



THE REPUBLIC OF UGANDA

THE LOCAL GOVERNMENT FINANCE COMMISSION



A CASE FOR CONTINUED COLLECTION
OF
GRADUATED TAX

Kampala, 2001

BACKGROUND

Graduated tax is mentioned in our constitution as one of the taxes that local governments can derive revenue from (Article 191(2) of the 1995 Constitution of the Republic of Uganda). The fifth schedule of the Local Governments Act, 1997 further specifies that graduated tax be collected from all able bodied male persons above the age of 18 and all able bodied women engaged in gainful employment.

Graduated tax constitutes a major source of local revenue for local governments. According to studies undertaken by the Commission¹, graduated tax contributed to about 75% of total local revenues that accrued to rural local governments in 1997/98, and about 35% of revenues to urban ones in the same year.

Despite the significance and importance of the tax to local governments, there is pressure from some politicians to abolish the tax all together, arguing that it is primitive and crudely collected.

The Local Government Finance Commission argues that before an abolition option is taken up, a viable and effective alternative source of revenue should first be developed. The Commission also contends that the major problems with the graduated tax relate to weaknesses in its administration and collection, which can be solved without necessarily abolishing the tax.

¹ LGFC 1999: Introduction of equalisation Grant to districts, and LGFC 2000 – Introduction of equalisation grant to Urban Authorities

RECOMMENDATIONS

Much as the difficulties of administering and managing the graduated tax in predominantly peasant households such as ours should be appreciated, focus should not be lost on the fact that graduated tax is the major contributor to revenue of local governments. An hurried abolition of the tax when a replacement is not in place will create more problems.

The Local Government Finance Commission therefore recommends that the graduated tax be retained and the following recommendations should be adopted to increase on transparency, compliance, efficiency of tax collection and yields.

- (a) Local governments should, with the assistance of the Ministry of Local Government, increase sensitisation and promote transparency by publishing tax registers and projects undertaken using graduated tax contributions.
- (b) Local government councils should adopt simple systems of motivating collectors, assessors and supervisors (including LC1 officials).
- (c) Local governments should provide tickets on time and guard against counterfeits.
- (d) Local governments should be encouraged to explore privatising assessment and collection operations (each to independent agencies) so as to reduce the effect of political interference.
- (e) Local governments, and especially sub-county councils should improve on record keeping and involve LC1s who are likely to identify taxpayers more reliably

(f) Local governments should be encouraged to identify and reward most compliant taxpayer say by sex and social status

(g) Local governments should explore collections through payment by instalment throughout the year or by harvest season

The Local Government Finance Commission on its part will integrate recommendations from the revenue enhancement study and the revenue sharing study so as to carry forward activities identified in the action plans of the two studies

POSITIVE ELEMENTS OF GRADUATED TAX

- (a) Graduated tax is a tax in which local governments derive financial autonomy as most of them use it to finance activities. It is even more important in lower level councils, which finance most of their activities using collections from graduated tax.
- (b) Graduated tax is an old and popular tax within the community and most taxpayers annually plan when to pay. This means that the level of expenditure required for tax education and mobilisation may not be as high as it would be if knowledge about the tax amongst taxpayers were poor.
- (c) Graduated tax has proved to be a dependable avenue for collecting other incomes such as development and education taxes.
- (d) The degree of graduated tax evasion amongst the poor are generally believed to be lower as they use the tickets as a way of identification and a sign of patriotism. Moreover, graduated tax has room for appeal and review.
- (e) Graduated tax imputed from agricultural outputs reduces redundancy of citizens as they work hard to produce enough for self and for the tax.

CAUSES OF RESENTMENT

Graduated tax is resented due to some of the following reasons:

- (a) Graduated tax has a bad colonial legacy associated with forced hard labour
- (b) Graduated tax has been in practice regressive meaning that the tax rate actually falls as income increases and this gives a negative impact on compliance when taxpayers begin to compare their contributions with that of well to do persons in the neighbourhood. Government has attempted to solve this by issuing a new tax schedule as of 1st July 2001. The new schedule has attempted to shift the tax burden from the poor to the rich but in the whole the tax rate is still largely proportional at 5%.
- (c) Effect of political interference. Often politicians have publicly made statements criticising the tax or even unilaterally exempting individuals from paying the tax as a way of canvassing for support from the people.
- (d) Problems in the assessment systems such as the use of not-well-motivated assessors or sometimes the use of poorly skilled assessors. This makes the assessment system vulnerable to fraud and subjective behaviour.
- (e) Problems with collection. People have decried the setting of roadblocks to trap defaulters as a cause of inconvenience to the entire road users. There has also been public criticism of the hostility with which defaulters are arrested and detained forcing some to hide in socially undesirable conditions to avoid arrests.
- (f) There are also many other problems, some of which relate to management deficiencies in local governments and others to externalities affecting

collections such as an effect of disaster, war, famine, etc.

EMPIRICAL FINDINGS

Empirical evidence from a study by the Commission carried out by PriceWaterHouseCoopers in the districts of Mpigi, Kibaale, Bushenyi, Nakasongola, Jinja, Gulu, Soroti and Moroto² indicate that

- (1) Graduated tax revenues are under exploited and there is still potential for increasing local revenues through this source by improving on collection methods and estimation procedures.
- (2) Contrary to general belief that the cost of collecting graduated tax is higher than realised revenues, the study indicates that in actual fact the cost of collecting graduated tax is generally below 40% of revenues from graduated tax and that there are still rooms for reducing on these costs by improving on the efficiency of collection and tax awareness.

Annex 1 presents data on cost of collection from the sampled local governments.

The study confirms that the resentment against graduated tax is more at the mechanics rather than its nature and agrees that the tax should remain at the present and efforts should concentrate on improving its fairness and performance.

Its recommendations were as follows:

- i) Make graduated tax top rates open ended up to the threshold of PAYE
- ii) Simplify assessment by reducing the number of tax bands from the current

37 to 10 or 12

- iii) Minimise the impact of the tax on the poor by raising the entry point and exempting the very poor from paying. The study propose an entry point of incomes of over 200,000/= per annum.
- iv) Regularly revise imputation values to reflect changing economic realities
- v) Make exemptions explicit. Districts should formalise and agree upon the exemptions within national guidelines and these should be widely published
- vi) Data on assessment should be published to improve transparency and compliance.

² Local Government Finance Commission – revenue enhancement Study

IMPLICATION OF ABOLISHING GRADUATED TAX

A non systematic abolition of the graduated tax without developing a viable alternative replacement source of own revenue source to local governments will in general undermine the decentralisation process and in particular imply some of the following:

- i) That sub-counties, divisions and lower level councils who depend entirely on local sources of revenues (graduated tax being the predominant) will be crippled and will not have the funds for operation, grass-root development and mobilisation – the way they have it now.
- ii) That alternative source of finance to fund costs of administration, council expenses and allowances and operation of some statutory bodies such as the district tender board has to be found. At the moment these are funded using local revenues of which graduated tax is predominant.
- iii) That greater pressure will be exerted on the already highly constrained consolidated fund as the Ministry of Finance will be made to immediately find alternative finance to bridge the gap that would have been created by scrapping graduated tax. Pressure on the consolidated fund will also mean that government will have to cut its expenditures in some sectors.
- iv) That government will have to bear an added cost of transferring money to local governments and will have to face a number of equity related challenges of transfers especially given that the present set-up of revenue sharing still have a lot of shortcomings yet to be addressed.
- v) If local governments are brought up relying on central transfers, it will mean that they will adopt accountability for the central government practices rather than practising accountability and good governance for the populace. In this way transparency might be compromised and the whole essence of decentralisation would have been put to question.

Annex. 1: COST OF COLLECTION OF GRADUATED TAX

DISTRICT/SUB-COUNTY/DIVISION	Cost as a % of Collection
Moroto District	13%
Moroto Municipality	9%
Moroto North Division	9%
Moroto Ngoleriet Division	64%
Moroto Rupa	156%
Gulu District	
Laroo Division	46%
Bobi Sub-county	197%
Bungatira Sub-county	62%
Bushe nyi District	
Kanyabwanga Sub-county	36%
Kyamuhunga Sub-county	16%
Jinja District	
Central Division	2%
Buyengo Sub-county	47%
Nakasongola District	46%
Kibaale District	23%
Mpigi District	26%
Kira Sub-county	20%
Ngando Sub-county	46%
Mpigi Town Council	8%

Source: Local Government Finance Commission – Revenue Enhancement Study, PriceWaterHouseCoopers. 2000