

DOMESTIC REVENUE MOBILISATION STRATEGY

2019/20 - 2023/24



Ministry of Finance, Planning, and Economic Development

October 2019

Statement by the Minister of Finance, Planning and Economic Development

I am glad to present to you this document on the Domestic Revenue Mobilisation Strategy (DRMS) as a summary of our discussions and statements of the intentions of various players. This document recognises the importance of having a medium-term strategy for government revenues, to guarantee a reasonable, realistic, and practical approach to sustainable resource mobilisation. The strategy set out in this document represents the next step in our government's fiscal policy, which has historically been highly successful in empowering the economic development of Uganda.

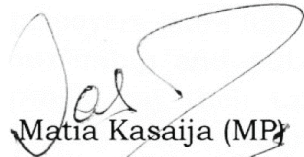
For this development to continue, there is a need to have a stronger and more certain revenue flow in order for the government to meet its expenditure needs and encourage foreign investment. This calls for a commitment to a prudent and sound medium-term strategy for financing our plans, to give confidence and certainty to our people and our investors. This Domestic Revenue Mobilisation Strategy brings transparency to the direction of tax policy in Uganda for the next five years and will strengthen the administrative effort to support it.

In order to achieve our revenue potential, we will move away from *ad hoc*, annual tax policy changes. These piecemeal adjustments, with little alignment to an over-arching strategy, have created a high degree of unpredictability and uncertainty in our tax policy direction. The DRMS will address this, as well as ensure that our future tax policy embodies the principles of simplicity, fairness, citizen welfare, and sustainability. Going forward, we will involve taxpayers more fully in the tax policy formulation process, restoring ownership and public confidence in the tax system by the way people pay their taxes. We will continue to provide a business-friendly tax environment and support investment; however, we will reduce unproductive revenue leakages from exemptions and publish a full tax expenditure framework to better understand the fiscal cost of supporting investment and social welfare.

Revenue generation does not happen in a policy vacuum. The tax administration has a key role to play, and it is here that we anticipate the most significant gains to be made. We will enhance the Uganda Revenue Authority's administrative capacity to collect taxes efficiently through additional staff recruitment, better training, and the modernisation of their technological infrastructure and systems. We will focus more explicitly on promoting compliance with existing laws from a higher proportion of businesses and individuals, particularly through more focussed taxpayer services and education.

Finally, it is important to recognise the role played by all arms of Government and Ugandan society in securing our financial independence. Future resource mobilisation efforts depend on Ugandans perceiving a closer link between taxes paid and public services enjoyed by citizens. As Government, we have a responsibility to strengthen this fiscal-social contract and redouble our efforts to stamp out corruption at every level. In return, we are expecting everyone with the means to pay their taxes.

We have set ourselves on the path towards creating a uniquely Ugandan tax system, one that respects our culture, our traditions, our ways of living, and our entrepreneurial spirit. This is an original document of our country's revenue strategy that will meet our financing needs for the future. We therefore urge everyone to play their part in ensuring the success of the Domestic Revenue Mobilisation Strategy.



Matia Kasaija (MP)

Minister of Finance, Planning, and Economic Development

Foreword from the Permanent Secretary/Secretary to the Treasury

It is my honour and privilege to welcome the words of the Honourable Minister of Finance and to acknowledge the guidance that he has provided in the development of this strategy. He has provided the leadership that has encouraged the investment that we needed and the consequent rapid growth in our economy, from which we all benefit today.

In this document, we take another important step towards creating a Uganda that is stronger, more independent, and better-equipped to set its own course through history and into the future. Uniquely among our peers, we have recognised the value that can come from having a transparent medium-term strategy for the development of our tax system - stability, sustainability, investor confidence in our direction of travel - and we have made it our duty to publish and share with the people of Uganda the results of our efforts and deliberations. Through this new revenue strategy, the DRMS, we will take greater control of our own budget, our own finances, and our own choices in resource allocation. In launching this strategy, we make a commitment on behalf of all Ugandans not to burden our children and our children's children unnecessarily with debt that they will have to repay.

Many Ugandans can contribute a little more towards financing our country's advancement. Our children will face their own challenges soon enough. We should not make them pay for our needs before they look to their own futures. We should have a system of taxation that is fair and balanced, one in which everyone can have confidence and one that will give us much more independence.

So, in this strategy document, we present our vision of how to take forward the development of our revenue system over the coming years, recognising that while taxation is never popular, it has its place in providing the funds to support the investment that we all need in infrastructure, in our healthcare and welfare systems, in our schools and universities, allowing us to devote more resources to the services on which we all rely.

We present our strategy for meeting those needs, based on the principles that we have established and that underpin our taxation system and recognising that our future, our financial independence, will only properly be secured with the contributions of all those who can afford to pay. Today, too small a group of Ugandans find themselves bearing a tax burden that should be shared with others. Many more who benefit from the development of our economy, of our society, of our personal freedoms and chances in life, need to play their part and make a contribution as taxpayers so that we can all share in a better future.

I recognise that we cannot take all the steps in our journey at once, some must follow on from the earlier steps and that change needs to be thought through, discussed, planned and implemented in ways that are acceptable and over a period that is realistic.

In this document, we set out the steps that we plan to take over the next five years to achieve the necessary development of government revenues. We set out how we will change the way

in which we raise revenue, making the system fairer and more balanced than it has been in the past, reflecting the fact that some can afford to pay a little more than others; and that the needs of others are sometimes greater than our own. We set out how we will seek to levy taxes in ways that are economically more efficient, in ways that are cheaper to collect. We set our commitment to levy, invest, and spend them in ways that make it more difficult for those few who seek to profit through dishonesty and fraud to subvert our society through their greed.

In this document, we set out how we will maintain our support, through the tax system, for those industries that bring productive investment, employment and opportunity to Uganda and ensure that neither our policies nor the administration and enforcement of our tax laws will frustrate investment or stand in the way of real economic progress.

But we will tighten both the rules and the enforcement of tax obligations in those cases where we find that there is abuse of our system and an unwillingness to bear a fair share of the burden with the Ugandan people. We will introduce measures to deter those who exploit our tax laws and move unduly profits and wealth out of Uganda. We will strengthen our ability to resist their manoeuvres and our capacity to prosecute their offences in our courts. We will make it harder for those who want to freeride on the efforts and contributions of others and not to put their hand in their own pocket for Uganda.

We will explore new ways to use the tax system to incentivise investment in the human capital of our great nation, the untapped resource that is our future, through additional measures to promote accredited workforce training and education and to support youth employment.

Tax revenues come from the efforts of Ugandans and they belong to the people of Uganda. They are collected to provide investment and services to our people. A few will always try to profit from revenues that they are employed to collect. A few will always try to divert funds that they have been trusted to spend wisely on behalf of all Ugandans. Just as we will have no tolerance of evasion and abuses by taxpayers, we will root out corruption within government and ensure that those officials who, through fraud, corruption, and extortion, usurp the roles that society has given them, will face the full rigour of the law. We will ask the courts to impose the maximum penalties for such breaches of trust.

In this document we also address the need to ensure that policy and administration measures are properly harmonised, and our DRM strategy envisages some important changes in the URA to achieve this. With the commitment of the Board and Management of URA, we will continue to work together for the transformation of the URA into a taxpayer-focused organisation, responsive to all Ugandans, helpful and friendly to all those who need its guidance. In this document we set out the key steps that will be taken to achieve this. These will prominently include providing funding for more staff at URA, better training, and the resources to modernise and expand their ICT capability and other necessary tools. In return, the URA is committed to fostering greater compliance, delivering a narrowing of the gap between the tax revenues that should be collected under existing law, and those actually collected. It is here that we expect to see the most significant improvements over the DRMS period.

Collecting those taxes that are due from the “free riders” in our system, the non-compliant, will allow us to ease the burden on those who already pay their share, perhaps more than their fair share, to extend our social policy provision in key areas such as education, training and healthcare, and continue our support for wealth-creation, industrialisation and the growth of meaningful employment, especially for the young.

The combination of policy measures and administrative changes that are set out in this summary of our DRMS can yield significant new revenues that will begin to enhance the financial independence of our great nation. But it is not enough. In our daily lives we need all to recognise that we have a duty as citizens, as beneficiaries of the labour and contributions of others, to pay our share of the taxes. The staff and management of the Ministry of Finance have all committed to this revenue strategy. But we will not commit only for others. We will commit for ourselves as well. We have a duty to provide leadership as civil servants, in what we say and particularly in what we do. We will lead by example.

His Excellency the President Yoweri Kaguta Museveni has inspired this strategy and the Minister of Finance, Planning and Economic Development has blessed it. It is now up to all of us to ensure that it is delivered.



Keith Muhakanizi

Permanent Secretary/Secretary to the Treasury

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Acronyms

CIT	Corporate Income Tax
COMESA	Common Market for Eastern and Southern Africa
DFID	Department for International Development
DIAMOND	Development of Implementation and Monitoring Directives
DPs	Development Partners
DRM	Domestic Revenue Mobilisation
DRMS	Domestic Revenue Mobilisation Strategy
DTA	Double Taxation Agreement
EAC	East African Community
EACCMA	East African Community Customs Management Act
EITI	Extractive Industries Transparency Initiative
EPRC	Economic Policy Research Centre
EU	European Union
FINMAP	Financial Management and Accountability Programme
FTA	Free Trade Agreement
FY	Financial Year
GDP	Gross Domestic Product
HNWIs	High Net Worth Individuals
ICT	Information and Communications Technology
IGC	International Growth Centre
IMF	International Monetary Fund
KfW	Kreditanstalt Für Wiederaufbau Development Bank
KPIs	Key Performance Indicators
LGs	Local Governments
MDAs	Ministries, Departments and Agencies
MFPED	Ministry of Finance, Planning and Economic Development
MTRS	Medium Term Revenue Strategy
NPA	National Planning Authority
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PAYE	Pay-As-You-Earn
PIT	Personal Income Tax
SCT	Single Customs Territory
TADAT	Tax Administration Diagnostic Assessment Tool
TAT	Tax Appeals Tribunal
TPD	Tax Policy Department
TREP	Tax Registration and Expansion Project
UBOS	Uganda Bureau of Statistics
UNDP	United Nations Development Programme
URA	Uganda Revenue Authority
USAID	United States Agency for International Development
VAT	Value Added Tax
WB	World Bank
WHT	Withholding Tax

Executive Summary

The Domestic Revenue Mobilisation Strategy (DRMS) set out in this document is the result of a long period of collaborative working, principally by the Ministry of Finance, Planning and Economic Development (MFPED) and the Uganda Revenue Authority (URA), with contributions from a wide range of institutions and development partners as well as civil society and the Ugandan business community.

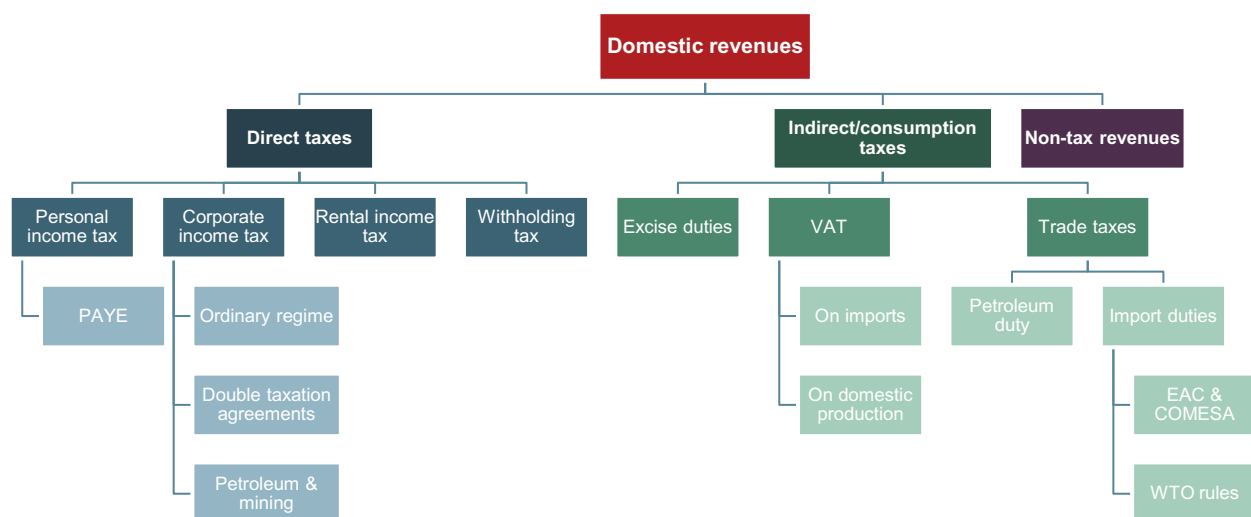
The publication of this document brings transparency to the direction of tax policy-making in Uganda for the next five years and to the strengthening of the administrative effort that will support it. The proposals it contains will enhance the stability and sustainability of the public finances and allow new investors and existing businesses to have confidence in the route that we have mapped out for the economy.

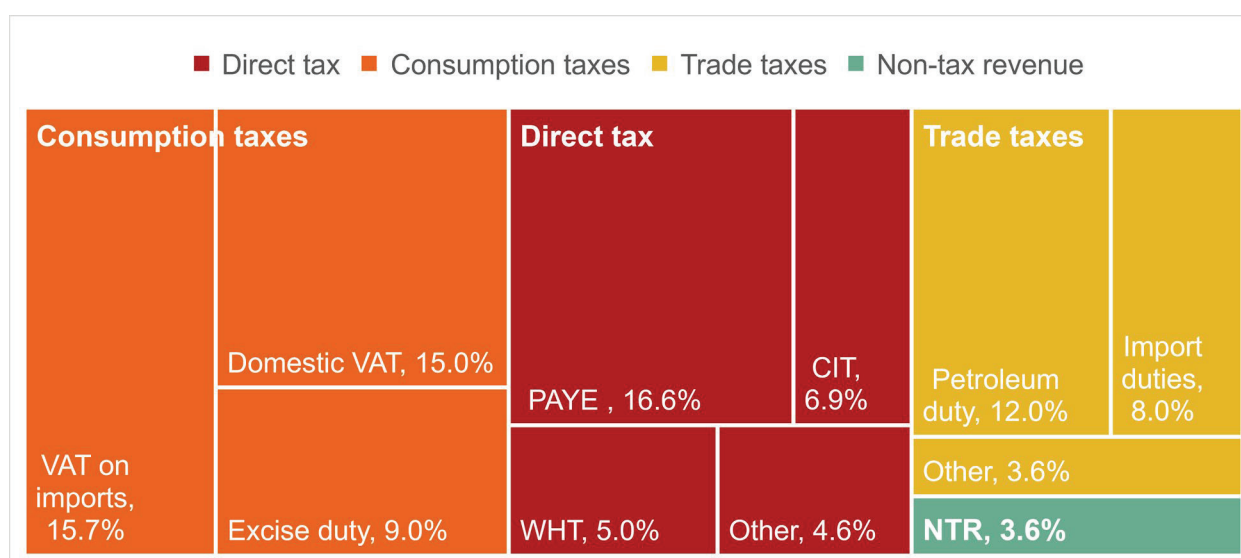
As a result of this new strategy, Government will be able take greater control of its budget and will have more freedom to plan its resource allocation. It will reduce the risk that Government has to borrow more extensively from international and domestic lenders to fund much-needed infrastructure investment and social policy spending.

Overview of Uganda’s tax structure

In line with international norms, Uganda’s tax system comprises several tax instruments, including direct personal and corporate income taxes, and indirect taxes such as excise duties and value-added tax. The revenues that the system generates reflect a broad balance between taxes on consumption, income, and international trade.

Tax Structure



Composition of Overall Revenue Collection, FY2018/19

Source: Tax Policy Department (2019)

Revenue performance

Government is committed to narrowing the gap between current and potential revenue performance. Academic research has estimated the potential to be in the range of 20-26%, against a revenue-to-GDP ratio of 12.9% in FY2018/19. This commitment builds on the government's existing policy of seeking to increase tax revenues as a share of GDP by at least 0.5% per annum, requiring them to grow at a rate in excess of the rate of growth in GDP (commonly referred to as buoyancy). Although this has been achieved year-on-year, the current revenue yield nevertheless remains below expectations for a country at Uganda's stage of development. This jeopardises economic growth and development by limiting the government's ability to provide the education and welfare programmes that would act as drivers of higher achievement. The tax system needs to be "competitive", but it also has to yield enough revenue to address these issues consistently and sustainably. It is not achieving that today.

The challenge of national budget financing

The budgetary challenges facing the Government of Uganda are significant. In the past few years, government expenditure has consistently been higher than revenue. In FY2017/18, the fiscal deficit widened to 4.75% of GDP, and spending exceeded the approved budget, requiring the government to resort to additional domestic borrowing. The short time-to-maturity on these loans, under 4 years on average, places additional pressure on Uganda's budget. Notwithstanding the domestic borrowing, Uganda's fiscal deficit is funded by external borrowing, predominately from the World Bank's International Development Association and China. Over the five years from FY2014/15 to FY2018/19, the debt-to-GDP ratio rose from 26.2% to 36.1%.

Methodology of the DRMS

Motivation for a medium-term strategy

Against this background of solid economic growth but a growing debt burden and a revenue performance that suggests room for improvement, the Government's decision to put in place a medium-term revenue strategy was motivated by the need to develop a robust but fair taxation system that would:

1. support the delivery of the National Development Plan and Vision 2040
2. encourage greater self-reliance in financing economic development and less dependence on the international capital markets and development partners
3. enjoy consensus support as the Ugandan approach to raising the necessary revenues to fund investment and spending needs
4. provide greater certainty of policy direction for investors
5. encourage formalisation, including through the provision of support for new employment opportunities in the formal sector
6. be cheaper and more efficient to administer
7. ease taxpayers into compliance and timely payment of taxes due.

Establishment of the DRM Committee

In 2016, the Permanent Secretary/Secretary to the Treasury established a DRM Committee to guide the development of the DRMS and coordinate interventions to support revenue mobilisation. The Committee was Chaired by the Acting Director of Economic Affairs and comprised representatives from MFPED, the URA, the World Bank, the IMF, UK-DFID, USAID, the EU delegation, KfW, UNDP, EPRC, and the IGC, as well as representatives of civil society through the Tax Justice Alliance.

Research and diagnostic work

A comprehensive stock-take of existing technical assistance reports and analytical work was undertaken, which identified key focus areas and challenges to Uganda's DRM efforts, as well as areas where further research was needed. Furthermore, to align the objectives and interventions proposed in the DRMS with existing national strategic plans, the Uganda Vision 2040, the Second National Development Plan, the National Budget Framework Paper FY2018/19 – FY2022/23, the MFPED Strategic Plan, and the latest Public Financial Management Reform Strategy were consulted.

The most influential studies included: an analysis of Uganda's revenue gaps and potential (World Bank, 2017), an excise duty diagnostic (World Bank, 2017), an IMF framework for a Medium Term Revenue Strategy (Baer, et al., 2017), and two assessments of the VAT gap (Lakuma, 2018) (Hutton, et al., 2014). During the drafting process, additional studies were commissioned. This included a functional revenue of the tax administration (covering both URA and TPD), a customs assessment, an ICT review, and an examination of the non-technical barriers to DRM, all undertaken by the World Bank.

Stakeholder consultations

Designing a medium-term revenue strategy should be all-encompassing and transparent, involving both public and private organisations, to build broad-based consensus. In pursuit of this, formal stakeholder consultations were conducted, in addition to several more informal, targeted consultations with selected stakeholders.

Process within government

Within government, the Tax Policy Department has led the day-to-day DRMS process and the partnership with URA, presenting the emerging thinking on the DRMS to MFPED leadership, including the Directorate of Economic Affairs, Top Technical, and Top Management. These internal discussions provided guidance on the design of the DRMS, created a unified direction, clarified the focus of the strategy, and created buy-in and ownership of the proposed interventions.

Objectives of the DRMS

The core objective of the DRMS is to improve revenue collection, lifting Uganda's tax-to-GDP ratio to between 16-18% within the next five financial years. This will bring Uganda closer to its theoretical potential and exceeds the target of a 16% tax-to-GDP ratio as set out in the NDP II and the Charter of Fiscal Responsibility.

In setting the objectives of the DRMS, the government was cognisant of the need to achieve a better balance between competing challenges:

1. to raise additional revenues to support the government's Budgetary position;
2. to encourage a healthy flow of investment; and
3. to address issues of fairness and transparency in the tax system.

The findings from the diagnostic work were expected to be critical to achieving that balance.

Key findings from the diagnostic work

The diagnostic work identified several key areas where there are issues to be addressed:

1. Fiscal-social contract:
It is critical to any future mobilisation efforts that Ugandans perceive a closer link between taxes paid and public services obtained and to have confidence that corruption in government has been tackled effectively. A weak fiscal-social contract negatively affects tax morale and compliance.
2. Informal economic activity:
Widespread informality, accounting for almost half of all economic activity in Uganda, is a major structural constraint on revenue growth. Many Ugandans conduct business wholly or partially in the informal sector, beyond the sight of the tax system. This

impacts horizontal equity and significantly raises the tax burden faced by those who are compliant.

3. Tax policy development:

In the area of tax policy development, the level of analysis and consultation undertaken in the course of policy design is insufficient. Good policy requires a greater depth of analysis and stakeholder engagement. Proper post-implementation review is also essential to establishing the effectiveness of reforms.

4. Weaknesses in major taxes:

Today, although the fundamental design of the tax system in Uganda is sound and appropriate for an economy at this stage of its development, both the tax yield and its rate of growth appear to be well below potential, with weaknesses apparent in most of the major tax heads, including VAT, CIT and PIT. There are concerns about the buoyancy of the main taxes. Measures are required to address these weaknesses.

5. Revenue administration:

Regarding revenue administration, a number of key areas of challenge emerged from the diagnostic and consultative work:

- a) URA performance is affected by governance challenges, including the lack of a clear reporting framework between URA management and MFPED, structural weaknesses, and a narrow performance monitoring framework, focussing almost exclusively on revenue targets.
- b) There are extensive human resource challenges, with gaps in both staff numbers and staff capacities, particularly on data analysis, specialised areas of taxation such as international tax, and audit and enforcement.
- c) The ICT infrastructure no longer meets URA's needs. Poor third-party data access and internal data management limit the ability of the organisation to capture potential taxpayers and validate taxpayer declarations.
- d) A more explicit focus on promoting compliance by a higher proportion of businesses and individuals is needed. The taxpayer register does not capture the full potential tax base, taxpayer services and education programmes are poorly targeted, under- and non-declaration is widespread, audit and enforcement action has had only limited success, and overdue tax arrears have increased very significantly over the past financial years.

These findings have been addressed in the development of the DRMS.

The Government's DRMS proposals

In response to the diagnostic work undertaken, a number of proposals have been developed that are designed to tackle:

1. the political economy constraints to DRM

2. the opportunity to improve the tax system through policy initiatives
3. the need to empower the URA to strengthen the administration and collection of domestic revenues

The proposals are summarised in Schedules I and II in [Annex I](#).

The decisions that have been made and the prioritisation that has been given to specific proposals have been informed by the over-arching philosophy of the government towards the development of the tax system.

A number of key themes are, therefore, embedded in the approach to the design of measures for the DRMS:

I. A Ugandan system for Uganda

This DRMS is a strategy for Uganda, developed by Ugandans. It should reflect our society, the way we live, and the way we do business. It identifies our needs and sets out how we will make changes over a period of years. That is the Ugandan way: not sudden change. This strategy document sets out the intended direction of travel for tax policy. The length of the DRMS period allows people the chance to contribute and bring their own wisdom, experience, and energy to the government's plans. It also provides time for the government to build analytical capability in the tax policy-making process so that the likely impact of particular measures can be better understood.

II. Address the weaknesses in the fiscal-social contract

The government recognises that public confidence in the tax system is not as strong as it should be. This should be tackled as a priority. Taxpayers should be drawn more fully, in the future, into the process of making tax policy and encouraged to contribute, so that the voice of Ugandans is heard more clearly. In addition, a series of steps will be taken to improve the transparency of the tax system, including the annual publication of a report on tax expenditures, in line with best international practice. Budget transparency will be improved, drawing the link more clearly between government investment and spending, and the raising of revenues to fund it. The government will redouble its efforts to stamp out corruption at every level so that taxpayers can have confidence that their payments will go into the public purse and be spent in value-generating ways.

III. Maintain support for investment

The Government of Uganda has long recognised the importance of bringing investment into the country. It has been a strategic intent to ensure that Uganda is able to offer a first class business environment to potential investors, including the provision of a business-friendly tax environment. This DRMS builds on that concept in order to enhance the sustainability of the growth of Ugandan economy in a rapidly changing and highly competitive world. This document sets out how the Government will maintain its support, through the tax system, for those priority industries that bring

productive investment, employment, and opportunity to Uganda, keeping the effective rate of tax at a competitively low level.

IV. Encourage investment in human capital

Human capital has become a critical factor in determining the location of investment. In the DRMS period, we will explore new ways to use the tax system to incentivise investment in the knowledge and skills of our people. We will introduce a package of measures that will support the creation of a range of apprenticeships in priority sectors, promote accredited training and education based on the workplace and develop new instruments to encourage our young people into formal employment.

V. Re-examine rules that allow leakage of revenues

The Government of Uganda has, over time, maintained a wide range of exemptions and zero ratings in the VAT system that are primarily intended to support social and welfare policies. The DRMS recognises the value of these measures and confirms that they will be maintained. Exemptions from VAT and zero-ratings will continue to apply to goods and services where they deliver an important part of the government's social and welfare policies and where they lubricate the engines of economic growth. However, as part of a broader review of "leakage" from the tax system, cost/benefit analyses will be undertaken with a view to restricting the scope of such measures where they are at the margin of policy objectives or add largely private value rather than delivering public good.

VI. Cut down on abuse of the tax system

It has become clear that some of the international investors have taken unfair advantage of the tax rules to avoid, and in some cases evade, paying taxes due. As a result, MFPED and the URA have already been obliged to tighten the rules that relate to the taxation of international business, but further measures will be required. The DRMS envisages that the government will tighten both the rules and the enforcement of tax obligations in those cases where there is abuse of the system and where investors show an unwillingness to bear their fair share of the burden with the Ugandan people. The government will introduce new measures to deter those international investors who try to move profits and wealth out of Uganda. The roll-out of the DRMS will strengthen the URA's ability to identify, challenge and resist their planning and enhance the government's capacity to prosecute offenders in the courts. There will be no tolerance of large businesses that deliberately break the country's tax laws.

VII. Empower the URA to improve the efficiency of its administration and collection

The government will use the opportunity of this DRMS initiative to support the URA to improve efficiency in the management and administration of the tax system and the collection of the taxes due. This document sets out the key steps that will be taken to achieve this. URA will be provided with the necessary funding for more staff, better training, and the resources to modernise and expand their ICT capability. The government expects that the most significant improvements in revenue yield over the DRMS period will come from this strengthened partnership and the empowerment of the URA.

VIII. Support compliance and enhance revenues through sharper focus on registration, improved taxpayer services and education

The URA is committed to narrowing the gap between the tax revenues that should be collected under existing law, and those actually collected. Despite a concerted effort, the current taxpayer register does not capture the full potential base. The government will use this DRMS period to understand better the reasons for that. Systematic surveys will be conducted, and analysis made to obtain and evaluate taxpayer feedback on URA products, services, and staff integrity. Understanding how taxpayers interact with and perceive the tax system is critical to creating a culture of compliance and helping taxpayers understand their rights and obligations. One of the pillars of the DRM strategy is to make it easier for Ugandans who are currently outside the tax system to become registered and active taxpayers; and more difficult for those who can afford to pay but won't, to continue to be "free riders", benefitting from the contributions of others that fund the development of our economy and our society and protect our personal freedoms. This process will be enhanced if Government understands their taxpayers better.

IX. Take measures to address the informal economy while preserving Uganda's entrepreneurial spirit

The spirit of Uganda is entrepreneurial, and this is reflected in the many small and micro-businesses that thrive in cities and villages. Notwithstanding the push for a significant increase in taxpayer registrations, the government sees no reason, in this DRMS, to launch a major clamp down on these businesses. Most of them exist outside the scope of the tax system and regulatory frameworks and so miss the benefits that come from operating in the formal economy, but it will take time to bring them to a point where they are ready to conform. There are, however, other informal or semi-informal businesses that need to be encouraged to register as taxpayers and to report their income in full. In this context, the Government has concluded that there is good reason to act more firmly in relation to professionals who either fail to report or under-report their income. Measures are planned for the DRMS period to tackle these abuses. Similarly, traders, renewing licences, will be expected to demonstrate compliance with

the applicable tax laws and regulations. If the level of non-compliance cannot be reduced, future increases in the tax-to-GDP ratio can only come through an ever-increasing tax burden on those who comply. That will damage confidence in the fairness of our system.

X. Strengthen the revenue-raising capacity of local government

The government recognises that the sense of community is strong at the local level and supports the principle of local funding for local needs. It is committed to working with authorities to strengthen their revenue base and to broadening the range of revenue instruments available to them. This will help to make them more independent of transfers from national government. While the main focus of this DRMS is on the development of the national tax system, resources will continue to be allocated, during the DRMS period, to the objectives of fiscal decentralisation and the empowerment of local decision-making.

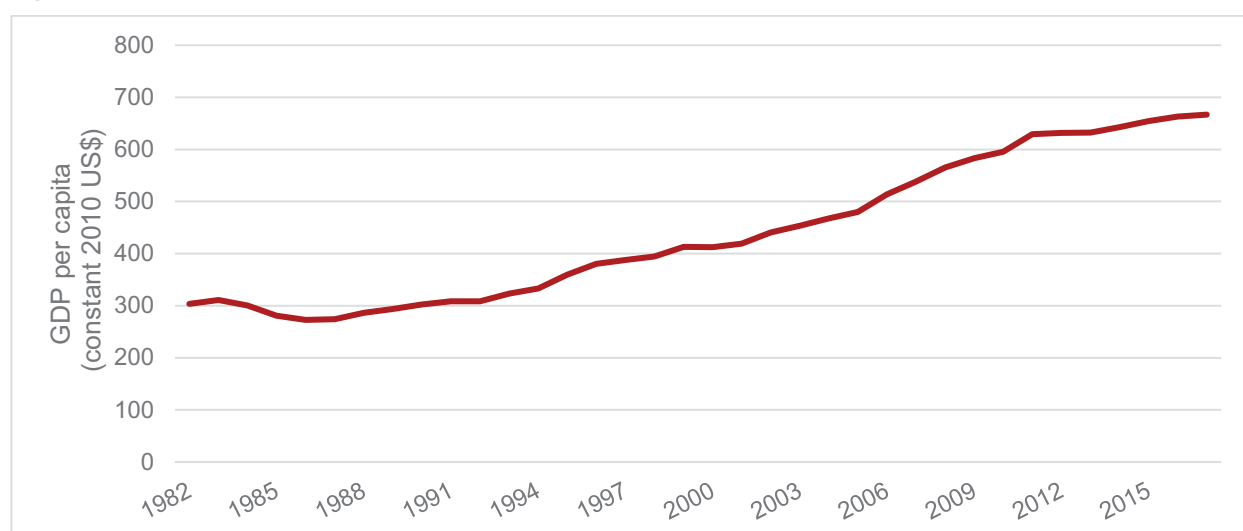
Introduction

I. Economic Context

Through prudent economic management and policy reforms, the NRM Government has stemmed the breakdown of the Ugandan economy that was witnessed in the 1970s and early 1980s. The end of the armed conflict in 1986 was followed by a period of structural reforms and investments, leading to high growth, and poverty reduction over the next three decades. Average annual growth was 7% during the 1990s and the early 2000s, although this slowed to 4.5% from 2011 to 2016. This slowdown was largely driven by poor weather, unrest in South Sudan, private sector credit constraints, and the poor execution of public projects.

More recently, however, the economy has regained momentum, largely driven by double-digit growth in the information and communication technology sector, strong food crop production, and relatively robust manufacturing performance. Real GDP growth rose to 5.1% in 2017 and 6.1% in 2018. A continuation of this rebound is contingent on favourable weather, strong external demand, the execution of planned capital spending, and increased foreign direct investment inflows in preparation for oil exports.

Figure 1: Growth in GDP per capita since 1982



Source: World Bank Databank (2019)

In 2007, Uganda adopted the Vision 2040 strategic plan (and developed the related five-year National Development Plans), which lays out Uganda's aspirations of attaining upper-middle income status with a per capita income of USD 9,500 by 2040. The Vision 2040 identified key fundamentals for the realisation of this ambition, including the improvement of infrastructure (including energy, water, transport, oil and gas, and ICT), a well-educated labour force, urbanisation, a competitive business environment, industrialisation, improved productivity of agriculture, and peace and security.

Despite resource constraints, Uganda has achieved, and even surpassed, several key socio-economic targets, partly through the effective use of tax revenues. For instance, infant and maternal mortality have both declined, life expectancy at birth has increased by over a decade, enrolment in primary education has improved eight-fold, and literacy and numeracy rates have increased substantially. Furthermore, the implementation of flagship infrastructure projects has benefitted from domestic revenues, including expanded access to electricity, the construction of hydropower dams, and improving the quality of the road network to increase market accessibility and facilitate trade.

Table 1: Progress against selected NDP11 and Vision 2040 targets

	Baseline 2010	2015/16	2016/17	2017/18	NDP11 target	Vision 2040
Per capita income (USD)	887.19	807.23	833.10	877.78	1,039	9,500
% of population below poverty line	24.5%	19.7%	21.4%	21.4%	14.2%	5%
Sectoral composition of GDP						
Agriculture	22.4%	23.6%	21.5%	24.7%	19.9%	10.4%
Industry	26.4%	19.8%	18.6%	19.9%	27.9%	31.4%
Services	51.25	48.7%	51.9%	47.6%	52%	58.2%
% of labour force employed	70.9%	56.8%	48%	53%	79%	94%
% of population with electricity access	11%	20.4%	22%	23%	30%	80%
Safe water coverage						
% rural		67%	70%	74.9%	79%	100%
% urban		71%	71%	92.3%	100%	100%
Paved roads as % of road network	4%		3.52%	21.1%		80%
Life expectancy at birth	51.5	63.3	63.3	63.3	60	85
Infant mortality rate (per 1,000 live births)	63	43	43	43	44	4
Maternal mortality rate (per 100,000 live births)	438	336	336	336	320	15
Literacy rate (%)	73%	72%	74%	73.5%	80%	95%
Population growth rate (%)	3.2%	3%	3.03%	3.02%	2.9%	2.4%

Source: National Planning Authority

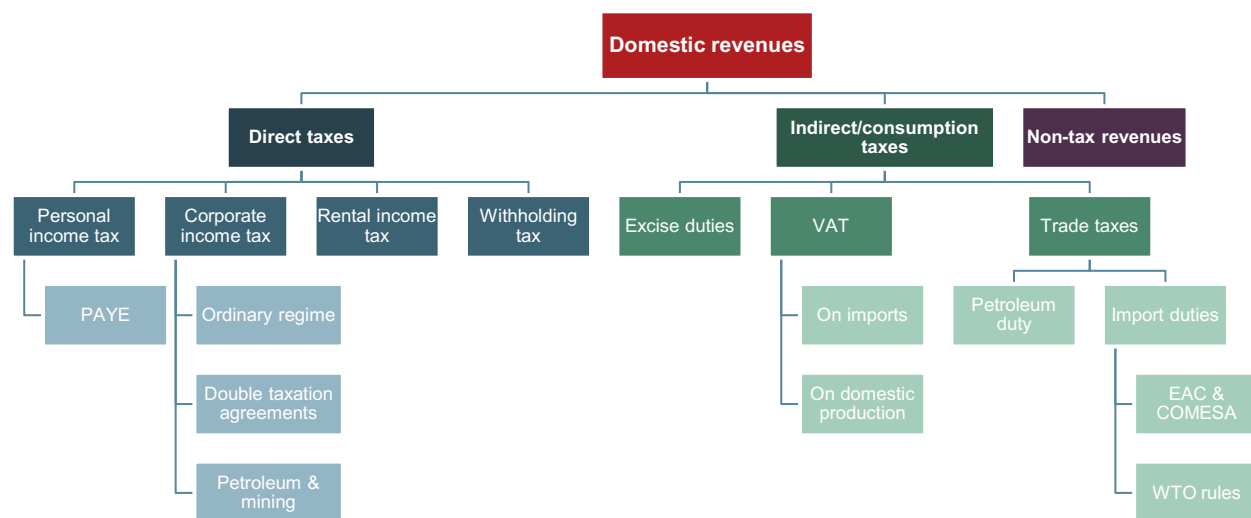
Now Uganda has reached a critical moment in its economic and social development. To sustainably finance the development agenda, Uganda needs to create a much stronger and more dynamic private sector, as well as give priority to addressing our tax effort. With this DRMS, Government seeks to minimise the gap between tax revenues and expenditure, meeting the increased demand for service delivery, infrastructure development, and investment.

II. Overview of Uganda's Tax Structure

While an improvement in revenue collection is of fundamental importance to the financing of the Government's NDPII and Vision 2040 agenda, a good tax system is one where revenue generation is not pursued at all costs. The system should still ensure a competitive business environment and promote social welfare. Uganda's tax system is guided by several underlying principles that ensure fairness, equity, collectability, simplicity, and convenience. In general, citizens do not like to pay taxes and taxes that distort economic activity and decision-making are particularly problematic. Citizens naturally try to avoid them if they can. Thus, the tax system should be designed to be as neutral as possible, encouraging compliance and minimising disturbances to market forces.

In line with international norms, Uganda's tax system comprises several tax instruments, including direct personal and corporate income taxes, and indirect taxes such as excise duties and value-added tax (VAT). The total income or wealth to which these taxes apply determines the tax base. Broadening the tax base does not simply refer to introducing new tax heads (which would typically apply to the same sources of income), but rather to bringing more Ugandans into the tax-paying net, encouraging potential taxpayers to participate in the tax system and boosting compliance. Figure 2 gives a broad picture of the main tax handles in the Ugandan tax system.

Figure 2: Uganda's tax structure



Direct taxes are levied on the income or profits of the person who pays the tax, rather than on goods and services. They are designed to be broadly progressive, collecting more revenue from the relatively better off, reducing inequalities. The tax base for income tax in Uganda is broad, covering income from personal employment, including all wages, salaries, bonuses, and allowances, business income, and property income. The scope of liability depends on a person's residency – non-residents are charged only on income derived from local sources,

whereas residents are charged on worldwide income. Individuals are deemed to be resident for tax purposes if they have a permanent home in Uganda, are present in Uganda for 183 days or more in a 12-month period¹, or are employees of the Government of Uganda posted abroad. A company is tax resident if it is formed under the laws of Uganda, has its management and control exercised in Uganda, or undertakes most of its operations in Uganda during the year of income.

Personal Income Tax (PIT) is charged on incomes above a minimum threshold of UGX 2,820,000 per annum, a threshold which aims to ensure that taxes do not crowd out the incomes of the very poorest in society. Above the threshold, incomes are taxed within 10%, 20%, and 30% bands, while incomes more than UGX 120 million per annum attract an extra tax of 10% on the value of the excess. In FY2018/19, Pay-As-You-Earn (PAYE) contributed 16.6% of total revenue (see Figure 3).

Corporate Income Tax (CIT) is simply charged at 30% on income (and capital gains), less allowable deductions, such as expenses incurred in deriving income and carry forward losses². Resident businesses with a turnover less than UGX 150 million are exempt from CIT but are subject to a simplified presumptive tax regime. Uganda is open and welcoming to foreign direct investment and has contracted ten Double Taxation Agreements³ (DTAs) to assure foreign investors of a predictable and internationally-accepted tax environment, reducing and removing tax constraints. The main effect of such treaties is to divide up the “rights” to tax cross-border investment between states, reducing the possibility that businesses will incur double taxation. In FY2018/19, CIT accounted for 6.9% of total revenue. Overall, income taxes are the second most important source of revenue (including revenue from withholding taxes, where tax due is deducted at source, tax on bank interest, rental income tax, and others).

Indirect taxes are levied on goods and services, thus taxing consumption. Value-added tax (VAT) is charged at a standard rate of 18% on supplies made by businesses with annual turnover greater than UGX 150 million. This was introduced in 1996, replacing the Commercial Transaction Levy and the Sales Tax. These taxes were inefficient and difficult to administer due to their multiple rates and limited scope to trace transactions through a defined trail. The current VAT raises revenue in a neutral and transparent manner, broadening the base and reducing opportunities for evasion. The tax is a staged collection mechanism in which successive taxpayers are entitled to deduct input tax on purchases and must account for output tax on sales. Thus, the tax collected by URA reflects the VAT paid by the final consumer to the

¹ If a person is present in Uganda during the year of income and in each of the two preceding years of income for periods averaging more than 122 days each year, they are also deemed to be resident.

² Other allowable deductions, subject to conditions, include bad debts written off during the year of income, interest incurred during the year of income, repairs of property used in the production of income, depreciable assets, initial allowances, capital expenditure on the construction of industrial buildings, start-up costs, costs of intangible assets, training expenditure, and charitable donations.

³ DTAs exist between Uganda and India, South Africa, Zambia, Italy, Belgium, Denmark, Mauritius, the Netherlands, Norway, and the UK.

final vendor. VAT is the largest source of tax revenue in Uganda, with VAT on local and imported goods and services accounting for 30.7% of total revenues in FY2018/19.

To alleviate the regressive nature of such a tax (as everyone pays the same rate no matter what the income level), Uganda applies various exemptions and zero-rates to essential goods and services (including health and educational materials and services, unprocessed foodstuffs, and social welfare services). In addition, Uganda applies exemptions to certain goods and services to promote strategic key industries, in line with the Vision 2040 and NDPII objectives, and all exports are zero-rated to improve the competitiveness of Ugandan products on the international market. Zero-rating a supply entails that the VAT applied to inputs can be recovered, whereas input VAT cannot be claimed on exempt supplies. Zero-rating can thus imply a larger revenue loss, and a greater compliance challenge through the vetting of refund claims.

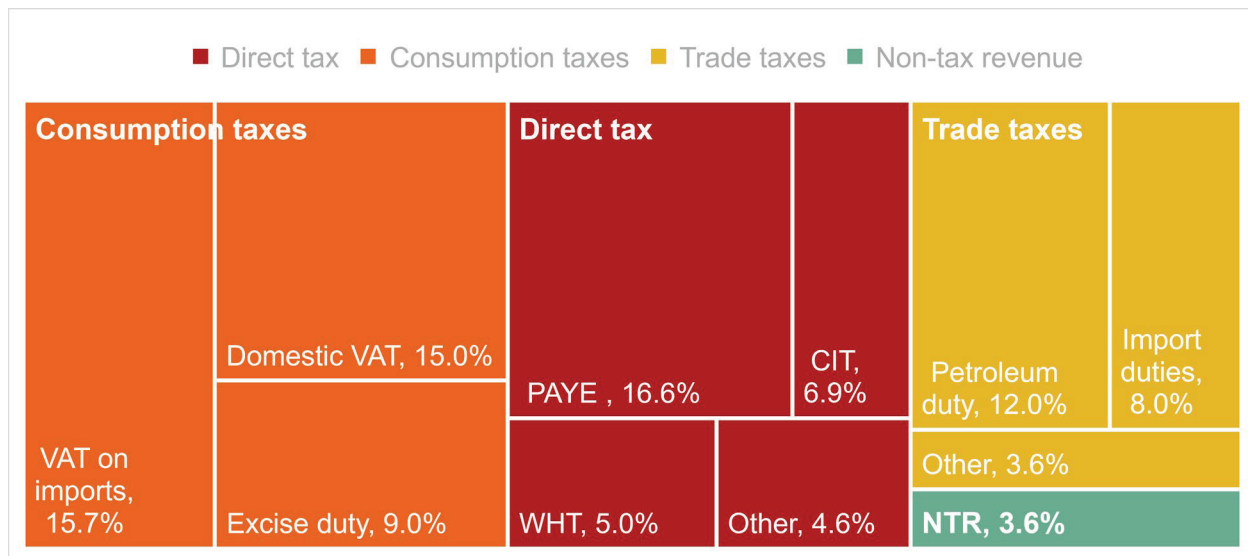
Excise duties are typically applied to specific products to address negative externalities and influence human behaviour, such as taxing alcohol and cigarettes. Thus, excises are a kind of “repair cost” for the incidental damages the product causes to health, the environment, or public finances (for example, the additional burden that smokers place on the healthcare system). A further rationale for excises is that they can encourage an “ability-to-pay” approach, taxing luxury items disproportionately consumed by higher-income individuals, such as perfumes. Over time, Uganda has shifted the policy approach to broaden the range of motivations and tended, instead, to use excise duties as a revenue-raising tool, introducing taxes on mobile money, airtime, sugar, cement, and cooking oil. These are applied partly due to the ease of administration, targeting products with few producers in well-developed markets. In FY2018/19, all excise duties accounted for 9% of total revenues.

The third largest source of revenues in Uganda are trade taxes, with petroleum duty and import duties amounting to 23.6% of total revenues. This is in line with the experience of other countries – duties typically contribute less than 50% of all revenue collected from taxing imports in developing countries (Brenton, et al., 2009). The sizeable contribution to total revenues is partly due to ease of collection. While collecting trade taxes only require observing trade flows at borders, income taxes require a more elaborate system for monitoring, enforcement, and compliance. Uganda currently applies various duties on imports, depending on their origin. Imports are currently subject to two preferential trade agreements: The East African Community (EAC) customs union and the Common Market for Eastern and Southern Africa (COMESA) free trade agreement. Further, intra-EAC trade (between member states) is generally free of all import duties. The EAC accounts for just over 10% of the value of Uganda’s total imports, with Kenya as the largest regional trading partner. The majority of Uganda’s imports originate from China, India, and the UAE, accounting for a total of 42.6% of import value in 2017 (UN Comtrade, 2019).

Finally, non-tax revenue (NTR) refers to all government revenue not derived from taxes, including fees levied on public services, payments for government services, mining and royalty

fees, and interest from government investments. In FY2018/19, NTR made up 3.6% of total revenue.

Figure 3: Composition of Overall Revenue Collection, FY2018/19

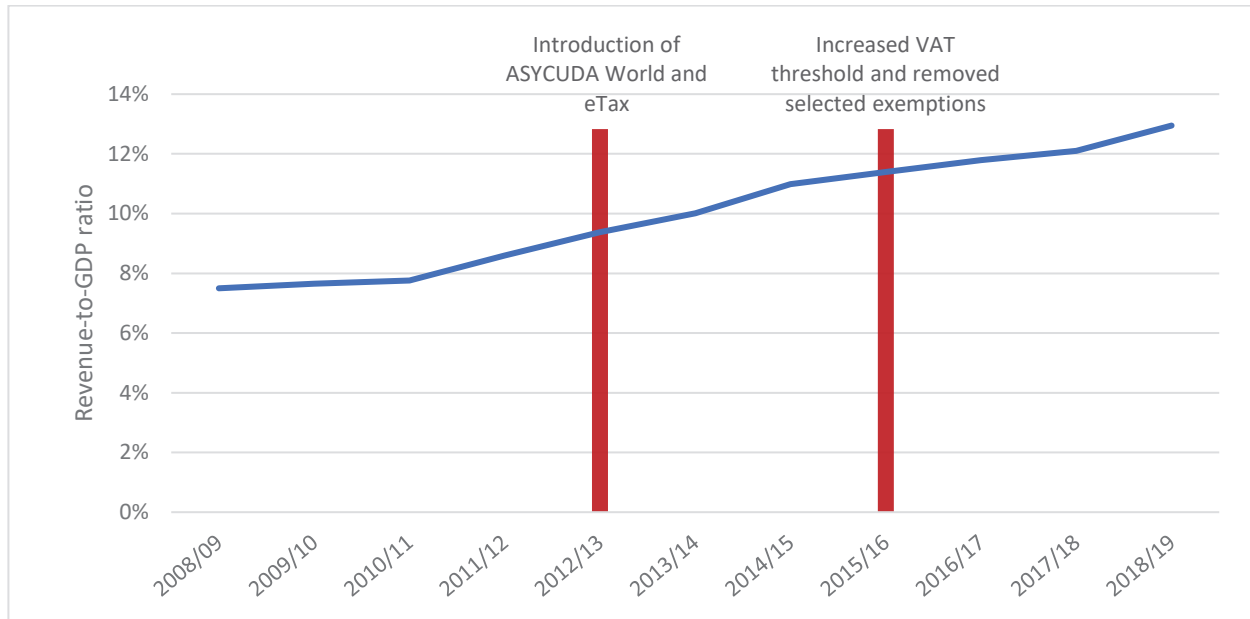


Source: Tax Policy Department (2019)

III. Revenue Performance

Over the past two decades, Uganda has implemented a wide range of tax reforms, which form the foundation for intensifying efforts for even stronger revenue outcomes. The establishment of the URA as a semi-autonomous body in 1991, the introduction of VAT in 1996, and reforms to the income tax regime contributed to a 4 percentage point increase in the tax-to-GDP ratio from 1990 to 1999. Further policy and administrative reforms over the years include the establishment of large and medium taxpayer offices, increased adoption of Information and Communications Technology (ICT) solutions to facilitate tax administration, the elimination of selected VAT exemptions, and increases in selected excise tax rates. In 2005, Uganda, along with East African peers, adopted the Common External Tariff (CET) under the EAC Customs Union. These reforms, together with compliance initiatives, have resulted revenue growth modestly in excess of GDP growth, reflected by a rising tax-to-GDP ratio.

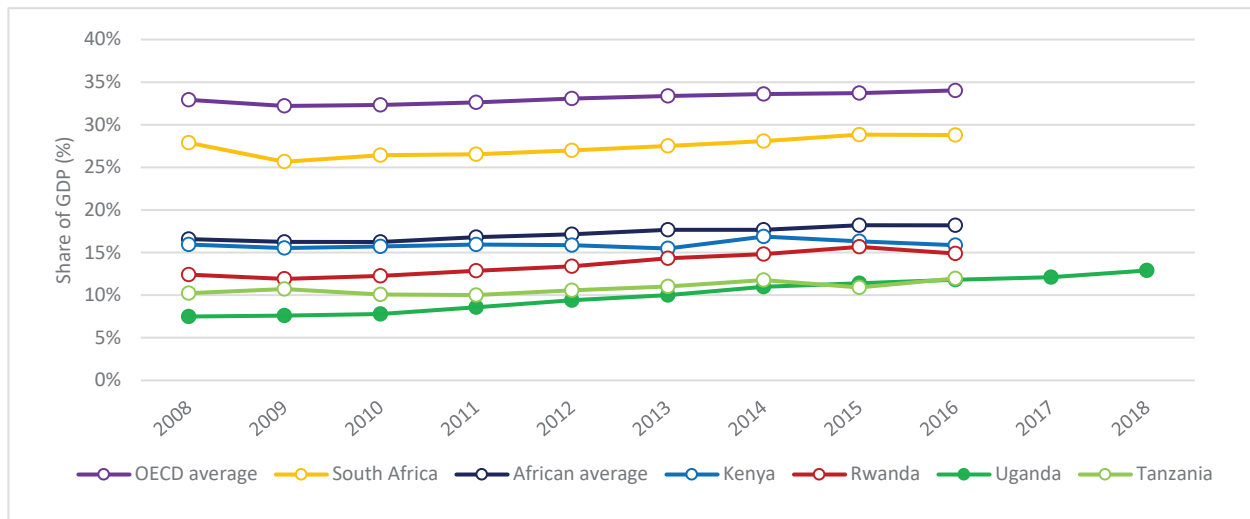
Figure 4: Growth in Revenue-to-GDP since 2008



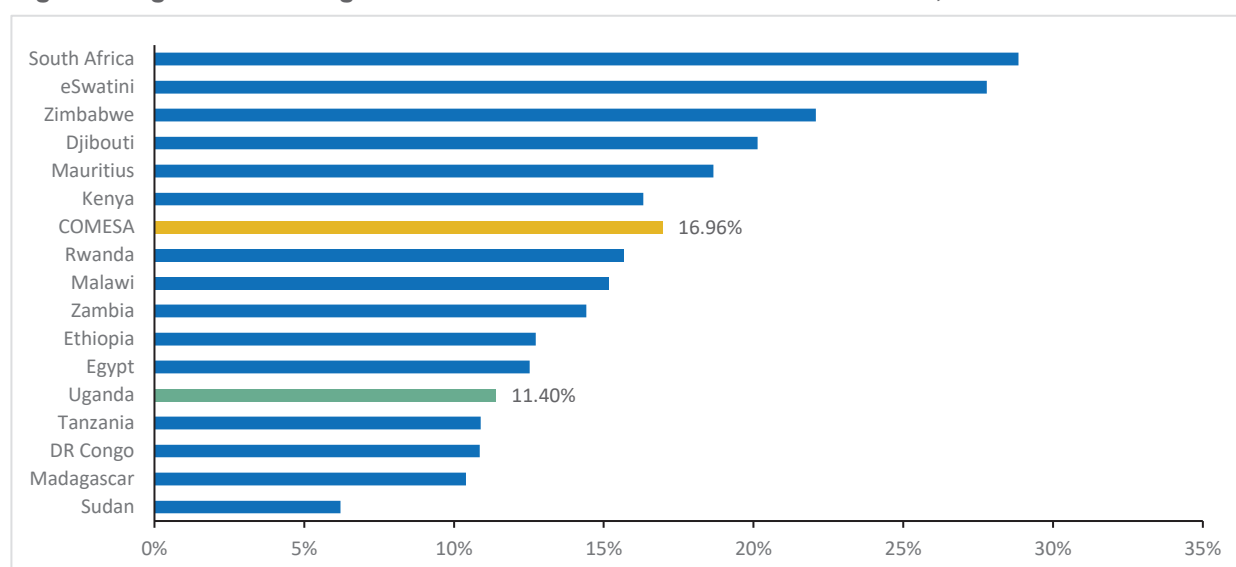
Source: Tax Policy Department (2019)

These reforms have contributed to consistent growth in revenue collections, and over the five-year period to 2017 revenue collection consistently improved. However, despite increasingly bringing Uganda’s tax system in line with international standards, Uganda has yet to reach the NDPII target of 16% tax-to-GDP and revenue collection has historically lagged that of regional peers, although over the past two years Uganda’s performance has increasingly converged (see 5 and 6).

Figure 5: Uganda’s revenues in comparison to peers, 2007-2018 (% of GDP)



NOTE: The OECD is an intergovernmental economic organisation with 36, mostly high-income, member countries.
Sources: ICTD/UNU-WIDER (2018), OECD Global Revenue Statistics (2019), Tax Policy Department (2019)

Figure 6: Uganda is trailing the tax collection of most COMESA countries, 2015

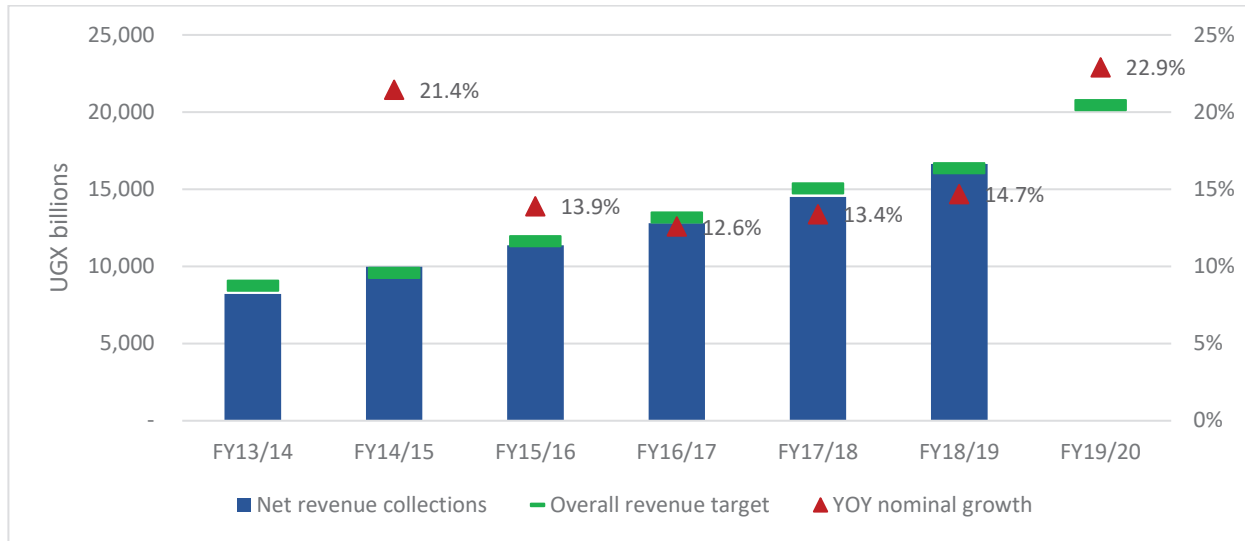
Note: Data for Figure 6 was only available up to 2015. The COMESA average excludes Uganda.

Sources: ICTD/UNU-WIDER (2018), OECD Global Revenue Statistics (2019), Tax Policy Department (2019)

In FY2018/19, several reforms were introduced, informed by the DRMS process. This included the harmonisation of excise duties applied to telecommunication services, strengthening the effectiveness of the limitation on excessive interest deductions, clarifying the obligation of foreign providers to account for VAT on online services consumed in Uganda, and administrative measures to enhance compliance, including strengthening risk management, dedicating more staff to arrears enforcement, and deploying scanners at all major border points. Partly due to these reforms, for FY2018/19, collections surpassed targets by nearly UGX 200 billion. Collections thus brought Uganda's tax-to-GDP ratio to nearly 13%. This is close to a commonly-held tipping point of 15% associated with a significant acceleration in growth and development. Maintaining strong growth in revenue collections will depend on fully implementing this DRMS.

Despite the substantial year-on-year increases in net revenues that the Government has consistently achieved, the consensus is that Uganda has only partially reached its potential. As Figure 7 shows, year-on-year nominal net revenues have grown by over 12% each year since FY2013/14, an impressive performance considering the substantial political economy, structural, and administrative constraints faced.

Figure 7: Revenue collections against targets, FY2013/14 to FY2018/19



Source: Tax Policy Department (2019)

Over the past five financial years, the compositional breakdown of revenue sources has remained fairly steady, as shown in Table 2. A notable exception is the recent growth in the contribution from excise duties. As a proportion of total consumption taxes and total taxes, excise duties have increased from 20.1% and 8.3% respectively in FY2013/14, to 22.7% and 9.0% in FY2018/19. This is at least in part due to the introduction of new excisable items in FY2018/19, including the mobile money levy, the OTT tax, and a duty of UGX 200 per litre of cooking oil. Collections from the first half of FY2018/19 indicate that the mobile money levy and cooking oil duty have performed well, achieving approximately 180% and 1200% of their targets, respectively. In contrast, collections from the OTT tax were less than 10% of the target, largely attributable to poor policy design facilitating high avoidance (using Virtual Private Networks, for example), and administrative difficulties as remittance depends on a consumer’s choice to pay.

Table 2: Breakdown of Revenue Performance, FY2013/14 to FY2018/19 (in UGX billions)

	FY13/14	FY14/15	FY15/16	FY16/17	FY17/18	FY18/19
Overall Net Revenue⁴	8,214.69	9,976.06	11,363.45	12,793.84	14,506.93	16,638.06
Income Taxes	2,644.01	3,297.53	3,767.09	4,268.07	4,744.62	5,612.01
PAYE	1,397.56	1,613.24	1,803.53	2,114.99	2,396.11	2,811.30
Corporate income tax	486.64	714.77	732.16	764.27	884.80	1,167.75
Withholding tax	406.70	546.86	699.34	677.93	754.29	846.66
Rental income tax ⁵	-	27.65	55.03	71.74	88.75	115.23
Others ⁶	373.12	395.01	477.02	639.13	620.67	671.08
<i>Income taxes as % of net revenue</i>	<i>32.4%</i>	<i>33.1%</i>	<i>33.2%</i>	<i>33.4%</i>	<i>32.7%</i>	<i>33.7%</i>
Consumption taxes	3,479.08	4,128.28	4,641.84	5,138.73	5,802.16	6,752.86
Excise duties ⁷	700.43	834.59	916.88	1,059.18	1,150.77	1,533.59
Value Added Tax	1,353.89	1,510.17	1,772.14	2,022.45	2,234.82	2,554.45
VAT on imports	1,424.76	1,783.52	1,952.82	2,057.11	2,416.57	2,664.81
<i>Consumption taxes as % of net revenue</i>	<i>42.4%</i>	<i>41.1%</i>	<i>40.8%</i>	<i>40.2%</i>	<i>40.0%</i>	<i>40.6%</i>
Trade Taxes	2,017.28	2,357.04	2,640.32	3,118.06	3,597.41	4,002.61
Petroleum duty	984.24	1,197.75	1,382.95	1,609.60	1,811.82	2,038.66
Import duties	747.53	839.84	940.07	1,043.65	1,223.75	1,350.46
Others	285.50	319.45	317.30	464.81	561.84	613.49
<i>Trade taxes as % of net revenue</i>	<i>24.6%</i>	<i>23.6%</i>	<i>23.2%</i>	<i>24.4%</i>	<i>24.8%</i>	<i>24.1%</i>
Tax refunds	(-188.18)	(-176.61)	(-202.96)	(-175.32)	(-203.64)	(-304.46)
NTR	242.50	369.81	517.16	444.30	566.38	611.03
<i>NTR as % of total revenue</i>	<i>3.0%</i>	<i>3.7%</i>	<i>4.6%</i>	<i>3.5%</i>	<i>3.9%</i>	<i>3.7%</i>
Nominal GDP	82,100.48	90,839.96	99,733.72	108,518.04	119,906.66	128,498.97
Net revenue % of GDP	10.0%	11.0%	11.4%	11.8%	12.1%	12.9%
Tax % of GDP	9.7%	10.6%	10.9%	11.4%	11.6%	12.5%
<i>Income taxes % of GDP</i>	<i>3.2%</i>	<i>3.6%</i>	<i>3.8%</i>	<i>3.9%</i>	<i>4.0%</i>	<i>4.4%</i>
<i>Consumption taxes % of GDP</i>	<i>4.2%</i>	<i>4.5%</i>	<i>4.7%</i>	<i>4.8%</i>	<i>4.8%</i>	<i>5.3%</i>
<i>Trade taxes % of GDP</i>	<i>2.5%</i>	<i>2.6%</i>	<i>2.6%</i>	<i>2.9%</i>	<i>3.0%</i>	<i>3.1%</i>

Source: Tax Policy Department (2019)

⁴ This does not include oil revenues or grants, only tax and non-tax revenue net of refunds.

⁵ No rental income tax data was recorded for 2013/14

⁶ Presumptive tax, casino and lottery tax, tax on bank interest, and tax on treasury bills.

⁷ This includes excise duties on both domestically produced and imported items

IV. The Challenge of National Budget Financing

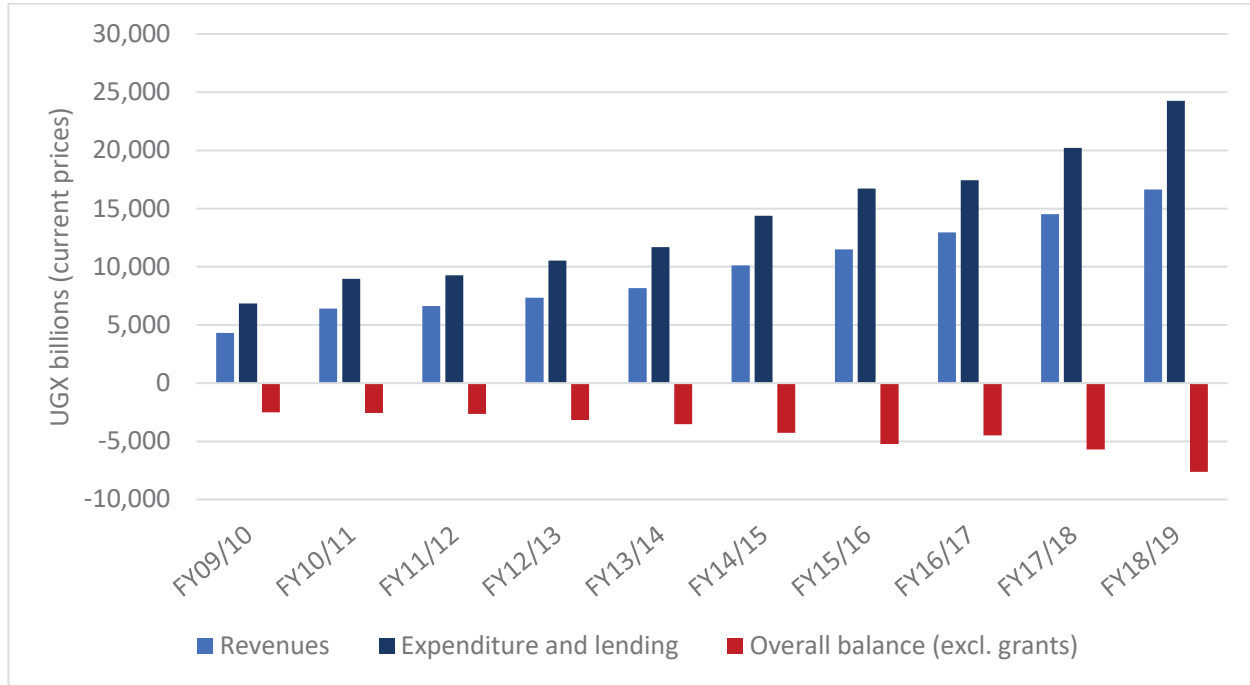
Recent performance aside, Uganda's full revenue potential has been estimated to lie between 22 to 26% of GDP by Langford and Ohlenburg (2016) and 20% by the IMF (2017), which would be higher than economies in the region with similar characteristics. Even if these estimates are overly optimistic, they indicate that Uganda's tax gap is likely to be significant. A tax effort below the country's potential hampers government's ability to finance its expenditure, as characterised by the persistent budget deficits. In the past few years, government expenditure has been consistently larger than revenue, particularly when considering domestic non-oil revenues (see the figure below). This has resulted in a large fiscal deficit and puts pressure on the government to borrow funds. In FY2017/18, the fiscal deficit widened to 4.75% of GDP, and spending exceeded the approved budget, forcing Uganda to resort to additional domestic borrowing. The short time-to-maturity on these loans, under 4 years on average, places additional pressure on Uganda's budget.

The bulk of Uganda's fiscal deficit is funded by external borrowing. Over the five years from FY2014/15 to FY2018/19, the debt-to-GDP ratio rose from 26.2% to 36.1%, with over two-thirds funded externally, predominately by the World Bank's International Development Association and China. The bulk of Uganda's debt stock is denominated in US dollars or euros, leaving Uganda's debt stability vulnerable to adverse currency shocks. In FY2019/20, debt-to-GDP is projected to increase a further 2.7 percentage points, up to 38.8%..

As a result, an increasing amount of the budget is being tied up in debt-related payments. The FY2018/19 budget indicated that from a total budget of UGX 32.70 trillion, UGX 5.27 trillion had been allocated to domestic debt refinancing, and a further UGX 2.51 trillion to interest payments. Thus, over one in every five shillings collected in revenue is used to finance debt, more than is allocated to education and health. This highlights the importance of better alignment between planned expenditure and available domestic resources.

As recognised in the NDPII and Vision 2040, strengthening certain factors is critical for growth and ensuring that Uganda is a competitive place to invest: a well-educated and skilled workforce with access to modern healthcare, better infrastructure providing easier access to markets, and more efficient and better-supported export industries. Realising this vision requires financing and the Government is now taking the decision to move away from aid, taking full ownership of Uganda's economic development, and enabling Uganda to gain financial independence. To address the constraints to growth, while avoiding the re-accumulation of debt, a stronger effort on revenue mobilisation is needed.

Figure 8: Revenue growth has not kept pace with expenditure



Source: Macroeconomic Policy Department (2019)

Table 3: Trends in Government Financing

	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15	FY15/16	FY16/17	FY17/18
Total revenue and grants	5,183.1	7,292.5	7,763.4	8,276.5	8,870.4	11,044.8	12,647.2	13,896.5	15,281.1
Revenues	4,319.5	6,402.0	6,634.1	7,340.3	8,167.9	10,114.0	11,500.0	12,946.8	14,506.9
<i>Tax revenue</i>	<i>4,205.7</i>	<i>5,114.2</i>	<i>6,135.9</i>	<i>7,149.5</i>	<i>8,031.0</i>	<i>9,772.9</i>	<i>11,059.1</i>	<i>12,463.4</i>	<i>14,076.1</i>
<i>Non-tax revenue</i>	<i>113.9</i>	<i>95.1</i>	<i>105.9</i>	<i>190.9</i>	<i>136.9</i>	<i>221.5</i>	<i>319.4</i>	<i>353.6</i>	<i>430.9</i>
<i>Oil Revenues</i>	<i>-</i>	<i>1,192.7</i>	<i>392.3</i>	<i>-</i>	<i>-</i>	<i>119.6</i>	<i>121.4</i>	<i>129.8</i>	<i>-</i>
Grants	863.6	890.5	1,129.3	936.2	702.5	930.8	1,147.2	949.7	774.2
<i>Budget support</i>	<i>467.3</i>	<i>515.5</i>	<i>576.0</i>	<i>198.7</i>	<i>191.4</i>	<i>258.2</i>	<i>339.7</i>	<i>259.3</i>	<i>154.5</i>
<i>Project support</i>	<i>396.3</i>	<i>375.0</i>	<i>553.3</i>	<i>737.5</i>	<i>511.0</i>	<i>672.7</i>	<i>807.5</i>	<i>690.5</i>	<i>619.7</i>
Expenditure and lending	6,831.1	8,972.5	9,273.4	10,521.5	11,682.3	14,378.7	16,726.9	17,437.5	20,201.6
Current expenditures	4,307.1	5,958.0	5,420.9	5,812.3	6,706.3	7,689.3	9,168.6	9,994.3	10,934.2
<i>Wages and salaries</i>	<i>1,308.4</i>	<i>1,659.5</i>	<i>1,831.8</i>	<i>2,160.5</i>	<i>2,385.3</i>	<i>2,759.5</i>	<i>2,966.4</i>	<i>3,382.0</i>	<i>3,481.4</i>
<i>Interest payments</i>	<i>385.1</i>	<i>423.5</i>	<i>603.3</i>	<i>889.7</i>	<i>970.1</i>	<i>1,213.0</i>	<i>1,681.8</i>	<i>2,360.2</i>	<i>2,260.5</i>
<i>Other recurrent spending</i>	<i>2,613.6</i>	<i>3,875.0</i>	<i>2,985.9</i>	<i>2,762.1</i>	<i>3,350.9</i>	<i>3,716.8</i>	<i>4,520.5</i>	<i>4,252.1</i>	<i>5,192.3</i>
Development expenditure	2,478.4	2,850.9	3,602.9	4,236.9	4,936.5	5,229.5	5,906.8	6,718.1	7,566.1
Net lending & repayments	(36.7)	(30.2)	(39.4)	409.4	19.4	1,235.2	1,532.5	541.0	1,396.5
Domestic arrears repayments	82.3	193.8	289.0	62.9	20.0	224.7	118.9	184.0	304.9
Overall balance (excl. grants)	(2,511.6)	(2,570.5)	(2,639.2)	(3,181.2)	(3,514.3)	(4,264.7)	(5,226.9)	(4,490.7)	(5,694.7)
Balance as % of GDP	- 4.68%	- 4.00%	- 3.81%	- 4.28%	- 4.28%	- 4.69%	- 5.24%	- 4.14%	- 4.75%
Net external financing	758.3	724.1	1,153.9	1,417.9	886.9	919.0	2,494.0	2,608.6	3,496.2
Net domestic financing	701.5	1,104.3	24.6	717.3	1,650.0	2,483.4	1,898.8	603.1	1,359.6

Source: Macroeconomic Policy Department (2019)

SECTION I: DRMS PROCESS AND OBJECTIVES

Methodology of the DRMS

I. Scope

Against the background above, the motivation for having a Domestic Revenue Mobilisation Strategy (DRMS) is clear. There are ten key drivers:

1. To support the delivery of NDPII and Vision 2040 by establishing a medium-term framework for generating the revenues that these require.
2. To encourage greater self-reliance in financing economic development in Uganda and a stronger sense of ownership of the policy levers.
3. To generate constructive and inclusive debate within Uganda about the shape and balance of the tax system.
4. To build consensus around an approach to taxation that represents a better fit with Ugandan aspirations, society, and ways of doing business.
5. To provide greater certainty and confidence for domestic and foreign investors in the planned direction of taxation policy.
6. To encourage a focus on investment-led formalisation of business over the medium term to promote growth and enhance the welfare of all Ugandans.
7. To establish a stronger and more detailed frame of reference against which to measure progress towards medium-term revenue objectives.
8. To highlight opportunities for a greater contribution to policy design and evaluation by academic and other experts and practitioners, through the development of a more formal and structured process of making tax policy.
9. To sharpen the focus on improving the efficiency of tax administration and collection processes within government.
10. To evidence the government's commitment to leaving no space in the administration and collection of taxes for corrupt practices.

It is an important part of the Government's strategy that the preparation, publication, and roll-out of the DRMS will facilitate the development of a new consensus around its approach to funding Government investment and spending, with a sharper focus on the intention that Uganda will take more responsibility for financing its own development. By specifying in this published document, the medium-term steps that will be taken to deliver growth in revenues, the Government will strengthen accountability for the implementation of the required policy changes and the administration of the revenue collection process.

With this in mind, the DRMS sets out medium-term objectives for the revenue system and a revenue mobilisation target, established through broad-based consensus. The DRMS adopts an approach of identifying key weaknesses and areas of untapped potential, followed by detailed reforms to address these over the five-year DRMS period. Section 2 of this DRMS

covers the three key constraints to revenue performance identified through the diagnostic work:

1. [The political economy of DRM](#)
2. [Improving the system through tax policy initiatives](#)
3. [Strengthening the administration of tax and non-tax revenues](#)

II. Establishment of the DRM Committee

In 2016, the Permanent Secretary/Secretary to the Treasury established a DRM Committee to guide the development of the DRMS and coordinate interventions aiming to support revenue mobilisation. The Committee comprises representatives from the Ministry of Finance, Planning and Economic Development (MFPED), the Uganda Revenue Authority (URA), the National Planning Authority (NPA), the Parliamentary Budget Office, the World Bank, the IMF, UK-DFID, USAID, the EU delegation, KfW, UNDP, EPRC, and the IGC. Civil society organisations, including SEATINI and CSBAG, were also brought on board.

III. Research and diagnostic work

To enable the development of an evidence-based reform strategy, the process began by consulting over 30 academic papers, diagnostic studies, and technical assistance reports, covering both Ugandan and global experiences⁸. Furthermore, to align the objectives and interventions proposed in the DRMS with existing national strategic plans, the Uganda Vision 2040, the Second National Development Plan, the National Budget Framework Paper FY2018/19 – FY2022/23, the Ministry of Finance Strategic Plan 2016-2021, and the latest Public Financial Management Reform Strategy were consulted.

A comprehensive stock-take of existing technical assistance reports and analytical work was undertaken, which identified key focus areas and challenges to Uganda's DRM efforts, as well as areas where further research was needed. The most influential studies included: an analysis of Uganda's revenue gaps and potential (World Bank, 2017), an excise duty diagnostic (World Bank, 2017), an IMF framework for a Medium Term Revenue Strategy (Baer, et al., 2017), and two assessments of the VAT gap (Lakuma, 2018) (Hutton, et al., 2014).

During the drafting process, additional studies were commissioned. This included a functional review of the tax administration (covering both URA and TPD), a customs assessment, an ICT review, and an examination of the non-technical barriers to DRM, all undertaken by the World Bank. These studies used the Development Implementation and Monitoring Directives (DIAMOND) methodology for measuring tax administration performance along a set of key indicators, using objectively verifiable data to compare across countries and time periods. EPRC was commissioned to examine the corporate income tax regime, calculating effective

⁸ A comprehensive list of all resources consulted can be found in at the end of this document.

marginal tax rates, and personal income tax evasion. Finally, the IGC attempted an assessment of the effectiveness of the incentives and exemptions regime under the Income Tax Act.

IV. Stakeholder Consultations

Designing a medium-term revenue strategy should be all-encompassing and transparent, involving both public and private organisations, to build broad-based consensus. In pursuit of this, three formal stakeholder consultations have been conducted, in addition to several other more informal, targeted consultations with select stakeholders.

1. MFPED and URA jointly hosted a consultative workshop for key stakeholders from the financial, insurance, social security, public, civil society, and private sectors. The workshop invited stakeholders to provide insights regarding Uganda's key DRM constraints, as well as proposed solutions.
2. Representatives from the Tax Justice Alliance (including both SEATINI Uganda and CSBAG) were invited to present a matrix of challenges and interventions that civil society organisations would like to see in the DRMS. The group were invited to develop their matrix further and share with the DRMS drafting team ahead of the conclusion of the strategy, to fully consider and incorporate the concerns of civil society. Other inputs from civil society organisations include work on double taxation agreements (SEATINI, 2014) and tax incentives (Tax Justice Alliance Uganda, 2017).
3. Several private-sector tax experts were invited to consult with the DRMS drafting team to validate specific tax policy reform options and administrative constraints, as well as identify any further gaps.

V. Process within Government

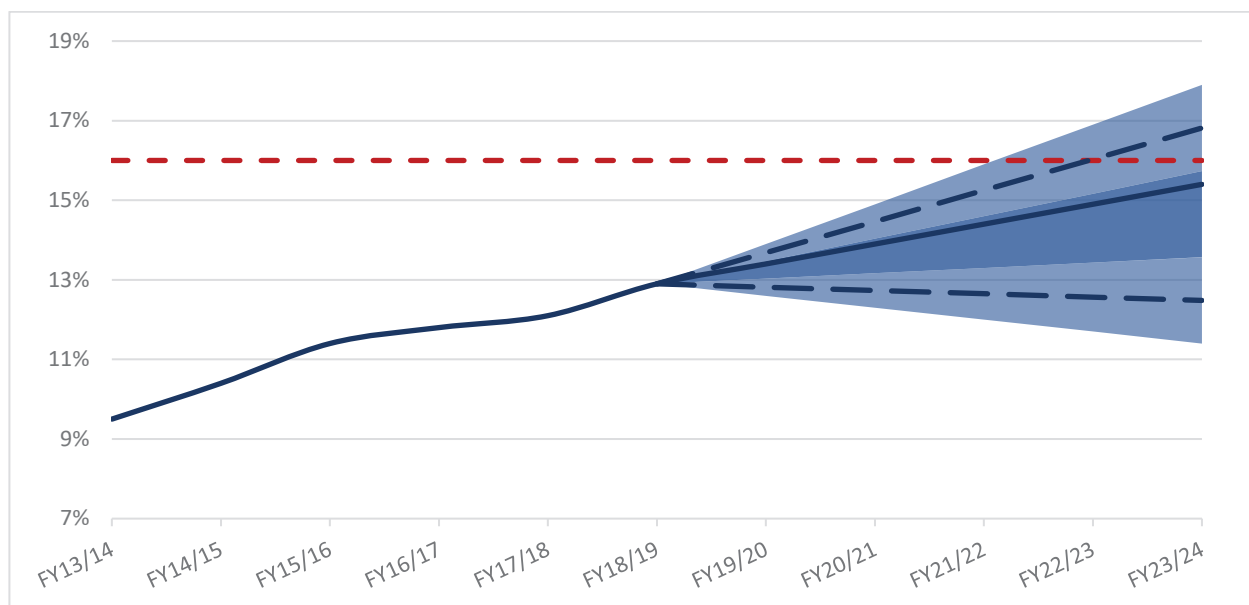
From the wider DRM Committee, a drafting committee was established, coordinated by the Tax Policy Department (TPD), and comprising officials from MFPED, URA, NPA, EPRC, and the Parliamentary Department of Research. In line with MFPED procedures, the draft versions of the paper have been considered by the various levels of MFPED leadership, including the Directorate of Economic Affairs, Top Technical, and Top Management. These internal discussions provided guidance on the design of the DRMS, created a unified direction, clarified the focus of the strategy, and created buy-in and ownership of the proposed interventions. This helped to ensure a sense of whole-of-government support for the DRMS.

Objectives of the Domestic Revenue Mobilisation Strategy

The core objective of the DRMS is to improve revenue collection, lifting Uganda's tax-to-GDP ratio to between 16-18% within the next five financial years. This will bring Uganda closer to its theoretical potential and exceeds the target of a 16% tax-to-GDP ratio as set out in the NDPII and the Charter of Fiscal Responsibility.

The figure below gives the recent performance of the tax-to-GDP ratio as well as three scenarios reflecting potential growth in this ratio. The baseline shows a continuation of the recent annual growth of 0.5 percentage points in the tax-to-GDP ratio, assuming limited reform to the tax system, some improvement in compliance, and no adverse shocks. On this trajectory, Uganda would reach the NDPII target of 16% tax-to-GDP after FY2023/24. The lower band shows weak or negative growth in the tax-to-GDP ratio, reflecting a scenario in which the DRMS is not implemented, resulting in a decline in compliance and a continuation, or extension, of detrimental tax policies. The top band shows the optimistic case in which proposed reforms to the tax system are implemented and tax compliance is substantially improved. This suggests that over the DRMS period, Uganda might attain a tax-to-GDP ratio closer to 18%. As can be seen in the figure, without at least partial reform to the tax system, Uganda will be unlikely to maintain its recent robust growth in revenue collection relative to GDP.

Figure 9: Tax-to-GDP forecasts under various reform scenarios



Source: Tax Policy Department (2019)

Exclusively concentrating on the tax-to-GDP ratio could be damaging, as pursuing tax revenue to the exclusion of all else undermines other objectives for the country, such as industrialisation, economic growth, and improved social welfare. Thus, in addition to improved revenue collection, the DRMS targets the following, changing the way in which we raise revenue:

- (i) Improving tax policies to create a sound and buoyant tax system that continues to promote industrialisation, social welfare, and private sector development. This ensures that revenues are raised in a fairer and more balanced way and generated as growth occurs by broadening the tax base.
- (ii) Lifting the capacities of the revenue administration entities, ensuring that revenue is raised in an economically efficient way and reducing the compliance burden for individuals and businesses.
- (iii) Improving citizen perceptions of taxation, raising visibility, and creating a tax system that makes us all proud to be Ugandan.
- (iv) Enhancing transparency and accountability in the tax system, making it harder for the few who would subvert our society to engage in dishonesty and fraud.
- (v) Enhancing taxpayer services, education, and information, ensuring that we are all on one path together.

Furthermore, it is necessary to note that the DRMS takes a more medium-term view of revenue mobilisation. Apart from some quick wins, the gains from implementing the strategy will not be immediate but will be gradual as the reforms take root in areas such as human capital development, which is critical to an efficient tax administration, and improved regulation of the economy.

Key Findings from the Diagnostic Work

The diagnostic work and consultative process undertaken in developing this DRMS identified three core constraints:

1. Political economy issues which might influence the rate of the achievement of this potential;
2. Structural factors in the tax policy design which have historically proved difficult to reform; and
3. The administrative effort that would be required to achieve expansions in the taxpayer base and compliance, and the related, necessary changes to improve the efficiency of revenue collection.

Political economy

The diagnostic work identified the need for Ugandans to perceive a closer link between taxes paid and public services obtained as critical for future resource mobilisation. A weak fiscal-social contract negatively affects tax morale and compliance. Similarly, the perception of a lack of integrity among tax, and wider government, officials discourages compliance with tax laws. Finally, the lack of positive political messaging on the value of paying taxes, and the historical tendency to prioritise investment over revenue generation, has further damaged morale. A fundamental shift in attitudes towards taxation, in Government and society, is needed to establish a culture of compliance and improve the productivity of Uganda's tax system.

Widespread informality, accounting for almost half of economic activity, was also identified as a key structural constraint to revenue growth. Many Ugandans conduct business wholly or partially in the informal sector, beyond the sight of the tax system, particularly in the agriculture and services sectors. This impacts horizontal equity and raises the tax burden faced by those who are compliant, as higher rates are needed to compensate for a smaller base. This DRMS is most concerned with firms and individuals who hide behind informality, avoiding their tax obligations by not disclosing all economic activity.

Tax policy

In the tax policy area, the research indicates that the level of analysis and consultation undertaken in policy design is insufficient. Well-considered and appropriate policies require a greater depth of stakeholder engagement as well as pre- and post-implementation analysis to establish the effectiveness of policy changes. Due to a combination of a stretched and under-resourced policy development process and the pressure for greater revenue, Uganda's tax laws have been adjusted with increasing frequency. The resulting lack of stability and predictability has increased the compliance burden for taxpayers and introduced unnecessary complications to revenue administration. The granting of tax exemptions and incentives adds to this complexity, especially when done on an ad hoc basis. These undermine fairness in the tax system, create an uneven playing field for businesses, and there is significant need for a comprehensive policy framework to evaluate, grant, and monitor these exemptions.

With respect to specific tax handles, the apparent underperformance of PIT, CIT, and VAT relative to reasonable expectations, given the recent growth in the economy, has been identified as a binding constraint. The productivity of PIT was found to be undermined by widespread under- and non-declaration, while the disparity between the high nominal CIT rate and the low effective rate suggests that yields have been distorted by a high number of allowable deductions (beyond the normal costs of doing business) and the treatment of losses carried forward. Uganda has suffered further base erosion through the abuse of Double Taxation Agreements and transfer pricing. VAT remains a critical tax for public finances, however yields may be below potential due to the large range of goods and services not taxed, the low number of VAT-registered traders, and the influence of deeming provisions. Finally, excise taxes have been undermined by poor regulation of certain sectors, a narrow tax base, and rates that are not commensurate to the negative externalities created by excisable products. Fiscal pressures have also resulted in the introduction of additional excise duties, beyond the traditional principles of an excise, contributing to a compliance burden and a perception of over-taxation.

Tax administration

Several key areas of administrative inefficiency emerged from the diagnostic and consultative work. Firstly, URA suffers from various governance challenges, including the lack of a clear reporting framework between URA management and MFPED, structural weaknesses, and a narrow performance monitoring framework, focussing almost exclusively on revenue targets. Secondly, there are extensive human resource weaknesses at both URA and TPD, with gaps in both staff numbers and staff capacities, particularly on data analysis, specialised areas of taxation such as international tax, and audit and enforcement. Third, the ICT infrastructure was found to no longer comprehensively meet URA's needs, while poor third-party data access and internal data management limit the ability of the organisation to capture potential taxpayers and validate taxpayer declarations.

Finally, a more explicit focus on promoting compliance by a higher proportion of businesses and individuals is needed. The current taxpayer register was found to only partially capture the full potential tax base, taxpayer services and education programmes are poorly targeted, under- and non-declaration is widespread, audit and enforcement action has had only limited success, and overdue tax arrears have increased very significantly over the past financial years.

There is no silver bullet to improving the performance of the tax system. Rather, successful reform will require steady and dedicated work in each of the three core areas, gradually building trust and support for the whole tax system. The remainder of this document provides a detailed discussion of these challenges and identifies the reform, action, or intervention necessary for plugging these gaps.

SECTION 2: LIMITATIONS AND INTERVENTIONS

The Political Economy of DRM

I. The Fiscal-Social Contract

The sustainability of a tax system depends on taxes being collectible and accepted by citizens who receive services in return. The government recognises that unless tax revenues are translated into visible public goods and taxpayer concerns are addressed, public buy-in and tax morale will remain low. Understanding the taxpayer perspective and the level of trust in government is thus key to achieving sustainability. This ‘fiscal-social contract’, in which beneficial expenditures are delivered to taxpayers in return for tax payments, is a precondition for an effective state and economic and social development.

Targeted Challenges

- (i) **Poor service delivery and a perception that government does not provide “value for money”.** If citizens do not believe that taxes are being used fairly to deliver services, there is little incentive to pay.
- (ii) **Limited stakeholder consultations conducted during tax policy development.** When consultation with business and the general public on taxation issues does happen, it is often unstructured and happens too late in the process. This results in a failure to capture the value of available expertise or create a sense of community with an interest in seeking the best outcomes.
- (iii) **Lack of high-level political messaging about the value of paying taxes, contributing to low tax morale.** There is a focus on the expenditure side of budget with limited in-depth and considered discussion of tax matters. Messages portraying investment and growth as more important than revenue collection creates contradictory motivations across many sectors, with citizens perceiving taxation as a “punishment”. Coverage of tax in the media tends to be inadequately informed, reactive, partisan, and emotional. This creates a climate wherein it is difficult to rationally debate the tax system. Revenue collection is likely to remain low without a change of mindset across all of government.
- (iv) **Tax incentives create perceptions of inequity and resentment.** Even if interest groups do not lobby explicitly for a policy change, it is likely that they will lobby for the persistence of or extensions to favourable treatment. In addition, granting incentives to one group or sector leads to pressure from others who regard themselves as equally “worthy” of special treatment. This creates the impression that the tax system does not fairly address all taxpayers.
- (v) **A strong perception of corruption in Government, from the Ugandan public and the global community, creates low compliance.** His Excellency the President has come out strongly against corruption in the civil service, saying at the event for the 25th anniversary of Transparency International that he will launch a new effort

against corruption, especially at institutions such as the Bank of Uganda, the URA, and KCCA that have been infiltrated by corruption⁹. Transparency International's 2017 Corruption Perception Index ranks Uganda a lowly 151 on a list of 180 countries. Corruption has wide ranging implications for Uganda's economy and its development objectives. Corrupt practices, especially in revenue administration, discourage foreign investment and deny government much-needed revenues that should be available for objectives such as improving healthcare outcomes, strengthening educational opportunities, and building critical infrastructure. Furthermore, corruption on the expenditure side at all levels of government depresses incentives to comply with tax obligations.

Interventions

- (i) **Strengthen links between tax and spending decisions, as well as budget transparency.** The use of tax revenues in social public expenditure and infrastructure should be better communicated. Furthermore, budget transparency should be enhanced, giving taxpayers the information necessary to hold government accountable for poor service delivery.
- (ii) **Develop and publish a comprehensive tax expenditure framework to properly evaluate all tax reliefs and allowances.** Exemptions and incentives that are granted should be pegged to clear objectives and outcomes and the practice of granting discretionary exemptions should be abandoned. This is developed further in the dedicated section on [tax incentives and exemptions](#).
- (iii) **Increase involvement of key stakeholders in tax policy design through structured consultations.** Consultations will be held in a predictable fashion and parties should be provided with adequate information to maximise the benefits of engagement. At least one phase of formal consultation on key aspects of tax reform must be held prior to the publication of draft legislation. Improvements to the policy development process more broadly are discussed in the [dedicated section below](#).
- (iv) **Increase the demonstrated commitment of political leaders to supporting taxation.** Encourage strong buy-in for the reforms outlined in the DRMS across government, civil society, and private sector, and create a positive discourse around the need for taxation. This includes building consensus among leaders, including traditional and religious leaders, on the importance of taxation and encouraging leaders to advocate in favour of the tax system. Compliance among citizens would be further encouraged through the demonstrated personal compliance of Uganda's leaders with the tax system, sending a message that not complying with one's tax obligation is dishonourable. Finally, more dedicated time should be given to discuss tax issues in Cabinet and Parliament.
- (v) **Strengthen the cross-government anti-corruption strategy.** The President has established the State House Anti-Corruption Unit and legal frameworks to denounce

⁹ <http://www.statehouse.go.ug/media/news/2018/12/05/corruption-defeatable-museveni>

corruption, indicating that corruption can be defeated. These initiatives have paved the way for Government to further strengthen public financial management, including transparent procurement, pay reform, and budget transparency, reducing the opportunities for corruption and the impact of offenses. Errant behaviour would be effectively sanctioned by improving the visibility and publicity of enforcement actions against corruption among tax officials and taxpayers, including denying offenders the ability to be employed in public office. Tackling cultural norms plays a key role in fighting corruption. When corruption is widely accepted as normal behaviour, efforts to curb it are significantly weakened.

- (vi) **Regularly conduct independent citizen perception surveys to measure the confidence in both the tax administration and wider government.**

II. Taxing the Untaxed Economy

One of the principal challenges for improving collection is broadening the base of taxpayers in Uganda. Registered and active taxpayers currently represent a small proportion of the economically active population of the country. This puts pressure on those who comply with business registration and tax registration rules, by requiring tax rates to be unnecessarily high and keeping the tax yield lower than it should be. The problem is compounded by the less-than-full compliance of taxpayers who are registered but who keep part of their activities out of the sight of the government.

The Ugandan economy is still dominated by agriculture and services, with a high proportion of small, informal firms in both rural and urban areas. In FY2017/18, approximately 51% of total GDP was generated in the informal economy¹⁰, where businesses are typically unregistered and thus not captured by the tax system. While estimates of the size of the informal economy vary, there is a substantial amount of economic activity that goes untaxed.

Informed by the diagnostic work, the untaxed economy can be divided into two segments:

- (i) Those individuals or businesses who operate partly in the formal economy and partly outside it. This segment is essentially not fully compliant.
- (ii) Those who are unregistered and operate entirely beyond the sight of the Ugandan tax system. This segment is truly informal.

Understanding the nature of informality in Uganda is key to designing appropriate policy measures. Taxation should avoid undermining traditional ways of doing business in Uganda, severely constraining business activity, and reducing the opportunities for the youth to participate in the economy, as the informal sector is often the only avenue for youth to obtain

¹⁰ For FY2017/18, total nominal GDP was UGX 119,907 billion, of which UGX 61,424 billion was attributed to economic activity in the informal sector (data provided by the Macroeconomic Policy Department, MFPED).

any employment. This approach would be doomed to fail, with low potential yields and high administrative costs.

Of great concern is the damage to equity that the existence of a large informal sector creates. On an individual level, while nurses, teachers, and public servants are compliant and have their income tax liability deducted at source (under PAYE), professionals and other businesspersons operating informally go untaxed, despite often having higher earnings. This is unfair and damages tax morale among those in the waged sector. Similarly, individuals, whether traders or professional persons, routinely carry out licenced activity but fail to report, for tax purposes, all, or part of that activity. These fraudsters are deceiving the tax administration by hiding income, and damage tax morale among the compliant.

The evidence also indicates high levels of non-compliance among large businesses, whether incorporated or unincorporated, who should ordinarily bear tax, but are partially hiding behind a cloak of informality. This informality can constrain growth, as the formalisation of firms facilitates easier access to credit, strengthens governance, and promotes political accountability. These factors accelerate growth at both the firm and economy-wide level.

Over the period of this DRMS, the Government will take steps to bring the non-compliant more fully into the tax system and to raise a fairer level of taxation from those who contribute less than they should.

Targeted Challenges

- (i) **The Ugandan economy is dominated by unregistered traders and undeclared employment.** This is particularly true in the agricultural industry, where subsistence farming is a predominant activity, but it is also widespread in real estate, transportation, hospitality, and professional services.
- (ii) **A large proportion of Uganda's youth depend on the informal economy for work.** The most recent estimates found that 13.3% of Uganda's youth¹¹ were unemployed (UBOS, 2017). However, the National Labour Force Survey indicated that the proportion of youth in informal employment, outside of agriculture, was 90.5% (UBOS, 2018). Given the rapid growth of the Ugandan population – half of the current population is aged 15 and below – a stronger focus on job creation for this cohort should be emphasised. Harnessing this demographic dividend will require drawing the youth into formal employment early on. Not doing so will have large implications for the economy, for society, and for future revenues.
- (iii) **Many taxpayers appear to be unaware of their tax obligation and how to be tax compliant.** This is true even among well-educated Ugandans. For example, a common misconception appears to be that the licence fees for doing business cover all tax liabilities.

¹¹ Defined as those aged between 18 and 30.

Interventions

- (i) Target large business non-compliance with stronger enforcement actions.** Large business compliance is essentially a matter for the URA. This DRMS seeks to put the URA in a position to carry out stronger enforcement actions, including the use of enhanced, risk-based techniques to target audit activity to those where the likelihood of under-declaration of income or failure to comply, for example, with PAYE requirements is perceived to be highest. It is likely that effective action against under-declaration by large taxpayers will yield substantial additional revenues.
- (ii) Significant levels of under-declaration by professionals merit stronger investigative and enforcement action by URA.** During the DRMS period, improving flows of information between different parts of government and from the private sector to the URA will empower investigators to cross-check aspects of the life-style and asset acquisitions of individual professionals and their families to ensure that under-declaration of income is identified, and appropriate action taken.
- (iii) Consider ways of promoting formal youth employment through the tax system.** Allowing a deduction or tax credit for a portion of the wage bill paid to youth employees is one measure that merits consideration. Such strategies should be considered holistically and the associated supply-side constraints, such as skills training, should be addressed. This might include a specific measure to support and help fund apprenticeships and the possible introduction of a “super-deduction” for accredited workplace-based education and training. A tax incentive in isolation is unlikely to achieve significant results if firms are more concerned about the skill level of young employees. Such programmes have had some success in other jurisdictions and inculcate a culture of formal work among the youth, boosting future revenue performance.
- (iv) Link tax compliance with re-licensing of traders and service providers, expanding the withholding tax regime to capture evaders at the point of engagement with Government.** Government will evaluate a scheme of taxation that will require an additional payment of tax at the point when licences and professional status are renewed. The payment required will be fixed as a flat fee, payable annually, and be set at an appropriate level. As part of the evaluation of the tax, before its introduction, Government will consider the possibility that it should be creditable against the tax payable when the individual’s tax return is filed. In the absence of a tax return, it will be treated as a final tax. Furthermore, Government will consider introducing a requirement to produce a tax clearance certificate from URA before traders and customs clearing agents are licensed or re-licensed.
- (v) Improve links between the local government and central government tax systems.** A comprehensive national tax database should be developed to identify businesses and individuals across the country for all points at which they interface

with government. This could later be expanded to include information from other regulators.

- (vi) **Improve and expand the existing taxpayer education strategy to encourage formalisation.** This is discussed further in the compliance continuum section below, with specific measures regarding [taxpayer education, service, and communication](#).

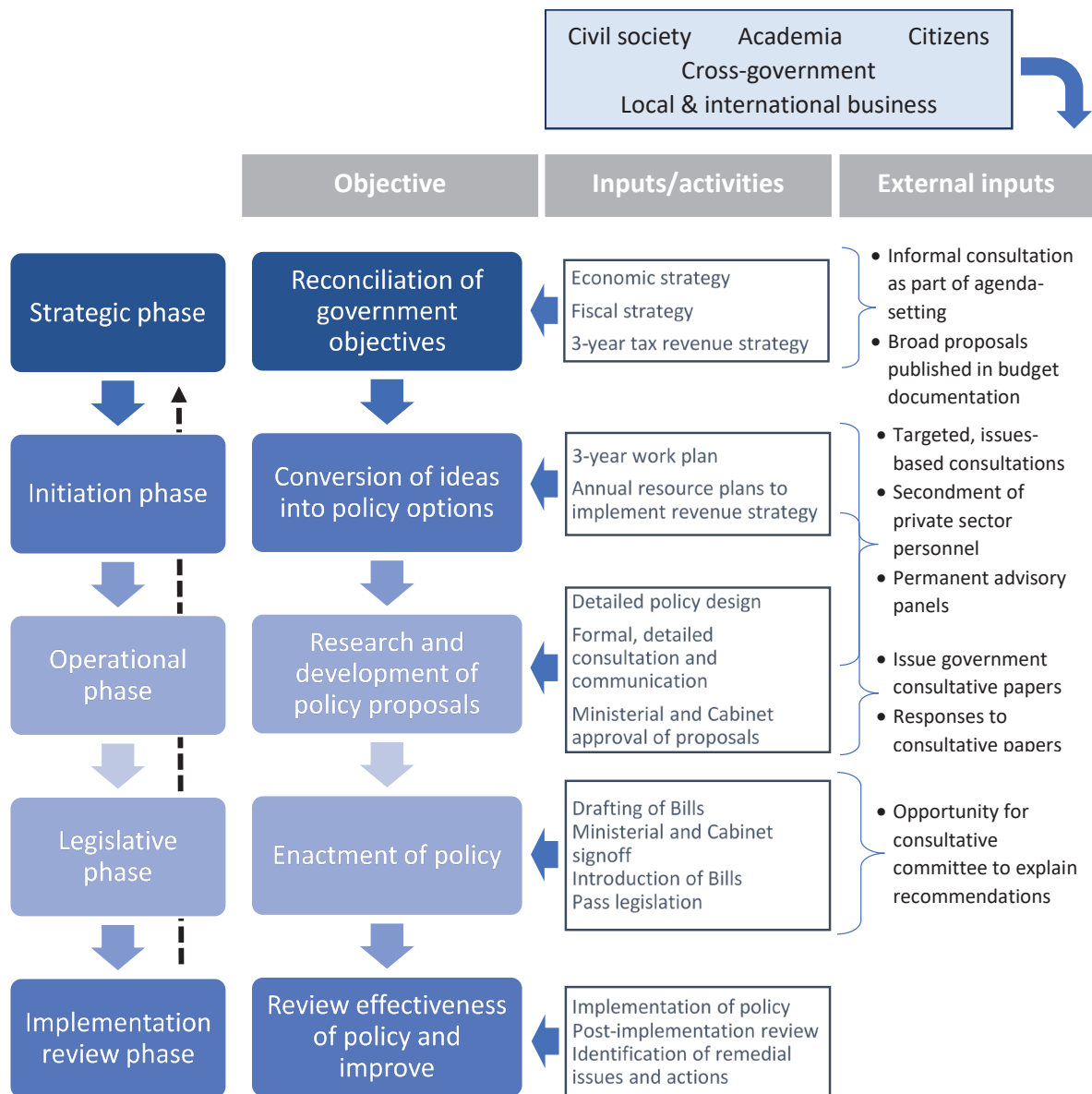
Improving the System through Tax Policy Initiatives

One of the most encouraging features of Uganda's tax system is that the tax policy as laid out in the tax laws and regulations is generally in good shape and follows the international best practices. However, some gaps remain. The following discussion identifies policy-related constraints to reaching Uganda's revenue potential, as well as related proposals for reform.

I. The Tax Policy Development Process

To design a tax system that encourages sustainable economic and social development and is widely supported by the public, it is essential that tax reforms are carefully assessed, quantitatively analysed, and openly debated. In the pursuit of well-considered and practical taxation policies, there is a need to establish a clearly delineated, formalised protocol for the development of tax policy. New Zealand's Generic Tax Policy Process has been singled out as a unique example of how policy ought to be made and documented (Wales & Wales, 2012). The 15-step, 5-stage formalised model publicises the stages of policy-making, is guided by medium and long-term strategy, and encourages close consultation with the private sector. The model creates space for early consideration of key policy proposals, provides for substantial external input into policy formulation, and clarifies the responsibilities of participants in the process. Through the various phases, from policy inception to enactment, proposals are improved through external input and consultation, drawing on expertise in the public and private sector (indicated in the diagram below). After enactment, the post-implementation review phase encourages learning and improvement, feeding back into the first stages.

Figure 10: New Zealand's Generic Tax Policy Process



Uganda’s tax policy process is not currently well-documented, is done in a more piecemeal fashion, and opportunities for external input and consultation are not well-structured, with limited specification of the timeframe and relevant stakeholders. Every stage of tax policy-making has an impact on the next, from the development of the initial idea, through policy analysis and consultation, the drafting of legislation, interrogation and approval by the legislature, and the subsequent review of the successes or failures of policy enactment (Wales & Wales, 2012). A breakdown at any stage weakens the tax policy instrument, risks policy error, and limits the opportunities for policies to be improved through proper analysis and consultation. Not mapping Uganda’s tax policy process is a missed opportunity to improve both policy-making and the strength of the tax system.

Targeted Challenges

- (i) No documented policy design manual exists, setting out the stages through which policy proposals should pass.** There is a need for a standard procedure for identifying, developing, and analysing tax policy proposals to improve the quality, legitimacy, and coherence of proposals. The lack of documented guidelines challenges transparency and introduces scope for bypassing due process in the development of policy, which undermines the role of MFPED and renders the MFPED reactionary. Furthermore, bypassing MFPED limits the opportunity for policies to be improved by the full technical expertise of MFPED officials and others.
- (ii) Tax policy is driven largely by short-term revenue pressures, with limited consideration for the full economic, distributional, and social welfare impacts.** When initiating and evaluating policy proposals, there has been a narrow focus on the revenue impact of policy changes, rather than understanding the full picture of the economic, social, business environment, and welfare effects. This would inform whether a policy change is, on balance, beneficial or detrimental. This analysis should also be extended to post-implementation to understand the full, real impact of policy changes. Furthermore, limited consideration is given to the administrative cost and changes required to implement a new policy, such as staffing levels, ICT changes, or budgetary issues. Policy changes also cause compliance adjustments for the private sector, which are not well-examined or understood.
- (iii) The excessive rate of amendment to tax laws creates undue complexity, unpredictability, and uncertainty in the private sector.** The pressure for revenue incentivises the introduction of new measures or alterations to existing measures on a yearly basis, negatively impacting on taxpayer certainty and investor confidence. Further, an unstable tax regime contributes to a high number of tax disputes. The frequency of amendment has resulted in piecemeal legislation, a time-consuming reconciliation process, and interpretation conflicts between taxpayers and the tax administration.
- (iv) Lack of a comprehensive monitoring and evaluation framework for tax management.** This includes the level of reporting on taxes required on a regular basis. MFPED is constrained in its ability to produce high-quality analysis by a lack of clear reporting requirements and limited data exchange. Access to data is critical for modelling purposes, and while it is important to honour taxpayer confidentiality protocols, TPD needs to be able to easily access the relevant data to ensure its successful operation.

Interventions

- (i) Document and publicise guidelines for tax policy development to improve the quality, buy-in, and legitimacy of proposals.** This should define the full process through which proposals should pass before approval by Cabinet and the full legislative process, including the initiation, consultation, and coordination of inputs

from both the Tax Policy Department (and wider MFPED) and the URA. This process should include fully costing the social and economic impact of a proposal, an investigation into the likely administrative and compliance issues, specification of necessary legislative changes, an assessment of a feasible timeline for implementation, structured consultations and stakeholder engagement, and a strategy for taxpayer sensitisation to avoid confusion and ignorance. Finally, the process should specify a post-implementation review phase to assess whether measures achieved the desired objective. The scope and timing of this review should be formally set out in the relevant legislation.

- (ii) **Enhance the analytical capacity of both TPD and URA.** This should encompass enhancing skills to undertake revenue forecasting, economic and social impact modelling (including the impact of policy changes on business, households, gender, and distributional analysis), quantification of the tax gap, drafting of tax legislation, and tax expenditure costing. Developing this capacity will require adequate staffing with considerable prior exposure to tax issues, and resources to facilitate and empower officers to undertake research. Tax is a dynamic field requiring regular upskilling to remain abreast of issues and exposure to international best practice.
- (iii) **Stabilise tax policy and adopt a more consistent tax regime.** There should be a deliberate effort to minimise the frequency of amendments and adopt a more long-term vision for the tax system. For key elements of the tax system, Government should commit to a timeframe for implementation well in advance to enhance predictability. Furthermore, policy-makers should ensure that tax laws are technically well-drafted, using precise language, to minimise the scope for misinterpretation. Ensure that URA is given sufficient time to sensitise staff and taxpayers to policy adjustments, adapt systems to facilitate implementation, and test changes.
- (iv) **Develop the reporting and monitoring framework for taxation.** This will entail creating a set of relevant indicators of tax performance (further developed in the section on [governance of URA](#) below), and the wider economy, and building the necessary database of information at MFPED. The demand for structured reporting of information from URA should be enhanced, empowering TPD officials to produce high-quality, regular reports, as well as improve the information available for research and public consumption. The exchange of data between TPD and URA should be made routine, in the format and within the timeframes required by both parties.

II. Enhancing the Status of Taxation within the Ministry of Finance

In designing a revenue system that fosters sustainable growth and development, the Government requires the support of a well-resourced, high-functioning Tax Policy Department

(TPD). The current TPD is contained within the Directorate of Economic Affairs and has a mandate covering a wide range of areas, including:

- a) Initiate, formulate, and evaluate tax policies to achieve economic policy objectives and raise domestic revenues to finance the budget
- b) Evaluate the impact of tax policy on citizens and the economy
- c) Forecast annual and medium-term recurrent revenue and produce revenue performance reports
- d) Coordinate and monitor URA operations to ensure effective implementation of tax policy and achievement of revenue targets
- e) Identify avenues for widening the tax base
- f) Coordinate with organisations including the Bank of Uganda, the Uganda Investment Authority, and the Private Sector Foundation on tax matters
- g) Draw up appropriate legal requirements for revenue collection and related legislation
- h) Participate in EAC negotiations, as well as COMESA and WTO activities
- i) Negotiate Double Taxation and Investment Promotion Agreements, as well as other international tax treaties.

However, TPD currently faces several challenges which has limited the department's ability to undertake thorough analysis of policy options, conduct wide high-level consultations with public and private groups, develop well-targeted proposals, and participate in treaty negotiations. Despite having a smaller economy than more developed nations, the complexity and range of tax issues that the Government of Uganda faces is not proportionately scaled down. Thus, there is a need to lift the capacity of the unit and ensure that it can operate optimally and meet the domestic revenue mobilisation requirements.

Targeted Challenges

- (i) **The institutional position in MFPED of the Tax Policy Department is not commensurate with the importance of its mandate.** A study on the institutional framework through which tax policy is developed across several countries noted that the importance of tax policy-making is often undervalued and underrepresented compared to other functions of government (Wales & Wales, 2012). This certainly seems to be true in Uganda. TPD's lower-level status relative to the Directorate of Budget and the Directorate of Debt, and the low prioritisation of revenue matters across government have undermined the importance of tax matters. This further impacts on the budget made available to the department, reducing the ability to properly train and equip staff on complex matters of taxation. Given the importance of revenue mobilisation, and TPD's role in that, the department should have better resources at its disposal.
- (ii) **The approved structure does not complement the wide mandate of the department and is not fully-staffed with relevant skills.** Without a proper enabling structure, the department runs a high risk of policy error, which can have

a considerable impact on government revenues. In addition, the mandate has recently been expanded to include management of the natural resources fiscal regime and implementing the Extractive Industry Transparency Initiative (EITI), providing leadership on designing, negotiating, and implementing the fiscal regime for the entire natural resource value chain (upstream, midstream, and downstream).

Interventions

(i) Establish an appropriate structure for TPD commensurate to the importance of taxation and ensure that this structure is fully-staffed with relevant skills.

The role of tax policy-making within MFPED should be elevated to be on par with that of budgetary and debt management issues. Furthermore, while there is merit in recruiting from a wide range of backgrounds, tax policy is a complex field and there is a need for a certain level of expertise. Thus, greater consideration should be given to the level of expertise needed in the department, particularly at a leadership level. Ensure that TPD is properly resourced in terms of budget, facilities, and equipment.

III. Policy Direction

The Government of Uganda has committed to narrowing the gap between current and potential revenue performance. This requires tax revenues to grow at a rate in excess of the rate of growth in GDP. The policy direction outlined in this DRMS responds to that commitment and to the broader needs of the Ugandan economy. The Government's strategy aims to establish a better balance between competing needs:

1. to raise additional revenues;
2. to encourage a healthy flow of investment and business competitiveness; and
3. to address issues of fairness and social welfare in the tax system.

Today, the fundamental design of the tax system in Uganda is sound and appropriate for an economy at this stage of its development; but both the tax yield and its rate of growth appear to be well below potential, with weaknesses apparent in most of the major tax heads, including [VAT](#), [CIT](#) and [PIT](#). There are concerns about the buoyancy of the main taxes. While the administration and collection issues addressed elsewhere in this document will play the largest part in addressing these shortcomings, there are, nevertheless, policy changes that will need to be made.

This medium-term strategy builds on the significant achievements of the past, but it recognises the need to sharpen the design of policy instruments for the future. The DRMS, therefore, incorporates policy proposals:

1. To continue supporting the competitiveness of priority sectors of the economy through appropriate, well-designed interventions in areas where there is the

potential for tax policy instruments to address key market failures. The tax system in Uganda has been found to be business-friendly and will maintain that attribute, but interventions to encourage investment will be more targeted.

2. To maintain the VAT system broadly as it is, with exemptions and zero-ratings retained that reflect key policy objectives, including social and welfare objectives, but others tightened that appear to deliver mainly private benefits.
3. To tighten the rules where evidence is found that taxpayers, typically large corporations, owned out-of-country, are abusing the tax system to the detriment of tax revenues; and where over-generous reliefs are creating long-term distortions in the revenue yield.
4. To ensure that international tax agreements and treaties minimise opportunities for abuse and are aligned to international best practices.
5. To ensure that fairness, especially horizontal and vertical equity, is firmly embedded in the design of the tax system and that, in particular, personal income tax thresholds and rates reflect that principle.
6. To encourage a new emphasis on the development of human capital, through measures that support education and training provided through the workplace and encourage the entry of young Ugandans into the formal workforce.
7. To stabilise and enhance the excise duty system to ensure its continued importance as a revenue source while staying true to the underlying principle of addressing negative externalities of consumption.
8. To bolster the taxation of the extractives sector to meet the changing conditions in the mining industry and address the potentially complementary interests of government and business in the oil and gas sector.
9. To develop policy instruments that will work with the grain of enforcement measures, to encourage formalisation within the economy without the loss of entrepreneurial energy.
10. To enhance the role of Local Government in developing revenue streams appropriate for its needs.
11. To put forward policy refinements that will facilitate the URA efforts to broaden the tax base and the number of registered, active taxpayers.
12. To limit ad hoc interventions in the tax system, which may create unwarranted distortions in tax administration and reduce revenue yield.

This DRMS document indicates the proposed direction of travel in the development of the tax system. Many of the measures outlined in this document require further work and analysis before being specified in detail. They will also benefit from consultation with those taxpayers likely to be affected by them.

The DRMS proposals that follow are organised by tax head, setting out the proposed changes in a conventional tax-by-tax approach. The analysis lays out the recent performance of the tax head, policy challenges that limit the productivity, and the related interventions to address those challenges. Taxpayers tend to see the tax system in a different way, reflecting the

various points at which it has an interface with their own lives – their employment or business activities, their role as consumers, savers, investors and property-owners, their dealings with those providing public services. In this document, it is not possible to capture all of those different viewpoints and understandings of the tax system, but it is possible to express a commitment to listen to the voice of Ugandans with those experiences and to draw them into the process of developing tax policy. Early-stage consultation on the ideas contained in this document has already attempted to identify issues not just from a government perspective but also from the point of view of specific industrial and service sectors, of civil society, and of the Ugandan citizen. It is expected that this strategy will be the subject of widespread discussion and any comments received will help to shape the conversion of the policy intent set out in this document into policy measures that can be legislated in our Parliament.

Strengthening the Productivity of VAT

VAT is one of the most important revenue sources in Uganda, however, the productivity of VAT is comparatively low. Research indicates that Uganda's VAT efficiency, the ratio of VAT revenue to the product of the standard rate and final consumption, is 28.6%, lower than the Sub-Saharan African average of 48.7%, and lower than regional peers, such as Kenya (44.4%), Rwanda (41.7%), and Tanzania (45.7%) (Hutton, et al., 2014).

VAT is normally a buoyant source of revenue, with growth expected to at least match that of GDP. The table below indicates a generally strong performance, with VAT revenue growth exceeding growth in nominal GDP in most financial years since 2013/14. The high growth rate between 2013/14 and 2014/15 has been attributed to the removal of many previously VAT zero-rated and exempt supplies. As a share of GDP, Uganda's VAT revenue contributed 4.1% in 2018/19, which is comparable to regional peers such as Kenya at 4.3% and Rwanda at 4.9%, however is considerably lower than South Africa at 6.8% and the OECD average of 7% (OECD, 2017).

Table 4: VAT performance against GDP

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
VAT revenue ¹² (UGX bn)	2,778.65	3,293.69	3,724.96	4,079.56	4,651.39	5,219.26
Nominal GDP (UGX bn)	82,100.48	90,839.96	99,733.72	108,518.04	119,906.66	128,498.97
VAT as % of GDP	3.4%	3.6%	3.7%	3.8%	3.9%	4.1%
VAT as % of net revenue	33.8%	33.0%	32.8%	31.9%	32.1%	31.4%
YOY ¹³ growth in VAT-to-GDP ratio		0.24	0.11	0.02	0.12	0.18
VAT revenue growth rate		18.5%	13.1%	9.5%	14.0%	12.2%
Nominal GDP growth rate		10.6%	9.8%	8.8%	10.5%	7.2%

Source: Tax Policy Department (2019)

To understand where improvements in VAT might be expected, it is useful to decompose VAT efficiency into two components – a compliance gap and a policy gap. The compliance gap gives the impact on potential yield for a given policy structure from non-compliance, while the policy gap refers to the impact on the potential yield due to exemptions and zero-rating.

The estimated VAT compliance gap was 6% of GDP in FY2012/13 (Hutton, et al., 2014), which has since narrowed to between 2% and 3% in FY2016/17 (Lakuma, 2018). Much of this gap has been attributed to the construction and the manufacturing sectors (Lakuma, 2018). There are two major components:

1. Inefficiencies in compliance management, stemming from the quality of the taxpayer register, poor control of offsets and refunds, failure to effectively analyse taxpayer information, and limited use of third-party data to reconcile returns information; and
2. Widespread tax evasion and other schemes to beat the law, such as the misuse of offset claims.

The policy gap was estimated to be around 1% of GDP by both the IMF (2014) and EPRC (in Lakuma, 2018). This is mainly due to VAT exemptions and zero-rated supplies (see Table 5), many of which reflect firm policy choices to support other government objectives, such as industrialisation and social welfare. At a sectoral level, the policy gap mainly consists of exemptions applied to agriculture, manufacturing, and transportation. The supply of petroleum fuels accounts for more than two thirds of tax expenditures in the manufacturing sector, zero-rating of international transportation services accounts for half of tax expenditure in the sector, and exemptions granted to unprocessed agricultural products, poultry and livestock feed, and cereals produced in Uganda explain more than 80% of tax expenditure in the agricultural sector (Lakuma, 2018).

¹² This encompasses VAT on domestic produce and imports.

¹³ Year-on-year

While it would be possible to eliminate exemptions representing clear policy choices, that would entail an undesirable about-turn in the direction of government policy and, in some cases, create significant hardship requiring a targeted programme of assistance for the worst-affected to minimise the pain. However, where exemptions and zero-rated supplies are inefficient in their scope, poorly targeted, or no longer effectively support other government objectives, they should be considered for removal to expand the VAT base.

Table 5: List of zero-rated and exempt supplies in the VAT system

VAT ZERO-RATED SUPPLIES	VAT EXEMPTIONS
1. Exported goods	1. Unprocessed foodstuffs, agricultural products, and livestock
2. International transportation of goods or passengers	2. Postage stamps
3. Domestic supply of:	3. Financial and insurance services
a. Educational materials used in schools, colleges, universities, and institutions engaged in adult education, vocational or technical education, or training for handicapped persons	4. Supply of unimproved land
b. Seeds, fertilizers, pesticides, and hoes	5. Sale, leasing, and letting of immovable property, excluding commercial premises
c. Cereals where these are grown, milled, or produced in Uganda	6. Education services
d. Sanitary towels and tampons and the inputs for their manufacture	7. Veterinary, medical, dental, and nursing services
e. Supply of leased aircraft, parts, and maintenance equipment	8. Social welfare services
f. Handling services with respect to medical supplies funded by donors	9. Betting, lotteries, and games of chance
	10. Supply of goods as part of a transfer of business as a going concern
	11. Burial and cremation services
	12. Passenger transportation services, except travel and tour operators
	13. Petroleum fuels subject to excise duty
	14. Dental, medical, and veterinary equipment
	15. Animal feeds and premixes
	16. Machinery, tools, and implements suitable for use only in agriculture
	17. Crop extension services
	18. Irrigation works, sprinklers and ready-to-use drip lines
	19. Deep cycle batteries, composite lanterns, and raw materials for their manufacture
	20. Menstrual cups
	21. Agricultural insurance premiums or policies
	22. Photosensitive semiconductor devices, light-emitting diodes, solar water heaters, solar refrigerators, and solar cookers
	23. Lifejackets, life-saving gear, headgear, and speed governors
	24. Any goods and services to the contractors and subcontractors of hydroelectric power, solar power, geothermal power or biogas, and wind energy power projects
	25. Bibles, Qur'ans, and textbooks
	26. Supply of movie productions

Source: Value Added Tax Act, Second and Third Schedule

Another constraint to the productivity of VAT is the relatively small VAT register relative to reasonable expectations given the amount of business activity in Uganda. The 2019 TADAT assessment indicated that at the end of FY2017/18, URA recorded 16,499 VAT-registered taxpayers. However, research indicates that a large proportion of these are small taxpayers, or in net offset positions. The table below uses data from FY2016/17 (the latest data made available for the study) and suggests a small number of VAT taxpayers account for a large proportion of VAT revenue. In FY2016/17, URA recorded 21,095 VAT taxpayers, of which 65% were net VAT payers, 14% were perpetual nil-filers, and 21% were perpetual off-setters (Lakuma, 2019). Furthermore, research indicates that 96% of VAT collected is paid by large taxpayers, with turnover above UGX 500 million. Ensuring the compliance of smaller taxpayers who do not file or are largely offsetting is administratively burdensome and can lead to the misallocation of compliance efforts.

Table 6: Distribution of the VAT register

Turnover band	Number of net taxpayers	Number of nil-filers	Number of offsetting taxpayers	Share of net taxpayers
<150 million	5,684	2,954	1,633	41%
150 million – 500 million	2,953	-	927	21%
> 500 million	5,133	-	1,811	37%
Totals	13,770	2,954	4,371	
% of total registered	65%	14%	21%	

Source: Lakuma, 2019, "Working paper: Increasing the VAT threshold"

Targeted Challenges

- (i) **Obtaining the optimal balance between the VAT threshold and rate to maintain a strong revenue yield while reducing barriers to firm growth.** The registration threshold should aim to alleviate the administrative burden, limiting the number of taxpayers to monitor, and exclude smaller businesses where the compliance and administrative costs are likely to outweigh the small amount of revenue received. While a lower threshold widens the tax base, a threshold that is too low generates administrative problems, as small businesses generally do not keep adequate accounting records. Furthermore, many smaller businesses are in net-VAT refund positions, threatening the sustainability of the VAT system. The current standard VAT rate is regionally comparable, however a rate change, together with a threshold adjustment, has strong redistributive potential.
- (ii) **Although most VAT exemptions support government objectives or reflect genuine collection difficulties, some may no longer be justified.** Exemptions are typically justified for goods and services which are administratively difficult to tax (such as the supply of financial services) or are consumed primarily by the poor. Exemptions are also applied to support certain key sectors and to improve equity by not taxing the supply of educational, medical, or social services. However,

extensive VAT exemptions cause distortions, can break the VAT chain, cost revenue, and increase the administrative burden. Furthermore, exemptions create the impression that taxes are not applied equally or fairly, and that some receive benefits while others are excluded.

- (iii) **Many VAT zero-rated supplies support government welfare objectives, however, expansions to this should be limited as zero-rating supplies leads to revenue leakages, increases the administrative burden, and negatively impacts transparency.** The practice of zero-rating non-export items is standard, but zero-rating has expanded beyond exports, eroding the tax base. This has been done to incorporate various progressivity features in the tax system, such as zero-rating the supply of drugs and medicine, educational materials, and certain agricultural supplies. However, international evidence suggests that this is an inefficient way of supporting the poor as multiple zero-rates reduces the productivity of VAT, drying up government funds needed to support the poor – zero-rating goods and services benefit the rich more than the poor because the rich spend more. Leakages occur as VAT is not applied to the final product, but input credits are allowed.
- (iv) **Government’s failure to provide counterpart funding on donor-funded projects creates distortions in the management of and accountability for VAT.** Partly due to this failure, the Government introduced “deeming”, whereby the tax payable on a supply made by a supplier to a contractor on an aid-funded project is *deemed to have been paid* by the supplier. This has continued the problem rather than solved Government’s failure to pay and created opportunities for abuse as suppliers claim that supplies went to Government when, in fact, they went to third parties. The expansion of the deeming provisions has eroded the revenue base.
- (v) **Government is failing to pay for its own consumption, undermining the ability of contractors to meet their tax obligation.** This contributes to a large stock of arrears, negatively affects the cash flow of businesses, and is damaging to tax morale as businesses are less inclined to comply with their tax obligations when Government is not seen to comply itself. The failure of Government to budget properly for its own procurement should be addressed immediately.

Interventions

- (i) **Review the current VAT threshold and rate to ensure that together these minimise administrative and compliance costs, encourage small business growth, and safeguard revenues.** The effects of allowing businesses below the threshold to voluntarily register for VAT should also be examined in this review. Issues to be considered include the likely impact on inflation, barriers to firm growth, the impact on economic growth, disparity within the EAC, and the impact on welfare. Any rate change should be accompanied by an enforceable obligation

on URA to pay VAT refunds on time and increase transparency for taxpayers around the refund process.

- (ii) **Remove unnecessary VAT exemptions to curb unjustifiable revenue leakages, while maintaining those that support Ugandan welfare and economic objectives.** Over the DRMS period, the list of VAT exempt items under the Second Schedule of the VAT Act will be reviewed, and exemptions that result in unfair competition or do not effectively benefit the targeted parties should be removed. In particular, exemptions applied to fee and commission-based services and insurance brokerage should be considered for removal. Furthermore, the definitions of certain items should be tightened to remove scope for abuse.
- (iii) **Limit the range of zero-rated supplies as far as possible.** The definition of zero-rated drugs and medicines should be tightened to limit abuse and zero-rating should be limited to local pharmaceutical producers, while imported drugs and medicines should rather be exempt. Certain items on the list of zero-rated supplies should be considered for removal, including the supply of cereals (as the threshold protects small businesses) and the leasing of aircraft, engines, spare parts, and maintenance (as the rationale is unclear).
- (iv) **Review the policy on deeming to allow the VAT system to function normally.** Where necessary, deeming should be limited to special circumstances where its application upholds the integrity of the VAT system. Simultaneously, all other supplies to Government should be made VAT-able to limit distortions. The main effect of this policy change would be budget-neutral, although, to the extent that this prevents abuse of the provisions, it would be revenue-positive.
- (v) **Government must exercise more discipline in budgeting for its own consumption and executing that budget accordingly.** Government should unequivocally honour its commitment to pay contractors on time. While this is not exclusively a VAT issue, non-payment undermines the short-term VAT yield and has a negative impact on tax morale.

Enhance the Income Tax System

The income tax system comprises several instruments: corporate income tax (CIT), personal income tax (PIT), including the Pay As You Earn (PAYE) withholding system, rental income tax, and withholding taxes, including on interest, dividends, professional fees, and assets purchased from non-residents. Special regimes apply to the taxation of incomes earned in the petroleum and mining sector, as well as small businesses with turnover less than UGX 150 million per annum, who are taxed on turnover rather than on chargeable income. The principle of progressivity underpins these taxes – those who earn more, should contribute more through taxes.

Table 7: Income tax yields in EAC region, 2015

Annual turnover	Number of taxpayers	Effective tax rate
Turnover less than UGX 2bn	23,323	2.06%
Turnover between UGX 2bn and UGX 15bn	1,732	0.85%
Turnover greater than UGX 15bn	577	1.09%

Source: ICTD/UNU-WIDER (2018)

Revenue yield from CIT as a percentage of GDP in Uganda is lower than other EAC countries, despite having the same CIT rate. Uganda also records CIT productivity¹⁴ around 10%, considerably lower than the Kenyan productivity of 14% or Ghanaian at 25% (World Bank, 2017).

This low yield can (at least partially) be explained by a divergence between the nominal tax rate (30%) and the low effective tax rate on net chargeable income. Research indicates effective rates of 1-2%, and the burden of taxation does not fall equally on taxpayers, with smaller taxpayers bearing a higher effective rate, affecting the progressivity of CIT (see table below). The divergence is partially due to the wide range of exemptions and allowable deductions, through which companies reduce their chargeable income. These include allowances for expenses on scientific research, depreciation, plant and machinery, and losses carried forward. Other explanatory factors include sophisticated domestic and international tax planning schemes by large domestic and multinational groups, administrative capacity constraints, and technology which evolves faster than the tax administration can adjust.

Table 8: Effective tax rates by size of taxpayer

	CIT rate	CIT revenue to GDP	PIT revenue to GDP
Uganda	30%	0.88%	2.17%
Kenya	30%	3.65%	4.47%
Rwanda	30%	2.60%	3.72%
Tanzania	30%	1.30%	2.04%

Source: Tax Policy Department (2019)

With respect to PIT, research has found lower contributions to revenue than for many regional comparators (see Enhance the Income Tax System

Table), mainly due to substantial tax avoidance and under-declaration, a relatively small share of formal sector employment, and weak compliance efforts on the administrative side. Furthermore, the use of tax reliefs and exemptions by certain groups undermines the progressiveness of the system. Certain classes of employees, by the nature of either their

¹⁴ CIT productivity reflects how well the tax performs in terms of revenue collection, given the tax rate. It is given as the portion of GDP in revenue that is mobilised for each point of CIT rate.

work or their residence, are not taxed, affecting perceptions of fairness and equity (World Bank, 2017).

One indication of non-declaration is the size of the PIT register relative to the size of the labour force. The Uganda National Household Survey indicates that the employed population amounts to almost 9 million (UBOS, 2017), while URA records only 1.2 million individual taxpayers¹⁵. Similarly, a study comparing levels of income reported on returns filed with the URA in 2015/16 with data from the Uganda National Panel Survey (UNPS)¹⁶ found significant levels of underreporting and non-declaration. The gross tax gap, defined as the difference between the implied baseline tax liability owed and the amount voluntarily remitted by taxpayers, was found to be more than UGX 1,700 billion (Lakuma, 2018). Against an estimated tax liability of UGX 3,382 billion, this implies a non-compliance rate of 53%. The bulk of this gap was attributed to non-payment by those who, according to the incomes declared in the UNPS, had a tax liability but did not remit any tax. Some of this tax gap is recovered through audit, compliance, and enforcement efforts by URA, and the remaining unpaid liability is referred to as the “net” tax gap. It was estimated that collection efforts by URA in FY2015/16 recovered UGX 130 billion, leaving a substantial UGX 1,652 billion “uncollected” (Lakuma, 2018).

Table 9 shows the performance of CIT, PAYE, and rental income tax relative to GDP in recent years. These taxes should be naturally responsive to GDP growth, given the stability in the tax rates, increases in the workforce and company registrations as the economy grows, and fiscal drag since thresholds have not been adjusted for inflation. CIT has performed inconsistently since FY2013/14, with revenue spikes followed by weak growth. This volatility is partially due to erratic compliance and enforcement action, as well as the settlement of disputes. PAYE revenue growth has consistently outpaced GDP growth, however outturns are subdued relative to growth in the labour force.

¹⁵ This is discussed further in the section on taxpayer registration [below](#).

¹⁶ Adjustments were made to the UNPS data to ensure comparability with URA data. Only those who indicated enough income to file returns and have a tax liability were included in the analysis.

Table 9: Income tax performance relative to GDP

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
CIT revenue (UGX bn)	486.64	714.77	732.16	764.27	884.80	1,167.75
CIT revenue to GDP	0.59%	0.79%	0.73%	0.70%	0.74%	0.91%
CIT as % of net revenue	5.9%	7.2%	6.4%	6.0%	6.1%	7.0%
YOY growth in CIT-to-GDP ratio		0.19	-0.05	-0.03	0.03	0.17
CIT revenue growth rate		46.9%	2.4%	4.4%	15.8%	32.0%
PAYE revenue (UGX bn)	1,397.56	1,613.24	1,803.53	2,114.99	2,396.11	2,811.30
PAYE revenue to GDP	1.70%	1.78%	1.81%	1.95%	1.99%	2.19%
PAYE as % of net revenue	17.0%	16.2%	15.9%	16.5%	16.5%	16.9%
YOY growth in PIT-to-GDP		0.08	0.03	0.14	0.04	0.20
PAYE revenue growth rate		15.4%	11.8%	17.3%	13.3%	17.3%
Rental tax revenue (UGX bn)	-	27.65	55.03	71.74	88.75	115.23
Rental tax revenue to GDP	-	0.03%	0.06%	0.07%	0.07%	0.09%
Rental tax as % of net revenue	-	0.28%	0.48%	0.56%	0.61%	0.69%
YOY growth in Rental-to-GDP	-	-	0.03	0.01	0.00	0.02
Rental tax growth rate	-	-	99.0%	30.4%	23.7%	29.8%
Nominal GDP (UGX bn)	82,100.48	90,839.96	99,733.72	108,518.04	119,906.66	128,498.97
Nominal GDP growth rate		10.6%	9.8%	8.8%	10.5%	7.2%

Source: Tax Policy Department (2019)

The underperformance of income taxes partly explains why Uganda has not met its revenue potential, and the current system does not meet the objectives of equity and administrative

simplicity. Through various measures, over the DRMS period, Government plans to lift the contribution from CIT and non-salaried personal income tax.

Targeted Challenges

Corporate Income Tax

- (i) **The wide range of allowances, including capital allowances, and deductions reduce chargeable income and the effective tax rate.** Uganda has historically used taxation instruments, including limited exemptions and holidays, to pursue economic growth and investment. The success of this approach is reflected in the businesses that have chosen to invest in Uganda, but it has had an impact on the overall tax yield. This is particularly reflected in the CIT performance. For instance, the capital allowances, including depreciation allowance, initial allowances, and industrial building allowance, are more generous than economic depreciation, ultimately contributing to the large tax losses claimed by businesses. In addition, the ability to carry forward losses indefinitely may incentivise companies to remain artificially in a tax-loss-making position, over-claiming losses. Tax losses carried forward within the CIT system are currently substantial and distort the yield from CIT.
- (ii) **The increased integration of Uganda's economy with the global economy introduces significant tax risks which erode tax yields.** The pursuit of investment, employment and growth opportunities has fuelled tax competition and places pressure on policy-makers to match various initiatives with a suite of base-eroding domestic tax incentives. This challenge is further compounded by the fact that most jurisdictions (including some of Uganda's major investment and trading partners), operate territorial tax systems, creating an incentive for off-shoring income that would ordinarily be classified as Ugandan-sourced. Recommended interventions at the international level such as the OECD/G20 BEPS actions go some way to addressing Uganda's international tax concerns, but do not fully cater for two major risks:
 - a. The inequitable sharing of taxing rights under double taxation agreements (DTAs). While DTAs were initially contracted to assure foreign investors of a predictable and internationally-accepted tax environment, and to facilitate off-shore tax administration, the evidence suggests that these are not necessarily associated with increased investment from treaty partners. Instead, multinational companies from non-treaty partners routinely "locate" in certain jurisdictions simply to exploit treaty benefits, such as a lower withholding rate, undermining the income tax base. Recently, there has been a global shift towards a more balanced approach to DTAs which better protect the interests of capital-importing, developing countries and eliminate abuse through tax planning and treating shopping. The extent of Uganda's exposure can be illustrated by recent FDI figures: FDI stocks from the Netherlands were almost

three times larger than any other country in 2016, while the United Kingdom and South Africa also rank in the top ten FDI source countries, as are Bermuda and the Seychelles, known tax havens (Bank of Uganda, 2018).

- b. Weak enforcement of regulations against international tax planning. For example, to curb transfer pricing¹⁷ malpractice, regulations were developed to require associates to price their transactions following an arms-length principle, as if they were independent entities. This aims to control the planned shifting of profits to other jurisdictions. However, this is difficult to enforce in practice as data on independent transactions to form a basis for such arms-length pricing is almost impossible to obtain.
- (iii) Poor transparency and weak access to information on taxpayers' transactions hampers enforcement, especially countering the domestic hidden economy, cross-border tax evasion, and illicit financial flows.** There is a need to enhance data sharing and transparency on transactions within the country and between jurisdictions, as well as enhance information-sharing between government agencies, including mutual assistance frameworks, particularly for the EAC. For instance, under the American Foreign Account Tax Compliance Act (FATCA), Ugandan financial institutions are obliged to report on assets and accounts held by US citizens in Uganda to the US Department of the Treasury. However, no reciprocal arrangement is in force. Other countries have signed inter-governmental agreements with the US to rebalance these reporting requirements and encourage mutual assistance.

Personal Income Tax

- (iv) Lopsided PIT exemptions create a non-neutral system and endanger tax morale.** Feedback from taxpayers and tax professionals suggests that, even though the direct yield implications may be quite small, such exemptions discourage compliance and encourage others to clamour for similar treatment, leading to exemption creep. Particularly problematic exemptions include those applied to judges, some streams of income for Members of Parliament, and expatriates and employees under donor-funded programmes.
- (v) The current PIT thresholds start at low levels of income and the progressivity of rates is steep.** This may encourage non-compliance or less-than-full compliance and reduces incentives to work in the formal sector, as well as disproportionately disadvantages employees whose incomes are taxed at source under PAYE. 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

¹⁷ Transfer pricing refers to the manipulation of prices charged by different arms of the same multinational corporation for goods, services, and financing to artificially reduce taxable income in high-tax jurisdictions, or to artificially inflate the taxable income reported in low-tax jurisdictions.

an exchange rate of UGX 3,702 to the US dollar¹⁸, taxation of income thus begins at US\$2.12 per day. Considering that the international poverty line is just US\$1.90 per day¹⁹, PIT appears to start at very low income levels. Furthermore, the third band is very wide, applying to annual incomes between UGX 4,920,001 and UGX 120,000,000 (see table below). 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 US\$3.69.

Table 10: Income tax rates and thresholds for residents

Chargeable Income Threshold, Per Annum (US\$ equivalent)	Rate
< UGX 2,820,000 (< US\$761.75)	0%
UGX 2,820,001 – UGX 4,020,000 (\$761.75 – \$1,085.90)	10% of amount by which income exceeds UGX 2,820,000
UGX 4,020,001 – UGX 4,920,000 (\$1,085.90 – \$1,329.01)	UGX 120,000 plus 20% of amount by which income exceeds UGX 4,020,000
UGX 4,920,001 – UGX 120,000,000 (\$1,329.01 – \$32,414.91)	UGX 300,000 plus 30% of amount by which income exceeds UGX 4,920,000
> UGX 120,000,000 (\$32,414.91)	Extra 10% of income more than UGX 120,000,000

Source: Income Tax Act, Part II

- (vi) **There is a perception that the current Income Tax Act does not sufficiently promote savings.** Various instruments to encourage savings are provided, including exempting pensions, lump sum payments made by resident retirement funds, and proceeds from life insurance policies from taxation. However, more can be done within the tax system.

Taxation of Small and Medium Enterprises

- (vii) **The tax burden on SMEs is significant in terms of its compliance costs.** To be tax compliant, SMEs are required to keep detailed records of accounts, and in some cases engage the services of a tax expert to determine their tax obligation. This led to the introduction of a presumptive tax regime, which has a higher effective tax rate (1.5% of turnover) than that borne by many larger firms. The incentives regime does not apply to SMEs, and Government does not offer SMEs any dedicated incentives to grow and formalise.

Rental Income Tax

- (viii) **Widespread under-reporting of income arising from the renting of both residential and commercial premises.** Property owners do not fully disclose rental income, shift costs from loss-making to income-generating properties to

¹⁸ This approximately reflects the Bank of Uganda's mid-market buying rate for January 2019.

¹⁹ In 2015, the World Bank revised the international poverty line upward from \$1.25 to \$1.90 per day.

reduce tax due and have been exploiting the law that exempts resident owners from paying tax. Furthermore, information from various regulatory obligations, such as approval of construction plans by the local authority and site inspections, is not exploited to identify property owners and support tax compliance. Without action, the leakages that these distortions create are likely to expand as the Ugandan economy continues to grow and formalise.

Interventions

Corporate Income Tax

- (i) **Rebalance the nominal rate and the incentives, deductions, and tax depreciation regime to increase effective corporate rates.** There are broadly two options: limiting allowable deductions or the amount of losses that can be offset. The number of allowable deductions should be reviewed, considering an alignment of tax depreciation with economic depreciation, where appropriate in accordance with national objectives. Secondly, consider the option of limiting the amount of the losses that can be offset each year to a proportion (e.g. 50%) of the profits of each future year that would otherwise be taxable. This ensures that a company claiming to offset historic losses against future taxable trading profits would have to pay some CIT. Losses can be thus be relieved in full, but companies can no longer avoid paying tax indefinitely by using strategies that “refresh” the losses carried forward. This system is also less likely to be distorted in favour of large companies. The proposal is also consistent with good international practice and modernises an underperforming tax, while generating revenues from large companies that may historically have paid little tax in Uganda.
- (ii) **Renegotiate all existing DTAs to bring them in line with the Ugandan DTA policy.** This is particularly relevant for the treaties with the Netherlands and Mauritius, both of which have had a high impact. Refrain from contracting new DTAs, although if required these should be aligned to the principles of the approved DTA policy. Rather than DTAs, the Government should focus on promoting Tax Information Exchange Agreements and mutual assistance procedures, consistent with global practice, to strengthen URA’s compliance efforts. This will require additional resources, in terms of systems and manpower to manage the exchange of information, and the use of this information, particularly for audit and investigations.
- (iii) **Modify source rules and transfer pricing provisions to protect Uganda’s tax base against tax avoidance and tax planning.** This should include adapting source rules to subject any income attributable to a branch in Uganda to force-of-attraction rules, modifying transfer pricing provisions to cover all intra-company transactions and limit the ability for domestic businesses to shift profits, and tighten protections against excessive revenue losses from non-resident management and service fee charges. Finally, Uganda should ensure that it satisfies all the criteria for

obtaining information available under the country-by-country reporting requirements of the Base Erosion and Profit-Shifting (BEPS) project.

- (iv) **Enhance the sharing of information within Uganda and between tax jurisdictions to facilitate mutual support.** This should include strengthening the platform for exchange of information by pursuing agreements to facilitate the automatic exchange of financial accounting information, country-by-country reporting by multinational enterprises, tax examinations abroad, mutual assistance procedures, and assistance in recovery. Uganda will consider signing an EAC Tax Information Exchange Agreement, as well as work towards enhancing the application of the Multilateral Convention on Mutual Administrative Assistance in tax matters. Locally, access to information between government agencies and within URA should be improved. This requires standardising the manner of capturing information and increasing the use of the National Identification Number as the principal identifier for accessing government services.

Personal Income Tax

- (v) **Review PIT exemptions for public officials and expatriates and consider their removal.** For taxation to have a positive effect on accountability, taxes should be felt by most citizens, including government servants. Furthermore, exemptions applied to expatriates under donor-funded programmes should only be applied to employees where double taxation is a legitimate concern. Unjustified tax exemptions are damaging to perceptions of fairness in the regime and can disguise the true levels of income.
- (vi) **Review the PIT thresholds and bands to ensure that the tax system does not unfairly reduce disposable income.** Any changes in the thresholds or rate bands will need to take account of likely revenue losses and behavioural shifts in income declaration but recognise that there may be an increase in declared work if the tax burden is perceived to be lower.
- (vii) **Develop a stronger policy to encourage savings and investment, particularly for retirement.** This could include adopting an “Exempt-Exempt-Tax” model for the taxation of pensions, ensuring that both employer and employee pension contributions are tax deductible, making contributions to life insurance policies tax deductible (up to a certain cap), and enhancing the benefits that firms receive for listing on the stock exchange.

Taxation of Small and Medium Enterprises

- (viii) **Review the current presumptive tax regime to encourage the growth and formalisation of SMEs.** Review the overall tax and licensing regime to reduce the number of rates and curb tax planning. Rates should be realigned to the objectives of the tax, improving equity and fairness, and to improve their use as a compliance and tax education tool.

- (ix) Expand the use of the withholding tax instrument as a tool for promoting compliance rather than raising revenues.**

Rental Income Tax

- (x) Rationalise the rental income tax structure to minimise abuse and profit-shifting.**

Tax Incentives and Exemptions

Incentives, although sometimes necessary to attract investment, develop the private sector, encourage employment, and support social welfare, pose a risk to the expansion of the tax base and revenue. Uganda's current tax structure provides for several generous exemptions, beyond the exemptions already discussed under VAT:

- Under Schedule V of the EAC Customs Management Act, 2004, certain goods are exempted from all taxes. This applies to, among others, various agricultural equipment and inputs, such as tractors, feeds, fertilisers, breeding stock, and refrigerated trucks; imported aircraft and aircraft accessories; approved educational materials; equipment for use in the oil and gas sector; solar and wind energy equipment; certain equipment for use in the hotel and tourism sector, including washing machines, air-conditioning, furniture, and motor vehicles; and certain equipment for use in hospitals.
- Export promotion: all packing materials are exempt from taxation when imported to pack goods for exportation; and raw materials used in the production of goods meant for export are allowed a duty draw-back, whereby import duties paid on inputs are refunded.
- Investment promotion: investors who make investments of at least USD 50 million for foreigners or USD 10 million for residents are granted a 10 year corporate income tax holiday.²⁰
- Manufacturing: a 10-year tax holiday is granted to exporters of finished consumer and capital goods, so long as at least 80% of produce is exported.
- Agro-processing: investors engaged in agro-processing and fulfilling certain narrow criteria are granted an income tax exemption. The exemption is renewable on a year-by-year basis.
- Petroleum and mining: special income tax deductions and exemptions are applied to companies in this sector, such as 100% depreciation of assets acquired for exploration.
- Discretionary exemptions granted to individual companies, which essentially function as private contracts between government and a third party, as well as effective exemptions where Government agrees to pay tax on behalf of a company.

²⁰ These thresholds were reduced in the Income Tax Act amendment of 2019 and apply to investors operating in industrial parks or free zones, or established investors who make an additional *new* investment.

Statutory exemptions allow Government the discretion to vary the conditions of the incentives, such as the timing and the scope, by changing the law. Discretionary exemptions, however, are ad hoc, are determined subjectively, create non-neutralities and administrative complexities, and put non-targeted firms at a disadvantage. Both types risk the integrity of the tax system, are not well-monitored currently, and their application and true cost is opaque. Finally, they can lead to a harmful “race to the bottom”, where nations adopt new tax incentives to remain regionally competitive in attracting private and foreign investments.

Exemptions and incentives have been historically successful in securing business investment. However, given that the tax base in Uganda is already narrow by international standards, Government now faces a trade-off between raising vital revenues and granting further incentives. International evidence suggests that while tax incentives might attract some additional investment, they are rarely a leading consideration. Investors consider an economy holistically, and the availability of skilled labour, adequate infrastructure, security, and policy stability are more important factors than a specific tax incentive. There is an urgent need to ensure that incentives are not given for activities that would have been undertaken without government financial support of this nature.

The table below gives an indication of the “revenue foregone” from tax incentives and exemptions, from the URA Exemptions Report 2017/18. Total revenue foregone in FY2017/18 amounted to less than 1% of GDP. Considering that many of these reflect active policy choices not to collect revenue (for instance, exempting educational materials from VAT), the real “revenue foregone” through irregular exemptions is not large. Indeed, international trade accounts for the largest percentage of revenue foregone, but the bulk of this is attributable to exemptions applied to imports under Schedule V of the EAC Customs Management Act, which Uganda does not have the unilateral ability to alter. This table does not, however, account for revenue foregone through discretionary incentives and exemptions historically given to individual companies, as URA does not currently track the revenue foregone due to these exemptions. In FY2016/17, these tax expenditures amounted to over UGX 104 billion. Furthermore, the current approach used by URA only includes income tax exemptions related to Section 21 of the Income Tax Act and do not account for initial allowances for exporters with exemption certificates and losses carried forward.

Table 11: Revenue foregone through tax exemptions (UGX billions)

	FY2014/15	FY2015/16	FY2016/17	FY2017/18
Income tax exemptions	9.25	10.91	12.09	14.0
VAT exempt supplies	252	298	77.08	30.11
VAT zero-rated supplies	33.70	39.93	28.85	30.11
Deemed VAT	92.74	147.39	105.65	202.59
International trade	666.43	590.10	553.54	513.97
Total revenue foregone	1,054.12	1,086.33	907.76	871.68
As a % of GDP (2009 base)	1.34%	1.24%	1.00%	0.86%

Source: URA Exemptions Report FY2017/18

A major challenge in the administration of tax exemptions and incentives in Uganda is the opacity in their governance. Increasingly, nations have developed frameworks for evaluating tax expenditures, to record and analyse the costs and benefits of all provisions that reduce the amount of revenue collected through special treatment of a particular class of individual, income, or industry. These typically encompass:

- a. An instrument (legal or otherwise) that restrains any authority from granting discretionary incentives in whatever form. Discretionary incentives undermine the tax system and disempower the tax administration in the course of their work;
- b. Subject each new proposed exemption or exception to existing policies to an extensive cost-benefit analysis, making impact evaluation a routine part of policy-making. Those that do not meet pre-specified criteria are automatically rejected;
- c. Assess whether existing exemptions are still relevant, publicly disclosing the results of this analysis to promote transparency; and
- d. Establish a ceiling on VAT exemptions and propose sunset clauses on existing exemptions.

Targeted Challenges

- (i) **Lack of a comprehensive Tax Expenditure Framework contributes to abuse of the system, limits the ability to monitor the effectiveness of tax expenditure, and reduces transparency in the governance of tax holidays, including the process for assessment and approval.** Without a proper mechanism to monitor the effectiveness and cost of incentives and exemptions, Uganda risks unintended revenue losses. Furthermore, URA's current annual Tax Exemptions report does not capture all revenue that Government has decided not to collect through statutory exemptions and deductions, including the treatment of losses carried forward, nor does it capture the cost of discretionary exemptions.

Interventions

- (ii) **Establish an appropriate, evidence-based Tax Expenditure Governance Framework to limit leakages and improve transparency.** This should include the four components given above and an annual tax expenditure report should be published as part of the Budget papers, to disclose to what degree compliance with exemption ceilings is being achieved. Any further income tax exemptions should be made on a statutory basis (as per the Tax Expenditure Governance Framework), ensuring that eligibility can be re-assessed periodically.

Improve the Excise Duty Regime

Excise duties are traditionally designed to address negative externalities and influence consumer behaviour, such as taxing alcohol and cigarettes. However, over time Government has shifted the policy approach to broaden the range of motivations and tended, instead, to use excise duties as a revenue-raising tool, introducing taxes on mobile money, airtime, sugar, cement, and cooking oil. Over-emphasis on revenue yield from excises has implications for Uganda's regional competitiveness and creates distortions within the EAC, partly because Uganda has opted to impose excise duties on non-traditional items which are not taxed elsewhere. Furthermore, stakeholder feedback indicates that taxpayers are overburdened by numerous taxes on the same commodities, creating high incentives to evade taxation and a compliance challenge.

Revenue from excise duties is normally responsive to growth in GDP, as more prosperous consumers purchase more excisable products. In most years, excise revenues have grown faster than GDP, partly attributable to increases in the variety of excisable products. However, these increases have been highly volatile from one year to the next. Government now seeks to take a smarter approach to excise duties, reducing complexity, ensuring buoyancy, and properly balancing revenue needs with targeting negative externalities.

Table 12: Excise duty performance relative to GDP

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Excise revenue (UGX bn)	700.43	834.59	916.88	1,059.18	1,150.77	1,533.59
Nominal GDP (UGX bn)	82,100.48	90,839.96	99,733.72	108,518.04	119,906.66	128,498.97
Excise revenue as % of GDP	0.85%	0.92%	0.92%	0.98%	0.96%	1.19%
Excise as % of net revenue	8.5%	8.4%	8.1%	8.3%	7.9%	9.2%
YOY growth in excise-to-GDP		0.07	0.00	0.06	-0.02	0.23
Excise revenue growth rate		19.2%	9.9%	15.5%	8.6%	33.3%
Nominal GDP growth rate		10.6%	9.8%	8.8%	10.5%	7.2%

Source: Tax Policy Department (2019)

Targeted Challenges

- (i) **Imposing excise duties on unconventional products as a revenue-raising measure is counter-productive.** Imposing excises on non-traditional products disregards the underlying principles of an excise duty, creates regional distortions, affects the business and investment climate, and unnecessarily burdens consumers. Furthermore, the frequent introduction of and adjustments to excise duties creates

policy design weaknesses, and some excise tax rates may not be optimally set to balance revenue maximisation and the deterrent effect on consumer behaviour. If the rate is set too high, consumers shift to alternative goods, society incurs higher losses, and government collects less revenue. Initial diagnostic work undertaken in collaboration with the World Bank (2017) indicated that there is scope to increase certain rates, for instance those applied to cigarettes, rather than continually impose new rates.

- (ii) **The excise regime on pollutants is not comprehensive.** For instance, a tax of 35% is imposed on every person that imports motor vehicles older than 5 years, and 50% for vehicles older than 10 years (excluding goods vehicles). Currently a four-and-a-half-year-old car attracts no tax, whereas a five-year-old car of almost identical value and environmental impact is taxed. This system has two major problems: a limited tax base and no scope to capture pollution through continued use. Furthermore, there is untapped potential to expand this Environmental Levy to cover other pervasive pollutants.
- (iii) **Multiple rates for certain products have created opportunities for tax planning and abuse.** For instance, the excise duty applied to beer, wines and spirits is determined based on the source of raw materials. This was intended to incentivise the use of local content but has created scope for manufacturers to artificially inflate local content to gain a more favourable tax classification. This policy also diverges from international best practice by implicitly encouraging the consumption of local over imported alcoholic products, despite similar health implications.
- (iv) **Poor overall regulation of alcohol and other excisable products reduces the tax base and endangers consumers.** For instance, the lack of regulation of the production, distribution, and consumption of alcohol leads to the availability of illicit, untaxed alcohol.
- (v) **Specific tax rates lose value with inflation.** Uganda applies specific rates, or a mixture of specific and ad valorem rates, on approximately half of the categories of excisable products. However, no indexation policy has been systematically adopted to factor the impact of inflation into specific rates²¹. Over time, this dilutes their effectiveness and leads to revenue losses in real terms.
- (vi) **Lack of harmonisation on excise policy and rates within the EAC.** The objectives of harmonisation include facilitation of cross-border business, investment, and regional integration, but disparities exist between the excisable products and rates. This creates distortions and complicates compliance enforcement, undermining the principles of the Common Market.

Interventions

- (i) **Develop and adopt a more holistic approach to excise duties,** focussed on the core objective of addressing externalities. In the development of policy, seek to

²¹ Ad valorem rates, by construction, account for inflation.

adopt a rate which balances revenue yield, the cost to consumers, and the deterrent effect. To improve the stability of the tax system, limit the arbitrary introduction of new excisable items.

- (ii) **Develop a broader environmental tax.** The range of taxed pollutants should be expanded to reduce the harmful impact on health and well-being. Designing a smart and broad-based regime will require significant technical assistance and support. This should include capturing all vehicles brought into Uganda and address pollution through continued vehicle use, through an increase in the excise on fuel for instance. This has the added advantages of improving the equity of the regime, since vehicles younger than five years also pollute the environment and limits distortions in consumer behaviour.
- (iii) **Rationalise multiple rates, designing an alternative incentive scheme promoting the use of local content.** Excises on alcohol are applied in response to the negative externalities resulting from their consumption, so the price observed by consumers should not differ according to the source of the inputs. The current regime dilutes the tax based on the use of local content. Manufacturers could be more directly incentivised to use local input.
- (iv) **Introduce and enforce strict regulations with regards to the production, distribution and consumption of alcohol and other excisable products.** Beyond strengthening the excise law, Government needs to expedite the development of legislation to control the alcohol and tobacco industries, as well as other sectors.
- (v) **Adopt inflation-indexing or ensure that rates are reviewed and adjusted frequently.** This would limit revenue losses due to inflation and maintain the real value of rates. Reviewing rates regularly is cumbersome, time-consuming, and may not be politically feasible as it entails frequent revisions to rates, which industry lobbyists are likely to oppose. Inflation-indexing is thus preferred, and appropriate legal provisions should be made for automatic indexing.
- (vi) **Review and adopt an EAC-wide policy on the harmonisation of excisable products and the applicable rates.**

Develop a Strong Extractive Industry Taxation Regime

The prospects of mining and oil revenues in Uganda have improved in recent years, as the mining sector has experienced growth over the last decade and oil deposits have been discovered in the Albertine Graben basin bordering the Democratic Republic of Congo and South Sudan. Uganda ranks among the countries in Africa with the greatest mineral deposits, and the full potential of this has not yet been realised. Uganda is projected to receive oil revenue no sooner than FY2022/23 and these deposits have the potential to supply domestic needs, as well as exporting a significant surplus. However, given that natural resources are by nature exhaustible, it is in the interests of Government to have a prudent fiscal policy that attracts investment while ensuring the Government retains a reasonable share of revenues,

as these resources belong to the people of Uganda. Effective natural resource management will be critical to long-term development in Uganda and an appropriate approach to the use of natural resource revenues will help to prevent other sources of revenue remaining under-developed.

Furthermore, designing a strong fiscal regime is critical for attracting the investment Uganda needs to develop the sector. Frequent changes to the regime reduce investor confidence in its stability and the likelihood of sufficient returns. Thus, to limit pressure for future changes, Uganda should seek to impose a tax burden that is neither too high nor too low, and effectively administer this. The current VAT, withholding tax, and income tax rules may not be entirely appropriate for promoting the development of the sector, while ensuring that the Government is able to extract a reasonable share of tax and other revenues.

Targeted Challenges

- (i) **The current fiscal regime may not be appropriate for taxing the full value chain in the extractive sector.** The Government needs to balance the objective of attracting foreign investment, while ensuring its share of revenues. The current fiscal regimes for oil, gas, and mining are generally sound, however, the appropriateness of the regime for taxing the full value chain, including mid-stream and down-stream businesses, and related transactions is limited.
- (ii) **Several tax provisions applicable to natural resource companies should be provided for in the relevant tax legislation, rather than in mining and petroleum agreements.** There is a risk to government revenues if tax provisions are negotiated on a case-by-case basis as the licensee is likely to have better information about the value of the resource than Government and tax provisions will differ from agreement to agreement depending on the negotiations. This increases the administrative burden for URA and tax provisions in individual agreements cannot ultimately override the tax law.
- (iii) **The current law on income tax for petroleum companies does not optimally calculate chargeable income.** Currently, Uganda applies a “profit oil as tax base” approach, rather than the more common method of calculating gross income as both cost and profit oil. A decision is necessary on whether to make adjusted profit oil the base for application of the tax rate, or whether to return to the more common method of calculating gross income as both cost and profit oil.
- (iv) **International tax rules need to be strengthened to limit aggressive tax planning.** In particular, the withholding tax rules for technical fees paid to non-resident subcontractors need to be reviewed to ensure that Uganda does not give up taxing rights (Daniel, et al., 2015).
- (v) **The current VAT design might burden investment in the resource sector.** VAT applied to the exploration and development phases of a resource can potentially increase exploration costs and deter investment (Daniel, et al., 2015). Exploration expenditure is incurred before companies begin making taxable supplies.

Therefore, companies might face long-term cash-flow issues if exploration costs are VAT-able, and an absolute cost if exploration is unsuccessful.

- (vi) **Transparency and disclosure are important priorities for governance of the petroleum sector.** Cabinet has recently ratified Uganda's bid to become a candidate in the Extractive Industries Transparency Initiative (EITI). The EITI is a global standard for open and accountable governance of natural resources, aiming to increase transparency over payments and revenues in the sector. The EITI is both a standard and a process, giving a comprehensive framework for the review and validation of information from the industry (Global Witness, 2015).
- (vii) **While the fiscal regime for the mining sector places a reasonable tax burden on larger, lower cost mines, the higher tax burden faced by smaller, higher cost mines could deter investment in these types of mines** or encourage investors to request further investment incentives and exemptions from Government (NGRI, 2018). Granting such exemptions creates a fragmented and opaque tax system which is difficult to administer, provides opportunities for corruption, and encourages further requests for exemptions, which may be unnecessary.
- (viii) **High potential for oil revenues to crowd out other government revenues.** Cross-country research indicates that for each additional percentage point of GDP in resource revenues, there is a reduction in domestic non-resource revenues of about 0.3 percentage points of GDP (Crivelli & Gupta, 2014). This is primarily driven by a diversion of government attention from supporting the non-resource economy, a reduced enforcement effort on taxes on goods and services, and a risk of oil-related currency fluctuations affecting the competitiveness of other exports.

Interventions

- (i) **Review the fiscal regime and adjust to fully capture revenue streams and the full value chain of the extractive and mining sector.** Several features of a strong regime include: a royalty, to ensure government revenue from the time production commences; a CIT so that returns to equity are taxed in a similar way as other companies; and an additional tax to ensure the government obtains an increased share in economic rents of more profitable projects. These objectives in Uganda are achieved through royalties, CIT, and profit petroleum share, in the case of oil and gas, and the variable income tax for mining. However, it is important that the regime is not eroded and is effectively administered.
- (ii) **As far as possible, all tax provisions in mining and petroleum agreements should be catered for in the tax law.** This enhances uniformity and ensures that the Income Tax Act comprehensively covers all relevant tax laws. Mining and petroleum agreements should simply cross-reference the tax laws.
- (iii) **Adjust the Income Tax Act to optimise the calculation of chargeable income for petroleum companies.** Adopt the method of aggregating a licensee's cost and

profit oil as gross income, then applying allowable deductions to arrive at chargeable income. This two-stage calculation is preferable to using profit oil as the base for applying the tax rate, as it is more uniform and transparent (Daniel, et al., 2015).

- (iv) **Strengthen international tax rules by modernising the source rules for technical fees and the definition of “branch”.** Ensure that technical fees attributable to a Ugandan branch of a non-resident are taxed and review the withholding tax rate. Any future tax treaties, and any adjustments to existing ones, should preserve Uganda’s taxing rights in relation to lease payments and technical fees.
- (v) **Adjust the VAT structure to ensure that investment in resource projects is not hindered.** Options for the consideration include: (a) allowing companies to register voluntarily for VAT during the exploration and development phases of a resource project; (b) exempting imports by a subcontractor from VAT if the imports are for direct and exclusive use in a resource project, which will require significantly enhanced surveillance to prevent abuse²²; and (c) repealing the VAT exemption for petroleum products, combined with a simultaneous reduction in the excise on these products, which might be more politically challenging to achieve.
- (ix) **For enhanced transparency and scrutiny of the extractives sector, fully implement the practices of the EITI.** This will promote open and accountable management of the extractives sector and ensure transparency throughout the natural resource exploitation chain. To join EITI, the Government is now required to establish a multi-stakeholder group to oversee the implementation of the EITI, and the group is required to maintain a workplan, fully-costed and aligned with the reporting and validation guidelines established by the EITI board (Global Witness, 2015). Implementing EITI will require changing some legislation, for instance requiring that companies disclose the payments they make to the Government by type, origin, and project. These regulatory changes should be prioritised to ensure compliance with EITI standards.
- (vi) **Consider options within and outside of the tax system to encourage the investment in small, high-cost mines.** The government should avoid subsidising smaller, loss-making mines as this causes significant distortions, however methods to encourage private sector investment to promote the success of the industry should be considered.
- (vii) **Encourage a more active programme of engagement with international experts on the extractive industry sector.** Guided by the principles outlined in this DRMS, strengthening the management and administration of revenues from the sector should be prioritised. Stakeholder discussions, with the private sector

²² A similar exemption is currently applied to subcontractors of hydro-electric power, solar power, geothermal power or biogas, and wind energy projects.

and civil society, should be conducted before changes are made to the existing tax treatment.

- (viii) Ensure that non-resource tax revenues form a stable revenue base before oil revenues come online.** Fully adopting the measures outlined in the DRMS will go a long way to creating a stable non-resource base. Once oil revenues come online, the full benefit can only be realised if the tax administration does not become complacent about collecting non-resource revenues.

Promotion of International Trade

While the contribution of international trade taxes to overall revenue has diminished over time, it is still an important source of revenue (see Table). The downward trend has been driven by the higher-level objective of promoting trade, and the lowering of tariffs and trade barriers that this entails. Uganda is already a member of two trading blocs – the East African Community (EAC), a common market for goods, labour, and capital, and the Common Market for Eastern and Southern Africa (COMESA), a free trade area with twenty-one member states stretching from Tunisia to Eswatini. The importance of regional integration can be seen in the distribution of trade partners – in 2017, Kenya, South Sudan, the Democratic Republic of Congo, and Rwanda were the top five export destinations for Ugandan goods and services, accounting for over 40% of the total export value (UN Comtrade, 2019).

Table 13: Performance of import duties against GDP

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Duty revenue (UGX bn)	747.48	839.84	940.07	1,043.65	1,223.75	1,350.46
Nominal GDP (UGX bn)	82,100.48	90,839.96	99,733.72	108,518.04	119,906.66	128,498.97
Duty revenue to GDP	0.91%	0.92%	0.94%	0.96%	1.02%	1.05%
Duty as % of net revenue	9.1%	8.4%	8.3%	8.2%	8.4%	8.1%
YOY growth in duties-to-GDP		0.01	0.02	0.02	0.06	0.03
Duty revenue growth rate		12.3%	11.9%	11.0%	17.3%	10.4%
Nominal GDP growth rate		10.6%	9.8%	8.8%	10.5%	7.2%

Source: Tax Policy Department (2019)

In November 2018, Uganda joined many peers in ratifying the African Continental Free Trade Area initiative, which will establish the world's largest single market. Integration of this nature expands the possible market for domestic producers, attracts cross-border investments, creates employment through expanded demand and production potential, and enhances peace and security through regional cooperation. Furthermore, imported goods are essential

to industrialisation, and lowering trade barriers encourages growth by lowering the price of inputs.

Government is also pursuing a strategy for support to local industries, promoting import substitution. Competition from exporters such as China and India have hurt Ugandan manufacturers and protecting certain sectors will help to build growth-enhancing industries. Tariff measures have been the chief tool used to protect domestic producers, to encourage the consumption of targeted products that are produced in sufficient quantity and to an acceptable standard locally. However, it is likely that for every product where Ugandan manufacturers desire protection, trade partners will have a similar interest. Thus, pursuing protectionism to the exclusion of other objectives risks tariff escalation, harming exporters, and raising consumer prices (Frazer, 2017). Achieving a balance between the objectives of export promotion, raising revenue, and supporting domestic industries will be essential to the sustainability of trade.

Being a landlocked country, Uganda is dependent on ports in neighbouring countries for the import and export of goods. Poor monitoring of long trade corridors, porous borders, and the extensive use of warehouses have introduced opportunities for smuggling and tax evasion. Furthermore, customs administration experiences challenges in determining the value of imported goods and the tax due, as well as the accuracy of declarations. This can undermine domestic producers and introduces tax competition, as different values are assessed for different importers.

Targeted Challenges

- (i) Balancing the objectives of import substitution, export promotion, and revenue generation.** Policies designed to support local industries should minimise the harm to social welfare through increased consumer prices and should be well-targeted to growth-enhancing industries.
- (ii) TPD is involved in a wide range of trade policy issues, but resource constraints impact on the level of analysis undertaken.** The current level of analysis informing the determination of tariff rates and the granting of incentives is not sufficient. This risks revenue, introduces scope for poor targeting, and can cause policy errors – set a tariff too high and the net effect on the economy is negative, with a large deadweight loss, and can undermine the competitiveness of the economy.
- (iii) Trade is often constrained by procedural inefficiencies and poor infrastructure.** Poor coordination between the various border control agencies, including customs, immigration, internal affairs, and authorities responsible for the verification of the quality of goods, affects the ease of trade. There is scope for improving import and export processes to avoid constraining trade, while still protecting the primary interests of the country. Furthermore, weak infrastructure routinely delays the processing of persons and taxes.

- (iv) **Lack of a comprehensive warehouse management system.** A high proportion of goods move through bonded warehouses, which are intended to improve the ability of suppliers to manage their stock. However, poor management has created leakages.

Interventions

- (i) **Determine the optimal level of protection for domestic industries.** This should avoid unnecessarily undermining welfare, creating trade diversion, or propping up inefficient industries.
- (ii) **Develop capacity on trade issues at TPD.** This should include building models to analyse the effects of tariff changes, deepening the level of analysis of protectionist policies, and developing trade negotiating abilities.
- (iii) **Improve inter-agency coordination and infrastructure to facilitate trade.** This should include deploying an appropriate number of scanners and tracking devices at border posts, as well as ensuring that ICT connections are uninterrupted. The Uganda Electronic Single Window should be fully operationalised as this will lead to improved data-sharing among trade regulatory agencies and reduce the time it takes to process import and export documents.
- (iv) **Improve the management of bonded warehouses.** This can be done by enhancing the automation of procedures and improving monitoring of restricted entry to customs-controlled areas. This, and other administrative issues, are discussed more fully in the section on [targeted Customs improvement initiatives](#).

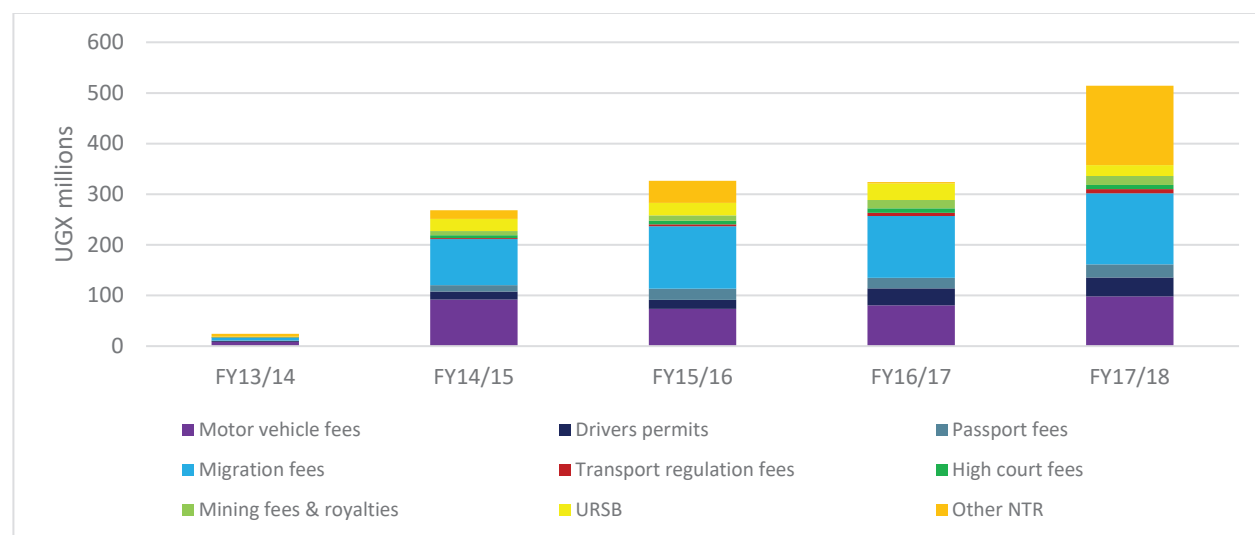
Improve the Effectiveness of Non-Tax Revenue

Non-tax revenue (NTR) includes all government revenue not derived from taxes, from both domestic and external sources. Domestic sources include user fees levied on the use of public services, such as rent for state-owned buildings, payments for government services, such as the issuance of permits, licences, and passports, mining and royalty fees, fines and penalties, and interest and dividends from government investments. External sources include grants and gifts from development partners, which have historically been the largest source of NTR.

Before FY2014/15, MDAs used a cash-based system for recording payments, which limited oversight of and accountability for revenues collected. The dramatic increase in domestic NTR collections between FY2013/14 and FY2014/15 (see Figure) has been attributed to replacing the cash system with a requirement to pay certain categories of NTR at a bank. The more recent improvement from FY2016/17 to FY2017/18 is largely due to Cabinet's decision that all MDAs should transfer the responsibility to collect NTR to the URA. Thus, from 1 July 2017, NTR was collected through the URA web portal and remitted directly to the Consolidated Fund, reducing the scope for leakage. NTR currently contribute around 0.5% of GDP and there is scope to improve NTR performance to at least 1% of GDP. In comparison, Rwanda collects approximately 2.6% of GDP in NTR, excluding grants, and Kenya collects approximately 1% of GDP (OECD/ATAF/AUC, 2017). Collecting NTR more effectively forms a key component of

improved domestic revenue mobilisation. Government now seeks to increase NTR collections and its contribution to the budget, further enhancing NTR administration, accountability, and reporting.

Figure 11: Trends in domestic NTR collections



Source: Tax Policy Department (2019)

Targeted Challenges

- (i) **No policy guides the introduction of NTR charges, and the multiplicity of charges has created concerns about over-taxation.** Consideration is rarely given to the full economic impact of introducing a new NTR, whether for services rendered or regulatory purposes. This also applies to the revision of rates, the collection, and the utilisation of charges. Many charges are applied to the same base, creating double-taxation concerns. High rates might undermine other government objectives, such as formalisation, and unduly increase the cost of doing business.
- (ii) **Collection, reporting, and monitoring of NTR at the MDA level has been weak.** There is a concern that MDAs do not fully report all NTR collected. Spending at the source of collection is prohibited under the arrangement with URA, however, spending at source encourages a sense of ownership and properly incentivises MDAs to pursue all revenues. Thus, there is a need to improve accountability and incentivisation in the current framework.

Interventions

- (i) **Streamline the policy on NTR to fully determine whether charges are necessary.** This should also cover how rates should be set, and the appropriateness of current charges should be reviewed. NTRs should be used to ensure conformity with regulation and law, rather than in the pursuit of revenue, especially when businesses are already subject to traditional taxes. Rates and licencing fees paid by

businesses should be simplified to ensure that one fee captures the rest. Furthermore, calls to ring-fence revenue sources should be resisted as this distorts budget credibility and accountability.

- (ii) **Strengthen the framework for reporting and monitoring of NTR collections.** Cabinet's directive that URA should collect all NTR should be fully enforced to improve transparency and budget accountability. URA should ensure that MDAs can access its systems and ensure that payment procedures are simple and user-friendly.

Harmonisation of Local and Central Government Taxation

The Government's fiscal decentralisation strategy provides a framework and set of principles for service delivery through Central and Local Government (LG) structures, based on devolution of powers and responsibilities to popularly-elected local governments. This is intended to improve service delivery, promote good governance, and develop political and administrative competence in the management of public affairs. The Local Government Act empowers LGs to generate own-source revenues from property rates, local service taxes, trading licenses, public transport, parking fees, rentals, advertising, ground rent, royalties, and hotel tax. These sources augment transfers from the Central Government. The revenue collected is intended to facilitate functions such as road maintenance, provision of healthcare, improving sanitation, providing agricultural advisory services, and garbage management. However, challenges have emerged since LG taxes overlap with the tax base for traditional taxes and the multiplicity of rates and charges create unnecessary complications and confusion for taxpayers. Furthermore, LGs typically lack the analytical capacity to assess and monitor their revenue sources.

This DRMS develops a direction for reform and the focus for LG taxation, while a fuller strategy for enhancing LG taxation will be developed separately.

Targeted Challenges

- (i) **LGs capacity to interrogate policy options, forecast, and analyse revenue streams is low.** Many LGs do not have a comprehensive system for monitoring revenues and LGs still predominantly use cumbersome, independent, manual systems that do not facilitate integrated reporting. There is poor taxpayer profile management, with details of the same customer paying different taxes maintained in different systems.
- (ii) **The lack of a clear framework for LG taxation.** Without guiding principles of LG taxation, the risk of distortions between various regions and elements of double taxation is high. Policy alignment with the national tax policy should be improved and collaboration between URA and LGs should be enhanced to facilitate collection.

Interventions

- (i) **Improve LG capacities for analysis, monitoring, and reporting.** Beyond boosting LG revenue collection, this will help the central government to monitor revenues and ensure that LGs receive the revenue required to facilitate service provision. The e-LogRev system should be rolled-out to more regions, automating processes and building capacity. This is an automated tool for taxpayer registration, assessment, e-payments, reconciliation, enforcement, and reporting which integrates with other Government systems. The 2016/17 pilot programme saw dramatic increases in revenue collected and taxpayer database, as well as reductions in the cost of collection²³. One site saw taxpayer registration double and revenues collected increased by 135 percent. Expansion of the project to 34 municipal councils is estimated to increase LG revenues by UGX 345 billion annually, reducing LG dependence on central government transfers.
- (ii) **Adopt an integrated approach to the introduction of LG fees and charges.** Re-examine the system of fees, as well as the rates, to determine optimality and streamline the charges. Consider merging certain taxes and fees that are levied on similar bases.

Taxation of Donor-Funded Projects

Globally, official development assistance (ODA) has generally been exempted from taxation in developing countries. Such exemptions are often provided in international treaties, as well as in project agreements between providers and recipients, which would be negotiated for each project and apply only to that project. The most common arguments for ODA tax exemptions are based on the premise of maximising the quantity of aid (Steel, et al., 2018). At the project level, if the imported inputs are taxed, then, for a given budget, fewer goods can be provided. However, at the country level, the argument weakens as any tax collected goes into the national budget and is thus still a benefit to the recipient country. Furthermore, if donors engage in both project and budget support, the case for exempting aid becomes even weaker. If project aid is taxed, donors can offset the taxation by reducing budget support accordingly. Thus, the net financial flows to the recipient country are unaffected. Another concern is that removing tax exemptions will cause donors to “shop around” for the best deals. Thus, imposing taxes on project aid might distort the allocation of aid and countries that tax aid would lose out to those maintaining exemptions. A UN report suggested that such shopping around is unlikely but is possible (Thuronyi, 2006). A final argument against the taxation of aid is that removing exemptions would entail a renegotiation cost. However, there is little to no evidence that the transaction costs would outweigh the benefits of removing exemptions.

²³ Over the three pilot sites, revenue collections increased from UGX 4.6 billion to UGX 6.6 billion and costs of collection decreased from UGX 462 million to UGX 228 million.

On the other hand, it can be argued that aid exemptions are a form of donor hypocrisy – donors are pushing recipient countries to use tax exemptions more effectively and improve their transparency, while simultaneously seeking exemptions for their aid (Steel, et al., 2018). Secondly, aid tax exemptions reduce the recipient country's tax capacity. Many of the largest infrastructure projects are donor-funded, meaning that, at least in part, they are exempt from taxation, despite the significant amount this contributes to GDP. In addition, exempting aid sets a bad example and creates a precedent for more exemptions. The discretionary agreements used to secure ODA exemptions potentially legitimise a practice that, when applied to investors, could facilitate corruption and harm perceptions of fairness in the tax system, undermining compliance.

The current regime for ODA tax exemptions is thus inconsistent with the broader drive to improve domestic revenue mobilisation in Uganda. It is difficult to make an empirical case that exemptions improve aid outcomes, and that these benefits outweigh the considerable costs detailed above.

Targeted Challenges

- (i) **Exempting employment income derived by individuals as part of aid agreements facilitates income tax avoidance.** Furthermore, this exemption disadvantages Ugandans seeking to participate in such projects. Non-resident employees and contractors are exempt from tax, while resident counterparts are taxed, favouring non-residents over residents. Thus, Uganda is effectively allowing donated money to flow out of Uganda, rather than benefiting from a multiplier effect whereby ODA boosts the wider economy by creating employment opportunities for Ugandans. Without ODA tax exemptions, non-resident providers would be liable for income tax in Uganda under source rules.
- (ii) **Imported duty-free supplies for donor-funded projects implicitly incentivises imports rather than promoting local suppliers.** This undermines other government policies to promote domestic production, including Buy Uganda, Build Uganda (BUBU). Local producers are thus disadvantaged when competing to supply donor projects, hindering local development.

Interventions

- (i) **Avoid cases where expatriates pay no tax on income earned in Uganda.** Ensure that donors use tax exemptions generally available under tax laws and follow standard administrative procedures, rather than first seeking special treatment. ODA tax exemptions should only be extended to contractors and their employees where they can demonstrate that double taxation is likely.
- (ii) **Review ODA tax practices to assess the revenue foregone and administrative burden for any new projects.** Consider renegotiating ODA framework agreements to ensure that donor funds are being fully exploited locally.

Taxation of the Digital Economy

E-commerce broadly refers to conducting business over the internet, including the sale of products and services online, such as Jumia, Uber, and Facebook. As the digital economy grows, it is becoming increasingly impossible to ring-fence the digital economy from the rest of the economy for tax purposes. Attempting to do so would entail drawing arbitrary lines between what is digital and what is not. Consequently, tax-related concerns are better addressed by focusing on the key features of the digital economy which might exacerbate challenges, in the context of existing structures. Furthermore, the digital economy is constantly evolving, so potential future developments should be closely monitored to assess the additional tax challenges that these may create.

However, due to the virtual nature of transactions, tax loopholes are invariably created. Unlike in traditional businesses, it is difficult to assess where e-commerce creates value, what it is, and how it should be measured. These problems are amplified by permanent establishment rules, based largely on physical presence. Thus, while digital companies operate virtually, their profits are often taxed only in the state where they have a physical establishment. Given the provisions of the Income Tax and VAT Act, Uganda is limited in its ability to tax businesses which do not meet the thresholds of physical presence. For instance, web-based businesses such as Facebook have a significant presence in the country, from which they profit, but do not qualify as resident under the current law. While the sourcing provisions allow for non-residents to be taxed on income derived through a branch in Uganda, the definition of this clearly envisages a physical branch.

Thus, while Uganda should look to limit revenue losses, it should also avoid creating a policy environment that is hostile to e-commerce and hinders the development of new technology.

Interventions

- (i) **Review the current tax laws to achieve a tax regime ready for the digital economy.** This review should take account of analysis and discussion that has resulted from the BEPS initiative. It will be important to ensure that, as far as is consistent with Uganda's national interests, any measures that are introduced go with the grain of international action. It will be difficult to maintain a contrary position.
- (ii) **Ensure that URA adapts to the new challenges posed by e-commerce, including the multi-jurisdictional, opaque nature of business.** One possible approach to build knowledge on handling the sector is to audit a representative group of known e-commerce companies based in Uganda. Finally, the implementation of key public infrastructure to authenticate digital transactions should be expedited.

Strengthening the Administration of Tax and Non-Tax Revenue

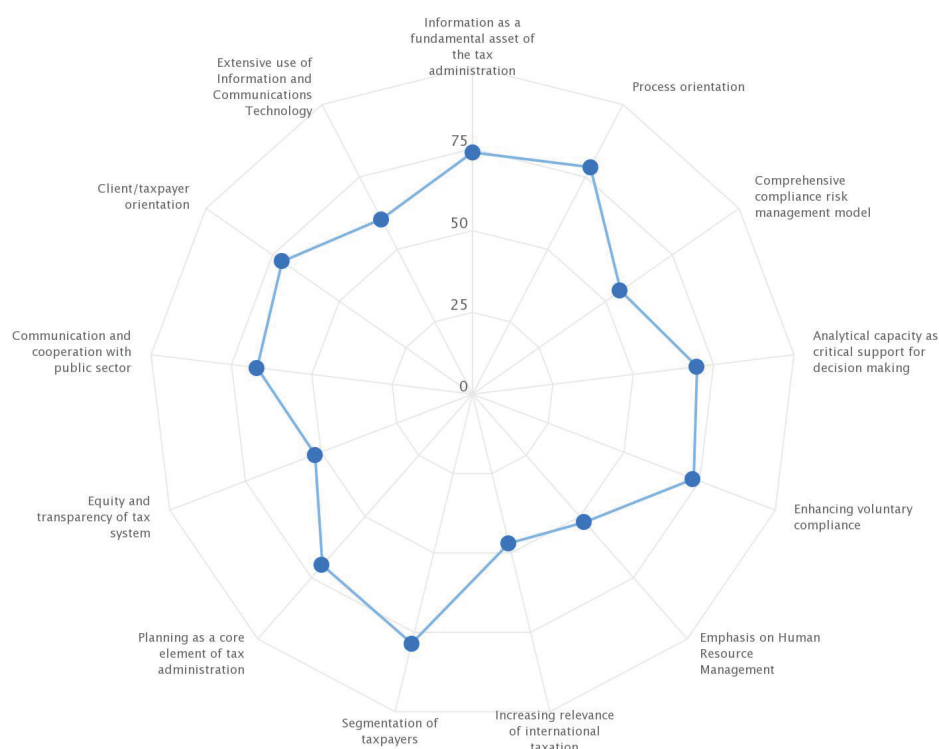
As noted above, Uganda's tax policy as laid out in the tax laws is generally in good shape, and there are few opportunities for dramatic gains through policy adjustments. In contrast, there are significant gains to be made on the administrative side through addressing various limitations in tax administration and boosting compliance with the existing tax laws.

URA's cost of collection ratio is around 1.74%, higher than the average of around 1% for OECD and selected non-OECD countries (World Bank, 2018). This compares the administration's costs with net tax revenue collected, an indication of efficiency, although reductions in this ratio can be driven by a number of factors beyond the effectiveness of collection, such as tax policy changes, increased levels of expenditure, or economic changes, and thus should be complemented with other indicators of effectiveness. One such indicator is the tax compliance gap, comparing the revenue potential of the tax system with the amount of taxes actually collected, however, URA does not systematically estimate and track this gap.

The DIAMOND²⁴ assessment undertaken in 2018 by the World Bank evaluated URA's strengths against 14 strategic dimensions, reflecting the key features and trends of modern tax administrations. These place a strong emphasis on encouraging voluntary compliance and broadening the tax base, as well as client orientation, equity, and certainty in the application of tax laws. The assessment shows that the URA has implemented basic good practices and has been able to provide key taxpayer services and compliance strategies. However, there is room for improvement in terms of extending the coverage of existing taxpayer services, overcoming constraints to accessing relevant third-party information, especially from the financial sector, strengthening the performance management system, and the tax audit business model (World Bank, 2018). The figure below indicates that URA needs to pay special attention to increasing the relevance of international taxation, human resource management, developing a comprehensive compliance risk management model, using ICT more extensively, improving cooperation with the public sector, and enhancing transparency.

²⁴ See the section on [key diagnostic studies](#) at the end of this paper for details on this methodology.

Figure 12: DIAMOND assessment results by strategic dimensions



Source: Tax Administration Assessment for the Uganda Revenue Authority, World Bank (2018)

I. Limitations of the Tax Administration

Governance and Management of URA

The URA Act (1991) established the URA as “an agency of government under the general supervision of the Minister of Finance” for the assessment and collection of specified revenue and to administer and enforce the laws relating to such revenue. The URA Board is responsible for monitoring the performance of the URA and determination of policies relating to staffing and procurement of the authority. Currently, the Board consists of six full voting members: two representatives of Government (from MFPED, and the Ministry of Trade and Industry), three representatives of the private sector (one of whom serves as chairperson), and the Commissioner General of URA. The Minister appoints the Commissioner General (CG) on the recommendation of the Board. The URA Act requires the CG to submit an annual report to the Minister and the Board containing: (i) revenue performance, (ii) human resource matters, (iii) URA court decisions, (iv) financial statements, and (v) any other information as the Board may direct.

URA’s structure has not been reviewed for some time and there is a need to realign the structure of URA to the changing demands on URA, as well as focus the roles played by

different actors, including the URA Board, the Commissioner General, and the Minister of Finance, particularly with regard to the framework for supervision of URA. The URA Act has been amended just once since its introduction in 1991 (to change the structure of the Board), and there is scope to sharpen the Act to improve organisational efficiency.

Targeted Challenges

- (i) **The current URA structure is a fusion of different models of tax administration, which may create tensions and duplications.** The structure merges functional units (e.g. investigations), type of taxpayer units (e.g. Large Taxpayer Office), and tax type units (e.g. Customs). Tax-type and taxpayer-type structures have some disadvantages, including increased administrative costs by duplicating common core and support activities (e.g. ICT) across types, duplication and fragmentation of staff limiting the ability to apply the best practice of centralised staffing, increased likelihood of inconsistent application of laws, policies, and procedures across taxpayer segments, and a high degree of dependence on a limited number of highly skilled managers and technical staff to design and administer educational and enforcement programmes for each segment. For instance, the Tax Investigations, Customs, and Domestic Tax departments currently all carry out their own risk management, deploy different audit and investigation processes, and have built separate systems²⁵.
- (ii) **Whereas the URA Act is broad in its provision on the mandate of the URA Board, oversight and supervision of URA should be expanded.** While the URA Act stipulates that the Commissioner General (CG) should submit an annual report to the Minister of Finance and the Board, the contents and frequency of this report is insufficient for constant monitoring and improvement. The current level of interaction between the URA Board and the Minister is too narrow for full oversight. The URA Act is broad and does not preclude the Minister from expanding the reporting requirements. Specifically, Part III of the URA Act specifies that “the board shall be responsible for monitoring the revenue performance of the authority” and Part V specifies that “the Commissioner General shall [...] submit to the Minister and the board an annual report containing (i) financial statements, (ii) performance indicators and other related information, (iii) a report on the operations of the authority, and (iv) such other information as the board may [...] direct”.
- (iii) **The effectiveness of URA is assessed almost exclusively by revenue performance.** Such targets can lead to short-term distortionary tax measures whose only objective is to raise revenue and whose gains are not sustainable. Furthermore, such targets could encourage a heavy-handed approach with taxpayers. Similarly, the current performance management system for the CG and the Board is not comprehensive and annual performance contracts do not include

²⁵ eTax has an end-to-end audit and investigation management module. However, each division has separate business intelligence and risk management systems.

a full set of key performance indicators (KPIs). The Minister of Finance should have a wider set of data points on which to evaluate performance.

Interventions

- (i) Review the URA structure to address current demands and promote the integration of cross-cutting processes and central offices.** Consideration should be given to establishing a common process for all processing of tasks such as registration, revenue management, or taxpayer services, while specialising the Large and Medium Taxpayer Offices, or the public sector units in areas such as tax audit or arrears management for complex cases. The review should also consider how to take advantage of automation to ensure efficiency and preparedness to absorb disruptive technologies. Analysing the impact of technology on revenue administration processes, human resource management, and organisational structures will be critical for ensuring that URA's business model remains sustainable.
- (ii) The oversight function of the Minister and the URA Board should be enhanced, requiring the Board to bring recommendations directly to the Minister of Finance.** To aid this, the CG should provide quarterly reports, premised on an expanded set of KPIs, to support regular and well-structured interaction.
- (iii) Expand the assessment framework for URA beyond the revenue target to enhance operational efficiency.** Generally, the KPIs should be balanced with both quantity, quality, and taxpayer satisfaction indicators, giving a wider view of the effectiveness of the administration. This should include the tax compliance gap, growth in *active* taxpayer population, on-time filing and payment rates, improvement of arrears collection, IT availability and response times. These KPIs can be cascaded down to manage the performance of the Board and the CG. Furthermore, the performance evaluation system should allow for a collaborative approach to setting targets, premised on sound forecasting and policy costing techniques.

Accountability and Transparency

While voluntary compliance by taxpayers supports all modern taxation systems, that principle is predicated on taxpayers' trust in government and their perception that the tax system is fair, equitable, and transparent. Afrobarometer (2016) found that between 2012 and 2015, public perceptions of corruption among tax officials worsened, with the percentage of respondents saying that "most" or "all" of tax officials are corrupt increasing from 40 to 48%. Corruption among government officials was rated similarly. The same survey found that tax officials ranked behind only the police on perceived institutional corruption. In view of the strong negative perception of corruption among tax and government officials, there is a need

to renew efforts to curb dishonest and fraudulent conduct, assuring citizens that this issue is being effectively tackled.

Targeted Challenges

- (i) **The investigatory and operational mandate of the Commissioner for Internal Audit and Compliance is too broad and creates difficulties in prioritisation.** The Commissioner is currently responsible for internal audit, serious staff wrongdoing and corruption, and lesser disciplinary matters. This has resulted in a large mandate and diminishes the ability of the division to pursue major offences of corruption and staff integrity. The Commissioner is also expected to investigate misdemeanours, lapses, discipline, and issues of performance referred by other URA divisions.
- (ii) **The mechanism for monitoring public confidence in URA is lacking.** Neither Government nor URA has commissioned an independent survey to assess public perceptions of integrity among tax officials and client satisfaction since 2012 (Okello, et al., 2019).
- (iii) **Uganda does not provide a credible avenue for taxpayers to vent their unresolved service, procedural, and administrative complaints, such as a Taxpayer Ombudsman or Advocate.** Taxpayers' perceptions regarding the transparency and fairness of revenue administration operations are critical in fostering voluntary compliance. These perceptions are often formed by frustrations with systems and processes, or belligerent application of these processes by URA officers. However, this does not amount to unethical or corrupt behaviour, so cannot be reported to URA's Internal Audit and Compliance unit or the IGG. Taxpayers thus need ready access to a credible complaints mechanism to address situations beyond corruption or assessment reviews.

Interventions

- (i) **Separate the Internal Audit and Staff Compliance functions to enhance the dedicated attention given to corruption and staff integrity.** A dedicated function at the level of Assistant Commissioner should be established to deal with integrity issues, directly accountable to the Commissioner General and the URA Board. This would enable the Staff Compliance function to concentrate exclusively on corruption and integrity. Meanwhile, Internal Audit can concentrate on processes, systems, controls, and quality assurance. The mandate of Internal Audit could then be expanded to include reviewing the integrity and performance of URA systems. Furthermore, given the importance of integrity in this area, any new staff should be subjected to extensive ethics tests before hiring.
- (ii) **As a matter of urgency, URA should commission an independent survey of taxpayer perceptions and develop an anti-corruption strategy premised on the results.** These surveys should use statistically valid techniques for sampling

taxpayer segments and obtain feedback on URA products, services, and staff integrity.

- (iii) **Establish a separate Taxpayers Ombudsman function to investigate service-related complaints with clear rules, procedures, and implications.** The Ombudsman should regularly report to the Minister of Finance and Parliament and be empowered to handle complaints related to: (a) mistakes, omissions, and oversights, (b) undue delays, (c) poor or misleading information, (d) unfair treatment, and (e) staff behaviour. This office would also provide an avenue for improving processes and procedures that will lead to efficiencies in the processes of the tax system. This function will improve URA's credibility, transparency, and accountability, as well as give taxpayers the confidence that administering tax laws is an objective process. In line with efforts to streamline the number of government offices and agencies, this function can be nested within an existing agency or body, such as under the Budget Monitoring and Accountability Unit, so long as it is granted sufficient independence. Establishment of this function is in line with international best practice on handling taxpayer complaints and the recommendations from the latest Tax Administration Diagnostic Assessment Tool (TADAT).

Lifting the Human Resource Capacity at URA

To support the achievement of the objectives of DRMS, the URA needs a productive, highly-skilled, and motivated work-force. The complexities involved in administering the tax system require appropriately-skilled staff, especially in core business areas such as tax audit, international tax, ICT, and tax arrears management. Weak human resource (HR) management is a major obstacle to modernising a tax administration. From the diagnostic work, four key issues have emerged: (1) staffing levels, (2) staffing allocation, (3) existing staff capacity and skills development, and (4) staff morale.

1. Staffing levels

The total personnel of URA is currently 2,549, including 1,031 in Domestic Taxes, 934 in Customs, 278 in Corporate Services, and 102 in the Commissioner General's Office. Table 14 compares the number of employees at URA with the total population of Uganda and the estimated size of the labour force. Compared to other jurisdictions, this indicates that URA is potentially understaffed, with current staff over-stretched and unable to cover the labour force effectively, an indication of the potential taxpayer population. The ratio of labour force-to-employees effectively approximates how many potential taxpayers one administrative member of staff would manage.

Table 14: Selected cross-country comparison of personnel ratios

Country ²⁶	Employees (incl. customs)	Population	Population/ employees	Labour force	Labour force/employees
Uganda	2,549	44,270,563	17,368	15,839,810	6,214
South Africa	11,836	55,291,225	4,671	21,348,710	1,803
Chile	4,705	17,762,681	3,775	8,963,430	1,905
Brazil	22,491	205,962,108	9,157	104,278,220	4,636
Peru	7,591	31,376,671	4,133	17,902,590	2,358
Malaysia	13,209	30,723,155	2,326	15,441,350	1,169
Japan	55,790	127,974,958	2,294	66,503,540	1,192
UK	56,488	65,397,080	1,158	33,870,290	600

Sources: URA (2018); OECD (2017); UN Population Division; World Bank Databank

2. Staff allocation

Research on staff allocation by major function indicates that other jurisdictions typically employ approximately 32% of staff in audit, investigations, and verification functions, and 10% of staff in enforced debt collection or arrears management. However, URA employs just 10.8% and 1.5% in these functions, pointing to potential misallocation of staff and understaffing in critical functions. While it should be noted that differences can arise due to the specific institutional arrangements of a given tax administration, the high disparity indicates that URA is potentially imbalanced.

Table 15: Average staff usage (% of total) by major administrative function²⁷

Function	URA staff usage	OECD average staff usage	Non-OECD average staff usage
Collection (taxpayer account management)	28.6%	30.8%	28.9%
Audit, investigation, verification functions	10.8%	32.4%	32.4%
Enforced debt collection and arrears management	1.5%	10.4%	10.1%
Legal	2.9%	n/a	n/a
Taxpayer information and assistance	25.2%	n/a	n/a
Corporate overhead management functions	17.2%	14.8%	15.6%
Other (management)	13.9%	11.7%	12.9%

Source: URA (2018); OECD (2017)

3. Skills development

Beyond mere numbers, URA also suffers from a lack of adequate skills development for existing staff. A recent institutional assessment of URA (World Bank, 2018) pointed to the need to specialise URA's staff in key areas of tax administration, especially in tax

²⁶ Note that South Africa was the only African country surveyed by the Organisation for Economic Cooperation and Development (OECD), an intergovernmental economic organisation from which the data below was drawn.

²⁷ In the survey, the OECD used the following categorisations: (i) taxpayer account management – all functions associated with registration, data processing, taxpayer accounting, filing, and withholding; (ii) audit, investigation, and other verification – all staff associated with verifying the information contained in tax returns; and (iii) corporate overhead management – all staff for human resource management, information technology, accommodation, supply, security, internal assurance, and finance functions.

investigation, arrears management, tax audit, and ICT. Though a training strategy has been developed in URA, it is not long-term in its nature and the content does not reflect the need for continuous professional development at all levels (World Bank, 2018). Required staff skills in core areas should be considered in tandem with staffing levels. There is a need to develop a comprehensive human resource strategy, covering internal reallocation, hiring of skilled staff, and training. As URA moves towards adopting new technologies and end-to-end automation, a new staffing pattern will be needed, reducing the number of relatively low-skilled positions, and scaling up high-skilled positions in audit, investigations, ICT, and taxpayer assistance.

4. Staff morale

An effective tax administration requires highly-skilled, but also highly-motivated, staff. URA has selective talent-sourcing and retention guidance, including bonuses when revenue targets are met, however lacks a salary and incentives policy designed to provide proper incentives for performance. International evidence suggests that staff may be less motivated than expected by the prospect of more money for working better (World Bank, 2018). Rather, performance-related pay should be considered as part of a comprehensive policy that provides growth opportunities for technical staff and assesses performance using indicators beyond the mere achievement of a revenue target. The current lack of such a holistic performance management policy contributes to low staff morale.

Targeted Challenges

- (i) **Staffing of several key functions is low and specialised skills are lacking, so staff are overstretched and unable to properly support improved taxpayer compliance.** As additional initiatives have been introduced, such as digital tax stamps, international taxation, extractive industry taxation, and enhanced customs audit, staff numbers have not grown in tandem, limiting URA's ability to implement new strategies. Furthermore, certain non-critical areas appear to be over-staffed, while critical, revenue-raising sections are under-staffed and under-skilled. As discussed above, staffing levels should be considered in conjunction with workload analysis to ensure that URA is optimally placed to handle emerging needs.
- (ii) **Existing staff development is inadequate and only 56% of staff employed in Domestic Taxes, Customs, and Investigations have completed the basic training in taxation²⁸.** URA lacks a comprehensive, well-structured staff training programme, covering acquisition of skills by staff from the time of joining URA to the time of exit. This has hampered URA's ability to handle complex tax matters and develop the required skills to match a rapidly changing business environment. Initial analysis points to the need to specialise URA's staff on key areas of tax

²⁸ As of 30 October 2018, 1,109 out of 1,964 staff employed in Domestic Taxes, Customs, and Investigations had completed basic training.

administration, focussed on continual professional development, as well as the need to verify the effectiveness of current training initiatives (World Bank, 2018).

- (iii) **Morale and motivation are low among URA staff.** This can be partially attributed to poor talent management processes as there are few opportunities for growth and promotion, especially for technically-gifted staff who do not wish to take on managerial duties. Bonuses and other rewards are not used optimally, and no incentives policy exists to reward strong performance (World Bank, 2018). This includes salaries, which decline sharply between Commissioners, Assistant Commissioners, Managers, and Officers, and have not been adjusted for inflation for five years. The flat structure, without many opportunities for growth, and poor talent management contributes to feelings of stagnation, and thus to staff attrition.
- (iv) **Conditions of work outside of Kampala are largely inadequate.** There is a need to sharpen the framework for staff deployment to field offices and abroad, including the terms of service, entitlements, and job descriptions. Furthermore, the current infrastructure, accommodation, and other services required by staff in field offices is inadequate.

Interventions

- (i) **Conduct an independent staffing review to pinpoint the most critical gaps, including workload analysis, aligned to a structural review of URA²⁹.** This review should also examine where staff might be internally reallocated to improve efficiency, prioritisation, and productivity. While URA clearly suffers from a shortage of staff, hiring decisions should be informed by an analysis of whether the current structure is still suited to URA's mandate, where new staff would be best placed, and what kind of prior experience new hires should have. Furthermore, consideration should be given to front-loading hiring and redeployment to areas that will have the greatest impact on domestic revenue mobilisation, such as enforcement, to properly cover revenue risk and the taxpayer population.
- (ii) **A comprehensive training strategy should be developed incorporating the results of the staffing review.** This would facilitate staff on-boarding, ensure that the necessary skills are acquired quickly, and achieve a higher level of productivity among all staff. The establishment of a formal URA tax training academy should form a part of URA's human capital development. A training strategy should have two elements: (i) stop-gap training to close immediate and pressing skills gaps, and (ii) a long-term training plan, considering the potential of alternative learning methods, such as distance and online learning. The impact of the adoption of new technologies should be factored into this training plan, enabling URA to react better to changes in the tax environment due to disruptive technologies.
- (iii) **Review the performance management and reward system to improve staff morale.** This should consider expanding the salary structure to support career

²⁹ As discussed in the section above on [Governance and Management of URA](#).

progression for high-performing technical staff, develop a framework based on clear KPIs to reward staff for good performance, and introduce clear criteria for the retention of key staff who are nearing retirement (as staff trainers, for example). Furthermore, salaries should be periodically adjusted for inflation. Developing a holistic performance management policy will strengthen staff recruitment, promotion, performance evaluation, and rotation (World Bank, 2018).

- (iv) **Develop and implement a framework for the deployment of staff, both in the field and abroad.** This should be based on an assessment of the number of staff and technical skills needed in these posts and include criteria for determining when and where to deploy officers, a clear mandate for deployments, tenure, remuneration, and oversight. Ensure that all offices and accommodation facilities outside of Kampala are properly resourced.

Data Management and Analytics

While URA has increasingly adopted a data-driven approach, data analysis has not been fully exploited to promote revenue generation and enhance voluntary compliance. With the age structure of the population skewed towards the young, the demand for e-government has increased, generating more and more sources of data on the activities of citizens. The recent creation of the National Identification Number, combined with improved computing power and broadband coverage, enables new methods for taxpayer registration, promotes stronger interactions between taxpayers and URA, and could facilitate greater interoperability with other government agencies and relevant stakeholders. Exploiting these opportunities will require overcoming data-related challenges at URA.

Weak data integrity lies at the heart of many of URA's challenges. Without clean data on the entire lifecycle of taxpayers and error-free account management, URA cannot have a full picture of their tax base or effectively manage compliance. Notwithstanding the improvements made following the introduction of the URA data warehouse, some data is still captured manually, introducing scope for human error, and affecting the soundness of government policy formulation. Furthermore, access to relevant third-party data limits URA's abilities to improve levels of voluntary tax compliance, as well as detect evasion. Finally, the demand for advanced data analytics and ICT skills should be enhanced. Not enough emphasis is given to data analysis when developing URA's strategic direction, leading to the under-prioritisation of data skills.

Targeted Challenges

- (i) **Poor access to third-party and other government agency data limits URA's ability to validate taxpayer data and improve accuracy, while also hindering government policy formulation.** No government-wide data management plan exists, resulting in inconsistencies across government agencies that impede data matching (different naming conventions, for example). This challenge is further

amplified by the lack of a standard, unique identifier for individuals. As a result, data has to be cleansed before it can be integrated, and accuracy is decreased. Relatedly, when data access is granted, cross-institutional cooperation and real-time integration are often undermined by requiring URA to sign separate MOUs with individual agencies annually.

- (ii) **Capacities for data analysis among URA staff should be enhanced.** Information is not fully-exploited to catch errors and detect fraud. A more robust use of data analytics is needed, and technical personnel should be appropriately trained. Furthermore, capacity development should be extended to include operations – available data will remain under-utilised unless operations knows what data is available and requests the analysis. Thus, operations should be able to drive the application of data to assess risks and non-compliance.

Interventions

- (i) **A data quality improvement strategy should be prioritised and processes to maintain data quality should be developed.** Comprehensive data cleaning should be undertaken. Without accurate and complete taxpayer data, many of URA's current challenges will persist, despite expensive information and communication upgrades. Regular cleaning of data should become a standard part of URA operations. Necessary adjustments to tax declaration and filing forms should be made to properly capture the information required to monitor tax performance.
- (ii) **Empower URA to access relevant third-party data and data from other government agencies.** Many agencies, including regulatory bodies, capture data that is highly relevant to tax administration. This particularly pertains to information from the lands registry, NSSF, the banking sector, company registry, and utilities. Without access to such data, the identification of the full tax base is impeded.
- (iii) **Create a formal data skills development plan, emphasising preparedness for disruptive technologies.** Staff skills throughout URA should be developed to ensure that data analytics capacities are high, giving the need for continuing education and improvement due consideration.
- (iv) **Develop a cross-government policy framework for data sharing and management to ensure that data is captured and stored in a systematic, standard way.** This would make data useable across government. The policy should include mandating the use of the National Identification Number to access government services, establishing a consistent way to identify citizens and capture their data. From a tax perspective, standardisation will assist in validating taxpayer return information with other government data sources, such as the land registry, licensing bodies, and motor vehicle registration. Furthermore, the framework should lay out clear procedures and policies for access to information, limiting unnecessary restrictions. The data governance board should be operationalised to provide oversight and tracking of the implementation of the data management strategy.

ICT Governance and Infrastructure

The URA's adoption of ICT has been impressive, with at least 70% of the core tax administration transactions processed electronically, including registration, taxpayer accounts, tax returns, payments, basic information, notifications, and tax refunds. The provision of these electronic services has allowed for a significant reduction of processing times (World Bank, 2018). However, missing electronic services include tax appeals, instalment plans, and the issuance of online registration, filing, and pre-filled tax returns. While eTax, introduced in 2008, has met the basic functional needs of the tax administration as contracted then, it now warrants an upgrade, especially given recent advances in technology and a more dynamic business environment. It has become imperative that ICT systems become less complex, more user-friendly, easily adjustable, and more intelligent, effectively moving to a level that allows for pre-populated returns. Furthermore, the introduction of the eTax system was not accompanied by an over-arching strategy for redesigning and simplifying tax services and processes using modern technology, and despite creating a Business Processes Unit, URA still lacks a technology master plan with a medium- to long-term focus. This has led to concerns of system duplication and a complex network of multiple different systems within URA. Relatedly, URA lacks a strategy for information security and integrity, including the implementation of firewalls, and an operational plan for upgrading ICT systems (World Bank, 2018).

Targeted Challenges

- (i) **While the eTax system has boosted URA's adoption of technology, numerous inadequacies exist, and it may not comprehensively meet the growing needs of a modern tax administration.** Key functional limitations include:
- a. Partial automation of some processes and others remaining entirely manual. While an independent assessment of URA's ICT (PwC, 2018) highlighted certain processes which are automated, partially automated, or manual, at a URA-wide level it is difficult to determine where automation has not been achieved;
 - b. Limited interface with internal URA systems and external systems (NSSF, NIRA, URSB, etc.) meaning that data-upload is often manual, time-consuming, and prone-to-error;
 - c. Partially unused modules, completely unused modules, and intermittent system availability with slow responses at times;
 - d. New and emerging user needs and a failure to fully support newly-enacted laws over the past 6-8 years;
 - e. Limited ability for URA staff to directly make adjustments; and
 - f. Oracle is ceasing support for its Oracle 11g database, requiring an update or complete replacement to continue supporting current data or processes.

- (ii) **The overall ICT infrastructure for the URA does not meet the business demands in relation to storage, speed, and availability.** Despite having advanced systems, such as the platform for ASYCUDA World, there are frequent outages that affect service delivery. There is a lack of space with sufficient power, cooling as well as physical access control to support the current systems in the current data centre. In addition, power sources are not able to support the systems in the upcountry offices.
- (iii) **ICT governance within URA does not match its importance.** URA business applications in Domestic Taxes and Customs are ably led by the respective commissioners, with the Head of ICT called in as necessary to support. Whereas this fosters ownership, the ICT department has limited oversight and coordination capabilities across the organisation, lacks a governance framework, and does not have effective mechanisms to ensure the uniform application of ICT standards (World Bank, 2018). Without sufficient seniority afforded to the Head of ICT, systems will become increasingly fragmented and unharmonized. While yearly strategic ICT plans are made, these should have a longer time horizon.

Interventions

- (i) **Design and implement a new ICT strategy and individual ICT operational plans for the URA, encompassing all ICT infrastructure and business needs.** The strategy should consider the needs to support the tax system going forward and consider future business requirements to be able to adapt to changes. Infrastructure needs should include system and platform needs, as well as the physical space and environment necessary to support systems. Consideration should be given not only to the ease of doing business to facilitate compliance, but also to the data and systems needed to ensure accuracy and enforce compliance.
- (ii) **Review options available and based on a proper assessment of costs, benefits, and risks of each option, upgrade or invest in a new eTax system to support DRM and meet URA's business needs.** The current functionality, user acceptance, user knowledge, and need to adapt to disruptive technologies should be considered in the new design. A completely new user-facing environment would be costly in both acceptance and training, and there is a risk that a completely different user environment may not function as well as the current design. In addition, data migration issues should be considered. The functional requirements and costs and risks of any upgraded system must be comprehensively studied before any commitment is made.
- (iii) **Standardise key government systems to improve integration.** This should include URSB, National Identification, Lands, Immigration, LGs, NSSF, and the Bank of Uganda. While this standardisation may take time, in the interim, solutions should be designed to enhance interfacing.

- (iv) **Enhance ICT governance to support the future ICT vision and elevate the voice of the ICT department in decision-making processes.** This should include developing an integration strategy, software development standards, a technology plan, internal ICT-related key performance indicators, and creating a systematic mechanism for capturing feedback from existing systems.

II. Improving the Compliance Continuum

The government's ability to collect taxes depends highly on citizens' willingness to pay them. Encouraging tax compliance depends on creating a predictable and consistent tax system, issuing technical interpretations in a timely fashion, helping taxpayers understand their obligations, ensuring that registration, filing, and payment is efficient, and promoting compliance and fairness through audit and collection enforcement. Generating a culture of compliance also requires a careful examination of motivations to pay taxes, how taxpayers experience and perceive taxation, and the related costs and benefits of compliance. As Uganda continues to struggle with widespread evasion and avoidance, strategies to tackle weaknesses across the entire compliance continuum are a key focus of this DRMS.

Figure 13: The compliance continuum



Taxpayer Registration

The taxpayer register is the cornerstone of any tax administration. Any lack of accuracy, reliability and credibility in the taxpayer register will in turn lead to deficiencies in collection and enforcement, increasing administrative and compliance costs. Identifying and registering taxpayers is thus vital for undertaking the full spectrum of compliance functions, such as detecting stop-filers and managing tax arrears. URA has adopted a system of one unique Taxpayer Identification Number (TIN) across all tax types, in line with best practice, however there are still numerous opportunities for improvement.

The table below gives an indication of weaknesses in the taxpayer register. In FY2017/18, URA had approximately 1.3 million registered taxpayers, of whom, 1.2 million were individual taxpayers. According to the Uganda National Household Survey, the employed population amounts to approximately 9 million, from a working age population of over 18 million (UBOS, 2018). It is unfair for just over 1 million Ugandans to pay for government-provided infrastructure and services that the rest enjoy at their expense. There is a need to discourage free riders who pay nothing even when they have the means to contribute.

Table 16: Movements in the taxpayer register

	FY2015/16		FY2016/17		FY2017/18	
	Totals	Active ³⁰	Totals	Active	Totals	Active
Total taxpayers	902,339¹		1,029,542		1,320,691	
VAT	16,230 ²	67.6% ²	18,061	69.5%	16,499	89.3%
CIT	70,765 ²	40.7% ²	79,814	40.8%	86,114	40.8%
PIT	111,873 ²	80% ²	172,107	63.5%	249,560	64.6%
PAYE withholding (# of employers)	17,544 ²	85.6% ²	20,994	81.8%	23,404	84.2
Domestic excises	258 ²	100% ²	265	97.4%	246	100%
Register growth	139,339 (18.3%)¹		127,203 (14.1%)		291,149 (28.3%)	

Source: ¹URA Annual Reports, ²TADAT (2019)

Targeted Challenges

- (i) **The tax registration process is sound, but significant challenges remain in ensuring that taxpayer information is accurate.** Individuals are required to provide two documents for identification, however, given that the national ID is not fully functional, this limits the ability to cross-check with other government databases as there is no unique, single identifier for people. This has created issues of duplication and “ghost” taxpayers who have registered multiple times under different names. Furthermore, the property and business registries are not fully automated, and many areas do not have formal street names or plot numbers.
- (ii) **The taxpayer register is not reliable and there is a low level of operational certainty as to the number of active taxpayers.** There appear to be a high number of inactive CIT and PIT taxpayers who have not been deregistered. Inaccuracies in the database have forced URA to use manual methods to check the validity of the information, meaning that duplicates or inactive taxpayers are not systematically found and dealt with (Okello, et al., 2019).
- (iii) **Initiatives to detect businesses and individuals who fail to register are weak.** Relative to the level of business and commerce undertaken in the Ugandan economy, the taxpayer register remains small. As an indication of missing taxpayers, the number of individual taxpayers amounts to only 14% of the employed population. The number of employers complying with NSSF obligations but not with URA in 2016/17 was 4,060, while the number of employees was 42,751. Use of third-party data to identify potential taxpayers is not systematic, largely due to weak access to information and a lack of adequate digitisation of data. URA needs to adopt a more targeted approach to registering taxpayers, focusing on high-risk sectors.

³⁰ This gives the percentage of registered taxpayers from whom returns are expected. An inactive taxpayer includes those who have not filed a return within at least the last year because the case is defunct, those who cannot be located, or those who are insolvent, and who have not yet been deregistered.

- (iv) **Taxpayer registration remains semi-online and eTax is not interfaced with relevant external systems.** To obtain a TIN and file returns, taxpayers are required to download an Excel spreadsheet from the URA portal, enable macros, complete the spreadsheet, and submit it online. This is unnecessarily cumbersome and can be intimidating for taxpayers who are not highly computer-literate. Furthermore, the current system limits the ability to automatically validate data entries from the taxpayer. URA is unable to accurately measure the average time to register and file returns, since part of the process is done outside of the eTax system. Finally, URA's main channel of communication with taxpayers is via email, however many taxpayers do not have truly operational email accounts.
- (v) **Poor overall regulation of certain sectors, for example alcohol and real estate, hampers registration and enforcement efforts.** Many people are producing and retailing alcohol, which is excisable, but do not appear on the register. In the real estate sector, many professionals conduct business as agents, in design, construction, and maintenance, but are not in the tax base. An incomplete land registry further complicates this. Many operators along the value-chain in the transportation sector have incomes higher than teachers and nurses, for example, but do not pay any income tax, whereas teachers and nurses have income tax deducted at source as PAYE.

Interventions

- (i) **Cleanse the existing taxpayer register to improve operational certainty.** Detect and deregister inactive and other "ghost" taxpayers and enhance real-time cross-checking of taxpayer information with other databases to facilitate this process. Proper cleansing will result in an initial decline in the number of registered taxpayers but is essential for understanding the nature of the tax base going forward. Register cleaning should be done on a continuous basis, rather than as a once-off activity.
- (ii) **Expand the use of the biometric National ID for registration.** Requiring a unique number for registration avoids duplication. All of government should be encouraged to require the National Identification Number to access government services, providing a full view of citizen interactions with government and facilitating cross-referencing of taxpayer data.
- (iii) **Improve the identification of potential taxpayers and verification of information through better access to and use of external data.** This especially applies to the National Identification and Registration Authority (NIRA), the Uganda Registration Services Bureau (URSB), NSSF, and the land registry from the Ministry of Lands, Housing, and Urban Development. This will assist in identifying potential taxpayers and verification of information. To minimise the need for cumbersome data requirements from taxpayers for registration, eTax should be linked to URSB,

NIRA, NSSF, the Ministry of Foreign Affairs, and more licensing and utilities databases.

- (iv) **Explicitly link assessments of URA's performance to demonstrated, real growth in the active taxpayer register.** This will improve URA's incentives to prioritise registration efforts, while preserving the integrity of the register.
- (v) **Adopt a simple and fully online registration system.** This would reduce the registration burden for taxpayers and facilitate automatic cross-checking of information with other databases.
- (vi) **Enforce the regulation of key sectors, particularly alcohol, real estate, and transportation.** Ensure that all actors in these sectors are fully registered or barred from operation. Furthermore, URA should have access to these business registers to enhance compliance.

Taxpayer Education, Service, and Communication

Facilitating full compliance requires improving both the efficiency and quality of taxpayer services. Recognising the link between better tax services and tax compliance, many revenue administrations have developed taxpayer service strategies centred on:

- (i) Reducing taxpayer uncertainty by clarifying legal and procedural ambiguities;
- (ii) Limiting the frequency with which the tax system is changed;
- (iii) Tailoring taxpayer services and information based on the characteristics of different taxpayer segments and underlying factors motivating non-compliance; and
- (iv) Setting service delivery standards and measuring performance against these standards, such as average time to process taxpayer refunds or resolve disputes.

While URA has a robust programme to promote access to information, through a range of user-friendly channels, the use and frequency of methods to obtain performance feedback from taxpayers on the standard of services provided is weak (Okello, et al., 2019). URA could benefit from the application of periodic independent taxpayer satisfaction and perception surveys to measure performance and perception over time, and survey results should be incorporated into future strategic plans. Furthermore, URA's taxpayer awareness and education campaigns are not embedded into a comprehensive programme and reflect an isolated approach unconnected to a compliance improvement strategy. There is a need to develop and implement a full taxpayer education and service strategy to promote transparency, information-sharing, partnership with stakeholders, and facilitating taxpayers through improved service provision. Finally, there is only limited integration of feedback from taxpayer perception surveys into URA's strategic planning and policies (World Bank, 2018).

Targeted Challenges

- (i) **URA has conducted expansive taxpayer awareness and education campaigns, however these have not been aligned to an overarching strategy.** Ad hoc and isolated campaigns have had limited impact. The current campaigns use multiple

media channels, are divided by region and sector, and collaboration with universities and non-governmental organisations is not done systematically. Furthermore, tax education is not yet part of the school curriculum. Finally, feedback from previous education and compliance campaigns is not systematically built into strategic planning for the future.

- (ii) **Taxpayer guides are not easily accessible, particularly as they are published in no official language other than English.** Filing guides on the e-Filing system and URA website are outdated and overly-technical. Taxpayer feedback indicates that taxpayers are routinely told to consult the tax laws when they have approached URA personnel for assistance.
- (iii) **Limited taxpayer facilitation through the e-Filing portal.** Taxpayer feedback suggests that the e-Filing system faces several weaknesses, including broken links, complicated language, difficulties in navigating to the desired page, and a lack of filing guides with information that matches the current filing system.

Interventions

- (i) **Develop a taxpayer engagement strategy premised on research and survey analysis, which has a logical design, clear objectives, and is tested amongst taxpayers before full roll-out.** This would improve the understanding of what is effective and solicits the desired response. The approach should be well-researched and systemically derived.
- (ii) **Clear, comprehensive, and easy-to-navigate tax guides should be made available to the public.** This would allow taxpayers to easily identify the relevant tax rates that apply to them, both personal and corporate. This should include publishing guides in languages other than English, particularly Luganda and Kiswahili.
- (iii) **Make online services more user-friendly.** The eTax help pages need to be updated, the layout of the website should be improved to make documents and resources easier to find, and all links should work. URA should also consider developing a system for reporting and resolving technical issues on the website (such as a resource not found or a page not loading correctly).
- (iv) **Regularly conduct taxpayer perception surveys and incorporate results into tax administration strategies.** URA would benefit from independent taxpayer satisfaction and perception surveys, conducted by a third-party on a periodic basis to measure service performance. In addition to quantifying compliance costs and risk perceptions of non-compliance, these surveys can measure the capacity of businesses to comply with tax laws, taxpayer perceptions about the availability of reliable information, attitudes towards compliance and evasion, perceptions of the competence of the tax authority, and weaknesses in the tax regime. Establish an institutional arrangement to take effective remedial action against negative feedback.

- (v) **Move towards a 24/7 “virtual office”.** This would enable URA to provide a wider range of services without requiring taxpayers to visit a tax office, such as fully online registration, submission of tax appeals, and a range of automated notifications and reminders. Furthermore, this could include providing a free service to those who cannot afford to hire tax consultants to help file returns and pay.
- (vi) **Enhance political engagement and leadership in tax education campaigns, as well as political support for taxpayer perception surveys and a stated commitment to action based on the conclusions.**

Timely and Accurate Filing

The tax system relies heavily on timely, accurate and complete reporting by taxpayers in their tax declarations. To mitigate fraud and revenue losses, tax administrations should therefore undertake a range of actions to ensure compliance. This includes verification activities (such as tax audits, investigations, and matching against third-party data) and proactive initiatives promoting cooperative compliance. Despite some interventions by URA, such as the establishment of a dedicated High Net Worth Individual Unit, non-compliance with filing obligations by prominent citizens, leading professionals, and highly-profitable businesses remains high. Limited focus on enforcing filing of tax returns and the large number of estimated assessments that are generated has contributed to the increase in disputes and uncollectible tax arrears (discussed in the next section) (Okello, et al., 2019). While electronic filing has been made mandatory for all taxpayers, on-time return filing ratios are low, although the full extent cannot be determined due to data limitations.

Low filing rates are prevalent across CIT and PIT, although PAYE displays a slightly better performance, and have changed little since FY2013/14. Client relationship managers monitoring filing at the Large Taxpayers Office have had a substantial effect, with CIT filing rates up to 86% and VAT up to 97% for taxpayers in these categories (Okello, et al., 2019).

Table 17: Filing of Tax Declarations

	FY2013/14	FY2017/18
CIT		
Number of declarations filed on-time	14,533	22,687
Number of declarations expected ³¹	43,919	72,995
On-time filing rate	33.1%	31.1%
PIT		
Number of declarations filed on-time	11,898	24,420
Number of declarations expected	90,185	168,024
On-time filing rate	13.2%	14.5%
PAYE Withholding		
Number of declarations filed on-time	96,013	171,326
Number of declarations expected	163,353	284,105
On-time filing rate	59%	60.3%
VAT		
Number of declarations filed on-time	123,164	171,147
Number of declarations expected	176,155	204,981
On-time filing rate	70%	83.5%

Source: TADAT (2019) & TADAT (2015)

Targeted Challenges

- (i) **On-time filing ratios for CIT and PIT are low and largely stagnant since FY2013/14.** The percentage of CIT declarations filed by the statutory due date as a percentage of the number of declarations expected was 33.1%, and for PIT the rate was just 14.5% for FY2017/18 (Okello, et al., 2019). The on-time filing rate across FY2017/18 for VAT was 83.5%. Many registered taxpayers completely fail to file returns and little follow-up action is taken.
- (ii) **Pre-filled filing is not available, inaccurate reporting on returns, and a high prevalence of fraudulent and fictitious behaviour.** The government and private systems are not interfaced to facilitate pre-filled filing. Mis- and under-reporting is common among both individual and non-individual taxpayers, especially given the ubiquity of cash transactions in the economy. Some providers of professional services minimise their tax liability by under-reporting income or claiming excessive deductions. Compliance problems are further compounded by salaried individuals, subject to PAYE, failing to report incomes derived from conducting wide-ranging, highly-profitable business outside of their regular employment. Non-compliant individuals are prone to “hiding” large amounts of income in profitable, untaxed real estate. Research indicates that untaxed income is commonly used to acquire and register property through third parties, especially family members. On VAT, many taxpaying VAT-registered persons over-declare their inputs, claiming

³¹ The number of declarations that URA expected to receive from registered taxpayers that were required by law to file declarations.

larger VAT credits than they are due. Using firm-to-firm transaction data, IGC (Almunia, et al., 2015) found that 87% of seller-firms declare amounts lower than those declared by the buyer. For these pairs of firms, 9,631 unique sellers were identified as under-reporting transaction amounts, with non-declared sales amounting to UGX 4,148 billion. This has an impact on the governmental VAT account – research indicates that if Government were to pay all offset claims indicated in taxpayer returns, all cash VAT would be refunded.

- (iii) **A high number of fictitious or dormant taxpayers complicates and obscures the true register.** Between FY2012/13 and FY2017/18, URA’s Tax Investigations Department found that, of the 179 taxpayers investigated, 40% were fictitious, despite generating invoices worth over UGX 200 billion. Further, over 2,000 taxpayers sought VAT credits using fictitious invoices.
- (iv) **Connectivity in certain regions is not reliable so the environment cannot support a fully online system.**

Interventions

- (i) **Introduce measures to strengthen the effectiveness of self-assessment.** Self-assessments can be better facilitated through: (a) moving taxpayer filing towards a fully-online system, allowing for automatic cross-checking, and later introducing pre-populated returns with data from third-party sources, and (b) enforcing strict penalties for non-filing and late filing. This will require improving the usability of the e-Filing portal and strengthened data exchange, as above. Targeted audits, based on risk assessment, should be enhanced to ensure the accuracy of filing.
- (ii) **Adopt monitoring of inaccurate reporting as a part of URA’s routine work, especially in the large taxpayer sector and HNWI.** For instance, in the real estate sector, purchasers should have to document their TIN in the purchasing sale agreement, and separately disclose the source of funds for the purchase.
- (iii) **Work more closely with relevant regulators to improve filing compliance.** This should include using regulators’ registers to find unregistered and non-filing taxpayers, as well as deny the renewal of licences to operators who cannot prove that they have met their tax obligations.
- (iv) **Address infrastructure constraints by offering points for connection across the country.**

Timely Payment of Taxes

Taxpayers are expected to pay their taxes by the due dates delineated in the tax laws and regulations. Non-payment and late payment of taxes has a detrimental effect on government budgets and cash management. Collection of tax arrears is costly and time-consuming. Achieving a low incidence of tax arrears depends on a high level of on-time filing to establish amounts owed and quick follow-up when payment is due. As evidenced below, there is a high

stock of arrears, which have more than doubled over the past three years and severely constrain tax performance. In addition to the significant rise in the stock of arrears, most of this is old debt. Tax arrears older than 12 months has grown from 23.6% in 2016 to 78.2% in 2018. Although URA has a debt management unit, the debt recovery and debt write-off procedures have not managed to reduce the amount of tax arrears older than 12 months effectively.

Table 18: Value of Tax Arrears (UGX Billions)

	FY2015/16	FY2016/17	FY2017/18
Total net tax revenue collections	10,786	12,262	13,867
Total tax arrears, including tax, penalties, and accumulated interest	1,218	1,961	2,560
Arrears as % of total tax revenue	11.29%	15.99%	18.46%
<i>of which: Collectible</i> ³²	252	253	667
Collectible arrears as % of total tax revenue	2.14%	2.06%	4.81%
<i>of which: Older than 12 months</i>	288	614	2,002
Older than 12 months as % of total tax arrears	23.65%	31.31%	78.20%

Source: TADAT (2019)

Table 19: Stock of tax arrears, as of March 2018

Type of debt	Outstanding arrears, UGX billions	% of outstanding arrears
Government arrears	74.1	3.1%
Non-government arrears	1,268.3	53.5%
Cases under court	1,028.5	43.4%
Total tax arrears ³³	2,370.9	

Source: Uganda Tax Administration Assessment Report, World Bank (2018)

Targeted Challenges

- (i) **The number and value of VAT payments made by the statutory due date are low.** The percentage of VAT payments made on time was just 48.9% in FY2017/18, weak relative to international good practice. The on-time payment rate by value³⁴ was higher, at 63.8% (Okello, et al., 2019).
- (ii) **Weaknesses in URA's ability to monitor and enforcement payment.** Approximately 48% of active taxpayers, across all tax heads, actually pay taxes.

³² "Collectible" tax arrears are defined as the total amount of domestic tax, including interest and penalties, that is overdue for payment and not subject to collection impediments. This generally excludes: (a) amounts formally disputed by the taxpayer and for which collection action has been suspended pending the outcome; (b) amounts that are not legally recoverable (e.g. debt foregone through bankruptcy); and (c) arrears otherwise uncollectible (e.g. the debt has no funds or assets).

³³ This differs slightly from the value reflected in Table 18 due to the different period under review.

³⁴ This reflects the value of VAT payments made by the statutory due date as a percentage of the total value of VAT payments due.

- (iii) **The stock of tax arrears is very high and comprises mainly old debt.** Table shows that in FY2017/18, arrears amounted to over 18% of net tax revenue, indicating that significant revenues are “uncollected”. Furthermore, the value of tax arrears has increased sharply in recent years, mostly due to a high number of non-governmental tax arrears. It is likely that the bulk of this debt is concentrated among a few taxpayers, calling for a risk-based approach to debt management. The procedures for writing off small or uncollectible arrears are weak and tax debt collection mechanisms are not fully-automated.
- (iv) **Government is one of the biggest contractors in the economy, yet data on government payments is not leveraged to enforce tax compliance.**

Interventions

- (i) **Strategies to reverse the current arrears and audit trends will be prioritised and developed in conjunction with URA and external support.** This should focus on non-government debts and tax arrears at the courts. It is recommended to incorporate collectability curve analysis, focusing on most recent debts, as the rate of recovery declines as arrears get older. URA should prioritise cases based on risk criteria including value, age, a taxpayer’s payment history, and collectability. Uncollectible arrears, such as when a taxpayer cannot be located or is bankrupt, should be promptly written-off. An automatic procedure for writing-off small amount debts should also be considered. Finally, URA should analyse the potential for using instalment payments.
- (ii) **Investigate options for enhancing the use of electronic payment methods,** particularly mobile money. Clarify what charges banks and other financial institutions may charge customers for payment of taxes and consider ways to make this service free to taxpayers.
- (iii) **Tax debt collection should be streamlined.** Develop a tax debt management framework that provides end-to-end procedures for accounting, reporting, collecting, and managing debt. This should include developing a policy on enforcement action, the engagement of third-parties to collect tax (such as auctioneers), the issuance and removal of agency notices, and a policy on paying in instalments.
- (iv) **Report on the status of tax arrears to MFPED on a regular basis to allow for better-informed decisions about necessary tax collection policies and procedures.**
- (v) **Empower URA to properly track payments made by government to contractors.** This should include building an eTax to BOU and IFMIS interface and interfacing eTax with the URA Enterprise Resource Planning system under implementation.

Tax Audit

Where voluntary compliance initiatives fail, the tax administration relies on effective enforcement strategies to deter, detect, and address non-compliance. With a low tax effort and high evasion, URA needs a smart approach to audit assessments and enforcement, premised on identifying the most significant risks. Audits are carried out to examine whether taxpayers have correctly assessed and reported their tax liability. If well-designed and managed, tax audits can have a far wider impact than simply raising additional revenues by identifying discrepancies. Detecting and penalising serious offenders serves as a reminder to all taxpayers of the consequences of inaccurate reporting and avoidance.

As an indication of URA's challenges, the table below shows the recent domestic tax audit performance. While URA has largely achieved the target number of audits per annum, this target has declined over the past three financial years, partly due to insufficient resources. Furthermore, the audit yield (the amount collected against the amount assessed) has declined dramatically.

Table 20: Domestic taxes audit performance

	FY2015/16	FY2016/17	FY2017/18
Target number of audits	2,540	2,386	1,113
Audits completed	2,739	1,908	1,345
Performance against target	108%	80%	121%
Amount assessed (UGX Bn)	309.56	366.71	291.68
Amount collected (UGX Bn)	146.19	88.36	45.35
Audit yield performance	47%	24%	16%

Source: URA Annual Report FY2017/18

Key limitations, including the lack of access to third party data, has limited URA's knowledge of the extent of business in the economy, as tax return information cannot be cross-checked effectively against taxpayer financial information or other governmental payment data. Furthermore, URA currently does not fully exploit technological solutions that assist in detecting inaccurate reporting, such as electronic receipting and digital tax stamps. These interventions have yielded positive results in other jurisdictions. For instance, in Ethiopia, research found that after the adoption of electronic sales registry machines (ESRMs), the average amount of VAT paid by firms increased substantially, and this effect is driven by firms that were more likely to evade taxes prior to the introduction of the ESRMs. The evidence suggests that ESRM adoption strengthened the administrative capacity and enhanced tax compliance among riskier firms (Ali, et al., 2015). However, this comes with an important qualification – the study only estimated the effect on firms *already registered* for VAT. If increased enforcement via ESRMs incentivised firms to shift operations underground, beyond the sight of the tax system, the revenue gains from ESRM use may be reduced through increased informality.

Targeted Challenges

- (i) **URA has not fully adopted technological solutions to promote compliance.** Whereas Government has adopted a policy mandating the use of digital tax stamps and put in place the necessary legislation, the implementation of this policy has not occurred. Digital tax stamps are a physical paper stamp applied to goods or their packaging containing tamperproof codes to verify the authenticity of the products and trace product movement. Furthermore, URA has not adopted electronic receipting technology, which would require a taxpayer to issue an e-invoice or e-receipt or employ an electronic fiscal device which is linked to a centralised invoicing and receipting system, or a device authenticated by the URA.
- (ii) **URA's risk-based audit approach is weak and case management remains partially offline.** Tax audits are a key element of URA's efforts to increase compliance and are used to: (a) detect and address individual cases of non-compliance, (b) foster voluntary compliance by increasing the probability of detection and penalties, and (c) gather data on evasion techniques used by taxpayers and detect loopholes in the tax system. Although URA's current approach uses some risk criteria to assess compliance through an excel sheet format, the eTax system does not currently support automatic case selection based on risk parameters. A lack of transparency in this process creates scope for abuse and bypassing the established procedure. Furthermore, comprehensive audits are time-consuming and URA does not have enough staff with specialised audit skills to target high-risk sectors and international taxation (World Bank, 2018).
- (iii) **Audit functions are separated across tax areas.** As URA continues to move towards effective segmentation of taxpayers, tax audits have become increasingly siloed and process integration is limited. Domestic tax audit, customs audit, and investigations processes are not well-integrated. This could lead the duplication of effort and limits the sensitivity to establishing links and common processes across taxpayer segments.

Interventions

- (i) **Consider the adoption of an electronic receipting and invoicing to monitor real-time production and sales.** International evidence suggests that such solutions have powerful compliance effects.
- (ii) **Fully implement the recently-adopted policy on digital tax stamps.** These stamps aid in combatting illicit trade, counterfeiting, tax evasion, and smuggling. In addition to improving revenue collection, the stamps protect consumers from counterfeits, enable the pre-population of returns, accelerates customs clearance, and enables traders and manufacturers to monitor the movement of goods easily.
- (iii) **Bring the entire audit and payment process online, allowing for improved oversight and checks.** Case selection should be automated based on distinct risk parameters and prompts should be entirely automatic. This will require increasing

the capacity of URA audit and investigations personnel, as well as modification to the risk system.

(iv) Strengthen URA’s audit function by adopting modern audit tools, enhancing the use of risk-targeting, and increasing the number of “mass audits”. This should include expanding the use of Computer-Assisted Tools to improve tax audit results and enhance the technical skills of tax auditors, focusing on sector-specialisation, especially international taxation. In addition, URA should increase the number of lifestyle audits undertaken among risky individuals. Consumption patterns can be used to infer incomes where under-reporting is a particular concern, such as purchasing vehicles and land, and the frequency of international travel. Transactions such as these can be used to make a presumptive tax assessment, thus shifting the burden of proof to the taxpayer. Finally, URA should consider adopting more “mass” or automated audits to increase audit coverage and the perception of risk. This would enable systematic matching of third-party information with tax return information to verify tax returns and detect non-compliance in a low-cost way.

(v) Expand the use of intensive sector-based audits for high-risk areas. There is always a case for auditing the entire company where risk assessments suggest that income reported, and taxes paid, fall below established norms. However, there can also be a case for carrying out targeted audits of certain types of company. The hospitality sector, for example, is often considered to have three key areas of risk:

- a. The under-reporting of occupancy and room tariffs at hotels, leading to an understatement of gross revenues for CIT purposes;
- b. The under-reporting of staff remuneration, especially where staff are employed for relatively short periods, leading to the under-declaration of PAYE; and
- c. The misdeclaration of sales of food and drink, typically in conjunction with an absence of fiscal receipts, leading to an understatement of gross revenues for both VAT and CIT purposes.

An audit programme focused on hotels and targeted at these three areas would potentially be much less resource-intensive for the URA than a series of full company audits. Announcing the programme in advance and giving taxpayers a short period in which to revise their returns would stimulate higher levels of compliance across the sector. Initial audits could potentially be supported by industry-experienced audit personnel loaned for short periods by donors.

(vi) Promote process integration. If audit functions remain separated by taxpayer segment, then collaboration and joint activities, where necessary, should be intensified to gain synergies across these sections. Coordination between tax audit and tax investigation should also be strengthened, allowing for a referral programme that would require auditors to refer cases to criminal investigation where there exists a firm indication of fraud. This would require a dedicated set of

policies and procedures, and specific training. URA should also analyse the option of developing integrated compliance plans that incorporate the entire lifecycle of non-compliance, to include targeted criminal investigations.

- (vii) **Include reports on audit activities and outcomes as an integral aspect of the regular reports that URA makes to the Minister of Finance.** These reports could be appropriately anonymised to mask taxpayer identities but would foster greater accountability for audit action. Audit yield should be adopted as one of the key indicators to monitor URA's performance.

Investigations & Enforcement

URA's Investigations Department carries out annual risk and threat assessments to determine problem areas. The identified areas are then investigated using information sourced internally and externally. However, poor access to technology, a lack of specialised skills, and low staff numbers have limited the ability to effectively tackle tax fraud, particularly as sophisticated tax crimes have proliferated, and transactions have become increasingly difficult to trace online.

Targeted Challenges

- (i) **The investigations department relies on exchange of information on request when tackling international tax evasion and other tax crimes, but access to this information is limited to prior knowledge of tax fraud.** Uganda currently has 431 multinational enterprises with registered operations in the country, all of whom have highly mobile finances. In FY2017/18, 49.2% of these reported losses, amounting to over UGX 320 billion. Without comprehensive information from other tax jurisdictions, the department is ill-equipped to handle fictitious cross-border transactions, unreported incomes, illicit flows, and aggressive tax planning.
- (ii) **URA's dedicated investigative resources and skills are not commensurate to the challenges faced and the rapid pace of changes in technology.** For instance, the abilities of the scientific and forensics laboratories do not match the sophisticated nature of cases that they are required to investigate.
- (iii) **Deterrents for non-compliance are not sufficiently strong.** While investigations are undertaken to provide a deterrent to fraud, the existing criminal penalty regime for tax offences may not be strong enough. For instance, a taxpayer who does not file a tax return by the due date is liable, on conviction, to a fine not exceeding UGX 500,000. A taxpayer who knowingly or recklessly fails to maintain proper records or makes false or misleading statements is liable to a fine of up to UGX 960,000 or imprisonment for a maximum of two years, or both.

Interventions

- (i) **Implement the Automatic Exchange of Information and Common Reporting Standards for tax purposes.** These protocols help to combat international tax evasion and detect illicit financial flows and transfer pricing issues through enhanced cooperation with other tax jurisdictions. They also expand the sources of information available to URA, covering traditional sources such as banks, and non-traditional forms of businesses, like e-commerce. With such information, the investigations department can detect evasion, as well as find new taxpayers.
- (ii) **Enhance resources to equip scientific and forensic laboratories and facilitate international accreditation.** Resources to facilitate the acquisition of relevant technologies, skilled staff, and necessary training should be prioritised. URA should adopt international standards, particularly to allow for the admittance of evidence into court.
- (iii) **Intensify penalties for non-compliance and increase the number of tax investigations.** This should include establishing a collection strategy that includes full use of asset seizures where appropriate and pursuing criminal prosecution for serious non-compliance. Strong enforcement gives teeth to the law.
- (iv) **Publicise the results of enforcement initiatives and criminal prosecutions.** Without publicising the success of efforts to curb non-compliance by specific taxpayers, enforcement programmes will have limited deterrent effect as they are not visible, and thus not as threatening. Publicity can occur at various points in the lifecycle of criminal investigation – upon indictment, after prosecution or when pleading guilty, and at the sentencing phase (so long as the sentence is sufficiently harsh to deter future non-compliance).

Dispute Resolution

Independent, accessible, and efficient review mechanisms safeguard a taxpayer's right to challenge a tax assessment and receive a fair hearing in a timely manner. In Uganda, this process is enshrined in the legal framework and taxpayers can dispute: (i) the accuracy of the facts used by the auditor, (ii) the correctness of interpretation of the tax law, and (iii) the amount of penalties imposed by URA. URA has adopted a tiered review mechanism, starting with submission to the internal Objections and Appeals Unit (OAU) for an administrative review. Where a taxpayer is dissatisfied with the outcome of an administrative review, the case may be escalated to the Tax Appeals Tribunal (TAT). After TAT, taxpayers can seek further redress by going to the High Court.

Currently, the tax administration is not adequately responsive, and the time taken to complete reviews is slow. During FY2017/18, only 79.5% of cases were finalised within 3 months (Okello, et al., 2019). Between 2008 and 2016, TAT received an average of 38 new cases per annum and resolved an average of 28. Over this period, the number of cases grew by 25% while the number of pending cases increased by 38.5%, indicating that the pace of case

resolution is not keeping up with the pace of new cases lodged (Sserunjogi & Lakuma, 2019). The high number of pending cases tie up large amounts of revenue and impact on business sentiment, as businesses are deterred from investing more by difficulties in resolving outstanding cases. Feedback from taxpayers suggests that the administrative review process is not well streamlined and there is a perception that it unduly favours the tax authority.

Table 21: Finalisation of administrative reviews, FY2017/18

	Number of cases	% of total
Finalised within 30 days	2,798	40.7%
Finalised within 60 days	407	5.9%
Finalised within 90 days	2,263	32.9%
More than 90 days	1,412	20.5%
Total finalised	6,880	

Source: TADAT (2019)

Targeted Challenges

- (i) **TAT staff are not properly facilitated to handle their large mandate.** The Tribunal only has five members, who are not employed on a full-time basis, and the Chairperson can only hold office for a three-year term, which does not allow for meaningful contributions as it takes time to gain experience. Furthermore, judicial officers who have acquired substantial training on tax matters are routinely transferred elsewhere, where tax disputes are not handled. TAT members are not given training on complex areas of taxation, such as international tax and transfer pricing, hampering the resolution of cases.
- (ii) **Human resource constraints are compounded by financial limitations.** The Tribunal only sits three times a week to hear cases and does not have financial resources to increase this. Furthermore, the Tribunal does not have funds for reporting its decisions. With respect to infrastructure, TAT does not have a well-stocked library to enable members to carry out research, access to online journals and libraries is insufficient, and office space is limited, resulting in no operational registry.
- (iii) **Limited public awareness of TAT operations and confidence in its independence from URA and MFPED.** Many taxpayers view TAT as an arm of URA and a tax-collecting institution, which negatively impacts on the perception of TAT's autonomy and ability to fairly adjudicate disputes. Furthermore, Members of Parliament and MFPED often quantify TAT's performance in terms of revenue generated, complicating its incentives.
- (iv) **Awareness and independence of the OAU.** Taxpayer feedback indicates that confidence in the independence of the OAU from URA is low, as the OAU belongs to the same institution who taxpayers feel "harmed" by. There is a need to improve the awareness of the entire dispute resolution mechanism and its separation from URA's other operations.

Interventions

- (i) **Facilitate TAT to expeditiously deal with cases by increasing staff training and numbers.** The training budget for TAT should be increased and members should have access to training opportunities available within URA and MFPED. The Chairperson of TAT should be appointed as a full-time position, on par with commissioners at URA and MFPED, and the terms of services of TAT members should be extended to allow members to gain the necessary experience and contribute meaningfully.
- (ii) **Provide adequate funding for TAT to cover infrastructure and resource constraints.** If not properly resourced, TAT can easily be compromised and overpowered by private-sector legal professionals in court. The principle used to provide a budget to URA should be extended to TAT, providing adequate financial resources, equipment, and infrastructure.
- (iii) **Improve the perception of the OAU and TAT among the public by providing information on the entire process of dispute resolution.** Ensure that the OAU and TAT are sufficiently independent from URA and MFPED and increase their presence and accessibility to taxpayers across the country.

Processing of Tax Refunds

In line with best practice, all refund claims are subjected to automatic risk assessment and review by a URA officer. Claims that are considered suspicious are subjected to a pre-refund audit, while credible cases receive lighter checks. However, few refund claims are processed timeously – of the 3,365 refund cases received in FY2017/18, only 6% were processed within the 30-day standard.

Table 22: VAT refunds for FY2017/18

	Number of cases	Value of claims (UGX)
Total VAT refund claims received	3,365	544 billion
Total VAT refunds paid	1,742	211 billion
Of which, paid within 30 days	132	8 billion
Total VAT refund claims declined	692	120 billion
Of which, declined within 30 days	74	6 billion
Total VAT refund claims not processed	931	212 billion

Source: TADAT (2019)

Targeted Challenges

- (i) **Processing of refunds is inefficient.** Analysis suggests that less than 50% of refund claims are paid promptly, and often not equivalent to the full amount approved. This gives the impression that the refund system is arbitrary, contributing to fraud and leakages.

Interventions

- (i) **Develop a plan to streamline the management of offsets and refunds, including the automatic cross-matching of taxpayer declarations within eTax every filing season.** Increasing resources to manage this process is likely to unlock increased revenue held up in illegitimate offsets. However, given the extent of VAT fraud, improving refund management should be balanced with a carefully planned and well-executed VAT compliance strategy. The effectiveness of the refund process could be improved by reviewing the VAT Act to increase the VAT offset thresholds, introducing a fast-track procedure for VAT refunds that would entail light controls for taxpayers who have regular contact with the tax administration, freeing up resources to handle more complex claims. Transparency in offset and refund management would be enhanced by improving online access to information about the amount and status of refunds due. Furthermore, URA should explore the possibilities of using big data to control compliance and management of tax refunds. To improve the effectiveness of refund processing, the DRMS envisages further eTax inter-module integration and effective eTax-ASYCUDA interfacing.

Targeted Compliance Improvement Initiatives to Mobilise Revenue

Certain sectors pose greater compliance risks and attract more revenue than others. Thus, specific compliance initiatives have been prioritised for the following areas: customs, the extractive industry, and high net-worth individuals.

1. Customs and Trade Facilitation

Uganda is an East African Community (EAC) partner state within the single customs territory (SCT). Goods originating from outside of the EAC are cleared at the external borders, with customs declarations and duty payments made directly into the IT systems of the destination countries. Further, the SCT aims to facilitate circulation of all goods (EAC and non-EAC) within the community. However, misclassification, misdeclaration, short landing, abuse of rules of origin, dumping of transit cargo, and outright smuggling pose a substantial risk to customs trade facilitation and revenue mobilisation.

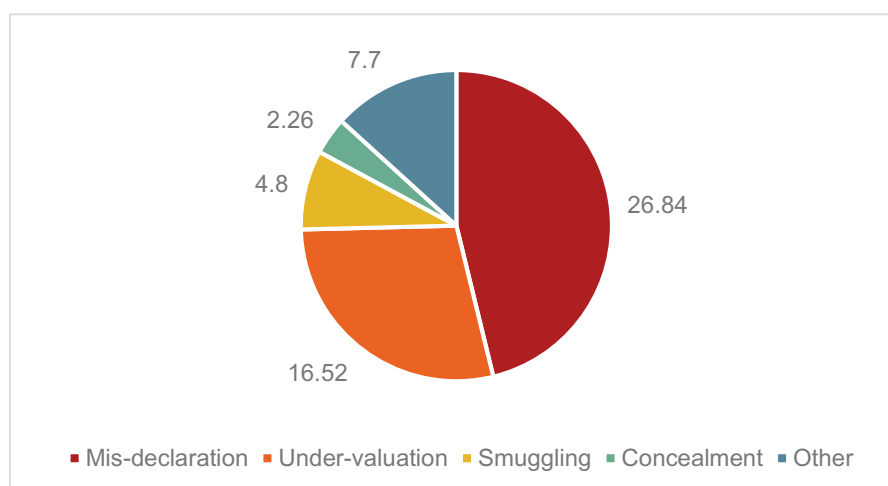
Targeted Challenges

- (i) **Targeting of high-risk cargo has not yet been adequately developed to achieve the expected results.** The proportion of goods cleared through the green and blue channels is still low, and the hit rates for the red and yellow channels are low, at 20% and 5% respectively. In a fully-effective risk management system, this rate should be closer to 50%. The current results indicate that a high proportion of red channel selections should have been channelled as green, which presents a significant obstacle to the facilitation of legitimate trade. Furthermore, the risk

management system is not fully automated, slowing clearance processes and resulting in only partial use of data to anticipate and mitigate non-compliant behaviour.

- (ii) **ICT solutions are sub-optimally applied to Customs risk management.** Customs is not able to adequately assess risk from the large volume of data generated from its interactions with trading partners through ASYCUDA-World. This inhibits the ability to comprehensively profile risk among authorised operators.
- (iii) **Undervaluation and misclassification continue to present significant challenges and cargo control is weak.** Additionally, smuggling remains a major offense reducing the volume of revenues collected from import tariffs. Long and porous borders and the importance of transit trade pose a real risk to revenue in Uganda, as does the low coverage of the electronic tracking system. Currently electronic seals cover only 25% of transit cargo, which has resulted in significant cargo dumping. The figure below showing revenue recovered from enforcement interventions, indicating the profile and extent of known revenue losses – UGX 60.68 billion was recovered in FY2017/18. This is likely to understate the true extent of Customs tax and tariff evasion as URA is unable to detect all offenses.

Figure 14: Revenue recovered (UGX billions) from Customs enforcement, FY2017/18



Source: URA Annual Report FY2017/18

- (iv) **Poor data exchange with other jurisdictions inhibits URA's ability to detect non-compliance.** Currently, a bilateral Customs Mutual Assistance Agreement exists between Uganda and South Africa, but the use of these should be expanded to other jurisdictions.
- (v) **Limited use is being made of advance information facilitating pre-clearance.** This is especially clear at the Mombasa Port, where pre-clearance arrival could be a useful measure to decongest the Malaba border post, which is facing challenges in terms of infrastructure and system connectivity.
- (vi) **A high usage of bonded warehouses gives rise to opportunities for leakages.** Around 95% of entries coming from Mombasa Port use bonded warehousing to

enter overseas goods into Uganda (World Bank, 2018). This is highly unusual, has implications for effective cargo control, and risks revenue. Reporting on warehousing performance and auditing of warehouse keepers is not systematic. For instance, online notification to importers who overstated goods is limited.

Interventions

- (i) **Strengthen and properly embed risk management practices in Customs.** The objective is to target high-risk sectors more effectively and improve the allocation of resources to deal with high-risk activities. Risk criteria should therefore be closely monitored to determine whether they are achieving the intended results. Improve the feedback mechanism for enhancing the risk management system, allowing for oversight of the performance of the risk criteria as well as the performance of the inspectors. Furthermore, managerial and procedural initiatives should be developed to ensure that automated risk management achieves set targets in terms of selection and facilitation.
- (ii) **Develop electronic systems to record incidents in customs processes,** including errors, procedures not acquitted in time, and arrears, to assist risk management. Furthermore, intelligence information such as tip-offs from informers and border agents should be recorded electronically to allow for proper follow-up. Swift enforcement action should follow any incident.
- (iii) **Strengthen the capacity to monitor transit procedures, detect evasion and non-compliance, and sanction offenders.** This should include expanding the use of modern equipment such as scanners and electronic seals to facilitate tracking and fully realise the potential of the Regional Electronic Cargo Tracking (RECTS) system. Analytical research should be performed by URA to establish emerging business trends with a view to managing classification and valuation risks. Furthermore, the inspection of incoming air passengers should be enhanced, with luggage examination supported by an automated profiling system.
- (iv) **Agree Customs Mutual Assistance Agreements (CMAA) and electronic exchange of information agreements with major trading partners.** This should include China, Japan, India, the United Arab Emirates, and Korea. Build the capacity of the URA Valuation Unit to undertake indicative research of comparable values, including the analysis of mirror data,³⁵ using data from the CMAAs and publicly available third-party information³⁶. Enhanced information exchange would also enable external users to generate trade statistics online, improving the transparency of Customs operations.

³⁵ Mirror data can be used to measure the gaps between exports to Uganda reported by a partner country and imports from that same partner recorded in ASYCUDA World by Customs domestically.

³⁶ This could include sources such as the UN COMTRADE database, UNCTAD commodity price long-term trends, and IMF and World Bank commodity price data.

- (v) **Make more pre-arrival and pre-clearance options available to facilitate the clearance of most entries at Mombasa Port.** This should include having a fully-fledged Ugandan Customs clearance office in Mombasa with adequate facilities, resources, and legal powers.
- (vi) **Enhance warehousing control.** This can be done by enhancing the automation of procedures and improving monitoring of restricted entry to customs-controlled areas, for instance by introducing smart access cards and by updating warehousing licensing standards. Customs should also aim to increase the direct clearance of goods for domestic consumption.

2. Extractive Industries Sector

In addition to mainstream non-oil revenue, Uganda is poised to become a major oil producer over the DRMS period. Managing compliance in the Extractive Industries sector is a relatively new challenge for URA. Formulating an appropriate risk-based strategy for the sector and developing a capable workforce with a sound understanding of the fiscal regime will be essential.

Targeted Challenges

- (i) **Numerous agencies have been created or nominated to manage oil extraction, such as the Uganda National Oil Company (UNOC), Uganda Chamber of Mines and Petroleum, and the Petroleum Authority of Uganda.** This has increased the risk of duplication, competing priorities, and introduced a lack of clarity over oil revenue management.
- (ii) **Delays in VAT refund payments constrain the cash-flow of natural resource companies.** This is partly due to the burdensome administrative requirements and procedures, but also due to URA's lack of financial resources to make payments, as the payment of refunds continues to be restricted by a budgeted amount for refunds.
- (iii) **Limited sectoral knowledge and technical expertise at URA to handle unique complexities.** As the sector migrates from exploration and development to production, refining, transportation, and marketing, URA staff will increasingly need to develop oil and gas expertise. Furthermore, knowledge of mining sector operations should be expanded.
- (iv) **Lack of a comprehensive staff development plan to build a long-term workforce capable of administering the sector.**
- (v) **The current tax return does not capture information required to assess the liabilities of mining licence holders.**

Interventions

- (i) **Clarify the mandate of the various agencies involved in oil extraction and implement memoranda of understanding to facilitate exchange of information across these agencies.**
- (ii) **Ensure that VAT refunds are paid timeously and consider moving to VAT accounting on a net basis, rather than budgeting for VAT refunds as a spending item.**
- (iii) **Build knowledge and expertise on tax issues unique to oil, gas, and mining.**
- (iv) **Develop a targeted, risk-based compliance strategy for both the oil and gas and mining sectors.** This should incorporate separate strategies for licensees as well as the large artisanal mining sector.
- (v) **Re-design the tax return form to capture more information from the extractives sector.**

3. High-Income Self-Employed and Professionals

Professional service providers in Uganda have a poor history of compliance with filing and payment obligations. This evasive behaviour is prevalent among lawyers, doctors, accountants, engineers, architects, and other professionals, who routinely earn much more than nurses and teachers (for instance), but do not have income tax deducted directly from their salaries. The situation is exacerbated by the widespread use of cash payments, limiting the ability of URA to track and trace incomes. Given their high potential revenue contribution, a specific compliance effort for these persons should be developed, in line with the principles and objectives of this DRMS.

Interventions

- (i) **Mandate that membership of professional bodies requires a valid TIN.** Ensure that this is applied and follow-up on any irregularities in TIN notifications. When renewing membership, professionals should be required to present a tax clearance certificate illustrating compliance with their tax obligations. This concept was developed in more detail in the section on [taxing the untaxed economy](#).
- (ii) **Ensure that URA is provided with data on professional society membership to facilitate data-matching and the mitigation of non-compliance with core tax obligations.** This was discussed further under the [Data Management and Analytics](#) section.

Ensuring the Success of the DRMS

MAJOR RISKS TO DRMS IMPLEMENTATION	MITIGATING ACTIONS
Inadequate financing of tax system reform, particularly of administrative interventions	<ul style="list-style-type: none"> • Many DRMS interventions have already been included under the PFM reform programme, REAP • Undertake a costing exercise to budget properly for remaining interventions • Leverage existing donor support programmes, such as the DFID “DRUM” programme, TAXDEV and USAID
Poor coordination, overlapping programmes of support, and the misallocation of resources	<ul style="list-style-type: none"> • Develop a comprehensive implementation plan detailing responsibility centres • Coordinate development partner (DP) involvement through existing frameworks (DRM Committee, PFM cluster groups) to streamline interventions • Ensure that DP involvement is demand-led, focused on the DRMS priorities • Routinely report on the progress and outcomes of interventions at DRM Committee meetings • Leverage the REAP coordination framework
Weak monitoring and evaluation	<ul style="list-style-type: none"> • Establish a baseline set of indicators to track the DRMS progress • Leverage the M&E abilities of the Budget Monitoring and Accountability Unit at MFPED • Undertake rolling annual reviews and update the strategy based on changing environments

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ANNEX I

SCHEDULE I – TAX POLICY

Proposed Intervention	Priority ³⁷	Revenue gain/(cost)	Timing	Consultation ³⁸	Legislation ³⁹
<i>Process reform and institutional changes</i>					
1 Reform of the tax policy-making process	H	n/a	19/20-20/21	Y	N
2 Elevate the status of taxation within MFPEd	H	n/a	19/20	N	N
3 Enhance the analytical capacity of TPD & URA	H	n/a	19/20-21/22	N	N
4 Address TPD structure and staffing/training needs	H	(L)	19/20-20/21	N	N
5 Strengthen partnership with URA and formalise arrangements	H	n/a	19/20	N	Y
<i>VAT</i>					
6 Maintain principal zero-ratings/exemptions	H	n/a	19/20	N	N
7 Review other zero-ratings/exemptions	M	L	19/20-20/21	Y	Y
8 Narrow deeming provisions	H	H	19/20-20/21	Y	Y
9 Re-assess registration threshold and rate	M	TBD	19/20-20/21	N	Y
10 Standardise government best practices	n/a	n/a	19/20	N	N
<i>GIT</i>					
11 Maintain support for priority sectors	H	n/a	n/a	N	N
12 Support workforce education/training	H	(M)	19/20-20/21	Y	Y
13 Rebalance the nominal rate and the incentives, deductions, and depreciation regime	H	M	20/21-21/22	N	Y

³⁷ L = low; M = medium; H = high

³⁸ Indicates whether external consultation is required to carry out the proposed intervention.

³⁹ Indicates whether the proposed intervention requires legislative change

14	Review and renegotiate over-generous treaty provisions	H	H	21/22-22/23	N	N
15	Strengthen international tax rules and enforcement	H	H	20/21-21/22	N	Y
16	Improve information-sharing domestically and internationally	M	M	20/21-22/23	N	Y
PIT						
17	Review exemptions and consider alternative approaches	H	L	19/20-20/21	Y	Y
18	Address thresholds, bands, and rates	M	(M-H)	20/21-22/23	N	Y
19	Consider scope to encourage saving through PIT system	M	(M)	20/21-23/24	Y	Y
20	Address weaknesses in rules for taxing rental income	H	M	19/20-20/21	N	Y
Incentives and exemptions						
21	Consider measures to encourage youth into formal workforce	H	L	19/20-21/22	Y	Y
22	Establish and publish a Tax Expenditure Governance Framework	H	(L)	19/20-20/21	N	N
Excise duties						
23	Develop a broader scheme of environmental taxes	M	M	21/22-23/24	Y	Y
24	Rationalise multiple rates	L	L	20/21-22/23	N	Y
25	Introduce and enforce strict regulations for excisable industries	M	M	20/21-21/22	Y	Y
26	Consider revised approach to inflation adjustments	M	L	20/21-21/22	N	Y
Extractives industry						
27	Fine-tune the framework for taxing the extractives industries	H	H	19/20-20/21	Y	Y
International trade						
28	Balance the objectives of export promotion, revenue generation, and support to domestic industry	H	L	19/20	Y	Y

29	Improve inter-agency coordination and infrastructure	M	L	20/21-22/23	N	N
Non-tax revenue						
30	Streamline the policy on NTR	L	L	19/20	Y	Y
Local government taxes						
31	Work with local government to strengthen analysis, monitoring, and reporting	L	M	20/21-23/24	Y	Y
Donor-funded projects						
32	Review the taxation of donor-funded projects	M	L	20/21-22/23	N	Y
Digital economy						
33	Address the impact of the digital economy on the tax base	H	M	20/21-21/22	N	Y

SCHEDULE II – TAX ADMINISTRATION

Proposed Intervention		Priority	Timing
Seizing opportunities and tackling inefficiencies			
Governance			
1	Review the URA structure and consider reorganisation to promote integration	H	19/20-20/21
2	Expand the range of measures for assessing URA's performance to reduce reliance on collection targets	H	19/20-20/21
3	Strengthen the oversight function of the URA Board and the Minister	H	19/20-20/21
4	Separate Internal Audit and Staff Compliance functions to enhance dedicated attention given to corruption and staff integrity issues	M	20/21-21/22
5	Establish a separate Taxpayers' Ombudsman to investigate service-related complaints	H	19/20-21/22
Lifting the Human Resource Capacity at URA			
6	Conduct an independent staffing review	H	19/20
7	Implement a comprehensive training strategy and develop a URA tax training academy	H	19/20-22/23
8	Review the URA performance management and reward system	M	20/21-21/22
Data Management and Analytics			
9	Prioritise a data quality improvement strategy and develop processes to maintain data quality	H	19/20-21/22
10	Empower URA to access relevant third-party data	M	20/21-21/22
11	Develop a cross-government policy framework for data sharing and management	H	19/20-21/22
12	Create a formal data skills development plan	M	20/21-22/23
Information, Communication, and Technology Infrastructure			
13	Design and implement a medium-term ICT strategy	H	20/21-21/22
14	Review options available and based on a proper assessment of costs, benefits, and needs, upgrade or invest in a new eTax system	H	19/20-20/21
15	Standardise key government systems to improve integration	M	21/22-23/24
Improving the Compliance Continuum			
Taxpayer registration			
16	Regularly detect and de-register "ghost" taxpayers to cleanse the taxpayer register	M	19/20-23/24
17	Expand the use of the biometric National ID for registration	H	19/20-21/22
18	Improve URA access to external data to identify potential taxpayers	H	19/20-21/22
19	Adopt a simple and fully-online registration system for those with internet access	M	20/21-22/23
20	Enforce registration as a qualifying requirement for professions and key trades	H	19/20-20/21
21	Promote political messaging supportive of a "civic duty to register"	H	19/20
Taxpayer Education, Services, and Communication			

22	Develop and test a taxpayer engagement strategy premised on research and survey analysis	H	19/20-21/22
23	Produce clear, comprehensive, and easy-to-navigate tax guides for taxpayers	M	19/20-23/24
24	Make online services more user-friendly and intuitive	M	19/20-23/24
25	Regularly conduct taxpayer perception surveys	H	20/21-23/24
Timely and Accurate Filing			
26	Introduce measures to strengthen the effectiveness of self-assessment	M	19/20-21/22
27	Adopt monitoring of inaccurate reporting as part of URA's routine work	H	19/20-23/24
28	Work more closely with relevant regulators to improve filing compliance	H	19/20-20/21
29	Address infrastructure constraints by offering points for connection across the country	M	19/20-21/22
Timely Payment			
30	Prioritise strategies to reverse the current arrears and audit trends	H	19/20-21/22
31	Investigate options for enhancing the use of electronic payment methods, including mobile money	H	19/20-21/22
32	Streamline tax debt collection and improve transparency	H	19/20-20/21
33	Prepare management reports on a regular basis to allow for better-informed tax collection policies	H	19/20-23/24
Audit			
34	Consider the adoption of real-time digital sales and production monitoring systems	H	20/21-21/22
35	Strengthen URA's audit function by adopting modern audit tools, enhancing the use of risk-targeting, and increasing the number of "mass audits"	H	19/20-21/22
36	Bring the entire audit and payment process online	H	19/20-21/22
37	Promote audit process integration across taxpayer offices at URA	M	20/21-22/23
38	Include reports on audit activities and outcomes as an integral aspect of reports to MFPED	M	19/20-23/24
Investigations & Enforcement			
39	Prioritise information from internal risk assessment indicators when initiating cases	H	19/20
40	Implement the Automatic Exchange of Information and common reporting standards for tax purposes	H	19/20
41	Enhance resources to equip scientific laboratories and investigations personnel	H	19/20-21/22
42	Intensify penalties for non-compliance and increase the number of tax investigations	M	19/20-21/22
43	Publicise the results of enforcement initiatives	L	21/22-23/24
Dispute resolution			
44	Facilitate TAT to expeditiously deal with cases by increasing staff numbers and training	H	19/20-21/22
45	Provide adequate funding for TAT to cover infrastructure and resource constraints	M	19/20-23/24
46	Improve the perception of OAU and TAT among the public	M	20/21-22/23
Processing of tax refunds			
47	Develop a plan to streamline the management of offsets and refunds, including automatic cross-matching of taxpayer declarations	H	19/20-20/21

ANNEX II

Reference Papers: Key Diagnostic Studies

As part of the DRMS process, a significant amount of diagnostic work was undertaken to identify the challenges and interventions. The table below gives a short overview of the major diagnostic work undertaken.

	Title of study	Organisation	Date
1	<i>Assessing Uganda's domestic revenue gaps and how to tap the potential</i>	World Bank	November 2017
	The report investigated all major tax heads as well as how the economic structure impacts tax capacity. A related action plan was developed, focussed on expanding the tax base, repairing the tax policy, and strengthening tax administration, which indicated reforms that could be undertaken over the next 3 years.		
2	<i>Improving Domestic Resource Mobilisation in Uganda, Background paper 2: Excise Duty Diagnostic</i>	World Bank	November 2017
	The main objective of this report is to support the World Bank and the Government of Uganda to identify avenues for maximising the potential of the excise duty system. It outlines tax policy measures and administrative actions to strengthen the excise tax system.		
3	<i>Uganda: A framework for preparing a medium-term revenue strategy</i>	IMF	October 2017
	The report focussed on the following challenges: (i) Tax policy: tax exemptions and special treatments for major taxes, especially when ad hoc, hurt the credibility of the system (ii) Administration: a more explicit focus on reducing compliance gaps is needed (iii) Broadening the number of taxpayers and traders to experience the consequences of non-compliance (iv) Public should perceive a closer link between the taxes paid and public services obtained (v) High-level leadership of the MTRS will be the key to its success. The report sets out a framework for the MTRS for Uganda for the next 5 years, identifying options for tax policy reform, measures to raise compliance, and selected tax law measures to support these compliance programmes.		
4	<i>Tax Administration Diagnostic Assessment Tool for Uganda</i>	IMF	October 2015
	The TADAT assessment identified relative strengths and weaknesses in the tax administration system, processes, and institutions. The main limitation of the TADAT framework is that it focuses on the major domestic tax processes (corporate income tax, personal income tax, VAT, and PAYE), leaving out customs, non-tax revenue, and local government taxation. There are also several overarching factors which are not covered by TADAT, including the institutional setting and human resource capacity.		
5	<i>Uganda: TADAT Performance Assessment Report</i>	IMF	March 2019
	A repeat assessment of the system of tax administration of Uganda was undertaken in February 2019, using the Tax Administration Diagnostic Assessment Tool. This repeat TADAT provides a highlight of reform achievements, or lack thereof, and forms a new baseline of information that can be used to determine reform priorities.		

6	<i>Uganda Improving Domestic Revenue Mobilization: Independent Review of the URA's Information, Communication and Operations</i>	<i>PwC (WB)</i>	<i>September 2018</i>
	PwC was engaged by the World Bank Group and URA to conduct a review of the URA ICT infrastructure, eTax system implementation, and customs information technology systems, including the ASYCUDA World, single window, and Electronic Cargo Tracking System applications to determine their integration and compatibility with eTax. Further, PwC provided options for consideration by the authorities to improve the efficacy and efficiency of revenue collection operations.		
7	<i>Institutional Assessment: Uganda Revenue Authority</i>	<i>World Bank</i>	<i>September 2018</i>
	This report encapsulated the findings and recommendations from three diagnostic assessments on Tax Administration, Customs, and ICT, to assess the effectiveness of each of the operational and supporting functions of URA. To carry out its assessments, the World Bank used a suite of tools – Development of Implementation and Monitoring Directives (DIAMOND) toolkit – which incorporates an analysis of the level of capacity of the tax administration and Customs. The report covers an overall analysis of URA's level of capacity, as well as the technical and non-technical drivers of tax reforms in Uganda. The baseline and recent trends are described, with specific recommendations proposed per driver.		
8	<i>Tax Administration Assessment for the Uganda Revenue Authority</i>	<i>World Bank</i>	<i>September 2018</i>
	The objective of this comprehensive assessment is to identify and evaluate the relative strengths and opportunities for improvement of the tax administration. The assessment report creates a baseline and reform action plan that can serve as a backbone of a forthcoming technical assistance programme whose objectives include improved tax collection, voluntary compliance, and an efficient and effective tax administration. Key performance gaps were identified in the areas of cooperation with relevant stakeholders and Government relations, HR, and in administration and finance.		
9	<i>ICT Assessment for the Uganda Revenue Authority IT Department</i>	<i>World Bank</i>	<i>September 2018</i>
	The assessment evaluated the relative strengths and opportunities for improvements of IT by comparing URA practices to global good practices. Key areas for improvements were identified in the management of organisation-wide standards, governance, feedback management, software engineering practices, HR development, and strategic thinking. The URA IT department was also found to lack an essential governance framework and strategic plan.		
10	<i>Customs Assessment for the Uganda Customs Department</i>	<i>World Bank</i>	<i>September 2018</i>
	As part of the DIAMOND review, the Uganda Customs Department (UCD) strengths and weaknesses were assessed. The results indicated that the UCD has adopted some good practices which translate into key strengths in central functional areas, such as		

importation, exportation, and border management. However, opportunities for improvement exist in risk management, transits, warehousing, cargo control, legal, and inspections. The absence of a fully-integrated and automated risk management system was identified as a key constraint.

DOMESTIC REVENUE MOBILISATION STRATEGY

Ministry of Finance, Planning, and
Economic Development