13.0: TAXATION

Overview: This topic equips a learner with knowledge about different taxes charged on business activities, and the dangers of non-tax compliance.

A tax is a compulsory charge/levy imposed by the government on persons/businesses in order to finance its activities.

Taxes are a general obligation and are not paid in exchange of a specific obligation.

Taxation is the process through which governments obtain money from eligible persons by application of the law.

In Uganda taxes are collected by Uganda Revenue Authority (URA) on behalf of the central government and local administrators collect local government revenue.

Terms used in taxation

1. Tax base. This is an item or economic activity that is subject to taxation. The tax base may include;
   - Income earned from employment e.g. wages, salaries, allowances, fear etc.
   - Property or assets such as houses, land and other investments.
   - Consumption of commodities which are subject to taxation.
   - Profits earned from economic activities such as manufacturing and trade.
2. Tax burden. This is the effect of a tax on a tax payer.
3. Tax impact. This is the initial resting place of a tax.
4. Tax incidence. This is the final resting place of a tax i.e. the one who actually bears the money burden of the tax.
5. Taxable income. This is a proportion of a person's income that is subject to tax.
6. Taxable capacity. This is the ability of an individual to pay tax assessed on him/her and yet remain with enough disposable income to maintain the SOL he is accustomed OR is the extent to which an individual can pay the taxes imposed to him without affecting his SOL.

7. Taxable capacity of a nation. Is the ability of the government to (collect) realize revenue from taxes charged on tax payers.

Reasons for low taxable capacity in Uganda

i. High poverty levels
ii. Wide spread unemployment
iii. Limited information about taxes
iv. Low levels of monetization
v. Dominance of the agricultural sector which is subsistence
vi. Many tax exemptions
vii. Political sabotage
viii. Under developed infrastructure
ix. High corruption levels

Measures that can be taken to increase taxable capacity in Uganda

i. Improving infrastructure
ii. Putting strict laws to punish corrupt officials
iii. Setting up anti-smuggling units
iv. Diversifying taxes by introducing new taxes
v. Carrying out intensive tax education among others

8. Tax evasion is the deliberate refusal by the tax payer to pay a tax assessed on him or her.

Examples of tax evasion

- Smuggling
- Bribing tax collectors
- Hiding from tax collectors
- Under declaring incomes
- Refusal to declare income or property owned
- Giving wrong value of goods and services
- Overstating expenses

Causes / reasons for tax evasion

✓ Unfair assessment characterized by high tax rates
✓ Discontent about provision of services by the government from taxes paid

- ✓ Low income levels/high levels of poverty
- ✓ Inadequate information about importance of paying taxes
- ✓ Desire by tax payers to retain all their earnings
- ✓ Weakness in the tax system
- ✓ Political sabotage
- ✓ High levels of corruption among tax officials

Negative effects of tax evasion

1. It leads to permanent or temporary closure of business.
2. It shows bad public image for the business
3. It leads to forceful payment of unpaid taxes from the entrepreneur's personal resources or business profits.
4. It results into penalty from nonpayment of taxes.
5. It leads to denial of public tenders.
6. It leads to loss of smuggled goods

9. <u>Tax avoidance.</u> Is where an individual dodges tax payment by exploiting the weakness within the tax system e.g. producing a commodity which is not taxed and abandon one which is taxed.
10. <u>Tax identification number (TIN).</u> This refers to a computerized number given to a specific tax payer.
11. <u>Tax compliance.</u> This is the degree to which the taxpaying community meets the tax obligation as set out in the appropriate legal and regulatory provisions.
12. <u>Tax threshold</u> is the level of income/profit at which you start to pay a tax.
13. <u>Tax liability</u>. This refers to the amount of money that a tax payer is expected to pay within a given period of time.
14. <u>Tax yield.</u> Is the total amount of tax revenue collected from a given number of taxes.
15. <u>Tax holiday.</u> Is a period of time during which a tax payer is exempted from paying tax.
16. Tax clearance. this is a process of certifying that one has completed settling his/her tax obligations.

Purpose for taxation

1. To raise government revenue. The revenue obtained is used to promote economic growth and development.
2. To discourage consumption of harmful commodities. This is through charging high taxes on such commodities making them very expensive for some individuals to buy.
3. To control inflation. High taxes imposed on people's incomes reduces their purchasing power and commodity price.
4. To protect infant domestic industries. Taxes are imposed on imported goods making them more expensive than locally produced goods.
5. To reduce income inequalities. A progressive tax is used where the rich are taxed highly than the poor.
6. To reduce dumping in the country. Improving high taxes on dumped goods, make them expensive which discourage their consumption.
7. To improve BOP position. High taxes imposed on imports discourages their importation hence saving the scarce foreign exchange.
8. To encourage hard work. Taxes encourage people to put in more effort in order to meet their tax obligations.
9. To recover community wealth which individuals have obtained not as a result of their effort but as a result of effort of other people.
10. To regulate economic activities in the country. This is through charging low taxes on desirable activities and high taxes on undesirable activities.
11. To create employment opportunities. This is through charging low taxes on business which creates more jobs.
12. To charge those who use government facilities such as roads, police and other social services.

Negative roles of taxation

1. Discouraging investment. This is due to high taxes on business profits.
2. Widening income inequalities. This is a result of indirect taxes charged on commodities consumed by both the rich and poor.
3. Reducing people's SOL. High taxes on incomes reduce total demand for consumer goods.

4. Discouraging saving. This is as a result of a reduction in people's disposable income.
5. Discouraging effort and hard work especially progressive taxes.
6. Encouraging illegal activities. This is as a result of high taxes on goods which force people to involve in illegal activities such as smuggling.
7. Making the government unpopular. High taxes cause people to hate the government in power.
8. Causing misallocation of resources. Taxation causes because people to transfer their capital from heavily taxed activities to less productive but low taxed investments.

Principles/canons of taxation

These are laws that should be followed/observed in assessment, collection and administration fo every tax. They include the following;

1. Principle of equity/fairness. Tax assessment should be such a way that tax payers bear appropriately equal burden.
2. Principle of certainty. Tax payers should be aware of the tax imposed against them, where to pay and the amount to be paid.
3. Principle of convenience. The time and method of payment should be favorable for the tax payers.
4. Principle of simplicity. The tax levied should be easy to understand by both tax payers and tax collectors.
5. Principle of elasticity/flexibility. The tax levied should be able to change with the changes in economic conditions or the tax base e.g. when income change, the tax rate should also change.
6. Principle of productivity. The tax levied should generate enough revenue for the government.
7. Principle of comprehensiveness/diversity. There should be different taxes targeting different sources rather than concentrating on a single source f tax revenue.

Types of taxes

There are two broad categories of taxes that is (i) Direct taxes (ii) Indirect taxes

Direct Taxes. This are taxes levied on incomes and profits of individuals and businesses.

Types of direct taxes

1. Income tax. This a tax levied on incomes earned by an individual or business.

   Forms of income tax

   a. Personal income tax is one imposed on incomes of individuals e.g. PAYE (Pay As You Earn)
   b. Company/corporation/profit tax is tax imposed on the net profit of the company. The tax base of income tax include;
   - Profits from business
   - Income from investments such as shares, debentures
   - Rent income and royalties
2. Wealth/property tax is a tax levied on one's total asset holdings such as buildings, land and other investments.
3. Capital gains taxis a tax imposed on profit received from the sale of fixed capital assets.
4. Death tax/estate duty is a tax levied on property of the deceased person. This is usually done before the property is shared out to the different beneficiaries.
5. Inheritance duty is a tax paid by the beneficiary from the property of the deceased.
6. Gift tax is the tax charged on property/income given freely to an individual. It covers assets given to a living person by another living person.
7. Road toll is a tax imposed on those who use particular road services.
8. Sur-tax is a tax levied on incomes of very rich people exceeding a certain level.

Advantages of direct taxes

1. They are flexible
2. They are easy to understand e.g. PAYE
3. They help to control inflation
4. They are based on the principle of certainty.
5. They help to reduce income inequalities. This is through use of a progressive tax system.

Disadvantages of direct taxes

1. They are easy to evade.
2. They discourage saving and investment.
3. They discourage people from working hard.
4. They are discriminative in nature since they are not imposed on all income groups.

INDIRECT TAXES

These are taxes imposed on commodities. The impact rests on producer or trader but the tax incidence can be totally or partially shifted to the final consumer of the products.

Types of indirect taxes

1. Customer duty is a tax imposed on either imports or exports i.e. import tax and export tax.
2. Excise duty is a tax imposed on locally produced goods or imported goods to influence their consumption.
3. Value added tax (VAT) is the tax levied on the valued added on the product at each stage of production.
4. Sales tax is the tax imposed as a percentage of the value of goods sold.
5. Sumptuary tax is a tax levied on a commodity to discourage its consumption.
6. Octopi tax is a tax levied on goods passing through territorial boundaries of another country.
7. Advalorem taxis a tax charged on goods according to their value.
8. Specific taxis a tax imposed on each unit of output produced or sold.
9. Lumpsum tax (many)is the tax imposed irrespective of level of output produced.

Advantages of indirect taxes

1. They are difficult to evade since they are included in the price of the community.
2. They are convenient to pay since they are paid for while buying the commodity.
3. They help to discourage consumption of harmful commodities.
4. They encourage hard work.
5. They are cheap to collect.
6. They are comprehensive in nature since they are charged on different kinds of commodities.
7. They help to protect infant industries where import duty is levied.

Disadvantages of indirect taxes

1. They are inflationary of indirect taxes
2. They discourage demand and there negatively affects the level of investment.
3. They force consumers to buy inferior/low quality products.
4. They tend to inconvenience the business community since they are paid before goods are sold.
5. They lead to misallocation of resources as business people run away from production that is highly taxed to producing a product that is not relevant in the economy.

MERITS OF VAT

- .Avoids double taxation since every expenditure on raw materials are refunded
- It encourages efficiency in business management since it promotes book keeping
- Encourages exports since exports are zero rated
- It's cheap or economical in terms of administration and collection
- It's difficult to evade since it is imposed in commodities

DEMERITS OF VAT

- It's difficult to understand as many tax payers are illiterate about this tax
- It's difficult to assess especially where there is limited book keeping
- It leads to low revenue collected as it is mainly an urban tax
- Reduces consumption of goods and services since it makes prices higher
- Increases inflation as the seller passes on tax burden to their customers
- Discourages investment as it increases production costs
- It tends to proportional hence hardening small firms more than large firms

Proportionate, progressive and regressive tax

Appropriate tax is one where tax rate is fixed at a given percentage irrespective of the size of income or tax base.

Progressive tax is one whose tax rate increases as one's income increases. It helps to reduce on income inequalities.

Regressive tax is one whose tax rate reduces as one's income increases. It encourages hard work as people try to avoid a higher rate charged on low incomes.

Tax Authorities in Uganda

There are two bodies responsible for tax revenue collection in Uganda i.e. 1. Ugandan Revenue Authority, 2. Local Government Authority

Local government authority

Local Government Authorities are responsible for collecting local revenue.

Uganda Revenue Authority

URA is responsible for collecting revenue of the central government.

Roles of U.R.A

1. Assessing taxes
2. Collecting taxes according to the tax laws.
3. Accounting for all the revenue collected to the Ministry of Finance in Uganda.
4. Advising government on matters of policy relating to tax and revenue administration.
5. Facilitating trade and investment e.g. clearing of imports and exports.
6. Issuing tax identification numbers (TIN) to tax payer/registering all tax payers.
7. Sensitizing of tax payers on tax matters
8. Keeping secrets of tax payers/confidentiality of tax payers

Challenges Faced By Tax Authorities

- Narrow tax base
- High levels of tax evasion
- Shortage of skilled man power to assist in management
- High levels of tax avoidance
- High rate of corruption and embezzlement among tax authorities
- Low taxable capacity
- Frequent changes in employment

- Under developed infrastructure to facilitate tax assessment, administration and collection
- Resistance from public against tax payment
- Conflicting government objectives which sometimes conflict with taxation system
- Difficulty in identifying tax base
- Political interference especially by opposition politicians
- Political instabilities in some parts of the country

Tax Compliance

Is a degree to which a tax paying community meets the tax obligations as a set out in the appropriate legal and regulatory provisions.

Tax compliant/tax payers meet timely and accurate declarations to tax authorities and also voluntarily settle their tax obligations.

Tax payers who are non tax complaint evade taxes e.g. by under declaring incomes, over stating expenses etc.

Levels of tax compliance

There are 4 levels of tax compliance and these include;

1. Tax payers who fully comply and are willing to fulfill their tax obligation voluntarily (supporters).
2. Tax payers who reluctantly comply. They know that non compliance will be expensive and therefore accordingly comply (triers)
3. Tax payers who show slight resistance to compliance. When such tax payers are advised or educated and some pressure is exerted on them, they will comply (resisters).
4. Tax payers who are non complaint and show strong resistance to meeting their tax obligation (disengaged).

Factors influencing tax compliance

1. Level of tax rate. High tax leads to resistance among tax payers leading to low levels of tax compliance while low tax rates encourage tax payers to meet their tax obligation resulting into high levels of tax compliance.

2. Levels of simplicity of tax laws. Complicated tax laws and along administrative procedures lead to low levels of tax compliance while easy to understand tax laws lead to high levels.
3. The extent to which the tax system is equitable (fair). Unfair tax systems discourages tax payments leading to low levels tax payment leading to low levels of tax compliance while fair tax system leads to high levels of compliance.
4. Level of consistence and fairness in application of tax laws. Inconsistent application of tax laws involving favoritism encourages tax evasion leading to low levels of tax compliance while fair and consistent application of tax laws leads to high level of tax compliance.
5. Popularity of government and quality of the governance. Popular government with high levels of honest and accountability for tax payers money encourage people to meet their tax obligations leading to high levels of tax compliance while unpopular government discourage tax payment leading to low levels of tax compliance.
6. Quality of tax administration. High levels of professional and customer care shown by tax administrators encourage tax payment leading to high levels of tax compliance while unprofessional behaviors by the tax administrators such as corruption lead to low levels of tax compliance.
7. The quality of business management in form of records or book keeping. Absence of accurate records of business transactions encourage tax evasion lading to low levels of tax compliance while presence of accurate book keeping leads to high level of tax compliance.

Factors that lead low levels of tax compliances

- High levels of tax rate
- Unpopularity of the government
- low levels of professionalism/unprofessional behavior
- Complicated tax laws
- Underdeveloped infrastructure
- Limited information about the importance of taxes
- Unproportional distribution of the tax burden among tax payers.
- Poor business management in form of poor record keeping
- Long procedures of paying taxes.

- Political instabilities
- Low levels of income among tax payers.
- Inconsistent application of the tax law
- High levels of corruption
- Inconvenient time for tax collection
- High rate of inflation

Measures for encouraging tax compliance

- Shortening tax payment procedures.
- Publishing the names of tax defaulters in media.
- Rewarding complaint tax payers e.g. with certificate of recognition.
- Making the tax system equitable whereby the tax burden is fairly distributed to the payers.
- Improving the quality of business management in terms of book keeping.
- Popularizing the government and improving the quality of governance in terms of accountability for public revenue.
- Maintaining low tax rates so as to allow tax payers to remain with enough disposable income to support the decent standards of living.
- Making the tax laws easy or simple for all tax payers to understand.
- Ensuring consistence and fairness in application of tax laws.
- Carrying out tax education to show the importance of paying taxes.
- Fighting and reducing corruption among tax officials.
- Improving of infrastructure such as computerizing the tax system.
- Ensuring political stability to encourage economic activities.
- Ensuring application of the principle of convenience such as collecting at a time when tax payers have received revenue from their economic activities.

Importance of tax compliance to the business

1. It earns good will and reputation. Customers and suppliers want to deal with a business that will continue surviving from a long period and not the one that can easily be chased.

2. It enables businesses get government support. Government support such as subsidization is usually given to only those businesses that are tax compliant.
3. It eases access to resources and finance. Finances such as Banks always want to deal with tax compliant businesses since they have no risk of being closed by the government.
4. Improves business chances of getting contracts. Government tenders are usually given to tax compliant businesses.