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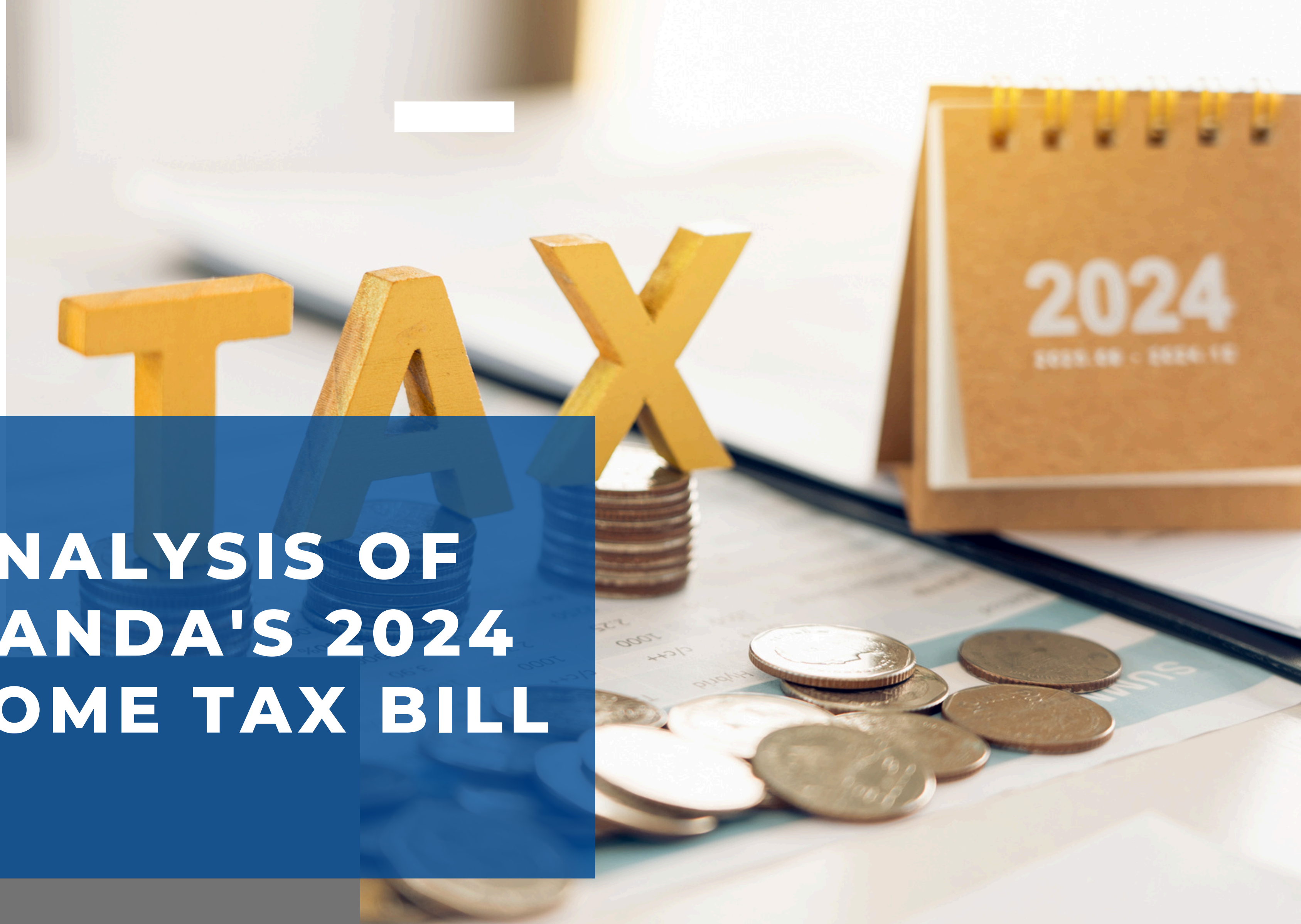
ANALYSIS OF UGANDA'S 2024 INCOME TAX BILL



Submitted to the Parliamentary Committee on Finance, Planning, and Economic Development

ISER
Facilitating Social Justice
INITIATIVE FOR SOCIAL AND ECONOMIC RIGHTS

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 and 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

The proposed tax amendments come at an unprecedented moment, with the cost of leaving still high and many struggling to access even the most basic needs like food and healthcare. Government debt levels have soared more than ever before, now at Ushs 96 trillion, with the state now being forced to incur an even larger chunk of the available budget resources on loan repayments as revealed in ISER's 2023 budget analysis[1]. This diversion of resources has left public services across the country in a dire state. From access to healthcare, to the availability of safe and clean water, the impact of the now newly proposed tax amendments on the currently strained public services system cannot be understated. It is crucial for policymakers to carefully consider the implications of these changes for the most vulnerable populations in order to ensure that essential services are not further compromised.

With the existing situation, there is now an even greater need for the state to mobilize resources from those with the ability to pay, i.e., the wealthy, through progressive taxation. As at the moment, Uganda's tax system is largely regressive, as it places a heavier burden on low-income individuals, i.e., exacerbating inequality and hindering access to vital services for those who need them most. As ISER's previous research has shown[2], a huge chunk of the country's tax revenues (64 percent)[3] is mobilized through consumption based taxes such as value-added tax (VAT) and excise duty. These taxes tax larger proportions of income away from the poor as

[1] https://iser-uganda.org/publication/balancing-on-a-slippery-edge-an-analysis-of-governments-2023-24-resource-measures/
[2] https://iser-uganda.org/publication/leveraging-progressive-taxation-to-fund-public-services/
[3] https://iser-uganda.org/publication/leveraging-progressive-taxation-to-fund-public-services/

compared to high-income earners, as the poor tend to spend larger portions of their incomes on consumption, which isn't the case for the wealthy.

An example of such regressive taxes is the recent diaper tax introduced last year (2023), which is already impacting the poor by making diapers unaffordable for those bearing children and catering for the elderly, grossly impacting hygiene and health outcomes for vulnerable populations. This highlights the need for policymakers to consider the impact of regressive taxation on marginalized groups and explore more equitable ways to generate revenue for the government. Another example now being introduced this year is the UShs 300 excise duty increment on kerosene that will impact poor households in villages that rely on kerosene for lighting purposes.

Uganda's tax system is also plagued by the challenges of a generous tax incentive regime that disproportionately benefits wealthy individuals and corporations; un-abated tax avoidance and evasion by these multinationals; and illicit financial flows that further deprive the government of much-needed revenue. These issues highlight the urgent need for comprehensive tax reform to ensure a fair and sustainable system that prioritizes the needs of all citizens, especially those in marginalized communities. It is also important that the government steps up investment in public services otherwise it loses credibility when it comes to demand for more taxes while people suffer from drug stock outs, in-access to affordable quality education among others.

In our analysis that follows, therefore, we examine the fairness and progressivity of the newly proposed income tax amendments with a view to providing recommendations for policymakers to ensure that income tax policies are largely mobilizing revenues from those who can afford to pay more, rather than placing a disproportionate burden on low-income individuals and families. By prioritizing progressive taxation measures, policymakers can work towards creating a more just and sustainable system of revenue generation that promotes economic equality and social welfare for all members of society.

2.0 ASSESSMENT OF THE PROPOSED 2024 INCOME TAX AMENDMENTS.

Income Tax Bill Proposed	Key points	ISER's Recommendation
Expansion of the retirement fund definition to include termination benefits	The proposed amendment seeks to broaden the scope of retirement funds by amending section 2 of the Income Tax Act to include termination benefits within the	ISER recommends that the proposal be approved.

The principal Act is amended in section 2 by inserting immediately after paragraph (III) (ii) the following - (iii) the provision of benefits for members of the fund in the event of termination of service or upon the occurrence of an event specified in the written law, agreement or arrangement;"	definition of a retirement fund. Specifically, the amendment suggests inserting a new provision that extends the definition to encompass the provision of benefits for members of the fund in the event of termination of service or upon the occurrence of specified events outlined in relevant legislation, agreements, or arrangements. Currently, under Section 2(lll) of the Income Tax Act, a retirement fund is narrowly defined as a pension or provident fund established primarily for the provision of benefits upon retirement or for the dependents of members in the event of the member's death. The proposed expansion introduces a significant alteration by acknowledging termination benefits as a legitimate component of retirement funds.	This expansion carries implications for the tax treatment of termination benefits. By including termination benefits within the definition of a retirement fund, such benefits may now be classified as non-taxable income, offering additional relief to individuals during periods of career transition. In simple terms, the proposed amendment is making things easier for people who save with their company's provident fund. Right now, if you get money from your company's provident fund when you leave your job, you might have to pay taxes on it. But with the new rule, you won't have to pay taxes on that money anymore.
Imposes a 5% withholding tax on gains from selling: Shares of private companies, Rental properties, and Land in cities and municipalities (excluding owner-occupied), all categorized as "non-business assets"	Insertion of section 5A to the principal Act The government is introducing a 5 percent withholding tax on the gains earned from the sale of shares of a private company, rental properties, and land in cities or municipalities other than that which the owner occupies. These	ISER proposes that this amendment be dropped. The sale of shares of private companies and rental properties should be included in the existing capital gains taxation framework. Any future proposals for lower capital gains on such items should be backed by a concrete cost-benefit analysis.

	items have been categorized as “non-business assets,” and the tax on them is being applied separately from capital gains tax, which applies to the sale of business assets.	Parliament however, should consider adopting the proposal to slap a 5 percent withholding tax on the sale of land in cities and municipalities but should explore the possibility of applying the tax to land value beyond a reasonable threshold. The proposed 5 percent tax on land sales in cities and municipalities is welcome as it will give rural land (that remains not be subject to the proposed tax), a competitive edge and thus supporting its development.
Proposal to exempt income derived by private equity and venture capital firms regulated by CMA upon selling their ownership in local startups	Amendment of section 21 of the principal act Government is proposing an exemption for income earned by private equity or venture capital firms that are CMA regulated once they sell their ownership/interest in local startups. A previous amendment (approved in 2021) required required 50% reinvestment of proceeds in order to qualify for tax exemption.	ISER proposes that this amendment be dropped because government would be foregoing revenue that would still be taxed from these firms back in their home countries. Tax incentives are just a fraction of the deciding factors for venture capital/private equity firms when they choose to invest. There are a whole host of other factors ranging from regulatory certainty to market potential and industry trends that are deciding factors in the investment decisions by such firms
Proposal to exempt income derived from the disposal of government securities on the secondary market	Amendment of section 21 of the principal Act The Finance Ministry is proposing an exemption of tax for income earned from the	ISER recommends that the proposed exemption shouldn’t be approved. Current market data shows active trading and interest without the need for exemptions,

	disposal/sell government bonds and bills on the secondary market. It is important to however keep in in mind that while tax exemptions can increase the attractiveness these investments, it can also lead to revenue loss for the government. Therefore, any decision to provide such exemptions should be weighed against the potential revenue implications and the overall goal of increasing market activity.	suggesting no additional incentive is required. The “government bond turnover ratio,” a measure that shows how often government bonds are bought and sold in the secondary market over certain period (in simpler terms, the “busyness” meter for the bond market) already is on an upward trend. In the second quarter of 2022, it rose to 68.8 percent[4] compared to 43.6 percent in the first quarter of 2022. This suggests increased liquidity and investor interest in the secondary market i.e. that investors find these bonds attractive and are actively engaged in trading them.
Introduction of an exemption on the manufacture of electric vehicles and electric charging equipment	Amendment of section 21 of the principal Act Government is proposing to introduce a tax exemption on the manufacture of electric vehicles and electric charging equipment.	ISER recommends that the proposal be approved. The proposal supports emerging electric car manufacturers and incentivizes innovation in the green technology space, ultimately contributing to a more sustainable future. Additionally, this exemption aligns with the government's goal of promoting environmentally friendly practices and reducing carbon emissions.
Introduction of an exemption for the operation of a specialized hospital facility	Amendment of section 21 of the principal Act	We recommend that Parliament rejects this proposal.

[4] https://www.monitor.co.ug/uganda/business/finance/treasury-bonds-in-secondary-market-grow-by-shs16-2-trillion-3950812

	The Finance Ministry is proposing the introduction of a tax exemptions for the operation of a specialized hospital facility.	Government should focus on investing in its own public specialized hospitals that can deliver the said services to all citizens regardless of social and income status. Private entities tend to levy abnormal charges even with incentives. This was evidenced at the height of the COVID pandemic.
Multinational enterprises will now be required to also submit their transfer pricing documentation at the point of filing their returns Section 90 of the principal Act is amended by inserting immediately after subsection (3) the following – "(4) A person to whom this section applies shall at the time of filing returns, submit transfer pricing information to the commissioner, in the format prescribed by the commissioner."	Amendment of section 90 of the principal Act The proposed amendment introduces a requirement for multinational enterprises to submit their transfer pricing documentation to the tax authorities at the point of filing their returns. In, the existing transfer pricing regulations, these firms were only required to ensure they have their transfer pricing documentation ready with them at the point of filing their returns so as to ensure that it can be availed incase required/requested by the authorities.	ISER recommends that this proposal be approved. Whereas the proposal will likely create an additional compliance burden/cost on small MNEs, it will in the long run foster greater transparency by MNEs, reduce illicit financial flows IFFs, and even likely reduce audit burdens on URA's end. IFFs refer to the movement of money across borders that is illegal in its source, transfer, or use. These flows can be associated with corruption, criminal activities, tax evasion, and transfer mispricing. Transfer pricing involves determining the prices at which related entities within a multinational corporation trade goods, services, or intellectual property across borders. It should be noted that while transfer pricing itself is a legitimate practice used to allocate profits and costs among different parts of a multinational

		company, it can be abused to facilitate illicit financial flows in several ways [as ISER's research on IFFs has shown.](https://iser-uganda.org/publication/curb-illicit-financial-flows-to-fund-quality-public-social-services-in-uganda/)[5] When companies manipulate transfer prices to shift profits to low-tax jurisdictions, it can lead to tax avoidance, tax evasion, and transfer mispricing. These practices result in reduced tax revenue for countries where economic activity occurs, distorted competition, inflated asset prices, weakened trust in institutions, and resource diversion from public spending and private investment.
Introduction of withholding tax on commission paid to a payment service provider	Insertion of section 118 I into the principal Act With this provision, government is introducing a 10 percent withholding tax on commission earned by banking agents e.g. Cente-agents. The aim is to level the playing filled with mobile money agents who already, have been paying this tax. The withholding tax will likely be collected by Commercial Banks at the point of remitting commission to the banking agents	ISER recommends that the proposal be approved. The proposal widens the tax base and increases revenue collections. Whereas some might likely argue that proposed tax could make agent banking services more expensive and thus hinder access for the poor who are largely reliant on them, it is worth noting that this will largely depend on the incidence of the tax i.e whether its burden is borne by the agents themselves or passed on to the consumers. Our understanding is that the proposed tax will be collected from the

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

		commissions earned by the banking agents when they facilitate transactions between customers and their banks. Say if a person called James withdrew UShs 50,000 from their Centenary bank account with the transaction being facilitated by a mobile cente-agent (who receives a charge/commission of UShs 1,000), Centenary Bank will now deduct 10 percent of the agent's commission (UShs 100) and remit it to the government. Contrary to the assumption that consumers will bear the tax burden, this example shows that it affects the agent's income. Instead of receiving the full commission of UShs 1,000, the agent now gets UShs 900 after tax deduction. The question therefore now becomes where the banking agent can shift this tax burden to the customer by raising the transaction charge or commission charge to say UShs 1,500 to cater for the additional tax that is being introduced. In our observation, it really isn't within the power of the banking agents for them to do so as transaction charges are set rather by the banks say centenary in this case. The question that then emerges

		would be then as to whether the Banks in the first case care about raising the commission/transaction charges just to cater to the earnings made by the agents.
Introduction of a 2 percent withholding tax on interest payment for funds borrowed from non-resident entities/persons in respect to debentures (except for government)	Amendment of section 83 of the principal Act A 2% withholding tax on interest payments to non-residents for debentures is being introduced with an exception for government payments. Debentures represent a form of long-term debt issued by corporations or governments to raise capital. When an organization issues debentures, it essentially borrows money from investors (including non-resident entities) who purchase these debt instruments. Organizations that issue debentures are obligated to pay interest to debenture holders at regular intervals (e.g., annually or semi-annually). The interest payments serve as compensation to debenture holders for lending their funds to the issuing entity. The proposed 2% withholding tax will be apply to the interest payments made by the issuing organization to non-resident debenture holders. When the interest	ISER recommends that the proposal be approved. It could contribute to revenue without deterring investment.By collecting a portion of the interest payments, the government can bolster its financial resources.

	payment is due, the organization will be required to deduct 2% from the total interest amount before disbursing it to the debenture holder. This withholding tax will therefore be collected at the source (i.e., by the organization making the interest payment). Initially the tax rate applicable was 0 percent i.e., no tax was being charged on interest payments to non-residents for debentures. The proposed tax exempts interest payments made to non-resident debenture holders when the issuer is the government. In other words, if a government entity issues debentures and pays interest to non-resident investors, no withholding tax will apply.	

3.0 Conclusions.

In the newly proposed income tax amendments, we find a number of notable measures aimed at strengthening the regulation of transfer pricing practices by large multinationals and thus ultimately curbing tax avoidance and illicit financial flows. These changes are highly welcome. However, on the other side, we do note a continued expansion of the tax incentive regime such as the proposed exemption on the disposal of government securities on the secondary market, the exemption for the operation of a specialized health facility, an exemption on income derived by private equity and venture capital firms upon selling their ownership in local startups all of which will likely erode the already limited tax base. Overall, a more focused approach that limits tax incentives would be more effective in achieving the goal of increasing revenue and deterring tax avoidance.

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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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