Implementation of the Domestic Revenue Mobilization Strategy: What are the limitations?

Overview

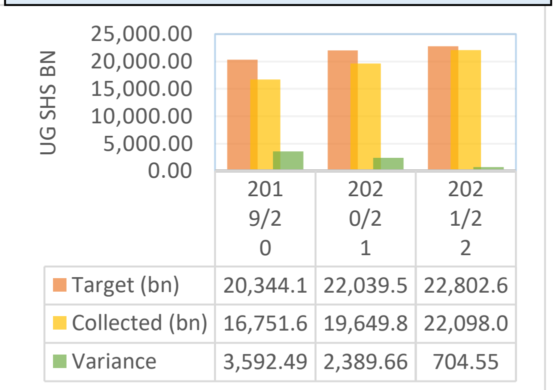
Revenue mobilization is one of the most important links of Government expenditure and service delivery. To maximize revenue mobilization, the Domestic Revenue Mobilization Strategy (DRMS) 2019/20-2023/24 was developed in FY 2019/20. The strategy's core objective is to improve revenue collection, and raise Uganda's tax to Gross Domestic Product (GDP) ratio from 12.5% to 16%-18% within the five financial years. The revenue strategy over the third National Development Plan (NDP III) period envisages improving compliance and efficiency in tax revenue collections through the implementation of the DRMS.

The DRMS is currently in its third year of implementation and although significant achievements have been registered, its execution has been constrained by a number of factors. This policy brief discusses the DRMS achievements and constraints hindering its implementation.

Introduction

The DRMS is a five-year strategic plan broadly geared towards: (i) raising additional revenues to support the government's budgetary position, (ii) encouraging a healthy flow of investment, and (iii) addressing issues of fairness and transparency in the tax system. In pursuit of this, five key stakeholders were tasked with the implementation and performance monitoring of the DRMS interventions. These include: The Permanent Secretary-Secretary to the Treasury (PS/ST), the Tax Policy Department (TPD), and the Budget Monitoring and Accountability Unit (BMAU), all under the Ministry of Finance, Planning and Economic Development (MFPED); plus, the Uganda Revenue Authority (URA), and various Non-Tax Revenue collecting Ministries Departments and Agencies. The DRMS is currently in its third year of implementation and since its inception, the tax collection to target variance has significantly narrowed (by 80%) and there has been a growth in the overall collection effort (by 32%) (Figure 1).

Figure 1: Tax Collection to Target



Source: URA Database

Key Issues

- Inadequate budget allocated to the Tax Policy Department to support the expanded scope.
- Generous tax incentives regime that compromises tax yield.
- Ineffective taxation of the informal sector.
- Low taxpayer compliance.
- Lack of data for high priority indicators.

However, the tax-to-GDP ratio continues to hover around 12.5% to 13% (Table 1). This is below the internal growth target of at least 0.5% per annum and lower than some of its counterparts in East Africa (i.e. in 2021 the tax to GDP was 17.7% for Rwanda and 16.8% for Kenya).

Table 1: Tax to GDP Ratio FY 2019 -2022

Financial Years	Tax to GDP Ratio (%)
2019	12.2
2020	11.4
2021	12.7
2022	13.0

Source: Author's Compilation

For the country to achieve its intended revenue mobilisation objectives, there is a need to address the persistent constraints hindering the full implementation of the DRMS.

Specific Limitations

The BMAU has semi-annually tracked the implementation of the DRMS interventions and performance since FY2020/21, using performance indicators of Tax Policy and Tax Administration. Some of the key limitations identified are listed hereafter.

Tax Policy

1. The low status of the Tax Policy Department within the MFPED

The DRMS proposes to see a steady and significant increase in the budget allocated to the Tax Policy Department (TPD), to enable it to undertake a thorough analysis of policy options, conduct wide high-level consultations with public and private groups, develop well-targeted proposals, and effectively participate in treaty negotiations.

Currently, TPD is housed within the Directorate of Economic Affairs and in FY 2021/22, TPD's appropriated budget decreased by 2% from Ug shs 15.0bn in FY 2020/21. The current funding of the department does not complement its wide mandate, thus the department is not fully staffed with the relevant human resources and skills-set.

2. Generous tax incentives regime

The tax system offers numerous tax incentives, which are sometimes overlapping, and hence difficult to analyse to track impact. In addition, the incentive regime does not have a monitoring and evaluation framework to assess its effectiveness. The tax system provides several incentives such as tax holidays, capital allowances, and a long list of zero-rated and exempt products under the Valued Added Tax (VAT) Act.

Despite registering a reduction in the total revenue foregone due to tax exemptions as a percentage of GDP, from 1.65% in FY 2019/20 to 1.33% in FY 2021/22, there is a need to reduce or remove some of these exemptions to increase the tax yield. For instance, several components of tax expenditure increased compared to the baseline year; i.e. tax deductions/allowances increased by 66%, tax reliefs/reductions by 36%, and tax credits by 19%. As such, the estimated value and share of total tax expenditures to total revenue increased by 31% from Ug shs 1,891.47bn in FY 2019/20 to Ug shs 2,478bn in FY 2021/22. The continuous increase of tax expenditures deprives the government of significant amounts of revenue.

3. Ineffective taxation of the informal sector

The taxpayers continue to constitute a small proportion of the economically active population in the country. However, the total taxpayer register grew by 834,455 new taxpayers, and there was a 20% growth rate in the active taxpayer population (of the selected tax categories: Income Tax, VAT, and Excise Tax) at the close of the FY 2021/22. This puts pressure on those who comply with business registration and tax registration rules, by requiring tax rates to be unnecessarily high, exposing compliant firms to unfair competition and keeping the tax yield lower than it should be.

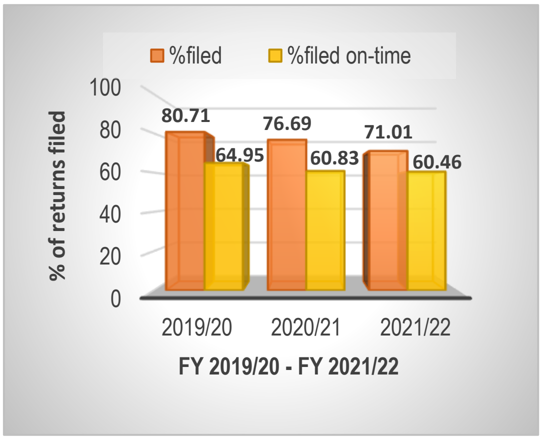
The problem is compounded by taxpayers who are partially informal i.e.; those that are registered but keep part of their activities out of sight of the government. Therefore, devising effective measures to tax the informal sector has the potential of improving the equity of the tax system and increasing tax revenue.

Tax Administration

1. Low taxpayer compliance

Tax non-compliance is common and observed in registration, filing of tax returns and payment of taxes. Specifically, with regards to filing rates of Withholding (WHT), Pay as You Earn (PAYE), VAT and Local Excise (LED), of the 852,254 returns expected in FY 2021/22, 71% were filed and 60.5% were filed on-time. The filing rates have continued to gradually decline over the last three years (Figure 2). In FY 2021/22, the filing ratios were below the target because taxpayers requested filing extensions due to COVID-19 effects.

Figure 2: Filing rates FY 2021/20 – 2021/22



Source: URA Database

2. Delays in processing tax refunds

The proportion of refund claims processed on time (within 30 days) increased by 10 percentage points to 35% in FY 2021/22, which was a slight improvement from the previous FY. However, this was not proportionate to the increase in the number and value of refund claims which increased by 27% and 104% respectively. The turnaround time was affected by lengthy audits, delays in the submission of additional documentation by taxpayers to support the audit process, pending objection applications and delays in Tax Appeals Tribunal (TAT) rulings. A lengthy refund process gives the impression that the refund system is arbitrary, and provides room for fraud and leakages.

Similarly, when taxpayers fail to remit taxes on time, penalties and interest accrue, yet the same benefit does not accrue to taxpayers when the Government delays to affect the tax refund in time. This disparity sometimes results in non-compliance and hostility between the taxpayer and URA.

3. Unreliable taxpayer database

The lack of a reliable taxpayer database makes it difficult to enforce tax compliance, ensure operational certainty and conduct timely and effective audits. During the FY 2021/22, the total percentage share of inactive taxpayers deactivated declined to 1.38% from 1.71% in FY 2020/21 for the identified functional areas (Income Tax, VAT, Excise Duty). Regular maintenance of the taxpayer database is crucial, as it prevents incurring unnecessary administrative costs.

There are also challenges related to the capture and utilisation of information from third-party sources to ascertain taxable transactions, and taxes due as well as detecting fraudulent transactions and tax evasion.

4. Ineffective arrears management

The government remains one of the biggest contractors in the economy, yet data on government payments is not leveraged to enforce tax compliance. The DRMS requires prioritisation of strategies to reverse the current arrears and audit trends, which should be developed in conjunction with URA and external support. During FY 2021/22, the total arrears increased by 11.8%. Specifically, the Customs portfolio grew at 105.6% from FY 2020/21, while the domestic portfolio grew at 9.9%. (Table 2) Domestic arrears were comprised of 99% non-government, which includes suppliers to the government, and 1% government.

Table 2: Total Arrears Stock

	FY 2019/20	FY 2020/21	FY 2021/22
Total Arrears Stock at Close of Fiscal Year (Ug shs bn)	2,989.52	4,190.10	4,682.89
o/w Domestic (Ug shs bn)	2,884.28	4,111.78	4,521.79
o/w Customs (Ug shs bn)	105.24	78.32	161.1

Source: URA Database 2022

General Limitations

1. Unassigned responsibility centres for some DRMS indicators

Several performance indicators within the DRMS monitoring framework have not been assigned to specific MDAs for implementation. Thus, these high-priority indicators are not addressed and the majority of them are close to or have already surpassed their implementation timelines (Table 3).

Table 3: Performance indicators with unassigned responsibility centres

Indicator	Data Source	Timeline/ Priority
% respondents indicating they know school pupils consuming alcohol and tobacco	Survey	**Medium 2020/21 – 21/22**
Managerial Effectiveness Index	Survey	**High 2019/20 – 2020/21**
Public perceptions of corruption among tax officials (% respondents saying “most” or “all” of tax officials are corrupt)	Survey	**Medium 2020/21 – 2021/22**
Tax Administration Competence Perceptions Index	Taxpayer Survey	**High 2020/21-2023/24**
Tax compliance costs as % of tax paid		
The proportion of taxpayers that perceive the OAU and TAT to be fair and independent	Taxpayer Survey	**Medium 2020/21- 2022/23**
No. of taxpayer complaints received relating to mistakes, omissions, and oversights in tax administration,	Establishment	**High 2019/20 – 2021/22**

Tax compliance gap (revenue collected as % of revenue potential)	Tax gap analysis study	**High 2019/20 -2020/21**

Source: DRMS Monitoring Framework

2. Lack of data for high-priority indicators

Some Tax Policy and Tax Administration indicators do not have sufficient information to draw meaningful conclusions about performance (Table 4). The majority of these are classified as medium to high priority and their implementation timelines have elapsed.

Table 4: Performance indicators with insufficient data

Indicator	Data source	Timeline/ Priority
Percentage of data records that are complete	URA,	**High 2019/20 – 2021/22**
PAYE taxpayers as percent of total NSSF contributors	URA, NSSF	**Medium 2020/21-2021/22**
Active TINs as % of active NWSC non-domestic clients	URA, NWSC	
Active TINs as % of active UMEME commercial clients	URA, UMEME	
Percentage of core tax administration transactions processed electronically	URA	**High 2020/21 – 2021/22**
Percentage of URA internal ICT-related key performance indicators achieved	URA	
Average No. of days taken to pay government contractors	**MFPED**	**Medium 2019/20**
Tax revenue foregone through tax incentives for the youth	URA,	**High 2019/20 – 2021/22**
No. of drivers arrested for drink-driving in a year	Police	**Medium 2020/21-2021/22**

Source: DRMS Monitoring Framework

Conclusion

This DRMS brings transparency to the direction of tax policy and administration in Uganda. Additionally, it strengthens the administrative efforts to improve revenue collection, to lift Uganda's tax-to-GDP ratio over the DRMS period.

However, its implementation has been constrained by some drawbacks. If the DRMS is to achieve its core objectives in the remaining implementation period and exploit the country's growing revenue potential, it is imperative to adopt a more candid approach to addressing the identified bottlenecks. There is also a need to ensure that all the interventions are being implemented as planned and that all the relevant stakeholders are fully engaged and aware of their responsibilities.

Similarly, all unproductive revenue leakages must be reduced through improved analysis of policy measures and the promotion of a transparent and business-friendly tax administration environment to foster equity and fairness.

Policy Recommendations

- The MFPED should enhance budgetary allocations to the Tax Policy Department to enable them to build the necessary capacity to effectively implement the DRMS intervention.
- The TPD should periodically conduct a cost-benefit analysis of tax expenditures especially tax exemptions for effectiveness.
- The MFPED should devise effective research-based measures to tax the informal sector.
- The URA should enhance the current taxpayer compliance initiatives and design a comprehensive package of reforms to address persistent non-compliance.
- The MFPED/DRMS Focal Unit should urgently review essential interventions in the DRMS and allocate responsibility centres for their implementation and action.

References

- BMAU Domestic Revenue Mobilisation Strategy Annual Monitoring Report FY 2021/22.
- Domestic Revenue Mobilisation Strategy for Uganda 2019/20 – 2023/24.
- URA Annual Revenue Performance Report for FY 2021/22.

Budget Monitoring and Accountability Unit (BMAU)
Ministry of Finance, Planning and Economic Development
P.O. Box 8147, Kampala
www.finance.go.ug