Are We Heading Towards a More Progressive Tax System?

ISER's Position on the 2023 Income Tax Amendment Bill

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ABOUT ISER

The Initiative for Social and Economic Rights (ISER) is a human rights Non-Governmental Organization (NGO), established in 2012 to ensure the full recognition, accountability, and realization of social & economic rights. ISER is an ardent advocate for the adoption and use of a human rights-based approach. ISER has four programs: Economic Justice and Social Protection: Right to Health; Right to Education; Business and Human Rights. ISER's Economic Justice and Social Protection program focuses on centering a rights based economy with a particular focus on budget analysis, taxation, debt, illicit financial flows, and social protection. We apply human rights lenses to fiscal, monetary, and broader macro-economic policy.

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1.0 INTRODUCTION

We live in unprecedented times and are facing a poly crisis: recovery from Covid 19 and Ebola, inflation, Russia/Ukraine and climate change, which have resulted in a high cost of living. In the face of missing tax revenues, Uganda is steadily increasing its debt. As ISER's research on Uganda's debt has found, we are at the precipice of a debt crisis, spending more on servicing debt than on health, education, and social protection combined.[1] At the same time, as the ongoing #UgandaHealthExhibition #ReclaimPublicServices campaign reveals, Ugandans are up in arms about the state of public services like health.

Rights require resources. Where will the money come from? Tighter monetary policy has limited developing nations' access to finance, as many are now turning to commercial lenders for funding, although at higher rates.

[1] ISER (2022) Uganda's Rising Debt and Public services: A Human Rights Impact Assessment, https://iser-uganda.org/wp-content/uploads/2022/09/Ugandas_rising_debt_and_public_services.pdf (last accessed 25 April 2023).

As the world is on the brink of recession, Uganda, now more than ever, must look inward for domestic resources. As the Lima Declaration on Tax Justice underscores, taxation is the "most important, the most reliable, and the most sustainable instrument to resource human rights" in a way that is "sufficient, equitable, and accountable."[2]

ISER has been advocating for a more progressive tax system where the rich pay their fair share of tax. As we found in our research, Leveraging Progressive Taxation to Fund Public Services,[3] and Corporate Income Tax Structure and the Realization of Human Rights in Uganda, [4] the government can use taxation as a critical tool to comply with its human rights obligations.

However, leveraging taxation has been a challenge for this country. According to OECD 2021 data, Uganda loses 1.2% of its GDP to tax abuse.[5] Even before COVID 19, according to the World Bank, Uganda's efficiency of revenue mobilization has remained at a rate of 3.5 out of 6 since 20185 lagging behind other East African countries like Kenya, which scored 4 out of 6 consistently from 2015 onwards.6

Failure to strengthen equitable domestic resource mobilization will force cash strapped countries like Uganda to make difficult choices, which will likely entail imposing austerity measures, cutting spending for public services. This is already ongoing as ISER's budget analysis reveals with cuts to critical sectors like health and education.[6]

The central question we have to address is who should contribute more tax at a time when the state urgently needs resources to build back better? Uganda's taxation system has been largely regressive centering on VAT thus letting lower incomes disproportionately bear

[2] https://iser-uganda.org/wp-content/uploads/2022/07/Corporate_Income_Tax_structure_and_the_realization_of_human_rights_in_Uganda.pdf

[3] ISER (2022) Leveraging Progressive Taxation to Fund Public Services, https://iser-uganda.org/wp-content/uploads/2022/10/Leveraging-Progressive-Taxation-to-Fund-Public-Services.pdf (last accessed 25 April 2023).

[4] https://iser-uganda.org/wp-content/uploads/2022/07/Corporate_Income_Tax_structure_and_the_realization_of_human_rights_in_Uganda.pdf

[5] ISER (2022) Curb Illicit Financial Flows to Fund Public Services in Uganda, https://iser-uganda.org/wp-content/uploads/2022/07/Curb_Illicit_Financial_Flows.pdf
(last accessed 25 April 2023); Tax Justice Network (2021) State of Tax Justice Report, https://taxjustice.net/wp-content/uploads/2021/11/State_of_Tax_Justice_Report_2021_ENGLISH.pdf (last accessed 25 April 2023)

[6] ISER (2023) ISER Position Paper on the Proposed 2023/24 Health Budget for Uganda,https://iser-uganda.org/wp-content/uploads/2023/04/Position-Paper-on-Proposed-2023-24-Health-Budget.pdf (last accessed 25 April 2023)

the tax brunt. Two thirds of Uganda's domestic revenue comes from indirect taxes.[7] The government provides a number of tax incentives despite increasing consensus that tax incentives do not stimulate Foreign Direct Investment (FDI).[8]

This policy brief to Parliament urges the government to adopt a human rights-based approach to taxation where processes and principles such as transparency, accountability and responsibility, efficiency and effectiveness, as well as fairness and justice are key. Accordingly, ISER assessed the proposed 2023 Income Tax Amendments through this lens as will be further discussed in section 2.

Finally, it is important that taxes are utilized to fund public services. Public services have been on the chopping block as the government seeks to undertake fiscal consolidation measures. By the first half of this financial year, the Ministry of Finance released only 20 percent of the earlier approved domestic development expenditure for human capital which detrimentally impacted people's access to public services like education.[9] As ISER's 2023 budget analysis found, the budget for health has been cut by 11.8% in the forthcoming 2023/24 budget.[10] Public services must be ringfenced from budget cuts.

Ultimately, how taxes are collected, spent, and redistributed equitably affects the government's legitimacy to tax and citizens' compliance. As found in our research, " Curbing Illicit Financial Flows to Fund Public Services," it is imperative to stop wasteful expenditure and prioritize public services so as to strengthen tax compliance measures.[11]

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[7] https://iser-uganda.org/wp-content/uploads/2022/07/Curb_Illicit_Financial_Flows.pdf

[8] IGC (2023) Are Uganda's corporate tax incentives meeting their objectives?, https://www.theigc.org/publications/are-ugandas-corporate-tax-incentives-meeting-their-objectives ; ISER (2022);Corporate Income Tax Structure and the Realisation of Human Rights, https://iser-uganda.org/wp-content/uploads/2022/07/Corporate_Income_Tax_structure_and_the_realization_of_human_rights_in_Uganda.pdf; Curtis, M., et al. (2012). "Tax competition in East Africa: A race to the bottom." Tax incentives and revenue losses in Uganda, Tax Justice Network-Africa and ActionAid International.;

[9] Ministry of Finance, Planning and Economic Development Semi Annual Budget performance report FY 2022/23, (Page 94); ISER (2023) ISER Position to Parliament On The 2023/24 Budget Resource Measures.

[10] "Provisional allocations towards health in FY 2023/24 stand at Ugx 4,179.2 billion down from the Ugx 4,739.1 billion approved for FY 2022/23." ISER (2023) ISER Position Paper on the Proposed 2023/24 Health Budget for Uganda,https://iser-uganda.org/wp-content/uploads/2023/04/Position-Paper-on-Proposed-2023-24-Health-Budget.pdf (last accessed 25 April 2023)

[11] ISER (2022) Curb Illicit Financial Flows to Fund Public Services in Uganda, https://iser-uganda.org/wp-content/uploads/2022/07/Curb_Illicit_Financial_Flows.pdf (last accessed 25 April 2023).

2.0 Assessment of the Proposed 2023 Income Tax Amendments

Income Tax Bill Proposal	Observation	ISER's position
Withdrawal of the tax benefit for individuals establishing manufacturing plants (plants, machinery, and industrial buildings) outside a 50 kilometer radius of Kampala.	Section 27A and Section 29 (1a) of the Income Tax Act are being repealed. The government is removing the 20% initial allowance for industrial structures, as well as the 50% initial deduction for plants and machinery, which applied to individuals establishing manufacturing operations outside of a 50-kilometer radius of Kampala. The existing incentive was to encourage investors to set up plants, machinery, and industrial buildings outside Kampala. It was seen as one way to drive investment into rural areas and thus generate employment for rural dwellers.	**This amendment should be adopted.** The existing incentive has forced the government to forego Ugx 198.7 billion[1] in revenue over the last four years. While re-introducing it earlier in 2017, after it had been repealed in 2014, government argued that the move would attract investment into rural areas and so create jobs for those who live there. However, several fiscal experts including the IMF have expressed skepticism about the efficacy of such incentives, pointing out that tax incentives are not the primary determinant of whether investors set up shop, but rather other factors such as regulatory clarity, infrastructure availability, and political stability are taken into account

[1] Ministry of Finance, Planning and Economic Development; Tax Expenditure Report for FY 2021/22; retrieved from: https://www.finance.go.ug/publication/uganda-tax-expenditure-report-fy-2021-22

	Persons that established industrial structures, machinery, and equipment outside of a 50-kilometer radius of Kampala were allowed to deduct 50% of the cost base for the plant and machinery in the first year of operation while filing their returns. They were also allowed to deduct 20% of the cost base for the industrial structures the following year.	
Introduction of withholding tax on profits (interest or dividends) earned by members from their investments in unit trusts.	Section 118I is being inserted into the Income Tax Act. With this proposal, the government intends to impose withholding tax rates of 5% and 15% on profits (interest or dividends) earned by members from their contributions to Unit Trusts in Uganda. The 5% will apply to members whose total contributions do not exceed Ugx 100 million, while the 15% will apply to	This proposal should be adopted, but with some changes. Unit trusts, it should be highlighted, have recently emerged as a viable channel for many ordinary income earners to save their monthly incomes in exchange for a moderate return on investment. Taxing them now will very certainly limit the appeal of unit trusts as a savings option for low and middle-income people, who may regard it as an additional financial burden.

	members whose total contributions exceed Ugx 100 million. The tax will be collectable by way of withholding tax which requires the unit trust to deduct tax before paying or crediting any earnings to its participants. The 5% and 15% tax is a final tax, and no additional tax obligations would emerge in relation to the participant's profit on contributions. A participant who contributes to more than one collective investment plan and whose contribution, in aggregate, exceeds one hundred million shillings will also be required to file a return with URA. It appears that with this move, government intends to cover up any tax avoidance strategies that investors over 100 million shillings might consider using, such as dividing their investments into smaller amounts and investing them in various unit trusts. Without this provision, high net worth individuals could potentially lower their tax liability by spreading their investments over multiple schemes.	This might worsen the country's saving culture even further. But on the other hand, there is still a pressing need to tax wealthy people, who currently, are still, to a large extent, not part of government's tax bracket. Due to the focus largely on salaried incomes by the revenue authority, which rather aren't the main income source for the wealthy, the current tax system has yet to effectively generate money from these people. Many rich currently acquire an enormous amount of their wealth through investments in real estate and unit trusts, among others, for which the latter has still been free from tax. Therefore, in order to target these individuals, it would be preferable to keep the proposal to tax unit trusts but with some small changes in this case, such as applying a considerably higher threshold for which the tax may apply. **In this scenario, we advise that the government consider imposing a 15% withholding tax on profits paid to participants whose contributions exceed one billion shillings.** This will ensure that only high-net-worth individuals who have made

		substantial investments in unit trusts are taxed, while smaller investors are not. It should be mentioned that the revenue generated by this tax could aid the government in funding social welfare programs and other public services.
Introduction of a **5% digital services tax** on online multinationals such as Facebook and Netflix that currently derive income from providing digital services to Ugandans	By introducing section 86A into the Income Tax Act, government is proposing a digital service tax on all non-residents that derive income from providing digital services in Uganda. The 5% digital service tax will be applied on gross incomes earned by these non-residents from digital/online services they may provide to Ugandan citizens. Some of the companies that will likely be impacted by this move include Netflix, YouTube, Uber, Airbnb, Booking.com, Zoom, and Facebook, among others. Government has defined the scope of digital services that may be subject to this tax to include those providing;- online advertising services; data services; services delivered through an online marketplace or	This proposal should be adopted, though with slight amendments. The need to tax digital multinationals has become more apparent than ever as we've re-echoed earlier in our brief on progressive taxation[2]. The digital economy has grown exponentially, and traditional tax systems are struggling to keep up with the pace of change. Adopting this proposal would ensure that digital multinationals pay their fair share of taxes and contribute to the economies in which they operate. Furthermore, the proposed tax would help level the playing field for traditional businesses and generate the much-needed revenues for governments. To that end, government has suggested a 5% tax on the

[2] ISER, Leveraging Progressive Taxation to Fund Public Services; retrieved from: https://iser-uganda.org/publication/leveraging-progressive-taxation-to-fund-public-services/

	intermediation platform, including an accommodation online marketplace, a vehicle hire online marketplace and any other transport online marketplace; digital content services, including accessing and downloading digital content; online gaming services; cloud computing services; data warehousing; services other than those services in this subsection, delivered through a social media platform or an internet search engine; and any other digital service as the Minister may prescribe.	gross revenue made by online multinationals from subscribers in Uganda. We are however worried that this falls outside the 1-3% range proposed[3] by the African Tax Administration Forum which is a network that unites all revenue bodies in Africa and of which Uganda is a member. **We recommend therefore, that; -** **-The proposal be adopted with a modified rate of 3 percent.** **-Government establishes the necessary administrative processes to ease its collection**
Introduction of a 5% withholding tax (on the gross amount of payment) in place of the current capital gains tax regime.	By substituting section 118B of the Income Tax Act, the government intends to introduce a 5% withholding tax on the gross amount of payment in place of the existing capital gains tax.	**This proposal should be dropped in its entirety.** The suggested amendment is retrogressive in nature.

[3]ATAF Suggested Approach to Drafting Digital Services Tax Legislation; retrieved from: https://events.ataftax.org/index.php?page=documents&func=view&document_id=79

The proposed withholding will apply to the sale of any asset, including personal assets. This will be the case regardless of whether the said asset is sold at a loss.	The government of Uganda, through its Income Tax Act, has always imposed a capital gains tax on the transfer of business assets. The tax applies to any gain arising from the transfer of business assets, e.g., shares, land, or buildings situated in Uganda, and is imposed at a rate of 30 percent. With the new proposal, the government now intends to replace the existing 30% capital gains tax with a 5% withholding tax. Furthermore, it intends with this proposal to broaden the scope of assets liable to this tax to now include all assets, even personal ones like homes, cars, personal land etc. Also note that the tax will be applicable regardless of whether the said asset is disposed/sold at a loss or gain. The responsibility to withhold the tax is imposed on the person purchasing the asset, who will then remit it to the revenue authority.	First, the 5% withholding tax may result in a significant loss of revenue for the government, as it is much lower than the current capital gains tax rate of 30%. This could potentially lead to a decrease in government funding for essential services, such as healthcare and education. Just three years ago, i.e., in 2020/21, the government generated revenue to the tune of 241 billion[4] shillings from CIPEF ETW (UK) upon its sale of Eaton Towers. It is now unclear what the fate of such revenue would be under the proposed 5% withholding tax. Secondly, it is unclear how the revenue body will ensure that persons comply with the measure, i.e., withhold and remit tax, in the event they purchase assets or items. Thirdly, the scope of assets to which the tax will apply will now cover personal items such as homes, cars, and household items, which is absurd. It seems the government wants to make up for its lack of revenue by taxing people's personal belongings. The

[4] URA, Annual Revenue Performance Report 2019/20; retrieved from: https://www.ura.go.ug/#

		focus should be rather on implementing a fair tax system that targets corporations and wealthy individuals instead of burdening ordinary citizens.
A new limit is being placed on firms' ability to indefinitely carry forward losses.	Government is amending Section 38 of the Income Tax Act so as to place a limit on firms' ability to indefinitely carry forward losses. The bill proposes that if a person has been carrying forward losses for five (5) years in a row, in year six, and the subsequent years, only 50% of the losses shall be carried forward[5]. Prior to this, the current practice allowed for the full amount of losses to be carried forward indefinitely until fully utilized.	**This proposal should be adopted by Parliament.** The proposal aims to promote tax compliance and discourage the misuse of loss carryover provisions. For example, a financial intermediary could accumulate losses for several years while investing in research and development. Under the old system, they could continue to carry forward these losses indefinitely and use them to offset profits once their product became successful. However, with the new limit in place, they will only be able to carry forward the full amount of losses for a set number of years, in this case five (5). It is even confusing how some businesses continue to operate with losses year after year without closing shop. The new limit on loss carryforward is a welcome change.

[5] Grant Thornton; Proposed Tax (Amendment) Bills, 2023; retrieved from: https://www.gtuganda.co.ug/publications/ProposedBills2023/

		After all, if you're still carrying forward losses after five years, it's time to accept that your business plan needs some serious rethinking. But I guess we can say goodbye to the age-old strategy of racking up losses to avoid paying taxes.

On an additional note, we applaud the government's new bill, the "**Convention on Mutual Administrative Assistance in Tax Matters - Implementation Bill**," which aims to facilitate automatic exchange of information on tax matters. The bill provides for all forms of administrative cooperation between states in assessment and collection of taxes. This collaboration includes automatic information exchange (AEoI) for tax purposes. According to the bill, information on people who live in other countries but have assets in Uganda shall be gathered and shared with their respective governments by reporting financial institutions such as banks, insurance companies, and other investment vehicles[6].

The benefit for Uganda is that other participating countries will gather information on Ugandans who have assets in those jurisdictions and share it with Uganda, specifically the Uganda Revenue Authority. With the passage of the bill, the government would be able to control vices such as money laundering by Ugandan residents who hide their assets and income in other countries.This will ultimately lead to increased revenue collection. Overall, the introduction of this bill is a positive step towards promoting transparency and accountability in tax matters something ISER has been advocating for[7].

[6] Grant Thornton; Proposed Tax (Amendment) Bills, 2023; retrieved from: https://www.gtuganda.co.ug/publications/ProposedBills2023/

[7] https://iser-uganda.org/publication/curb-illicit-financial-flows-to-fund-quality-public-social-services-in-uganda/

3.0 CONCLUSION

This year is one where we've seen the government put forward a number of progressive tax proposals, at least from the income tax side. It is a great indicator that the advocacy we've undertaken over the years has begun to reap some dividends. But we wait to see if the government enacts them into law. Moving forward, ISER along with other CSOs, will continue to engage with Parliament and monitor the progress of these bills.

About the Initiative for Social and Economic Rights (ISER)

ISER is a registered Non-Governmental Organization (NGO) in Uganda founded in 2012 to ensure full recognition, accountability and realization of social and economic rights primarily in Uganda but also within the East African Region.

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