganda, metered water, electricity and telecommunication services are variable. In addition, telecommunication services attract excise tax implying that the urban poor are disproportionately burdened.

On the other hand, Younger (1996) found that about 70 per cent of the additional tax revenues raised from the 1980s tax reform in Ghana were accounted for by the highly regressive cocoa export duty and petroleum excises, suggesting tax reform was bad for the poor. However, it is also worth recognizing that export taxes may be the most effective means of taxing certain groups, whether smallholder cash-crop producers or

relatively rich plantation owners or mining companies. Evidence from Africa shows that car/petrol taxes are strongly progressive; alcohol taxes appear quite progressive in most cases, and even tobacco taxes are reasonably progressive in Madagascar.

Gemmell & Morrissey (2005) summarize the evidence from various studies on the impact of taxes on the poor as follows:

- Taxes on private transport (gasoline, autos) tend to be strongly preferred on distributional grounds.
- VAT and sales taxes tend to be more progressive than import taxes or excises.
- Export taxes and taxes on kerosene are often regressive and are the least preferred taxes on a welfare criterion. Taxes on mining or plantation exports are unlikely to be regressive.
- Progressivity of the so-called 'sin taxes' on alcohol and tobacco is variable.
- Uniform taxation of fuel would be problematic because of the very different consumption patterns for gasoline and kerosene (or paraffin), which are respectively highly pro-rich and pro-poor in their consumption. Furthermore, as fuel is an input to transportation, the economic incidence may be more regressive.

On account of this, Gemmell & Morrissey (2005) made several recommendations for enhancing the potential for tax reform to be pro-poor:

- Commodity taxes, both on sales and trade, should have few rates with a low dispersion (i.e. no very high rates).
- Ensuring commodity taxes are zero-rated on goods consumed predominantly by the poor rather than the rich, and on activities that are engaged in predominantly by the poor.
- Subsidize the price of commodities that are consumed by the poor

but not by the rich (e.g. kerosene, some staple foods).

- Reducing the dispersion and average level of tariff rates is pro-poor.
- A more simple tax structure (fewer and lower rates) contributes to collection efficiency and economic efficiency. Simplification of tax structures usually increases revenue.
- A simple progressive income tax.

Tax policy has implications for the poor through the principles of fairness and equity, economic growth and efficiency, and appropriate Government revenues. In agriculture, the major source of income for the poor, most inputs and outputs in the sector are either zero-rated or exempt. The evidence of Uganda's tax policy focusing on generation of higher revenues can be adduced from the imposition of an excise tax on airtime, cigarettes, cement and the numerous increases of taxes on petroleum products.

In Uganda, direct taxes do not directly affect the poor because of the low income levels. The direct taxes include PAYE, corporate tax, presumptive tax, withholding tax, rental income tax, tax on bank interest and casino and lottery tax. Personal income tax is the only really progressive tax and at present it affects only a small portion of the population.⁷ The poor do not pay PAYE, corporate tax, presumptive tax and casino and lottery tax (i.e. poverty line is U Shs 39,746). A typical poor Ugandan is estimated to spend less than U Shs 1,225 per day on goods and services. The poorest Ugandan (first Decile) in 2005/06 was estimated to consume U Shs 13,116 in a month (UBOS, 2006).

Meanwhile, a transparent tax system is one that taxpayers are able to understand. Transparent tax systems impose less uncertainty on taxpayers, allowing them to better plan their decisions about employment,

investment and consumption (Holtzman, 2007). Tax systems that are difficult to comply with and administer may lack transparency. A non-transparent tax system could be difficult to administer because tax administrators may have difficulty in applying the law to taxpayers in similar situations consistently. In this sense, transparency is closely linked to the simplicity and the effective administration of the tax system.

A transparent tax system should include the following elements:

- *Taxpayers can easily calculate their liabilities:* taxpayers can easily follow instructions and tax rate tables in order to determine their tax base, their marginal tax rate, and their tax liability to the government.
- *Taxpayers grasp the logic behind tax laws and tax rates:* taxpayers can look at a tax form or a tax rate schedule and understand the lawmakers' reasoning.
- *Taxpayers know their own tax burden and the tax burden of others:* irrespective of who actually writes a cheque to the government, taxpayers can identify who actually bears the burden of a tax.
- *Taxpayers are aware of the extent of compliance by others.*

Complex and non-transparent tax laws drive up compliance costs and invite tax evasion and tax avoidance which are not pro-poor. In this same vein, frequent changes to the tax code increase tax uncertainty. Ugandan taxpayers do not understand the extent to which the tax laws are enforced, meaning that they do not know how likely their friends, neighbours and business competitors actually pay what they owe. Uganda's tax system cannot be said to be transparent because many taxpayers do not get the logic behind tax laws and tax rates, they cannot calculate their liabilities and they may not know actually who bears the burden of a tax.

In addition, the problems of tax evasion and avoidance are a reflection of a non-transparent tax system. Thus, non-transparent tax systems negatively affect government efforts to raise the necessary local resources that are important for poverty eradication. Uganda's tax system to a large extent does not meet the principle of transparency and visibility. In Ghana, in an attempt to manage especially tax laws and tax information so that households and businesses can make their consumption, savings and investment decisions in the most efficient way possible, a comprehensive document on tax policies and administrative measures was published (The Republic of Ghana, 2007).

Meanwhile, URA considers tax policies as equitable, fair and transparent because they depend on consumption and some basic items (education and health) are not taxed. The supply of Education services in Uganda is tax-exempted. However, it was found out that most commodities consumed by the poor in Uganda are taxed. Sugar, soap, matchboxes and paraffin have various taxes. Soap in Uganda attracts import duty, excise duty and VAT of 25 per cent, 10 per cent and 18 per cent respectively. Sugar attracts import duty, excise duty and VAT of 25 per cent, 25 per cent and 18 per cent respectively. An additional U Shs 50 per kilogramme of sugar was introduced in 2006. Paraffin (kerosene) has attracted excise duty of U Shs 200 per litre since 1998. Tax on iodized salt is remitted and there is a proposed exemption of VAT on table salt. It should be noted that while there have been increases in excise duty for other petroleum products; excise duty on paraffin has remained at U Shs 200; the intention may have been to make it more pro-poor. The government would make paraffin more pro-poor by abolishing the excise tax imposed on it. The estimated tax expenditure out of this action would be U Shs 6.3 billion using the 2005 paraffin sales estimates of 31,367 cubic metres (BOU, 2006).

Table 9: Evidence on tax Progressivity/Regresivity from Dominance Testing in Uganda and Ghana

	Uganda	Ghana
Progressive	Imports VAT/Sales Tobacco Alcohol Non Alcohol Beverages Gasoline	Alcohol Non Alcohol Beverages Gasoline
Neutral/inconclusive	Excises	VAT/Sales
Regressive	Exports Kerosene/Paraffin Kerosene/Paraffin	Exports Tobacco

Source: Adopted from Gommell & Morrissey (2005) Distribution and Poverty Impacts of Tax Structure Reform in Developing Countries: How little we know.

Evidence from studies using dominance testing that have been conducted on Uganda show that taxes on paraffin and exports are regressive. The findings on excise taxes in Uganda have been inconclusive (see Table 9). Taxes on tobacco, alcohol, non-alcoholic beverages and gasoline have been found to be progressive (see Table 7). It has also been argued that comprehensive VAT is regressive since lower income taxpayers consume a higher proportion of their income than do middle and upper income taxpayers. Imports and VAT/Sales taxes in Uganda have also been found to be progressive.

3.5 The impact of Value Added Tax on the Poor People

Value added taxes have been the main domestic 'replacement' tax for tariffs and a wide array of excises in many reforms, and by 1998 were used in the majority of Least Developed Countries (Gemmell & Morrissey, 2002). The VAT is more complex to administer than trade taxes and typically requires new capacity within the tax administration. The VAT also tends to be a more visible tax than trade taxes, which can make it politically difficult for governments to raise as much revenue through the VAT. The VAT is not collected in the informal sector of the economy, which is much larger in developing countries than in developed countries. In Uganda, a single-rate VAT was introduced in July 1996. It replaced the previous sales tax and CTL. The main objective of introducing VAT was to widen the domestic tax base. The introduction of VAT sparked a strike by traders lasting two months. Traders were asking the GOU to increase the taxable threshold.

Although VAT is a more equitable tax, it was initially resisted by the business community, notably participants in the informal sector (Kayizzi-Mugerwa, 2002). VAT administration pre-supposes the keeping of proper records, which had not been the case for decades. There was fear that record keeping might increase tax liabilities. There were also complaints that VAT of 20 per cent would make Ugandan products non-competitive in regional markets, especially since neighbouring Kenya, which is not landlocked with better infrastructure had a lower VAT.

Proponents of VAT, especially for developing countries, argue that it would enhance efforts to mobilize much-needed tax revenue, not only directly but through wider improvements in tax administration and compliance. In the case of Uganda, the amount of revenue generated from VAT has increased from only U Shs 260.93 billion on its introduction to U Shs 1,138.3

billion in 2007/08. Value added tax is an important component of the tax system contributing around 36 per cent of the total domestic revenue equivalent to around 4.7 per cent of GDP.

In addition, most countries exempt from the VAT some or all consumption related to health care, education, housing and food. For instance, health care is generally consumed in greater quantities when one is ill, so charging VAT on health care would impose a larger burden on people who are sick. The tax system has VAT exemptions and zero-rated commodities. Exempting an item from the VAT means that no tax is charged on the final sale of that good or service.

Normally, an exemption is provided within a class that government wishes to promote economically. VAT on zero-rated supplies is chargeable at a rate of zero per cent (URA, 2007). A person dealing in zero-rated supplies is entitled to claim input tax incurred in making the zero-rated supplies. In addition to equity concerns, certain sales are exempt or zero-rated for general development reasons, e.g. passenger transport, educational and health services. A recent study has found that zero rating of the key taxable consumer items consumed by the poor in Uganda would have little fiscal consequences. The amount of revenue foregone would be less than the Graduated Tax (head tax) foregone (Ssewanyana & Okidi, 2007). The VAT exemptions are not well designed to reduce tax burdens on the poor.

The efficiency gains associated with VAT are hard to observe directly but countries with VAT tend to have a higher ratio of total tax revenues to GDP. Studies of VAT in developing countries are still few, but there is growing evidence that the VAT is not an especially regressive tax (Ebrill et al, 2002). Studies for Côte d'Ivoire, Guinea, Madagascar and Tanzania all show that the poor pay less than their share of total consumption as a share of total VAT revenues. Notably, VAT had proved more progressive than the trade taxes it often replaced.

In Uganda, the largest portion of the tax burden borne by the poor households originates from VAT followed by excise duties and Graduated Tax. Increasing VAT while other taxes remained constant would increase the tax burden on the poor but the non-poor households would continue paying more taxes relative to their expenditures than the poor households (Ssewanyana & Okidi, 2007). These findings agree with Gemmell & Morrissey (2002) study which reported that while VAT is relatively low on the progressivity rankings, it tends not to be regressive. VAT/sales tax in Uganda was found to be progressive. In line with earlier studies, it seems the broad-based VAT may not generally regressive in Uganda, partly because of the use of exemptions and zero rating.

3.6 Tax proposals for the 2008/09 National Budget and their Impact on the Poor

The major changes in 2007/08 included the introduction of Local Service Tax and Local Hotel Tax in response to the abolition of Graduated Tax in 2005/06. In 2008/09, government is proposing tax breaks and incentives, introducing taxes on the Extractive Industry (Oil) and Excise Duty to raise revenue and strengthen measures that protect the environment.

There are still fears that the two major taxes in 2007/08 (i.e. Local Service Tax and Local Hotel Tax) may encounter problems during implementation similar to those that were faced by GT before it was abolished, in addition to the problem of creating small nuisance taxes. The local service tax levied on wealth and incomes has also been viewed as an extra burden to those contributing PAYE. This is an additional tax burden on those currently paying PAYE. There is also the problem of local hotel tax unfairly benefiting and boosting revenues of the highly urbanised districts (i.e. Kampala, Jinja, Gulu, Mbarara and Mbale) as opposed to rural districts which only

have limited hotel facilities. While revenue from hotel and lodge occupants may be pro-poor, it will be highly dependent on the willingness of the hotel and lodge owners to comply and cooperate in collecting the money from the occupants.

Some of the problems that were associated with Graduated Tax included being charged inequitably in favour of the rich include difficulty in enumerating, assessing and collecting. The money was at times misused or embezzled and a substantial proportion was used to pay staff costs. Graduated tax contributed to the overall regressiveness of local taxes, was characterized by oppression and harassment of taxpayers, had extensive political interference and was clearly hurting the poor (Bahigwa, Elliss, Feldspar & Iversen, 2004).

It was also noted by a key informant that the proposed exemption of income tax and withholding tax on international airlines and resident airlines did not benefit the poor. He equated some of the proposals to 'political pronouncements' that would impact negatively on the poor. Exemption from withholding tax on interest income derived out of deposit auctions by BOU would lead to unnecessary revenue losses and transfer of income to the rich. With or without exemption, the actions would take place without seriously affecting the conduct of liquidity management. The write-off arrears of duty and tax relating to the principal, interest and penalty that had accrued up to 30 June 2002 should be supported to ease administrative constraints in the sector.

The proposed increase of the environmental levy on used vehicles and goods, exemption from import duty on garbage trucks plus the earlier environmental tax on polythene bags and plastic containers are good for environmental protection. The tax on polythene and plastic containers could lead to switching to the use of paper and other local decomposable local materials.

The proposals for revenue generation including the reviewing of excise duty and non-tax revenues are important for the poor. The 2008 tax proposals stated tax expenditures amounting to U Shs 24 billion against the stated revenue that would be generated from the new sources of U Shs 53.1 billion. On the other hand, apart from the 2008/09 tax proposals, most proposals in the last five have been implemented. In the last five years, traffic fees and charges have been revised five times (see Appendix 1). Goods and services that attract excise taxes have had the most changes including increased excise duty on airtime, beer, spirits, bottled water and fuel.

Meanwhile, Lall (2003) urges developing countries to offer incentives to those industries that bring in new technologies and investment in incremental changes to encourage innovation-led growth. Investment incentives have been a constant feature in Uganda's budgets with either incentives being introduced or abolished. Like in the past, the budget also proposes incentives to enhance investments, employment, competitiveness and growth. The 2008/09 tax proposals have nine tax breaks and incentives for business people, investors and consumers. The tax breaks and incentives are likely to affect revenue mobilization efforts. A number of proposals aimed at boosting production include:

- Exemption of duty and tax payments on construction materials in education and health sector for a year;
- Reduce the excise duty on beer made from local raw materials to 20 per cent;
- Exempt VAT on trucks of loading capacity of 3.5 tonnes and above;
- Reduced import duty on cement from 40 per cent to 25 per cent.

Another important revenue proposal in 2008/09 is one that relates to payments in the extractive industry, particularly the oil industry where it

is proposed:

- To align the Income Tax Act with the Production Sharing Agreements;
- Tax imports and other supplies for companies undertaking petroleum exploration, development and production.

These proposals are important because while the extraction of oil and gas generates a large portion of government revenues, it can pose problems for the management of revenues and expenditures and hamper transparency and accountability in the budget process. Most oil-rich countries remain mired in poverty; in many, standards of living actually plummet after the discovery of oil (Friedman, 2008). Oil revenues have often been accompanied by increased corruption and weaknesses in governance, human rights, and poverty- reduction efforts. For this reason, countries with significant oil reserves are often said to be plagued by the “resource curse”, which has several aspects (Tsalik, 2003):

- **Economic issues.** Booming oil exports, while generating significant revenues, can still have negative consequences for the economy. For instance, large influxes of foreign currency can cause the domestic currency to rise in value. This makes goods produced in the oil state relatively more expensive, which in turn makes it harder for producers to export their goods and to compete domestically with cheaper imports.
- **Fiscal issues.** The volatility of oil prices often prompts governments to take on large amounts of foreign debt that undermine the country’s fiscal position. When world oil prices are high, governments tend to spend oil revenues freely, raising popular expectations and dependence upon this spending.
- **Political issues.** Revenues from oil exports most often flow to central governments rather than to entrepreneurs spread across the economy, and hence they can increase the concentration of economic

and political power. Such concentrations of power reduce accountability and hinder transparency, thereby encouraging corruption and mismanagement of public finances.

- **Social issues.** Most countries with abundant oil resources have failed to translate oil-derived income into better lives for their citizens. According to the World Bank, about 60 developing or transition countries are dependent on oil, mining, or gas revenues, with two-thirds of the world's most impoverished people living inside their borders on less than \$2 a day. Countries that depend on oil and mineral wealth also face a much higher chance of civil war and conflict; comparisons show that natural resource-dependent countries are almost a quarter more likely to have civil conflict than other countries.

Since 2006, there has been substantial activity in petroleum exploration and development. Uganda has signed production-sharing contracts (PSCs), with a number of companies. In a PSC, a multinational oil company enters into a contract with the government to extract the oil. The company retains a certain amount of oil (called "cost oil") to cover its production costs, including the company's initial investment. In some cases, the "costs" to be covered include social-development projects and other "quasi-fiscal activities" that the company carries out on behalf of the government in regions where the extraction occurs. After the appropriate amount of cost oil has been determined, the remaining "profit oil" is divided between the contractor and the host government (or national oil company). The host government can decide whether to receive its portion of the profit oil as oil or cash. Although PSCs are individually designed, many governments base their contracts on some form of "model" contract that adheres to the country's general petroleum laws.

The other system is tax/royalty system which is more common in industrialized countries, although it is also found in the developing world (for example, in Chad). In a tax/royalty system, the government licenses a company to explore, exploit, and sell the oil. In return, the government receives royalties, or a percentage of the proceeds from oil sales. These royalties vary from country to country. For example, in Chad, the government receives 12.5 per cent of the sales of oil produced, after transportation costs have been deducted. In addition to these royalties, the company also pays the government certain taxes and fees (Friedman, 2008).

While profit oil (under PSCs) or royalties (under tax/royalty systems) tend to be the largest streams of revenue from natural resources for developing countries, governments under both systems often receive additional revenues through the following instruments:

- *Bonuses* may be paid by the company to the government at the licensing stage, when new reserves are discovered, and/or when a production target is achieved.
- *Corporate income taxes* or *profit taxes* may have to be paid on the company's profits generated in the country.
- The company may pay *fees* to the government for starting exploration or for the retention of a concession area.
- *Customs duties* may be levied on goods and equipment the company brings into the country.

Uganda has signed PSCs with a number of companies without a general petroleum law and is proposing tax/revenue measures on oil without the same. Under the early production scheme (EPS) oil production will start in mid 2009. This is not a good sign in terms of accountability and transparency. Thus, given the nature of the oil industry, calls for improved

revenue transparency in extractive industries through pushing for mandatory disclosure of all company payments to governments, encouraging governments to publish data on payments and trying to track government oil revenues. Civil society groups in Uganda could attempt to track government oil revenues and bring more transparency and accountability to the use of these revenues.

The 2007/08 Tax proposals do not directly address the problems of poverty reduction but are aimed at boosting output. However, the tax policies in existence that affect the livelihoods of the poor directly like agriculture inputs and outputs, health and educational materials have remained zero-rated or exempt. The proposals emphasize investment incentives, environmental protection and revenue generation. Thus, it is unlikely that the tax incentives will enhance investments, employment, competitiveness and growth.

3.7 Allocation of Tax Revenue to Government Programmes

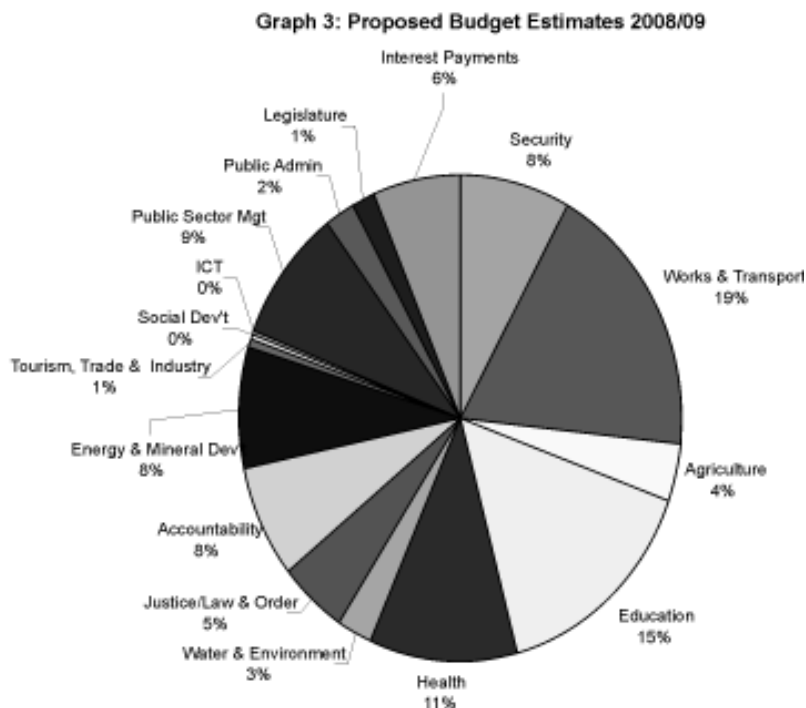
Public expenditure in Uganda has gone down from a high of 26 per cent of GDP in the mid 1990s to around 21 per cent of GDP in the last five financial years. The share of recurrent and development expenditure has averaged 60 per cent and 38 per cent respectively in the last five years. The Works and Transport sector in 2008/09, with 19 per cent of the total budget will have the largest share of expenditure overtaking the Education sector. Expenditure on Education has dropped from 24 per cent of the total budget in 2001/02 to 15 per cent of the total budget in 2007/08 (see Graph 3). The agricultural sector which employs more than 70 per cent of the labour force has seen the share of expenditure on it increase from around 2 per cent in 1996/97 to around 4 per cent in 2008/09. The amount of resources allocated to the Public Administration and Security Sectors have also had

considerable decrease. Expenditure on public administration has decreased from 28 per cent in 2000/01 to 11 per cent of the budget in 2007/08. Expenditure on security has decreased from 17 per cent in 2000/01 to eight per cent of the budget in 2007/08.

Table 10: Fiscal Operations 2002/03-2007/08

U Shs Billions	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Expenditure	2,658.16	2,990.11	3,274.66	3,609.2	4,210.0	5,057.6
Recurrent Expenditure	1,586.64	1,891.57	1,986.92	2,231.64	2,404.18	2,861.8
Development Expenditure	1,030.02	1,047.75	1,229.03	1,255.85	1,690.08	2,054.1
PAF	646.10	730.67	794.00	865.00	1,109.00	1,285.30
Domestic Revenue	1,433.64	1,669.15	1,914.55	2,230.9	2,625.8	3,159.0
Expenditure /GDP	23%	23%	22%	21%	22%	21%
Recurrent Expenditure/ Total Overall Budget	60%	63%	61%	62%	57%	57%
Development Expenditure/ Total Overall Budget	39%	35%	38%	35%	40%	41%
PAF/Total Overall Budget	24%	24%	24%	24%	27%	27%
Recurrent Expenditure/ domestic Revenue	111%	113%	104%	96%	89%	85%
Domestic Revenue/GDP	12.2%	12.4%	12.9%	13.5%	13.1%	13.1%
Donor Grants & Loans	11%	12%	10%	8%	10%	8.5%
Overall Fiscal Deficit	-10	-10	-9	-7.2	-8	-7.5

Source; Budget Speech for Financial Year 2008/09, Background to the Budget & Authors Calculations



The Budget is divided between the PAF-protected areas and the non-PAF areas, responding to PEAP priorities. The areas prioritised by Government in the budget under PAF are protected from cuts in reallocation programmes or cash limitations due to liquidity constraints. Most of the expenditure areas under the PAF were formally classified as the Priority Programme Areas (PPA), they include: Education, Primary Health Care, Feeder Roads, Water and Sanitation, and Agriculture. The allocations to the PAF accounted 27 per cent of the total budget in 2006/07 (see Table 10). The resources channelled to the PAF activities come from Government of Uganda, Donors and Loans. The GOU's own resources in the 2007/08 budget were U Shs 774.60 billion representing 69.4 per cent of the total available for PAF expenditures. It should be noted that the 2008/09 budget proposals have shifted emphasis from the PAF framework/approach to an investment-based approach targeting the "the prosperity for all strategy".

Domestic/local revenue is allocated to both recurrent and development expenditure. Apart from the last two financial years, domestic funding in Uganda has not been able to cover recurrent expenditure. Recurrent expenditure was more than domestic revenue by 11 per cent in 2002/03. Domestic revenue is allocated between both recurrent and development expenditure. Indeed, some expenditure items like primary teachers' wages under PAF are of recurrent expenditure in nature. In 2005/06, domestic funds allocated to development expenditure were U Shs 518.5 billion, representing 41 per cent. The amount of domestic revenue allocated to development expenditure has been growing and is projected to increase from U Shs 459.9 billion in 2002/03 to U Shs 704 billion in 2007/08.

Table 11: Expenditure Performance by Votes in 2006/07 (U Shs billion)

	Approved Budget	Percentage of Total Budget (%)
Central Votes	1,735.98	56.59
Wage	424.43	13.84
Non-wage	796.81	25.97
Development	514.7	16.78
District Votes	881.79	28.74
Wage	521.41	17.00
Non-wage	192.47	6.27
Development	167.91	5.47
Statutory Votes (Excluding Interest)	196.08	6.39
Wage	29.97	0.98
Non-wage	143.07	4.66
Development	23.04	0.75
Interest Payments	253.90	8.28
Total Including Interest	3,067.75	100.00

Source: MFPED (2007a) & Authors Calculations

**Table 12: Development Expenditure Performance by Votes in 2006/07
(U Shs billion)**

	Approved Budget	Percentage of Total Budget (%)
Central Votes	514.75	72.94
District Votes	167.91	23.79
Statutory Votes (Excluding Interest)	23.04	3.26
Total	705.70	100.00

Source: MFPED (2007a) & Authors Calculations

The expenditure performance by votes is skewed towards the central votes as opposed to the districts votes. This does not support the further deepening of decentralization in Uganda. Out of the approved budget for 2006/07 of U Shs 3,067.75, the central and districts votes were allocated U Shs 1,738.98 billion and U Shs 881.79 billion respectively. This represented 57 per cent for central votes and 29 per cent for district votes (see Table 11). Statutory votes and interest payments were allocated 6 per cent and 8 per cent respectively. A half of the approved budget for district votes was wages and while only one quarter of the funds approved for central votes was for wages. Similarly, development expenditure for 2006/07 was retained in the centre as opposed to districts. Seventy-three per cent of the approved budget was for central votes while districts had 24 per cent (see Table 12).

⁵ Recent changes in the calculation of GDP has completely altered the sectoral shares of Agriculture, Industry and Services sectors in the economy

⁶ Contribution to development expenditure from domestic revenue

⁷ [http://links.jstor.org/sici?sici=0022-278X\(196611\)4%3A3%3C390%3ALTIT%3E2.0.CO%3B2-A](http://links.jstor.org/sici?sici=0022-278X(196611)4%3A3%3C390%3ALTIT%3E2.0.CO%3B2-A)

4.0 Conclusions and Recommendations

4.1 Conclusions

The purpose of the study was to review and analyse the current taxation policy and its implications for poverty reduction and economic growth in Uganda. Fiscal policy has focused on stimulating economic growth, strengthening tax administration and raising tax revenue. A flexible fiscal regime heavily influenced by strong support from multilateral and bilateral donors has been maintained. The concern has been the sustainability of the fiscal stance in light of the fact that domestic resources only cover recurrent expenditure.

Like many developing countries, Uganda has undertaken comprehensive tax reforms encompassing most of the important revenue sources. The goals of tax reforms have been fourfold: broaden tax base, increase efficiency of collection, create incentives for the private sector and ensure equity of taxation. The reforms have not achieved increased revenue to GDP ratio and the widening of the tax base. Uganda's revenue collection is among the lowest in the East African region. The low levels of revenue have been attributed to the structure of Uganda's economy. Uganda has a significantly large agricultural sector, accounting for 21.4 per cent of GDP in 2006/07. The phenomenal increase of the service sector may not be significantly contributing to revenue mobilisation (e.g. real estate activities which have overtaken posts and telecommunications sector). About 70 per cent of the working population is self-employed in agriculture

and half of the households depend on subsistence farming.

Tax policy has mainly concentrated on simplifying the tax system, revenue generation and restricting people from consuming certain commodities rather than directly protecting the poor. Tax policy actions have been in line with PEAP objectives through increased production, minimizing distortions, human development and generally exempting the poor from paying certain taxes. Government has gradually removed all taxes on health and education which sectors are vital for human capital development. At the same time, studies on the impact of excise taxes on poverty in Uganda have been inconclusive and taxes on paraffin and exports have been found to be regressive. While taxes on tobacco, alcohol, non-alcohol beverages and gasoline have been found to be progressive.

The tax system is dominated by indirect taxes which depend on goods and services consumed. The system has raised insufficient revenues to finance essential government expenditure and the level of donor support has been significant. The rate of increase in revenue has not matched the overall growth rates in output and increases in people's incomes. The amount of domestic revenue allocated development expenditure has been growing though it is skewed towards central votes as opposed to the districts votes.

Meanwhile, the overall growth rates have averaged to more than 6 per cent since the early 1990s and poverty has reduced to 31.1 per cent in 2006. In the last five years, the transport and communication sector has experienced the highest levels of growth (i.e. averaging 15.8 per cent). As a result, the telecommunications sector has become a major source of tax revenue for the treasury. The changes in international trade taxes

seem to have positively affected GDP, fixed capital formation and private consumption. The tax regime does not appear to affect growth which ties in with the fact that there were no dramatic changes in growth rates after the major tax policies were initiated.

The growth in income seems to have benefited the majority of Ugandans resulting in the proportion of people living in poverty declining. There is a strong regional dimension to poverty with much of the chronic poverty and descent into poverty occurring in the northern region. Poverty is still more prevalent in the rural areas. Movements in cash crop (like coffee) prices have been found to contribute to moving into and out of poverty. This indicates the need for investments to enhance agricultural production and productivity, agro-processing and marketing.

The broad-based VAT seems not to be generally regressive partly because of the use of exemptions and zero rating. However, the largest portion of the tax burden borne by the poor households in Uganda originates from VAT followed by excise duties and Graduated tax. Metered water, electricity and telecommunication services are taxable, implying that the urban poor are disproportionately burdened.

There has been substantial activity in petroleum exploration and development. Government expects under the early production scheme (EPS) to start oil production in mid 2009. The much needed transparency in oil activities is inadequate or even lacking. The legal framework does not exist and a number of stakeholders have not been taken on board on this new development.

Apart from UMA, CSOs have not been involved in tax policy issues especially at the legislative level. The business community has begun voicing concerns

and organizing responses on tax policy proposals. The peasants and elites are not represented in tax policy formulation but the elites have the alternative of airing views through the media.

On the other hand, complex and non-transparent tax laws drive up compliance costs and invite tax evasion and tax avoidance which are not pro-poor. Tax laws in Uganda have several cross amendments and they undergo changes annually. Parliamentary Committees' oversight and scrutiny function on taxation is not well developed and in most cases is performed on ad hoc basis. In most cases, the House passes tax proposals with minimal amendments or rejections.

4.2 Policy Recommendations

They study recommends that:

4.2.1 Economic Growth and tax efficiency Improvement

Tax reforms have been comprehensive and broad-based but they have not achieved increased revenue to GDP ratio and the widening of the tax base. The threshold for PAYE has not changed like is the practice in many countries to make wage earners' incomes tax inflation proof. Government should develop policies that recognise the importance of the informal economy, particularly increasing the productivity and improving the working conditions while also attempting to incorporate members of the informal economy into the formal sector. More tax reforms should be limited and they should take an incremental process of change targeted at increasing economic growth and tax efficiency. The other policy actions include:

- Maintaining a single VAT rate with minimal exemptions for commodities mainly consumed by the poor.

- Reviewing and raising the minimum threshold of PAYE to U Shs 235,000 to cater for the losses in welfare that have resulted from price increases.
- Introduction of taxes on minerals like gold.
- URA must bring the informal sector into the tax net. It should increase efforts for presumptive taxation through detailed 'sectoral studies' of informal sector firms.

4.2.2 Simplification of the Tax System

It is generally accepted that Uganda's taxpayers do not understand the tax system. The number of tax disputes between URA and taxpayers handled by the TAT are large. These problems leave no doubt that despite the quite comprehensive changes in the tax structure in recent years; the tax system is still complicated and non-transparent. There should be more renewed efforts aimed at simplifying the tax system and educating the taxpayers. Civil Society Organizations like UDN should supplement the current efforts by URA in simplifying the tax system and educating the taxpayers. Civil society groups should produce a citizen's revenue guide to broaden understanding of the country's tax systems and to inform tax debates.

4.2.3 Simplification of tax administration

Occasionally, crude methods of revenue collection have been employed to enforce compliance in revenue collection. Simplifying taxation approaches should include markedly reducing tax exemptions, deductions and privileges that cause losses to the treasury as well as corruption tendencies. Assessors should not have wide discretionary powers to interpret tax laws, for instance, to allow or disallow expenses or charges, or to exempt items from import duties. To improve on tax administration and also encourage

voluntary compliance, a simplified but comprehensive document on tax policies and administrative measures should be published by government.

4.2.4 More technical Reviews for the 2008/09 tax proposals

The 2008/09 tax proposals did not directly address the problem of poverty reduction. There is evidence that tax incentives have in the past been abused and the criterion for giving incentives has not been clear. A number of scholars have also advocated for incentives for those firms that bring in new technologies and investment in incremental changes. The MFPED should carry out more technical reviews on the proposed local service tax, local hotel tax, VAT on sale of residential properties, tax breaks and investment incentives with the idea of dropping some of the proposals.

4.2.5 Making Tax Policy more Pro-poor

The introduction of broad based taxes, zero rating of education and health services and taxes on consumption are a characteristic of a pro-poor tax system. Tax policy has mainly focused on generation of higher revenues. Most of the commodities consumed by the poor in Uganda are taxed. The government should transcend the revenue maximization phase and embark on long-term strategies for a tax system based on an optimal level of taxation. Tax policy should be made more pro-poor through the exemptions of taxes on paraffin and matchboxes without incurring large tax expenditures.

4.2.6 Reduction on Tax Expenditures

Government has had an on and off tax regime aimed at attracting investors and increasing output. Tax incentives are distortionary and they have at times been a source of conflicts with taxpayers. In the last two financial

years, taxes and duties waived have amounted to more than the amount of revenue raised from taxing kerosene. Government should not only stop at announcing the amount of tax expenditure but it should also indicate the achievement of public policy objectives in a given duration and the intended beneficiaries. Government should also have a limited proliferation of tax expenditures which can result in a serious loss of transparency. Tax laws, regulations, and other documents, including explanatory materials, should be accessible to the general public and be kept up-to-date. Changes to tax legislation should be given sufficient publicity so that taxpayers understand how they might be affected and there should be a mechanism in place whereby taxpayers can have their queries answered.

4.2.7 Proper Planning and Transparency in petroleum exploration, development and production activities

The extraction of oil and gas will constitute one of the most important sectors of the economy and is expected to generate a large portion of government revenues. Uganda can live by example by avoiding being plagued into the “resource curse”, with its attendant economic, fiscal, political and social consequences. Government should expeditiously define the legal and regulatory framework and this should precede the introduction of taxes on the petroleum exploration, processing and development. A framework should be developed for regular publication of all material oil, gas, and mining payments by companies to and all material revenues received by government from oil, gas and mining companies to a wide audience in a publicly accessible, comprehensive and comprehensible manner. There should be deliberate effort by the Government and Oil companies to bring all stakeholders on board. Studies should be conducted to assess the expected impact of the production of oil.

4.2.8 Continuous Improvement in Expenditure Allocations

Public expenditure has been on the decline in the medium term and expenditure allocations on public administration and security have considerably decreased. The decrease in public expenditure is good for a country like Uganda whose domestic revenue generation has performed below the Sub-Saharan African levels. The allocations on PAF have increased slightly, while domestic allocations to development expenditure have increased. Government should continue improving expenditure allocations especially to productive sectors like agriculture.

4.2.9 Reviewing the Tax System

Uganda's tax system has not generally achieved the objectives of adequate revenue, economic efficiency, provision of equity, an optimal tax mix, simplicity and effective tax administration and transparency. As suggested by the MFPEd, there should be more comprehensive reviews of tax policies aimed at identifying ways of achieving the objectives of adequate revenue, economic efficiency, provision of equity, simplicity and effective tax administration.

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Appendix 1: Detailed Tax Reforms Measures in Uganda: 2003/ 04-2007/08

2003/04	VAT/Sales Tax/CTL Import Taxes Excise Tax Other Admin. Measures	<ul style="list-style-type: none"> • VAT exemption on hotel accommodation limited to hotels outside Kampala and Entebbe only • Reduced excise duty on carbonated waters (soft drinks) from 15% to 13% • Beer made from malt of locally produced raw materials to pay excise duty at 20% • Cellular air time excise duty increased from 7% to 10% • Increased excise duty on petrol by Shs 50 per liter and on diesel by Shs 30 per liter • Increased automobile fees/licenses from Shs110 per cc to Shs 200 per cc except cars and passenger vehicles carrying more than 28 people
2004/05	Direct Taxes Import Taxes Excise Tax Other Admin. Measures	<ul style="list-style-type: none"> • Amended the Income Tax Act to allow lesser to claim capital depreciation benefits • Increased excise duty on cigarettes from 130% to 150% 2004/05 • Increased excise duty on spirits from 45% to 60% • Revised traffic fees and charges upwards by 10%
2005/06	Income tax. Excise Duties Value Added Tax Local Government Taxation- Graduated Tax Customs duty	<ul style="list-style-type: none"> • Loans to agriculturalists exempted from tax • Started licensing companies to operate collective investment schemes • Exempted income of unit trusts and other CIS from withholding tax, where income was distributed to unit trust holders • Increased excise duty on petrol from Shs. 660 to Shs.720 per litter, for diesel from Shs. 400 to Shs. 450 per litre. • The duty on kerosene of Shs. 200 remained unchanged • Increased the excise duty on airtime from 10 to 12 percent • Introduced a specific excise duty rate of Shs. 50 per kg on imported or locally produced sugar • Increased the rate of Value Added Tax (VAT) from 17 percent to 18 percent • Suspended graduated tax with effect from July, 1st 2005

		<ul style="list-style-type: none"> • Abolished The duty rate on medicaments • Remitted duty on deep cycle batteries to 0 percent • Remitted paper for printing textbooks, examination papers and covers to 0 percent to enhance literacy programs in the Community • Remitted the duty on speed governors to 0 percent • Reduced the East African Customs Union Common External Tariff rate on second-hand clothes from 70% or US 0.5 cents to 40% or US 0.3 cents per kilogram
2006/07	<p>Withholding tax</p> <p>Value Added Tax</p> <p>Income Tax</p> <p>Excise Duties</p> <p>Traffic Fees and Licenses</p> <p>Non Tax Revenues</p>	<ul style="list-style-type: none"> • Reduced withholding tax on dividends distributed by companies listed on the stock exchange from 15 percent to 10 percent • Exempted the income of the investor compensation fund • Exempted VAT on Liquid Petrol Gas (LPG) to increase its affordability as an alternate source for lighting and cooking • Exempted VAT on contraceptives sheaths and acaricides to promote the use of condoms in the fight against HIV/AIDS • Widened the scope of withholding agents to include beer manufacturers, soft drinks bottlers, banks, petroleum, telecommunication, insurance, and construction companies • Introduced a final withholding tax of 15 percent on gross interest received from purchases of Government securities • Increased duty on non-malt beer from 20 percent to 30 percent • Imposed a 10 percent duty on bottled water • Imposed a specific rate of Shs 500/- per 50Kgs bag of cement • Imposed 5 percent duty on landlines and public pay phones • Introduced a 10 percent environmental levy on motor vehicles and a specific rate of between Shs 20,000 - 50,000 on household appliances • Increased traffic fees and licenses on motor vehicles by 5 percent • Revised Non Tax Revenues collected by the ministries upwards by an average of 20 percent • Increased fees on work permits for foreign employees from Shs 135,000/- to US\$ 1,000 • Reduced the duty imposed on selected goods from

		<ul style="list-style-type: none"> Kenya from 10 percent to 8 percent Exempted energy saving appliances from import duty due to the then power crisis
2007/08	<p>Local Service Tax</p> <p>Local Hotel tax</p> <p>Import Taxes</p> <p>Excise Tax</p> <p>VAT</p> <p>Tax investment incentives</p>	<ul style="list-style-type: none"> Introduced local Service Tax to be levied on wealth and incomes Introduced local Hotel tax on all Hotels and Lodge Occupants Introduced a fixed levy of US \$ 0.25 per kilogram on hides and skins Introduced a 10% environmental levy on used motor vehicle spare parts Introduced an excise duty of 120% on polythene and plastic bags of more than 30 microns Increased/Introduced excise duty on Fuel (Petrol U Shs 720 to U Shs 850 & Diesel U Shs 450 to U Shs 530). VAT on sale of Residential Properties reduced from 18% to 5% Importation of Buses for the transportation of more than 25 persons at a reduced Common External rate of 10% from 25% Abolished road license Fees except for charges on first registration Abolished Government payment of VAT on hotel inputs International carriers exempted from tax on income derived from Uganda Proposed tax investment incentives for investors engaged in the exportation of finished consumer and capital goods as follows: <ul style="list-style-type: none"> 10 year tax holiday to companies engaged in value exports Withholding tax exemption on interests, raw materials and plant and machinery Stamp duty exemption from increase in share capital and mortgages Duty and tax exemption on raw materials and plant and machinery
	<p>Income tax</p> <p>Import Taxes</p>	<ul style="list-style-type: none"> Schools and tertiary institutions Exempt from income tax Exempt resident airlines from income tax and withholding tax on payment of lease rentals Exempt income tax on new agro processing investments commencing

	<p>Excise Tax</p> <p>VAT</p> <p>Environment</p> <p>Non Tax Revenue</p>	<ul style="list-style-type: none"> • Align the Income Tax Act with the Production Sharing Agreements • Total cost on imports and other supplies for companies undertaking petroleum exploration, development and production • Reduced import duty on cement from 40 percent to 25 percent. • The import duty rate for Palm Stearin fractions was revised from 0 percent to 10 percent, but Uganda was allowed to stay application of the rate of 10 percent and apply 0 percent for one year • Exempted import duty on milk tankers, gym equipment for hotels, deep cycle batteries, computer printers and telecommunication equipment. • Exemption of duty and tax payments on construction materials in education and health sector for more year • Reinstated excise duty on diesel for generators on behalf of manufacturers • Reduce the excise duty on beer made from local raw materials to 20 percent. • Raise the excise duty on cigarettes in order to raise revenue • Exempt Heavy Fuel Oil from VAT. • VAT on plant and machinery to including essential industrial spare parts is deferred at importation
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Source: Budget Speeches & Various Revenue related Reports