INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS
OF UGANDA

ICPAU TAX PROPOSALS FOR FY 2022/23 BUDGET

AUGUST 2021

ICPAU TAX PROPOSALS FOR FY 2022/23 BUDGET

The Paper highlights the Key Tax Policy Measures proposed by the Institute of Certified Public Accountants of Uganda (ICPAU), giving the Current provisions of the law where applicable, the Challenge(s) arising from the current status and the Proposed Measure(s).

The Proposals enlisted within the Paper are listed below;

1. Amendment to Section 25 –Interest Capping
2. Reinstatement of Withholding Tax on Agricultural Supplies
3. Re-visiting the Residence and Source Rules for Income Taxation in Uganda
4. Enforcement of Transfer Pricing Documentation Requirements
5. Raising the PAYE Threshold
6. Provide Clarity on the Rental Tax Amendment of FY 2021/22
7. Withholding Tax Exemption
8. Restriction of Immigration and Transfer of Corporate Residence
9. Enhancing the Capacity of the Tax Authority to Collect Taxes

1. AMENDMENT TO SECTION 25 OF THE ITA - INTEREST CAPPING

Issue	**Amendment to Section 25 Interest Capping**
Current Law	Sec. 25 of the ITA as amended excludes 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.
Challenge(s)	Deducting accumulated tax losses when determining EBITDA under section 25(3) of the ITA distorts the prevailing earnings against which the capped interest deduction should be offset. This is because, by allowing a tax deduction in respect to the previous year's tax losses, when determining the current year tax EBITDA, the basis for deducting interest expense (i.e. by matching interest with activities that generate taxable income and value creation) is lost. Assessed losses arise from an excess of allowable revenue expenses and/ or capital allowances over gross income for a particular year of income. Accordingly, whilst these expenses are allowed as a tax deduction in a particular year, the same expenses, in some instances, are used to the detriment of a taxpayer in determining interest deductibility. This is because the inclusion of an assessed loss in some instances results in negative tax EBITDA irrespective of an entity's earnings capacity in the current year. In this instance, no interest will be deductible for that particular year of income. Disallowing interest expense based on negative tax EBITDA (created by the mechanics of the tax law and not economic activity), in principle results in taxation of an otherwise tax-deductible cost which is not equitable. In addition, BEPS Action 4 made some recommendations for interest deductibility in respect to loss-making entities within a group of companies.
Proposed Measure(s)	Section 25(5) of the ITA should be amended to add another subsection (c) which will exclude the accumulated losses from EBITDA, to read as follows; *In this section -*

	*(a) "tax earnings before interest, **tax**, depreciation and amortisation" means the sum of………* *(b) ……………………...............................* ***c) The allowable deductions do not include accumulated losses brought forward."***
Justification	a. In order to reflect the true economic activity of a company for a given year of income, only earnings arising from that specific year of income should be taken into consideration for purposes of deriving the EBITDA used for interest capping. b. In addition, the inclusion of the word "**tax**" before the words depreciation and amortisation provide clarity to the fact that the depreciation and amortisation being considered is the one determined as per the tax laws and not accounting principles.

2. REINSTATE WITHHOLDING TAX ON AGRICULTURE SUPPLIES

Issue	**Re-instate Withholding Tax on Agriculture Supplies**
Current Law	N/A
Challenge(s)	Despite being a 'COVID-19 winner' having benefited from the restrictions, the agricultural sector has remained largely untaxed and contributes very little (contributes less than 1% of total tax revenue) to the overall tax burden in Uganda - statistics from UBOS FY19/20. The Sector also enjoys a multitude of subsidies and tax exemptions, which has limited tax revenue. Cognizant of the fact that agriculture is largely practiced by the rural populace (85% of whom are poor), we also know that there are some large-scale commercial farming operations in the sector that record significant profits and contribute limited taxes. We believe attempts should be made to expand taxation of these large-scale operations so that they contribute their fair share of taxes. In 2018/19, when a 1% withholding tax was introduced on agricultural supplies in excess of UGX 1 million, it raised over UGX 32.6 billion (USD 8.6 million) in tax revenue—almost twice that collected in income

	tax from all agricultural taxpayers. However, the amendment was abolished the following year as the tax became politicized and all efforts to reinstate it have repeatedly failed.
Proposed Measure(s)	We recommend that government: a. Re-negotiates the introduction of a 1% withholding tax on agricultural supplies in excess of UGX 1 million. By introducing the 1% WHT, government should be able to add to its tax base. The rate of tax should be maintained at a low 1% so as to encourage compliance. b. Defines the term "agricultural supplies" or include a schedule of items that fall within the meaning of "agricultural supplies" in the law to help provide clarity.
Justification	a. This is the only effective way to tax the agriculture sector. b. The measure will also see increased formalization of the agricultural sector and bring on board a number of unregistered taxpayers to the tax register.

3. RESIDENCE AND SOURCE RULES OF INCOME TAXATION IN UGANDA

Issue	**Residence and Source Rules for Income Taxation in Uganda**
Current Law	Uganda uses both the residence and source principles for purposes of income taxation. The rules have been articulated under the ITA to determine the particular liability for income tax purposes. These rules affect both individuals and corporations.
Challenge(s)	The weaknesses are: a) That residence for Uganda's income tax purposes is calculated based on physical presence (permanent home, no of days visited the country and structure of operations for corporations). It is therefore possible to avoid taxation by registering permanent homes in other people's names

	and visiting the country for periods less than 6 months or 183 days or other periods indicated in the law. b) The rules defining and determining source of income for taxation as have been provided under the law allow or require an individual or corporation to calculate income or losses from any employment, business or investment that has a source of income from Uganda. These provisions can be by passed through manipulating residence and not disclosing the sources of income from Uganda. The income from Uganda could be transferred to another country as 'remittances' from relatives for personal use or consumption and thus escape income taxation both at home and abroad.
Proposed Measure(s)	Revisiting the residence and source rules for income tax purposes by enhancing the existing criteria in the law. Technology and globalization have overtaken the present set criteria, and the rules as prescribed currently can easily be beaten.
Justification	To eliminate possibilities of double non-taxation of persons, permanent establishments and non-resident corporations.

4. ENFORCEMENT OF TRANSFER PRICING DOCUMENTATION REQUIREMENTS

Issue	**Enforcement of Transfer Pricing Documentation Requirements**
Current Law	The Transfer Pricing Regulations of 2011 provide the detailed documentation requirements, usually required for compliance purposes, which involve reviewing existing related party transactions, policies, and testing for consistency with the arm's length principle.
Challenge(s)	We note that URA has not been very aggressive in enforcing compliance with these documentation requirements as laid out in the transfer pricing regulations of 2011.

Proposed Measure(s)	Section 164 of the ITA gives the Minister powers to make regulations for better carrying into effect the purposes of the Act. We recommend a review of the whole transfer pricing project to bring it up to date with the developments in the area and also improve the Transfer Pricing Regulations of 2011 to: a. Require all entities that are part of a group to include related party information when submitting their returns. b. Include a section in the returns that allows disclosure of such information. c. Introduce penalties for entities that are not adhering to the requirements as prescribed.
Justification	a. To encourage compliance and greater enforcement of these requirements. b. Try and close any leakages that might exist as a result.

5. RAISING THE PAYE THRESHOLD

Issue	**Raising the PAYE Threshold**
Current Law	Section 6(1) of the Income Tax Act (ITA) prescribes the rates of tax and thresholds applicable to chargeable income of individuals as prescribed in part 1 of the Third Schedule to the Act.
Challenge(s)	The MoFPED DRMS[1] clearly recognizes that '*the current personal income tax thresholds start at low levels of income and the progressivity of the rates is steep. This, may encourage non-compliance or less-than-full compliance and reduce incentives to work in the formal sector, as well as disproportionately disadvantage employees whose incomes are taxed at source under PAYE*'. The lower band of the PAYE threshold has been fixed at UGX 235,000 since July 2012. Low income earners are brought into the tax net at very low income levels stifling their capacity to save, invest and consume as their disposable income shrinks in real terms. The above surely works against the poverty alleviation

[1] Domestic Revenue Mobilisation Strategy 2019/20 – 2023/24

objectives of the government.

Under the current structure, the first tax bracket (10%) starts at incomes of UGX 2,820,000 per annum. This equates to just UGX 235,000 per month or UGX 7,833 per day. At an exchange rate of UGX 3,702 to the US dollar, taxation of income thus begins at USD 2.12 per day. Considering that the international poverty line is just USD 1.90 per day, PAYE appears to start at very low-income levels. Furthermore, the 3rd band is very wide, applying to annual incomes between UGX 4,920,001 and UGX 120,000,000. This also gives an indication of how quickly the brackets climb – UGX 4,920,001 per annum equates to just UGX 13,667 per day or USD 3.69 per day.

It has been proved that increasing the threshold does not necessarily lead to reduced tax revenue. When the threshold was increased in 2012, PAYE collections increased by 20% from 2011/2012 to 2012/13. Below is the PAYE performance as shown on Page 55 of the MoFPED Background to the Budget 2014/15 Fiscal Year:

	2011/2012	*2012/2013*	*Increment*	*% increase*
PAYE UGX Bn	*996.9*	*1,196.5*	*199.6*	*20.0*

Proposed Measure(s)

a. Government should consider re-designing the personal income tax – PAYE, to make it more progressive by applying higher tax rates on higher income brackets. This would require consideration of raising the threshold to at least UGX 410,000 per month, which is just USD 1.79 above the international poverty line. The second band would then start at UGX 620,000, the third band at UGX 830,000, while the 40% highest rate can be maintained at UGX 10,000,000 per month.

Chargeable income	***Rate of Tax***
Not exceeding Ushs. 4,920,000 (410,000 pm)	*Nil*
Exceeding Ushs. 4,920,000 (410,000 pm) but not exceeding Ushs. 7,440,000 (620,000 pm)	*10% of the amount by which chargeable income exceeds Ushs. 4,920,000 (410,000 pm)*
Exceeding Ushs. 7,440,000 (620,000 pm) but not exceeding Ushs. 9,960,000 (830,000 pm)	*Ushs. 120,000 (10,000 pm) plus 20% of the amount by which chargeable income exceeds Ushs. 7,440,000 (620,000 pm)*
Exceeding Ushs. 9,960,000 (830,000 pm)	*a. Ushs. 300,000 plus 30% of the amount by which chargeable income exceeds Ushs. 9,960,000 (830,000 pm); and*

	b. Where the chargeable income of an individual exceeds Ushs. 120,000,000 (10,000,000 pm) an additional 10% on the amount by which chargeable income exceeds Ushs. exceeds Ushs. 120,000,000 (10,000,000 pm). b. Government should also consider eliminating all kinds of personal income tax exemptions particularly those relating to official employment income of Members of Parliament and judicial officers, among others. These individuals are Ugandan Citizens and must bear their fair share of the financial burden of administering the country. They should thus not be immune to sharing with other citizens the material burden of financing government, and therefore their payment of a non-discriminatory tax laid generally on all citizens should not be considered as a burden for as long as they earn beyond the set thresholds.
Justification	Among the many effects of the COVID-19 pandemic has been the loss of income, and rising precautionary savings, which have in turn led to a broad-based reduction in private investment and consumption. We are aware that besides income taxes, Uganda's main source of tax revenue is the consumption-based taxes. In the short run, it may seem like government is losing by raising the threshold, however in the long run the proposal will yield double benefits. With expanded PAYE bands, people's disposable income increases resulting into a wider effective demand thereby stimulating production, profitability and government revenue. Government is likely to reap from the consumption taxes levied on the taxable items as result of an enhanced aggregate demand.

6. PROVIDE CLARITY ON RENTAL TAX AMENDMENT OF 2021/22

Issue	**Provide clarity on the Rental Tax Amendment of 2021/22**
Current Law	Section 22 of the ITA was amended in subsection (1) by substituting for paragraph (c) the following;

	In case of rental income, 75 per cent of the rental income as expenditures and losses incurred by a person in the production of such income, subject to verification by URA.
Challenge(s)	There are issues that arose out of this amendment: 1. The Act now allows normal deductions under Section 5 (3) (c) '*expenditures and losses incurred by a person, other than an individual, in the production of rent shall be allowed as a deduction under this Act for any year of income'*, but also gives the 75 per cent of the rental income as expenditures and losses incurred by a person in the production of such income. 2. The gazetted version of the Income Tax (Amendment) Act, 2021 provides for 75 per cent deduction for rental tax purposes, b*ut subject to verification by URA.* The law does not indicate what happens upon verification. Will the landlord only be entitled to the expense amounts that have been verified or not? 3. There is also likely to be disparity in applying the 75% deduction, thereby leading to different tax payers being subjected to different tax approaches. The ultimate outcome being that taxpayers are allowed different percentages of deductions with some having a full 75% allowance, others below that, and some no allowance at all. Such discretion may be prone to abuse and we believe this was not the intention of the legislature.
Proposed Measure(s)	1. Align the two Sections because they are confusing in the current state. 2. Drop the requirement for verification by URA because of the challenges it poses to tax enforcement and administration of rental tax. For example, by their 'informal' nature, it may not be feasible for all landlords to keep appropriate documentation or for URA to have capacity to verify the documentation.
Justification	To provide clarity.

7. WITHHOLDING TAX EXEMPTION

Issue	**Exemption from WHT for tax-compliant sellers of businesses or business assets and agricultural supplies**
Current Law	Section 118B - Withholding of Tax by the Purchaser of an Asset
Challenge(s)	Under the law, this 6% WHT is not a final tax and therefore these tax compliant sellers will account for the full income taxes by the appropriate due dates.
Proposed Measure(s)	We propose that the benefit of this exemption be extended to apply on purchase of businesses or business assets and agricultural supplies.
Justification	a. This exemption will help to align and provide uniform treatment with the other 6% WHT on purchase of goods and services where tax-compliant suppliers that appear on the WHT Exemption list for a given year are exempted from Withholding Tax. b. It will also encourage compliance as more people will want to comply and be able to benefit from the exemption.

8. RESTRICT IMMIGRATION AND TRANSFER OF CORPORATE RESIDENCE

Issue	**Restriction of Immigration and Transfer of Corporate Residence**
Current Law	N/A
Challenge(s)	Currently the ITA is silent on this practice, which encourages Corporations to easily relocate to other Countries without paying up considerable potential income taxes.

	In some Countries, transfer of residence of corporations is treated as a tax evasion measure. The transfer may require that the company is wound up or deemed to be liquidated in several civil law jurisdictions. This is the practice in Australia and parts of Europe. In Germany for example, the law will automatically dissolve a German Company which transfers its headquarters abroad. The law also restricts a foreign company from establishing its headquarters in Germany. In other countries an 'exit tax' is imposed on a corporation when it ceases to be their resident and also a capital gains tax is imposed on its deemed sale. This is the practice in the United States, United Kingdom, Canada and Australia.
Proposed Measure(s)	We recommend that Government should impose restrictions on immigration and transfer of corporate residence, through special anti-avoidance rules and exit taxes. For example is a person has been operating in Uganda say for 5 or 10 years and have not paid any corporation tax probably because they have been loss-making. We propose an exist tax of 1% of the proceeds from the deemed sale of all their assets.
Justification	To widen Uganda's income tax base.

9. ENHANCE CAPACITY OF TAX AUTHORITY TO COLLECT TAXES

Issue	**Enhance the Capacity of the Tax Authority to Collect Taxes**
Current Law	N/A
Challenge(s)	The capacity of the tax administration to effectively enforce existing tax rules is limited. The Uganda Revenue Authority is one of the most understaffed tax authorities in Africa. According to the African Tax Administration Forum (ATAF), Uganda has a ratio of labour force to tax administration staff of over 6,000:1. Most countries in Africa have a ratio of less than 4,000:1. Staffing gaps limit the authority's enforcement and audit capacity.

	Weak technical capacity and a lack of access to information is most problematic for taxation of players in the e-commerce area. Current tax law in Uganda also puts an emphasis on physical presence, making regulation and taxation of e-commerce firms particularly challenging.
Proposed Measure(s)	Consideration should be given to resources needed for tax collection. URA needs to spell out all the resources needed every financial year. These should include human resources, training and capacity building, the management information system, equipment, capital, infrastructure to enable mobility and stationery. The country should also invest in a robust Management Information System (MIS).
Justification	Taxation will be central to Uganda's economic recovery process, and therefore investment in the tax collection processes/ systems is key so that the capacity of the authority to implement and be able to collect taxes is already enhanced when the economy eventually starts to recover.