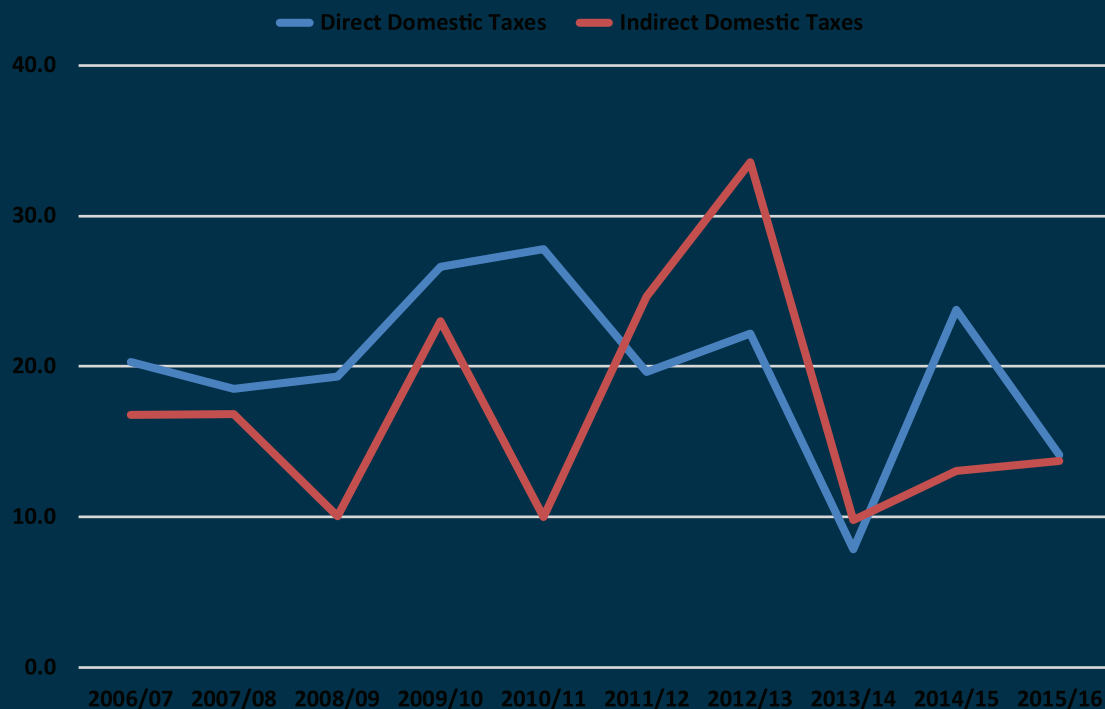


BOOSTING DOMESTIC REVENUE MOBILISATION IN UGANDA



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ABBREVIATIONS / ACRONYMS

BoU	Bank of Uganda
C-efficiency	Collection efficiency
CET	Customs External Tariff
CSO	Civil Society Organisation
CTL	Commercial Transaction Levy
DRM	Domestic Revenue Mobilisation
EAC	East African Community
ETR	Effective Tax Rate
FY	Financial Year
GDP	Gross Domestic Product
GoU	Government of Uganda
ICT	Information, Communication and Technologies
IFF	Illicit Financial Flows
KCCA	Kampala Capital City Authority
LoG	Local Government
MDAs	Ministries, Departments and Agencies
MoFPED	Ministry of Finance, Planning and Economic Development
NDP	National Development Plan
NTR	Non-tax revenue
OECD	Organisation for Economic Co-operation and Development
PAYE	Pay-As-You-Earn
SSA	Sub Saharan Africa
TREP	Tax Payer Register Expansion Project
UBOS	Uganda Bureau of Statistics
UGX	Uganda Shilling
URA	Uganda Revenue Authority
URSB	Uganda Registration Services Bureau
USD	United States Dollars
VAT	Value Added tax
WHO	World Health Organisations
WHT	Withholding Tax

EXECUTIVE SUMMARY

Despite numerous reforms, domestic revenue mobilisation in Uganda is still below its potential. While the ratio of tax revenue to Gross Domestic Product (GDP) has improved from 11.7 percent in 1999/00 to approximately 14 percent in 2016/17, it is still below the Sub-Saharan Africa (SSA) average of approximately 16 percent. However, Uganda's public expenditure is growing at a fast rate due to the need to finance her National Development Plan (NDP) with the goal of attaining middle income country status in the next three years. Owing to the rising public expenditure coupled with the low levels of revenue collection, Uganda's stock of public debt, both domestic and external, has increased significantly. To curb the growth in public debt, there have been calls for increased domestic revenue mobilisation (DRM). The present study focuses on the requirements to increase DRM in Uganda.

The study employed different but complementary approaches to gather the relevant data and information. First, an extensive review of the previous studies on revenue mobilisation in Uganda, as well as the relevant policy documents, was conducted. Second, consultations with relevant stakeholders from government ministries, departments and agencies (MDAs), civil society organisations (CSOs), academia and the private sector were held, and third, secondary data were analysed following the tax gap approach (which measures the difference between total taxes owed and taxes paid on time).

The study findings show that despite sustained annual growth in domestic revenue collections, overall revenue mobilisation in Uganda is still below its potential. Uganda continues to lag behind her regional neighbours in terms of the tax to GDP ratio. Regarding revenue collection efficiency, the tax gap analysis shows that tax collection efficiency (**C-Efficiency**)—which measures the extent to which tax actual revenues deviate from the maximum possible revenues in a perfectly enforced tax system—is below its potential for all tax categories. In 2015/16, the C-Efficiency ratio was 20.7 percent, indicating that Uganda was unable to collect most of the potential taxes. Nonetheless, the C-Efficiency has significantly increased in the recent past—increasing by approximately 8 percentage points from the average of 11.8 percent, estimated for the period 1991/92 to 2000/01, to an average of 19.7 percent during 2011/12-2015/16.

Furthermore, there have been both positive and negative annual changes in the constituents of the C-Efficiency ratio i.e., the compliance gap (which measures the effectiveness of tax administration and tax payer compliance) and the policy gap (which measures the impact of tax policy choices, e.g., differentiated tax rates and exemptions). Nonetheless, the sustained positive changes in the C-efficiency ratios during the past 15 years have been driven by changes in policy gaps. This finding suggests that the trends in C-efficiency ratios are explained less by changes in tax compliance than by changes in the effects of tax policy.

Direct taxes: The C-efficiency for direct taxes rose from 14 percent in 2000/01 to 21 percent by 2015/16—held back by challenges relating to compliance. The analysis shows that a bulk of the compliance gap in direct taxes is as a result of default in submitting PAYE, corporation tax, withholding tax and tax on bank interest leading to loss of revenue averaging 8.15 percent of GDP per annum between 2009/10 and 2015/16. Cumulatively, this compliance gap is valued at UGX 3.6 trillion, a value equivalent to the government's total wage budget in FY 2016/17.

Indirect taxes: For indirect taxes, the compliance gap as a share of GDP for VAT has remained fairly stable over the years under review, which reflects the improvement in the VAT tax base over the years. However, the C-efficiency for VAT was low, at 29 in 2015/16. This finding means that considerably more revenue could be raised from the VAT, even without increasing the standard rate of 18 percent. For instance, if the VAT C-efficiency increased to 40, it would increase its VAT revenue by approximately 1 percent of GDP.

Customs: Since 2001/2, the C- efficiency for customs has been improving on year -on -year basis, and stands at

21 percent in 2015/16. This is largely due to improvements in the policy environment, such as the EAC Custom Union harmonisation programme and the strengthening of border cooperation between Kenya, Rwanda and Uganda, with the aim of improving data sharing. However, further research needs to be performed to reduce compliance gaps fostered by smuggling, tax avoidance, trade miss-invoicing and other forms of illicit financial flows. Findings further show a number of reasons, including relatively high dependency on international taxes, relatively weaker tax administrative system, high levels of informality, tax evasions, and tax incentives, account for Uganda's relatively poor domestic revenue collection.

Non-tax revenue (NTR): The study also looks at the potential for non-tax revenue (NTR) to increase domestic revenue collection. NTR includes user fees levied on the use of public services, as well as payments for government services, such as fees for granting or issuance of permits and license fees. Domestic NTR is largely dominated by fees and licenses, which have increased steadily from UGX 30 Billion in 2002/03 to UGX 330 Billion in 2016/17. There is potential for growth of NTR. However, mobilising and collecting NTR in Uganda faces a number of challenges, inadequate capacity and technical skills, lack of transparency in the collection and usage of this revenue, and inadequate record keeping by the authorities. Furthermore, some NTRs are set and collected by statutory bodies; this situation cannot be changed without amending a series of legal instruments.

The study recommends that to increase DRM, Uganda needs to devise new and innovative tools that will improve collection efficiency, improve compliance, and increase the effectiveness of the tax administration. Such innovations include the following:

Widening tax payer registration: Registering tax payers should be extended beyond the current Tax Registration and Expansion Project (TREP) effort to further broaden the tax base and reduce the size of the informal sector. While the TREP project focusses on identifying and registering small businesses that operate in the capital and other municipalities, there is a need to expand the project beyond businesses to capture individuals who operate within the informal sector.

Simplifying the tax system to encourage formalisation: Differentiation of tax rates and tax heads provides fertile grounds for tax evasion, and can also push many otherwise willing taxpayers out of the system entirely. Thus, there is a need to create homogenous tax rates.

Compliance gaps: The large overall tax gaps in Uganda are largely explained by compliance gaps other than policy gaps. In this regard, improvement of collection efficiency will largely depend on reducing compliance gaps than policy gaps. In this case, risk assessments and profiling to identify tax avoidance schemes will be prudent. It should be noted that risk assessment will depend on the quality of data and analytics done by the URA. As such, data collection to facilitate tax audits will be prudent on the part of the URA. In addition, tax education to improve voluntary compliance will also be prudent.

Policy gaps: While tax exemption does not provide an immediate risk, granting of exemptions should be justified by an economic cost–benefit analysis, rather than political considerations. There is also a need to review the stability of the policy and the level of differentiation, especially on the excise tax, due to the effect of the policy on revenue collection.

1. INTRODUCTION

Since the 1990s, Uganda has implemented a number of reforms geared towards increasing domestic revenue collection. Such reforms include introduction of the Value Added Tax (VAT), increasing income tax rates and tax administration reforms, among others. As a result of some of these reforms, revenue collection has grown significantly during 2001/2-2016/17. In particular, net tax revenue collection increased more than tenfold, from UGX 1,212 Billion in 2001/02 to approximately UGX 12,719 Billion in 2016/17 (Uganda Revenue Authority, 2017). Notwithstanding this progress, revenue performance remains below potential based on revenue or tax to GDP ratio. Specifically, Uganda's tax to GDP ratio has increased from 11.7 percent in 1999/00 to 14 percent in 2016/17. This growth has been slow with episodes of stagnation, especially between 2007/08 and 2014/15 (Table 1). A comparison with other countries shows that Uganda's tax revenue to GDP is still below the Sub-Saharan Africa average of approximately 16 percent. In addition, Uganda lagged behind her East Africa Community (EAC) neighbours, such as Kenya (18.8 percent) and Rwanda (16.1 percent), in 2015/16.¹

On the other hand, Uganda's public expenditure is growing at a fast rate due to the need to finance her National Development Plan (NDP), with a quest to attain middle income country status by 2020. Owing to the rising public expenditure, coupled with relatively low levels of domestic revenue collection, Uganda's stock of public debt—both domestic and external—has increased significantly. Uganda's stock of public

debt has almost tripled in the last ten years, from USD 2.9 Billion in 2006 to USD 8.7 Billion in 2016 (MoFPED, 2017). While the debt is still within sustainable levels, the pace at which it is growing, coupled with the country's increased appetite for infrastructure investment, raises concerns.² Domestic revenue mobilisation (DRM) is important for Uganda for other reasons as well. For instance, it can potentially be the biggest source of long term financing for sustainable development, and enables a state to become independent of aid and have increased ownership and policy space to implement strategies that reflect her development priorities.

It is against this background that the present study focuses on the required changes to increase DRM in Uganda. Specifically, the study analyses DRM reforms, strategies and special initiatives undertaken by Uganda, and discusses how the strategies and initiatives have affected the country's performance in regard to DRM. The study also offers a detailed analysis of the efficiency, compliance and policy gaps of various taxes. It examines the commitments made under the EAC integration process, and the impact on domestic revenue of those actions. The study also examines the potential of Non-Tax Revenue (NTR) mobilisation to increase DRM in Uganda.

1.1 Methods and data sources

The study employed a number of complementary approaches to analyse drivers of revenue mobilisation in Uganda. First, an extensive review of the literature from previous studies on revenue mobilisation in

¹ East African Revenue Authorities (2017) Comparative Revenue Analysis 2015/16

² Interest payment for both domestic and external debt are projected to be UGX 2,675 Billion in 2017/18 and this debt service will only be 18 percent of expected domestic revenues. This is within the threshold of IMF's debt sustainability framework.

Table 1: Uganda Tax Revenue Performance FY2014/15- FY2016/17

	2014/15	2015/16	2016/17
Net Revenue (UGX Billions)	9,715	11,230	12,719
Tax to GDP Ratio, %	12.3	13.5	14.1
Tax to Budget, %	64.6	66.8	62.3
Number of Registered Taxpayers	763,150	902,339	1,029,542
Number of Value Clients	147,797	176,942	492,648

Source: URA (2017).

Uganda and the relevant policy documents was conducted. The main data sources are URA’s administrative data and the World Bank’s World Development indicators (WDI). These secondary data sources were complemented with stakeholder consultations. These consultations were at two levels: through various meetings and through face-to-face consultations with key informants.

A major feature of the current study is an estimation of the tax collection efficiency using the tax gap approach, (which measures the difference between total taxes owed and taxes paid on time). These estimates are based on aggregate data at the macro level. The analysis focuses on the period FY2001/02-FY2015/16.

The collection efficiency (**‘C-Efficiency’**) is an important indicator for assessing the performance of a tax system. It is defined as the ratio of the revenue it yields to the product of consumption and the standard rate of tax (see Appendix 2). The higher the **‘C-Efficiency’** ratio, the higher the tax collected. To understand precisely where improvements/deterioration occur in a given tax, the paper decomposes the C-Efficiency into a “compliance gap”, a “policy gap” or both. The

‘compliance gap’ reflects the difference between the actual given tax collected and that theoretically due.³ The higher the compliance gap, the higher the tax default.

The paper relates the ‘policy gap’ to aspects of design, such as uniformity of rate and impact of exemption (see appendix 2 for decomposition of policy gap). The higher the policy gap, the higher the rate of exemptions and differentiation. Exemptions are a zero rating of a tax for specific amount a time, while differentiation is the degree of diversity in the tax rate for a tax head. For instance, direct taxes (e.g., Pay-as-you-earn (PAYE) and corporation tax) have different tax rates depending on income and wage status (Table 2).

The rest of the paper is organised as follows: Section 2 provides an overview of Uganda’s DRM reforms, strategies and initiatives. Section 3 presents a discussion on the performance of various tax revenues. Section four discusses Uganda’s progress on non-tax revenues (NTR), focusing largely on domestic sources.

³ This paper estimates compliance using tax records at the end of each financial year. Therefore, the value of the compliance gap includes the effects of filing for past periods, assessments and collections of arrears.

Table 2: Income tax rates applicable to resident individuals

(A) Income Taxes	
Rate, %	Annual income
10	not exceeding UGX 4 Million
20	not exceeding UGX 5 million
30	more than UGX 5 million
40	more exceeding UGX 120 million
(B) Pay as you Earn (PAYE) rates	
Monthly Chargeable Rate of tax	
Not exceeding UGX 235,000	Nil
Exceeding UGX 235,000 not exceeding UGX 335,000	10% of the amount by which chargeable income exceeds UGX 235,000
Exceeding UGX 335,000 but not exceeding UGX 410,000	UGX 10,000 plus 20% of the Amount by which chargeable income exceeds UGX 335,000.
Exceeding UGX 410,000	a) UGX 25,000 plus 30% of the amount by which chargeable income exceeds UGX 410,000 and
	(b) Where the chargeable income of an individual exceeds UGX10,000,000 an additional 10% charged on the amount by which chargeable income exceeds UGX 10,000,000.

Source: URA (2017)

Section 5 concludes and highlights priority policy actions.

2. NATIONAL POLICY RESPONSES TOWARDS BOOSTING DRM

The government of Uganda (GoU) has instituted a number of tax reforms since the 1990s. The reforms have been geared towards broadening the tax base and increasing domestic revenue collection. The reforms have greatly focused on improving the tax administration.

2.1 Administrative reforms

The tax administration reforms started with the establishment of the URA under the Uganda Revenue Authority Statute of 1991, as a semi-autonomous agency with the mandate of administering and collecting specified taxes and revenues in accordance with various taxation statutes. The establishment of URA restricted the functions of the Ministry of Finance, Planning and Economic Development (MoFPED) to tax policy formulation. The other administrative reforms include administration business process re-engineering, automation of work processes and procedures, and investing in human resource capacity for tax audits, investigation, and enforcement.

The reforms commenced with the restructuring of the organisation, which resulted in a reduction of the administrative layers from seventeen to seven (URA, 2014). This greatly reduced bureaucracy, and improved communication, decision making and turnaround time. Furthermore, the URA embarked on a modernisation reform to make the organisation more efficient and effective. This desire led to several administration reforms, namely: massive tax payer sensitisation and education on tax policy changes; strengthening the international taxation function; introduction of the Tax Payer Register Expansion Project (TREP), bringing together the Uganda Registration Services Bureau (URSB), Kampala Capital City Authority (KCCA) and local governments (LoGs) to identify taxpayers and collect taxes from small businesses that are difficult to reach by the URA. This was aimed at reducing the size of the informal sector and widening the tax base. Other initiatives include the expansion of the rental register;

establishment of a public sector office to improve monitoring of revenue from government ministries and agencies; improvement of compliance in select sectors, such as real estate, transport, communication, construction, manufacturing, and retail/wholesale activities; rollout of a single customs territory for all dry cargo; implementation of the automated valuation controls and the warehouse stock control module; enhancement of ASYCUDA system controls with online appointment of agents for all imports, automatic selectivity, and online queries (URA, 2014).

Since 2015/16, further reforms aimed at enhancing revenue efficiencies, collection and trade facilitation for both international and domestic taxes were implemented. These reforms include the operationalisation of the one stop border pots (OSBPs) at Uganda's five border posts (Busia, Malaba, Mutukula, Mirama Hills and Elegu), which are expected to reduce the time taken to cross the border by about one third; implementation of the centralised document processing centre, which shortened customs declaration time; rolling out of the regional electronic cargo tracking system; implementation of the Uganda electronic single window, etc. To increase domestic taxes, the URA eased taxpayer payment channels, enabling payment of taxes using mobile platforms, and launched online and point of sale tax payments for VISA and MASTERCARD holders. Further, interventions under TREP 3 facilitated registration of 100,000 tax payers by June 2017.⁴

While the URA's reforms were administratively comprehensive, in general terms, the reforms have neither been focussed nor driven by specific performance outcomes, such as improved enforcement. The main objective of the reforms has been to meet the set revenue target by MoFPED (AfDB, 2010). Additionally, excessive tax exemptions and corruption could have significantly cancelled out the prospective impact of the reforms on tax revenue performance.

⁴ In 2016/17, the URA also intensified audits and arrears enforcement. The authority audited 1382 cases worth UGX 198 Billion, while arrears collections recovered UGX 201.83 Billion (URA, 2017).

2.2 Tax policy reforms

Between 2004 and 2016, a number of policies were introduced with an aim to impact revenue collections.⁵ These policies in effect targeted: raising revenue to support government programmes; promoting investment; ensuring equitable distribution of income; protecting sectors offering public goods, such as education, health and agriculture; facilitating international trade; promoting the growth of the local industries; correcting market failures, such as supply shortages; and protecting the health of Ugandans from consumption of harmful products (URA, 2014). Some of the major Value Added Tax (VAT) and income tax policy changes in the last two decades (2000-2016) are summarised in Box 1.

2.3 Legislative reforms

Uganda's system of assessing and collecting taxes identifies specific taxes and tax rates applicable every financial year. The system emanates from the provisions of the tax laws existing in the country, which include the following: the Income Tax Act (ITA), Cap.340, as amended; the Value Added Tax Act (VATA), Cap.349, as amended; Subsidiary Legislation and Legal Notices under the Income Tax Act and the Value Added Tax Act; practice notes issued by the Commissioner General of URA; Statutory Instruments under the Gaming and Pool Betting (Control and Taxation) Act, Cap.292; and the East African Community Double Taxation Agreement. The others laws are the Traffic and Road Safety Act, 1998; the Excise Management Act, 1970; the Stamps

Box 1: Some major VAT and income tax policy changes, 2000-2016

- Between 2001/02 to 2013/14, the government exempted the payment of VAT on computers and computer software. In addition, it introduced a new rule requiring that the government only issue contracts to VAT registered suppliers, a VAT on accommodation in hotels and tourist venues was imposed, which were previously VAT exempt, and a tax on interest payable on treasury bills was imposed.
- Further reforms between 2004/05 and 2006/07 resulted in exemption of VAT for constructors of roads and bridges and providers of consulting services for the same. While in effect from June 2005, the standard rate of the VAT increased to 18 percent. Additionally, in 2005/06, interest earned by financial institutions on loans granted to the agricultural sector was made exempt from income tax. This was meant to increase lending to the sector, whose share of total credit to the private sector was low. However, despite this exemption, the share of credit to agriculture is still low compared to other sectors. Statistics from the Bank of Uganda (BoU) show that the share of credit to agriculture has increased slowly from 6 percent in 2007 to 11 percent in 2017 (Appendix 1). In 2006/07, the government zero rated VAT on liquid petroleum gas to increase its affordability.
- In 2007/08, the government granted non-complaint taxpayers an amnesty on penalties and interest for principal taxes. This tax policy was a success because not only were new taxpayers registered, but the government realised UGX 41 Billion from voluntary disclosures (AfDB, 2010). During the year, the government proposed a policy for writing off arrears of duty and taxes relating to principle, interest and penalties that had accrued to 30th June 2002 (ibid).
- Further policy changes in 2012/13 to raise revenue resulted in increasing the withholding tax on income from treasury bills and bonds from 15 to 20 percent, while the PAYE threshold was raised from UGX 130,000 to UGX 235,000 per month in an attempt to protect the poor (SEATINI, 2017). Additionally, the government re-instated a VAT of 18 percent on the supply of piped water, re-instated a VAT on the supply of biodegradable packaging materials and increased the Gaming and Pool Betting Tax from 15 percent to 20 percent. Further reforms to reduce undervaluation, observed the government increase the excise duty of spirits made from locally raw materials from 45 to 60 percent in 2012/13, while a 10 percent excise duty was imposed on cosmetics and perfumes and on individuals with chargeable income of UGX 120 million and above, per year.
- In 2016/17, the government facilitated investments in the petroleum, mining and construction sectors by granting VAT relief to supplies procured from the domestic market for aid funded projects. In addition, the government increased excise duties on diesel and petrol, soft cup and hinge lid cigarettes, stamp duty on transfer of property, sweets and confectionaries as well as registration fees for personalised number plates, among others.

⁵ Earlier tax policy reforms included the introduction of the Value Added Tax (VAT) in 1996 to replace Sales Tax and Commercial Transaction Levy (CTL). VAT was chosen for its high revenue potential, efficiency and ability to eliminate the cascading problem of improving tax compliance and enforcement (Cawley & Zake, 2010). Various tax rates and tariffs were rationalised and harmonised in addition to abolishing taxes on exports.

Act, 2014; the East African Community Customs Management Act, 2004; the Gaming and Pool Betting (Control and Taxation) Act (1968); and the Excise Duty Act 2014.

Major legislation reforms for boosting DRM began in 1997 with the enactment of the Income Tax Act. The Act broadened the definition of taxable income and eliminated most discretionary tax exemptions and incentives (Ayoki *et al.* 2005). The Income Act, 1997 repealed the minister's power to grant tax holidays under the investment code of 1991. Furthermore, a provision in the Customs Management Act, which empowered the minister to grant a specific waiver of import taxes and duties, was repealed in 2001. Furthermore, in 1997, the Tax Appeals Tribunal was established under the Tax Appeals Tribunal Act of 1997 to provide a mechanism for a taxpayer to appeal any decisions taken by the commission general that does not satisfy the taxpayer (URA, 2004). In addition, in 2005, the East African Customs Union (EACU) came into force, and a customs law was provided for tax regimes that are common in the EAC and all exemptions expected to be in the law. This process brought on-board harmonised working hours across borders; all non-tax collected by URA, and tariffs removed from goods originating from the EAC (NPA, 2015). The removal of tariffs did not lead to a fall in revenue due to an increase in the volume of imports.

In 2014, the government enacted the Tax Procedures Code Act to guide and harmonise the administrative procedures of the current tax law, hence easing the compliance process for tax payers. At the presentation of the budget proposals for 2015/16, the government proposed 31 tax revenue measures contained in the Finance Bill 2015, Excise Duty (Amendment) Bill 2015, Value Added Tax (Amendment) Bill 2015, Income Tax (Amendment) Bill 2015 and Business Licenses Bill 2015. Government has also developed a new policy to guide double taxation agreements.

In addition, there have been efforts to curb illicit financial flows (IFF).⁶ The IFF undermine the benefits generated by sustained economic growth in Uganda. A study by Global Financial Integrity, which estimated

the impact of trade miss-invoicing on tax revenues in a number of African countries, showed that Uganda lost USD 884 million annually through illicit capital flows during 2002-2011—predominantly of imports (Global Financial Integrity, 2014).⁷ Out of the average annual gross of illicit flows of USD 884 million, the share of illicit outflows for Uganda was 95 percent. Other countries in the region exhibited lower shares of outflows, e.g., 71 percent for Kenya and 44 percent for Tanzania, due to experiencing both illicit outflows and inflows. Uganda's dominance of illicit outflows is explained by import miss-invoicing (especially import over-invoicing), and this may be partly explained by the country's tax exemptions on the export of products. Due to the above outflows, Uganda lost an average of USD 243 million per year in potential tax revenue. Therefore, GoU has undertaken a number of initiatives to curb IFF. Such initiatives include the enactment of a number of laws and establishment of a number of government agencies to help combat this problem. These include, The Financial Intelligence Authority, The Capital Markets Authority, the Anti-Money Laundering Act of 2013, the Financial Institutions Act of 2004, Financial Institutions (AML) Regulations 2010, The Anti-Corruption Act of 2009, The Anti-Terrorist Act of 2002, and The Capital Markets Authority Act.

3. PERFORMANCE OF REVENUE MOBILISATION

Uganda's taxes include direct and indirect taxes. Indirect taxes are taxes levied on consumption of goods and services collected. In Uganda, indirect taxes are subdivided into domestic and international levies. Indirect taxes include Value Added Taxes (VAT), excise duty, and import duty (URA, 2011). Domestically, excise duty is collected on goods and service, including cigarettes, beer, spirits/waragi, soft drinks, phone talk time, sugar, bottled water, cement, cosmetics, mobile money transfers, and international calls, while VAT is collected on cigarettes, beer, spirits/*Waragi*, soft drinks, sugar, bottled water, cement, utilities (electricity and water), phone talk time, and other

⁶ Illicit financial inflows are defined as illegal movements of money or capital (illegally earned, transferred, and/or utilized) from one country to another.

⁷ Global Financial Integrity defines trade miss-invoicing as "a method for moving money illicitly across borders which involves deliberately misreporting the value of a commercial transaction on an invoice submitted to customs". It forms the largest component of illicit financial outflows.

goods and services.

As a result of the above reforms, Uganda has registered a significant increase in total revenue. Gross revenue collection has increased approximately nine times, from UGX 1,267 Billion in 2001/2 to about UGX 12,719 Billion in 2016/17. In the same period, net URA collections excluding government taxes and tax refunds have increased from UGX 1,409.3 to UGX 12,719 Billion. Statistics also show that before 2008, revenue from international trade taxes accounted for a larger share of net tax revenue compared to domestic taxes. In particular, the share of international taxes averaged 52% from 2001/2-2008/9, but have since reduced to 45% from 2009/10-2015/16.

A number of reasons for the rise in the domestic share of taxes include increased domestic economic activities, population growth leading to increased revenue in the form of consumption taxes, tax reforms and improvements in tax administration. On the domestic side, direct taxes have grown faster than indirect taxes (excise duty and value added tax).⁸

⁸ Direct taxes are levies imposed on income arising from business, employment and property. Examples of direct taxes collected in Uganda include corporation tax, individual income tax, e.g. Pay As You Earn (PAYE), capital gains tax, tax on bank Interest, withholding tax, casino and lottery tax, and rental tax (URA, 2011).

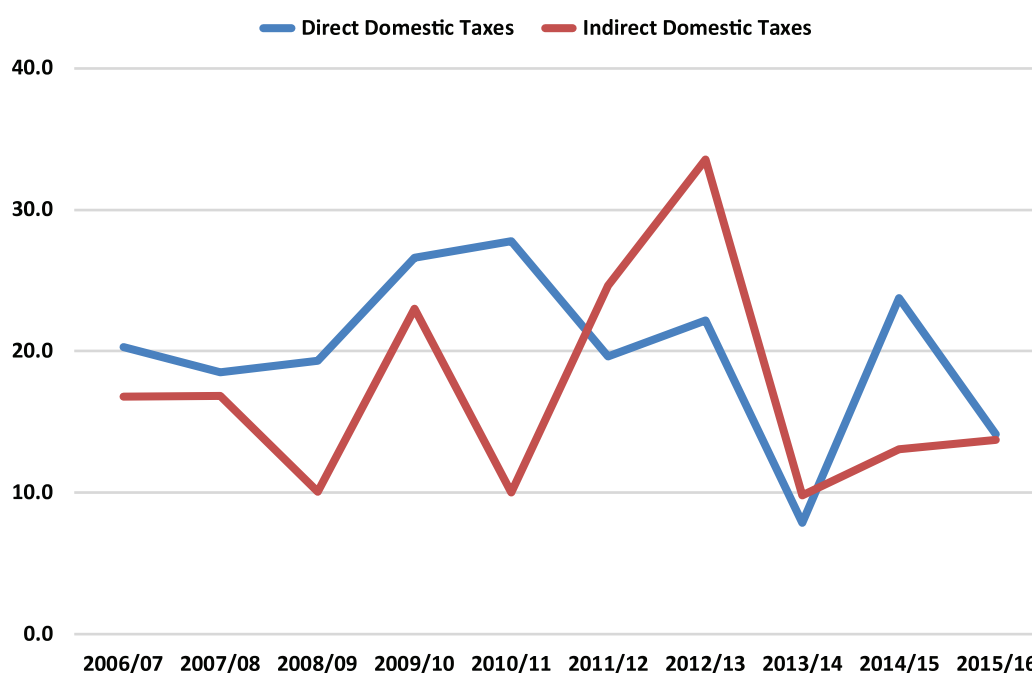
Domestic direct taxes have increased by over 14 times, from UGX 259 Billion in 2001/2 to UGX 3,707 Billion in 2015/16, while domestic indirect taxes have only increased at a speed of about half as much (i.e., approximately seven (7) times), from UGX 329 Billion in 2001/2 to UGX 2,443 Billion by 2015/16. Figure 1 shows that with the exception of the period 2011/12-2013/14, direct domestic taxes expanded much faster than indirect domestic taxes.⁹

The surge in direct domestic taxes can partly be attributed to an increase in formal employment as well as changes in the structure of the economy, which has seen services growing faster and contributing more to GDP, while manufacturing (previously the main source for both domestic VAT and Excise taxes) as a percentage of GDP has barely changed.¹⁰ Other factors included the government's commencement to remit PAYE

⁹ The dip during 2011/12-2013/14 could be explained by changing of the income tax thresholds during the 2012/13 FY. Estimates by Ssewanyana and Kasirye (2015) show that Uganda lost approximately UGX 125 Billion (approximately 0.2% of the 2012/13 GDP) by revising the minimum monthly income tax threshold from UGX 130,000 to UGX 235,000. Even the corresponding increase in the top income tax rate from 30% to 40%--for those earning more than UGX 10 million, could not compensate for the loss of the very many low-income earners below UGX 235,000.

¹⁰ Whereas GDP growth averaged at 5.5 percent per annum between 2008/09 to 2016/17, growth in the telecommunication and the financial services sectors was 15.9 and 12.8 percent, respectively (for details see Appendix figure 17).

Figure 1: Annual growth rates in domestic tax revenue, 2006/7-2015/16 (%)



Source: URA 2017.

contributions of its employees in 1998/99, revision of PAYE thresholds in 2012/13 and improvements in tax administration and compliance (AfDB, 2010).

3.1 Domestic direct tax compliance and policy gap analysis

As earlier mentioned, we examine the efficiency of Uganda’s tax system using the tax-gap approach. As earlier noted, this approach estimates the **C-Efficiency ratio**—a measure of actual revenue compared to the theoretical possible revenue—to gauge the overall efficiency and effectiveness of Uganda’s tax system. The C-Efficiency captures the gaps due to compliance as well policy gaps, which capture the impacts of noncompliance to tax regulations and policy choices, respectively.

3.1.1 Compliance analysis

Estimates show that the C-Efficiency ratios increased from 14.1 percent in 2001/2 to 20.7 percent by 2015/16—the average for the review period was 17.1 percent, suggesting that direct tax collections remained way below the potential. Figure 2 breaks down annual changes in C-Efficiency over the sample period into effects through compliance and policy gaps. It shows

that the C-Efficiency ratios were positive over the 15-year period, and these were driven by changes in policy gaps. This suggests that, in Uganda, much of the loss of revenue is explained by gaps due to noncompliance rather than policy decisions.

Table 3 breaks down the extent of compliance gaps for direct taxes as a share of GDP for the last 6 years. The table shows that a bulk of the compliance gap in direct taxes is as a result of default in submitting PAYE, corporation tax, WHT and tax on bank interest. The aforementioned tax units explain an average of 8.15 percent of GDP in lost annual revenue from 2009/10 to 2015/16. Cumulatively, this is valued at UGX 3.6 Trillion, which is high by any standard and is equivalent to the government’s total wage for FY2017/18.

This difference in compliance could be attributed to a high level of tax avoidance, as well as weaknesses in tax administration, which thus partly explains Uganda’s relatively low tax effort. As an illustration, in 2006, 74 percent of firms in Uganda reported did not report any sales for tax purposes, compared to 71 percent, 29 percent and 43 percent in Tanzania, Rwanda and Burundi, respectively (Figure 3).

Figure 2: Percentage Changes in C-Efficiency Ratios, Compliance and Policy Gaps for Direct Taxes 2001/2-2015/16.



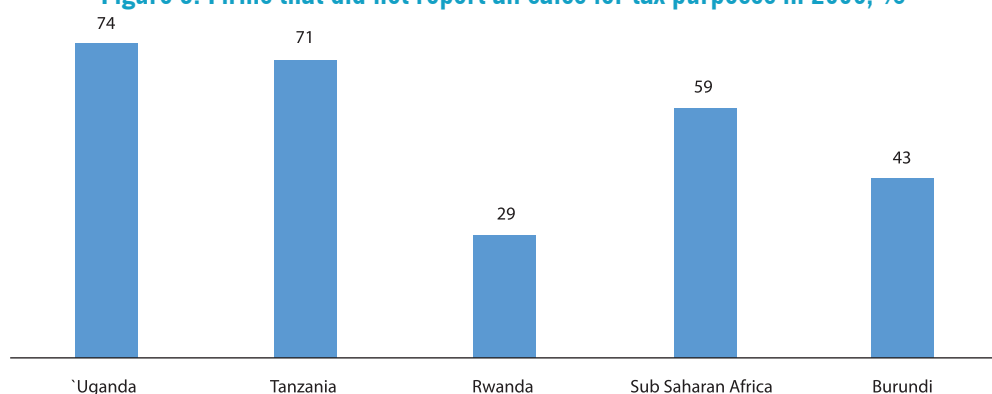
Source: Authors’ computations based on URA data.

Table 3: Direct tax compliance gaps by item, % of GDP

Tax Item	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
PAYE	3.71	3.84	3.86	4.07	4.82	4.73	4.32
Corporation Tax	1.78	1.95	2.15	2.03	1.68	2.09	1.75
Withholding Tax	1.20	1.28	1.27	1.32	1.40	1.60	1.67
Tax on Bank Interest	0.38	0.34	0.40	0.76	0.93	0.85	0.85
Other Income Tax	0.11	0.04	0.01	0.06	0.19	0.12	0.10
Rental	0.00	0.00	0.00	0.00	0.00	0.08	0.13
Casino and Lottery Tax	0.01	0.02	0.02	0.03	0.04	0.04	0.04
Agricultural Products	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Un-Allocated Revenue	0.02	0.04	0.00	0.00	0.00	0.00	0.00
Total	7.20	7.50	7.71	8.26	9.06	9.52	8.87
GDP Trillion, UGX	37.66	40.96	44.63	46.73	48.37	50.82	53.33

Source: Authors' computations based on URA data.

Figure 3: Firms that did not report all sales for tax purposes in 2006, %



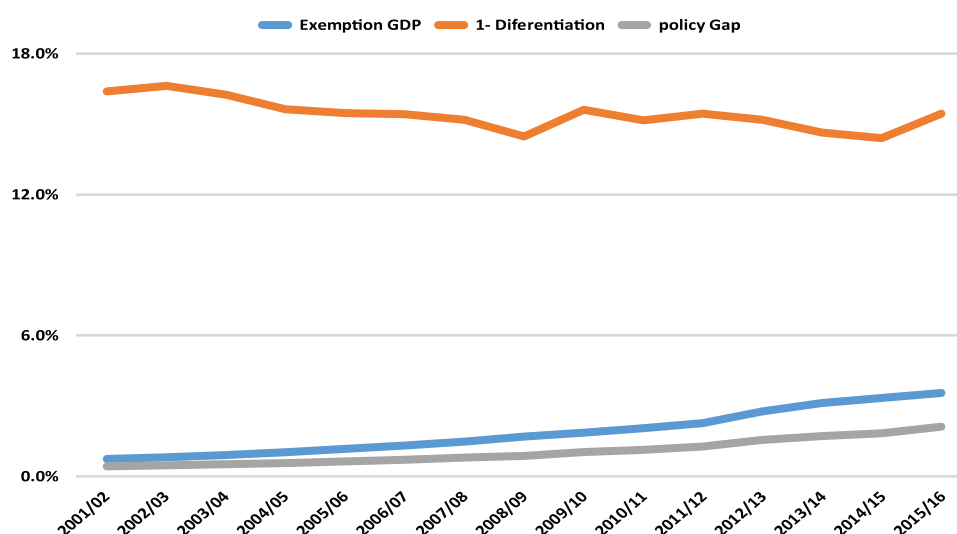
Source: Authors' computations based on World Bank (2017), World Development Indicators.

3.2.2 Policy gap

Direct taxes are relatively less differentiated than excise and custom taxes, as discussed in the subsequent sections. Nevertheless, the rate of differentiation is still significant and may lead to significant loss of revenue due to exemptions of certain income thresholds. Figure 4 estimates the differentiation to be at 15 percent. In addition to differentiation, income tax

exemptions led to annual revenue loss worth 4 percent of GDP in 2015/16. Incomes from export incomes and agricultural income are exempt from income taxes. These exemptions are valued at UGX 1.8 trillion, which is equivalent to the energy and mineral sector budget for the year 2017/18. In this regard, attempts to increase taxes should include an evaluation of the cost and benefits of the income tax exemption.

Figure 4: Decomposing Direct Tax Policy Gap



Source: Authors Construction using data from URA

3.2 Indirect taxes compliance and policy gap analysis

3.2.1 VAT compliance analysis

The C-Efficiency for VAT and its components are presented in Figure 5. What stands out is that the C-Efficiency for VAT in Uganda is low, at 29 in 2015/16, which means that considerably more revenue could be raised from the VAT even without increasing the current standard rate of 18 percent. If Uganda, for instance, were to increase its C-Efficiency to 40, it would increase its VAT revenue by approximately 1 percent of GDP (an amount equivalent to UGX 557 Billion in 2015/16).¹¹

The compliance gap for VAT remained fairly stable as percentage of GDP over the years under review, which reflect the improvement in the VAT tax base over the years. The improvement in VAT compliance is associated with reforms, such as Section 32(1) and (3) of the VAT Act that gives power to the Commissioner General of the URA to presume the VAT is payable in circumstances where the taxpayer is unable to maintain records. Presumptive taxation is expected to promote book-keeping. Other reforms included the establishment of the Tax Identification Number (TIN), the Large Tax Payer Department (LTD), the Tax Appeal

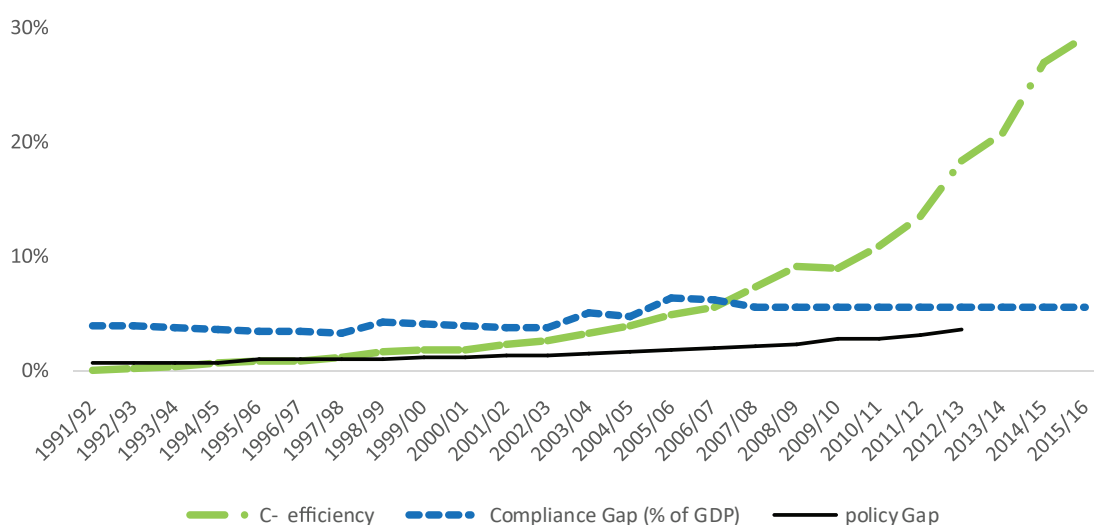
Tribunal (TAT), the introduction of pre-shipment inspection, and the GATT valuation system.

However, previous studies, such as Hutton *et al.* (2014), suggest that the estimated VAT non-compliance levels for Uganda are significantly higher than those that have been estimated for other low income countries in the recent years. For example, in the Latin American region, the highest compliance gaps (Nicaragua and Guatemala), averaged between 1 - 2 percent of GDP (Ibid) in comparison to the estimate for Uganda of 6 percent of GDP. This estimate is equivalent to UGX 3.2 trillion, which is higher than the total budget for the Roads and Works sector in FY 2017/18.

Considering compliance at the detailed tax item level, Table 4 shows significant compliance gaps in the aforementioned products. An average of 1.3 percent of GDP was lost owing to VAT tax default by cigarettes, beer, spirits/waragi, soft drinks, sugar and bottled water over the years under review. The amount lost annually is equivalent to an average of UGX 598.95 Billion. The estimated amount lost would be able to finance 90 percent of the health sector budget in FY 2017/18. The non-compliance could be an unintended consequence of tax exemptions, especially for the agro- manufactures. In Uganda, agricultural raw materials used in manufacturing cigarettes, beer, spirits/waragi, soft drinks, sugar and bottled water

¹¹ Uganda's GDP in 2015/16 in constant 2009/10 prices was UGX 55,755 Billion (MoFPED 2017).

Figure 5: Decomposing the VAT C- Efficiency, % of GDP



Source: Authors' computations based on URA data.

Table 4: VAT Compliance Gaps by Item, % of GDP

Tax Item	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Cigarettes	0.02	0.02	0.01	0.03	0.08	0.24	0.11
Beer	0.27	0.23	0.50	0.56	0.36	0.55	0.12
Spirits/Waragi	0.01	0.00	0.00	0.02	0.02	0.01	0.02
Soft Drinks	0.10	0.11	0.20	0.28	0.36	0.26	0.10
Sugar	0.42	0.47	0.36	0.50	0.65	0.67	0.62
Bottled Water	0.06	0.09	0.07	0.11	0.09	0.15	0.18
Cement	0.32	0.15	0.16	0.23	0.45	0.45	0.35
Electricity	0.25	0.24	0.14	0.48	0.35	0.60	0.15
Water	0.15	0.17	0.05	0.13	0.21	0.18	0.15
Phone Talk Time	1.19	0.82	0.74	0.65	0.69	0.96	0.75
Imports	2.2	2.4	2.4	2.6	2.7	3.1	2.8
Other Goods and Services	1.17	1.02	1.05	0.58	0.51	0.38	0.25
Total	6.16	5.72	5.68	6.17	6.57	7.55	5.40
GDP Trillion UGX	37.66	40.96	44.63	46.73	48.37	50.82	53.33

Source: Authors' computations based on URA data.

are exempt from VAT, but at times, these products are charged VAT along the value chain that is not easy to recover. Many businesses that are charged VAT along the value chain also chose not to claim a refund in an attempt to keep tax inclusive prices low. This practice creates an incentive within supply chains for business to under declare or to not declare their VAT liabilities to tax authorities. This calls for a review of the value chains in the agro-processing sector.

3.2.2 VAT compliance by specific products

Cement: With many on-going infrastructure and development projects, both in Uganda and the EAC region, the contribution of cement to taxation has increased significantly. During the FY 2011/12-2015/16, the nominal VAT collected on cement increased at average rate of 28 percent per annum. However, Table 5 estimates non-compliance in the cement industry at an annual rate of 0.3 percent of GDP for the years under review. This non-contribution is equivalent to an annual loss of UGX 138 Billion, which is three-fold the 2017/18 budget for the tourism, trade and industry sector and is more than 10 times the budget for the Information and Communication Technology (ICT) sector. This finding calls for a thorough investigation of compliance risks in the cement industry.

Electricity, water and phone talk time: The compliance gaps for the main utilities, i.e., water and electricity, are also large. The average compliance gap during 2009/10-2015/16 for electricity is twice that of water (0.31 percent versus 0.15 percent). The utilities compliance gaps are largely explained by the significant number of illegal connections. The speed of new connections to the national electricity grid has been slow due to factors such as the high cost of the initial connection.

As for phone talk time, from Table 4, annually Uganda lost VAT revenue worth 0.82 percent of GDP. This is equivalent to an annual loss of UGX 378 Billion. This is equivalent to the public administration sector budget for FY2017/18. The loss is largely due to small operators that have exploited loopholes in the One Area Network (OAN) system through offering cheap international calls. The small operators use “*Sim boxes*” to exploit loopholes in the OAN system by terminating calls originating from countries outside the gazetted territory in Kenya, Rwanda or South Sudan before routing them to Uganda, leading to substantial losses in VAT revenue.

Imports: VAT revenue emanating from imports has the largest compliance gap, an average annual loss of 2.6 percent of GDP for the years under review (Table 4). This is equivalent to an annual loss of UGX 1.2 trillion.

This loss is equivalent to the total interest payment on external and domestic debt in 2016/17. This suggests that the customs administration is struggling to control rent-seeking, and regional integration may have exacerbated the challenges. In this regard, progress in implementing integrity-enhancing measures (such as adequate salaries and working conditions, management control systems, computer systems to streamline procedures and minimise face-to-face contacts, and accreditation of customs brokers and importers) require strengthening. Additionally, shifting fiscal control from national to regional borders requires new ways to collect import VAT and certify export-related refund claims, and potentially new policy frameworks to address intra-regional transactions, which poses a considerable challenge for Uganda.

3.2.3 VAT Policy Gap

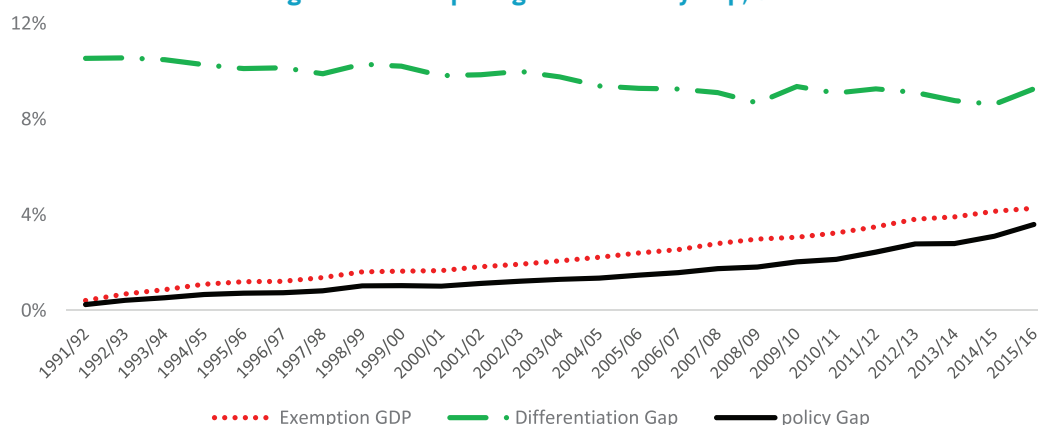
What emerges from Figure 6 is that there is little differentiation in the VAT rate in Uganda. As such,

most persons and businesses pay a uniform rate of 18 percent. However, there is room for improving the coverage of the VAT by reducing exemptions on credit for input on imported services made by a licensee, reducing the VAT threshold from UGX 150 million and reducing the cash basis accounting for VAT purposes from UGX 500 million. These exemptions and others are estimated to have grown to 4 percent of GDP in 2015/16. This increase should be the focus of attention in considering any further increase in revenue from the VAT granted that the loss is worth UGX 2 trillion, the size of government's the total wage bill in FY2017/18.

3.3.4 Excise duty compliance analysis

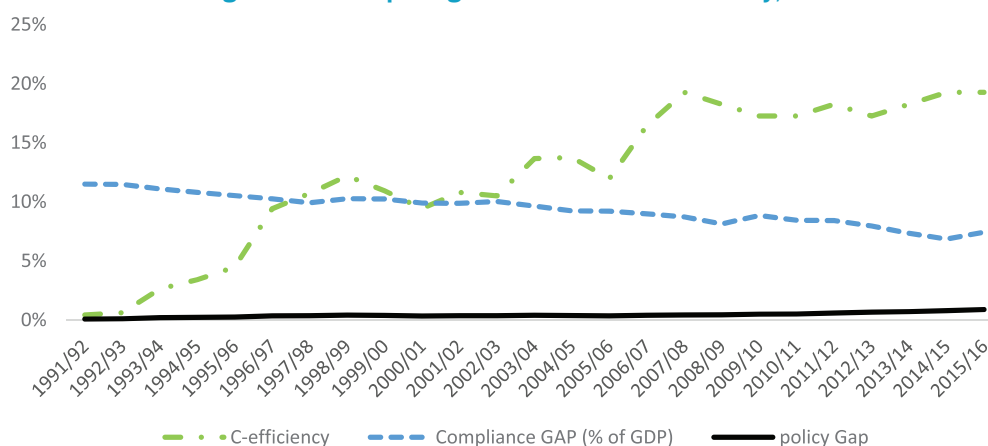
Figure 7 the decomposition of C efficiency for the excise tax. The C-Efficiency for excise tax in Uganda has increased over time from less than 1 percent of GDP in the 1990s to 19 percent in 2015/16. However, there has been a long-term stagnation in the Effective Tax Rates (ETR) for excise tax. This suggests that the

Figure 6: Decomposing the VAT Policy Gap, %



Source: Authors Construction using data from URA.

Figure 7: Decomposing the Excise Tax C- Efficiency, %



Source: Authors' computation based on URA data

economy is growing faster than the changes in the efficiency of the excise tax rate. The calculated ETR for excise tax has stagnated at 1 percent of GDP since FY1996/97.

This stagnation could be related to the high, albeit falling, compliance gaps, which are estimated at 7 percent of GDP in 2015/16. This is equivalent to UGX 3.2 trillion, which is equivalent to the total road and works budget for FY2016/17. The stagnation in ETR for excise tax could also be explained by the menu of different excise tax rates and the frequent changes in the excise tax rate. The changes in the tax rates have not justified growth in the C-Efficiency, which remains low and calls for expansion of the tax base as opposed to the tax rate.

Next, the paper discusses the compliance gaps for selected tax items as presented in Table 3. It is indicated that the compliance gaps to tobacco are low. It is possible that the 2004 tobacco tax reforms—which changed the taxation system from an ad-valorem to a three-tier specific tax—facilitated the stabilization of cigarettes compliance gaps. Specifically, these reforms imposed excise taxes based on each cigarette stick rather than per kilogramme as was the case prior to 2004. The tiers were reduced further to two in 2015. As a result of this reform, Uganda’s duty on cigarettes increased from UGX 35,000 (US\$ 10.4) to

UGX 45,000 (US \$13.4) and from UGX 69,000 (US\$ 20.5) to UGX 75,000 (US \$22.3) for soft cap and hinge lid, respectively, per 1,000 sticks. This success is also attributable to political commitment to reduce consumption of tobacco and improve global health consistent with the 2007 World Health Organisation’s (WHO) Framework Convention on Tobacco Control (WHO FCTC) as well as the Tobacco Control Act 2015. Despite frequent changes in the beer and spirits/waragi tax rates, compliance gaps remain significant, with an average annual rate of 0.06 and 0.01 percent of GDP, respectively, for the years under review. These are equivalent to UGX 27.64 Billion and UGX 4.6 Billion, respectively. This loss could be due to differentiation in the excise tax rate levied on the final sale. In this regard, beer and spirits/waragi made from locally produced raw materials pay 30 and 20 percentage points less excise tax than imported beer and spirits/waragi, respectively. It should be noted that exemptions levied at final sale tend to reduce tax revenue, since any further sale of the item will be liable for tax refund claims.

In addition, the 13 percent excise tax rate on non-alcoholic beverages exposes bottled water and soft drinks to relatively high cross-price elasticities, which places collections at risk from noncompliance due to substitution. The non-compliance in the beverage segment averaged 0.02 percent of GDP (UGX 9.2

Table 5: Excise Compliance Gaps by Item, % of GDP

Tax Item	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Cigarettes	1.01	1.00	1.00	1.00	1.00	1.00	1.00
Beer	1.07	1.07	0.08	1.07	1.05	1.04	1.04
Spirits/Waragi	1.01	1.51	1.51	0.61	0.41	0.31	0.61
Soft Drinks	1.02	1.52	1.52	0.62	0.42	0.52	0.42
Bottled Water	1.00	0.51	0.50	0.50	0.80	0.70	0.50
Sugar	1.01	0.51	0.50	0.30	0.70	0.70	0.50
Cement	0.01	0.01	0.01	0.01	0.00	0.00	0.01
Cosmetics	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Phone Talk Time	1.07	0.56	0.56	0.76	0.55	0.95	0.64
International Calls	1.00	0.50	0.50	0.40	0.32	0.42	0.31
Mobile Money Transfers	0.00	0.00	0.00	0.00	0.00	0.01	0.01
Custom Excise	0.23	0.23	0.28	0.33	0.30	0.34	0.35
Total	8.43	7.42	7.46	5.60	5.55	5.99	5.39
GDP Trillion, UGX	37.66	40.96	44.63	46.73	48.37	50.82	53.33

Source: Authors’ computations based on URA data.

Billion) in the period under review (Table 5). In economic terms, tax-paid goods may be substituted by the same or similar goods on which domestic excise has not been paid. The substitution goods may be purchased legitimately in other EAC partner states where excise rates and prices are lower, or they may have been smuggled into the domestic market without paying tax. The states could have also evaded excise by other means, such as non-tax paid counterfeit goods, or diversion or other frauds.

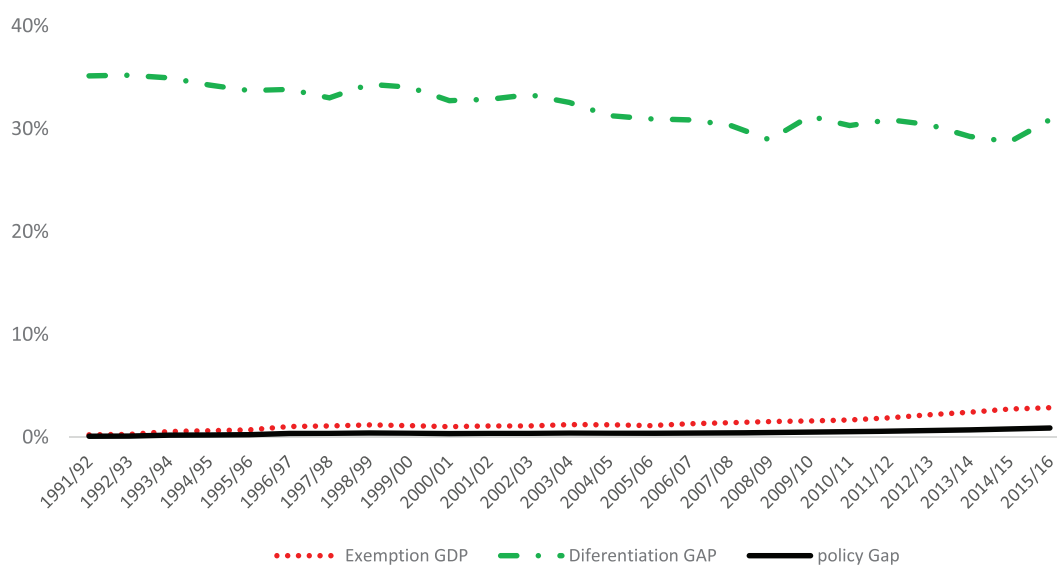
Data from URA shows total excise duties collected from international calls dropped by 12 percent from UGX 21.3 Billion (\$6.2 million), recorded between September and November 2014, to UGX 18.7 Billion (\$5.5 million), posted between the period December 2014 to February 2015. In addition, the total excise duties collected from this segment fell by 43.6 percent from UGX 18.7 Billion (\$5.5 million), registered between December 2014 and February 2015, to UGX 10.5 Billion (\$ 3 million), posted between March and May 2015. Total excise duties rose by 20.5 percent to UGX 12.7 Billion (\$3.7 million) between June and August 2015, the data revealed. However, a yearly comparison shows excise duties collected from international calls stood at UGX 7.3 Billion (\$2 million) by close of September 2014 compared to UGX 3.3 Billion (\$962,376) registered in September 2015.

Table 5 further indicates that there are large losses associated with the compliance gap on excise taxes imposed on international trade, an annual average of 0.29 percent of GDP (UGX 133.36 Billion) for the years under review. Apart from compliance gaps caused by smuggling and counterfeiting, compliance gaps could emanate from a lack of clarity on the various schemes that have been devised to obtain inputs free from duty or to grant refunds of the same. There is a need for clarity and scrutiny on what inputs are exempt from excise duty and the modalities that should be used to claim excise tax credit.

3.2.5 Excise tax policy gap

As mentioned earlier, Uganda’s excise tax is highly differentiated. Figure 8 suggests that the differentiation is at 31 percent. Indeed, as of August 2017, there were 18 different excise tax rates for imports coming to Uganda, with peak rates of 200 percent for tobacco based items. In this regard, the soft cap cigarettes and hinge lid cigarette that dominate Uganda’s cigarette market are subject to different excise rates. Similarly, excise rules and rates differ according to the origin of the raw materials and alcoholic content, for example, by categorising alcoholic drinks into beer, wine or spirits. Differentiation can lead to loss of revenue in some circumstances and needs to be examined further. On the other hand, excise tax exemption granted under the

Figure 8: Decomposing the Excise Tax Policy Gap, %



Source: Authors’ computations based on URA data.

fifth schedule of the 2004 EAC Customs Management Act (EACCMA) and the zero rating of cereals grown and milled in Uganda cost the country an average 2 percent of GDP for the period from 2009/10 – 2015/16.

3.3 Customs taxes compliance and policy gap analysis

3.3.1 Compliance analysis

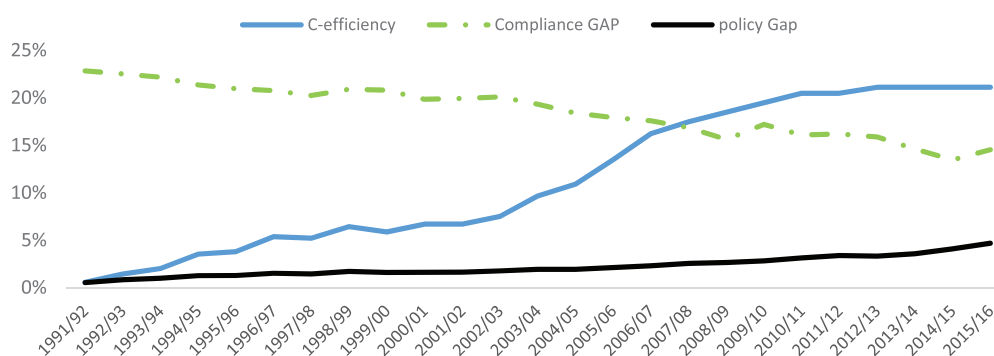
The C-Efficiency for customs taxes has been improving on a year-on-year basis, and stands at 21 percent in 2015/16 (Figure 9). This is largely due to the EAC Custom Union harmonisation programme and the strengthening of border cooperation between Kenya, Rwanda and Uganda, with the aim of improving data sharing. However, a lot more needs to be done to reduce the compliance gaps fostered by smuggling, tax avoidance and under-declaration.

While there has been a long-term increase in the ETR for custom taxes from 3 percent in 2000/01 to

9 percent in 2015/16, non-compliance in the tax categories (petroleum duty, import duty, surcharge on used imports, withholding taxes and temporary road licenses) diminish the tax potential of custom taxes. Table 6 estimates a non-compliance of the aforementioned items at an average of 3.64 percent of GDP for the years under review. The non-compliance is valued at UGX 1.7 trillion, equivalent to the annual budget of the public management, public administration and parliament sectors in FY2017/18.

Non-compliance can partially be explained by the frequent changes of custom rates that provide an incentive for under-declaration and smuggling. For example, increases in the customs charges on petrol, diesel and motor vehicle lubricants by approximately 10 percent could have led to a substantial loss of revenue. However, petroleum prices are higher in Uganda than in neighbouring countries, which creates a significant risk of cross-border shopping.

Figure 9: Decomposing the Customs C- Efficiency, %



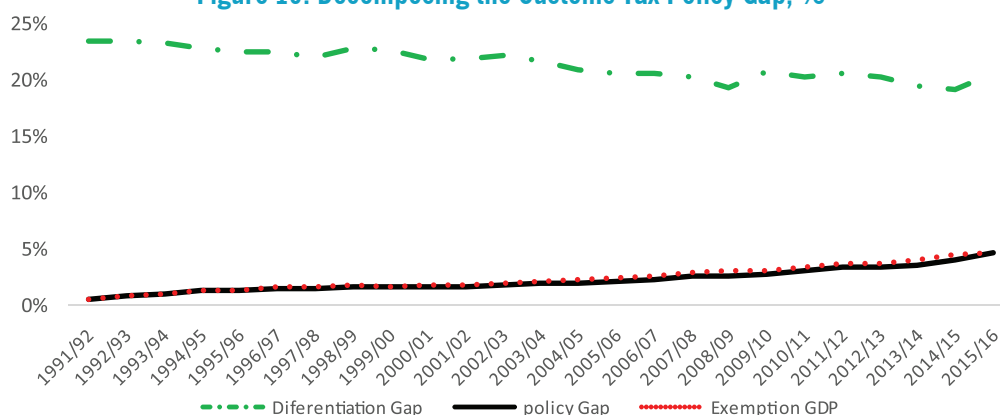
Source: Authors Construction using data from URA

Table 6: Customs Compliance Gaps by Item, % of GDP

Tax Item	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Petroleum Duty	2.04	2.02	1.94	1.63	1.90	2.05	1.97
Import Duty	0.99	1.10	1.06	1.23	1.44	1.44	1.34
Surcharge on Used Imports	0.11	0.12	0.11	0.13	0.14	0.16	0.19
Withholding Taxes	0.20	0.21	0.25	0.32	0.25	0.26	0.23
Temporary Road Licenses	0.07	0.11	0.09	0.10	0.10	0.10	0.08
Excise Duty	0.23	0.23	0.28	0.33	0.30	0.34	0.35
VAT on Imports	2.18	2.42	2.45	2.58	2.71	3.06	2.78
Commission on Imports	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Re-Exports Levy	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Hides and Skins Levy/Exports Levy	0.00	0.02	0.00	0.00	0.01	0.02	0.02
Coffee Stabilisation Tax	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total	5.82	6.22	6.18	6.30	6.85	7.43	6.96
GDP Trillion, UGX	37.66	40.96	44.63	46.73	48.37	50.82	53.33

Source: Authors' computations based on URA data.

Figure 10: Decomposing the Customs Tax Policy Gap, %



Source: Authors' computations based URA data.

3.3.2 Policy gap

Similar to excise tax, Figure 10 shows significant differentiation in the custom tax rates, 21 percent in 2015/16. This phenomenon could affect the revenue yield, especially if the gaps between the tax rates are significantly wide. On the other hand, custom tax exemptions are estimated at 5 percent of GDP. This is equivalent to UGX 2.3 trillion, equal to the budget for education in 2017/18. The loss is as a result of zero-rating and reduction of rates, such as the 2015/16 reduction of insurance WHT from 15 percent to 5 percent that led to considerable revenue losses.

3.4 Implications of Uganda's commitments under the EAC to DRM

At the EAC level, a number of commitments have been made to promote regional integration, which presents implications for DRM in Uganda. These commitments emanate from the treaty establishing the EAC Article 75 of the treaty establishes a Customs Union. The treaty also provides for partner states to harmonise and rationalise tax incentives for investment, harmonise their tax policies, and harmonise policies impacting capital markets, particularly the granting of incentives for the development of capital markets and free movement of capital by removing controls.

The Customs Union protocol, which came into force in 2005, affects DRM in Uganda. This protocol is employed because it provides for the following: the elimination of internal tariffs and other charges of equivalent effect; the elimination of Non-Tariff Barriers (NTBs); establishment of a Common External Tariff (CET); application of Rules of Origin (RoO) as well as duty drawback, refund and remission of duties and

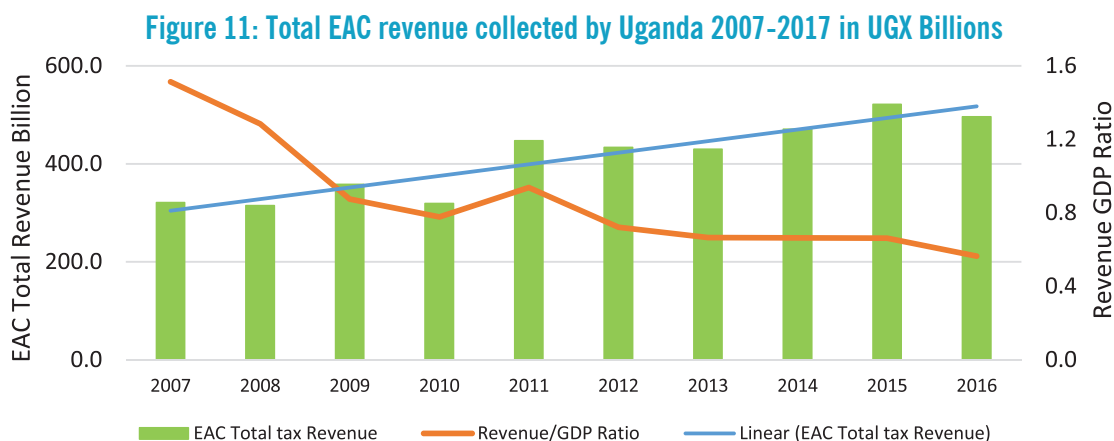
taxes. The Protocol also provides for trade facilitation measures, notably the simplification and harmonisation of trade documentation and procedures. Article 75 of the EAC states that “partner States shall not impose any new duties and taxes or increase existing ones in respect of products traded within the Community and shall transmit to the Secretariat all information on any tariffs for study by the relevant institutions of the Community”. Under the EAC CET, partner states apply the same tariffs for goods originating from outside the region at the rates of zero percent for raw materials and capital goods, 10 percent for semi-finished products and 25 percent for consumer goods.

Table 7 presents the trends of all the taxes Uganda collects from the EAC partner states on goods entering Uganda. Among all the different taxes, Uganda collects most of the tax revenue from VAT and excise, and the former grew to be the largest over the period from 2005 – 2016. Whereas excise duty revenue remained largely constant at an average of UGX 160 Billion, VAT increased from UGX 117 Billion in 2007 to UGX 305 Billion in 2016. This suggests that, in nominal terms, VAT more than doubled over the period and excise remained the same. The other categories worth mentioning are the customs and WHT revenues. WHT revenues marginally increased from UGX 13 Billion in 2007 to UGX 15 Billion in 2016. Customs duty revenues understandably declined considerably from UGX 27 Billion in 2007 to UGX 14 Billion in 2016. Note that the contribution of this tax to the overall revenue generated is extremely small to the extent that its decline insignificantly impacts the overall collection. The overall revenue generation grew from UGX 321 Billion in 2007 to UGX 495 Billion in 2016.

Table 7: Uganda's revenue collections on goods from the EAC partners (UGX Billion)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Environmental	0.0	0.00	0.07	0.11	0.09	0.11	0.07	0.09	0.07	0.10
DVAT	0.32	0.28	0.31	0.26	0.32	0.34	0.40	0.65	0.66	0.43
WHT	12.6	13.3	16.8	14.2	21.5	16.6	15.9	25.2	19.7	14.5
Customs Duty	27.4	32.6	39.5	24.1	34.5	28.0	43.2	26.8	21.7	14.1
Excise	163.2	122.6	133.4	108.4	138.1	142.5	127.0	137.8	150.9	161.3
VAT	117.1	145.7	167.7	171.5	252.3	246.0	242.7	279.8	328.4	305.4
Total Taxes	320.6	314.5	357.8	318.5	446.7	433.5	429.3	470.3	521.4	495.9

Data Source: UBoS, 2017.



Data Source: UBoS 2017.

The growth in VAT suggests that the EAC CU treaty provisions did not negatively impact the overall tax revenue collected, since it only affected customs duties which, although reduced, did not significantly impact nominal collections. However, when the total revenues generated are treated as a ratio to the national GDP, as demonstrated in Figure 11, a decline in real terms is observed. The ratio of the revenue to GDP declined from 1.5 percent in 2007 to less than one percent in 2016. Therefore, it is plausible to argue that, in real terms, the country lost revenue as it implemented the internal tariff liberalisation provisions of the EAC treaty and protocol.

It is noted that the value of EAC imports over time significantly increased as from UGX 918 Billion in 2007 to UGX 2,001 Billion in 2016. This suggests that Uganda was compensated by charges on the other taxes (VAT, excise, withholding and environmental) through the increasing volumes of goods imported from the EAC partner states. Therefore, the significant growth of import trade volumes from the EAC partner states and the maintenance of the other tax charges

contributed to this compensation.

When countries integrate, it is an established fact that any liberalisation leads to loss of customs tax revenue from regional partners. However, through benefits of economies of scale and an expanded market, it is anticipated that partners are compensated. Through this channel, Uganda realised an increase in exports to the EAC partner states following the removal on internal tariffs and scaling down of non-tariff barriers. Table 8 provides a trend analysis of the exports by Uganda to the other EAC partner states. Kenya is the main export destination for Uganda within the EAC, followed by Rwanda, Tanzania and then Burundi. There was an increase in the value of Uganda's exports from UGX 503 Billion in 2007 to UGX 2,305 Billion in 2016. In addition, statistics show that the revenue generated from the CET by Uganda more than tripled from UGX 400 Billion in 2007 to UGX 1,246 Billion in 2016. Therefore, even when Uganda lost customs revenue, this period observed an increase in value exports to the EAC region, as well as increases in revenue from the CET.

Table 8: Uganda's Exports to the EAC region from 2007 – 2016 (UGX Billions)

Importers	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Kenya	216.5	283.7	299.3	386.4	493.4	640.9	787.5	769.4	1,110.1	1,309.5
Rwanda	152.6	235.9	232.8	303.2	421.4	570.4	541.7	634.7	617.6	626.3
Tanzania	56.0	52.6	58.1	76.4	91.9	136.3	120.1	144.9	158.0	223.2
Burundi	78.2	78.2	95.9	104.2	90.3	116.3	122.0	112.4	120.3	1,46.2
EAC	503.3	650.5	686.1	870.2	1,096.9	1,463.9	1,571.4	1,661.4	2,006.1	2,305.2

Data Source: Trademap, 2017

3.5 Uganda's tax revenue collection performance in comparison to other EAC partner states

Despite the growth in nominal tax collection during the past 10 years, Uganda's revenue collections are still very low when we use standard measures of tax performance, e.g., the tax to GDP ratio. Comparisons with other African countries show that Uganda's tax revenue to GDP is still below the Sub-Saharan Africa average of approximately 16 percent. Furthermore, within the EAC, Uganda lags behind her neighbours, also. In 2014, Uganda's tax revenue to GDP ratio stood at 11.4 percent compared to 12.4 percent and 13.5 percent for Rwanda and Tanzania respectively (Table 9).

A number of reasons account for Uganda's relatively poor performance in regard to revenue collection. Among these are the relatively higher dependency on international taxes, relatively weaker tax administrative system, high levels of informality, tax evasions, tax incentives, etc. The previous literature on Ugandan

tax performance reveals that the low tax to GDP ratio emanates from a number of reasons, namely, the existence of a large informal sector that falls out of the tax net (Ssennoga *et al.* 2009), wide spread tax evasion (Matovu, 2008), continued revenue leakages through smuggling (Cawley and Zake, 2010) and the growing number of exemptions granted by the government over the years (IMF, 2010).

In terms of PAYE, which provides a measure of the tax paying culture and efficiency of revenue administration in a given economy, Uganda's PAYE to total revenue as well as the PAYE to GDP is among the lowest in among the EAC partner states (Figure 12). In 2015/16, Uganda registered a PAYE to total revenue of 14 percent, compared to Kenya's 23 percent and Rwanda's 24 percent. Additionally, the individual income tax contribution to GDP is lower in Uganda, at 2 percent, compared to 4 and 7 percent for Rwanda and Kenya, respectively. The low observed PAYE to total revenue and GDP ratios for Uganda could be attributed to, among other reasons, low tax compliance, the large informal sector and tax exemptions.

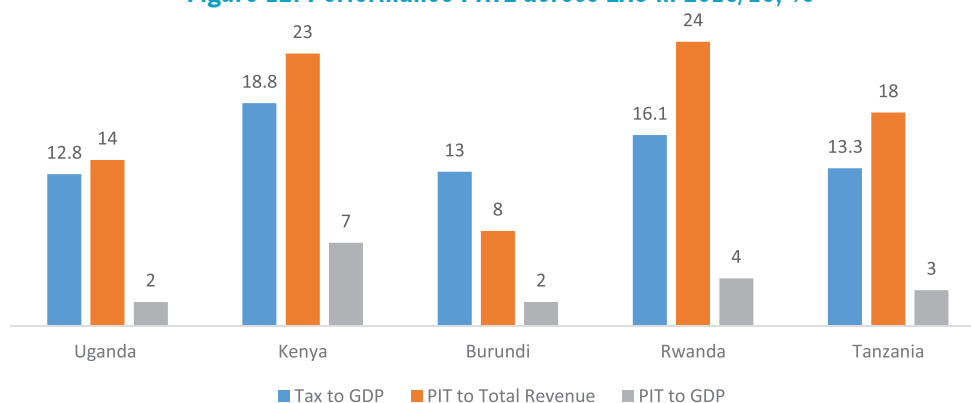
Table 9: Trends in tax revenue (% of GDP)

	2009	2010	2011	2012	2013	2014	2015
Uganda	10.4	10.3	13.3	10.9	11.0	11.4	10.3
Tanzania	11.7	12.1	12.3	12.7	13.2	12.4	..
Rwanda	12.1	12.4	13.1	13.5	14.0
Kenya	15.5	15.7	15.9	15.9	15.5
Sub-Saharan Africa*	15.4	14.9	15.2	15.7	15.8

Notes: *these figures do not change when high income countries are excluded.

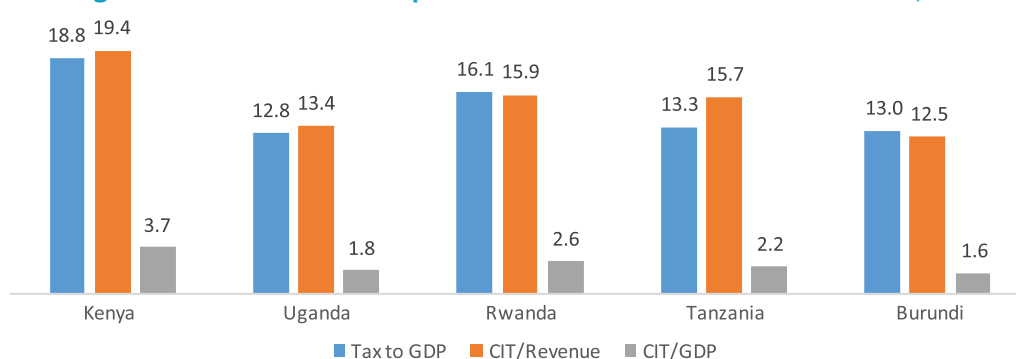
Source: World Bank (2017), World Development Indicators.

Figure 12: Performance PAYE across EAC in 2015/16, %



Source: Authors' computation based on data from the EAC Fact & Figure Report 2016.

Figure 13: Performance of corporate income tax across the EAC in 2015/16, %



Source: Authors computation based on data from the EAC Fact & Figure report 2016.

Considering the performance of corporate income tax (CIT), Figure 13 reveals that Uganda's corporate tax income in total revenue is still low compared with other EAC partner states. In 2015/16, CIT contributed 13.4 percent to total revenue, compared to Kenya's 19.4, Rwanda's 15.9 and Tanzania's 15.9. The low contribution of CIT to total revenue has in turn affected Uganda's CIT to GDP ratio. Uganda registered the lowest contribution of CIT to GDP of only 1.8 percent compared to Kenya's 3.7 and Rwanda's 2.6 percent.

one (URA, 2014). From table 10, Uganda's informal sector stands at 43 percent, which is comparable and slightly lower than many EAC countries, such as Rwanda (46 percent) and Tanzania (48 percent). Both of these countries, as noted before, have a tax to GDP higher than that of Uganda. This suggests that, apart from informality, there are other underlying factors explaining Uganda's relatively lower tax to GDP ratio.¹²

3.6 Challenges facing DRM collection

As shown from the previous sections, Uganda's tax to GDP ratio is below potential and below the ratios of her regional peers. Below, we details some of the challenges.

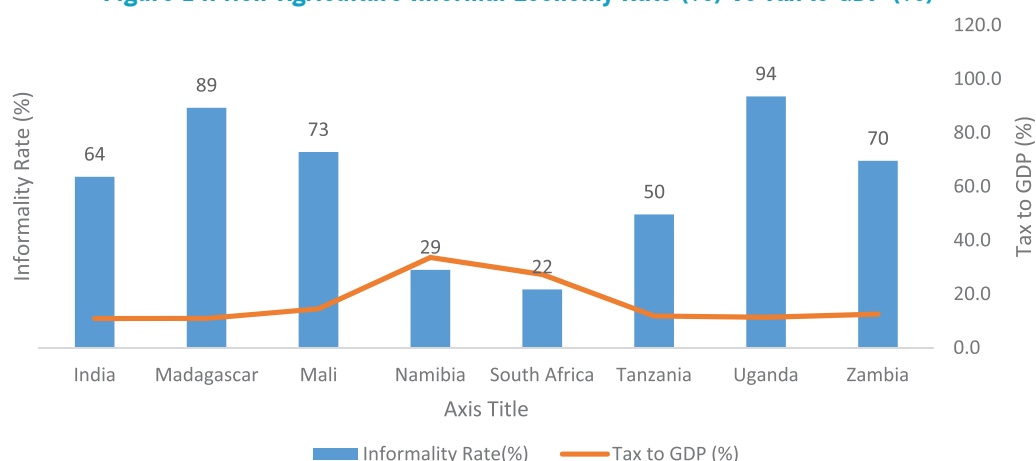
Informality: Informality has been identified as one of the most challenging factors for increasing revenue collection in Uganda. However, while it is true that countries with a large informal sector have lower tax to GDP ratios compared to countries with a smaller

¹² It may also suggest that there are differences in measurements and definitions of informality between the different countries. For example, the international labour organisation defines the informal sector as broadly characterised as consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes for the persons concerned. Within this definition, units operate at a low level of organisation, with little or no division between labour and capital as factors of production and on a small scale. In addition, labour relations - where they exist - are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees (OECD, 2017). On the other hand, the informal sector definition in Uganda covers all business activities that are characterized by the absence of financial accounts, having less than 5 employees, no fixed location, in most cases not registered and sometimes such businesses are operational for only 6 months or less (UBOS, 2010).

Table 10: Shadow Economy/Informal Sector, %

	1999	2000	2001	2002	2003	2004	2005	2006	2007	Average
Uganda	43.5	43.1	42.9	42.9	42.5	42.4	42.2	41	40.3	42.3
Kenya	33.7	34.3	34	34.8	34.6	33.7	32.7	31.1	29.5	33.2
Tanzania	58.6	58.3	57.7	56.9	56.6	56	55.4	54.7	53.7	56.4
Burundi	39.1	39.5	39.6	39.4	39.6	39.6	39.7	39.6	39.6	39.5
Rwanda	40.5	40.3	40.6	39.9	40.7	40.2	39.3	39.1		40.1
Ethiopia	40.6	40.3	39.5	39.6	40.1	38.6	37.7	36.3	35.1	38.6

Source: A. Buehn, F. Schneider (2012).

Figure 14: Non-Agriculture Informal Economy Rate (%) Vs Tax to GDP (%)


Source: Authors' computations based on HS, LFS, LFS and WDI (World Bank) data.

Looking at the non-agriculture informal economy rate shows that countries with high informality have a relatively lower tax to GDP ratio compared to countries with lower informality rates (Figure 14). Apart from negatively impacting revenue collection, having a large informal sector retards innovation and business growth. Statistics show that firms competing against

unregistered firms as a percentage of all firms in Uganda increased from 73 percent in 2006 to 95 percent in 2013. Regional comparisons also show that, in 2013, 95 percent of Uganda's firms were competing against unregistered firms as a percentage of all firms, compared to 73 percent in Tanzania and 59 percent in Kenya (Table 11).

Table 11: Informality indicators

	Percent of firms competing against unregistered or informal firms	Percent of firms formally registered when they started operations in the country	Number of years a firm operated without formal registration	Percent of firms identifying practices of competitors in the informal sector as a major constraint
Burundi (2014)	51.3	87.1	0.8	24.4
Ghana (2013)	69.4	76.5	1.1	29.5
Kenya (2013)	59.3	91.0	0.4	26.9
Rwanda (2011)	56.7	89.8	0.4	37.6
South Sudan (2014)	69.8	80	0.6	38.1
Tanzania (2013)	72.6	75	0.8	45
Uganda (2013)	95.2	63.2	1	37.9

Source: Enterprise Surveys, World Bank 2017.

Note: * This indicator is computed using data from manufacturing firms only.

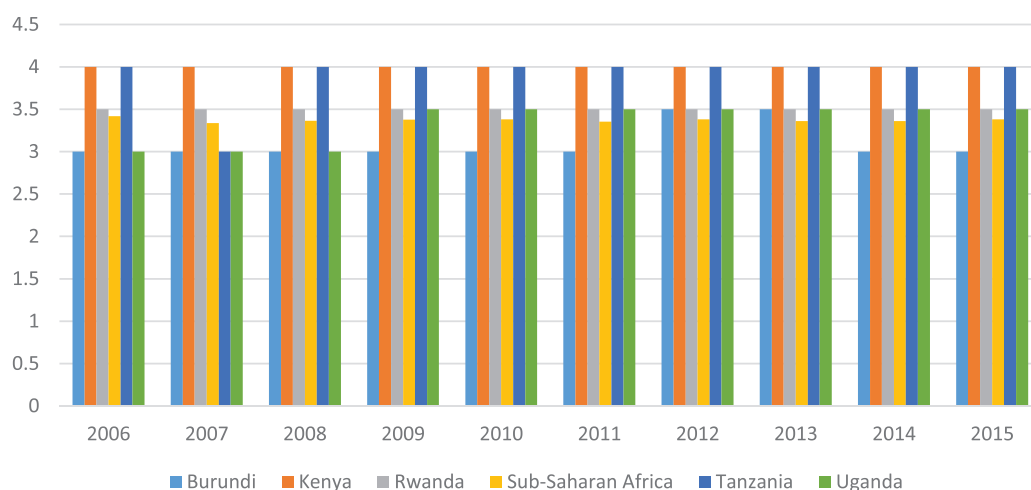
Efficiency of revenue mobilisation: The efficiency of revenue mobilisation¹³ assesses the overall pattern of revenue mobilisation (World Bank, 2015). In Figure 15, compared to other East African peers, Uganda registered the lowest revenue mobilisation efficiency between 2006 and 2009. However, afterwards, the country’s revenue mobilisation efficiency improved and surpassed the Sub-Saharan Africa average but has since stagnated at 3.5, far below that of Tanzania and Kenya.

declining trend and was below that of Rwanda and Tanzania. However, after 2011/12, Uganda’s cost of collection increased drastically from 1.91 percent to over 2.6 percent in 2012/13, and has since remained above that of Kenya and Rwanda. Uganda’s high cost of revenue collection can be explained by the various initiatives that the country has undertaken to expand the tax register under the Tax Registration Expansion Program (TREP) but also the continuous investment in technology for improving efficiency in the collection of both domestic and international taxes. Nevertheless, URA needs to reduce its cost of collection to 1 percent, which is the East African target to maximise her tax revenues.

Cost of collection: Between 2007/08 and 2011/12 (Table 12), Uganda’s cost of collection exhibited a

13 The countries are ranked from 1 to 6. (1 representing the country with the lowest revenue mobilisation and 6 the country with the highest mobilisation efficiency).

Figure 15: Efficiency of revenue mobilisation



Source: Author’s computation from World development indicators data

Table 12: Trends in the cost of collection

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Kenya	1.7	1.8	1.7	1.8	1.8	1.6	1.3	1.3	1.2
Rwanda	2.9	2.4	2.7	2.8	2.6	2.4	2.1	2.1	2.2
Tanzania	2.7	3.8	3.3	2.6	2.3	2.3	2.7	2.3	2.2
Uganda	2.7	2.5	2.4	2.1	1.91	2.6	2.5	2.3	2.1
Burundi	-	-	-	2	2	2.8	2.8	2.8	3.6

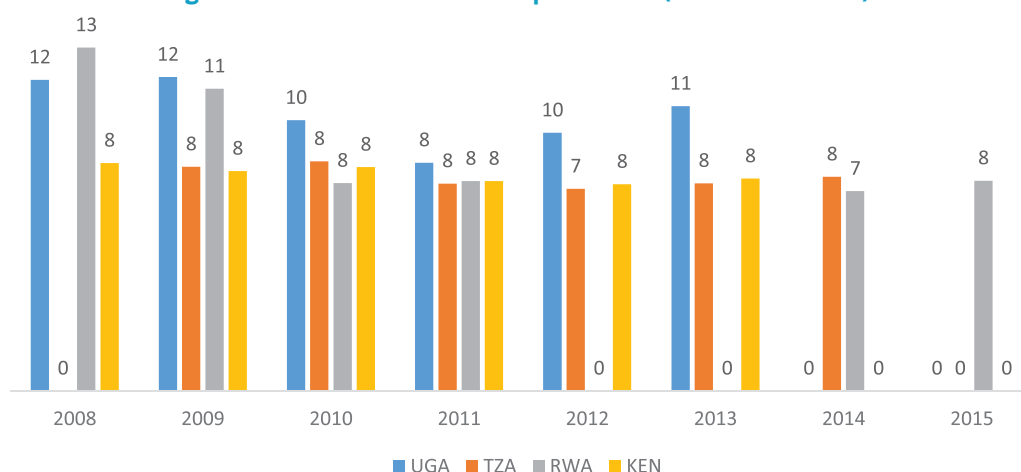
Source: East African Revenue Agencies report 2017.

Dependency on international trade and consumption taxes: Despite noted reductions in the share of international trade taxes, statistics also show that Uganda has a higher dependency on international trade duties compared to other EAC countries (Tanzania, Kenya and Rwanda). In 2013, 11 percent of its tax revenue was collected from customs and other import duties, compared to 8 percent for Tanzania and Kenya (Figure 16). Studies have shown that a high dependence on consumption taxes, such as VAT and excise duty or on import levies, is reflective of a regressive tax system. The poor end up paying a relatively high amount of tax, as they spend all their income on goods subject to VAT, as well as import levies. It has been found that the proportion of trade tax to total tax revenue is negatively related to the level

of development and to the size of the country, while it is positively related to economic openness (Borg, 2006).

Tax base: Uganda has one of the lowest income tax rate on profits among its regional peers (Table 13). Specifically, Uganda's average tax rate of 35.2 percent is far below that of Kenya (44.2 percent), Tanzania (44.1 percent) and the Sub-Saharan Africa region (60.7 percent). The lower income tax rate could be a result of tax competition and the various tax exemptions offered with a view of luring foreign direct investments in the EAC region. Indeed, between 1991/92 and 1997/98, the levels of corporate tax collections were reduced as a result of the investment code, which was subsequently abolished and replaced with depreciation and tax allowances (AFDB, 2010). In the EAC, Uganda has

Figure 16: Customs and other import duties (% of tax revenue)



Source: Authors' computations based on data from World Development Indicators, World Bank, 2017.

Table 13: Total tax rate (% of commercial profits)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
UGA	35	37	35	37	37	34	34	37	34	34	34
TZA	44	44	44	44	44	45	45	44	44	44	44
RWA	41	37	37	35	35	35	35	33	33	33	33
KEN	50	49	49	49	49	49	44	37	37	37	37
SSF	73	73	72	72	69	58	57	51	46	46	47
SSA	74	73	73	72	69	59	58	51	46	46	47
BDI	280	280	280	280	155	47	47	45	40	40	40

Source: World Development Indicators, World Bank, 2017.

the lowest total tax rate on commercial profits after Rwanda. In 2016, Uganda’s total tax rate as percent of commercial profits stood at 34 percent compared to 33 percent, 44 percent, and 37 percent for Rwanda, Tanzania and Kenya, respectively. The average of Sub-Saharan Africa countries stands at 47 percent.

4. NON-TAX REVENUE

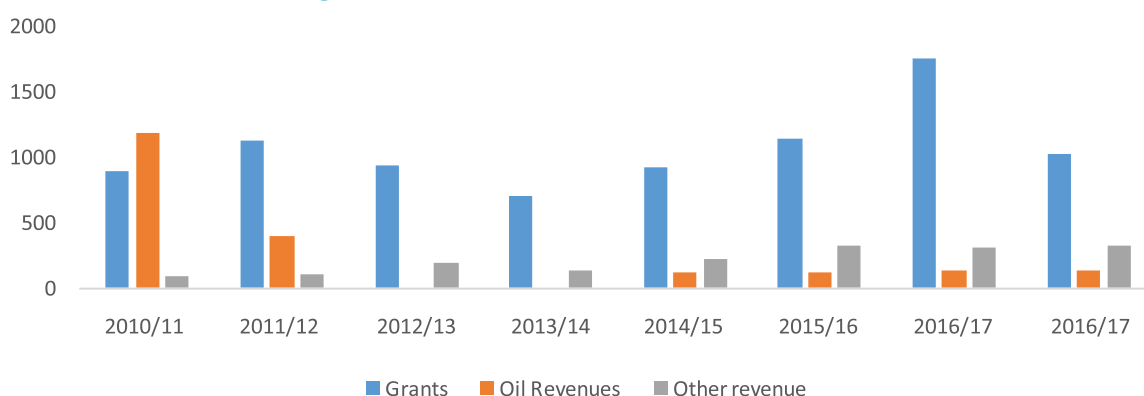
4.1 Performance of NTR

Non-tax revenue (NTR) refers to all government’s revenue that is not derived from taxes. Such revenue can come from either domestic or external sources. For the case of Uganda, external sources include grants and gifts from development partners and other international bodies. Grants represent the largest source of non-tax revenue (Figure 17). However, this is likely to change as foreign aid is projected to reduce in the future in addition to projected future revenue increases from oil and gas exports.

The domestic sources include rent from state-owned buildings, parks and reception facilities; the sale of goods, including used cars, office equipment, heavy equipment, computer equipment and furniture; payments for government services, such as passport fees, license fees, driving permit fees; mining and royalty fees; migration fees and company registration fees. NTR is also collected in the form of fines and penalties as well as interest earnings and dividends from government investments. The subsequent discussion focuses largely on NTR from domestic sources.

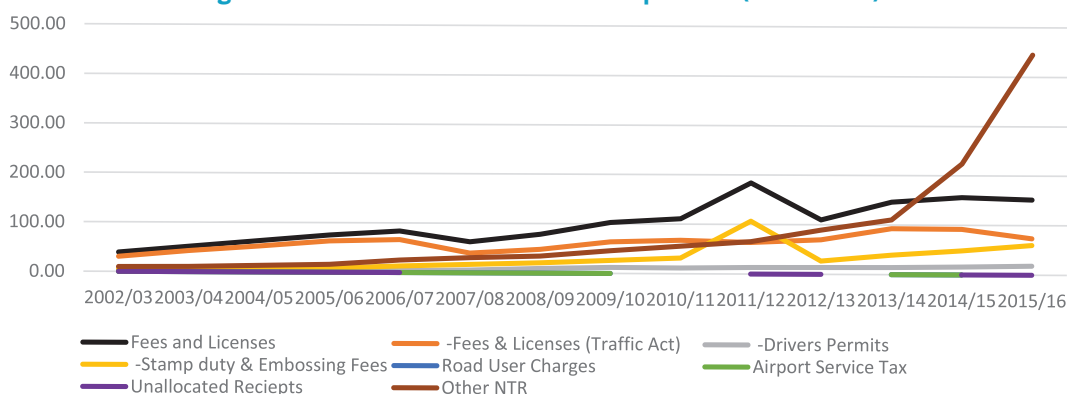
From figure 18, domestic NTR is largely dominated by fees and licenses, which have increased steadily from UGX 30 Billion in 2002/03 to approximately UGX 151.7 Billion in 2014/15. This revenue is collected from fees and licenses as stipulated in the traffic act, driver’s permits, stamp duty and embossing fees and road user charges. Other forms of NTR have also shown significant growth, especially in the last five years,

Figure 17: Trends in Non-Tax Revenue (UGX Billion)



Source: MoFPED, 2017.

Figure 18: Trends in Domestic NTR Composition (UGX Billion)



Source: MoFPED, 2017.

increasing from UGX 65 Billion in 2011/12 to 445 Billion in 2014 - outperforming fees and licenses.

NTRs are imposed by specific Acts of Parliament and administered by ministries and other government departments and agencies. NTR in Uganda is collected both at the local and central government levels. At the central government level, the majority of NTR is collected by URA on behalf of Government Ministries, Departments and Agencies (MDAs) and some is collected at MDAs level (which is either remitted to the Consolidated Fund or retained as Appropriation in Aid). However, this arrangement has created challenges in monitoring the effectiveness of NTR revenue collections at MDA levels. The various government audit reports cite challenges of under declarations. In addition, paragraph 94 of Treasury Accounting Instructions (TAI) 2003 Part 1- Finance prohibits revenue collectors from utilising NTR at the source unless authorised by the Accountant General. On some occasions, MDAs have been found to utilise NTR collections without authorisation. Following this, the MoFPED has directed that effective FY2017/18, all NTR and Appropriation in Aid shall be collected by the URA, and be remitted directly to the Consolidated Fund in accordance with the 2015 Public Finance Management (PFM) Act (GoU, 2017). Thus, the allocation of NTR resources to MDAs will be through the national budget process. Notwithstanding the benefits of efficiency in collection that is expected to come through the URA, this shift might negatively impact some categories of NTRs if not well managed. For some revenue categories, first, spending on source (Appropriation in Aid) creates

a sense of ownership that acts as an incentive to effectively explore all available sources of revenue. Second, some categories of NTR collection are better suited for MDAs or LoGs due to its nature, e.g., park charges, rental of LoG buildings, market dues, etc.

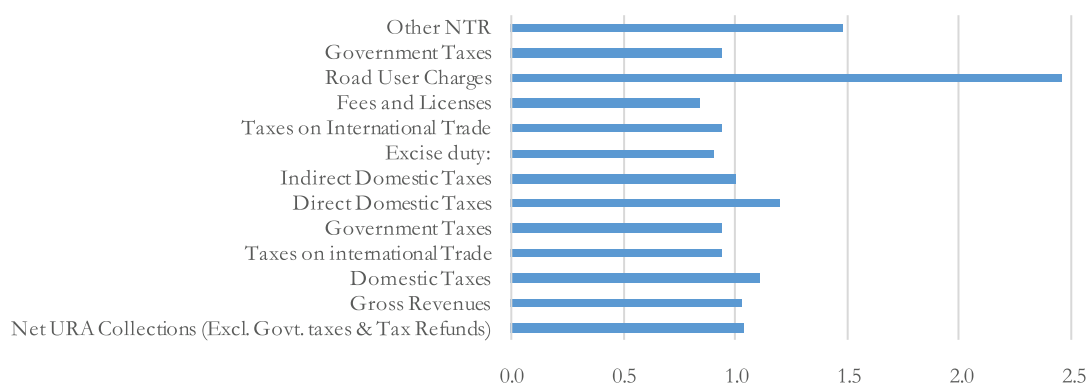
4.2 Challenges to NTR collection

Mobilising and collecting NTR in Uganda faces a number of challenges, including volatility on NTR categories, inadequate capacity and technical skills, lack of transparency in the usage and collection of this revenue, inadequate record keeping by the authorities, the weak tax-benefit linkages, some categories such as user fees are regressive in nature and the alleged corruption.

Volatility: We measure the relative volatility by dividing the standard deviation of each revenue category with the average value. This coefficient provides a measure of the volatility in each of the selected revenue categories. Figure 19 suggests that NTR is more volatile compared to tax revenue despite its relatively smaller contribution to total revenue. The high volatility implies that such revenue is harder to predict and, therefore, hard to control and thus has a high potential of contributing to fiscal shocks. Road user charges show the highest level of volatility, followed by other non-tax revenue, which includes revenue from oil.

Inadequate capacity and technical skills: There is still inadequate capacity at MDAs and LoG levels in assessing and appropriately collecting NTR.

Figure 19: Volatility of the Different Revenue Sources



Source: Authors' computations based on data from URA, 2017.

Determining with the appropriate user fee rate for a particular service can be a complicated endeavour that requires special skills. For example, setting the appropriate rate for a service, e.g., a city/municipal street parking fee, in principle should consider such issues as the objective of imposing the fee, whether it is to decongest the city streets, raise revenue or reduce pollution by discouraging private transportation, the beneficiary of the service and the cost of providing the service. Some of the required skill are lacking, especially at the LoG level. As a result, fees are at times set at a very high rate, which leads to evasion or discourages the consumption of the service, or the rates a set low leading to loss of revenue.

Lack of transparency in the usage and collection of this revenue: As noted before, under declaration and misuse of NTR collections at the MDA level is a documented challenge.

Inadequate record keeping by the authorities and tax payer: There are inadequate records, both at the revenue collecting offices and tax payers, especially at LoG levels. For example, some hotels do not always issue receipts, which makes assessing the correct hotel tax due to the LoG difficult. From the revenue collectors' side, revenues such as market dues or street parking fees are poorly recorded, which leads to under reporting of revenue collected. Some LoGs have thus tendered the NTR collections to private companies and individuals. While this arrangement offers an efficient alternative, the tendering process is prone to political capture, as well as corruption, which at times leads to more loss in revenue.

Political interference: Striking a balance between raising revenue and appeasing voters can be challenging to revenue collecting agencies. In regard to NTR, this aspect gets worsened by the fact that most NTR categories are payments for government goods and services, making it easy for politicians to interfere to appease certain factions of society to gain political popularity. This interference erodes the power of revenue collecting agencies and breeds a culture noncompliance.

Alleged corruption: Certain NTRs by their nature are prone to corruption. For example, fines and penalties

tend to attract corruption in the form of bribes. This is because they are set high to deter certain activities or behaviours. The higher the fine/penalty, the higher the chances of one offering a bribe to the collectors. On the side of the collector, with other conditions, such as ethics and income levels, held constant, the higher the fine is, the higher the temptation to accept the bribe is.

Regressive in nature: Since a number of NTRs are charges for goods/services provided by the government, they are regressive and, thus, have welfare implications. Although it can be argued that it is fair for users of the government sent services to pay for them, because of the uniformity of price, low income earners find themselves spending a larger share of their income compared to the rich.

Double payment/Taxation: For certain NTR categories, mainly charged at the LoG level, challenges of double payments have risen. For example, in the transport business, commuter taxis and buses find themselves paying parking fees and licences to every local authority that they operate in. While daily parking fee charges are fairly easy to regulate, monthly licences are more complicated if every LoG imposes a license fee. Of recent, this has caused friction between the commuter tax operators and local authorities in some districts. As the NTR continues to gain importance as a source of revenue for LoGs, a framework for determining to which LoG one pays for the licence to, and how revenues are collected from activities that are carried beyond one LoG jurisdiction are shared between the concerned LoGs.

5. CONCLUSIONS AND POLICY RECOMMENDATIONS

Despite all of the reforms undertaken over the years, Uganda's DRM is still low. However, this study has demonstrated that Uganda has the potential to raise domestic revenue sufficiently to finance her development needs. Despite this potential, a number of obstacles do prevent Uganda from achieving its full revenue mobilisation potential as observed from the tax gaps. Such obstacles include tax exemptions and incentives, informality, tax evasion, political interference in revenue collection, limited capacity in

curbing tax evasion and illicit financial flows, etc.

Thus, to increase DRM, Uganda needs to devise new and innovative tools that will improve collection efficiency, improve compliance and increase the effectiveness of tax administration. Such innovations include strengthening and expansion of tax payer registration and intensifying audits, as follows:

- i. **Taxpayer registration:** Registering tax payers should be extended beyond the current TREP effort to further broaden the tax base and reduce the size of the informal sector. While the TREP project focusses on identifying and registering small businesses that operate in the capital and other municipalities, there is a need to expand the project beyond businesses to capture individuals who operate within the informal sector. To do this requires linking the ongoing mass registration exercise to the URA's Tax Identification Number (TIN) efforts. Every individual who is eligible for nation identity card registration should also be allocated a TIN for their current and future tax obligations and declarations.
- ii. **Mandatory income declaration:** To improve compliance as well as collect income tax from the informal sector, it should be mandatory for every citizen of working age (18 above and not in school) to declare their income and file tax returns once or twice every year. Declaring income and filing tax returns should be done regardless of their income level or whether they earned income or not. Those whose incomes fall above the minimum income tax threshold should therefore honour their tax obligations in accordance with the income tax law. The success of mandatory income declaration will depend largely on the success of tax payer registration mentioned above.
- iii. **Simplify the tax system to encourage formalisation:** Differentiation of tax rates and tax heads leads to tax evasion, and can also push many otherwise willing taxpayers out of the system entirely. Thus, there is a need to create homogenous tax rates.
- iv. **Compliance gaps:** The large overall tax gaps in Uganda are largely explained by compliance gaps other than policy gaps. In this regard, improvement of collection efficiency will largely depend on reducing compliance gaps rather than policy gaps. In this case, risk assessments and profiling to identify tax avoidance schemes will be prudent. It should be noted that risk assessment will depend on the quality of data and analytics done by the URA. As such, data collection to facilitate tax audits will be prudent on the part of the URA. In addition, tax education to improve voluntary compliance will also be prudent.
- v. **Policy gaps:** While tax exemption does not provide an immediate risk, granting of exemptions should be justified by an economic cost–benefit analysis rather than political decisions. There is also a need to review the stability of policies and the level of differentiation, especially regarding the excise tax, due to the effect of the policy on revenue collection.

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APPENDIX

Appendix 1: Sectoral shares of credit to the private sector (% of total lending)

	Jun-07	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17
Agriculture	6.7	6.0	4.5	6.4	6.5	6.2	7.3	9.2	9.3	9.8	11.1
Mining and Quarrying	2.4	0.4	0.3	0.8	0.3	0.4	0.4	0.3	0.5	0.6	0.6
Manufacturing	14.1	12.4	15.2	13.6	14.1	13.9	14.4	13.7	16.0	14.6	13.3
Trade	15.6	12.2	20.6	19.2	21.5	21.7	20.3	20.8	19.6	17.9	19.0
Transport and Communication	6.1	6.9	5.8	7.8	7.8	6.6	5.8	5.4	5.2	7.1	6.8
Electricity and Water	0.4	0.9	0.6	1.2	0.9	1.0	1.5	1.2	1.7	2.1	1.9
Building, Mortgage, Construction and Real Estate	11.2	15.1	16.4	18.6	20.5	23.3	23.3	23.2	23.2	23.5	21.2
Business Services	0.0	0.0	0.0	3.2	4.4	3.6	5.0	4.4	4.7	3.7	4.2
Community, Social & Other Services	0.0	0.0	0.0	2.9	3.3	3.5	3.2	3.4	3.3	3.4	3.3
Personal Loans and Household Loans	17.9	15.4	21.9	21.2	15.8	15.4	13.8	17.3	15.2	15.9	17.8
Other Services	25.7	30.8	14.6	5.0	4.8	4.3	5.2	1.3	1.3	1.3	0.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: BoU, 2017.

Appendix 2: Method on tax compliance and policy gap analysis

The paper follows (de Mooij & Keen, 2012) to calculate the tax gaps in the various tax brackets. Equation (1) defines collection efficiency ('C' – Efficiency) E^C as the ratio of the revenue it yields to the product of consumption and the standard rate of the tax, τ_s :

$$E^C = \frac{\text{Tax Revenue}}{\tau_s(\text{Consumption})} \quad (1)$$

For a perfectly enforced tax levied at a single rate on all consumption, C-Efficiency would be 100 percent. A low E^C suggest that a country can considerably raise more revenue from the tax even without increasing the standard rate. A high E^C mean a country can raise more revenue by increasing the tax rate.

But low C-Efficiency can arise from either poor implementation, poor policy design, or both. Equation (2) decomposes C-inefficiency as.

$$E^C = [(1 - \text{Policy Gap}) (1 - \text{Compliance Gap})] \quad (2)$$

The 'compliance gap' reflects the difference between actual tax collected and that theoretically due, while the 'policy gap' relates to aspects of design, and can in principle be further decomposed as (3): Where the first term on the right reflect departures from a uniform rate structure and the second the impact of exemptions.

$$(1 - \text{Policy Gap}) = [(1 - \text{differentiation}) (1 - \text{Exemptions})] \quad (3)$$

The paper denotes by C_i and C_i^* respectively the values of the true consumption of commodity i and the part that is brought into tax, the difference between the two being imperfect implementation; and by T_i and T_i^* the statutory and effective rates of tax on final consumption of i, the latter reflecting not only of tax levied directly on i but also of indirect effects through exemptions on intermediate inputs (mediated by the input-outputs structure). Total revenue, for instance, is thus. $\sum_i T_i^* C_i^*$ Equation 2 and 3 become:

$$E^C = \frac{\sum_i T_i^* C_i^*}{\tau_s \sum_i C_i} = \left(\frac{\sum_i T_i^* C_i^*}{\sum_i T C_i^*} \right) \left(\frac{\sum_i T_i C_i}{\sum_i T C_i} \right) \left(\frac{\sum_i T_i C_i}{\tau_s \sum_i C_i} \right) \quad (4)$$

Equation (4) bears the interpretation:

$$\text{Exemptions} = \frac{\sum_i (T_i - T_i^*) C_i^*}{\sum_i T C_i^*} \quad (5)$$

$$\text{Compliance} = \frac{\sum_i T_i (C_i - C_i^*)}{\sum_i T C_i} \quad (6)$$

$$\text{Rate of Differentiation} = 1 - \frac{\sum_i T_i C_i}{\tau_s \sum_i C_i} \quad (7)$$

The impact of exemptions is thus measured by the loss of revenue from taxing at effective rather than statutory rates—which may be negative, given the cascading effect of exempting intermediate transactions (an instance of poor design that leads to higher C-Efficiency). The compliance gap is measured simply as the revenue loss (at nominal tax rates) from failing to bring some final consumption into tax and the rate differentiation effect reflects the extent to which the weighted average tax rate is lower than the standard rate.

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