INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF UGANDA

PROPOSALS FOR THE FINANCIAL YEAR 2020/2021 BUDGET

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EXECUTIVE SUMMARY

The Institute of Certified Public Accountants of Uganda (ICPAU) successfully held its 7thEconomic Forum in July 2019 under the theme: Transformation for Socio-Economic Empowerment and a request for tax and economic policy proposals for the period 2020/21 was circulated among ICPAU members. This paper highlights key tax and economic policy measures aimed at enhancing efficiency in tax collections and management by providing clear suggestions on how to expand the tax base, correct unclear provisions within the tax laws to ensure certainty and give guidance on other relevant economic policy measures.

The paper details each policy recommendation giving the current provisions of the law (where appropriate), the challenge arising from the current status and the proposed suggestion. The proposals enlisted within the paper include:

- Strengthening Enforcement of Tax Laws
- Interest Capping
- Creating a Specific Tax Office for High Tax Net Worth Individuals
- Enhancing Youth Employment
- VAT Cascade – 'VAT on VAT' on Disposal of Business Assets
- Capital Gains Tax – Indexation
- Other Economic Policy Measures

INTRODUCTION

The Institute of Certified Public Accountants of Uganda (ICPAU) on annual basis prepares budget proposals mainly emanating from recommendations from its members.

ICPAU successfully held its 7thEconomic Forum under the theme: Transformation for Socio-Economic Empowerment. Request for tax and economic policy proposals for the period 2020/21 was circulated among ICPAU members. The overall goal of the Forum was to debate Uganda's socio-economic transformation record and come up with policy suggestions to guide future planning and budgeting to achieve socio-economic empowerment of all Ugandans. The discussions and recommendations at the above engagements have been properly documented and hereby presented for consideration.

This paper covers, ICPAU proposals highlighting the present situation, challenges brought about by existing tax provisions, proposed amendments and justification of the proposals.

It is hoped that the proposals in this paperwill be considered for widening the tax base and for the better administration of taxes.

PROPOSAL ONE: STRENGTHEN ENFORCEMENT OF TAX LAWS

Title	Strengthen enforcement of tax laws to increase tax base
Current Law	Section 16 (5) of the Tax Procedures Code Act (TPCA) requires a taxpayer with an annual turnover of the amount prescribed in Schedule 3 to furnish with the taxpayer's return of income audited financial statements prepared by an accountant registered by the Institute of Certified Public Accountants of Uganda.
Anomaly/ Challenge	Ever since section 16(5) of the TPCA was passed into law, there has been alot of implementation difficulties. The motivation behind this clause was to ensure that reliability and accurateness is improved when making a return. This is because a tax payer's return would have to be checked by a professional who is bound by a code of ethics and hence any mis-declaration would come with multiple consequences. However, to date, the tax body has failed to implement or check that taxpayers' returns abide by this provision of the law. In addition, URA's Information systems have not been improved to allow upload of audited financial statements to accompany any tax return. Due to this laxity, many tax payers have continued to file returns based on unaudited financial statements and the amounts declared in respect to tax liability left at the volition of the taxpayer. In other instances, some unregulated persons have continued to file returns for taxpayers and in case of any under declaration, such people cannot effectively be brought to book. According to Pramod K. Rai[1] avenues of taxation in developing economies are much less when compared to developed economies and the prospects of taxation become bleaker on account of the presence of a rampant black economy, an economy whose proceeds may largely escape the tax net. Rai notes that the size of the black economy in developed Organization of Economic Co-operation and Development (OECD) countries is much smaller compared to the size of the black economy in developing countries and this is attributed to a number of factors including but not limited to ineffective enforcement of tax laws.
Proposed Measures	a) Facilitate URA to update its information systems to allow easy upload of audited financial statements and tracking of emerging tax bases. b) Increase and encourage formalization of the economy. For example government could ban non formalized entities or individuals from carrying out certain trades starting with transporting passengers and goods. This will increase the tax base.

[1]Pramod K. Rai, 'The Challenges of Tax Collection in Developing Economies (with Special Reference to India)' 2004, *University of Georgia School of Law*,

	c) The authority could also enhance the option of taxpayer segmentation (the practice of partitioning taxpayers into distinct groups for different treatment by the tax authorities) primarily by size, sector, geographical area, past behavior, but also in regard to 'hard-to-tax' segments such as high wealth individuals to map tax collection opportunities as a key focus for tailoring enforcement actions and the provision of taxpayer services.
Justification	To combat non-compliance and widen the tax base.

PROPOSAL TWO: INTEREST CAPPING

Title	**Capping of interest deductions**
Current Law	Sec. 25 of ITA as amendedexcludes financial institutions and insurance companies from the interest deduction limitation, which limits the amount of deductible interest in any year of income to 30% of EBIDA (Earnings Before Interest Depreciation and Amortization) for all debts owed by a taxpayer who is a member of a group.
Anomaly/ Challenge	The implication of the above provision is such that apart from the banks and insurance companies, all other sectors will have to abide by the 30% cap to claim interest deductibility. This tends to constrain economic growth and development as the economy undertakes massive infrastructure development and a general big push to all other sectors. If the intention was to ensure and augment the fact that financial institutions and insurance companies take centre stage in development of the country, it is important to note that this may be contrary to the original thin capitalisation rules whose principle objective was to deter arbitrary repatriation of profits in pretext of loan servicing. Take an example of the following: (i) The Banking sector comprises of 33 financial institutions – 24 banks, 5 microfinance deposit taking institutions and 4 credit institutions. Top 7 banks (via assets) controlled over 72% of the market share in 2016 and these were largely foreign ownedand hence the likelihood of repatriation funds out of the economy inform of interest payments would equally be detrimental to economic progress especially that the practice cannot be curtailed as the spirit of the current law seems to suggest. (ii) The sectoral contribution to nominal GDP for Financial and insurance activities stood at 3.1 way below other sectors like agricultural,

	forestry and fishing (24.9%), manufacturing (8.2%), real estate activities (4.5%) and construction (7%)[2] (iii) If the intention of the clause was to boost access to loans by ensuring that financial institutions easily access loanable funds from their parent companies to extend cheap credit to the private sector since they would be allowed 100% deductibility of interest from the group, the outcome seems to be contrary. Lack of affordable financing has continued to be a key impediment to doing business in Uganda. Loans are generally short-term with interest rates ranging from 15-24%. In addition to high rates, little liquidity exists for loans of a long period above 5 years. The above only demonstrate that any concerted efforts to use the financial institutions and insurance sectors as drivers of economic progress may only achieve limited success. Even with stronger transfer pricing rules, we are not convinced that transfer pricing would be the most effective way to prevent profit-shifting using high-priced related party debt. When borrowing from a third-party, commercial pressures will drive the borrower to try to obtain as low an interest rate as possible – for example, by providing security on a loan if possible. These same pressures do not exist in a related-party context. There are no commercial tensions driving interest rates to a market rate. Indeed, it can be profitable to increase the interest rate on related-party debt – for example, if the value of the interest deduction is higher than the tax cost on the resulting interest income. Therefore introducing the interest cap to all other sectors and exclude the banking and insurance sectors may not yield the desirable goals.
Proposed Measure	We suggest that the 30% restriction on interest deductibility should be applied only on that debt from related parties in the spirit of what the **thin capitalization rules** used to apply and this should equally apply to all businesses. We thus propose an amendment to read as follows; a) "The amount of deductible interest in respect of all debts owed by a taxpayer ***who borrows within a group to which the taxpayer is a member*** shall not exceed thirty percent of the tax earnings before interest, depreciation and amortization."
Justification	a) To allow tax deduction on interest payment only on debts contracted within a group without any exception. This will not only re-echo the intentions of thin capitalisation but will also affirm the OECD objectives under BEPS

[2] Uganda Bureau of Statistics, 2017

PROPOSAL THREE:CREATING A SPECIFIC TAX OFFICE FOR HIGH TAX NET WORTH INDIVIDUALS

Issue	**Create a Specific Tax office for High Tax Net worth Individuals**
Current Law	N/A
Anomaly/ Challenge	There are a number of individuals in the country who own or have accumulated wealth that is unexplainable. Such individuals possess expensive fleets of cars, huge mansions and have been seen openly engaging in a lot of philanthropy work. Such wealth seems not to correspond with the amount of tax such individuals pay.
Proposed Measure	URA should intensify efforts to bring more high net worth individuals with unexplainedincomes into the tax net. Forming a separate unit dedicated to these types of individuals—that is distinct from the large tax office, can y. Clear measures targeting these individuals should be developed for example encouraging voluntary compliance, requiring all candidates vying for political offices from LC III up wards to have obtained a tax clearance certificate which would ascertain their tax compliance status, disclosure of information relating to the source of wealth by such individuals among others. Scholars like Jalia(2016), have advocated for encouraging quasi voluntary compliance. Tax experts argue that quasi-voluntary compliance is more attainable: compliance that is defined by limited resistance from taxpayers because they appreciate the role of taxes. One of the challenges with taxing this group of individuals is that they are either politicians or politically connected. For this reason, the most effective approach to tax this type of individuals would be to identify the individuals and then engage in dialogue with them about the importance of taxes and their contribution to the same. This approach takes cognisance of the fact that coercion is costly and should only be applied in cases where quasi-voluntary compliance fails (Jalia, 2016)[3].
Justification	It is a common requirement in most countries for political leaders to be held accountable when it comes to tax affairs. It will widen the tax base as many high net income individuals will be captured in the URA register.

[3]JaliaKangave et al, '**Boosting Revenue Collection through Taxing High Net Worth Individuals:** The Case of Uganda,' 2016, ICTD Working Paper 45

PROPOSAL FOUR: ENHANCING YOUTH EMPLOYMENT

Title	**Enhance Youth Employment**
Current provision	N/A
Anomaly/ Challenge	Uganda has one of the highest population growth rate of about 3.18 % which is the sixth highest in the world.[4] This high population growth rate has ensured a steady rise in the number of job seekers in a largely rural and agrarian economy whose capacity to create decent employment is rigid. Furthermore, Uganda has a very young population with about 50 % of the population estimated to be below 15 years, while the youth population between 18-30 years accounts for about 22% of the population or 7.7 million people (UBOS 2013) The unemployment rate in Uganda, measures the number of people actively looking for a job as a percentage of the labour force. Unemployment Rate in Uganda increased to 2.10 percent in 2017 from 2 percent in 2016. Youth unemployment stands at between 64% and 70% yet an estimate of over 400,000 youths are released annually into the job market to compete for approximately 9,000 available jobs. About 30% of the youths who are institutionally qualified in Uganda are unable to find jobs, and the situation is even worse for semiskilled and unskilled youths (ACODE 2014). The youth in Uganda face a number of challenges; social and economic which have greatly affected their quality of life. Youths, who remain unemployed or underemployed and do not exploit their full potential, are often associated with high incidences of drug abuse and gambling Despite the fact that government has had a series of interventions, some of the challenges have persisted. Limited attention has been paid to the role of tax as a tool that can be used to address these challenges. Worse still the youth have also not been able to actively engage in the tax processes which could provide an avenue for solutions to some of the challenges they face.
Proposed Measure	We propose to have tax reductions or removal (in respect to VAT import duty) on specific sports equipment for the youth to ably engage in sports as a career/ profession.
Justification	Uganda is signatory to the 2013 Addis Ababa Declaration on Population and Development in Africa Beyond 2014, which recognizes the role of population dynamics in socio-economic transformation and seeks to unleash the full potential of the youth to boost socioeconomic

[4] https://www.cia.gov/library/publications/resources/the-world-factbook/fields/344rank.html accessed at 31 December 2018

	development. It is paramount that strategic interventions are instituted to promote more meaningful youth participation in socioeconomic development of this country. The above proposal is likely to promote sports and investment in sports which would provide an alternative source of activities to the growing youthful population. The multiplier effect of investment in sports is threefold that is, it would promote exportation of sports men and women and hence inflow of foreign currency; forward and backward linkages that would result from sports establishments and activities; and it would reduce redundancy among the youth.

PROPOSAL FIVE: VAT CASCADE – 'VAT ON VAT' ON DISPOSAL OF BUSINESS ASSETS

Title	**VAT Cascade – 'VAT ON VAT' on disposal of business assets**
Current Law	Section 18(9) of VAT Act Cap 349 - a sale of a business asset by a taxable person is a taxable supply and Section 28(5) blocks the VAT credit of some assets like motor vehicles transporting sitting persons
Anomaly/Challenge	Section 18(9) requires VAT to be charged on a disposal or sale by a VAT taxable person of business assets including Cars/Passenger Automobiles, residential accommodation for staff, and assets acquired for non- business use. However, under Section 28(5) of the VAT Act, the respective input tax credit on acquisition of such assets is prohibited from being claimed. The future sale of the above assets will attract VAT, with no relief for the input VAT that was disallowed at the time of acquisition. This goes against international principles of VAT mechanism which prevent VAT from cascading, that is, there being a' tax on a tax'. There is no definition of a business asset in VAT Act Cap 349. A definition is provided in Income Tax Act Cap 340 (Section 2(h), - a *business asset is defined - '…..to mean an asset which is used or held ready for use in a business, and includes any assets held for sale in a business and any asset of a partnership or company…'* It appears that this meaning is used by the URA under the VAT Act provisions to the disadvantage of the taxpayer. This clearly goes against the canons of taxation as taxpayers pay tax twice since they pay output VAT on disposal or sale yet were denied (disallowed) input VAT at the time of acquisition/purchase.

Proposed Measure	Where input VAT on acquisition of an asset was not allowed by law as is the case with residential accommodation, passenger automobile and other assets, there should be no VAT charged on their eventual sale/disposal. Alternatively, grant a notional input VAT at the time of sale equivalent to what would have been claimed at the time of purchase (based on cost) and that should be set off against the attendant output VAT.
Justification	▪ It removes double taxation or cascading effect that it is against principles of taxation, generally and international VAT principles, specifically. ▪ It makes cost of such assets lower and encourages ownership of assets by different entities, with attendant benefits. It is logical, makes business sense and concretizes the main idea of input VAT mechanism that makes VAT advantageous over other taxes

PROPOSAL SIX: CAPITAL GAINS TAX – INDEXATION

Title	**Capital Gains Tax - Indexation**
Current Law	Section 50 of the ITA provides that; "The amount of any gain arising from the disposal of an asset is the excess of the consideration received for the disposal over the cost base of the asset at the time of disposal."
Anomaly/Challenge	The current provision does not cater for changes in the value of assets that may arise purely from macroeconomic dynamics like inflation. An asset that was acquired 15 years ago cannot be assessed on the same cost base as it was 15 years later. The lack of indexation means that a taxpayer is taxed based on imaginary gains instead of real gains. These are on indexed values to cater for the effect of inflation.
Proposed Measure	Section 50 of the ITA should be amended to read "The amount of any gain arising from the disposal of an asset is the excess of the consideration received for the disposal over the cost base of the asset at the time of disposal adjusted by the prevailing consumer price index (CPI) published by Uganda Bureau of Standards (UBOS)."
Justification	To cater for changes in the value of an asset due to macroeconomic dynamics, specifically removing the effect of inflation from the gain in asset values and also allow for property to be transferred seamlessly by corporates as part of group restructuring for operational efficiency and encourage business growth.

<u>PROPOSAL: ECONOMIC POLICY MEASURES</u>

SN	**SECTOR**	**PROPOSED MEASURES**
1	**Education (**human capital development)	• Government needs to revise the human capital development policy to focus more and prioritize vocational training which could be the key to Uganda's unemployment problem. The policy should be changed to <u>free OR subsidized technical education and privately financed university education</u> as an incentive to encourage Ugandans to enroll for vocational and technical education and training. It would be good to make it mandatory to attend vocational training before joining university, necessitating Government to support (subsidized salaries, technical support) private vocational institutes e.g. farm institutes to make them deliver the necessary education that produces

		manpower with hands-on practical skills to drive SME growth and job creation. • Government also needs to address the policy-practice gaps in UPE and USE schools to solve the paradox of having children in the school-going age bracket out of school yet the education is free. Whereas the total enrolment in Primary Schools in government and Private Schools is 8,840,589m; 1,457,277m students enroll for Secondary Schools and 186,412 (96,305 in public universities and 90,107 in private ones) end up in Universities while only 70,248 students end up in Government Technical and Vocational Schools.[5]There must be a deliberate effort to have all children compulsorily in school during school time. • There is need for GoU to invest in the education infrastructure in order to facilitate learning for the 21st Century (bring the industry into classroom and take the classroom to the industry). This would necessitate government's intervention in increasing learners' access to free internet and free public libraries to cater for learners' information needs. • Government must also have a deliberate policy that promotes lifelong learning and non-formal education (for learners to attain life skills including communication, leadership, and character development) alongside formal education.
2	**Health**	• In operationalizing the newly rehabilitated General and Referral Hospitals, government wants to turn these into private facilities yet these have been built with tax payers' money. We propose that government sticks to the original idea of having a facility in every division of Kampala that is freely accessible to Ugandans and then in other plans, build private facilities for those who can afford them. The National and general referral facilities (Mulago, Kawempe and Kiruddu) should not be converted into private facilities, but be saved to provide basic health care to the poor people.

[5] State of the Nation Address by H.E. YoweriKaguta Museveni President of The Republic Of Uganda. At the Uganda International Conference Centre, Serena, Kampala 6th June, 2019

		• Government hopes to fast track implementation of the recently proposed National Health Insurance (NHI) scheme, which assumes that both public sector & private sector (which is largely profit driven) will deliver health care to the entire country. We propose that before government considers implementation of the NHI scheme, it gives due consideration to a <u>cheaper and more effective alternative approach driven by the NSSF</u>. The proposed alternative would have the following salient features; a) Focuses on improving the existing healthcare delivery system which consists of both the delivery channels and the actual health care service in order to be able to reach out to the less privileged and poorest people in the rural villages, rather than focusing on financing medical cost on a per service basis. With over 72% of Ugandans living within 5 km of a health care facility (Health Centres II, III &IV, the general hospitals, regional referral hospitals and the national facility); the implication is that improving and strengthening the already existing public health delivery system will ensure that more than 70% of Ugandans who live in the rural areas will have access to decent and affordable health care. b) Would save government the administration and operation costs of having to establish another Fund to manage its operations. c) Would greatly reduce costs of collectionby utilizing the NSSF network and collection system, which is already extant, and Ugandans would not incur significant additional costs of collection. d) To finance this scheme, we propose an affordable contribution by both employers and employees of 1% each which would not over burden the already heavily taxed Ugandans.
3	**Agriculture**	Agriculture needs to be recognised as the key growth driver of Uganda's economy given its dominant share of output. However, as it stands, much of it is small holder with limited tax capacity because of its vulnerability, low

		productivity and profitability. Agricultural productivity has continued to drop over the years from over 50% contribution to GDP to about 20%, yet the sector still employs over 70% of Uganda's population. We propose the following interventions; 1. Government needs to address climate change issues that make the sector weak and vulnerable. To ensure year round cultivation Government should consider subsidizing irrigation costs for private farmers. 2. There is need to rethink agriculture education, extension and research systems if the sector is to blossom and become more productive and profitable. For example, government could establish performance contracts for all farmer extension workers, clearly showing the outputs per day worked with farmers. 3. For effective management of farm inputs, the government should consider introducing a voucher system of providing agricultural subsidies as opposed to provision of physical inputs such as seedlings, fertilizers, pesticides, tools, etc; to allow farmers liberty to choose their own suppliers to curb the tendency of supplying fake inputs to farmers. 4. Government should establish regional technology centers/ hubs to drive mechanization and commercialization of agriculture (use of technology, modernized farming practices, post-harvest handling methods, etc). 5. Government should strengthen organisation/associations/ cooperation among farmers/ farmer groups through the cooperative model, as a potential tax target. Organized farming is a potential tax area, and much of it is currently exempted from taxation. 6. Establish structures for accessing international markets for agricultural produce e.g. government could re-introduce the concept of marketing boards to find markets (link entrepreneurs to out-grower farmers) and negotiate prices on behalf of farmer organisations. The board could charge a fair fee for the services from

		participating farmer organisations, and this could be a source of government revenue.
4	**Industry**	"Industrialization for job creation and shared prosperity" has been GOU Budget theme for the last two years. Industry is a potential source of a lot of tax revenue if operating at sufficient capacity. We propose the following; a) Government should develop a framework to implement rational electricity costs for manufacturers and industrialists so as to promote industrialization. Electricity cost as it is has the production and consumption at 1,700 and 600 megawatts respectively, skewed to less and less individual usage. Subsidizing industrial power would boost production and make Ugandan products competitive in the region and other external markets. Through export, the country will be able to earn a lot of forex as exports increase and support government's import substitution drive. b) Reduce corporate tax rate to 15% for industries operating plastic recycling plants for the first five years in order to encourage eco-friendly processing operations.
5	**Energy**	Energy is a very big factor in development, however the cost of this (electricity) is very high in Uganda, which has forced individual consumers, business owners, industry, to turn to alternatives that are not eco-friendly. Over 30m Ugandans have no access to electricity, despite it being in excess. The cost of power is just too high for them to afford. Therefore; 1. Government should continue to invest in access to electricity by extending power lines and reducing connection charges. While government has been subsidizing electricity connections to domestic consumers in a certain proximity to a pole, the move can only benefit people who are near the transmission lines and transformers leaving out the majority who live deep in the rural. The objective should be to have as many people as possible connected to power lines.

		2. In addition, Government should subsidize domestic solar installations as this would bring many people on board and it is ecofriendly.
6	**Micro, Small &Medium Enterprises Sector(MSMEs)**	Uganda's economy is largely an informal economy with MSMEs making a tremendous contribution to employment and fiscal revenue. MSMEs contribute over 75% in GDP and over 90% employment and job creation. Therefore, the budget should encourage growth and development of MSMEs as a way of sustaining their contribution to employment and fiscal revenue. Some of the reported business constraints of MSMEs include; high taxes, access to credit, cost of credit, high electricity tariffs among others. We propose the following interventions; 1. Government should exempt small businesses from tax for the first 3 years of operation for all businesses below an annual turnover of say 30 million. This will give time for these businesses to stay afloat and make it to the tax bracket. Research shows that most businesses in Uganda collapse before making 5 years. This would create a bigger tax base in the medium to long term than suffocating them with taxes in their early stage. 2. We propose that government introduces an amnesty covering penalties and interest, on any outstanding tax for two years prior to listing onto the alternative markets, for MSMEs to access affordable financing through capital markets.
7	**Infrastructure**	Infrastructure development is critical for sustainable growth and inclusive development. Research has shown that there is a positive correlation between infrastructure growth and GDP growth. Inadequate infrastructure shaves up to 2% off Africa's average per capita growth rates.[6]Government, therefore, should not target mass production of infrastructure at the expense of quality of the infrastructure and their long-term sustainability in order to be able to reap the full benefits. We propose the following measures;

[6] World Bank Database, 2017 data

		• There is need for stakeholder engagement (KCCA, NWSC, Telecom Companies, GoU/CCTV/NITA-U, and the private developers) in the physical development planning process to coordinate activities and reduce the cost of building infrastructure. • Just like the airline, government also needs to revamp the Uganda Railways by repairing some critical lines using the appropriate technology before upgrading to the SGR; and extend the people transport services by Uganda Railways by increasing the routes and connecting stations.
8	**Labour and Social Development**	1. There is need for proper manpower planning such that the few jobs being created through the industrialization drive do not get externalised (foreigners). 2. The Department of Immigration ought to regulate the issuance of work permits to foreigners whose skills are available in the country. Ugandans need jobs to get empowered – and many have the skills and competencies and are committed to do work but cannot find it because it is taken up by foreigners. 3. Government should bolster associations and cooperatives as opposed to free financial handouts to a few people. 4. Government should streamline the international labor so that international laborers register at the embassies and renew their registration every year to curb enslavement of the exported laborers and increase remittances. 5. Government should incentivize employers who employ a large number of youth as it is the case with those whose workforce is comprised of 5% persons with disabilities.
9	**Environment**	There is an urgent need to balance economic growth and sustainability in order to preserve social and environmental assets. Statics show that Uganda's forest cover has reduced from 28% coverage to about only 8% cover. • The Government should impose a 5% environmental levy on entities that engage in activities that impact both the social and environmental assets.

		• Government should also enforce the ban on polythene bags (kaveera) to avoid further environmental degradation.
10	**Government borrowing**	50% of the current GOU Budget is about borrowing (borrowing and repayment of borrowed funds). This level of borrowing is not sustainable and the practice sends a wrong signal to public to believe that; a) It is more beneficial to lend to government, than invest in business b) The banks focus their lending to government, refuse to lend to business and other individuals leading to crowding out effects. We propose that government reduces its borrowing; restructure existing loans through renegotiation and refinancing.