Appendix IV

INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS
OF UGANDA

ICPAU TAX POLICY PROPOSALS FOR FY 2023/24 BUDGET

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

The Tax Proposals enlisted within the Paper are listed below;

1. Definition of “Retirement Fund” in the Income Tax Act
2. Amendment to Section 25 – Capping of interest deduction under Section 25(3) of the ITA
3. Raise the PAYE Thresholds
4. Reinstate Withholding Tax on Agriculture Supplies
5. Taxation of Income of Educational Institutions
6. Amendment of Section 19 of the Income Tax Act - Employment income
7. Enhancing and Deepening the URA Tax Education Strategy

1. DEFINITION OF 'RETIREMENT FUND' IN THE INCOME TAX ACT

Issue	Definition of "Retirement Fund' in the Income Tax Act
Current Law	**Section 2: Interpretation** "Retirement fund" means a pension or provident fund established as a permanent fund maintained solely for either or both of the following purposes— a. the provision of benefits for members of the fund in the event of retirement; or b. the provision of benefits for dependents of members in the event of the death of the member;
Challenge(s)	The current definition is inconsistent with that of a retirement benefits scheme in the Uganda Retirement Benefits Regulatory Authority (URBRA) Act. The definition within the ITA seems to focus on retirement funds intended only for provisions of benefits upon a member's retirement or upon their death. This is contrary to the current practice within the sector, where there are notable occupational retirement schemes whose benefits are accessible by their members upon the termination of employment with the respective employers. While the URBRA Act scopes such schemes within the definition of retirement benefits scheme, the ITA does not and this exposes them to a danger of contrary treatment if the taxman chooses to do so.
Proposed Measure(s)	We propose the following: a. Replace the words "retirement fund" with the words ***"retirement benefits scheme"*** b. Substitute the definition of "retirement fund" with ***the definition of "retirement benefits scheme (RBS") as follows; "retirement benefits scheme (RBS) means a legally binding agreement or arrangement other than a contract for life assurance whether established by a written law or by any other instrument, under which members are entitled to benefits in the form of an annuity or a lump sum payable upon retirement, or upon death, termination of service or upon the occurrence of an event specified in the written law, agreement or arrangement."***
Justification	To align it with the definition in the URBRA Act.

2. AMENDMENT TO SECTION 25 - CAPPING OF INTEREST DEDUCTION UNDER SECTION 25(3) OF THE ITA

Issue	**Amendment to Section 25 - Capping of interest deduction under Section 25(3) of the ITA**
Current Law	This section limits interest deduction to 30% of tax EBITDA regardless of whether the debt is from a related party or a third party (such as a financial institution) and the excess interest can be carried forward for up to three years. Borrowers who are financial institutions or insurance companies are exempted from this limitation.
Challenge(s)	However, we believe that bringing a cap on interest payments on all debt goes far beyond the purpose and intent of restricting any misdeeds that may arise from inter-company borrowings. It would be self-defeating for the law on one hand to exempt financial institutions and insurance companies yet on the other hand those entities supplied with debt for such institutions are not fully protected.
Proposed Measure(s)	We suggest that the 30% restriction on interest deductibility should be applied only to that debt from related parties in the spirit of what the thin capitalization rules used to apply. Also, the capping should exclude funding sourced from licensed financial institutions to allow businesses to borrow and expand/ grow and invest in long-term ventures. We thus propose an amendment 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***, other than a financial institution or a person carrying on insurance business, ***or a person engaged in long-term investments***, shall not exceed thirty percent of the tax earnings before interest, depreciation, and amortization." b. ***In this section, long-term investments include:*** • ***Pipeline projects*** • ***Power infrastructural projects*** • ***Capital-intensive industries***
Justification	While the interest limitation is intended to curb the erosion of Uganda's tax base using interest as a tool, the design of this law widens its net to cover taxpayers who are not practicing harmful tax planning and

	this impedes business growth. In particular, the coverage of this law includes Ugandan-based groups of companies that do not have nexus to tax jurisdictions outside Uganda to erode Uganda's tax base. Furthermore, the interest capping provision assumes that businesses are generally in positive EBITDA for at least three years including from inception. However, this is not the case for investments that have a long gestation period, especially those that involve construction for a long-time such as hydropower projects which take a number of years during the construction stage yet depend heavily on debt. The current limitation of interest with respect to long-term projects increases the tax cost of such projects, thus affecting the project's internal rate of return and investment attraction.

3. RAISE THE PAYE THRESHOLDS

Issue	**Raise the PAYE Thresholds**
Current Law	Section 6(1) of the Income Tax Act (ITA) prescribes the rates of tax and thresholds applicable to the chargeable income of individuals as prescribed in part 1 of the Third Schedule to the Act.
Challenge(s)	The current PAYE threshold of UGX 235,000 per month was last revised in 2012 (about ten years ago). 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. This brings low-income earners 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 work against the poverty alleviation objectives of the government. The government's DRMS[1] itself clearly recognizes that "*the current personal income tax thresholds start at low levels of income and the progressivity of the rates is steep, which 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*".

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

Over the years, inflation has increased considerably and has been made worse by the impact of covid-19 and the rise in energy prices.

Furthermore, the 3rd band is very wide, applying to annual incomes between UGX 4,920,001 and UGX 120,000,000. This 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. The 40% top band which was introduced to tax high-income earners more, with a baseline at income above UGX 10 million per month also needs to be adjusted for inflation as the current UGX 10 million per month is much lower than UGX 10 million per month in 2012.

Proposed Measure(s)

a. Government should consider re-designing the personal income tax – PAYE to make it more progressive. 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% top band can be maintained at UGX 10,000,000 per month as illustrated in the table below:

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. The thresholds should be indexed yearly for the cost of living.

c. Government should require minimum salary disclosures from employers especially the multinationals who engage expatriates to be able to obtain the right data and expand taxation.

d. Government should also consider eliminating all kinds of personal income tax exemptions, particularly those that relate to official employment income of Members of Parliament (MPs) and judicial officers. 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 a burden for as long as they earn beyond the set thresholds. Taxation on MPs' allowances alone could yield the government about 2.3bn per month (over 25bn annually) which would more than compensate for the lost amounts in raising the tax bands.

Justification

a. 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*

b. Among the many persistent effects of the COVID-19 pandemic have 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 consumption-based taxes. In the short run, it may seem like the 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 in 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 a result of enhanced aggregate demand.

c. A tax-free threshold is intended to cushion low-income earners and enable them to have disposable income to meet their basic needs. The rise in inflation over the years has made the existing threshold of UGX 235,000 per month have little or no impact on the livelihoods of low-income earners in the country.

4. REINSTATE WITHHOLDING TAX ON AGRICULTURE SUPPLIES

Issue	**Reinstate Withholding Tax on Agriculture Supplies**
Current Law	N/A
Challenge(s)	The agricultural sector remains 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 supplies in this sector are very huge and there are large-scale commercial farming operations in the sector that record significant profits but contribute limited 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 believe attempts should be made to collect data from these large-scale farming operations/ suppliers and expand taxation of these in the longer term after data has been availed to generate more revenue. 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, the 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 includes a schedule of items that fall within the meaning of “agricultural supplies” in the law to help provide clarity.

Justification	a. This is an effective way to tax the agriculture sector, and the measure will also see increased formalization of the agricultural sector and bring on board a number of unregistered taxpayers to the tax register. b. This will generate additional tax revenue for the government that could help close the revenue lost when the PAYE threshold proposal is considered.

5. TAXATION OF INCOME OF EDUCATIONAL INSTITUTIONS

Issue	**Taxation of Income of Educational Institutions**
Current Law	Section 2(bb)(i)(B) of the ITA includes within the definition of exempt organization educational institutions of a public character. This then means that their income is exempt from tax under Section 21- Exempt income.
Challenge(s)	The education sector in Uganda is comprised of both government-aided/ public educational institutions (which are the ones most recognized to be of 'a public character' and private-run education institutions. public educational institutions are highly subsidized/ facilitated and charge almost the same fees as their private-sector counterparts. However, while public educational institutions remain untaxed, their private-sector counterparts have continued to be subjected to tax.
Proposed Measure(s)	We recommend that there should be a universal requirement for all education institutions to pay taxes.
Justification	a. This is in the spirit of fairness and equity. There is a need to level the playing field for both players in the sector in order not to disadvantage those in the private sector. b. This will generate tax revenue for the government that could help close the revenue lost when the PAYE threshold proposal is considered.

6. AMENDMENT TO SECTION 19 OF THE ITA – EMPLOYMENT INCOME

Issue	**Amendment of Section 19 of the Income Tax Act - Employment income**
Current Law	The Section currently does not provide any tax relief to employees on their employment allowances.
Challenge(s)	We note that employees in the formal sector are the most taxed individuals in the country. They are taxed 100% of their allowances, which is an injustice and imbalance. Other jurisdictions, including those in the developed world, provide some tax relief for certain employee allowances. While the income tax provides the employer tax relief for expenses incurred including subscriptions to professional institutions and staff training and development costs, there are no such tax reliefs on the employment income under the income tax act.
Proposed Measure(s)	We believe there is a need to provide tax reliefs to employees who meet expenses of registration, membership, and subscriptions to professional institutions as well as training and development if required by any law. The Accountants Act 2013 Section 34 (2), for example, requires that all heads of accounts, finance, and internal audit in public and private sector entities with public interest should be members of the Institute. This requirement comes along with costs including membership registration and subscriptions to the professional institution, staff training and development costs, among others. It is more often than not that these costs are not met by the employer, but by the individual staff.
Justification	This is in a bid to maintain fairness and balance in taxation.

7. ENHANCE AND DEEPEN URA'S TAX EDUCATION STRATEGY

Issue	**Enhancing and deepening URA's Tax Education Strategy**
Current Law	N/A

Challenge(s)	Lower levels of distrust coupled with low levels of citizen engagement results in low levels of tax compliance. The informal sector accounts for about 43.1% of Uganda's total economy (source: UBOS), but is mostly hidden and the operations are unreported or unknown. This informality impedes revenue collection since the tax authority cannot fully capture activities. There is a perceived taxpayer education program by the taxman, but URA needs to invest in more innovative ways of engaging the business community for them to appreciate the value of paying taxes.
Proposed Measure(s)	a. We propose increased and deepened training, education, and capacity-building programs for both current and potential taxpayers. Engaging and educating them will enhance their understanding and appreciation of the whole tax system. Conducting more rigorous tax education is very important if all potential taxpayers are to be attracted to register for tax purposes. Tax education serves as a tool to help reach and encourage new taxpayers; explain the role of tax in society; build tax morale; and ultimately increase revenues, and those taxpayers who distrust the tax authorities most are likely to be more in need of tax education. This should also be done for political and other leadership categories in the country. Targeted education, which includes segmenting the audience, identifying their different needs and designing specific tax information/ messages for delivery, is desirable. As taxpayers grow, they need different things, and therefore understanding what these different needs are, as well as the different aspects therein is key. b. We believe that for tax education to take root, every individual must be required to file an income tax return and declare their expenses. This will drive the demand for these tax education programs and taxpayers will be drawn to them whenever they are organized. The government will also be able to pick up more information from potential taxpayers in the process. c. To support the aforementioned proposal, the authority will need to further simplify the return to allow everybody to be able to submit their returns from wherever they may be, but also dedicate teams (physically), preferably at the local administrative units to help with the input

	of data in the system.
Justification	Providing citizens with the information to understand how the tax system works, the rights and obligations of taxpayers, and how citizens can influence the development of the tax system, is vital to building public trust in tax systems. It is a key component in raising tax morale and encouraging voluntary compliance.