



ASSESSMENT OF THE COHERENCE BETWEEN UGANDA'S TAX LAWS AND POLICIES AND THE EAC COMMON MARKET PROTOCOL

POLICY PROPOSALS FOR REFORM



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INTRODUCTION.

The East African Community (EAC) identified and prioritized the harmonization of taxation regimes of the Partner States as a way of fostering its goal towards the implementation of the Common Market Protocol. This is on the backdrop that EAC countries have some huge differences in their tax systems including the definitions of their tax bases. These differences invariably confer unfair tax competition and unequal treatment of tax payers, goods and services in the region, which if not addressed distort the effective functioning of the Common Market. Harmonization of tax policies and domestic tax laws is, therefore, an important aspect of macroeconomic convergence that is also one of the benchmarks to be attained for effective functioning of the Common Market thereby facilitating intra-regional trade and investment.

The further the integration process is moving, the more, policy areas have to be investigated regarding possible discriminatory effects against the partner countries and no area is more susceptible to the need for reform and improvement than the tax system. This is especially true because it causes distortions for the cross-border transactions, capital flows and the regional labour division.

AN ASSESSMENT OF THE COHERENCE BETWEEN SELECTED UGANDAN TAX LAWS AND THE EAC COMMON MARKET PROTOCOL

The Common Market Protocol in Article 32 enjoins Partner States to undertake progressive harmonization of their tax policies and laws to remove tax distortions in order to facilitate the free movement of goods, services and capital and to promote investment within the Community.

Tax systems consist of indirect and direct taxes, the former relates to consumption, while the latter relates to income. The main components of indirect taxes are the excise taxes levied on single consumption goods and the VAT on general consumption usually borne by the final consumer. Direct taxes are income taxes usually levied on the taxable income of persons (Persons being individuals and business entities) and profit taxes. EAC Partner States have quite a similar tax structure regarding the main components¹. This policy brief identifies areas of divergence while examining potential impact on the proper functioning of the common market.

I. The Value Added Tax (VAT)

Under Uganda's VAT Act the general rate of tax is 18% while that of Kenya is 16% with a reduced rate for certain goods or services at 12%. The rate of Tax in Tanzania is 18%, 18% in Rwanda and the rate in Burundi is 18% with a reduced rate of 10% and 0% for some items. It is apparent that the standard simple average rate of VAT in the East African region is 17.6% however with the exception of Kenya the rest of the countries have a higher rate.

There are also differences in the various thresholds for VAT registration across the Partner States for instance the VAT registration threshold in Uganda is 150,000,000 Uganda shillings whereas in Kenya,

¹ These include aspects such as incidence to tax; tax heads; computation of tax; allowable deductions; and tax treatment.

businesses above the turnover of 3,000,000 Kenya shillings are required to register while those in the business of jewellery, timber, pre-recorded music, household apparatus, motor vehicle parts among other selected supplies are required to register regardless of whether they meet the threshold. In Tanzania, the VAT registration threshold is 100,000,000 Tanzania shillings. The VAT threshold in Burundi and Rwanda respectively is 100,000,000 BIF and 20,000,000 Rwandese Francs.

The Partner States have differing VAT treatment on the various supplies especially in relation to exemption, zero rating or standard rating categories: While Kenya's effective VAT rate is 16% with a reduced rate of 14 and 5%, Uganda Rwanda and Burundi have an effective tax rate of 18% with Burundi having a reduced rate of 10% and the others not having a reduced rate while the effective rate in Tanzania is 20%. If goods are exported outside a Partner State where VAT isn't charged or where there are lower or reduced VAT rates, thresholds, for a trader seeking to access the various markets the differences in rates are counterproductive to ease intra-regional trade as it will distort the fair market value prices, and destabilize the harmony that the CMP seeks to achieve. The differences in VAT rates deter free movement of goods in that traders purchasing goods from a partner state with a lower VAT rate, say 16% will experience losses when they sell the same goods in a partner state with a higher VAT rate, say 18%.

As a result of these differences, a taxable person in Uganda due to a lower threshold may have a legal obligation to be on the tax register while the same person may not be required to register in another Partner State thereby causing different treatment across different States for same items. The same can be said of other aspects of the Uganda VAT regime such as items that are considered for exemption or zero rating which may follow Ugandan policy but not be in conformity with the other Partner States who may have a different policy in relation to the same leading to different application of VAT rules in different States to the Common market protocol.²

It is therefore apparent that there is need for VAT Systems Harmonization which can be achieved through a common East African VAT model, a reduction and uniform application of zero-rated transactions with a view of limiting the same to exports only but also ensuring uniformity of treatment across East Africa, harmonization and reduction of exempt transactions, maintenance of border controls in a mid-term perspective and harmonization of tax bases by clearly defining the place of supply in every detail, application of harmonized rules and practices for VAT refunds and durations, timelines and equalization of administrations and tax procedures in all Partner States. These policy and legal measures will go a long way in ensuring uniform application of tax rules and counteract the creation of an undue advantage to some member states against others while at the same time advancing the goals and aspirations of the common market protocol.

2. The Income Tax Act

In Uganda, the threshold for taxation of individuals for personal income tax is 2,820,000 Uganda shillings per year while the effective tax rate can go up to 40% for persons who earn amounts exceeding 10,000,000 Ugandan shillings. The Corporate income tax rate is 30% same as the branch profits tax while mining taxes range from 25% to 45%. Uganda offers tax credits and incentives such as a tax holiday for exporters who

² The different East African countries have different supplies which are treated as exempt, standard rated or zero rated bringing about different tax treatment of same supplies depending on the country.

export at least 80% of their produce subject to conditions; 100% allowance for scientific research expenditure; 50% capital allowance on developments done outside Kampala and ministerial approved tax exemptions on deserving tax payers. Depreciation rates on capital expenditures are in between 20 percent to 40 percent.

In Kenya, the maximum rate of personal income tax is 30% charged on income in excess of KES 51,373. The Corporate Income Tax rate is 30% while that for branches and foreign permanent establishment is at 37.5%. There are however special rates such as export processing zones where for the first 10 years the rate of tax is 0%, the next 10 years 25% and thereafter 30% and SEZ which are taxed at 10% for the first 10 years and 15% for the succeeding 10 years. Depreciation rates on capital expenditure are between 12.5 to 37.5.

In Tanzania, the maximum personal income tax rate is 30% while the corporation income tax rate is also 30% on income of a resident corporation or a permanent establishment and 5% is charged on turnover for technical and management service providers.

Nondeductible are the income tax itself and distributed profits. In contrast to Kenya, capital gains are taxable at the same rate as other profits and no relieves are allowed for inflation or reinvestment. Dividends from controlled companies are exempt if the recipient holds at least 25 percent. Losses can be carried forward indefinitely. Losses abroad can only be offset against foreign profits.

There is need to review and harmonize all tax incentive schemes as seen above from the main East African countries, taxes, tax bases and tax incentives vary from one country to another. Capital initial allowances need harmonization and there is also need for harmonization of treatment across the East African regions of losses carried forward. Withholding tax rates especially on nonresident suppliers and contractors need to be synchronized since the different application of income tax rules across the EAC which is a big hindrance to the furtherance of the common market protocol.

The EAC Double Taxation Agreement with third party countries is ideal for the harmonization of income tax rules in East Africa in seeking fiscal certainty among potential investors and in trying to avoid the disastrous impact of double taxation on the developing vibrant business community in East Africa, the EAC Partner States signed an agreement on double taxation avoidance. It provides a well-balanced and reliable structure for the fair, just and predictable taxation of all cross-border income and activities. The challenge that lies ahead is the ratification of the same to bring it into force and the uniform application and interpretation of the DTA in all EAC Partner States. At the moment, only Tanzania and Burundi are yet to sign and ratify the DTA.

3. Excise Taxes

There are disparities in rates, structures and practice of excise duty amongst the Partner States. Uganda collects excise duty differently and taxes different goods. The excisable goods are also classified differently. This has led to a compliance burden for nationals of the different Partner States and certainly hinders products from having uniform application. Discriminatory excise tax remission schemes also exist based on local raw materials which are entitled to lower rates since these schemes are geared at making locally manufactured goods more competitive. For example, for the case of juices, Uganda charges a lower excise

duty for juices extracted from fruits that are locally produced and a higher rate for juices produced from chemical concentrates. According the EAC Time bound Program, 2017, Uganda also charges varying excise duty rates for certain imports such as pharmaceuticals and cigarettes.

Given that trading blocs require certain and equitable tax systems, variances in rates and application of excise duty among the Partner States should be ironed out in order to attain the single East African Market. Excise tax neutrality should be the aspiration since such wont tamper with the flow of the factors of production and won't cause firms or individuals to shift their economic choices.

4. The East African Customs Management Act

Several strides have been taken with the implementation of the East African Customs management Act, although challenges abound for Uganda. A case in point is the implementation of the Common External Tariff. This is seen through the varying customs procedures resulting in different computed values for taxation. Uganda has since 2005 produced a list of industrial products that are exempted from the Common External Tariff in a bid to spur its industrialization and other Partner States have also done the same. Another area for examination is standards and the goods allowed in the Partner States. While Uganda allows used motor vehicles which are eight years and older but with an environmental levy, other Partner States such as Kenya do not permit used motor vehicles which are eight years and older. This illustrates that in the absence of harmonization of the taxes including goods permitted to be imported, the common market protocol gets affected adversely.

Other challenges faced in the implementation of the Common Market Protocol include challenges emanating from Special Economic Zones and Export Processing Zones and other investment promotion authorities. These tend to be protectionist in nature and could have adverse effects on the common market protocol if implemented in isolation of the regional uniform needs and aspirations. Special economic zones are geographically demarcated areas within a country which function differently usually with more liberal, administrative, regulatory and fiscal regimes to the rest of the country. In the context of the common market protocol these incentives aimed at attracting investment tend to loosen existing rules in exchange for investment.

Partner States have all implemented the EAC tariff schedule, eliminating tariffs on each other's goods or intra-regional trade, however EAC certificates of origin are often not recognized at borders and Uganda has to-date not complied with the EAC Council's recommendations to enact domestic legislation to impose penalties on people who furnish false documentation to obtain them.³

There are multiple certification marks in the East African Community and some are not approximated to Uganda's marks due to unharmonized conformity assessment infrastructure in the region as such this affects their effectiveness in the promotion of free movement of goods in the region. There is also a lack of monitoring mechanism by the East African Community to ensure that the provisions of the Standard

³ The Common Market scorecard 2016 observes that all partner states have officially adopted the East African Community tariff schedule and revised their rules of origin which includes provisions to address false claims with respect to rules of origin but there is use of tariff equivalent measures and lack of recognition of Rules of Origin certificates among East African states.

quality metrology and testing Act regarding the adoption and implementation of East African Standards are undertaken in Uganda and other Partner States.

In seeking to ensure the full implementation of the Common Market Protocol Uganda should ensure the free movement of goods across the EAC Partner States, should strengthen efforts to: Ensure complete elimination of tariffs and equivalent measures affecting intra-regional trade, Ensure elimination of non-tariff barriers (NTBs), Ensure greater effective implementation of the common external tariff⁴ since a common external tariff (CET) is critical to ensure free circulation of goods in the EAC, and implies the application of the same customs duties to all goods entering the EAC regardless of which country within the area they are entering. Under Article 12 of the EAC Customs Union Protocol, Partner States agreed to adopt a CET with a three-band structure (0% for raw materials, 10% for intermediate goods, and 25% for finished goods efforts should be made to fully implement that and should circumstances require a change in tariff such easy policy measures should be taken in consultation with all partner states so as not to adversely affect the proper functioning of the Common Market Protocol.

CONCLUSION

The East African Community Common Market Protocol has potential to build considerable economies of scale, accelerate competitiveness, technology diffusion and accelerate movement of people and fostering the ultimate political integration of the region. It is true that for the CMP to realize its true aims there must be elimination of Tariffs, Non-Tariff barriers and technical barriers to trade; removal of border controls, liberalization of financial markets, standardization of industrial regulations and product specifications; removal of restrictions on the right of establishment and residence of nationals from other partner states; harmonization of rules of origin and Value Added Tax and the elimination of other trade barriers.

The key findings in relation to taxes across the region is that there is no consistency in the effort to unify tax regimes as such there is a hindrance to cross border trade volumes and a hindrance to the widening of the east African common market which invariably also affects investment decisions and the ability to reliably forecast returns. This has also in turn hindered the accelerated development across the east African region for which individual countries would take longer to achieve single handed.

⁴ EACMS 2014 AT PAGE 26