Domestic Resource Mobilisation for Poverty Reduction in East Africa:

Lessons for Tax Policy and Administration
# Table of Contents

## Foreword
VI

## Preface
VIII

## Acknowledgements
X

## List of Abbreviations
XII

## Glossary of definitions of selected terms
XV

### Part I
Comparative Analysis and Best Practices

#### Chapter 1
A Policy Note
3

### Part II
International experience and lessons

#### Chapter 2
South Africa
25

#### Chapter 3
South Korea
78

### Part III
East Africa experience and lessons

#### Chapter 4
Burundi
118

#### Chapter 5
Kenya
148

#### Chapter 6
Rwanda
198

#### Chapter 7
Tanzania
240

#### Chapter 8
Uganda
276

#### Chapter 9
Proceedings of the Domestic Resource Mobilization Stakeholder Workshop
317
Successful implementation of Poverty Reduction Strategy Papers (PRSPs) and National Development Plans (NDPs) depends on effective resource mobilisation and utilisation. In recent years, development aid has been crucial in filling the financing gap. However, on-going global financial uncertainty is likely to lead to reduced aid and unpredictable private capital flows to Africa. Continued stability in PRSP or NDP financing will, thus, depend on a country’s ability to strengthen their domestic resource mobilisation (DRM) efforts. This is especially pertinent in a region like East Africa where countries have historically relied heavily on development aid to finance their public spending.

This flagship report is the outcome of a study that has been conducted over the last two years and also complements the theme of the Bank’s 2010 African Economic Outlook on ‘Public Resource Mobilisation and Aid in Africa’. The aim of the study was, through case studies, to draw lessons for tax policy and administration in order to enhance DRM in East Africa. The case studies covered the five East African Community Partner States (Kenya, Tanzania, Uganda, Rwanda and Burundi) and two non-members (South Africa and South Korea). South Africa was chosen as a success story from within the African continent, whilst South Korea was selected as it has been able to mobilise significant domestic resources to support rapid structural and economic transformation since the 1960s.

Several Development Partners have already been working in East Africa to support countries in enhancing DRM and achieve their PRSP or NDP goals. The African Development Bank as a founding member of the African Tax Administration Forum – the focal point for sharing good practices and setting strategic direction for African Tax Administration – undertook this study to build on previous efforts to enhance DRM in East Africa. This study is also aligned with the Bank’s mandate to support better coordination in policy formulation and implementation between Regional Member Countries (RMCs), so as to foster more integrated regions across Africa.

We expect that the findings of this report will be used in the East African region, as well as in other countries across Africa, to guide the appropriate reforms and enhance a country’s DRM capabilities. This report is also expected to contribute to harmonisation of tax regimes and, thus, support the wider regional integration agenda of East African Partner States.

The Bank looks forward to continued dialogue and collaboration with various stakeholders, in order to develop bold and innovative approaches for enhancing DRM in its RMCs.

Aloysius Uche Ordu
Vice President
Country and Regional Programs and Policy
African Development Bank Group
Preface

The African Development Bank (AfDB) has partnered with the African Tax Administration Forum (ATAF) and the East African Community (EAC) Secretariat on a Domestic Resource Mobilisation (DRM) project for the EAC partner states. The project is designed to build capacity for tax administrators and tax policy experts in the Bank’s Regional Member Countries in the EAC sub-region, with an emphasis on sharing lessons from within the sub-region and from South Africa, South Korea and other international best practice. For this work, DRM is defined to include only tax policy and administration and excludes other possible components of DRM, such as domestic financial markets.

The project’s objective is to make recommendations, from case studies of the EAC partner states, South Africa and South Korea, on the priority reforms and ways to sequence and implement them so that EAC countries can significantly enhance their DRM efforts. The case studies seek to respond to the following question: What key factors have contributed to or inhibited DRM in the EAC? The achievements and lessons contained in the case studies will inform the priority reforms for EAC partner states and how these reforms should be sequenced and implemented.

The project was funded by the Korea-Africa Fund for Economic Cooperation (KOAFEC) Trust Fund and involved three phases: (i) a study tour to Korea for tax policy and tax administrators from EAC partner states – completed in December 2009; (ii) preparation of country case studies for the EAC partner states, South Africa, and South Korea – completed in October 2010; and (iii) a stakeholder validation seminar held in Kampala from 9-10 November 2010. The core principle of the framework used in the project is to analyse the interaction between the political economy of tax performance and tax reforms. An explanatory approach is adopted to match patterns from analysis of the literature and key informant interviews.

South Africa and South Korea were selected as benchmarks in this project for several reasons. At 29.1% of GDP (2007/08), South Africa has one of the highest emerging market economy tax collection rates. This success is linked to several factors including the post-apartheid reforms spearheaded by the Katz Commission of Enquiry and a tax administration model underpinned by autonomy and unwavering political support.

Korea’s rise from a highly impoverished country in the 1960s to an economic super power, in just one generation, also offers key lessons for the EAC partner states. In its early years, the socio-economic conditions were similar in many respects to those of EAC countries today. Korea’s achievements are attributed to, among others, a series of successful tax policies aimed at promoting capital formation and export industries, and strategies to progressively reduce dependence on external assistance.

This flagship report is organized as follows: Part I presents the Policy note; Part II discusses the international experience in DRM; and Part III elaborates on the EAC achievements, challenges, drivers, and areas for reform.

I hope that the findings of this project will motivate additional research, further the debate on appropriate policies and reforms to enhance DRM, and, ultimately, greatly improve the mobilisation of domestic resources in the EAC region and in other African countries.
Acknowledgements

This report has been prepared by a core team in the African Development Bank’s (AfDB) Regional Department East ‘A’ (OREA). The team was led by Edward Sennoga and Richard Walker (Country Economists, OREA). Mrs. Catherine Baumont-Keita (Lead Economist, OREA) provided overall guidance to the team. Christian Lim (Private Sector Specialist) was instrumental in initiating and managing the project in its early stages. The team also benefitted from the general direction provided by Mr. Gabriel Negatu, (Director, OREA) and Mrs. Diarietou Gaye (former Director OREA).

Edward Sennoga and Richard Walker prepared the Policy Note (Chapter 1). Christian Lim and Gil Seong Kang (formerly with the Economic Development Research Department at the AfDB), with assistance from Richard Walker, prepared the South Korea country case study (Chapter 3). Consultants (PricewaterhouseCoopers) assisted in the preparation of the South Africa and East African country case studies (Chapters 2 and 4-8). Evarist Twimukye and Jeff Alumai (both the Economic Policy Research Center in Uganda) assisted in documenting proceedings from the Domestic Resource Mobilisation stakeholder workshop (Chapter 9).

Mr. Aloysius Ordu (Vice President, Country and Regional Programmes), Mr. Steve Kayizzi-Mugerwa (Director, Regional Department East ‘B’), and Ms. Radhika Bharat (Investment Officer) helped initiate the project and were involved in its early design.

The production of this report and all study outputs were made possible by the generous financial support from the Korea-Africa Fund for Economic Cooperation. The case studies and policy note benefitted from the proceedings of a high level workshop on DRM held in Kampala from 9-10 November, 2010. Workshop participants (see Chapter 9) included the African Tax Administration Forum, East African Community Secretariat, EAC Ministers of Finance and Revenue Authority Commissioners General, representatives of regional organisations, taxpayer representatives, private sector organisations, academics, think-tanks, and bilateral and multilateral development partners. We are grateful for the extremely productive exchanges and valuable insights provided to us in preparation of the case studies and during the workshop.

The project also benefitted from valuable feedback provided by staff in different departments of the AfDB at headquarters and in field offices (Kenya, Tanzania, Uganda and Rwanda); in particular Andrey Klevchuk, Alex Mubiru, Désiré Vencatchellum, Toto Same Achille Charles, Makonnen Negatu, Joachim Hoettcke, Albert Mafusire, Shirley Jean, Walter Odero, Nathalie Francken, Choi Ji Eun, and Mariki Wilberforce. External reviewers were Tom Richardson, Kalyebbi B. Magoola, Tim Lamont, Dave Beer, Andrew Okello, Charles Lwanga, Obald Hakiziman, Natalie Skerritt, Bohela Lunogela, Mary Ngelela Maganga, Scott Rogers, Jonah Ogaro, and John Njiraini.

We are grateful to Fetor Komlan, Aminata Traore, Florence Wamala, and Robert Kimbugwe for coordinating the financial and administrative aspects of the project. Book design, editing and production where coordinated by Catherine Baumont-Keita, Edward Sennoga, Richard Walker, and Arshad Mahmud (copy editing consultant). There is not enough space here to name each person who contributed immensely to the successful completion of this report. As a result, we seek the indulgence of all the contributors in accepting this blanket acknowledgement and appreciation of their efforts. We are indeed very thankful to all of them.

Edward B. Sennoga
Richard Walker
Editors
List of abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AACB</td>
<td>Association of African Central Banks</td>
</tr>
<tr>
<td>ACBF</td>
<td>Africa Capacity Building Foundation</td>
</tr>
<tr>
<td>ACS</td>
<td>Anti-Corruption and Security</td>
</tr>
<tr>
<td>AEO</td>
<td>Authorised Economic Operator</td>
</tr>
<tr>
<td>AfDB</td>
<td>African Development Bank</td>
</tr>
<tr>
<td>AfDF</td>
<td>African Development Fund</td>
</tr>
<tr>
<td>AFRODAD</td>
<td>African Forum and Network on Debt and Development</td>
</tr>
<tr>
<td>AIDS</td>
<td>Acquired Immunodeficiency Syndrome</td>
</tr>
<tr>
<td>AMT</td>
<td>Alternative Minimum Tax</td>
</tr>
<tr>
<td>ANC</td>
<td>African National Congress</td>
</tr>
<tr>
<td>APRM</td>
<td>African Peer Review Mechanism</td>
</tr>
<tr>
<td>ARA</td>
<td>Autonomous Revenue Authority</td>
</tr>
<tr>
<td>ASYCUDA</td>
<td>Automated System for Customs Data</td>
</tr>
<tr>
<td>ATAF</td>
<td>African Tax Administration Forum</td>
</tr>
<tr>
<td>ATR</td>
<td>Advance Tax Ruling</td>
</tr>
<tr>
<td>AU</td>
<td>African Union</td>
</tr>
<tr>
<td>BIF</td>
<td>Burundi Franc</td>
</tr>
<tr>
<td>BLNS</td>
<td>Botswana, Lesotho, Namibia and Swaziland</td>
</tr>
<tr>
<td>BMS</td>
<td>Block Management System</td>
</tr>
<tr>
<td>BNR</td>
<td>National Bank of Rwanda</td>
</tr>
<tr>
<td>BSC</td>
<td>Balanced Score Card</td>
</tr>
<tr>
<td>BSP</td>
<td>Budget Strategy Paper</td>
</tr>
<tr>
<td>CAGR</td>
<td>Compounded Annual Growth Rate</td>
</tr>
<tr>
<td>CAMIS</td>
<td>Cargo Management Information System</td>
</tr>
<tr>
<td>CCA</td>
<td>Customs Controlled Area</td>
</tr>
<tr>
<td>CDF</td>
<td>Constituency Development Fund</td>
</tr>
<tr>
<td>CED</td>
<td>Customs and Excise Department</td>
</tr>
<tr>
<td>CET</td>
<td>Common External Tariff</td>
</tr>
<tr>
<td>CGT</td>
<td>Capital Gains Tax</td>
</tr>
<tr>
<td>CIT</td>
<td>Corporate Income Tax</td>
</tr>
<tr>
<td>CITPROD</td>
<td>Corporate Income Tax Revenue Productivity</td>
</tr>
<tr>
<td>CMVRS</td>
<td>Central Motor Vehicle Registration System</td>
</tr>
<tr>
<td>CNDD</td>
<td>National Council for the Defense of Democracy</td>
</tr>
<tr>
<td>COMESA</td>
<td>Common Market for East and Southern Africa</td>
</tr>
<tr>
<td>CPAF</td>
<td>Common Performance Assessment Framework</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>CTL</td>
<td>Commercial Transaction Levy</td>
</tr>
<tr>
<td>CTS</td>
<td>Compliant Trader Scheme</td>
</tr>
<tr>
<td>DAD</td>
<td>Development Assistance Database</td>
</tr>
<tr>
<td>DFID</td>
<td>Department for International Development</td>
</tr>
<tr>
<td>DPAF</td>
<td>Development Performance Assessment Framework</td>
</tr>
<tr>
<td>DRC</td>
<td>Democratic Republic of Congo</td>
</tr>
<tr>
<td>DRD</td>
<td>Domestic Revenue Department</td>
</tr>
<tr>
<td>DRM</td>
<td>Domestic Resource Mobilization</td>
</tr>
<tr>
<td>DTD</td>
<td>Domestic Tax Department</td>
</tr>
<tr>
<td>EABC</td>
<td>East African Business Council</td>
</tr>
<tr>
<td>EAC</td>
<td>East African Community</td>
</tr>
<tr>
<td>EASSy</td>
<td>Eastern Africa Submarine Cable System</td>
</tr>
<tr>
<td>eFiling</td>
<td>Electronic Filing</td>
</tr>
<tr>
<td>EIU</td>
<td>Economist Intelligence Unit</td>
</tr>
<tr>
<td>EPRC</td>
<td>Economic Policy Research Centre</td>
</tr>
<tr>
<td>EPZ</td>
<td>Export Processing Zone</td>
</tr>
<tr>
<td>E-registration</td>
<td>Electronic registration</td>
</tr>
<tr>
<td>ERP</td>
<td>Economic Reform Programme</td>
</tr>
<tr>
<td>ERS</td>
<td>Economic Recovery Strategy for Wealth and Employment Creation</td>
</tr>
<tr>
<td>eTax</td>
<td>Integrated Tax Management System</td>
</tr>
<tr>
<td>ETR</td>
<td>Electronic Tax Register</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>ExCO</td>
<td>Executive Committee</td>
</tr>
<tr>
<td>FAQ</td>
<td>Frequently Asked Question</td>
</tr>
<tr>
<td>FDD</td>
<td>Forces for the Defence of Democracy</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FIAS</td>
<td>Financial Investment Advisory Service</td>
</tr>
<tr>
<td>FIFA</td>
<td>Fédération Internationale de Football Association</td>
</tr>
<tr>
<td>FTSE</td>
<td>Financial Time Stock Exchange</td>
</tr>
<tr>
<td>GBS</td>
<td>General Budget Support</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GEAR</td>
<td>Growth Employment and Redistribution</td>
</tr>
<tr>
<td>GNP</td>
<td>Gross National Product</td>
</tr>
<tr>
<td>GoB</td>
<td>Government of Burundi</td>
</tr>
<tr>
<td>Acronym</td>
<td>Full Form</td>
</tr>
<tr>
<td>----------</td>
<td>---------------------------------------------------------------------------</td>
</tr>
<tr>
<td>RRA</td>
<td>Rwanda Revenue Authority</td>
</tr>
<tr>
<td>Rwf</td>
<td>Rwanda Franc</td>
</tr>
<tr>
<td>S2005S</td>
<td>Simba 2005 system</td>
</tr>
<tr>
<td>SACU</td>
<td>South African Customs Union</td>
</tr>
<tr>
<td>SADC</td>
<td>Southern Africa Development Cooperation</td>
</tr>
<tr>
<td>SAP</td>
<td>Structural Adjustment Programme</td>
</tr>
<tr>
<td>SARB</td>
<td>South African Reserve Bank</td>
</tr>
<tr>
<td>SARS</td>
<td>South African Revenue Service</td>
</tr>
<tr>
<td>SBP</td>
<td>Single Business Permit</td>
</tr>
<tr>
<td>SDL</td>
<td>Skills Development Levy</td>
</tr>
<tr>
<td>SIGTAS</td>
<td>Standardised Integrated Government Tax Administration Systems</td>
</tr>
<tr>
<td>SITE</td>
<td>Standard Income Tax Employee</td>
</tr>
<tr>
<td>Siyakha</td>
<td>An indigenous word for “we are building”</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium Enterprise</td>
</tr>
<tr>
<td>SMS</td>
<td>Short Messaging Service</td>
</tr>
<tr>
<td>SMTO</td>
<td>Small and Medium Taxpayers’ Office</td>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>STC</td>
<td>Standard Tax on Companies</td>
</tr>
<tr>
<td>TAXSTAFF</td>
<td>Ratio of Tax Staff per Population</td>
</tr>
<tr>
<td>TEAMS</td>
<td>East African Marine Systems</td>
</tr>
<tr>
<td>TIN</td>
<td>Taxpayer Identification Number</td>
</tr>
<tr>
<td>TMP</td>
<td>Tax Modernisation Programme</td>
</tr>
<tr>
<td>TOPP</td>
<td>Training Outside Public Practice</td>
</tr>
<tr>
<td>TPE</td>
<td>Taxpayer Education</td>
</tr>
<tr>
<td>TRA</td>
<td>Tanzania Revenue Authority</td>
</tr>
<tr>
<td>TRAMED</td>
<td>Tanzania Revenue Authority Monitoring and Evaluation Database</td>
</tr>
<tr>
<td>UIF</td>
<td>Unemployment Insurance Fund</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom of Great Britain and Northern Ireland</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>URA</td>
<td>Uganda Revenue Authority</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
</tr>
<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
</tr>
<tr>
<td>VAT</td>
<td>Value Added Tax</td>
</tr>
<tr>
<td>VATGCR</td>
<td>VAT Gross Compliance Ratio</td>
</tr>
<tr>
<td>VMS</td>
<td>Vehicle Management System</td>
</tr>
<tr>
<td>WCO</td>
<td>World Customs Organisation</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
</tr>
</tbody>
</table>
### Glossary of definitions of selected terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>CITPROD</td>
<td>It indicates how well CIT does in terms of producing revenue, given the prevailing tax rate. It is calculated by dividing total corporate income tax revenues by GDP and then dividing this by the general corporate income tax rate.</td>
</tr>
<tr>
<td>PITPROD</td>
<td>It attempts to provide an indication of how well the personal income tax in a country does in terms of producing revenue. It is calculated by taking the actual revenue collected as a percentage of GDP, divided by the weighted average PIT rate.</td>
</tr>
<tr>
<td>Tax effort</td>
<td>Actual tax revenue as a percentage of estimated potential tax revenue</td>
</tr>
<tr>
<td>Tax gap</td>
<td>The difference between estimated potential tax revenue and actual tax revenue</td>
</tr>
<tr>
<td>VATCGR</td>
<td>This is a measure of how well the VAT produces revenue for the government. It is computed by dividing VAT revenues by total private consumption in the economy and then dividing this by the VAT rate.</td>
</tr>
</tbody>
</table>
Part I

Comparative Analysis and Best Practices
Chapter 1

A Policy Note
Summary of Key Findings

Domestic Resource Mobilisation (DRM) is a cornerstone of broad-based development. More specifically, generation of savings and taxes from domestic resources and their allocation to productive economic and social sectors is vital for bridging Africa’s fiscal gap. To be fair, Official Development Assistance (ODA) can bridge some of this gap, but ultimately it cannot substitute for well-established mechanisms that generate domestic revenue. The East African Community (EAC) partner states have been implementing various tax reforms since the 1990s, including establishment of autonomous revenue authorities (ARA), simplifying tax systems, improving revenue collection efficiency and reducing tax evasion/avoidance. However, domestic resource mobilisation through taxation is still below its potential. Other measures such as revenue productivity and VAT efficiency are also low, which indicate that additional scope exists for expanding the tax base without compromising economic growth.

The African Development Bank (AfDB), in partnership with the African Tax Administration Forum (ATAF), the EAC Secretariat and with funding from the Korea-Africa Fund for Economic Cooperation, has undertaken a study aimed at sharing lessons learned from DRM efforts through case studies of the EAC partner states, South Africa and South Korea. These studies – which focus exclusively on tax revenues – examine the key challenges to achieving greater revenue mobilisation in each EAC country.

This Policy Note summarises the key lessons for improving tax revenue mobilisation in three broad areas, including: (i) general enabling environment for tax policy and administration; (ii) tax policy and legislative frameworks; (iii) and tax administration. In general, the enabling environment for domestic revenue mobilisation is weak across the EAC region. At the same time, tax policy is not rigorously linked to a country’s development strategy and tax legislation is either outdated or not enforced. Although all revenue authorities have implemented measures to improve tax administration efficiency, several weaknesses in compliance management and enforcement continue to constrain their mobilisation efforts.

The Policy Note concludes by identifying short- and longer-term priority recommendations for increasing EAC countries’ tax revenue mobilisation and expanding their tax bases. The short-term priorities are defined as those actions which are within the ambit of the Ministry of Finance or the Revenue Authority. The longer-term priorities are, however, those which are outside their purview and lie at a broader and/or more political level.

The short-term measures include:

(i) Reviewing tax incentives and exemptions so as to eliminate the unproductive ones;

(ii) Providing each tax payer with a unique tax identification number (TIN) and linking this to the taxpayer’s personal ID or company registration number;

(iii) Leveraging third party information from company, property, and vehicle registries to expand the tax base; and

(iv) Improving compliance management and enforcement by improving taxpayer services and undertaking comprehensive taxpayer risk profiling.

The longer-term measures comprise:

(v) Aligning tax policies – and using taxes as an instrument – to achieve broad national development objectives;

(vi) Ensuring managerial autonomy of the revenue authorities in accordance with existing
legislation, and holding them accountable to
an agreed set of performance measures; and

(vii) Expanding access to financial services for
facilitating tax enforcement and compliance,
while managing the potential trade-off between

savings mobilisation and using financial infor-
mation for tax administration.

Simultaneous implementation of these seven recom-
mendations is likely to have the strongest impact on
enhancing tax revenue mobilisation and broadening
the tax base in EAC countries.
Introduction

Domestic Resource Mobilisation (DRM) - the generation of savings and taxes from domestic resources and their allocation to economically and socially productive investments – is vital for bridging Africa’s fiscal gap. Although Official Development Assistance (ODA) can bridge some of this gap, it ultimately cannot substitute for well-established mechanisms that generate domestic revenue. The EAC partner states have been implementing various tax reforms since the 1990s, including establishment of autonomous revenue authorities, simplifying tax systems, improving revenue collection efficiency and reducing tax evasion/avoidance. These reforms have mostly been geared towards broadening tax bases, rationalising taxes to improve investment climate, enhancing compliance and improving other aspects of tax revenue administration.

However, DRM through taxation is still below its potential. For example, during the decade leading to 2006 and 2008, tax-to-GDP ratios in the EAC sub-region ranged from 12.3% to 22.1%, compared to an average of 35.6% and 25.4% for the Organisation for Economic Co-operation and Development (OECD) countries and South Africa respectively. Other measures such as revenue productivity and VAT efficiency are also low, which indicate additional scope exists for expanding the tax base without compromising economic growth. Moreover, following reduction in ODA commitments to developing countries caused by the recent global financial crisis, there is renewed urgency for the EAC partner states to improve mobilisation of public resources.

Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

The African Development Bank (AfDB), in partnership with the African Tax Administration Forum (ATAF), the EAC Secretariat and with funding from the Korea-Africa Fund for Economic Cooperation, has undertaken a study aimed at sharing lessons learned from DRM exercises through case studies of EAC partner states, South Africa and South Korea. These studies—which focus exclusively on tax revenues—examine the key challenges to achieving greater revenue mobilisation in each country.

The various case studies reveal at least three key challenges impeding revenue mobilisation in the EAC. These include the general absence of voluntary compliance among taxpayers, weak relationships between tax policy and national development objectives, and weaknesses in tax administration. This Policy Note summarises lessons for improving tax revenue mobilisation in three broad areas: (i) general enabling environment for tax policy and administration; (ii) tax policy and legislative frameworks; and (iii) tax administration.

The rest of this Policy Note is organised as follows. Section 2 discusses the utility of a robust enabling environment to DRM, while Sections 3 and 4 present reform priorities for tax policy and legislation and tax administration respectively. Section 5 summarises the key reforms to enhance tax revenue mobilisation in the EAC partner states.
A robust enabling environment

It consists of two aspects: (i) political economy environment; and (ii) national economic and institutional infrastructure.

Political economy environment

Information and evidence gathered in the country case studies show that creating an enabling political economy environment is crucial to achieving and sustaining high performance in tax revenue mobilisation. To this end, EAC countries generally need to pay attention to two important facets of the political economy of taxation.

Forging a fiscal contract and engendering tax morale

A fiscal contract is where governments, acting as agents of taxpayers, sell services in return for revenue. Under such a scenario, the more accountable a government is perceived to be, the more willing (higher level of voluntary compliance) tax payers will be to pay for the services offered. This improved ‘tax morale’ will limit the case for coercion and, thereby, reduce collection costs and facilitate tax administration. The case studies have shown, however, that a fiscal contract does not exist in the EAC region and, as a result, tax morale is either non-existent or very low. This perhaps explains why there is widespread evasion (e.g., high tax gaps) and relatively low levels of tax revenue generation in the region. Moreover, even though four of the EAC countries (Kenya, Rwanda, Tanzania and Uganda) have introduced comprehensive tax reforms, their implementation and performance are constrained by the absence of a fiscal contract and very low tax morale. Such a contract is missing due, among other things, to high levels of perceived corruption, uncertainty (and lack of communication) about the use of tax revenues, and poor delivery of public services. In order to build a fiscal contract (and the concomitant tax morale), the top political leadership must lead the efforts, involving the main political constituencies, as well as tax payer representatives. Evidence from South Korea, South Africa and, more recently, Rwanda, has shown that explicit and strong support from top political leaders has helped to enhance a tax-paying culture. For example, the Rwanda Revenue Authority (RRA) has been fortunate to have the personal backing of the President, who plays a major role in the campaign to change public attitude towards paying taxes. His personal involvement was crucial for generating tax revenues for financing poverty reduction expenditure and fighting corruption. In fact, there needs to be zero tolerance for corruption, which will convey an important signal to reassure taxpayers that taxes are being collected and spent in a frugal, fair and accountable manner. It is also critical that government is transparent in using taxpayer resources for goods and services that are considered to be a priority by the taxpaying citizens. To a degree, this is practiced within the framework of the public expenditure review process, particularly in Tanzania and Uganda, which provides a useful platform amongst different stakeholders (government, private sector, research institutions and civil society) to discuss the use of public resources. Finally, the use of resources needs to be communicated to the public through effective platforms, such as education campaigns, promotional materials and media.

Ensuring full managerial autonomy of revenue authorities

A major reason for the success of revenue authorities in South Africa and South Korea was due to the political support and protection they were given by top political leadership. Fortunately, all EAC countries have established ARAs to enhance domestic revenue mobilisation by giving them a free hand to exercise their mandates, as specified in legislation, and operate without political interference. The legislation for ARAs in EAC countries provides for their autonomy to manage budgets on an

---

1. The ‘National Taxpayers Day’ is one of the two most important national events that the President of Rwanda personally attends.
2. In South Korea, the president was personally committed to the success of the tax administration, approving targets himself and closely monitoring performance.
annual basis, reorganise operations, recruit and develop personnel, and set staff compensation levels. In practice, however, this is not the case and the functioning of some ARAs has been disrupted by political interference and/or wavering political commitment/support (see Section on ‘Tax Administration’ for details).

National economic and institutional infrastructure

Modernisation of national economic and institutional (i.e., ICT-based data and information) infrastructure can profoundly impact tax administration, compliance and enforcement, as well as the size of tax base. It facilitates access to information, and monitoring and control of transactions made by existing and potential taxpayers. In this regard, four factors are of critical importance to EAC countries.

A sound national identification system

International experience suggests that national biometric identification (ID) cards facilitate information-sharing across public institutions (including ARAs) and the tracking/authentication of taxpayer transactions. Furthermore, South Korean officials noted that a comprehensive national ID system was vital to support tracking, cross-checking, and collation of information. Moreover, it serves as the cornerstone of their successful e-tax system. The case studies show that EAC countries have comparatively under-developed national ID systems or have only recently embarked on their implementation. The most advanced, Rwanda and Kenya, are in the process of upgrading their systems to allow for real time data transmission and sharing with other national agencies.

A unique tax identification number (TIN)

Each taxpayer (individual or organisation) should be issued one unique TIN that is linked to a person’s ID number (for individuals) and company registration number (for organisations). It facilitates: (i) taxpayer
registration (the first point of contact in the compliance management chain); and (ii) more effective management of taxpayer information across all tax and duty types. Most ARAs in the EAC issue TINs to taxpayers although, in the absence of national biometric ID cards, these are not unique and usually a separate identifier is also issued to VAT payers. This complicates compliance management and increases the risk of tax evasion. EAC partner states need to ensure that TINs are unique, which may necessitate cleaning up of taxpayer registers and creation of thorough taxpayer data bases.

An expanded banked population

Increasing the banked population – and expanding access to financial services in general – should be a major priority of government policy and reforms (e.g., reducing costs of banking). Significant proportions of the population in EAC countries are, however, without access to financial services. To the extent that the majority of the unbanked population will likely fall into the hard-to-tax informal sector, enhancing access to financial services will play a key role in expanding the tax base. At the same time, tax enforcement and compliance will also be easier, especially since formal transactions (e.g., credit card, bank transfers) provide an audit trail. Moreover, having a bank account eases the burden of paying taxes and facilitates refunds. Innovations in the EAC, such as mobile and agent banking, provide affordable options for increasing access to financial services and should be judiciously promoted. South Korea has capitalised on mobile telephony to implement a cash receipts system (see Korean case) that allows national tax authorities to track taxable cash transactions.

There is, however, an important trade-off that needs to be managed here: people may be discouraged from using financial services (e.g., saving), if they perceive it will bring them under the tax net. If this perception holds in a particular country, then a more astute approach would be for tax authorities to use bank accounts only for easing the means to pay taxes (i.e., compliance) and provide refunds, and not for tracking taxable transactions.

Use of third party information

Underdeveloped registries and the absence of enabling legislation in almost all the EAC partner states, with the exception of Kenya, have impeded utilisation of third party information by ARAs. In general, good quality national databases, including company, property and vehicle registries, as well as enabling legislation, would allow ARAs to use third party information for improving tax compliance and enforcement. For its part, Kenya uses information from the government’s business and land registries to validate tax returns and to inform tax investigations. Third party information is also used by ARAs in other countries to pre-populate tax returns and, as a result, reduce taxpayer burden. In South Africa, for instance, from 2007/08 taxpayers began to receive pre-populated and restructured personal income tax forms, resulting in the reduction of errors and increased client satisfaction.

---

3 Studies (see cases) have shown that about 90%, 33%, 52%, 52% and 62% of the population in Burundi, Kenya, Rwanda, Tanzania and Uganda having no access to financial services respectively.
Tax policy and legislation

Development policy objectives and tax policy regime nexus

The choice of tax policies can significantly impact the direction and tempo of national economic development and as such, a tax policy regime should be guided by a country’s long-term development strategy. During the last 30 years, EAC partner states have indeed, made several attempts to align tax policies with national development strategies. For instance, the major tax policies implemented in the EAC during the 1980s and 1990s were largely informed by Structural Adjustment Programmes (SAPs), which were in vogue at the time. Since the SAPs advocated for economic liberalisation, the resultant tax policy changes mostly emphasised on reducing tax rates to promote savings and investment. It was done to bolster economic growth and broaden tax bases through introduction of VAT, improvement of tax administration, and reduction of fiscal deficits. However, since the EAC countries were more agriculture oriented, liberalisation did not lead to the envisaged structural and economic transformation. In addition, the absence of clear linkages between tax exemptions and national development priorities only resulted in producing long lists of economically unjustifiable tax incentives.

South Korea’s development model, during its take off period in the 1960s and 1970s, provides a contrast to the SAP model adopted in the EAC (see Box 1.1).

It is, however, important to note that Korea had put in place rigorous institutional arrangements to guide tax incentives and exemption awards. International best practice (for instance, in Canada and South Africa) also requires a full cost-benefit analysis for any major piece of legislation—including tax legislation aimed at attracting foreign investors—to assess the associated financial and economic costs, benefits and impact on various stakeholders, and in particular, on a country’s long-term tax revenues.

Designing and implementing effective tax policy

Tax policies in the EAC have been developed over the years on a piecemeal basis, either in response to emerging economic activities or to combat tax evasion and avoidance. Some of the current tax laws date back to colonial times. Tax policy formulation has generally not benefited from rigorous research or consultations with stakeholders. This complicates tax compliance and leads to policy uncertainty. For instance, the average number of hours per year to comply with major types of

Box 1.1: Aligning tax policy with the development strategy – South Korea in the 1960s and 70s

During its take off period, South Korea proactively and strategically utilised its tax policy regime to support rapid economic growth and industrialisation. Tax reforms, as well as other policy tools, were integrated into the five-year Economic Development Plans (EDPs) and designed to achieve its goals. In the 60s, the first five-year EDP focused on export manufacturing. As a consequence, several tax laws were amended to introduce supporting tax incentives, including drastic reductions in the taxation of capital, tariffs on inputs, and income from “key and strategic industries”, including export industries. A 50% exemption on income tax was granted to all foreign exchange-earning businesses. Machinery and equipment directly employed in foreign exchange-earning activities were allowed depreciation rates of up to 30% higher than the standard rates. Tax on interest income was close to zero to encourage savings. In addition, corporate taxes were lower for open listed companies than for closely-held companies aimed at increasing investment opportunities through capital markets. These incentives contributed to the national strategy by increasing the financial attractiveness of investments in priority sectors and limiting those in non-priority sectors. When a policy shift to liberalisation was implemented in 1980, the focus of tax policy shifted to eliminating exemptions to achieve market-based resource allocation.
tax in the EAC is 210 hours and ranges from 140 hours in Burundi to 417 hours in Kenya\(^4\). The two examples below point to areas where improvements in tax policy design can lead to marked gains in terms of tax policy objectives.

The choice of an appropriate tax mix, in particular, necessitates a thorough examination of country-specific circumstances including the neutrality, simplicity, and progressivity implications of a given tax structure. Country experiences present diverse tax mix choices. For instance, the experience from the Andean community (Bolivia, Colombia, Ecuador, Peru, Chile, and Venezuela) seems to favour indirect taxes. The VAT design and implementation within this community is seen to have achieved the tenets of neutrality, simplicity, and progressivity of the tax system.

Evidence from the case studies indicates that excise taxation is another area where reform, particularly in terms of tax simplification, can achieve robust results. The EAC’s progressive tariff rates on imported vehicles, for example, are usually subject to misrepresentation, under-declaration and corruption. Likewise, tax treatment of domestic and imported alcohol and tobacco products in the EAC sub-region has often led to the creation of domestic monopolies and rent seeking behaviour, which undermines efficient production. Lastly, taxation of gasoline, fuels and lubricants raises several concerns, including the differentiation between end users, public transporters and manufacturers.

Thus, the most appropriate balance between direct and indirect taxes for the EAC partner states, as well as

---

**Box 1.2: Harmonising, updating and fully implementing current legislative provisions**

First, income tax legislation in Burundi and Kenya was enacted more than three decades ago. Burundi has embarked on the promulgation of a new income tax code while Kenya’s Income Tax Act, which was first enacted in 1973, has undergone substantial amendments over the years. Modelling Kenya’s income tax legislation after those in force in Tanzania and Uganda has the potential to improve simplicity, close tax loopholes, and enhance tax harmonisation. For instance, Section 3(1) of Kenya’s current Income Tax Act limits tax liability to income derived from Kenya (source) as opposed to taxing on a worldwide basis.\(^5\) Harmonisation of tax legislation will, as in the case of the East Africa Income Tax (Management) Act of 1958, improve clarity and simplicity of the tax regime and thus enhance investment opportunities in the region. The achievements under the EAC Customs Management Act of 2004 should be complemented through removal or reduction of the intra-EAC withholding taxes. This can be done by adopting a standardised approach to addressing transfer mis-pricing, aligning the taxation of VATable international services, and promulgation of an EAC excise duty policy to curb tax evasion and inefficient allocation of resources.

Second, the tax legislative regimes in EAC partner states, with the exception of Rwanda, require simplification. In 2005, Rwanda harmonised its income tax, withholding tax, VAT and property tax procedures into a single legislative code. The process covered such aspects as: registration requirements; book keeping and tax declarations; assessment; audit and investigations; dispute resolution; recovery; and interest and fines. These reforms have contributed to a reduction in the number of hours per year required to comply with major tax legislation in Rwanda from 168 hours in 2005 to 148 hours in 2010.

Third, EAC partner states are not effectively enforcing some of the existing tax laws, for example, on capital gains. Kenya is also the only country in the EAC that does not levy capital gains tax (CGT) following its suspension in 1984. International best practice, as observed in South Africa, suggests, in addition to providing additional revenues, CGT enhances efficiency of the income tax system by discouraging taxpayers from categorising ordinary income into tax-free capital gains. CGT also promotes equity by ensuring taxpayers with the same levels of income bear comparable tax burdens irrespective of their sources of income.

---

\(^4\) The OECD average from the 2010 World Bank paying taxes survey was about 194 hours.

\(^5\) However, Section 5(1) of the Act includes worldwide employment income for Kenya tax residents.
other tax policy choices, should be informed by rigorous country-specific assessments of the implications for tax policy and national development objectives. It should also take into account the overarching regional commitments — for instance, the convergence criteria of the EAC Monetary Union. This study is a first step in supporting EAC partner states to improve tax revenue mobilisation through sharing of both regional and international experience.

Harmonising, updating and fully implementing the current legislative provisions

Pending comprehensive reviews and evidence-based changes to tax policies as recommended earlier, three priority areas concerning legislative-oriented measures to enhance tax revenue mobilisation for EAC countries need to be focused on. They include: (i) updating outdated key legislation; (ii) simplifying and harmonising existing tax laws; and (iii) fully implementing the existing legislation. Box 1.2 sketches the scope and efforts needed to update current legislation and the imperative to fully implement this.

Fiscal decentralisation and local tax revenue mobilisation

Local government tax revenue mobilisation is quite constrained in the EAC partner states. National governments have over the past 10 years abolished one or more major local revenue sources and replaced them with additional intergovernmental transfers, instead of more efficient local revenue sources. The case studies identify three major constraints to local government revenue mobilisation: (i) economic/fiscal reasons, such as poorly-defined tax bases, absence of tax handles, and inadequate local government tax enforcement mechanisms; (ii) impact of intergovernmental fiscal transfers: for instance, “matching grants” can encourage local revenue collections, while a discretionary transfer system negatively affects local tax collection efforts; and (iii) political economy considerations: for instance, limited accountability of national and local politicians usually discourages local tax effort, especially in the absence of explicit linkages between local taxation and public service provision. In addition to overcoming these constraints, the case studies recommend local property taxes and broad-based local taxes on income and business activity as options for enhancing local revenue mobilisation.

6 The Local Authorities Service Charge was abolished in Kenya in 1999; the Regional Service Council (RSC) Levy was repealed in South Africa in 2006; the Development Levy abolished in Tanzania in 2003; while the Graduated Tax was repealed in Uganda in 2005.
Tax administration

Full managerial autonomy of revenue authorities and accountability for results

The case studies suggest that political commitment is critical for establishing and sustaining a professional and effective revenue administration. The impact on tax administration efficacy of the strong political and union support given to the South African Revenue Service (SARS) and South Korea’s Presidential support to the National Tax Service are cases in point. All EAC partner states have established ARAs aimed at enhancing revenue mobilisation efforts by allowing them full authority to operate without political interference. Some ARAs receive extensive political support to achieve their objectives (e.g., Rwanda and Tanzania), whereas operations of others have been disrupted by political interference or wavering support. For instance, due to budget ceilings imposed by the Ministry of Finance, the Uganda Revenue Authority (URA) has faced severe staff turnover in critical skills, such as audit and ICT. In Kenya, the Treasury has been reported to withhold tax refunds and resources to implement salary increments. In Rwanda, on the other hand, the RRA has enjoyed political backing to unequivocally pursue its mandate of collecting revenues for national development.

Needless to say, political support and autonomy should be matched by accountability for results. Politicians and policymakers should expand the performance targets for ARAs beyond the annual revenue targets. They should include measures to expand the tax base, such as levels of tax compliance, quality of taxpayer services, and operational efficiency. Such measures should also include a monitoring framework to be used in setting service delivery standards and annual performance assessments, as is the case for SARS. EAC partner states have made attempts to assess tax administration performance with a view to informing reform priorities. For instance, majority of ARAs in the EAC use medium-term strategic plans to guide their reform paths and have, to varying degrees, developed balanced scorecard metrics and performance targets for monitoring and evaluation purposes. However, the utility of such measures is yet to be rigorously quantified, since most ARAs do not collect or analyse data that would permit specific conclusions to be drawn.

Strengthening compliance management and enforcement

The case studies reveal that while ARAs have adopted several tax enforcement measures, none of them has a comprehensive framework for compliance management. A comprehensive compliance management regime has two prongs. First, using taxpayer risk-profiling to inform deployment of tax enforcement resources and second, engaging taxpayers on

Box 1.3: The BMS in Tanzania

Tanzania Revenue Authority’s (TRA) Block Management System (BMS) focuses on physical identification and mapping of taxpayers. The BMS is designed to perform all compliance and monitoring activities for the identified taxpayers located within a specific manageable area or block. Following a mapping exercise undertaken in Dar es Salaam in 2007/08, TRA was able to register an additional 13,300 new taxpayers. The pilot BMS initiative in Dar es Salaam was successful in capturing new taxpayers and evaders, and has subsequently been rolled out across the entire country.
initiatives to increase tax compliance. For instance, Korea’s National Tax Service strengthened its research capacity to underpin taxpayer risk-profiling and audits. Reduction of tax compliance costs, for instance, through e-Filing, tax simplification, and tax education are among the measures used in Korea to enhance taxpayer engagement. The rationale of an integrated compliance management approach is to develop specific and more appropriate mitigating strategies, which address the underlying tax system risks and causes of tax loopholes in a rational way. Such an approach consequently focuses on high-risk areas, with minimal or phased intervention in low-risk areas.

Compliance management can be enhanced by: (i) identifying, assessing and prioritising compliance risks, and analysing their impact (e.g., through modelling, taxpayer segmentation, use of indicators); (ii) assessing any loopholes in legislation as well as developments in external environment; (iii) strengthening internal capabilities (e.g., using ICT to facilitate compliance); (iv) designing tax compliance programmes that minimise the cost of collection ratio; and (v) using both quantitative (such as revenue targets or compliance levels) and qualitative (for instance, taxpayer perceptions on service quality or complexity of tax procedures) measures to evaluate performance. In addition, publicising the outcome of tax enforcement measures in the media, a practice that is often neglected by EAC partner states, has the potential to promote greater voluntary compliance.

**Enhanced and efficient utilisation of available organisational capacities**

In terms of human capacity, EAC ARA staff-to-population ratios range from 0.05 for Tanzania to 0.12 for Kenya and are below the corresponding average for sub-Saharan Africa (0.37). Whereas plans to increase the ARA human resource capacities are at various stages of implementation, policymakers need to prioritise resource utilisation through risk profiling. Identifying sectors with the highest risks to revenue collection will allow ARAs to fill the most critical skills gaps, particularly in the areas of tax investigations, internal audit and compliance, operations research, planning, and data management. ARAs have designed several innovations to improve operational capacity and efficiency, including tax payer segmentation in Rwanda and Uganda, and the Block Management System (BMS) in Tanzania and Rwanda (see Box 1.3).

Collaboration, especially in sharing of information between ARA departments and other government agencies (such as land and company registries and financial institutions), is minimal or non-existent in the EAC. For instance, only Kenya uses third party information, primarily from the property and business registries, to support its compliance management interventions. On the other hand, utilisation of this resource by other EAC members is hampered by the absence of supporting legislation.

While all ARAs maintain basic taxpayer identification information, only Kenya and Rwanda have national identifiers, which are also linked to other public and private information infrastructure. ARAs also make limited use of withholding regimes and self-assessment to facilitate tax collection. For example, with the exception of Kenya, self-assessment is restricted to

**Operational capacity**

Implementing successful reforms in tax administration will necessitate marked improvements in the way of working, in particular, making more efficient use of available financial, human, and other supportive resources, such as ICT. For instance, innovations in ICT should be utilised to support specialisation in the ARA by freeing up resources to target high revenue, high risk,
VAT and income tax filing by corporations. In Kenya, individual taxpayers are required by law to file annual income tax returns.

**Effective utilisation of ICT**

Effective ICT applications can enhance performance, for instance, by reducing processing times and costs; improving client service and promoting voluntary compliance; minimising rent-seeking opportunities by decreasing the level of interaction between taxpayers and ARA staff; and enhancing evidence-based decision making by aiding data consolidation and analysis. To maximise these benefits, EAC countries have made substantial investments in ICT systems with an initial focus on internal operation and support systems, including sharing of customs information between the EAC partner states and eFiling of tax returns. However, absence of supporting legislation, in particular Electronic Transactions legislation, in some EAC countries has constrained the full implementation of eFiling.

To maximise returns from ICT investments, ARAs should ensure that the next generation of ICT reforms focus on: (i) integrating core tax systems to engender a single-view of taxpayer; (ii) integrating ARA ICT systems with third party source data systems, such as land and company registries; (iii) optimising ICT system usage by providing incentives to taxpayers to file taxes in off-peak periods; and (iv) optimising utilisation of data generated by ICT systems for evidence-based decision making.

**Operational research capacity**

Mitigating the tax policy analysis constraints discussed in §3.2 requires developing tax policy and operational research capacity. Such capacity would regularly and reliably provide useful indicators of the efficiency and effectiveness of interventions in such performance aspects as: taxpayer feedback on ARA staff attitudes and services (e.g., the ease of use of ICT systems for eFiling), and voluntary compliance. Also, operational research would seek to understand emerging trends in particular sectors and industry groups, so as to inform the design of more appropriate interventions for improving compliance management and enforcement.

Tanzania Revenue Authority’s comprehensive and in-depth studies of the construction, petroleum, wholesale and retail sectors have apparently yielded important information on tax potential of these sectors and thus informed tax enforcement initiatives. EAC partner states may consider a phased approach to building the requisite in-house research competencies, in particular, out-sourcing research functions to think-tanks and, thereafter, building a cadre of competent in-house researchers in the medium-to-long term.
Key reforms to enhance tax revenue mobilisation in EAC countries

Figure 1.1: Assessment of EAC countries and South Africa across reform areas (1=very weak to 5=very strong)

Source: Authors

This section summarises the role of key reforms in enhancing tax revenue mobilisation in EAC countries by answering the following two questions:

- How do EAC countries fare in terms of the reform areas discussed under the three broad themes of enabling environment, tax policy and legislation, and tax administration? and

- What reforms should EAC countries prioritise in order to enhance tax revenue mobilisation?

Annex 1.A depicts an assessment of the five EAC countries and South Africa within each of the reform areas. Although Burundi has only recently launched its revenue authority (Office Burundais Des Recettes) and is just embarking on transforming its tax system, it is included to create a baseline going forward. South Africa is included as a comparator outside the EAC region. The scoring is a subjective process based on the best judgment of the authors. It is intended to uncover strong and weak performers, as well as similar strengths or deficiencies. A summary of the results from Annex 1.A is presented in Figure 1.1.

South Africa is in a far superior position, compared to any of the EAC countries. It has made great strides in its enabling political environment, has a fairly robust tax policy and legislative framework, and boasts of a very efficient and well-supported revenue administration (SARS). Burundi is obviously in the weakest position, which is not surprising given that it is only now embarking on transforming its tax system. The performance of the other four EAC countries continues to be weak, which indicates that they still require major strategic initiatives and considerable implementation efforts across the board. There are a few points worth noting – some good examples, which other countries might try to emulate, and some specific areas of acute weakness:
In general, the enabling environment for domestic revenue mobilisation is weak across the region. Kenya shows a reasonable score for ‘economic and institutional infrastructure’, due to its well-established ID system and KRA’s use of property and business registration systems. However, both Tanzania and Uganda display significant weaknesses. Neither seems to have a fiscal contract, nor any sort of tax morale. This poses questions regarding the Government’s delivery of public services and the perceived use of public resources. There is also a perception of political meddling in the Uganda Revenue Authority (URA). Both countries also fare poorly in the enabling economic and institutional infrastructure, due to lack of a national ID system, no unique TIN, large unbanked population and limited use of third party information by the revenue authorities.

The state of tax policy and legislation measures more closely across the region. All countries perform poorly when it comes to whether tax policies are at the core of development strategy. The important issue here is that there is no clear policy/process in any of the countries about how tax incentives and exemptions are awarded, measured and the related costs/benefits for the economy. In addition, there are generally weak scores across the board for policy making, where changes seem to have been made on a piecemeal basis. This further reinforces the lack of alignment between a country’s development strategy and tax policies. Furthermore, although some countries have supporting legislation, local revenue mobilisation is still constrained across the region.

There is some difference across the region in tax administration. Rwanda and Tanzania fare reasonably well in terms of the ‘performance measures’ that are used to gauge the performance of their revenue authorities (RAs). In addition, they both seem to provide some managerial autonomy to their RAs, which is a lesson that Kenya and Uganda could emulate. Kenya does, however, have a lower tax gap, whereas the other countries need to significantly strengthen their compliance management and enforcement to reduce their tax gaps. This would also be supported by reducing tax incentives and effective enforcement of the legislation that is already in place. Kenya also shows progress in enhancing its operational capacity through use of e-Filing and ETRs. Tanzania, on the other hand, has been proactive in improving operational research capacities to support monitoring and enforcement of tax administration.

Having answered the first question by showing that EAC countries are generally performing poorly in the three reform areas, the remainder of this section examines what these countries should prioritise in order to enhance tax revenue mobilisation and broaden their tax bases.

Two dimensions are considered: what can be done now (i.e., short-term priorities) and what will likely take longer to achieve. The short-term priorities are defined as those actions which are within the ambit of the Ministry of Finance or Revenue Authority to implement. The longer-term priorities are, however, those that lie within the purview of a broader and/or more political level. Four short-term and three longer-term priority recommendations for enhancing domestic revenue mobilisation in EAC countries are discussed below:

1. There needs to be an immediate review, in all countries, of the tax exemptions and incentives regime with a view to eliminating the unproductive ones. While such exemptions and incentives could help promote investment, they tend to dampen tax effort, complicate tax administration, facilitate evasion and encourage corruption;
2. Each taxpayer (individual or organisation) should be issued with one unique TIN that, if possible, is linked to a person’s ID number (for individuals) and company registration number (for organisations). In order to ensure that TINs are unique, this will necessitate cleaning up of taxpayer registers and creation of thorough taxpayer databases;

3. RAs need to start making full use of third party information. Good quality national databases, including company, property and vehicle registries, as well as enabling legislation, would allow RAs to use third party information to improve tax compliance and enforcement. That information can also be used to pre-populate tax returns and, as a result, reduce the taxpayer burden and associated filing errors and, thereby, enhance both client satisfaction and administrative effectiveness;

4. Linked closely to the preceding two recommendations is the need for tax administrations to strengthen their compliance management and enforcement. As a initial priority, taxpayers need to be engaged in initiatives to increase tax compliance. For instance, e-Filing, strong client service (e.g., call centers and walk-in-centers), tax simplification, and tax education are among the measures used by SARS and in Korea to enhance taxpayer engagement. Furthermore, comprehensive taxpayer risk profiling (i.e., through increased research and audit capacity) needs to inform the deployment of limited tax enforcement resources. Such an approach would focus on high-risk/yield areas, with minimal or phased intervention in low-risk/yield areas. In parallel to the preceding short-term recommendations, there are three recommendations that are likely to take longer, and involve more players and actions across a broader spectrum.

5. Most importantly, a process needs to be set in motion to align tax policies to achieve broad national development objectives. The choice of tax policies can significantly impact the direction and tempo of a nation’s economic development and, as such, a tax policy regime should be guided by a country’s long-term development strategy. Following on from this, EAC governments must make greater efforts to link tax effort to tangible development outcomes and, thereby, start creating a fiscal contract and building tax morale;

6. RAs in EAC countries must be given, in accordance with existing legislation, managerial autonomy to exercise their mandates and operate on a daily basis without political interference, and under an agreed set of performance measures that provide clear accountability for results; and

7. Finally, governments must continue to prioritise the roll-out of financial services to increase, among others, the size of the banked population. Expanding access to financial services will play a key role in enlarging the tax base. Tax enforcement and compliance will also be easier, especially since formal transactions (e.g., credit card, bank transfers) provide an audit trail, and having a bank account facilitates the means for paying taxes and refunds. The trade-off, however, of using financial services as a perceived means to enforce tax administration needs to be carefully managed.

From the analysis of the case studies, external literature and international experience, simultaneous implementation of these seven recommendations is likely to have the strongest impact for enhancing tax revenue mobilisation and broadening the tax base in EAC countries.
## Annex 1.1

### Assessment of EAC countries and South Africa across reform areas (1=very weak to 5=very strong)

<table>
<thead>
<tr>
<th>Reform areas</th>
<th>Burundi</th>
<th>Kenya</th>
<th>Rwanda</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>S.Africa</th>
<th>Key observations and explanation (informed by country case studies)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enabling environment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Enabling political economy landscape | 1 | 2 | 2.5 | 1.5 | 1 | 4 | *Burundi: recently post conflict, no fiscal contract nor tax morale, OBR recently established  
*Kenya: limited fiscal contract and tax morale, KRA has enjoyed relative leadership stability and autonomy since 2003  
*Rwanda: principle of fiscal contract well upheld and tax morale evolving, RRA received strong political support  
*Tanzania: no fiscal contract nor tax morale, RRA received strong political support  
*Uganda: no fiscal contract nor tax morale, political meddling in URA  
*South Africa: strong fiscal contract and evolving tax morale, SARS receives strong political support |
| Enabling economic and institutional infrastructure | 1 | 3 | 2 | 1.5 | 1.5 | 3.5 | *Burundi: no IDs, not unique TIN, 90% unbanked, no use of 3rd party information  
*Kenya: well-established ID system, not unique TIN, 33% unbanked, use of property and business registration systems  
*Rwanda: introduced ID system and unique TIN, 52% unbanked, limited use of 3rd party information  
*Tanzania & Uganda: no IDs, not unique TIN, greater than 50% unbanked, limited use of 3rd party information  
*South Africa: established ID system, unique TIN, X% unbanked, use of employer and other government systems |
| Average | 1.0 | 2.5 | 2.3 | 1.5 | 1.3 | 3.8 |  |
| Tax policy and legislation | | | | | | |  |
| Tax policies at core of development strategy | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 4.5 | *EAC countries: no explicit linkage btw tax policy and development strategy, incentives and exemptions need to be rationalised  
*South Africa: more explicit linkage btw tax policy and development strategy, incentives and exemptions granted on an extremely exceptional basis and following a thorough assessment of both the associated benefits and costs |
| Effective tax policy and legislative framework | 2 | 2 | 2 | 2 | 2 | 4 | *EAC countries: tax policy changes undertaken on a piecemeal basis, compared to the comprehensive approach in South Africa. Capacity for policy research and analysis is also weak. |
## Reform areas

<table>
<thead>
<tr>
<th>Key observations and explanation (informed by country case studies)</th>
<th>Burundi</th>
<th>Kenya</th>
<th>Rwanda</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>S.Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Harmonising, updating and fully implementing current legislative provisions</td>
<td>2.5</td>
<td>2.5</td>
<td>3.5</td>
<td>3</td>
<td>3</td>
<td>4.5</td>
</tr>
</tbody>
</table>
| *EAC countries: principal tax laws (i.e. income tax) are outdated in Kenya and Burundi, and not fully implemented elsewhere. No country, other than Rwanda, has harmonised tax administration procedures. EAC Customs Management Act 2004 is in force, but more needs to be done to harmonise income taxes, VAT and excise duty.*  
*South Africa: legislative provisions up-to-date and fully implemented.* | | | | | | |
| Fiscal decentralisation and local tax revenue mobilisation | 1 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| *Fiscal decentralisation not underway in Burundi. Supporting legislation in place in Uganda, Tanzania, Rwanda, and South Africa. New constitution in Kenya paves the way for fiscal decentralisation. However, local revenue mobilisation is constrained in all study countries.* | | | | | | |
| Average | 1.8 | 2.1 | 2.4 | 2.3 | 2.3 | 3.9 |

### Tax administration

<table>
<thead>
<tr>
<th>Key observations and explanation (informed by country case studies)</th>
<th>Burundi</th>
<th>Kenya</th>
<th>Rwanda</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>S.Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managerial autonomy of ARAs and accountability for results</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>3.5</td>
<td>2</td>
<td>4.5</td>
</tr>
</tbody>
</table>
| *Burundi: OBR recently established*  
*Kenya & Uganda: limited performance measures, managerial autonomy curtailed by Ministry of Finance/Politicians, efforts made to transform KRA/URA organisational culture*  
*Rwanda: limited performance measures, some managerial autonomy, efforts made to transform RRA organisational culture*  
*Tanzania: well-tested set of performance measures, some managerial autonomy, efforts made to transform TRA organisational culture*  
*South Africa: performance measurement system undergone improvements since 2001/02, managerial autonomy, SARS has taxpayer focused orientation* | | | | | | |
| Strengthening compliance management and enforcement | 1 | 3 | 2 | 2 | 2 | 4 |
| *Burundi: tax evasion is high*  
*Kenya: tax gap is significantly lower than other EAC countries*  
*Rwanda, Tanzania & Uganda: significant tax gap*  
*South Africa: minimal tax gap* | | | | | | |
| Operational Capacity | 1 | 3 | 2 | 2.5 | 2 | 4.5 |
| *Burundi: OBR recently established*  
*Kenya: leads in the roll-out of e-filing and ETRs in EAC*  
*Tanzania: proactive in operational research*  
*All EAC countries: tax officers serve fewer taxpayers than in OECD countries*  
*South Africa: millions of taxpayers use e-filing, undertakes fairly rigorous research & analysis* | | | | | | |
| Average | 1.0 | 2.7 | 2.3 | 2.7 | 2.0 | 4.3 |
Annex 1.2 Bibliography

Part II

International Experience and Lessons
Chapter 2

South Africa
Summary of Key Findings

Political economy and fiscal legacies

A review of political economy legacies underscores the fact that politics has pervasively impacted fiscal governance options in South Africa. Indeed, the highly lopsided fiscal policies of the apartheid era mostly favoured the minority Whites vis-à-vis the majority Blacks. Interestingly enough, the post-apartheid leaders, instead of jettisoning all the fiscal and macroeconomic legacies of the apartheid era, actually embraced some of them as the rationale for righting the historical wrongs, by using taxation as a distributional policy instrument. In addition, the new leaders were apprehensive that their well-known pre-1994 socialistic orientation might deter international capital from South Africa. As a result, they quickly adopted more moderate, pro-investment tax policies aimed at sending a positive signal to foreign investors. To further demonstrate their commitment, the new Government put strong emphasis on administrative measures by empowering the newly-created South African Revenue Service (SARS). These measures yielded certain immediate results in the form of declining personal income tax rates and, in some cases, elimination of trade tariffs. All this underscored the imperative to make South Africa globally competitive as an attractive investment destination. Although the country has a strong natural resource base, the bulk of its economy remains in the manufacturing and services sectors, which are open to external competition.

Given the constraints under which the post-apartheid governments have exercised fiscal governance, the administrative capacity and performance of SARS remain the key determinant of both fiscal space and effort. Therefore, political leaders have had to rely on SARS to augment domestic resources and enable the expansion of fiscal space despite a decline in tax rates. As Smith (2003) observes, in post-apartheid South Africa, the involvement of politicians has positively impacted on SARS’s effectiveness. She also contends: “SARS’s experience shows that where the political and revenue-raising authorities have a common interest in enhanced collection, their collaboration is an important source of effectiveness”.

In our view, three main factors will play out in the fiscal governance of South Africa in the short-to-medium term. First, sustained pressure from political leaders and trade union representatives (of low wage workers) on the government to move rapidly and expand its public expenditure programmes for employment creation and poverty reduction. Second, the negative effects of the global financial crisis in terms of reduced trade volumes, commodity prices and business profits, and their impact on domestic revenue. Third, is – what The Economist (2010) has described as a large and growing problem – corruption. According to this publication, although in 2009 South Africa fared well in the Transparency International Corruption Perception Index ranking (55th out of 180 countries), corruption in the country is on the rise. The ANC has publically expressed concern about the scourge.

Tax reforms: Sequencing, implementation and results

The end of apartheid heralded reforms in the tax system. Between 1994 and 1999, the Katz Commission set the stage for reforming policy and institutional aspects of the tax system. Most of the Commission’s recommendations in these two areas have been implemented. The next series of reforms had taken place following the establishment of SARS. Specifically, between 1997 and 2000, SARS made changes to some of its operational processes, which contributed to the organisation surpassing revenue collection targets. However, SARS’s management considered these changes as ‘incremental’ and was of the view that the organisation was performing significantly
below its potential. Therefore, the management initiated a diagnostic study of its operations in order to identify issues and problems and recommend measures for resolving them. This exercise culminated in the development of a program, called 'Siyakha' ('we are building').

Phase 1 of Siyakha's implementation commenced in 2001 and ran until 2005/06. It was sequenced by province. Key initiatives implemented under Siyakha 1 included: development of a taxpayer and business strategy; process redesign in revenue and customs; overhauling taxpayer services; implementation of policies to promote integrity and professionalism among staff (e.g., by re-advertising all new positions and through training, standardizing work methods, creation of work teams, creating a professional management cadre); and refurbishment and re-tooling initiatives to improve the working environment. SARS reports the following results for Siyakha 1: (i) its organisation structure is flatter; (ii) processes were redesigned and standardised; (iii) a dedicated taxpayer function was established; (iv) enforcement function was strengthened; and (v) staff were better trained and more motivated.

In 2007/08, SARS launched Siyakha 2. The thrust under this second wave of reform centred on the modernisation of SARS over a five-to-seven-year period, in particular, “transforming both the tax and customs administration through automation and other operational efficiency gains”. Siyakha 2 comprises 10 programmes of modernisation, which are clustered around implementing a new operating model and national priorities (i.e., protecting borders and introducing social security and wage subsidy); and strengthening SARS’s operational foundation. At the end of Siyakha 2, SARS anticipates that it will be able to better: secure revenue; enhance compliance; protect and manage its borders; and maximise productivity as a result of operational effectiveness.

**Domestic revenue performance**

On the basic parameter of tax revenue to GDP ratio, the tax system in South Africa has consistently improved since the onset of the reforms following the end of apartheid. In 1980, according to the South African Reserve Bank (SARB), national revenue as a percentage of GDP was 20.2%. When the new democratically elected government took office in 1994, national revenue as a percentage of GDP had risen slightly to 21.9%. By 2007/08, this figure had increased to 27.8%.

It’s worth noting that over 95% of general government funding from taxes is raised nationally, 3.5% by municipalities and less than 1% by provincial governments (Republic of South Africa, 2008). Tax revenue over the 13 years to 2007/08 grew at an average annual rate of 13.3%, in spite of the overall reduction in tax rates at the beginning of the decade. The latest published tax statistics indicate that in 2007/08, the four largest sources of domestic revenue in South Africa, in order of their magnitude of contribution to total tax revenue, were: Personal Income Tax (29.5%); Value Added Tax (26.3%); Corporate Income Tax (24.5%); and the fuel levy (4.1%).

The wide breadth and depth of policy, and institutional and administrative changes, were informed by the analytical, policy and strategic development work of the Katz Commission, which existed in parallel to both the mainstream government policy organs and tax administration systems for a period of five years (1994-1999). One instructive facet of the Katz Commission was the phasing of its recommendations, which were delivered in nine separate packages (reports) over the five-year period.

**Challenges and issues**

As SARS moves ahead to becoming a world class services provider, it grapples with a number of challenges and issues, including:
• DRM efforts must be stepped up to finance national development strategies: South Africa needs to mobilise even more resources to fund programmes for job creation, expanding education and health, rural development, and combating crime. SARS is challenged to raise gross tax revenue as a percentage of GDP from about 24.5% in 2009/10 to 26.2% by 2012/13;

• A different approach for dealing with taxpayer segments is needed: SARS management recognises that it cannot sustain the tax compliance culture it has cultivated over the years without rationalising the way in which it utilises its human resources. To this end, SARS has embarked on a review of segmentation arrangements, because it has realised that it does not have sufficient capacity to run them all;

• SARS must continue to widen its tax base for the foreseeable future by: further expanding its outreach through ‘walkabouts’ to establish unknown economic activities, which are outside the tax net; assessing how it can expand its footprint into areas where it has no branches; and increasing the number of lifestyle audits;

• SARS’s staff capacity must keep abreast with its transformation: A leadership management training initiative needs to be rolled out across the organisation. Furthermore, SARS is also looking at options for recruiting and retraining staff in critical areas with gaps such as enforcement, customs, strategy and analysis;

• The additional burden of administering non-tax government programmes: SARS has undertaken an initiative to support the implementation of government’s social security and wage subsidy interventions, and to administer a cash reimbursement system for employers. These developments place an additional administrative burden on SARS;

• The increased cases of crime and corruption need to be kept in check: SARS reports an increase in syndicated crime, particularly in the areas of fraud and corruption. Also, such crimes have extended to the banking system, and there are increasing risks of using bank accounts and cheques to defraud SARS;

• Challenges around regional trade integration: There are issues around rules of origin, which lead to a lot of paperwork. Also some member states of the South African Customs Union may be unwilling to reduce common external tariffs and/or admit new members. South Africa is challenged to lead in addressing these issues.

Lessons learned

Although there are considerable lessons from South Africa, only six are highlighted in this case study:

• Strong collaboration between SARS and the National Treasury has been instrumental to successes in revenue mobilisation: For example, since 2009, the National Treasury, in partnership with SARS, has initiated the production of very comprehensive tax statistics. A close working relationship is also evident in annual reports and strategic plans produced by SARS, which invariably contain insightful messages from the Minister of Finance;

• Solid policy formulation and evaluation capacity are key to strong revenue performance: The Government of South Africa has strong tax policy capacity within SARS and the National Treasury. The latter also welcomes SARS’s views on: new tax policy proposals, and the implications of trade policies and agreements for customs;

• Compacts with professional and industry groups can reinforce compliance and facilitate administrative
efficiency and effectiveness: Compacts such as the banking accord can definitely be extended to other industries and professional groups;

- Minimising the level of exemptions ensures tax policies remain neutral: The government grants tax exemptions on an extremely exceptional basis. Only a few public benefit and public sector organisations are eligible for exemptions, and these are legislated and not discretionary;

- Modernising through the use of ICT can result in significant operational efficiencies, but must be applied judiciously: Particularly relevant lessons learned from SARS’s extensive use of ICT applications include: integrating core tax systems is critical to enabling a ‘single view of the taxpayer’; use of eFiling throughout the year should be encouraged by offering incentives; and implementation should be gradual to cater for complexities in the tax environment;

- Good client service is critical for promoting voluntary compliance: SARS has focused its approach and efforts on three services: call centres, walk-in centres and eFiling. This also includes a lot of effort during the filing season to assist taxpayers in completing their tax returns;

- A policy of zero tolerance for corruption is an important deterrent: SARS established an Anti-Corruption and Security (ACAS) Unit in 2007. The Unit’s work is informed by SARS’s risk engine. It is also noteworthy that the unit: has developed standards to safeguard physical and information access; works closely with the police, banks, and the intelligence service; and pre-investigates each reported incident to establish its validity. In addition, the Unit’s work is informed by extensive research and analysis.

The rest of the chapter is organised as follows: the first section discusses the political economy and fiscal legacies, the second section covers trends in the tax system, the third section explores domestic revenue performance, the fourth section highlights the challenges to increasing DRM, and the fifth section concludes with lessons learned.
Context – Political economy and fiscal legacies

The legacy of the apartheid economy

In 1994, when South Africa’s first post-apartheid democratic government assumed power, the nation’s economy was in poor shape. Between 1985 and 1994, the economy grew by an average rate of 0.8% of GDP, representing a decline of “-1.3% in per capita terms” (Du Plessis and Smit, 2007). Thirty-two years of an institutionalised apartheid regime which was vanquished by a long liberation struggle, and economic sanctions in later years, had contributed to high interest rates, low levels of investment, double digit inflation, and, a weak international reserve position (Nowak, 2005). Furthermore, by 1993/94, the fiscal deficit had grown to 10.2% and 11.2% of GDP at national and provincial government levels respectively (IMF, 1998). According to the South African Reserve Bank, in 1994, total national debt as a percentage of GDP was 43.5%.

In the decade to liberation, the tertiary sector accounted for 94% of GDP growth (see Annex 2.3: Table 1). However, between 1984 and 1994, manufacturing was a significant contributor to the economy. Prior to the lifting of economic sanctions, South Africa’s trade policy was essentially protectionist. Until the 1970s, the apartheid government facilitated import substitution industrialisation to promote local manufacturing, which tended to be capital-intensive. This policy contributed to the generation of “current account deficits and …[drained] foreign exchange reserves”, which could not be covered by the revenue generated from mineral exports (Lowenberg and Kaempfer, 1998). Furthermore, by the 1970s, import substitution industrialisation started to have less impact on economic growth. Government therefore started to encourage non-gold exports through the provision of incentives. In tandem, it attempted to reduce the level of protectionism by curtailing quantitative restrictions on imports.

Another major socio-economic legacy of the apartheid regime was that the new government inherited “a large pool of unskilled and unemployed labour, and acute widespread poverty” coupled with a vast majority of South Africans having limited or no access to basic social services, such as education and health (Nowak, 2005). The poverty levels and inequality were also high by middle-income country standards. Leibbrandt et al (2001) estimate that the percentage of the population living on R91 a month (or US$2 a day) in 1996 was 26% (Leibbrandt et al, 2009). There were also huge disparities in South Africa’s per capita income across different races.

Post-apartheid economic and development trends

Given the state of affairs presented above, the newly-elected democratic government initiated several measures to ensure macro-economic stabilisation, including reducing the fiscal deficit by exercising prudence over debt management, reforming the tax regime and revenue administration, and lowering public sector consumption expenditure (e.g., by limiting increases in the wage bill, reducing subsidies, rationalising structures and improving management, particularly at provincial level) (Ajam and Aron, 2009; Horton, 2005).

Government’s development objectives have remained consistent since the 1990s. Its priority areas, with respect to development, continue to evolve around: promoting economic growth; investing in social and economic infrastructure; rural development; building human capacity through provision of basic education and job creation; improving the health of South Africans; curbing crime and corruption; community development; effective resource management; and improved services delivery. Public expenditure as a percentage of GDP was 27.2% in 1997/98 and remained more or less at the same level until 2007/08.
(29%). In 2008/09, public expenditure was budgeted to rise to 31.3% of GDP².

In 1994, the Government launched a Reconstruction and Development Programme (RDP) aimed at mobilising revenue resources for development to meet the challenges of poverty and inequality. The programme “stressed tax simplification, reorientation… in spending, greater budget transparency, and the development of a five-year fiscal framework” (Horton, 2005). The RDP mainly financed social sector investments. Later, it was effectively replaced by the Growth Employment and Redistribution (GEAR) Strategy, which set a vision and framework for growth from 1996 to 2001. Key medium-term interventions under GEAR included: accelerating fiscal reforms; strengthening trade and industrial policy reforms; investing in infrastructure; further relaxing exchange controls; moderating wages and prices to enhance public service delivery. Promoting the growth of small, medium and micro-enterprises was a key area of focus. Reforms in education, health and welfare, and housing were also high on the agenda.

All these measures bore fruit. By 2001, they had contributed to reduced inflation and lower interest rates. As a result, the economy started to grow, and government was able to mobilise additional domestic resources through taxes (Faulkner and Loewald, 2008). From 2000/01 to 2005/06, the economy grew at an average rate of 3% of GDP. Thereafter, in 2006/07 and 2007/08, economic growth rose to about 5%. The fiscal deficit as a percentage of GDP steadily declined between 1997/98 (3.8%) and 2002/03 (1.1%), before it rose again in 2003/04 to 2.3%³. In the fiscal years 2005/06, 2006/07 and 2007/08, there were positive budget balances⁴.

Figure 2.1: Trends in South Africa’s overall development financing mix (1996 to 2008)

Source: Africa Economic Outlook (AEO) 2010 data

---

² Ibid.
⁴ Ibid.
Development financing mix and challenges

Figure 2.1 presents South Africa’s overall development financing mix from 1996 to 2008. During the period, domestic revenue and exports of goods and services were two top sources of development financing, representing 24.6% and 28.9% of GDP respectively. Following the collapse of apartheid and the removal of sanctions, South Africa played a more active role in the international trade and finance markets. For example, it is a signatory to various preferential trade agreements. In addition, the Government has been proactive in promoting exports through such measures as the Export Marketing and Investment Assistance Scheme and Industrial Development Zones (IDZs) (SARS, 2007b).

Private savings were the third largest source of development financing. However, between 1996 and 2008, gross private savings declined from 16.8% to 10.3% of GDP. This was due to such factors such as financial liberalisation, which encouraged “borrowing by the personal sector to an excessive degree” and high levels of unemployment (Aron and Muellbauer, 2000).

Foreign direct investment (FDI) in South Africa averaged at 1.4% of GDP between 1996 and 2008, which is lower than the benchmark for emerging economies of 2.7%. A higher proportion (2.8%) of foreign investments was made through the financial markets by way of portfolio inflows. Combined FDI and portfolio inflows constituted an average of 4.2% of GDP from 1996 to 2008.

South Africa has consistently resisted the influence of international development organisations in its macroeconomic and fiscal affairs. Until 2009, its relationships with the IMF and World Bank were limited to Article IV consultations and sharing of knowledge. Also, it does not receive any significant assistance from any bilateral government source.

The recent global financial crisis adversely affected Government’s ability to mobilise domestic resources from taxes. Nonetheless, it has undertaken initiatives to stimulate economic recovery through capital investments. It has also made a commitment to sustain the level of financing for social services. However, one of South Africa’s development financing challenges is that at liberation, debt levels were significant. This high level of debt implied high servicing costs and squeezing out resources needed for development. Furthermore, there was concern that in the absence of a marked reduction, the high level of debt would be passed onto future generations. Thankfully, the Government recognised the challenge, which has been reflected in the Finance Minister’s budget speech over the years high lighting its objective to reduce the overall level of debt. It is worth noting that since 1999/2000, the Government was able to reduce its overall debt level through restructuring and divestiture of state assets. Moreover, it also benefited from the reduction in domestic interest rates, attributed to prudent fiscal and monetary policies. In its most recent budget proposals (2009/10), the Government indicated that over the medium term (to 2015/16) debt will peak at 44% of GDP. It also appears fairly bullish that investors will remain confident in its favourable macroeconomic policies, and as a result South Africa’s sovereign investment ratings will be maintained at current levels.

Political economy dynamics underpinning DRM

The synopsis of the political economy legacies that have impacted DRM, as presented in the following
Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

subsections, is based on Brautigam’s (2008) analytical framework. It consists of five facets: (i) level of economic development and economic structure; (ii) societal factors: culture, values, trust and ‘tax morale’; (iii) war and taxes: bureaucratic modernisation as a response to threat; (iv) political institutions and tax systems; and (v) taxation and fiscal contract.

A modern economy but major structural imbalances persist

At liberation, the economic structure was modern (see Annex 2.3: Table 1). Therefore, from one perspective, the apartheid regime did not wholly bequeath its successors an economy in a shambles. DRM at a national government level was comparatively modest (at 22% of GDP) compared to 38% for industrialised countries (Ndulu et al, 2007). However, the economy was already contracting. Yet, in comparison with virtually all other states on the continent, South Africa is credited to have the most modern and strongest economy.

The downward trend in economic growth and fiscal performance in the sunset days of the apartheid regime were symptomatic of the malaise afflicting the political economy with regard to DRM. A comparatively small proportion of privileged White, Coloured and Asian populations had considerable wealth and property in the modern economy. Individual taxpayers were also preponderantly from the same communities. The vast majority of the population was conscribed to low pay, a peasant existence, unemployment and poverty.

An earlier section outlined government’s efforts since 1994 to grow and restructure the economy. Until the global financial crisis whose impact was most felt in 2009, the government had succeeded in restoring macro-economic and fiscal stability, steadily growing the domestic product, and expanding the tertiary sector. In the latter context, the scope for DRM was significantly enhanced over the period. However, the imbalances from the apartheid regime persist.

The abhorrent dual system institutionalised under the apartheid regime, underlies the socio-cultural divide in South African society. On one hand, the majority remains engaged either in the primary and informal sectors or unemployed. Furthermore, the unemployment situation has much worsened since 1994.

According to the South African Institute of Race Relations: “The number of unemployed South Africans, using the strict definition of unemployment, increased from nearly 2 million to 4.3 million between 1994 and 2007. The unemployment rate increased from 20% to 25.5% over the same period”.

On the other, there is a comparatively small proportion of the population that derives its income from modern economic activities, and therefore contributes most to the domestic resources. Thus, out of a population of 49 million, only 5 million (or 10% of the population) are registered as taxpayers, which is low for a country at South Africa’s stage of development. In this regard, for example, in 2007, two other upper middle-income economies, Chile and Latvia, had 45% and 44% of their population registered as taxpayers respectively (OECD, 2009a).

A culture that is more trusting of government and higher tax morality is evolving

According to Smith (2003), the apartheid regime cultivated a culture of compliance among the majority taxpayers. Still, the author notes that there is a widespread perception among tax specialists that “apartheid-

---

7 Brautigam’s framework is adopted because, compared to others that were examined, it is judged to be more comprehensive and elegant. However, given the fact that this framework’s historical perspective also derives from the emergence of the modern European state, it needs to be carefully interpreted when applied to states that are legacies of colonial rule and apartheid.


9 In a society where “tax morale” is high, there are low levels of tax evasion and avoidance. It is only in a social culture where citizens generally appreciate their responsibility for sustaining state services and where they have a trust in their state institutions and leaders that a “tax morale” evolves.
era tax collection was characterised by high levels of avoidance”. This latter view appears to be borne out of data in the growth of registered taxpayers, which has more than doubled since liberation.

Some of our key informants also suggest that although the banking and mining industries were key drivers of the economy before 1994, they did not necessarily pay taxes. However, compliance levels from these sectors has since considerably improved.

Furthermore, South Africa has demonstrably vigorous anti-corruption and enforcement agencies. It can therefore be surmised that over the past decade or so, a culture that is more trusting of government and higher tax morality is evolving.

The insecure apartheid state modernised its bureaucracy by co-opting a White minority to pay high tax rates

The increasing global resistance to the apartheid regime, especially after the Soweto riots of 1976, which was followed by the progressive introduction of sanctions by the international community in the 1980s, posed a clear threat to the regime and its privileged beneficiaries. These developments explain the high tax rate regime and the legacy of an efficient Inland Revenue administration.

As the minority White regime in successive decades promoted its apartheid policies and an anti-communist stance, it co-opted its followers who also dominated the modern economic sector to pay taxes (Lieberman, 2003). It is significant that by 1972, the top personal income tax rate in South Africa was 62%. By then, resistance to the regime by the non-White population was gaining momentum.

Post-liberation - there was strong political and union support to increase DRM through tax reform

A top priority of the African National Congress (ANC), the dominant party in the post-apartheid coalition government of 1994, was to vastly and rapidly enhance its domestic resources aimed at funding its ambitious growth and poverty reduction programmes. Therefore, in 1994, it pushed for the establishment of the Katz Commission to undertake an extensive review of tax policies and administration (Manuel, 2002). On the basis of the Commission’s interim report, the autonomous South African Revenue Service (SARS) was established in 1997. It is noteworthy that the first Commissioner of SARS (Pravin Gordhan) as well as the long-serving former Minister of Finance (Trevor Manuel) are longstanding ANC stalwarts “who believe that tax collection is key in the shared political project of economic growth with redistribution” (Fjeldstad and Moore, 2008). Furthermore, as long as he remained in charge of SARS (until 2009), Commissioner Gordhan, did not hesitate to mobilise the ANC structures to campaign and educate for DRM among all sections of the population. The strong trade unions in South Africa have been close allies of the ANC for decades. According to Lieberman (2003), this alliance has not only served to support SARS, but also advanced policies for resource redistribution through taxation. For these two predominant political institutions, the tax system is one of the several institutions targeted for righting past wrongs.

There is an implicit fiscal contract between the government and its taxpayers10

The relatively high compliance with taxation among the White population, and near total tax avoidance by Blacks under the apartheid is readily explainable. In

---

10 Fiscal contract has its genesis in agreements between European monarchies and the propertied class and merchants that the latter would contribute to state coffers, especially to fund war in return for specific benefits. In modern times, a fiscal contract would be characterized by government pledges of specific socio-economic benefits to justify taxation. This is a more realistic proposition in a democratic dispensation.
the post-apartheid regime, compliance levels have rapidly risen across the population, as reflected in the growth of registered taxpayers. The majority of the Black population still expects that government will deliver on its pledges to improve access to social services, and create employment and combat poverty. In this regard, the majority of the Black elite have a strong sense of the need to expand the public expenditure framework, and therefore the compelling case for them to pay taxes. The majority of the non-Blacks as well as the Black elite also support the expansion of government programmes to develop infrastructure, and reduce unemployment and thereby crime. Therefore, at an individual level, there is an implicit fiscal contract between the Government and its taxpayers, which in any case is underscored in successive post-apartheid budget speeches. In this regard, for example, Lieberman (2003) asserts that while:

“Upper groups have expressed desires to shift the tax burden downwards,…the normative order of post-apartheid…has provided compelling reasons for the rich to pony up to their tax obligations”

According to Lieberman (2003), the cohesiveness that existed among businesses in apartheid South Africa on matters of fiscal policy, has since become stronger. By 2003, there was “remarkably little polarization within the ranks of businesses and professionals on key policy positions, particularly with respect to taxation” (Lieberman, 2003).

Furthermore, since the National Treasury and SARS have adopted a participatory approach to policymaking, and tax rates have been generally on the decline since the late 1990s, the business community, on the whole, appreciates the benefits that they derive from the government’s services that are funded by their tax contributions.

Fiscal governance drivers, results and trajectory

The synopsis on political economy legacies underscores the fact that politics has pervasively impacted fiscal governance options in South Africa. The failure of fiscal governance contributed to the wrought of apartheid politics, which precipitated its end. In other words, the increasing inability of the apartheid regime to sustain a balanced fiscal position and thus a credible macroeconomic environment was an important contributory factor to its demise. However, the legacy of that fiscal and macro-economic regime continues to influence the politics of fiscal governance in the post-apartheid era. The discrimination in the provision of public services under the apartheid regime is a key driver for the rapid expansion of the fiscal framework with a view to addressing historical disparities. Inherently, there is a continuing and strong momentum to rapidly grow resources, which can be made available for public expenditure.

Although the South African economy is relatively modern, it has remained fragile. Since the days of apartheid, the high political risks associated with capital flight have persuaded the government to maintain stringent foreign exchange controls. For this reason, South Africa has kept away from the option of mobilizing resources from the Bretton Woods institutions, which in all probability would demand the end of such controls. Yet, at the same time, by remaining disengaged from these institutions, South Africa significantly constrains itself from international resource mobilisation. Therefore, it has remained predominantly reliant on DRM.

Post-apartheid politics espoused the rationale of using taxation as a distributional policy instrument to right the historical wrongs. However, the ANC’s initial sensitivity that its pre-1994 socialistic orientation could deter
foreign capital not only prompted the new leaders to considerably moderate tax policies, but also put strong emphasis on administrative measures – beginning with the establishment of SARS. This perspective, in part explains, the gradual decline in income tax rates. The other important factor underlying the policies to reduce personal income taxes, and in some cases, eliminate trade tariffs, is the imperative to remain globally competitive as an attractive investment destination. Although the South African economy has a strong natural resource base, it largely relies on manufacturing and services sectors, which are open to external competition.

Given the constraints under which the post-apartheid governments have exercised fiscal governance, the administrative capacity and performance of SARS remains the key determinant of both fiscal space and effort. Therefore, political leaders have had to rely on SARS to grow domestic resources and enable the expansion of fiscal space despite a decline in tax rates. As Smith (2003) observes, in post-apartheid South Africa, the involvement of politicians has positively impacted on SARS’s effectiveness. She also contends that “SARS’s experience shows that, where the political and revenue-raising authorities have a common interest in enhanced collection, their collaboration is an important source of effectiveness”. This is reflected in the growth of registered taxpayers (see Annex 2.3: Table 16).

In our view, three main factors will play out in the fiscal governance of South Africa in the short-to-medium term. First, sustained pressure from political leaders and trade union representatives of low wage workers on the Government, to move rapidly and expand its public expenditure programmes for employment creation and poverty reduction. In other words, a strong socio-political demand for an expanded fiscal space and enhanced effort will prevail.

Second, the negative effects of the global financial crisis led to reduced trade volumes, commodity prices and business profits, as well as domestic revenue.

Since the option of contracting the public expenditure framework may not be politically tenable, the need for alternative sources of additional revenue or raising the tax rates appears inescapable. With regard to the latter, for instance, as indeed already indicated by the Minister of Finance in his latest budget speech (for fiscal year 2010/11), there are distinct prospects that income tax and VAT rates will be raised in coming years.

Third, what the Economist (2010) has described as a large and growing problem – is corruption. According to this publication, although in 2009, South Africa fared well in the Transparency International Corruption Perceptions Index ranking (55th out of 180 countries), corruption in the country is on the rise. The ANC has publicly expressed concern about the scourge. The Economist suggests that this trend is entangled with a culture of Black entitlement to compensation for past suffering under apartheid, and many South Africans seem unconcerned about its negative impact. If this trend is not checked, there is a high risk that it will exacerbate corruption in the tax administration system. All this will lead to an increase in tax avoidance and collection leakages.
Trends in the tax system

Changes in tax policies over the years

This section covers three episodes in tax policy changes in South Africa: (i) those in place during the apartheid era; (ii) policies formulated following the dismantling of apartheid; and (iii) tax policies post-1994.

Tax policies in the apartheid era

Before and during the apartheid era, major source of revenue was income tax. According to Lieberman (2003), after many failed attempts, income tax was first introduced in South Africa just before the First World War, in 1914. This was about the same time it was introduced in many European countries. In 1962, new income tax legislation was enacted. It consolidated the responsibility for collection of major taxes, collected at a provincial government level, to be transferred to the central government; and introduced the pay-as–you–earn (PAYE) system. Over the next two decades, the Income Tax law was amended to reflect changes in rates. In addition, the Customs and Excise Act was promulgated in 1964. Since then, as outlined below, there were two key periods in tax policy reforms.

Major tax policies formulated in the early 1990s

The VAT, which replaced the goods and services tax, came into force in 1991 amid huge protests by unionised workers (Lieberman, 2003). Still, VAT remained in force and was levied at a rate of 10% until 1993 when it was raised to 14% and remains the same today. The VAT rate in South Africa is lower than the rest of Africa and many other European countries. There have been calls by international financial institutions and businesses to raise it.

Tax policies introduced in 1994

After liberation, Government revised tax policies following recommendations made by the Katz Commission (1994 to 1999). Since 1994, South Africa’s tax policy objectives have centred on: curbing evasion; widening tax base; promoting greater compliance; facilitating private sector investment by ensuring that tax rates are competitive; reducing the compliance burden; and ensuring that the tax regime is equitable and neutral. Its focus is on policies, which affect South Africa’s three main sources of revenue: personal income tax (PIT); corporate income tax (CIT); and the VAT. Then again, Government has formulated new policies outside these three main categories, which are in line with international best practices and/or more suited to the modern-day South Africa.

The Katz Commission recommended that one way by which government could widen the tax base with respect to VAT was to expand it to “include all fee-based financial services, except for premiums on life policies, contributions to pension, provident fund, retirement annuity and medical aid funds” (Manuel, 2002). Also, in 1998, Government, recognising the pitfalls of VAT as being often susceptible to evasion and fraud, introduced VAT on all exports and imports from Botswana, Lesotho, Namibia and Swaziland (BLNS countries) to minimise “round tripping, which occurs when goods are exported to the BLNS countries, and then re-imported and sold in South Africa without the payment of VAT” (SARS, 1999).

With respect to personal income tax, legislation was rationalised on the advice of the Katz Commission. It was done, for instance, to: reduce the number of income tax brackets; offer greater relief to low income earners; and adjust tax thresholds. It also progressively lowered CIT rates (see Annex 2.3: Table 2). From 2000, in an effort to broaden the tax base, various taxation
policies were amended to: disallow certain allowances given to employees as tax free; provide for individuals and companies to start paying taxes on a worldwide rather than resident basis; and remove loopholes in the income tax law (SARS, 2001). The Government was able to sell these policy changes to taxpayers largely because of its promise to reduce taxes over time.

The Commission’s recommendation also helped Government to introduce a capital gains tax (CGT) in 2001. The rationale for a CGT was to:

- Make the income tax system more efficient by discouraging taxpayers from categorising ordinary income into tax-free capital gains;
- Promote equity by ensuring taxpayers with the same levels of income bear comparable tax burdens irrespective of their sources of income;
- Mobilise greater levels of domestic revenue; and
- Align South Africa’s tax regime with international practices. For example, countries such as Australia, Brazil, Canada, India, Japan, Nigeria, the UK and USA levy CGT.

More recently, in 2008, Government introduced new measures to align South Africa’s corporate tax policies with international good practices. Specifically, in an effort to remove the burden placed on companies to pay a Standard Tax on Companies (STC), which is levied on profits and then distributed through dividends, a dividend tax² plan was announced. Furthermore, the Mineral and Petroleum Resources Royalty Act, 2008 requires mining companies to pay royalties on the ground that minerals belong to the state and are not renewable sources of energy. The Minister of Finance, however, postponed implementation of the Act due to intensive debate on the formula, and the recession in 2008/09. Nonetheless, the legislation became effective in 2010.

Over the years, to encourage taxpayer registration and/or compliance, Government has also offered various tax amnesties. First, the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003 gave amnesty to residents with unlawful holdings time to register them (SARS, 2004). An exchange control levy of 10 or 5% was payable if the illegal asset was kept offshore or repatriated to South Africa respectively. Second, the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 gave small businesses a chance to voluntarily state non-compliance with the law (SARS, 2007a). Third, the Minister of Finance, in his most recent budget speech, announced that government will offer non-compliant taxpayers the opportunity to disclose and make good their tax liabilities under the Voluntary Disclosure Programme which will run for a period of 12 months from November 2010.

A study by the World Bank’s Financial Investment Advisory Services (FIAS) group found “that overall the [tax] compliance costs are regressive – the smaller the business, the heavier the burden” (2007). As a result, the majority (over 60%) of businesses with an annual turnover of R300,000 or less preferred not to formalise their businesses. The study recommended the design and implementation of a simplified tax regime for small businesses. A 2008 survey of small business enterprises commissioned by the USAID endorsed a similar proposal. Accordingly, from 1 March 2009, Government introduced a simplified tax system for micro-businesses (including sole proprietors, individuals, partnerships, close corporations, companies and co-operatives) with a turnover of R1 million or less. The new system requires that small taxpayers pay a single turnover tax rather than five separate taxes (i.e., VAT, provisional tax, income tax, CGT and STC).

South Africa has been very proactive in the international dialogue on trade facilitation. Therefore, the government remains cognisant of the global trends,

---


37
and in particular, customs duty which is not part of the government budget. As a consequence, today, over 70% of South Africa’s imports are tax free. “This is not the case in most Sub-Saharan African countries where Customs duties still account for a large, even majority share of total state revenues” (SARS, 2007b). The Minister of Trade and Industry sets the rates of customs and excise duties based on recommendations received from the International Trade Commission of South Africa.

Institutional changes

By the mid-1990s, morale in the former Directorates of Inland Revenue and Customs and Excise was low. For example, poor pay contributed to high staff turnover. Furthermore, the directorates were severely underfunded. In 1996, the directorates were merged into a general government department under the leadership of an ex-chief executive of a major bank (Marcus et al., 2005). Thereafter, as a means for “taking on the issues of large-scale tax evasion and ineffective countering of avoidance, and to reduce the considerable tax gap” SARS was established under Act No. 34 of 1997 (Fan et al., 2007).

SARS is headed by a Commissioner, appointed by the President, who is accountable to the Minister of Finance. The Commissioner works closely with an Executive Committee (ExCo) that he chairs, and which comprises about 15 members from senior management. ExCo is supported by various themes (e.g., on people and modernisation) and oversight committees (e.g., audit with some external members). It is noteworthy that until 2002, SARS had an Advisory Board. However, this board was dissolved following the passage of the SARS Amendment Act of 2002 (SARS, 2003).

SARS’s organisational set-up has undergone restructuring over the years. It is currently composed of three types of business units: (i) delivery business units; (ii) enabling; and (iii) advisory (SARS, 2009b). Specifically, the following divisions fall under:

- **Delivery**: (i) taxpayer services; (ii) business enabling and delivery services; (iii) large business centre; (iv) customs and border management; and (v) enforcement and compliance risk;
- **Advisory**: (i) strategic services; (ii) legal and policy; (iii) segmentation and research; and (iv) governance and enterprise risk;
- **Enabling**: (i) finance; (ii) human resources; (iii) institutional enablement and integrity; (iv) modernisation and technology; and (v) internal audit.

There are 54 designated ports for customs purposes in South Africa – five marine, eight airports and the remainder land border points. In addition, SARS has 46 inland branch offices and mobile tax units. Branch offices are spread around the country’s nine provinces.

As of 31st March 2009, SARS employed a total of 15,307 employees, out of which 556 were hired on a temporary basis (SARS, 2009b). It is noteworthy that almost 90% of SARS staff were employed to support its core business functions. Under its enabling Act, SARS has management autonomy, including freedom to operate outside the conditions of employment in the public service. In this latter regard, SARS aims to pay most of its staff against median market salary levels.

Changes in administrative systems

SARS management has, over the years, exercised its influence in the areas of staff and other resource management to overhaul its administrative systems. For example, it:

---

13 Under apartheid, there were also separate revenue administrations in the homelands.
• Operates two bonus schemes. An annual bonus is paid out when SARS meets its revenue target and is tied to individuals meeting balanced scorecard metrics. There is also the ‘Amakhwezi’ Programme which runs throughout the year – Managers are allocated a certain number of points each year, which they use to reward exceptional performance;

• Has also invested heavily in transforming the culture and work ethics of its work force through: intensive communication; enforcing ethical practices; and skills enhancement;

• Initiated a leadership management training initiative in 2008/09 targeted at mid-career managers and team leaders. The training aims to embed four main leadership qualities and competencies that SARS identifies as essential for supporting and reinforcing its values (SARS, 2009a). They are: higher purpose and integrity; empowering delivery; transformation; and insight.

Also, since its establishment 13 years ago, SARS has invested heavily in modernizing its systems, driven by its objectives to increase revenue and reduce costs. Providing good service and making compliance easier underpin these objectives. Electronic filing (eFiling), the launch of a call center and the automation of key support systems are probably the most fundamental and successful parts of the modernisation efforts that SARS has introduced (see Annex 2.4).

Fiscal decentralisation and taxation by local governments

The 1996 Constitution recognises three autonomous levels, or “spheres”, of government: national, provincial, and local (municipal). The South African intergovernmental fiscal transfer system is generally regarded as well-designed and well-implemented. The overarching system is defined by the Intergovernmental Fiscal Relations Act (1997) and the Financial and Fiscal Commissions Act (1997). The latter Act establishes the Financial and Fiscal Commission, which is constitutionally mandated to make recommendations to Parliament on the equitable division of revenues among the three spheres of government.

Over three-quarters of municipal revenues are collected from own source revenues (see Annex 2.3: Table 18). Self-financing of municipal services is believed to ensure that they are directly accountable to local residents for the functions performed and the services provided. Local revenues empower residents to play an important role in deciding on the services they prefer and are willing to pay for, and ensure that municipalities remain responsive to the needs of their residents.

Municipalities in South Africa have traditionally had three main sources of own revenues: service charges (including electricity fees, water tariff, sewerage fees and refuse collection charges), property taxes (known as property rates), and the RSC Levy. Municipal revenue potential varies considerably among jurisdictions, with metropolitan municipalities and urban local governments collecting the bulk of own source revenues.

Reform sequencing, implementation and results

Overview

The end of apartheid heralded reforms in the tax system. According to Lieberman (2003), the “election of Nelson Mandela in 1994 provided a significant opening to reform the country’s tax system”. Between 1994 and 1999, the Katz Commission set the stage for reforming policy and institutional aspects of the tax system in nine
reports. Most of the Commission’s recommendations in these two areas have been implemented and are reflec
ted earlier. The subsequent series of reforms took place following the establishment of SARS. Specifically, between 1997 and 2000, SARS made changes to some of its operational processes, which contributed to the organisation surpassing revenue collection targets. However, SARS management considered these changes as ‘incremental’ and was of the view that the organisation was performing significantly below its potential (SARS, 2000). Therefore, the management initiated a diagnostic study of its operations in order to identify issues and problems and recommend measures for resolving them. This exercise culminated in the development of a programme, called ‘Siyakha’ (‘we are building’), whose main objectives were to: “broaden the tax base, encourage a culture of voluntary compliance… (so making tax cheaper to collect), and create a much more efficient and effective business” (SARS, 2005). Siya-
khá was approved by the Cabinet in September 2000.

Sequencing and implementation of reforms under ‘Siyakha’

Siyakha 1’s implementation commenced in 2001 and ran until 2005/06. It was sequenced by province as follows: Kwa Zulu Natal (2001); Western Cape (2003); Gauteng (2004); and other provinces (2005/06). Key initiatives implemented under Siyakha 1 included: development of a taxpayer and business strategy; process redesign in revenue and customs; overhauling taxpayer services; implementation of policies to promote integrity and professionalism among staff (e.g., by re-advertising all new positions and through training, standardising work methods, creation of work teams, creating a professional management cadre ); and refurbishment and re-tooling initiatives to improve the working environment (SARS, 2000). SARS reports the following results: (i) its organisational structure is flatter; (ii) processes were redesigned and standardised; (iii) a dedicated taxpayer function was established; (iv) enforcement function was strengthened; and (v) staff were better trained and more motivated. In 2007/08, SARS launched Siyakha 2. The thrust under this second wave of reform centred on the modernisa-
tion of SARS over a five- to seven-year period, in particular, “transforming both the tax and customs administration through automation and other operatio-
nal efficiency gains” (SARS, 2008). Siyakha 2 comprises 10 programmes of modernisation, which are clustered around implementing a new operating model, and national priorities (i.e., protecting borders and imple-
menting social security and a wage subsidy), and strengthening SARS’s operational foundation. At the end of Siyakha 2, expected to be completed in the next couple of years, SARS anticipates that it will be able to better: secure revenue; enhance compliance; protect and manage its borders; and maximise productivity as a result of operational effectiveness. Siyakha 2 is sequen-
ced into three implementation lots, each spanning over two or so years (see Table 2.1). Some of the preliminary implementation results from Siyakha 2 are as follows:

- SARS’s operating model was restructured. Speci-
fically, in addition to the segmentation of large businesses, SARS clustered the remainder of its taxpayer base into nine segments14;

- The nine segments are served by state-of-the-art call and walk-in centres and the eFiling service. With respect to the latter, since 2007/08, taxpayers began to receive populated and restructured personal income tax forms, resulting in the reduction of errors, (which dropped by 85% from 600, 000 in 2007 to 90 000 in 2008)) and increased client satisfaction (see Annex 2.4);

- Risk management processes were modernised. Using an intelligent risk engine, SARS profiles cases for audit/investigation to enable "enforcement to focus its activities on higher possible yield cases”

14 The nine segments include: (1) tax practitioners; (2) trade intermediaries; (3) complex individuals; (4) standard individuals; (5) standard income tax employees and below threshold; (6) medium businesses; (7) micro to small businesses; (8) non governmental organisations, public benefit organisa-
tions and government departments; and (9) employers as agents (SARS, 2009b)
Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

(SARS, 2008). Furthermore, it is also able to compare tax returns against third party information to identify any anomalies;

- SARS was in the process of replacing 42 legacy systems in customs with TATIScms software. The increased use of ICT is expected to reduce the level of interaction with importers, and reduce corruption (see Annex 2.4);

- SARS staff continue to receive training in client service and tools to enable them to be more responsive to taxpayer queries. It is noteworthy that SARS:
   - Developed a knowledge database as “a repository of FAQs [Frequently Asked Questions], tax information and scripted responses” (SARS, 2009b);
   - Put in place standard operating procedures and scripted information for staff in customs and Inland Revenue branch offices respectively. These procedures aim to limit any level of discretion around day to day work, and ensure clarity and certainty in decision making;
   - A multi-lingual interactive voice response (IVR) system was launched in November 2008 to facilitate self-service. By March 2009, 1.3 million callers had used the IVR (SARS, 2009).

Initially, other than working towards meeting revenue targets, SARS focused on a number of key result areas (e.g., improving technology, tighter customs control, business process changes). However, since 2001/02 it embarked on the development of a performance management system informed by the ‘balanced scorecard’ approach (SARS, 2001). From 2007, SARS’s annual reports published actual achievements against targets (see Annex 2.3: Table 20). In sum, the results suggest that the administrative reforms contributed to increased tax revenue due to one or more of the following factors: simplification of systems and processes encouraging voluntary compliance; improved enforcement arrangements (e.g., with respect to risk-based audits and debt collection); and quicker processing times (e.g., for tax returns).

With respect to these reforms, it is also noteworthy that e-Filing contributed to a dramatic reduction in the time taken to process income tax returns - in 2006/07 and 2007/08 the percentage of tax returns processed within 48 hours was 1.6% and 34% respectively. Table C19 also shows that efforts to improve SARS’s compliance and enforcement (i.e., audit, debt collection and investigation) functions paid off. In 2006/07 and 2007/08, the number of registered taxpayers (particularly CIT payers) grew by 17% and 12% respectively. So did SARS’s success in risk-based audits – 68% (2006/07) and 73% (2007/08) of cases yielded additional revenue.
Table 2.1: Sequencing of Siyakha 2 interventions

<table>
<thead>
<tr>
<th>Lot 1: Create capacity, design and prepare for modernisation</th>
<th>Lot 2: Implement new model per segment</th>
<th>Lot 3: Deliver world-class service</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Align organisation on strategic choices and direction</td>
<td>• Implement new business model per segment</td>
<td>• Change the way SARS acts and performs in all areas and on all organisation levels</td>
</tr>
<tr>
<td>• Launch division-specific quick-wins and no regrets moves</td>
<td>• Capabilities in place</td>
<td>• Deliver full results according to aspirational targets and desired end state (revenue, compliance, border management)</td>
</tr>
<tr>
<td>• Develop intelligence and transparency on taxpayer and trader segments and develop differentiated business model</td>
<td>• Shift in effort and allocation of resources</td>
<td></td>
</tr>
<tr>
<td>• Develop core skills and capabilities to deliver</td>
<td>• Core tax process re-design</td>
<td></td>
</tr>
<tr>
<td>• Take actions to improve performance transparency and business processes</td>
<td>• Broader people process and values programme</td>
<td></td>
</tr>
<tr>
<td>• Develop organisational capabilities and capacity</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: SARS*
Domestic revenue performance

Domestic revenue performance trends

According to the South African Reserve Bank (SARB), national revenue as a percentage of GDP was 20.2% in 1980. When the new government took office in 1994, national revenue had risen slightly to 21.9%. By 2007/08, the figure had increased to 27.8% (see Figure 2.2). It is noteworthy that over 95% of general government funding from taxes is raised nationally, 3.5% by municipalities and less than 1% by provincial governments (Republic of South Africa, 2008). Furthermore, non-tax revenues (departmental receipts) as a percentage of total budget revenue are low. In 2007/08, 2008/09 and 2009/10, non-tax revenues as a percentage of total budget revenue (gross of SACU payments) were 2%, 1.9% and 1.7% respectively.

Tax revenue over the 13 years to 2007/08 grew at an average annual rate of 13.3%, despite the overall reduction in tax rates at the beginning of the decade. The latest published tax statistics indicate that in 2007/08, the four largest sources of domestic revenue in South Africa in order of their magnitude of contribution to total tax revenue were: PIT (29.5%); VAT (26.3%); CIT (24.5%); and fuel levy (4.1%). Revenue from CGT is included as part of PIT and CIT collections (see Annex 2.3; Table 9). Other sources of tax revenue and their contribution in 2007/08 were: customs duties (4.7%); STC (3.6%); and specific excise duties (3.2%) (Republic of South Africa, 2008).

It is noteworthy that, PIT revenue peaked at 10.3% of GDP in 1999/00, but by 2007/08 it had declined to 8.2%, mainly on account of the substantial levels of tax relief provided largely to low income taxpayers - in line

Figure 2.2: Tax and non-tax revenue as a percentage of GDP (1994/95 to 2007/08)

Source: Republic of South Africa (2008). Also see Table 6 in Annex 2.3

Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

with government’s policy objective to do with equity. “Tax relief in the 2002/03 - 2003/04 period amounted to R28.3 billion or 14.6% of PIT collected, while the relief in the 2004/05 - 2007/08 period amounted to R32.2 billion or 5.9%” (SARS, 2008). Still, PIT revenues did grow at an average annual rate of 10.8% in the period from 1994/95 to 2007/08. This increase is partly attributed to higher levels of employment and compensation in the economy.

VAT collections grew by an average rate of 13.5% between 1994/95 and 2007/08. SARS attributes this growth to an increase in consumer consumption, higher than expected prices, and increases in fixed capital formation in certain years (SARS, 2003). Also, since 2004/05, SARS started to adjust VAT refunds against other types of tax owed by taxpayers (SARS, 2005).

As earlier observed, despite reduction in top marginal rates, SARS was able to record a remarkable average annual growth in CIT revenue collections of 21.5%. Specifically, CIT revenue grew from 2.4% of GDP in 1994/95 to 6.8% in 2007/08. The largest contributors to CIT growth were from the financial services, manufacturing, retail and wholesale, and telecommunications sectors which all recorded strong growth (SARS, 2009b). Also, the tax policy to widen the CIT base to include income from foreign sources yielded positive results.

In addition, SARS introduced a range of administrative reform measures to enforce and promote compliance. The key ones were:

- Ensuring that provisional CIT payments were more in line with companies’ latest profit positions as provided for in legislation;

- Measures to enhance operational efficiencies (e.g., audits, debt collection). In particular, SARS assesses returns with the aid of a risk engine. Any discrepancies are subject to follow up by the Compliance Risk Unit. If a discrepancy cannot be resolved then the return is subject to audit. Investigative audits look into: allegations of intentional non-compliance; [and] ensure punitive actions are taken against offenders (SARS, 2008). SARS also investigates criminal cases, which it hands over to the criminal justice system (i.e., the National Prosecution Service, Police and Courts);

- Introduction of an advance tax ruling (ATR) system in October 2006 to discourage tax avoidance or aggressive tax planning. The ATR “is intended to promote clarity, consistency, and certainty in respect of the interpretation and application of the tax laws to which it applies”16. Specifically, in an ATR, SARS sets out its interpretation of tax legislation in the context of a transaction proposed by the taxpayer who applied for the ruling; and

- Fostering “better and proactive” relationships with corporate taxpayers (SARS, 2008) (see discussion further on).

In addition to the above, other tax policies introduced since 1994 have also positively contributed to domestic revenue performance. First, the Exchange Control Amnesty and Amendment of Taxation Laws Act of 2003 achieved its intended purpose. SARS reports that it received 40,000 applications from South Africans with unlawful foreign exchange assets and income (SARS, 2004). In his 2005 budget speech, the Minister of Finance announced that the total value of assets disclosed was R65 billion. In its 2005/06 budget, the Government projected it would collect R2.1 billion in exchange control levies.

Second, the Small Business Tax Amnesty of 2006 was also a success. SARS launched an extensive media campaign through ‘imbuzu’ (meetings) and by sponsoring industrial theatres to encourage small

businesses to apply for amnesty. “Almost 350,000 applications were received, which included 12% new registrations” (SARS, 2008). In 2007/8, SARS collected an additional R12.8 billion as a result of the small business tax amnesty (SARS, 2009b). In 2007/08, this additional revenue constituted 2.2% of total tax collections.

Tax administration performance benchmarks Performance efficiency

SARS’s operating costs as a percentage of tax revenue collections have remained at around the 1% mark (see Annex 2.3: Table 3), which is comparable to the collection cost in countries with a tax revenue to GDP ratio in the same range as South Africa. This ratio spans from less than 0.6% (USA) to over 1.4% (Japan) (OECD, 2009a). However, between 1998/99 and 2007/08, operating costs grew at an average annual rate of around 14.8%. Employee costs (62%), administrative expenses (20%) and professional and special services (13%) constituted the bulk of SARS’s expenditure in 2007/08. Yet it is worth drawing attention to the fact that the number of tax staff available for every 1,000 persons in South Africa is 0.30 (see Annex 2.3: Table 4). This ‘tax staff per population ratio’ is low compared to World and Sub-Saharan African averages, which are 0.82 and 0.37 respectively. This low ratio is partly attributable to the fact that over two million taxpayers submit their pre-populated tax returns electronically, thereby demanding fewer SARS resources to check submissions. It is unlikely therefore that SARS will vastly increase its staff numbers - rather the priority is to improve the way in which the organisation targets high revenue-generating taxpayers through specialisation.

As alluded to in the previous section, SARS is organised along functional lines. As part of its delivery function, in 2004, SARS launched a Large Business Centre (LBC), with offices in Cape Town, Durban, Johannesburg and Port Elizabeth. The LBC is currently organised around industry sectors (e.g., manufacturing, mining, communications, construction, financial services). It serves around 22,000 taxpayers – both entities and high net worth individuals who in aggregate contribute 80% of CIT revenue. Each taxpayer has an assigned Tax Relationship Manager. All senior managers in the LBC have been recruited externally (e.g., from large accounting firms and banks), where they held senior positions.

The World Bank’s 2010 Doing Business survey ranks South Africa 23rd out of 183 countries in terms of ease of paying taxes. The tax regime makes it easier for taxpayers to comply by keeping the number of yearly payments at a low level. According to the World Bank’s 2010 Paying Taxes Survey, a company is required to make only nine payments a year, which are far less than the Sub-Saharan Africa (SSA) and OECD averages of 37.7 and 12.8 respectively (see Annex 2.3: Table 15). Furthermore, the use of the risk engine to assess tax returns together with eFiling services have been instrumental in speeding up the length of time taken by SARS to make income tax and VAT refunds. In 2006/7, SARS reported that it was able to process 81% and 83% of income tax and VAT refunds within 30 days and 21 days respectively (SARS, 2007). These turnaround times were maintained in 2007/08.

As part of its administrative reforms (see earlier discussion), SARS has also been fairly aggressive since 2004/05 in collecting tax debt (see Annex 2.3: Table 10). Specifically, tax arrears as a percentage of total tax revenue declined from 19.8% in 2002/03 to 10.7% in 2007/08. SARS ascribes this reduction to its debt equalization practice – in which a taxpayer’s VAT, PAYE

18 The residual refund applications took longer to process as they were identified as ‘outliers’, requiring an audit.
and income tax refund and debt balances are offset against each other. SARS also established a collections centre to chase up tax debts. In addition, where it is uneconomical to collect, SARS uses the provisions of Section 91A of the Income Tax Act to write-off or suspend tax debts (SARS, 2007).

South Africa has a high VAT gross compliance ratio (VATGCR) of 86.90 in comparison to the world average of 65.48\(^{19}\) (see Annex 2.3: Table 11). It suggests that this revenue is collected very efficiently with minimal exemptions, albeit with some leakages (e.g., arising from under declarations, fraudulent VAT refunds). Nevertheless, a high VATGCR has benefited from increased enforcement efforts. For example, in 2007/08, SARS, in collaboration with other government institutions, reported 228 convictions and 32 successful prosecutions; and a further 27 cases were referred to criminal investigations.

Measures from the same source of both CIT revenue productivity (CITPROD) and PIT revenue productivity (PITPROD) of 0.27 and 0.22 respectively indicate that South Africa uses the two taxes more efficiently in generating revenue than World averages of 0.13 and 0.14 for CITPROD and PITPROD respectively – again due to strong enforcement and other improvements in the tax system. The preparation of a preliminary compliance evaluation report in 2007/08 was instrumental to the development of SARS’s enforcement programme. As part of this, SARS launched “specialised campaigns to bring into the tax register’s ambit entities such as small businesses”. It is also better able to identify cases for audit (as discussed earlier).
Furthermore, “improvements in service and outreach to large corporations have generated a strong culture of tax compliance” (Fan et al., 2007).

**Allocative efficiency**

South Africa’s equivalent to the export and special processing zones in East Africa is the industrial development zone (IDZ). The government offers various customs and VAT incentives to firms operating in IDZs, such as: duty and VAT suspension on imported goods for manufacturing or storage; zero rating of VAT on local inputs; and various trade facilitation services. However, any duty and tax waivers are only offered within a customs controlled area (CCA). When manufactured goods are exported they are not subject to tax. But should goods enter the domestic market, they are subject to tax as they are deemed to be imports. Therefore, IDZs have no real tax expenditure implications and as such, are more allocatively efficient than their equivalents in EAC countries.

**Performance equity**

Figure 2.3 presents the average PIT liability in 2006, by each taxpayer group. It suggests that the regime is progressive, with low income earners (groups A to I) who constitute about 38% of total taxpayers, each paying taxes ranging from an average of Rand 0 to Rand 6,952 (around US$ 0 to US$ 964). In contrast, high income earners (groups S to Y) constitute 7% of total taxpayers, and each pay taxes ranging from an average of Rand 95,014 to Rand 3.4 million (approximately US$ 13,200 to US$ 470,000) or between 27% and 68% of total income tax respectively.

Under South Africa’s PIT regime, low income taxpayers retain around 47% more income after taxes, making it “one of the most progressive tax systems in the world” (Lieberman, 2003). Furthermore, the Government regularly revises tax brackets (see Annex 2.3: Table 13). For example, between 2002/03 and 2008/09, it increased the tax brackets for the lowest and highest income earners by 205% and 104% respectively. In the process, some lower income earners dropped out of the tax net, because of the upward shift in tax brackets, which will prolong their graduation to a higher category.

Yet, if one analyses the tax burden for CIT, large taxpayers contribute almost 80% of this revenue source (SARS, 2009b). Furthermore, key informants indicate that the top 50 and 200 large taxpayers pay 30% and 80% of CIT revenues respectively. However, the ‘total tax rate’ as a percentage of profit of 30.2% is more than half and significantly lower than the SSA and OECD averages of 67.5% and 44.5% respectively (see Annex 2.3: Table 16).

A few studies on the equity of VAT in South Africa suggest that to a minor degree it is regressive. In particular, a study by Fourie and Owen (1993) suggests that the VAT in South Africa is ‘mildly regressive’ even though legislation provides for exemptions or zero rated items (e.g., on basic foods and paraffin) utilised by poor households (Go et al., 2004). Also, a subsequent study by Go et al. (2004) concludes that the “presence of a VAT in the South African tax system impacts negatively on the welfare of low-income households” with high and low income groups spending less than 4% and more the 5% of their incomes respectively. “Removing the VAT on food and increasing the base rate on other goods to 16.4% so as to keep VAT revenue constant transforms” it into a progressive tax system (Gillingham, 2008).

Another indicator of the tax burden has to do with the amount of time taken by taxpayers to comply with the major types of taxes. In this regard, the 2010 World Bank paying taxes survey indicates that South African
companies spend 200 hours a year on this task, as opposed to 350 hours in 2008\textsuperscript{22}. This figure compares favourably with the OCED average of 194.1 hours.

**Performance effectiveness**

According to IMF computations, there was no tax gap in South Africa in 2005 – it was -0.4% (see Annex 2.3: Table 18). Furthermore, the tax effort was 101.4%. However, the results of SARS’s enforcement initiatives suggest that a tax gap exists. On one hand, key informants to this case study indicated the tax gap may range between Rand25 billion and Rand35 billion (or 4.4% of 2007/08 revenue). On the other, the Commissioner of SARS is recently quoted to have said that a definitive amount is not available – “We have to be certain that we can depend on a figure and explain it before we release any percentage” (Temkin, 2010a). Still, relative to the EAC countries, South Africa has a substantially lower tax gap and higher tax effort.

At an operational level, SARS seeks to improve its effectiveness by soliciting feedback on its performance from various sources as a basis for informing the authority on its strengths and areas for improvement. Each year, it engages big businesses from up to five industries on tax trends, policies, and administration in South Africa vis-à-vis the rest of the world. It has in recent times also started to dialogue with public sector institutions (primarily parastatals and local governments) focusing on compliance trends. These interventions also both directly and indirectly aim to promote tax morality, and discourage aggressive tax planning.

In 2009, SARS and the Banking Association signed the South African Banking Accord, setting out a framework for cooperation, which, for instance, aims to ensure that: SARS provides the industry with quality services; there are high levels of compliance by banks; and impermissible tax avoidance is prevented. As part of the accord, both parties have established ‘A Banking - SARS Operational Forum’ comprising senior executives from the authority and association, which will meet every six months to discuss tax compliance, administrative and legislative issues. The Commissioner of SARS is also expected to meet the Banking Association’s Board at least once a year (OECD, 2009b). The signing of the accord is a major scoop for SARS in that very few countries in the world have such an arrangement. And yet, the financial services sector tends to have many complex transactions. The sector can also be the source of extremely useful third party information.

In addition, SARS commissions independent surveys on the effectiveness of its services on an annual basis. In 2005/06, SARS reported that: it achieved a year-on-year reduction in the number of complaints of 14%; and a customer satisfaction index rating of 93% (SARS, 2006). Also, in its 2006/07 annual report, SARS highlights “widespread public approval of SARS as revealed by market research; [and] a high rating in ‘best government department’ newspaper surveys” (SARS, 2007). In 2007/08, it focused on obtaining feedback from taxpayers on the services provided by the LBC.

**Summary of overall trends**

On the basic parameter of tax revenue to GDP ratio, the tax system in South Africa has consistently improved performance since the onset of the reforms that followed the end of the apartheid era (see Figure 2.2). The wide breadth and depth of policy, institutional and administrative changes were informed by the analytical, policy and strategic development work of the Katz Commission, which existed parallel to both the mainstream government policy organs and tax administration systems for a period of five years, 1994-1999.

One instructive facet of the Katz Commission was the phasing of its recommendations, which were delivered in nine separate packages (reports) over the five-year period. In this sense, the Commission set the strategy
and pace for the sequencing of reforms in the early years of their implementation. Thus, for example, the establishment of SARS in 1996-1997 was in line with the early recommendations of the Commission. Thereafter, the sequencing of the reforms was anchored in successive strategic plans of SARS.

Yet another unique feature of the reforms that reflect the comprehensiveness and rigor of the Katz Commission work was the depth of policy development. An example of the latter was the successful introduction of the policy to levy tax on income earned on a world-wide basis. This policy, introduced in 2000, has yet to find a place in, for instance, many SSA countries – possibly because it is administratively challenging.

Impressive and sustained improvements in the efficiency and effectiveness of SARS since its establishment, has, of course, been crucial to achieving the overall high growth rate in tax revenue (an annual average rate of about 13.3% in the 1995-2008 period). SARS has been particularly successful in building and applying systems and capacity for enforcements as well as encouraging compliance. In more recent years, aggressive and smart utilisation of ICT applications has been the bedrock of the reforms.
Challenges and issues

SARS is respected by many revenue administrations in Africa and beyond. It is particularly strong because of its ability as an organisation to: be introspective, reflective, plan next steps and take action. As SARS charts its way to becoming a world class services provider, in our considered view, it grapples with a few key medium- to long-term challenges and issues. In addition, there are some challenges with policy implications or which require involvement of other public sector institutions. These challenges and issues are elaborated in the remainder of this section.

DRM efforts must be stepped up to finance national development strategies

When he presented South Africa’s Medium Term Budget Policy Statement (MTBPS) for 2010/11 to 2012/13, Minister Gordhan acknowledged that Government has “made much progress since the advent of democracy, yet much more remains to be done” particularly with respect to job creation, provision of services in educa-

Box 2.1: Rationale for restructuring the LBC

There are several issues that call for the reorganisation of the LBC. First, the case for being organised around industry sectors (which was influenced by arrangements in the UK) is, with hindsight and experience, not entirely suitable for South Africa. There is therefore a proposal that in future the LBC operates along functional lines (in the same way that firms such as PwC operate). However, the LBC is likely to maintain some industries specialising in mining and financial services as these two sectors have specific tax rules.

Second, there is a view that too many criteria are currently used to select taxpayers for the LBC. For instance, a taxpayer is eligible to receive LBC services if: it is a listed entity or a parastatal or financial services or mining or multinational institution; or has a turnover of over R250 million, or an annual income of more than R7 million, or assets worth more than R75 million for individuals. Therefore, SARS, on the basis of country comparisons, is considering revising the eligibility criteria to: groups with a combined turnover of more than R1 billion; and entities which are considered risky (e.g., multi-nationals, financial services and mining institutions). If SARS adopts this new measure, around 10,000 taxpayers will be transferred from the LBC, possibly to a medium-sized taxpayer grouping.

There are also discussions as to whether high net worth individuals should continue to be served by the LBC or be moved into the ‘complex individuals’ segment. Many high net worth individuals in South Africa have international investments, which are currently dealt with by the LBC only as their tax implications require specialised skills. If these individuals are shifted, then the LBC would need to sign service level agreements with other units in SARS. However, SARS is aware that a similar change in the USA was subsequently reversed.

Source: Key informant interviews
tion and health, rural development, and combating corruption and crime (National Treasury, 2009). To these ends, it is imperative for the Government to mobilise greater levels of resources to address its development priorities.

Government has indicated that it will borrow resources as a short-term measure while the economy recovers, and as tax revenue collections rise. By 2012/13, it expects to reduce the fiscal deficit from its current level of 7.6% to 4.2%. This expected reduction implies that SARS must raise gross tax revenue as a percentage of GDP from its projected level in 2009/10 of 24.5% to 26.2% by 2012/13.

**A different approach for dealing with taxpayer segments is needed**

The MTBPS anticipates that SARS will sustain the tax compliance culture that it has cultivated over the years. SARS management recognises it cannot achieve this objective without rationalising the way in which the authority utilises its human resources. Most SARS staff serve middle-level taxpayers who form the bulk of its clientele but contribute much less revenue than large businesses and high net worth individuals. In order to perform better with the same resources, modernising SARS’s systems to minimise processing effort, coupled with ensuring that staff dealing with large taxpayers become increasingly specialised will be critical.

There is also an ongoing review of segmentation arrangements. Specifically, SARS has assessed that it does not have sufficient capacity to run them all. The LBC is already undergoing restructuring (see Box 2.1). The restructuring of other segments will build on existing infrastructure. However, it will be important to bear in mind the different risks associated with each segment (e.g., keeping practitioners honest and ensuring that any exceptions arising with respect to small businesses are dealt with at contact).

**SARS must continue to widen its tax base for the foreseeable future**

In addition to the above, SARS is challenged to bring into the tax net both new taxpayers evolving as a result of economic growth, and actors operating in the informal economy. With respect to the latter group, Friedman (2003), contends that SARS has not been successful in assessing “the ideologies, and institutions which underpin informal activity”, and thereafter devise interventions which could be used to enhance compliance. However, in recent years, it has attempted to engage both groups through education and outreach initiatives, such as the small business amnesty, which was an enormous success. Still, in the medium-term, SARS is challenged to reduce the tax gap by:

- Further expanding its outreach through ‘walkabouts’ to establish unknown economic activities, which are outside the tax net;
- Assessing how SARS can expand its footprint into areas where there are no branches. For example, according to key informants, Soweto has one branch but should probably have five. Such an expansion would offer SARS the opportunity to educate small businesses but may not be economically viable in the short-term;
- Increasing the number of lifestyle audits. A SARS spokesperson recently indicated to the press that “a lifestyle questionnaire is used to obtain infor-
mation about the lifestyle of an identified taxpayer” (Temkin, 2010b). In the same article, a tax practitioner described what lifestyle audits entail:

“SARS may obtain information about nondisclosure of taxable income from various sources, for instance, a disgruntled employee, a recently divorced spouse or media reports that raise suspicion about a taxpayer…”

SARS’s staff capacity must keep abreast with its transformation

SARS is aware that whilst it has made great strides in enhancing staff capacity, more needs to be done to strengthen skills. The leadership management training initiative (see discussion earlier) needs to be rolled out across the organisation. It must also deepen its staff’s business and technical skills, ensuring that they are aligned with the new operating model. In this regard, for example, one of the priority areas of action in 2009/10 was the development and launch of a customs core skills training programme (SARS, 2009a). SARS was also looking at options for recruiting and retaining staff in critical areas with gaps, such as enforcement, customs, strategy and analysis.

There may be trade-offs between administering tax and non-tax revenues

In addition to administering taxes, SARS currently collects UIF contributions and SDLs on an agency basis. It has also undertaken to support the implementation of government’s social security and wage subsidy interventions from 2010. According to the Minister of Finance’s 2010/11 budget speech, the government is considering offering “a cash reimbursement to employers for a two-year period, operating through the SARS payroll tax platform”. Whilst there is clearly advantage in using SARS’s infrastructure and intelligence on compliant taxpayers, this initiative is likely to place an additional burden on the authority.

The increased cases of crime and corruption need to be kept in check

The composition of the tax gap includes revenue foregone as a result of criminal and corrupt activities. On this matter, SARS reports an increase in syndicated crime, particularly in the areas of fraud and corruption. It is also alleged that corrupt officers employed by the Companies and Intellectual Property Registration Office may have been part of a syndicate, which registered non-existent companies with the intention of defrauding SARS of VAT revenue23. In addition, key informants indicated to us that syndicated crime has extended to the banking system – specifically by using bank accounts and cheques to defraud SARS.

There are challenges around regional trade integration

The SACU arrangement has been in place since 1910 when the Republic of South Africa was formed. South Africa and the BLNS countries, which form SACU, have agreed fixed common external tariffs (CETs). The formula for sharing customs receipts is as follows: the customs duty pool is shared on the basis of intra-SACU imports; and the excise duty pool is split two ways – 85% on the basis of GDP, and the remaining 15% on developmental indicators (e.g., life expectancy and literacy). Edwards et al (2009) argue that current revenue sharing arrangements could encourage countries to overstate SACU intra-trade statistics. Furthermore, the same authors consider that “the formula has perpetuated a depen-

dency on customs revenue as a source of government revenue in many BLNS economies”.

There is ongoing dialogue around expanding this customs union arrangement to the 14 SADC countries, which are all signatories to a free trade agreement. However, there are issues around rules of origin, leading to a lot of paperwork. Also, Edwards et al (2009) suggest that some BLNS countries may be unwilling to further reduce CETs and/or admit new members to a customs union as these measures would imply a reduction in customs revenue. South Africa is challenged to lead in addressing these issues.
Lessons learned

There are considerable lessons to be learned from South Africa’s experience around the trends in the tax system, Siyakha, revenue performance and even the challenges it faces going forward. However, in this section we have selected what we consider to be the six most profound lessons to be considered for inclusion in the EAC policy note.

The strong collaboration between SARS and the National Treasury has been instrumental to revenue mobilisation

SARS and the National Treasury collaborate effectively at several levels. Since 2009, the Treasury, in partnership with SARS, has initiated the production of very comprehensive tax statistics. SARS also participates in a committee chaired by the Treasury, which sets revenue targets. There is even closer collaboration on a daily basis. SARS advises the Treasury on a daily basis of any likely changes to cash collections. If there is a collection shortfall, this notification allows the Treasury to borrow funds on a short-term basis to finance public expenditure.

By all accounts, the National Treasury seems in constant touch with SARS’s plans, operations and performance. A close working relationship is evident in annual reports and strategic plans produced by SARS, which contain insightful messages from the Minister of Finance, that, for example, reinforce the linkage between government’s development agenda and revenue performance. In the Minister’s budget speeches, there is always mention of the results and impact of SARS’s administrative reforms. It is also laudable that on the first day following the fiscal year end (31 March), as a result of excellent planning and coordination as well as unyielding commitment, SARS staff are able to provide the Minister with preliminary revenue results for the year that has just ended. The Minister announces the results to the press on the same day.

Solid policy formulation and evaluation capacity is also key to strong revenue performance

The Government of South Africa has strong tax policy capacity within SARS and the National Treasury. Until three or so years ago, SARS was extensively involved in tax policy development and drafting of legislation. Since then, the National Treasury has developed its own capacity in this area. Nevertheless, in recognition of its expertise, the Treasury welcomes SARS’s views on the: extent of fit of new tax policy proposals with the prevailing tax structure, and implications of trade policies and agreements for customs. Key informants indicate that when the two institutions deliberate on tax policy proposals, there is a ‘healthy tension’.

It appears that the arrangements above have borne fruit. Government’s post-liberation tax policies have achieved their intended aims. Furthermore, the government has not buckled at any time to reverse any tax policies in the face of resistance from strong lobby groups. Rather, it has been accommodating of national and global economic developments. Thus, for example, the small business amnesty had been extended to April 2010, and the Mining Royalties Act of 2008 will not be enforced until 2010/11.
Compacts with professional and industry groups can reinforce compliance and facilitate administrative efficiency and effectiveness

SARS has entered into a unique accord with the banks in South Africa. Under the accord, it has committed to provide quality services to the banks, and in turn the banks have committed to promoting tax compliance, and in particular, discourage tax avoidance among their customers. This kind of compact can definitely be extended to other industries and professional groups. The results of SARS’s initiative should be closely watched for possible replication by other ARAs.

Minimising the level of exemptions ensures tax policies remain neutral

The government grants tax exemptions on an extremely exceptional basis. Only a few public benefit and public sector organisations are eligible for exemptions, and these are legislated and not discretionary. Also tax incentives offered in IDZs are designed to have limited implications for tax expenditure (see earlier discussion).

Modernising through the use of ICT can result in significant operational efficiencies but must be applied judiciously

This paper has highlighted SARS’s accomplishments in the application of ICT. In particular, SARS has used ICT to simplify its operating environment and enhance business intelligence (e.g., through the use of third party information and risk engines), enabling it to reduce transaction and compliance costs, and focus more on high risk taxpayer segments. Yet, there are some discernible lessons of experience for other revenue authorities embarking on the modernisation journey as follows:

• It is invaluable to have a ‘single view of the taxpayer’, and therefore, integrating core tax systems is critical – this practice was not observed by SARS at inception, but measures are underway towards this goal. Integrated systems also assist in enhancing data quality;
Systems usage by eFilers is not even throughout the year. It peaks towards the end of the filing season. This uneven usage can have significant cost implications. In this regard, SARS is considering offering taxpayers discounts for filing within prescribed periods – as in the UK;

The tax environment is complex and therefore change must be gradual. Table 17 in Annex 2.3 shows the number of registered CIT, PIT and VAT taxpayers. In addition, customs deals with an even higher volume of transactions. For example, SARS indicates that in a year there are: 1.7 million import transactions; 1.8 million SACU movements; almost 1 million export transactions; and 14 million passengers passing through customs;

Systems need to be kept secure on an ongoing basis. In this respect, SARS is continuously strengthening its security. It is subject to two phishing attempts a week. This statistic should not come as a surprise considering the magnitude of SARS’s revenue collections, and the fact that the bulk of taxpayer payments are effected electronically;

Once systems are fully functional, maximising the use of information generated is critical. In this respect, SARS works on using the information available from its modern ICT systems more effectively by continuously questioning what it should be measuring. This quest is expected to drive up revenue collection;

There is need to accommodate taxpayers who, for whatever reasons, cannot access electronic services. It should be kept in mind that very few Africans have access to Internet, and hence use of ICT must be applied judiciously in tax administration.

Good client service is critical for promoting voluntary compliance

One key informant aptly described SARS’s overall strategy around services delivery as to ensure that ‘people pay taxes with a smile’. SARS’s approach has therefore been to resist intimidating taxpayers. Instead, considerable effort has gone into enhancing its three product offerings – call centres, walk-in centres and eFiling. In addition, as part of its taxpayer education (TPE) service, SARS puts in a lot of effort during the filing season in assisting taxpayers to complete their tax returns. According to key informants that we interviewed, in 2009, SARS served up to 56,000 taxpayers a day. This latter part of SARS’s TPE service offering is unique on the African continent. And so is TPE’s:

Points of service intervention for which SARS employs a two-pronged approach. First, SARS partners with shopping malls who provide space and internet access to enable it to provide services to individual taxpayers. Second, SARS provides the same service in collaboration with other government departments via ‘Thusong’ (one-stop) centres;

Outreach service. TPE vets applications for VAT registration by physically inspecting applicants’ places of business. It passes suspect cases to the enforcement and compliance risk unit for further investigation.

A policy of zero tolerance to corruption is an important deterrent

On 1 April 2007, SARS established an Anti-Corruption and Security (ACAS) Unit. Its mandate is to detect and investigate: taxpayers who are registered but do not make full or submit fraudulent declarations; and
employees who steal from taxpayers. The Unit’s work is informed by SARS’s risk engine, which provides information on taxpayers: who are generally compliant (and therefore low risk); and those who are non-compliant (and therefore high risk).

The ACAS has developed a model to support its efforts to curb corruption and ensure security covering: prevention; detection; and investigation. It is worth noting that as part of its:

• Prevention intervention, the unit has developed standards to safeguard physical and information access. Furthermore, all SARS personnel must be vetted prior to their confirmation of employment, and are also required to declare their interests on an annual basis;

• Detection activities, the unit works closely with the police, banks, and the intelligence service. The unit maintains a register of incidences, which list the type of crime and whether it is limited, medium or serious;

• Investigation activities, the unit pre-investigates each reported incidence to establish its validity. If an allegation is valid, the unit fully investigates the case, which could result in a staff dismissal and/or the criminal prosecution of a taxpayer/staff. SARS employs prosecutors who compile case evidence for submission to the National Prosecution Service and South African Police. SARS also makes every effort to recover lost revenue.

The work of the unit is also informed by research and analysis activities, which pinpoint: the most prevalent crimes; and thematic/systemic problem areas to address. As syndicated operations continue to become more complex with time, SARS also uses the results of research and analysis to fine-tune its policies, procedures and systems.
Annex 2.1: Key informants

Aidan Keanly (Mr), South African Revenue Service
Alfred Cuevas (Mr) – Senior Resident Representative, International Monetary Fund
Andrew Fisher (Mr), Group Executive – Segmentation, South African Revenue Service
Brandley Ngcobo (Mr), Senior Manager Capacity Development, South African Revenue Service
Clifford Collings (Mr), Head of Anti-Corruption and Security, South African Revenue Service
Deprose Muchena (Mr), Economic Justice Programme Manager, Open Society Initiative for Southern Africa
Erich Kieck (Mr), Group Executive - Customs Policy and Strategy, South African Revenue Service
Frank Strake (Mr), Manager - Taxpayer Services (Services), South African Revenue Service
Franz Tomasek (Mr), Group Executive, Legal Research and Development, South African Revenue Service
Godfrey Modise (Mr), Manager - Taxpayer Services (Services), South African Revenue Service
Hannelie Schoeman (Ms), Remuneration (Human Resources), South African Revenue Service
Hope Selana (Ms), Self-employed
John Roberts (Captain), Marine Superintendent/Barge Move Master
Joseph Rock (Mr), Group Executive: Large Business Centre, Technical Enablement, South African Revenue Service
Keith Brebnor (Mr), Chief Executive Officer, Chamber of Commerce and Industry – Johannesburg
Lionel Schoeman (Mr), Project Management Office (IDZs), South African Revenue Service
Logan Wort (Mr), Group Executive – Reputation Management, South African Revenue Service
Mike Jarvis (Mr), Head of Architecture Division – Modernisation and Technology, South African Revenue Service
Nancy Dubosse (Dr), Head of Research – Economic Governance Programme, Idasa
Randall Carolissen (Dr), Group Executive: Revenue Analysis, Planning and Reporting, South African Revenue Service
Saki Macozoma (Mr), Chairman, Business Leadership South Africa
Sandeep Mahajan (Mr), Lead Economist and Cluster Leader – Poverty Reduction and Economic Management, World Bank
Sekgobela Mi Conty (Mr), Employee in the service sector
Sobantu Ndlangalavu (Mr), Manager – Taxpayer Services (Education), South African Revenue Service
Varsha Singh (Ms), Senior Manager International Relations, South African Revenue Service
Victor Masola (Mr), Executive - Enforcement Legal (Enforcement), South African Revenue Service
Yotam Longwe (Mr), Divisional Executive: International Finance Cluster, Development Bank of South Africa
Annex 2.2: Bibliography


Bolnik, B. (2004); Effectiveness and Economic Impact of Tax Incentives in the SADC Region, Technical report submitted to USAID contract no. PCE-1-00-98-0016-00.


Friedman, S. (2003); Sending them a Message: Culture, Tax Collection and Governance in South Africa Policy: Issues and Actors 16(3).


Mathews, C. (2010); Industrial Development Zones Continue to Attract Investors Business Day 18/02/2010, p.4


OECD (2009b); Building Transparent Tax Compliance by Banks. OECD, 2009.


Temkin, S. (2010a); Information the Currency of Tax Collection Business Day 28/04/10, [online].

Temkin, S. (2010b); Long Arm of the SARS Lifestyle Audit Business Day 01/03/10, [online].

The Economist (2006); Chasing the Rainbow: A Survey of South Africa The Economist 08/04/2006, p.1-10

The Economist (2010a); Corruption in South Africa: Stop that Virus The Economist 06/02/2010, p.41.

The Economist (2010b); South Africa’s Economy: Steady As She Goes The Economist 27/02/10, p.41.


Annex 2.3: Selected indicators

Table 1: An analysis of sector contributions to production

<table>
<thead>
<tr>
<th>Sector</th>
<th>Ratio to nominal GDP (%)</th>
<th>Average annual real change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>4.8</td>
<td>4.6</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>12.7</td>
<td>7.3</td>
</tr>
<tr>
<td><strong>Secondary sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>23.0</td>
<td>20.9</td>
</tr>
<tr>
<td>Electricity, gas and water</td>
<td>3.7</td>
<td>3.6</td>
</tr>
<tr>
<td>Construction (contractors)</td>
<td>3.7</td>
<td>3.1</td>
</tr>
<tr>
<td><strong>Tertiary sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale and retail trade, catering and accommodation</td>
<td>11.6</td>
<td>14.2</td>
</tr>
<tr>
<td>Transport, storage and communication</td>
<td>9.0</td>
<td>8.7</td>
</tr>
<tr>
<td>Financial intermediation, insurance, real estate and business services</td>
<td>13.1</td>
<td>16.0</td>
</tr>
<tr>
<td>Community, social and personal services</td>
<td>18.3</td>
<td>21.5</td>
</tr>
<tr>
<td>GDP at basic prices</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: South African Reserve Bank and Du Plessis and Smit (2007)

Table 2: Tax policy – Maximum marginal tax rates (1994/95 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>PIT</th>
<th>CIT</th>
<th>STC</th>
<th>VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994/95</td>
<td>-</td>
<td>35%</td>
<td>-</td>
<td>14%</td>
</tr>
<tr>
<td>1995/96</td>
<td>-</td>
<td>35%</td>
<td>-</td>
<td>14%</td>
</tr>
<tr>
<td>1996/97</td>
<td>-</td>
<td>35%</td>
<td>-</td>
<td>14%</td>
</tr>
<tr>
<td>1997/98</td>
<td>-</td>
<td>35%</td>
<td>-</td>
<td>14%</td>
</tr>
<tr>
<td>1998/99</td>
<td>-</td>
<td>35%</td>
<td>-</td>
<td>14%</td>
</tr>
<tr>
<td>1999/00</td>
<td>45%</td>
<td>30%</td>
<td>-</td>
<td>14%</td>
</tr>
<tr>
<td>2000/01</td>
<td>45%</td>
<td>30%</td>
<td>-</td>
<td>14%</td>
</tr>
<tr>
<td>2001/02</td>
<td>42%</td>
<td>30%</td>
<td>-</td>
<td>14%</td>
</tr>
<tr>
<td>2002/03</td>
<td>40%</td>
<td>30%</td>
<td>12.5%</td>
<td>14%</td>
</tr>
<tr>
<td>2003/04</td>
<td>40%</td>
<td>30%</td>
<td>12.5%</td>
<td>14%</td>
</tr>
<tr>
<td>2004/05</td>
<td>40%</td>
<td>30%</td>
<td>12.5%</td>
<td>14%</td>
</tr>
<tr>
<td>2005/06</td>
<td>40%</td>
<td>30%</td>
<td>12.5%</td>
<td>14%</td>
</tr>
<tr>
<td>2006/07</td>
<td>40%</td>
<td>30%</td>
<td>12.5%</td>
<td>14%</td>
</tr>
<tr>
<td>2007/08</td>
<td>40%</td>
<td>30%</td>
<td>10%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Source: Republic of South Africa (2008)
Table 3: Tax administration costs (1998/99 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Operating cost (R million)</th>
<th>Operating cost as a % of tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998/99</td>
<td>1,663.2</td>
<td>0.90%</td>
</tr>
<tr>
<td>1999/00</td>
<td>1,906.3</td>
<td>0.95%</td>
</tr>
<tr>
<td>2000/01</td>
<td>1,922.5</td>
<td>0.87%</td>
</tr>
<tr>
<td>2001/02</td>
<td>2,332.6</td>
<td>0.92%</td>
</tr>
<tr>
<td>2002/03</td>
<td>2,878.5</td>
<td>1.02%</td>
</tr>
<tr>
<td>2003/04</td>
<td>3,562.8</td>
<td>1.18%</td>
</tr>
<tr>
<td>2004/05</td>
<td>4,311.7</td>
<td>1.21%</td>
</tr>
<tr>
<td>2005/06</td>
<td>5,135.5</td>
<td>1.23%</td>
</tr>
<tr>
<td>2006/07</td>
<td>5,156.1</td>
<td>1.04%</td>
</tr>
<tr>
<td>2007/08</td>
<td>5,607.9</td>
<td>0.98%</td>
</tr>
</tbody>
</table>

Source: Republic of South Africa (2008)

Table 4: Ratio of tax staff per population (TAXSTAFF)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>South Africa’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Upper income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXSTAFF</td>
<td>0.30</td>
<td>0.82</td>
<td>0.37</td>
<td>0.88</td>
</tr>
</tbody>
</table>


64
### Table 5: National government revenue, debt and deficit as a percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
<th>Debt</th>
<th>Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>20.2%</td>
<td>35.9%</td>
<td>-3.1%</td>
</tr>
<tr>
<td>1981</td>
<td>21.2%</td>
<td>30.4%</td>
<td>-0.1%</td>
</tr>
<tr>
<td>1982</td>
<td>20.2%</td>
<td>29.6%</td>
<td>-2.1%</td>
</tr>
<tr>
<td>1983</td>
<td>21.2%</td>
<td>30.9%</td>
<td>-2.2%</td>
</tr>
<tr>
<td>1984</td>
<td>20.5%</td>
<td>30.8%</td>
<td>-3.2%</td>
</tr>
<tr>
<td>1985</td>
<td>21.5%</td>
<td>32.4%</td>
<td>-3.3%</td>
</tr>
<tr>
<td>1986</td>
<td>23.8%</td>
<td>31.6%</td>
<td>-2.3%</td>
</tr>
<tr>
<td>1987</td>
<td>22.5%</td>
<td>32.3%</td>
<td>-4.4%</td>
</tr>
<tr>
<td>1988</td>
<td>22.2%</td>
<td>33.0%</td>
<td>-5.0%</td>
</tr>
<tr>
<td>1989</td>
<td>23.5%</td>
<td>36.4%</td>
<td>-3.5%</td>
</tr>
<tr>
<td>1990</td>
<td>25.1%</td>
<td>36.8%</td>
<td>-1.4%</td>
</tr>
<tr>
<td>1991</td>
<td>24.0%</td>
<td>35.3%</td>
<td>-1.9%</td>
</tr>
<tr>
<td>1992</td>
<td>22.6%</td>
<td>36.8%</td>
<td>-3.7%</td>
</tr>
<tr>
<td>1993</td>
<td>21.7%</td>
<td>40.4%</td>
<td>-7.3%</td>
</tr>
<tr>
<td>1994</td>
<td>21.9%</td>
<td>43.5%</td>
<td>-5.6%</td>
</tr>
<tr>
<td>1995</td>
<td>22.5%</td>
<td>49.1%</td>
<td>-4.6%</td>
</tr>
<tr>
<td>1996</td>
<td>22.5%</td>
<td>49.5%</td>
<td>-5.1%</td>
</tr>
<tr>
<td>1997</td>
<td>23.0%</td>
<td>48.9%</td>
<td>-5.0%</td>
</tr>
<tr>
<td>1998</td>
<td>23.4%</td>
<td>48.0%</td>
<td>-3.7%</td>
</tr>
<tr>
<td>1999</td>
<td>24.2%</td>
<td>49.9%</td>
<td>-2.8%</td>
</tr>
<tr>
<td>2000</td>
<td>23.7%</td>
<td>46.6%</td>
<td>-2.1%</td>
</tr>
<tr>
<td>2001</td>
<td>22.7%</td>
<td>43.9%</td>
<td>-1.9%</td>
</tr>
<tr>
<td>2002</td>
<td>23.7%</td>
<td>43.9%</td>
<td>-1.4%</td>
</tr>
<tr>
<td>2003</td>
<td>23.2%</td>
<td>38.5%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>2004</td>
<td>22.9%</td>
<td>36.3%</td>
<td>-2.3%</td>
</tr>
<tr>
<td>2005</td>
<td>24.0%</td>
<td>35.0%</td>
<td>-1.5%</td>
</tr>
<tr>
<td>2006</td>
<td>25.5%</td>
<td>32.6%</td>
<td>-0.3%</td>
</tr>
<tr>
<td>2007</td>
<td>26.3%</td>
<td>28.6%</td>
<td>0.7%</td>
</tr>
<tr>
<td>2008</td>
<td>26.9%</td>
<td>24.0%</td>
<td>0.9%</td>
</tr>
<tr>
<td>2009</td>
<td>20.2%</td>
<td>22.4%</td>
<td>-1.2%</td>
</tr>
</tbody>
</table>

*Source: South African Reserve Bank*
### Table 6: Total budgeted tax and non-tax revenue as a percentage of GDP gross of SACU payments (1994/95 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Tax revenue</th>
<th>Non-tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994/95</td>
<td>22.9%</td>
<td>0.4%</td>
</tr>
<tr>
<td>1995/96</td>
<td>22.6%</td>
<td>0.5%</td>
</tr>
<tr>
<td>1996/97</td>
<td>23.2%</td>
<td>0.6%</td>
</tr>
<tr>
<td>1997/98</td>
<td>23.6%</td>
<td>0.5%</td>
</tr>
<tr>
<td>1998/99</td>
<td>24.4%</td>
<td>0.6%</td>
</tr>
<tr>
<td>1999/00</td>
<td>24.1%</td>
<td>0.5%</td>
</tr>
<tr>
<td>2000/01</td>
<td>23.2%</td>
<td>0.4%</td>
</tr>
<tr>
<td>2001/02</td>
<td>24.1%</td>
<td>0.4%</td>
</tr>
<tr>
<td>2002/03</td>
<td>23.5%</td>
<td>0.4%</td>
</tr>
<tr>
<td>2003/04</td>
<td>23.5%</td>
<td>0.5%</td>
</tr>
<tr>
<td>2004/05</td>
<td>24.9%</td>
<td>0.4%</td>
</tr>
<tr>
<td>2005/06</td>
<td>26.3%</td>
<td>0.5%</td>
</tr>
<tr>
<td>2006/07</td>
<td>27.4%</td>
<td>0.6%</td>
</tr>
<tr>
<td>2007/08</td>
<td>27.8%</td>
<td>0.6%</td>
</tr>
</tbody>
</table>

**Source:** Republic of South Africa (2008)

### Table 7: Tax revenue collected at national, provincial and local government level as a percentage of GDP (2002/03 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>National</th>
<th>Provinces</th>
<th>Local government</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002/03</td>
<td>23.5%</td>
<td>0.2%</td>
<td>1.4%</td>
</tr>
<tr>
<td>2003/04</td>
<td>23.5%</td>
<td>0.3%</td>
<td>1.5%</td>
</tr>
<tr>
<td>2004/05</td>
<td>24.9%</td>
<td>0.2%</td>
<td>1.6%</td>
</tr>
<tr>
<td>2005/06</td>
<td>26.3%</td>
<td>0.3%</td>
<td>1.6%</td>
</tr>
<tr>
<td>2006/07</td>
<td>27.4%</td>
<td>0.3%</td>
<td>1.0%</td>
</tr>
<tr>
<td>2007/08</td>
<td>27.8%</td>
<td>0.2%</td>
<td>1.0%</td>
</tr>
</tbody>
</table>

**Source:** Republic of South Africa (2008)

### Table 8: Breakdown of provincial and local government tax revenues (2002/03 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Provinces</th>
<th>Local government</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Casino taxes</td>
<td>Hose racing licenses</td>
</tr>
<tr>
<td>2002/03</td>
<td>19.2%</td>
<td>3.7%</td>
</tr>
<tr>
<td>2003/04</td>
<td>19.7%</td>
<td>3.1%</td>
</tr>
<tr>
<td>2004/05</td>
<td>20.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>2005/06</td>
<td>20.8%</td>
<td>2.2%</td>
</tr>
<tr>
<td>2006/07</td>
<td>22.1%</td>
<td>2.6%</td>
</tr>
<tr>
<td>2007/08</td>
<td>22.5%</td>
<td>2.4%</td>
</tr>
</tbody>
</table>

**Source:** Republic of South Africa (2008)

---

24 Budget figures
Table 9: Composition of national government tax revenues (1994/95 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>PIT</th>
<th>CIT</th>
<th>STC</th>
<th>VAT</th>
<th>Fuel levy</th>
<th>Customs</th>
<th>Excise duties</th>
<th>Other</th>
<th>Total tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994/95</td>
<td>39.50%</td>
<td>10.5%</td>
<td>1.1%</td>
<td>25.7%</td>
<td>7.3%</td>
<td>4.9%</td>
<td>4.8%</td>
<td>6.0%</td>
<td>100%</td>
</tr>
<tr>
<td>1995/96</td>
<td>40.20%</td>
<td>11.0%</td>
<td>1.0%</td>
<td>25.7%</td>
<td>7.0%</td>
<td>4.8%</td>
<td>4.8%</td>
<td>5.4%</td>
<td>100%</td>
</tr>
<tr>
<td>1996/97</td>
<td>40.40%</td>
<td>11.5%</td>
<td>0.9%</td>
<td>24.4%</td>
<td>7.1%</td>
<td>4.9%</td>
<td>4.0%</td>
<td>6.8%</td>
<td>100%</td>
</tr>
<tr>
<td>1997/98</td>
<td>41.30%</td>
<td>11.9%</td>
<td>0.9%</td>
<td>24.3%</td>
<td>7.3%</td>
<td>3.4%</td>
<td>4.5%</td>
<td>6.4%</td>
<td>100%</td>
</tr>
<tr>
<td>1998/99</td>
<td>42.10%</td>
<td>11.0%</td>
<td>1.0%</td>
<td>23.8%</td>
<td>7.4%</td>
<td>3.3%</td>
<td>4.4%</td>
<td>7.1%</td>
<td>100%</td>
</tr>
<tr>
<td>1999/00</td>
<td>42.60%</td>
<td>10.4%</td>
<td>1.6%</td>
<td>24.0%</td>
<td>7.1%</td>
<td>3.4%</td>
<td>4.4%</td>
<td>6.5%</td>
<td>100%</td>
</tr>
<tr>
<td>2000/01</td>
<td>39.20%</td>
<td>13.4%</td>
<td>1.8%</td>
<td>24.7%</td>
<td>6.6%</td>
<td>3.7%</td>
<td>4.1%</td>
<td>6.4%</td>
<td>100%</td>
</tr>
<tr>
<td>2001/02</td>
<td>35.80%</td>
<td>16.8%</td>
<td>2.8%</td>
<td>24.2%</td>
<td>5.9%</td>
<td>3.4%</td>
<td>3.9%</td>
<td>7.1%</td>
<td>100%</td>
</tr>
<tr>
<td>2002/03</td>
<td>33.40%</td>
<td>19.8%</td>
<td>2.2%</td>
<td>24.9%</td>
<td>5.4%</td>
<td>3.4%</td>
<td>3.7%</td>
<td>7.2%</td>
<td>100%</td>
</tr>
<tr>
<td>2003/04</td>
<td>32.60%</td>
<td>20.1%</td>
<td>2.0%</td>
<td>26.7%</td>
<td>5.5%</td>
<td>2.8%</td>
<td>3.8%</td>
<td>6.6%</td>
<td>100%</td>
</tr>
<tr>
<td>2004/05</td>
<td>31.30%</td>
<td>19.9%</td>
<td>2.1%</td>
<td>27.7%</td>
<td>5.4%</td>
<td>3.7%</td>
<td>3.7%</td>
<td>6.2%</td>
<td>100%</td>
</tr>
<tr>
<td>2005/06</td>
<td>30.10%</td>
<td>20.6%</td>
<td>2.9%</td>
<td>27.4%</td>
<td>4.9%</td>
<td>4.4%</td>
<td>3.5%</td>
<td>6.1%</td>
<td>100%</td>
</tr>
<tr>
<td>2006/07</td>
<td>28.40%</td>
<td>24.0%</td>
<td>3.1%</td>
<td>27.1%</td>
<td>4.4%</td>
<td>4.8%</td>
<td>3.3%</td>
<td>4.8%</td>
<td>100%</td>
</tr>
<tr>
<td>2007/08</td>
<td>29.50%</td>
<td>24.5%</td>
<td>3.6%</td>
<td>26.3%</td>
<td>4.1%</td>
<td>4.7%</td>
<td>3.2%</td>
<td>4.2%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Republic of South Africa (2008)

Table 10: Analysis of tax arrears (2002/03 to 2007/08)

<table>
<thead>
<tr>
<th>Item</th>
<th>Fiscal year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002/03</td>
</tr>
<tr>
<td>Due debt (R billion)</td>
<td>56.0</td>
</tr>
<tr>
<td>Total tax revenue (R billion)</td>
<td>282.2</td>
</tr>
<tr>
<td>Debt revenue (%)</td>
<td>19.8%</td>
</tr>
</tbody>
</table>


Table 11: CIT and PIT revenue productivity and VAT gross compliance ratio (2008/09)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>South Africa’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Upper income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>CITPROD</td>
<td>0.27</td>
<td>0.13</td>
<td>0.09</td>
<td>0.15</td>
</tr>
<tr>
<td>PITPROD</td>
<td>0.22</td>
<td>0.14</td>
<td>0.08</td>
<td>0.14</td>
</tr>
<tr>
<td>VATGCR</td>
<td>86.90</td>
<td>65.48</td>
<td>42.3</td>
<td>70.82</td>
</tr>
</tbody>
</table>

Table 12: Analysis of PIT and CIT burden – Tax assessed as a percentage of taxable income (2002/03 to 2005/06)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>PIT assessed as a % of taxable income</th>
<th>CIT assessed as a % of taxable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002/03</td>
<td>23.8%</td>
<td>30.2%</td>
</tr>
<tr>
<td>2003/04</td>
<td>21.7%</td>
<td>30.1%</td>
</tr>
<tr>
<td>2004/05</td>
<td>21.7%</td>
<td>29.9%</td>
</tr>
<tr>
<td>2005/06</td>
<td>20.7%</td>
<td>28.8%</td>
</tr>
</tbody>
</table>

Source: Republic of South Africa (2008)

Table 13: Personal Income Tax (PIT) brackets, 2002/03 and 2008/09

<table>
<thead>
<tr>
<th>Segment</th>
<th>Number registered</th>
<th>CIT</th>
<th>VAT</th>
<th>PAYE</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large businesses</td>
<td>21,561</td>
<td>79%</td>
<td>4%</td>
<td>43%</td>
<td>31%</td>
</tr>
<tr>
<td>Medium businesses</td>
<td>42,286</td>
<td>12%</td>
<td>57%</td>
<td>26%</td>
<td>22%</td>
</tr>
<tr>
<td>Micro to small businesses</td>
<td>2,347,341</td>
<td>9%</td>
<td>36%</td>
<td>16%</td>
<td>15%</td>
</tr>
<tr>
<td>Complex individuals</td>
<td>2,750,000</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>18%</td>
</tr>
<tr>
<td>Standard individuals</td>
<td>2,900,000</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>9%</td>
</tr>
<tr>
<td>SITE</td>
<td>5,600,000</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td>NGOs, PBOs, Embassies and Government departments</td>
<td>27,568</td>
<td>0%</td>
<td>3%</td>
<td>15%</td>
<td>4%</td>
</tr>
<tr>
<td>Total</td>
<td>13,688,756</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: SARS (2009b)
Table 15: World Bank Doing Business indicators on the tax burden (South Africa only)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Year</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa’s global ranking</td>
<td>-</td>
<td>23</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>11</td>
<td>9</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>350</td>
<td>200</td>
<td>200</td>
<td></td>
</tr>
</tbody>
</table>


Table 16: World Bank Doing Business indicators (2010) on the tax burden (South Africa vis-à-vis the OECD and SSA)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Region</th>
<th>South Africa</th>
<th>OECD</th>
<th>SSA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of tax payments a year</td>
<td></td>
<td>9</td>
<td>12.8</td>
<td>37.7</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td></td>
<td>200</td>
<td>194.1</td>
<td>306.0</td>
</tr>
<tr>
<td>Total tax rate as % of profit</td>
<td></td>
<td>30.2%</td>
<td>44.5%</td>
<td>67.5%</td>
</tr>
</tbody>
</table>


Table 17: Growth of registered taxpayers

<table>
<thead>
<tr>
<th>Registered as</th>
<th>Total Number Registered for Tax</th>
<th>Percentage increase (1998/99 to 2007/08)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individuals</td>
<td>2,485,703</td>
<td>3,415,432</td>
</tr>
<tr>
<td>Companies</td>
<td>777,864</td>
<td>814,894</td>
</tr>
<tr>
<td>Trusts</td>
<td>-</td>
<td>254,593</td>
</tr>
</tbody>
</table>

Source: Smith (2003) and Republic of South Africa (2008)
Table 18: Tax gap and tax effort for select EAC countries and South Africa (select years)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Tax revenue (A)</th>
<th>Estimated potential tax revenue (B)</th>
<th>Tax gap (B) – (A)</th>
<th>Tax effort (A)/(B) as a %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>As a % of GDP</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kenya</td>
<td>2001</td>
<td>17.8</td>
<td>20.8</td>
<td>3.0</td>
<td>85.5</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>18.6</td>
<td>20.6</td>
<td>2.0</td>
<td>90.5</td>
</tr>
<tr>
<td>South Africa</td>
<td>2001</td>
<td>24.8</td>
<td>26.7</td>
<td>1.9</td>
<td>92.9</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>27.4</td>
<td>27.0</td>
<td>-0.4</td>
<td>101.4</td>
</tr>
<tr>
<td>Rwanda</td>
<td>2001</td>
<td>10.7</td>
<td>20.9</td>
<td>10.2</td>
<td>91.2</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>12.2</td>
<td>21.4</td>
<td>9.9</td>
<td>57.0</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>13.5</td>
<td>22.0</td>
<td>8.5</td>
<td>61.4</td>
</tr>
<tr>
<td>Tanzania</td>
<td>2001</td>
<td>9.7</td>
<td>20.0</td>
<td>10.3</td>
<td>48.5</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.2</td>
<td>20.5</td>
<td>9.3</td>
<td>54.4</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>15.0</td>
<td>20.9</td>
<td>5.9</td>
<td>71.6</td>
</tr>
<tr>
<td>Uganda</td>
<td>2001</td>
<td>10.4</td>
<td>19.2</td>
<td>8.8</td>
<td>54.3</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.8</td>
<td>19.5</td>
<td>7.8</td>
<td>60.3</td>
</tr>
</tbody>
</table>

Source: IMF (2009b)

Table 19: Aggregate municipal operating revenue in South Africa, 2005/06 to 2009/10

<table>
<thead>
<tr>
<th>Operating Revenue (R Million)</th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09</th>
<th>2009/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property rates</td>
<td>17,401</td>
<td>18,521</td>
<td>21,486</td>
<td>22,770</td>
<td>24,136</td>
</tr>
<tr>
<td>Service charges</td>
<td>40,201</td>
<td>44,498</td>
<td>49,223</td>
<td>51,549</td>
<td>54,777</td>
</tr>
<tr>
<td>Regional Service Levies</td>
<td>7,604</td>
<td>386</td>
<td>95</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Investment revenue</td>
<td>2,357</td>
<td>2,970</td>
<td>3,845</td>
<td>3,818</td>
<td>4,133</td>
</tr>
<tr>
<td>Government grants</td>
<td>17,398</td>
<td>27,223</td>
<td>26,571</td>
<td>28,311</td>
<td>28,491</td>
</tr>
<tr>
<td>Public contributions</td>
<td>664</td>
<td>695</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other own revenue</td>
<td>10,375</td>
<td>11,763</td>
<td>17,184</td>
<td>16,260</td>
<td>16,167</td>
</tr>
<tr>
<td>Total revenue</td>
<td>96,000</td>
<td>106,056</td>
<td>118,404</td>
<td>122,710</td>
<td>127,704</td>
</tr>
</tbody>
</table>

Percentage of total revenue

| Property rates                | 18.1%   | 17.5%   | 18.1%   | 18.6%   | 18.9%   |
| Service charges               | 41.9%   | 42.0%   | 41.6%   | 42.0%   | 42.9%   |
| Regional Service Council (RSC) Levies | 7.9% | 0.4%    | 0.1%    | 0.0%    | 0.0%    |
| Investment revenue            | 2.5%    | 2.8%    | 3.2%    | 3.1%    | 3.2%    |
| Government grants             | 18.1%   | 25.7%   | 22.4%   | 23.1%   | 22.3%   |
| Public contributions          | 0.7%    | 0.7%    | 0.0%    | 0.0%    | 0.0%    |
| Other own revenue             | 10.8%   | 11.1%   | 14.5%   | 13.3%   | 12.7%   |
| Total revenue                 | 100.0%  | 100.0%  | 100.0%  | 100.0%  | 100.0%  |

Note: RSC levies abolished on 1 July 2006. Interim replacement grant included in Equitable share. Figures for 2006/07 reflect Budget Estimates; figures for subsequent years reflect medium-term estimates.

Source: National Treasury local government database / Local Government Budgets and Expenditure Review 2008 (Table 3.2).
Table 20: Balanced scorecard performance measures

<table>
<thead>
<tr>
<th>Strategic objective</th>
<th>Performance indicator</th>
<th>Target</th>
<th>Actual results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2006/07</td>
<td>2007/08</td>
</tr>
<tr>
<td>Optimizing compliance &amp; managing risk</td>
<td>Revenue collections</td>
<td>Budget</td>
<td>Exceeded</td>
</tr>
<tr>
<td></td>
<td>Administrative cost as a % of total revenue</td>
<td>1.06%</td>
<td>1.04%</td>
</tr>
<tr>
<td></td>
<td>Due debt as a % of total revenue</td>
<td>14%</td>
<td>12.6%</td>
</tr>
<tr>
<td>Ensuring a better taxpayer &amp; trader experience</td>
<td>% achievement against service charter</td>
<td>85%</td>
<td>94%</td>
</tr>
<tr>
<td></td>
<td>Call center—80% of calls answered in 20 seconds</td>
<td>80%</td>
<td>71%</td>
</tr>
<tr>
<td></td>
<td>Branch office walk ins- attend 95% in 15 mins, 90% (peak)</td>
<td>Off peak - 95% Peak - 90%</td>
<td>Off peak – 96.5% (March – June) Peak – 93.9% (July – February)</td>
</tr>
<tr>
<td></td>
<td>Correspondence—respond to 80% within 21 working days</td>
<td>80%</td>
<td>80%</td>
</tr>
<tr>
<td>Improving enforcement</td>
<td>% overall increase in compliance behavior— increase in active register, decrease in outstanding returns, &amp; decrease in debtors</td>
<td>9%</td>
<td>Increase of 17% in active register Decrease of 8% in Outstanding Return book Decrease of 3.75% in debt book</td>
</tr>
<tr>
<td></td>
<td>Increase ineffective tax rates per selected industry</td>
<td>5%</td>
<td>Not measured</td>
</tr>
<tr>
<td></td>
<td>Due debt collected</td>
<td>R17bn</td>
<td>R17.7bn</td>
</tr>
<tr>
<td></td>
<td>% success in risk based audits</td>
<td>70%</td>
<td>68%</td>
</tr>
<tr>
<td></td>
<td>Audit coverage across all tax types</td>
<td>66,000</td>
<td>69,270</td>
</tr>
<tr>
<td>Continuing staff development &amp; promoting a culture of integrity &amp; professionalism</td>
<td>% compliance with equity plan</td>
<td>100%</td>
<td>90%</td>
</tr>
<tr>
<td></td>
<td>% closure of skills gap</td>
<td>25%</td>
<td>55.4%</td>
</tr>
<tr>
<td></td>
<td>Implement new performance management development system</td>
<td>90%</td>
<td>90%</td>
</tr>
<tr>
<td>Enhancing trade facilitation &amp; border control</td>
<td>Imports 4 hrs – electronic data interchange</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>% success of anti-smuggling activities : SACU</td>
<td>15%</td>
<td>30.3%</td>
</tr>
<tr>
<td></td>
<td>% achievement of passenger examination and success rate: SACU success rate</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>Strategic objective</td>
<td>Performance indicator</td>
<td>Target</td>
<td>Actual results</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Ensuring greater efficiency</td>
<td>% of returns processed within target time: income tax</td>
<td>Non-peak period: 80% within 34 working days (March – June)</td>
<td>Non-Peak period: 34% of returns processed within 48 hours (March – June)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Peak period: 80% within 90 working days (July – February)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>% accuracy of assessments</td>
<td>92%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>91.2%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>% of returns reworked as a result of own error</td>
<td>4%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2.7%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Maintaining success rate in litigation of appeals</td>
<td>65%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>82% (average)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>82%</td>
</tr>
<tr>
<td>Ensuring good governance</td>
<td>% of governance framework implemented across organization</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: SARS annual reports and OECD (2009a)
Annex 2.4: Changes to the administrative systems at SARS

SARS first introduced eFiling in July 2001 for VAT and provisional income tax returns and payments, which were submitted via a third party provider at a cost. The initial uptake in 2001/02 of 10,500 returns was not as high as expected due to the associated third party provider costs (SARS, 2002). Not surprisingly, the third party provision was abandoned; instead taxpayers were encouraged to file returns directly to SARS. Since then, eFiling has been extended to cover PAYE, SDL, UIF, STC, transfer duty, ATR and Provisional Tax. With respect to PAYE, SARS launched ‘e@syfile for employers’. This platform enables SARS to receive over 90% of PAYE submissions electronically.

Furthermore, SARS has since directed significant resources to pre-populating PIT records with information available from third parties (e.g., employers and individuals), thereby enhancing the accuracy of records. In addition, SARS restructured the cumbersome tax return form from 11 to 2 pages; and “the need to provide paper schedules with the tax returns was done away with” (SARS, 2008). Also, SARS invested resources in educating taxpayers on new arrangements – especially eFiling. Taxpayers have every incentive to file their returns electronically, especially since they have a longer submission deadline than those who submit returns manually. Furthermore, SARS is able to provide eFilers with a 24/7 service as well as a short messaging service (SMS) to remind taxpayers when returns are due. SARS estimates that there are currently 2 million eFilers. Moreover, this technology has enabled SARS staff to improve its workflow management – it now takes 48 hours to complete a tax assessment as opposed to 58 days under the manual filing system; and empowered frontline staff by providing them with business intelligence and data mining facilities.

In 2004/05, SARS launched a National Call Centre to offer a single contact for all taxpayer enquiries (SARS, 2005). Within one year, SARS reported that it received over 3 million calls of which 80% were answered within 20 seconds. This level of responsiveness can be attributed to staff training to maximise timeliness of service – in particular: a taxpayer only calls once; call times are reduced; issues are resolved as quickly as possible; and backlogs are minimised. In 2008/09, SARS further modernised the call centre by incorporating an interactive voice response system.

SARS has also modernised its internal systems. In 2004/05, it settled on a SAP solution for its financial management system (SARS, 2005). The SAP system enables SARS to: undertake bank reconciliations nationally on a daily basis; obtain a daily report on revenue accounts; and a view every 15 minutes on deposits which serves many uses – for example, SARS sends daily SMS on collections to relevant staff. In 2008/9, SARS extended the functionality of SAP to manage its human resource processes and transactions.

Over and above the SAP financials platform, considerable effort has gone into finessing revenue planning and monitoring systems. In particular, SARS maintains various models (e.g., time series, regression analysis, bottom-up) to inform revenue forecasting. The models are built on the basis of indicators in the macro-economic framework, collection patterns, compliance trends and so forth. SARS tests the validity of the models on an ongoing basis. It also compares its models with those used in world class revenue services.

In terms of the framework in place for monitoring and evaluation (M&E) of its operations, SARS prepares medium-term strategic plans with clear objectives and specific measures of performance. These plans feed into SARS’s MTEF for financial resource allocation purposes. In addition to revenue targets by type of tax, the M&E framework defines targets for: number of taxpayers and traders; volumes of tax returns and bills of entry to be processed per annum; service volumes; processing and response times; compliance actions (e.g., number of audits per annum); and effectiveness
(e.g., success rates) (SARS, 2009a). SARS reports on its performance in annual reports, which detail actual performance against the targets set in the strategic plan. These metrics are supplemented by narratives, which explain any positive and negative variances (SARS, 2009b).

SARS was in the process of replacing 42 legacy systems in customs with TATIScms software. The new system builds on the lessons learned from the modernisation of the income tax system. TATIScms offers features such as: generation of statistics; reconciliation/acquittal; risk engine rules; and facilities to support the Authorised Economic Operator (AEO) accreditation programme across SACU and SADC. SARS, on the back of TATIScms, has embarked on simplifying processes (in a similar way to Inland Revenue), so that there is no requirement in future for importers/agents to provide supporting documentation. Furthermore, increased use of ICT is expected to reduce the level of interaction with importers, and minimise corruption.

SARS receives a grant from the National Treasury to fund its operations. It budgets for its resource requirements in the Medium Term Expenditure Framework (MTEF). “Other operating revenue consists mainly of commissions earned from acting as the agent for the Department of Labour” (SARS, 2009b). In particular, SARS collects Unemployment Insurance Fund (UIF) contributions and Skills Development Levies (SDLs) in line with the Unemployment Insurance Contributions Act, 2002 and the Skills Development Levies Act, 1999. SARS invests surplus cash and retains any interest.
Chapter 3

South Korea
Summary of Key Findings

This case study explores some of the key achievements of South Korea’s tax reforms undertaken during its takeoff phase - 1960s and 1970s -- with a view to drawing useful lessons for East Africa Community (EAC) member countries today. It is part of a broader project on Domestic Resource Mobilisation (DRM) carried out by the African Tax Administrations Forum (ATAF), with the support of the African Development Bank (AfDB). The project aims at sharing best practices among EAC member countries, South Africa and South Korea.

Korea’s spectacular rise from an impoverished country in the 1960s to an economic power house in just a generation is an unprecedented success story in human history. In the early years, its socioeconomic conditions were similar in many respects to those of the EAC member countries today. Korea’s Gross Domestic Product (GDP) per capita grew from US$130 in 1954 to about US$19,115 in 2008. This growth was relatively well shared among its people, as evidenced by a Gini coefficient of 32 in 2008, which is equal to the European average. Korea implemented an export-oriented infant industry strategy to transform itself from a third world country into a first world economic power in one generation. In the 1960s, Korea’s GDP per capita was similar to that of EAC member countries today and much lower than South Africa’s. It was a fragile state, emerging from a devastating war with North Korea. It was also predominantly rural, with a large informal sector. This formed the project’s rationale for inclusion of Korea’s tax experience in the 1960s and 1970s.

Korea’s tax reforms in those years consisted of three phases which successively focused on: improving policies and laws; efficient implementation; and strengthening equity and the introduction of Value Added Tax (VAT). First, until 1966, reforms concentrated on revising tax policies to increase revenue collection and support growth. This involved merging a number of taxes, increasing the share of indirect taxes and using tax incentives to support selected sectors. These measures, along with others, contributed to boosting growth, which reached 9.3% in 1963 and has since been sustained at an average of 7.2%. But revenue collection still fell short of expectations. The focus therefore shifted from reforming tax policies to implementing them efficiently. Consequently, the second phase, from 1966 to 1974, focused on strengthening the tax administration. The creation of the National Tax Service (NTS), as a semi-autonomous body in 1966, initiated a period of rapid revenue growth. During the third phase, from 1974 to 1980, the importance of equity as an objective of tax policy increased and VAT was introduced. Government revenue increased from 9% of GDP in 1966 to 15% in 1980. Combined with a decrease in government expenditure, this enabled Korea to rapidly achieve fiscal balance, which was a priority strategic objective. Furthermore, tax incentives also contributed to stimulating growth, though to a much lesser extent than non-tax incentives, such as targeted credit subsidies.

Two lessons of particular relevance to EAC countries emerge from Korea’s tax experience.

First, Korea achieved faster results by focusing its tax policies on a few priorities fully aligned with its national development strategy. In the 1960s and 1970s, Korea’s national strategy, on one hand, was to rapidly achieve fiscal balance with a small government budget, and on the other, to promote growth through an infant industry policy. To this end, it successfully implemented tax policies aimed at increasing adequate revenues to match low levels of expenditures by international standards, broadening the tax base, and providing incentives to strategic sectors. At the same time, less priority was given to other tax objectives, such as neutrality and equity. However, trade-offs in the tax space were largely made up in other policy areas, in particular through equity-oriented expenditure, rural
development programmes and growth. All this provided Korea with sustainable means to achieve equity. EAC countries are also challenged by multiple tax objectives, which can be conflicting if pursued at the same time. For instance, exemptions can be necessary to provide safety nets or stimulate investments, but they conflict with the objectives of broadening the tax base and minimising distortions. The priorities opted by Korea may or may not fit the strategies of EAC countries. But prioritisation and sequencing could help overcome the general problem of conflicting tax objectives.

Second, Korea broadened its tax base by making its tax administration simultaneously empowered and accountable. The National Tax Service (NTS) benefitted from full support by top Government officials. NTS was shielded from political interference in its operations, as illustrated from the President’s personal support to the Commissioner against external pressure. In addition, enforcement capability of the tax administration was dramatically strengthened. For instance, three years after its creation, NTS staff headcount increased by 70% to reach 0.3 staff for 1000 inhabitants, 5 times the EAC average. On the other hand, the President was personally committed to the success of the tax administration, approving targets himself and closely monitoring its performance. Operational empowerment and accountability for performance together helped Korea succeed in broadening its tax base. This is illustrated by a VAT Gross Compliance Ratio of 55%, which was achieved by 1978, against a range of 27% (Uganda) to 41% (Kenya) in the EAC today.

One useful way to interpret these lessons is that part of Korea’s success can be explained by a strong emphasis on implementation, over and above strategy and policies. In fact, many of Korea’s policies and strategies have been adopted in the EAC in one form or another. These include, for example, incentives to promote investment, simplified tax filings for small enterprises, and special initiatives for large tax payers. Korea, therefore, stands out for its emphasis on implementation rather than the nature of its policies. Indeed, focused and coherent strategies are a prerequisite for solid implementation. Likewise, empowered and accountable execution agencies are critical for effective delivery. Implementation plays a central role in Korea’s experience in general, beyond the field of taxation. As an illustration, it is said that President Park Chung Hee, Korea’s leader during its takeoff phase, allocated 20% of his time to decision making, and 80% to implementation. As a result, over his 18-year tenure, he spent about 119 days a year crossing the country, demonstrating his commitment to results, monitoring them and listening to practical feedback from the ground.
Introduction

This case study explores some of the key achievements of Korea’s tax reforms undertaken during its takeoff phase - the 1960s and 1970s - with a view to drawing some useful lessons for EAC member countries today.

It is part of a broader project on Domestic Resource Mobilisation carried out by the African Tax Administrations Forum (ATAF), with the support of the African Development Bank. This project aims at sharing the best practices among EAC member countries, South Africa and South Korea. It consists of a case study or a summary paper for each of the countries included in the project (Burundi, Rwanda, Uganda, Kenya, Tanzania, South Africa, and South Korea). The project also included a study tour of Korea’s tax system and history, which took place in November 2009. It gave top Korean and East African tax officials an opportunity to exchange views about their respective experience. A comparative study will bring the lessons from the case studies, summary papers and study tour together and propose policy recommendations.

South Africa and South Korea were included in the project in order to put East African experiences in perspective with that of countries with more advanced systems and which had experienced most of the challenges being faced by East African countries today. While South Africa brings another example on the same continent, Korea brings an example from a different one.

South Korea’s development is one of the most successful in human history, and yet, in the 1960s, it faced many of the challenges that African countries still encounter today. Korea’s GDP per capita grew from US$130 in 1954 to about US$19,115 in 2008. This growth was relatively well shared, as evidenced by a Gini coefficient of 32 in 2008 - equal to the European average. Korea implemented an export-oriented infant industry strategy to transform itself from a third world country into a first world economic power in one generation. In the 1960’s, Korea’s GDP per capita was similar to that of EAC member countries today and much lower than South Africa’s. South Korea was a fragile state, emerging from a devastating war with the North. It was also predominantly rural, with a large informal sector. This formed the rationale for inclusion of Korea’s tax experience in the 1960s and 1970s in the project.

This study focuses on Korea’s tax reforms during its takeoff period, in the 1960’s and 1970’s. Indeed, as we will see, those were the periods when Korea’s economy was most similar to that of EAC member countries today, and hence its experience is most relevant. They were also the periods when Korea achieved rapid tax revenue growth, on which relatively little has been written. On the other hand, it would have been neither feasible nor desirable to explore in detail the tax policies of modern Korea, as for the most part, they have already been extensively studied and are not relevant to today’s Africa. For instance, one of the key problems faced by Korea’s tax system today is the impact of an ageing population, which obviously is not relevant to Africa. That said, a brief overview of Korea’s tax system from the 1980s to the present time is also provided to illustrate the long-term effects of Korea’s early policies.

This study also focuses on domestic and central taxes. Customs taxes are not covered in detail, because the EAC integration process and international trade agreements result in a reduction of their importance in the EAC countries’ revenue composition. In addition, local taxes are not discussed, because they remained at relatively low levels in Korea during the 1960s and 1970s, the focus periods of this study, and very little research material seems available on this. However, basic information on these taxes and on their contribution to total revenues is provided as part of the background for domestic and central taxes.

It is important to emphasise that Korea’s tax experience in the 1960’s and 1970’s is in general poorly docu-
mented. As explained earlier, Korea in the 1960s was very poor – per capita GDP was about US$130 during the first half of the decade -- and was not producing even basic statistics such as detailed national accounts. Most of the data that we used was actually produced by the National Tax Service, created in 1966. Still, it took many years for the NTS to produce comprehensive and consistent data sets. Much of the data used in this study is the result of a reconciliation and cross-checking of various sources. Some discrepancies could not be fully resolved. There was therefore also extensive use of qualitative information collected from the literature - mostly Korean - to check and complement the quantitative evidence available. Some uncertainty will therefore remain on the details presented in this paper. Still, we believe the study’s main findings do emerge quite clearly from the evidence available.

The case study is structured around three parts. First, the “Background and context” section presents Korea’s development since the end of the Korean War in 1953, and discusses the comparability of Korea during its takeoff years with that of the EAC today. Second, Korea’s tax reforms are set out chronologically, presenting at each phase policies and administrative reforms. The third section discusses two selected key lessons from an EAC perspective.
Background

This section presents Korea’s development since the end of the Korean War in 1953 until today, and discusses the comparability of Korea during its takeoff period with that of the EAC today. Though the focus of this study is the takeoff period, this section provides an overview of Korea’s development until today. Indeed, this is necessary to understand the long-term consequences of the tax reforms during the takeoff period.

Korea’s development experience and strategy

From 1962 to 2008, Korea’s real GDP grew at an impressive rate of 7.2% on average, while achieving remarkable equity and social development. Its GDP per capita grew from US$130 in 1954 to about US$19,115 in 2008 (Figure 3.1). Korea’s Gini index was 32 in 2008 – equal to the European average – reflecting the success of its model in mitigating the risk of high inequality despite rapid growth. Social indicators also made impressive gains. For instance, life expectancy increased from 55 to 79 years between 1962 and 2008; and secondary school enrollment increased from 42% in 1971 to 98% today.

Following the War, the military Government adopted an import substitution policy, which did not result in significant growth. Foreign aid was the principal source of income until 1958, accounting for 45% of government revenues and 70% of imports. In 1957, the United States, which provided the bulk of the aid, unexpectedly announced that it was phasing out financial aid, which effectively started to decline from 1958. The import substitution policy was to a large extent devised to address the fiscal and current account deficits, which as a result, were widening. The Government exercised, in particular, currency control and import licensing.
In 1961, a military coup brought Park Chung Hee to power. He changed the policy from import substitution to export promotion. Another important feature of his policy was to achieve economic freedom, highlighted in the slogan “From Poverty to Self-sufficiency”. In order to design and implement this policy, President Park created a number of institutions. For instance, the Economic Planning Board was established in July 1961 with the mission to develop 5-year Economic Development Plans (EDP), including both macroeconomic planning and detailed implementation plans. A year later, the Korea Trade Investment Promotion Agency was established, which reported its progress in monthly meetings to the President towards meeting the export targets.

The export strategy resulted in rapid growth in the 1960’s and 1970’s. It relied on intensive government intervention to protect and promote private investment in infant industries in selected sectors. Indeed, the Government considered that Korean industries had not reached the critical mass to be able to compete on international markets and therefore required protection as economies of scale were being built. Government intervention took many forms, in which tax incentives played a role. However, the central area of its intervention was in financial markets. The support system included placing the central bank under the authority of the Government, nationalising banks, giving them lending objectives by sector, controlling interest rates, subsidising credit and providing government guarantees. Other measures included: foreign exchange control (in particular the 1964 devaluation); pooled marketing boards (which purchased imported inputs in bulk for Korean SMEs); selection of high potential SMEs for special support and close government performance monitoring; capacity building for SMEs; and overhauling the education system to supply skilled labour to the priority industries.

The first and second EDPs, covering the 1962-1971 period, focused on manufacturing exports, such as steel, machinery, and chemical industries. Basic inputs for production were also emphasised, such as coal, electricity, fertilizer, oil refining, synthetic fibers and cement. The third and fourth EDPs focused on higher value added and heavy industry exports, including household electronics, cars, shipbuilding and petrochemicals.

By the end of the 1970s, however, the distortions accumulated over 20 years of strong government interventions in the financial and labour markets had become unsustainable. In particular, some industries were suffering overinvestment and excess capacity. The wage of skilled labour increased very rapidly, up to 31% per year from 1974 to 1980. This, along with the creation of rents in priority sectors, caused growing inequalities. Further compounding the problem was a persistent high inflation, which started with the first oil shock in 1973. All this resulted in growing disenchantment against the regime, culminating in the assassination of President Park in October 1979. After a brief political interregnum, General Chun Doo Hwan came to power through a coup.

In 1980, the change of regime, combined with the economic crisis, marked the shift from a high government intervention to a liberalisation policy. As General Chun took power the second oil crisis hit Korea, making a tight stabilisation policy even more urgent. It focused on zero-based budgeting, including a freeze on public wages and a monetary squeeze. As a result, inflation declined from 21% to 2% during 1981-1984. In addition, the financial sector was rapidly liberalised, leading to privatisation of four of the five largest banks and creation of two commercial banks, along with many other private financial institutions. At the same time, government credit control progressively phased out. The Banking Act was amended to prevent Chaebols from owning excessive shares in financial institutions. By 1986, Korea had resumed high growth rates. It was, in particular, benefiting from a low dollar

---

1 Interestingly, ambassadors were also given sales objectives and were assessed on this basis
2 Chaebols are large family-owned Korean business conglomerates, which benefitted from strong government support to become powerful multinationals. There are several dozen Chaebols, including well-known brands such as Samsung, Hyundai and LG.
and low oil prices. Its current account surpluses reached 8%. Liberalisation continued, with direct investment by foreigners in the Korean stock market being allowed from 1992, Korea joining the World Trade Organisation (WTO) in 1994 and the Organisation for Economic Cooperation and Development (OECD) in 1996. The liberalization was considered successful until the financial crisis in 1997 hit Korea and international financial flows abruptly reverted. Identifying the root causes of the crisis is difficult as both pro- and anti-liberal interpretations of the Asian financial crisis can be found. However, there is a broader agreement that over-investment by the Chaebols and excessive maturity mismatches in financial institutions were some of the key reasons for the rapid loss of investor confidence. Korea’s economy grew a little above 4% as a result of the crisis, which was very low compared to its 8% average growth from 1962 to 1997. It has since recovered and grown at an average of 6.2% from 1999 to 2007. The 2008 financial crisis took a heavy toll on Korea, causing growth to decline to 2.2% that year. Korea has since benefited from a steady recovery, in line with the faster growth of the global economy.

Comparing Korea in the 1960s/1970s and the EAC today

Korea was included in this project because of its impressive development and the importance of the role of taxation.

In addition, this study focuses on Korea in the 1960s/1970s because it was then similar to EAC member countries in many respects. We therefore present the following similarities with EAC member countries, which make them relevant to Korea’s experience. However, we also present some of the key differences, which are important to bear in mind when considering applying such lessons.

3 The specificities of Korea’s initial conditions and their implication for replicating Korea’s approach to development in general have been discussed extensively. Examples can be found in the “Korea’s Development experience” section of the list of references.
Korea in the 1960s was in the same income group as the EAC today. After adjusting for inflation and purchasing power parity (constant 2005 US$ at PPP), Korea’s GDP per capita in 1962 was US$1849, about 25% greater than that of Kenya in 2008, the EAC country with the highest GDP per capita. However, EAC countries today and South Korea in 1962 should still be considered in the same income group as South Korea’s GDP was less than one-fourth of that of South Africa (constant 2005 US$ 9343 at PPP) and the average of other Middle-Income countries, and 19 times less than the average of OECD countries (see Figure 3.2).

Since 1954 until 1968, Korea’s budget (excluding grant revenues) and current account were in chronic deficit (for instance, 6% and 12% of GDP in 1962 respectively). These deficits were largely financed by grants from the USA.

Korea’s economic structure, like the EAC today, comprised a large agrarian sector, but was less industrialised and had lower levels of trade. Agriculture contributed 36% of GDP in 1962, as against 30% in the EAC in 2005. Industrial output accounted for only 17% of GDP in 1962, which was 26% in the EAC in 2005. In addition, the level of trade (exports + imports) in Korea was 21% of GDP in 1962, compared to 59% in EAC in 2007.

Korea was a post-conflict country, emerging from the Korean War and faced constant threat of invasion from the North. Similarly, Burundi, Rwanda and Uganda have suffered from armed conflicts, which have been followed by continued tensions.

Moreover, Koreans had developed a culture of tax evasion, which became widespread under the Japanese occupation as a form of resistance, but continued, nonetheless, even after the end of its colonisation. Similarly, many authors share the view that tax evasion is widespread in EAC countries.

Differences emerge on social dimensions. Health indicators were similar but education levels were much higher in Korea. Life expectancy was 55 years in 1962, against 54 in the EAC in 2007. However, gross secondary school enrollment was 42% in 1971, against 35% in the EAC in 2007.

Moreover, in contrast with the EAC, Korea’s tradition of centralised government was centuries old. Taxation systems, from the Three Kingdoms Era dating back to 54 BC, had evolved into advanced systems of delegation of powers to and control of the local level. This system was severely affected by the Japanese colonisation and the Korean War. However, it would be fair to assume that institutions that were centuries old were able to survive to some extent and provide a starting base for a new government, including the tax administration.

Korean culture strongly emphasises education and savings. Koreans traditionally invest enormously in the education of their children. Indeed, the education

---

4 2005 was chosen as a reference year in this section because in the World Development Indicators (WDI) database – our main source for PPP GDP at constant value - PPP exchange rates are available for this year only. In interpreting these PPP and inflation adjusted figures, one should bear in mind that inflation adjustments over long periods of time – here five decades – are subject to significant inaccuracies, especially when the structure of economies have changed significantly, as it is the case for Korea. Inaccuracies are caused in particular by the significant changes, which occur over long periods in the basket of reference goods and services used to calculate inflation.

6 WDI, data missing for some EAC countries after 2005

7 WDI, data missing for some EAC countries after 2007


9 WDI, population-weighted average, data missing for some EAC countries after 2007

10 WDI, no data is available before 1971, and no other education than secondary school enrollment indicator could be found.

11 WDI, population-weighted average, data missing for some EAC countries after 2007

85
system under the empires was designed to identify talented students from lower class and provide them with rapid career progress in the administration. Stories of poor students reaching the top of the hierarchy, thanks to their talent and intelligence, abound in the literature. This reflects the general sense that education is a way to rapidly move up the social ladder. In addition, learning to be frugal in spending and save is also steeped in Korean tradition.

One other distinctive aspect was the strength of Korea’s national sentiment. It has been sustained by a relatively united people and fueled with an urge to catch up with Japan. This contrasts sharply with a history of ethnic tensions found in the EAC and South Africa. The global environment in several respects was more favourable in Korea than it is today. International competition was not as fierce as today and Korea could take advantage of its low wages in those days more easily than Africa today, which is competing with cheap labour in China and India. Then Korea was not bound by many trade agreements or regional tariff structure as many African countries are today, and therefore had much more freedom to negotiate its trade policies.

On the other hand, many African countries can benefit from increasingly integrated regional markets that are significantly larger than the domestic market of Korea at the time.

Importantly, the ongoing digital revolution is offering African countries many opportunities to increase productivity, including in the area of taxation that Korea did not have at the time.

**Korea’s tax experience**

In this section, Korea’s tax reforms are set out chronologically, presenting policies and administrative reforms in each phase. This section is mostly descriptive, while
the analysis is presented in the next section. It starts with an overview, followed with a detailed presentation by sub-period, both focusing on the takeoff period – 1960s and 1970s. However, some basic information on Korea’s taxation from the 1980s to date is also provided, putting the reforms undertaken during the takeoff period in perspective with Korea’s long term sequence of reforms.

Overview

The beginning of Korea’s modern tax system dates back to 1948, when North and South Korea were separated. However, a major disruption occurred with the Korean War (1950-1953), which brought a special tax system designed to finance the war, mainly relying on land taxation. Because the tax system created in 1948 did not have the time to mature until the end of the war in 1953, this overview starts from 1953. The history of Korea’s taxation can be broken down into two periods, which mirror the economic policies at the time:

• 1953-1980 – Fiscal balance and growth
• 1980-present – Allocative efficiency and equity

During the fiscal balance and growth period, after a slow start until 1962, Korea’s economy and tax revenues grew phenomenally. Between 1953 and 1962, the focus was on moving from a war to a civilian tax system and increasing government revenues. However, central tax revenues remained volatile, averaging around 7% to 8% of GDP. In 1962, one year after President Park took power, and as part of the first Five-Year EDP, a comprehensive tax reform was undertaken, for the first time incorporating tax as an important tool to stimulate growth. Another major milestone was achieved in 1966, when the NTS\textsuperscript{12} was created as an independent administration in charge of collecting taxes. In 1970, the Korea Customs Service (KCS) was also established as

\textsuperscript{12} At first, it was called the Office of the National Tax Administration (ONTA) and then the National Tax Administration (NTA).
an independent organisation, with the mission to collect tariffs but also to provide first class services in response to growing trade volumes. The creation of NTS marked the beginning of a rapid growth in revenues. From then on, central tax revenues increased dramatically from 9% to reach around 15% in 1980 (7% to 11% for domestic taxes alone). Over the same period, government expenditures declined from an average of 20% of GDP to 15%, achieving fiscal balance. As inflation started to increase following the 1973 oil crisis, equity measures were introduced in 1974, including tax-based safety nets and comprehensive income tax. Equity measures were then improved and mainstreamed from the 1980s. Another significant development was the introduction of VAT in 1976.

From 1980, along with the national strategy, tax policies shifted to liberalisation in order to minimise distortions and ensure equity. Taxes became more neutral and the focus was on maintaining fiscal balance, and further broadening the tax base by curtailing exemptions and equity.

First, an analysis of the composition of tax revenues shows that Korea has heavily relied on indirect taxes, significantly more than international benchmarks. Indirect taxes progressively increased from about 45% to 55% of total taxes, against an average of 32% in OECD countries in 2005. The progressive increase of indirect taxes’ share was initiated in 1960 during the so-called tax reforms of the Democratic Party. The thinking then was that in a low-income country, indirect taxes were easier to collect.

Second, customs taxes were designed to promote strategic export sectors during the 1960s/1970s, and dramatically reduced from the 1980s as a result of liberalisation. Customs revenues remained just below 30% of central government revenues from the 1960s through the 1970s and until about the mid-1980s. During the take-off period, import tariffs were removed or significantly reduced on imports to support strategic infant industries. Similarly, tariffs were reduced for exports of the same industries. Furthermore, import tariffs were raised to protect the domestic market from foreign competitors in the priority industries. The reduction in customs taxes in the mid-1980s was driven by trade liberalisation policy. From the mid-1980s, customs revenue has fallen as a share of total central government revenue to about 8%, due to reductions in customs tax rates. Direct taxes increased from 1989 to compensate for that loss. This increase was largely driven by two reforms: (i) a more comprehensive income tax system was introduced, including financial revenues; and (ii) introduction of taxes on real estate gains in 1990 in order to curb rising speculation.

Measures to improve performance of customs and local taxes are not discussed further in this paper. Customs taxes are not covered in detail because the EAC integration process and international trade agreements reduced the importance of customs taxes in the revenue composition of EAC countries. In addition, local taxes are not discussed, because they remained at relatively low levels during the 1960s and 1970s. Indeed, up until 1987, the share of local taxes was consistently around 10% of total taxes (1% of GDP). However, it is worth noting that local taxes have played an increasingly important role in financing public services from the 1980s. The basic information provided above is aimed at giving a sense of the relative contribution of central domestic taxes to total revenues.

---

13 OECD (2007)
14 In 1988, the share of local taxes to total taxes suddenly increased to about 14%, to progressively reach just over 20% of total taxes in 2006 (5% of GDP) (Choi, 2008). This can be compared to the average of the share of local taxes in other OECD countries, which is 13.8% (Kim, 2005). The sudden increase in 1987 was driven by a new excessive land holding tax to help curb land speculation, and it was administrated locally. In 1989, this ratio then increased to around 20%, due the tobacco sales tax being changed from a national to local tax. This seems to have been part of the preparations, in 1989, for an election campaign, whereby tobacco sales tax was changed to a local tax in order to make it a major source of revenue for local governments. This has indeed been the case, with the reallocation of the tobacco tax providing local governments with an additional 39.8% of tax revenues in 1989 (Choi & Hyun, 1997).
Box 3.1: Summary of tax incentives during the takeoff phase and continuous improvement

<table>
<thead>
<tr>
<th>Incentives to increase savings</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduced tax on interest, dividends and capital gains</td>
<td>Increase returns from savings</td>
</tr>
<tr>
<td>Special Consumption Tax on luxury goods</td>
<td>Reduces the opportunity cost of saving</td>
</tr>
<tr>
<td>Reduced income tax on listed companies</td>
<td>Increases the demand for savings hence interest rates</td>
</tr>
<tr>
<td>Greater share of consumption tax in the tax mix</td>
<td>Increases the cost of consumption</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Incentives to increase investment in priority sectors</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax reduction</td>
<td>Increases Return On investment (ROI)</td>
</tr>
<tr>
<td>VAT exemption on export products</td>
<td>Increases ROI</td>
</tr>
<tr>
<td>Accelerated depreciation</td>
<td>Increases ROI</td>
</tr>
<tr>
<td>Investment tax credit</td>
<td>Increases ROI</td>
</tr>
<tr>
<td>Reduced taxes on inputs for export industries</td>
<td>Increases ROI</td>
</tr>
</tbody>
</table>

Source: consolidated by the authors from various sources

Though the incentives introduced in the early 1960s remained the same throughout Korea’s takeoff phase, their design was improved frequently until the liberalisation period, in part to address issues with firms abusing these preferential treatments. In trying to learn from Korea’s experience, it is therefore important to understand the reasons for the changes in the design of tax incentives that are particularly insightful.

First, in 1967, the accelerated depreciation incentive was improved benefits that are proportional to the actual share of exports in a company’s sales. Indeed, export companies would initially qualify for accelerated depreciation, regardless of how much they would export. This resulted in abuses, with companies registering as exporters even with very small shares of exports. Making the extent of the accelerated depreciation proportional to the share of exports solved this issue.

Second, in 1974, key and strategic industries were given the choice between three types of incentives: tax holidays, investment tax credit, and special depreciation. Tax holidays consisted of 100% exemption over the first three years, then 50% for two years. The investment tax credit was 8% on foreign capital goods and 10% on domestic capital goods. A special depreciation on 100% of asset value was also offered. This was decided after a decade of trying different tax incentives. It was perhaps a clever way to let the market choose what incentive was best for each type of industry, rather than the government trying to guess so.

Third, again in 1974, all incentives were unified under one law: «Tax exemption and reduction control law». This was probably a way to improve the transparency of the incentive system, and hence eliminate duplications and reduce abuses.
1953-66: Improving policies and laws

From 1953 to 1966, the central objective was to increase tax revenues and promote export-led growth. Following the end of the Korean War, attempts to increase tax revenues took many different forms. New taxes, such as the education tax (a surtax on income tax), asset revaluation tax and foreign exchange tax were introduced in 1958. It is in 1960 that the strategy to raise indirect tax rates and reduce direct taxes was introduced for the first time. It was done so considering that indirect taxes were easier to collect in a poor country with a large informal sector. This resulted in indirect taxes contributing a prominent share to tax revenues in Korea, a feature that still prevails today.

For the first time during this period, tax incentives, aiming at stimulating growth, were introduced. In 1960, tax exemptions were introduced to support export, investment and SMEs in key industries. For instance, a 30% corporate tax rate exemption was granted to export businesses. It was, however, only in 1961, when President Park took power that tax incentives for growth assumed a truly central role. He created the Economic Planning Board, in charge of defining the 5-year EDPs. Tax reforms, as well as other policy tools were integrated in the EDPs and designed to achieve its goals. The first 5-year EDP focused on export manufacturing. As a consequence, 10 tax laws were revised to introduce a complete system of incentives. It included a drastic reduction of taxation of capital, tariffs on inputs, and income in “Key and strategic industries” and export industries. A 50% exemption on income tax was granted to all foreign exchange-earning businesses. Machinery and equipment directly employed for foreign exchange-earning activities benefited from a special depreciation, at rates 30% higher than the standard rates. Tax on interest income was close to zero to encourage savings. In addition, corporate taxes were greater for open listed companies than for closely-held companies to increase investment opportunities through capital markets. Box 3.3.1 provides an overview of tax incentives used by Korea and of some of their improvements over time.

The Park Administration also introduced a number of reforms aimed at improving administrative efficiency. There were attempts to simplify the tax administration - such as absorbing the textile tax into the commodity tax in 1953, streamline the functioning of regional tax offices, and tax officials were screened to keep the best performing staff.

Though growth did start in 1963, with a rate of 9.3% which was later sustained, tax revenue performance fell short of expectations, remaining at around 7% of GDP. The Park administration analysed the reasons for the failure which led them, from 1966, to refocus their approach from tax policy reforms to their implementation.

1966-74: Focusing on implementation

Tax incentives continued to be used extensively during this period and the following one (Chapter 3.4). But they were not developed further because, as most other policies, they did not change in nature following their introduction during the first 5-year EDP. Most tax incentives were introduced in the previous EDP\textsuperscript{15}. The subsequent changes only concerned the sectors to which they applied and the rates of exemptions, reflecting changes in the sectors which were given priority. In addition, their design was improved. These improvements have been summarized in Box 3.1. The key reform of this period was the establishment in 1966 of the National Tax Service (called Office of National Taxation at the time) in order to dramatically reinforce tax administration. NTS was created as an independent government agency, with the mission to

\textsuperscript{15} One exception is the investment tax credit, which was introduced in 1968.
assess and collect direct and indirect central domestic taxes. Before its creation, these functions were carried out by the Tax Bureau under the Ministry of Finance. The Bureau was responsible for formulating tax policies and drafting tax laws.

Many analysts interpreted the disappointing performance of the previous policy-focused reforms as a result of weak implementation, and recommended the creation of a tax administration with strong capacity. After significant tax reforms in 1961, a comprehensive tax reform in 1962 and numerous other reforms were introduced until 1965, when tax revenues grew less than the economy and remained very volatile. In 1954, the Nathan Report on tax policy suggested that improvements in tax investigation and collection would be imperative to increase tax revenues (KDB, 1954). In 1964, the Economic Planning Bureau (EPB) recommended creation of an independent tax agency. In 1965, during his mission to Korea as a member of the Nathan economic advisor, R.A. Musgrave, from Harvard University, also emphasised the need to establish a tax agency focused on fighting tax evasion (NTS, 1986).

Subsequently, President Park formed a Special Investigation Team, with the mission to assess the potential revenue increase from a fully capacitated administration. The team was created in September 1965. It was led by a secretary, reporting directly to him (Mr. Lee, Nak-Sun), and comprised 12 staff from the office of the President (the Blue House), the Board of Audit and Inspection, and the prosecution service. It was an excellent combination of political leadership, professional expertise and investigation power. The President entrusted the team with full powers to conduct tax investigation, and provided the team leader with a mission letter saying: “all executive and investigating authorities as well as all chiefs of state and local government agencies must comply with the team’s requests related to its duty.” (KIPF, 1997).

The investigation results convinced President Park of the benefits of creating the National Tax Service. The Special Investigation Team decided to focus on the textile industry as an example. It was chosen because of its complex value chain, which provided numerous opportunities for tax evasion. By the end of the year, the Team had uncovered tax evasions worth US$9.3 million in that industry alone. Though the investigations concerned a small fraction of the economy, the extent of evasion uncovered was very substantial, at almost 5% of the total tax revenues collected in 1965 (US$205 million). The outcome convinced President Park that tax revenues could increase substantially by strengthening the tax administration, prompting him to create the NTS in 1966.

NTS’s implementation relied on the following principles:

- full top-down accountability;
- full empowerment;
- dramatic strengthening of enforcement capacity;
- promoting voluntary compliance; and
- increasing legitimacy.

### Full top-down accountability

The President made a strong public and personal commitment to meeting revenue mobilisation objectives. He appointed Mr. Lee, the head of the Special Investigation Team, who had won his confidence as the NTS Commissioner. He was in the process making him fully accountable for his recommendations. President Park set targets based on the recommendations of the Team, and personally monitored results. One anecdotal evidence best illustrates how serious the level of the President’s commitment was. Confident of the high potential of taxation, in 1966, he asked NTS to collect tax revenues of KRW70 billion (US$258 million), an amount 30% higher than revenues in the previous year, and which many considered to be over ambitious. As a
symbolic gesture of his resolve, President Park changed both his car plate number and telephone number for “700” (KIPF, 1997). Eventually, the Commissioner met the target.

In addition, a chain of targets, called the target revenue approach, were set at all levels of the organisation, from the Commissioner of NTS to the heads of Regional Tax Offices to the heads of District Tax Offices to the division managers, down to the tax officers. These targets were broken down by geographical areas and tax categories. Monetary incentives were introduced at all levels, which rewarded outperformers with bonuses and penalised underperformers.

The President made a public commitment to implement a zero-tolerance policy for corruption. He explicitly pointed out that repairing the shame and blame of the past resulting from corruption was one of the main objectives of the NTS creation. A clear and strict rule established that whoever was involved in corruption would be fired and punished. This was enforced by a special anti-corruption team of 20 young, committed government officials, who were selected through the Senior Government Official Examination. To increase their visibility, they used to wear blue neckties and their slogan was an old Korean proverb, which means “Treat gold as stone”. The fight against corruption also targeted bribers. In the first years of President Park’s rule, 24 leading business men were arrested for corruption.

Full empowerment

Such stringent accountability system would not be successful without a commensurate empowerment. NTS benefited from full empowerment under two forms: political and financial.

First, NTS received full political support from the President. The Commissioner, as a result of NTS’s intensive investigations, faced high levels of pressure powerful people. But he didn’t budge because of the President’s unstinted support.

Second, NTS was given resources to dramatically increase its size and capability. From 1966 to 1969, in just three years, its budget increased by 71% in real terms, and its number of staff per inhabitant by 57%. During that short time, staff strength rose by 3747 personnel, from 5500 to 9247. The increase benefited both headquarters and local offices. A substantial part of these resources was used to strengthen the administration’s enforcement capacity.

Dramatic strengthening of enforcement

First, research functions were significantly strengthened. These functions are of course not limited to enforcement only. Research, for instance, can be used to assess the impact of tax policies on equity, or on competitiveness. We focus here on two research functions that are critical for enforcement: the assessment of revenue targets at a macro level; and at the tax payer level. If properly conducted, these two functions can help ensure targets are realistic and that appropriate taxpayers are identified for investigation. NTS research department extensively developed and used differential tax payer management systems. They consist of cross-checking all sources of information available – including sector level surveys, and individual reports – about tax payers to categorise them into degrees of presumed compliance. High income earners categorised in the low degrees of presumed compliance would be targeted in particular for in-depth investigation. In addition, to secure highly qualified and fully committed tax officials, the National Tax Officials Training Institute was established in 1967. In 1968, the institute had 88 staff. Information Technology was introduced in the very early days, in 1970, to facilitate processing of large amounts of information. Computers were installed and training of in-house IT specialists began in earnest. The
strong IT support also enabled introduction of the General Income Tax in 1975 and VAT in 1977, which involve heavy processing of income and transaction data (KIPF, 1997).

Second, NTS dramatically strengthened its capacity to conduct on-site investigations. Before the creation of NTS, the division responsible for on-site investigations within the Ministry of Finance was also responsible for other tasks, such as staff performance evaluations. It was therefore not possible to carry out intensive tax investigations until NTS was created, with one investigation division at headquarters, and one in each field office. Investigations were sequenced in several campaigns, each with its own focus. For instance, in 1966 the focus was on high income earners. In 1969, the focus shifted to taxpayers with a poor reporting record. Each campaign was carefully prepared by intensive data analysis and field surveys.

Third, NTS heavily invested in decentralisation. Between 1966 and 1968, the number of staff in district tax offices increased from 4,906 to 8,033, which represents a 64% increase. Research teams were created in each local tax office. Investigation teams were reinforced. At its creation, NTS had four Regional Tax Offices and 77 District Tax Offices. In its first two years, two new Regional Tax Offices and 14 District Tax Offices were added.

Fourth, NTS enforced a policy of full registration and simplified tax filing for small businesses. One registration was required for each business location. This system lasted until 2008, when registration by business unit (with one consolidated balance sheet) became required for every business. Given the geographical nature of the full registration policy, local offices were in charge of enforcing it. Relevant regional or district tax offices were in charge of ensuring that all businesses were registered and of all the subsequent steps of the tax cycle, including collecting returns, payments, and investigation. Full registration would not have yielded results had the small businesses been requested to submit tax returns based on book-keeping and tax invoices. Instead, small businesses were simply required to pay tax calculated with the Standard Assessment Method, which has been widely used in Korea for both income tax and sales taxes. It was later replaced by VAT. The Method estimates income and sales based on a series of objective and easy-to-observe measures. These can be used, for instance, for calculating the number staff or machines. Ratios based on these measures and defined in a standard assessment guide were then used by tax officials to determine the base for calculating taxes, either gross sales in the case of sales tax or gross income in the case of income tax. Tax payers were given the option to file full returns to determine their taxes if they felt they would pay less taxes (Choi, 1990).

Promoting voluntary compliance

Many efforts were directed towards encouraging voluntary and unvarnished submissions and registration of tax payers. At the same time, a system of incentives was put in place to reward tax payers using transparent reporting methods and penalise those who were not.

The “Green Report System”, established in 1965, was the Government’s first effort to introduce voluntary self-assessment system. Once a taxpayer was found to be a green reporter as a result of faithful reporting, he was granted preferential treatments, such as tax deductions and installment payments. As an illustration, one of the criteria for becoming a green reporter was that field investigations would confirm earnings within +/-5% of the amount originally reported. However, some green reporters exploited the system to evade tax. As a result, from 1968, additional control measures were taken, such as field investigations of green reporters.19

NTS also made substantial efforts to encourage bookkeeping, as a way to increase compliance and accuracy of tax submissions. These efforts started in 1966 and continue uninterrupted until today. The number of taxpayers using bookkeeping was 5163 in 1966. It was 219,000 in 1987 and 1,585,000 in 2007, which constituted 33.2% and 54.7% respectively of Global Income Taxpayers.

From 1966, NTS held seminars for various types of businesses and conducted promotional campaigns through mass media to encourage bookkeeping. In 1972, Regional and District Tax Offices were given responsibility to actively guide tax payers on double- and single-entry bookkeeping techniques. Since 1985, NTS has maintained a database of target taxpayers to guide them on bookkeeping. It also distributed a simplified bookkeeping form in 1999. In 2004, tax rates were raised for negligent bookkeepers. Certificated Tax Attorneys (CTA) were trained to help taxpayers – mainly personal taxpayers and small businesses – produce compliant books, tax returns and payment claims. In 2007, a total of 7,260 CTAs were registered.

**Increasing legitimacy**

With strong emphasis on enforcement, it was critical at the same time to increase legitimacy of taxation.

Zero-tolerance policy for corruption played an important role in this regard. As explained in Chapter 3.3.1, the President publicly committed to eradicate corruption and introduced very visible anti-corruption measures. This was important as taxpayers initially had a negative image of tax officials because of widespread corruption. Interestingly, it was observed that as their image improved, the morale of the tax officials also improved. Public relations and education were also emphasised. In 1967, Government set March 3 as the Tax Day to be observed every year in order to promote a clean image of the tax administration, create awareness of the central role of taxation in meeting the nation’s development goals, and encourage self-compliance. The event was chaired by President Park himself. Some of the interesting features of the Day included award of prizes to the best taxpayer and involvement of national celebrities. The Tax Day is still observed today. In addition, as part of the public relation effort, an NTS-sponsored Woman volleyball team was created.

A greater emphasis was also put on improving the fairness of taxation. This involved *improving the accuracy of the Standard Assessment Method* (see Chapter 3.3.3). It was very basic at the beginning, and became gradually more sophisticated. At the creation of NTS, research teams in Regional Tax Offices undertook a revision of the ratios of the standard assessment based on field surveys of reference businesses. Subsequently, in 1975, a multi-stakeholder group -- involving tax administrators, tax specialists, representatives from the business community and financial institutions -- was set up to revise the guidelines. In 1978, the method was adjusted based on geographic considerations, and business cycles were taken into account. In 1981, the standard ratios also reflected many other factors, such as the amount of capital, type of facility, business reputation and so on.

**1974-80: Strengthening equity and introducing VAT**

The main features of tax reforms of this period were strengthening of equity as an objective of taxation, and introduction of VAT.

**Strengthening equity**

Following the 1973 oil crisis, the equity objective became more important. Korea experienced two years
of lower growth: 7.2% in 1973 and 5.9% in 1975, as opposed to an average of 9.3% from 1963 to 1971. Growth shot up to 10.6% in 1976, but inflation remained high (33%, 26% and 25% in 1974, 1975 and 1976, while it had remained below 18% since 1965), eroding purchasing power of the poorest.

As part of the effort to improve progressivity, and broaden the tax base among the wealthy, the Comprehensive Personal Income Tax was introduced. Until 1966, individual income was taxed at a flat rate by income categories. The first significant step towards global taxation was taken in the 1967 reform, which introduced a progressive income tax based on comprehensive income. However, it was rather narrowly defined and the income tax system continued to be better approximated by flat taxes on various income categories, rather than by a progressive tax based on a broad income category. The definition of comprehensive income was broadened subsequently, in particular, under the tax reform of 1974 (effective 1975), which introduced basic framework of the current individual income tax system (Choi, 2004). Under the comprehensive income tax system, the number of tax brackets increased and the highest marginal tax rate was raised to 70% in 1975 from 50% in 1970.

In addition, the Government granted generous tax relief to low wage earners. The level of tax-free personal deduction rose from KWR120,000 in 1970 to KWR780,000 in 1975, then to KWR2,380,000 in 1980. Various deductions and credits were newly introduced.

In addition to personal deductions, a wage earner was eligible for several other deductions, such as labour income and educational and medical expenses. Finally, in 1974, the National Tax Tribunal was established as an independent agency to handle appeals under the new Basic Law of National Taxes. By protecting taxpayers’ rights, the Tribunal contributed to improve both equity and legitimacy of taxation.

### Introducing VAT

The value-added tax (VAT) was introduced in 1977, following legislation passed in late 1976.

One purpose of this legislation was to streamline the indirect tax system and its administration. Eight indirect taxes and a special consumption tax (SPC) were consolidated under VAT.

VAT was also adopted to introduce greater neutrality into the indirect tax system. The previous cascade turnover tax system had a number of resource misallocation and inefficiency disadvantages, including: encouraging vertical integration and penalising specialisation, because the reduction of inter-firm sales reduced total tax liabilities.

In addition, VAT aimed at promoting exports and capital formation. In order to promote exports, they were zero rated at the final stage of production under VAT, and rebates were available on taxes paid at earlier stages of production. This was in contrast to the previous system.

---

22 Choi (2008)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of brackets</th>
<th>Lower rate</th>
<th>Highest rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>9</td>
<td>7%</td>
<td>50%</td>
</tr>
<tr>
<td>1975</td>
<td>16</td>
<td>8%</td>
<td>70%</td>
</tr>
<tr>
<td>1980</td>
<td>17</td>
<td>6%</td>
<td>79%</td>
</tr>
</tbody>
</table>

Table 3.1: The Structure of the Personal Income Tax

Source: Choi (2004)
where cumulative taxes at “earlier stages of transactions in exported goods were either not rebatable or merely partly refundable”. Unlike most of the taxes it replaced, VAT does not burden capital goods because the consumption-type VAT provides full credit for the tax included in the purchase of capital goods.

VAT was introduced and imposed at a single 10% rate on a wide range of goods and services, and collected through the invoice method. Thereby, each firm collected VAT on all sales, unless they were exempt, and was then entitled to a credit against its liabilities for taxes invoiced by its suppliers. Activities exempted from VAT included: exports (zero rated), daily necessities such as unprocessed foodstuffs and tap water, and financial services. One feature introduced with VAT was a change to a quarterly payment, which was easier for businesses to comply with than the more frequent two-month tax period used under the old business sales tax system.

A special consumption tax (SPC) was introduced simultaneously with VAT to inject some progressivity into the indirect tax system. The SPC imposed higher taxes on goods and services consumed disproportionately by high-income groups. In addition, a number of exemptions were also used to reduce regressivity of the VAT burden.

Although Korea adopted a single 10% VAT rate, small businesses received special treatment. If their annual

---

Box 3.2: Cash-Receipts – A recent innovation using technology and incentives to further broaden the tax base

Like many other countries across the globe, Korea has faced difficulties in accurately identifying tax revenues from small-sized businesses, especially since the Korean public tends to prefer paying in cash and don’t maintain a record of their receipts. In 2000, for example, credit card purchases, Government has, since 2000, tried to promote the use of credit cards. It has expanded the number of businesses accepting credit cards, showered gifts on raffle winners drawn from the pool of credit card users every month, and offered tax deductions for credit card purchases. As a result, credit card payments expanded to 41.7% of the nation’s total private spending by 2004. This contributed to increased transaction transparency and, therefore, the ability to better identify tax sources. Yet, cash transactions still made up more than 50% of total private expenditures.

To address this problem, Korea introduced the world’s first-ever cash-receipt system in 2005. It is a programme through which cash purchases are tracked by a customer presenting a membership card or a cell phone number, as opposed to getting a regular receipt, which is then a record of sale for use by the buyer and the seller. When this cash receipt information is entered after a cash purchase, the information is sent straight to the National Tax Service. To encourage use of this system, the Government offers cash incentives to consumers. The threshold for registering transactions stood at KRW 5,000 ($3.75) until July 2008 and then changed to KRW 1. The individual taxpayer is able to receive a 20% deduction on his/her year-end tax settlement for the amount of total cash spending that exceeds 20% of one’s reported yearly income, up to a total of 5 million KRW. For businesses, a 1% rate of applicability is in place. In 2007, the number of cash-receipt issuances surpassed the 700 million mark, while 1.37 million businesses were registered as cash-receipt issuers.

Source: Korean Government Official Website (Korea.net), NTS

---

22 Choi (2008)
23 The credit does not subsidise the purchase of capital goods; it simply eliminates the tax that had been imposed.
24 These included televisions, refrigerators, pianos, passenger cars, coke, coffee, and - quite surprisingly given the intention of progressivity - sugar.
sales were below a certain amount (KRW24 million, or US$50,000 when VAT was first introduced), they were taxed at a rate of 2% of turnover. The special treatment for small businesses tended to be abused by them because they were prone to under-report their turnover. To tackle the issue, Government has tried to expose transactions as much as possible with various measures, such as increasing the use of credit cards and introducing cash receipts system (see Box 3.2). As a result of these efforts, proportion of special taxpayers decreased below 40% by 2006.

Careful examination and extensive preparation preceded the introduction of VAT. The Economic Planning Board and Ministry of Finance worked very closely in formulating and implementing VAT. This was done to ensure that there was close alignment of the new tax with the ongoing five-year development plans (the purpose of introducing VAT in the late 1970s is noted above). Foreign tax experts and well-known institutions (e.g., the IMF) assisted in developing the VAT system.

Government launched extensive information campaign and education programmes about a year before VAT became effective. These included educating taxpayers and the general public about the characteristics of the new tax, as well as about new requirements which taxpayers would have to comply with. VAT guidebooks were distributed through trade and business associations, and nationwide test exercises involving filing of tax returns were carried out before VAT was introduced.

Government expanded and retrained the tax administration personnel. The number of staff at NTS increased from 9,443 in 1976 to 11,442 in 1977. The new recruits did not begin working for VAT straight away and, instead, were put into other sections in order to release more experienced staff for VAT administration. This was complemented by staff handbooks prepared by NTS for officials working on VAT.

The success of VAT largely depended on the degree of voluntary cooperation from the business community. In order to build this support and allow for business input, Government set up different committees, which included representatives from the Chamber of Commerce, Korean Tax Accountants Association and other relevant institutions.

A decentralised regional system was put in place. NTS considered registration by operation important since VAT, in principle, is imposed per place of business. In this light, VAT administration – assessment, collection and investigation – has been conducted mainly under the responsibility of relevant regional or district tax offices. Initially, VAT officers were specified for each area, where they were responsible for almost all taxation procedures, including: business registration, tax returns and payment, investigation, and tax base development. In addition, they provided guidance and reviewed tax reports to ensure faithful compliance and early settlement of VAT disputes.

From its first year of introduction, a computerised system was put in place to cross-check seller and purchaser invoices of general tax payers. In the last half of 1977, 7.2% of all invoices did not match, but in 1982, the proportion of mismatches decreased to 1.4%. Improved compliance enabled the administration to progressively decrease the number of tax invoices processed.25

1980-today: Liberalisation

From the 1980s, in keeping with a policy of structural adjustment and liberalisation, tax reform activities slowed down.

The focus was on reducing the range of tax incentives and broadening the tax base to improve allocation efficiency. In 1982, liberal tax privileges of strategic industries were almost completely removed. The 1988 tax reform significantly reduced remaining exemptions. This
effort has continued ever since, along with the 1998 reform, which removed VAT exemptions on professional services, such as lawyers and accountants. In 1993, the real-name system of financial transactions included tax on capital income into the individual tax base, completing the efforts of the 1976 comprehensive income tax to improve progressivity. In addition, a number of ad-hoc revisions of tax policies were introduced to address new issues as they arose.

To curb real estate speculation, the excessive land holding tax in 1986 significantly increased land-related taxes. These included taxes on capital gains and land property. These measures have often been viewed as ineffective, in part due to their not being comprehensive and hence not creating enough incentives for the wealthiest to reduce speculation.

Following the 1997 Asian crisis, it became critical to rapidly restructure inefficient chaebols. Incentives were granted to transaction-related taxes, such as capital gains, acquisition, and registration tax. For instance, corporate assets after mergers and acquisitions were exempted from registration tax.

As part of the efforts to reverse capital flight prompted by the crisis, the Foreign Investment Promotion Law (FIPL) was enacted in 1998. For instance, foreign businesses and investors who made investment in advanced technology in Korea were eligible for exemption from individual and corporate income taxes for the first seven years, and a 50% reduction for each of the following three years.

One of the more recent challenges faced by Korea has been the ageing population. The National Pension Fund was created in 1988 to help address this issue. Annual contributions have grown to 7% of GDP today (see Fig 4). According to OECD simulations, Korea’s public spending on health and long-term care might rise by 6 to 9 percentage points of GDP by 2050, the largest increase in the OECD area. OECD recommends taking early action to increase revenue so as to limit the long-term cost from the higher fiscal burden.

---

26 Choi (2004) p81
27 Randall (2009)
Select lessons from an EAC perspective

While the previous section provided a narrative of Korea’s tax reforms during its takeoff phase, this section analyses two lessons of particular relevance to EAC member countries. First, Korea achieved faster results by focusing its tax policies on a few priorities fully aligned with its national development strategy. Second, Korea broadened its tax base by making its tax administration both empowered and accountable.

Focusing on a few priorities aligned with the national development strategy

Like EAC member countries today, Korea, during its takeoff years, was challenged by multiple and conflicting tax objectives. They included increasing revenues, allocating resources efficiently, stimulating savings and investment, providing safety nets and promoting social equity. However, stimulating investments or providing safety nets, for instance, involve exemptions, which unfortunately conflicts with the objectives of allocating resources neutrally and broadening the tax base.

Korea focused its tax policies on a few priorities fully aligned with its national development strategy. In the 1960s and 1970s, its national strategy, on one hand, was to rapidly achieve fiscal balance through low level of expenditure, and on the other, to promote growth by supporting an infant industry policy. To this end, Korea focused on increasing revenues from a very low base up to a level still low by international standards, broadening the tax base, and providing incentives to strategic sectors.

Figure 3.5: Government budget and growth

Source: WDI, calculations by the authors
The following illustrates the alignment of Korea’s tax policies with three specific national strategies: (i) small balanced budget; (ii) active export promotion; and (iii) liberalisation.

**Small and balanced government budget**

During the takeoff period and after 1980, government budget was small by international standards, with tax revenues and expenditures below 16% of GDP (see Figure 3.5). Central tax revenues of 16% are in the same range as in the EAC today and much lower than in South Africa. Average tax revenues in 2008 in the EAC stood at 16%\(^{29}\), ranging from 12% (Uganda) to 19% (Kenya). It was 28% in South Africa in 2008. In addition, a study by Bahl, Kim and Park (1986) compares Korea’s expenditure to 31 other developing countries from 1973 to 1976, making adjustments to ensure comparability. It finds that the average expenditure share of GDP in Korea was significantly lower than in the comparator countries (15.9% vs. 28.4% including military expenditures, and 11% vs. 17.4% for nondefense expenditure).

One of the main rationales for a small government budget was to rapidly achieve fiscal balance. Achieving fiscal balance primarily stemmed from an anticipated decline in foreign aid. Following the Korean War, United States was the main provider of aid to Korea, which accounted for up to 45% of government revenues and 70% of imports. In 1957, USA unexpectedly announced that it was phasing out financial aid, which effectively started to decline from 1958. From that year, addressing the resulting twin deficit became a central objective of government policies. The government expenditure was reduced from around 20% of GDP in the early 60s to 16% in the 70s, while tax revenues were increased from 9% to 15% during the same period. Government has consistently achieved fiscal balance from the mid-1970s.

The other important rationale was to encourage private investment and growth. Korea’s development was

---

\(^{29}\) GDP-weighted average, calculated by the authors from IMF staff reports.
fundamentally private-sector oriented. Although the Government very actively worked with the private sector to provide a conducive environment to achieve competitiveness, including ‘temporary protection, targeted subsidies, adequate human resources, infrastructure, support in international sales and marketing etc.’, production was primarily driven by the private sector. This policy required maximising savings available to the private sector, lowering corporate taxes to the extent possible, and encouraging private consumption. Maintaining a small government budget was considered critical to achieving these objectives.

Accordingly, Korea’s taxation system during the takeoff phase aimed at contributing to achieving fiscal balance while maintaining a low tax burden. Fiscal balance was indeed achieved by both reducing expenditures and increasing revenues. In addition, tax revenue was capped at a low level, below 16% of GDP, which along with a broad tax base (see Chapter 4.2.1), contributed to making low tax rates possible. For example, VAT was 10%, against 16% to 20% in the EAC. Korea’s VAT rate is among the lowest in the world. Still, it contributed substantially to total revenues, at about a fourth of central tax revenues (25% in 1980). Furthermore, Corporate Income Tax for small and medium enterprises was also low, at 15% and 25% for listed and non-listed small enterprises respectively\(^{30}\), against 30% to 35% in EAC countries.

The small balanced budget strategy, including its tax component, contributed to a dramatic increase in domestic private savings and investment (Figure 3.6). Savings started at 10% of GDP in 1960 and increased dramatically to 30% in 25 years. Investment followed a similar progression, but remained greater than savings during the entire takeoff period. The gap between investment and domestic savings was mainly filled by private foreign loans, many benefitting from government guarantee. Korea sustained an average savings ratio of 30% from the 1980’s, which is high compared to both the EAC (savings stood at 10% in 2008 in Kenya and 18% in South Africa) and advanced economies (Germany and USA in 2005 had domestic savings ratios of 22% and 14% respectively\(^{31}\).

---

\(^{30}\) Corporate income tax rates in 1968 for listed and non-listed companies

<table>
<thead>
<tr>
<th>Taxable income (KRW)</th>
<th>Taxable income (2000 PPP US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>between</td>
</tr>
<tr>
<td>Small enterprise (2)</td>
<td>0</td>
</tr>
<tr>
<td>Medium enterprise (2)</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Large enterprise (2)</td>
<td>5,000,000</td>
</tr>
</tbody>
</table>

Source : K.Chai,(2004), Tax policy and tax system in Korea, Chapter 1 table I-8, KIPF
Notes : (1) Conversion by the author, based on WDI PPP exchange rates and CPI
(2) Qualification of the taxable income bracket by the author

\(^{31}\) It is worth noting that following the decline in external aid to zero in 1974, foreign capital played a significant role in the financing of Korea’s development, but second to domestic savings. Foreign capital largely composed of private loans, which hovered around 7%. Foreign Direct Investment (FDI) was insignificant until 1997, when Korea opened its stock exchange to foreign investors in an attempt to reverse the capital flight triggered by the financial crisis. FDI has since remained below 2%.
From active export promotion to liberalisation

Korea’s tax strategies closely mirrored the sequencing of its development policies. As explained in Chapter 2.1, from 1962 to 1980, Korea pursued an export-oriented infant industry policy, providing temporary protection and privileged support to selected industries. Consequently, during this period, one objective of tax policies was to promote growth of these selected industries. Tax incentives were extensively used, as explained in Chapter 3.2. Similarly, from 1980, as the national policy moved to liberalisation, tax exemptions were eliminated to achieve effective market-based resource allocation.

A number of studies demonstrated that tax incentives did contribute to the financial attractiveness of investment in the priority sectors, but less than credit-based incentives. Kwack (1992) finds that over the period of 1966 to 1985, up to 37% of total investments were provided to key and strategic industries in the form of tax privileges. According to KIPF (2004), in 1970, tax exemptions amounted to 30% of total tax revenue. However, Kwack (1984), using a modified version of the effective marginal tax rate formula developed by D. W. Jorgenson and M. A. Sullivan, found that effective marginal corporate income tax rates were still high and that benefits from tax privileges were effectively lower than one would have expected. The high effective marginal tax rates resulted from high inflation and depreciation regime based on historical costs. Finally, KIPF (2004) found that tax incentives played a role in reducing the cost of capital for export companies, but this impact was much smaller than the credit-based incentives provided by the Government. For instance, in 1966, tax incentives and direct financial incentives reduced the cost of capital from 63% to 54% and 42% respectively.

Benefits of an integrated economic planning process

Korea could fully align its tax policies with the national strategy because it was formulated as part of the integrated five-year economic development plans. The plans were developed by a small team called the Economic Planning Board, established in 1961 by President Park and directly reporting to him. The plans...

---

32 For instance, in 1975, when the benefits were largest, two firms producing machinery, electrical and electric equipment, one qualifying for tax privileges and the other one not, would pay an effective marginal tax rate of 53.2% and 38.7% respectively. The marginal effective tax rate on capital income is the expected pretax rate of return minus the expected after-tax rate of return on a new marginal investment, divided by the pretax rate of return. It therefore measures a reduction on rates of return. The marginal effective tax rates and the tax rate are therefore different concepts and cannot be compared directly.

33 Real discount rate + economic depreciation rate
encompassed all policies, including taxation, focusing on a few common objectives (see earlier for details). The impact of tax policies was enhanced because they were complementing other policies. The list of complementary non-tax measures during the takeoff period is long and included the following: the won was devalued in 1964 by 50%, official interest rates on deposits were raised dramatically in the mid-1960’s to encourage savings, credit-based subsidies were provided to key industries, preferential access to imports in the form of quotas was given to companies with strong export performance, free trade zones were established with streamlined customs procedures, public investments focused on export infrastructure such as ports, systems of centralised wholesale purchase of imported inputs were put in place to increase bargaining power of export-oriented SMEs, high potential SMEs were selected for special support including capacity building and close government performance monitoring, ambassadors were given export targets and held accountable for meeting them. In the social sector, special education programmes were put in place to provide priority industries with adequate skills, and active family planning cut fertility rate from 6.0 to 1.6 over the period 1960-87, thus facilitating capital accumulation (including human capital). Furthermore, tax policy trade-offs could be made up by non-tax policies, illustrating that prioritisation and sequencing offer a solution to overcome conflicting tax objectives. The objectives of increasing revenues and providing incentives for savings and investment in target sectors were given higher priority than others--such as neutrality and equity. However, these trade-offs were largely made up by the outcome of other policies. These, rather than direct revenue transfers, focused on providing pro-poor opportunities. They included equity-oriented expenditure programmes--such as the New Village Movement, which provided performance-based subsidies to villages to improve productivity, a thorough land redistribution programme between 1945 and 1950, and education policies that promote upward social mobility. These policies, combined with decades of sustained growth, enabled Korea to achieve better performance in equity, as evidenced by Korea’s Gini coefficient of 32 in 2008, which is equal to the European average.

Empowering and holding the tax administration accountable

Korea broadened its tax base by making its tax administration both empowered and accountable. The most visible result of creating the NTS was the subsequent rapid increase in central tax revenues, from 9% of GDP in 1966 to 15% in 1980 (7% to 11% for domestic taxes, the remaining coming from customs taxes, under the responsibility of a separate agency). Most EAC member countries have achieved revenue levels in the same range over similar period. However, at similar levels of revenues, Korea seems to have achieved a broader tax base. Below, we present evidence of Korea’s relatively broader tax base and analyse the links between this performance and two distinctive features of Korea’s tax system: a tax administration benefitting from adequate resources and...
Box 3.3: Drivers of tax revenue increase: number of taxpayers and size of the individual tax base

Three factors can individually drive an increase in tax revenues, all other things being equal: increase in tax rates; broadening of the tax base; and improvement in collection (in the narrow sense of effective collection of taxes as they have been calculated). Of course, these factors can move in divergent directions and together result in either an increase or decrease in revenues. For instance, a broadening of the tax base along with a decrease in tax rates can still result in an overall increase in tax revenues.

The tax base is what is taxed. Its broadening can therefore take essentially two forms:

- increase in the number of taxpayers, following an improvement in the identification and registration of tax payers, or a reduction of exemptions; and
- increase in the individual tax base - by tax payers, following a reduction in evasion, a greater accuracy of the estimate of the individual tax base – either through enforcement or voluntary compliance, and an increase in sales and income of individual tax payers

This framework is simplified as it does not explicitly show the feedback effects that link the different parameters. For instance, a decrease in tax rates can contribute to increasing the individual tax base.

Table 3.2: Domestic taxes: drivers of revenue growth – Average yearly growth rate from 1966 to 1969

<table>
<thead>
<tr>
<th>Tax</th>
<th>Real revenue (1)</th>
<th>Average tax rate (2)</th>
<th>Nb. of tax payers (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal income tax (3)</td>
<td>31%</td>
<td>7%</td>
<td>32%</td>
</tr>
<tr>
<td>Corporate tax</td>
<td>26%</td>
<td>-3%</td>
<td>4%</td>
</tr>
<tr>
<td>Business sales tax</td>
<td>27%</td>
<td>0%</td>
<td>6%</td>
</tr>
<tr>
<td>Commodity tax</td>
<td>24%</td>
<td>0%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: NTS, calculations by the authors

Notes:
(1) Arithmetic average of annual growth rates
(2) the average tax rate is the average of the tax rates in each bracket.
The correct average rate should be weighted by the tax base in each bracket.
As the tax base by tax bracket was not available, the average was used as a proxy.
(3) The change in number of tax payers is shown only for the individual business income tax
high level political support, and at the same time fully accountable for results.

**Evidence of a broadened tax base**

A number of macro-level indicators show that Korea succeeded in broadening its tax base. Micro-level indicators for the 1960s and 1970s, such as measures of tax productivity by type of tax could not be calculated because of the lack of detailed data on different tax base (personal and corporate income in particular). First, tax revenues increased significantly, while tax rates and collection efficiency did not, indicating that a broadening of the tax base was a key driver. Most of the revenue increase occurred in the four years following the creation of the NTS, from 1966 to 1969, with an average annual real growth rate of 25%. Our focus was therefore on those four years. Furthermore, the top four domestic taxes were personal income tax, corporate income tax, business tax and commodity tax (both indirect taxes), which accounted for 43% of total tax revenues in 1966, and grew at an annual real rate of 27%. We therefore focus our analysis on these taxes.

Depending on the type of taxes, the growth in revenues was driven by either an increase in the number of taxpayers, or a broadening of the individual tax base. First, there is no indication that collection efficiency improved over the same period – in fact, it might have slightly deteriorated, as arrears (ratio of arrears to tax collection) increased from 8% to 10% from 1966 to 1970. Second, Table 3.2 shows that changes in average tax rates were marginal, between -3% and +7%. As a result, the increase in revenues must be

---

**Figure 3.7: VAT Gross Compliance Ratios– Korea, Uganda and Kenya**

Source: NTS, WDI, Institute of Policy Research and Analysis (Uganda, 2008)
explained by a broadening of the tax base in the form of an increase in the number of taxpayers or broadening of the individual tax base (see Box 3.3).

In the case of personal income tax, the increase of the number of taxpayers was instrumental in broadening the tax base. Personal income tax revenue is composed of many different forms: labour income tax (employees), individual business income tax (small business owners), real estate income tax, and interest income tax. Table 3.2 shows the growth in the number of tax payers for one of these components—the individual business income tax. It grew by a staggering 32% on average from 1966 to 1969.

For both corporate income tax and indirect taxes, increase in individual tax payers was the main driver behind the tax base expansion. Indeed, Table 3.2 shows that the number of tax payers for corporate income tax and business sales tax increased by 4% and 6% respectively, which is largely insufficient to explain a growth rate of 26% and 27% respectively.

The second macro-level indicator, which shows that Korea succeeded in broadening its tax base, is its high level of VAT gross compliance ratio. Because of its flat rate across almost all goods and services, VAT efficiency is one of the easiest and most accurate to measure. Because VAT was put in place in 1977 at the end of the reform period examined in this study and its implementation relied on the systems that were developed from 1966 to 1976, measuring the VAT efficiency at its inception is an indirect way to assess performance of the reforms that enabled its implementation. Figure 3.7 shows the Gross Compliance Ratio (GCR) for selected years in Korea, Uganda and Kenya. Firstly, Korea had had a high GCR, increasing from 39% to 70% over the period.

---

38 Data on the number of tax payers for all components of the personal income tax is not available. A detailed analysis of changes in the number of tax payers by category of personal income tax revealed that there were significant multiple counts of the same tax payers for several categories of personal income tax. For instance, one labour income tax payer was counted for each tax bracket. Therefore, for many personal income tax categories, it was difficult to determine with certainty whether an increase in the number of tax payers resulted from an increase in the number of tax brackets or an actual increase in the number of tax payers. However, the figure for individual business income tax was presented, because the problem did not apply to this tax category. Indeed, the number of tax brackets increased from 5 to 6 over 1966-1969, which could explain an artificial increase in the number of tax payers of 7% per year (20% averaged over three years), far below the 32% achieved.

39 Ratio of VAT revenue to consumption – as a proxy for the taxable base of VAT, divided by the standard tax rate.
Table 3.3: Size of revenue authorities and performance (2008 values unless specified otherwise)

<table>
<thead>
<tr>
<th></th>
<th>Korea, 1966</th>
<th>Korea, 1969</th>
<th>Korea, 1977</th>
<th>Korea, 2008</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Tanzania</th>
<th>Rwanda</th>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff to 1000 population (excl. customs) (1)</td>
<td>0.19</td>
<td>0.30</td>
<td>0.34</td>
<td>0.41</td>
<td>0.11</td>
<td>0.03</td>
<td>0.05</td>
<td>0.09</td>
<td>0.29</td>
</tr>
<tr>
<td>Operating cost to revenue (2)</td>
<td>2.1%</td>
<td>1.8%</td>
<td>1.5%</td>
<td>1.1%</td>
<td>1.6%</td>
<td>3.0%</td>
<td>2.8%</td>
<td>2.7%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Domestic tax revenues</td>
<td>7%</td>
<td>10%</td>
<td>10%</td>
<td>15%</td>
<td>19%</td>
<td>12%</td>
<td>15%</td>
<td>14%</td>
<td>28%</td>
</tr>
<tr>
<td>VAT gross compliance ratio</td>
<td>N/A</td>
<td>N/A</td>
<td>55%</td>
<td>86%</td>
<td>41%</td>
<td>27%</td>
<td>27%</td>
<td>30%</td>
<td>87%</td>
</tr>
</tbody>
</table>

Source: Fiscal reform.net, TRA, KRA, URA, SRA reports and IMF staff reports, NTS, WDI, calculations by the authors

Notes: (1) Because Korea’s revenue authority does not collect customs taxes, in other countries adjusted staff numbers were calculated by multiplying the total staff number by the share of non customs taxes in tax revenues. This provides an estimation of staff number for a similar organization focusing on domestic taxes only.

(2) Only domestic costs and revenues in Korea, total costs and revenues in other countries, including customs

about 55% in 1978 to almost 80% today. This is high by international standards. For instance, Gallagher’s team (2005) calculated the international benchmark value for GCR as 69% for advanced countries. Secondly, the Korean GCR is consistently higher than those for Uganda and Kenya, even when comparing Korea in 1978 with the two East African countries in 2008.

Korea’s ability to collect indirect taxes contributed largely to the overall efficiency of the tax system. Indeed, indirect taxes, at 45% to 50% of revenues in the 1960s and 1970s, were by far the largest tax revenue contributors.

**Empowerment**

Though a combination of factors probably explains Korea’s ability to broaden its tax base, we present one distinctive feature, which played an important role: empowerment of the tax administration. Two aspects of the high-level of empowerment of NTS are the President’s personal support to the Commissioner against external pressure, and the relatively large size of Korea’s tax administration. The administration was protected by top government officials from interference in its operations. For instance, as explained in Chapter 3.3.2, the President personally supported the Commissioner against external pressure. In contrast, many examples can be found in Sub-Saharan Africa (SSA), where Commissioners or high ranking officials are often changed as a result of external influence. For instance, following creation of the Kenya Revenue Authority (KRA), the first two Commissioners General were not able to complete their three-year terms. In Uganda in 1998, as a result of distrust between the Uganda Revenue Authority (URA) and the political leadership, the Ministry of Finance, Planning and Economic Development (MoFPED) curtailed the mandate and administrative autonomy of URA’s Board with an explicit cue from the President.40

In addition, Korea’s tax administration in 1977 and South Africa’s today are better staffed than EAC’s by several orders of magnitude. Korea had about five times as much staff per population as the EAC on average today41, and up to 10 times more than Uganda.

---

40 Fjeldstad (2005)
41 Excluding Burundi, for which data was not available.
Analysing the breadth of the tax base against the size of the administration suggests that EAC tax administrations may be inadequately resourced. Figure 3.8 shows VAT GCR against the size of the tax administration (as explained in the previous chapter, for lack of better measures available, VAT GCR is used as a proxy for measuring the breadth of the tax base). In this sample, no tax administration in EAC has achieved the VAT performance of Korea and South Africa with significantly less staff. This does not mean that increasing the size of the administration is sufficient to achieve a broader tax base, but does indicate that more adequate resources may be necessary to do so.

Using the operating cost-to-revenue ratio as benchmark for the size of a tax administration is misleading and can result in undersized administrations. This ratio is often quoted to justify limiting the size of EAC tax administrations. For instance, an operating cost ratio of 3% in Uganda (see Table 3.3) would be considered high, suggesting that its tax administration would be too large. This is incorrect as it measures size only against one dimension of performance: revenue-to-GDP ratio. It leaves out another critical dimension of performance: the breadth of the tax base, also rightly called efficiency of a tax administration. In the case of Korea, generating high levels of revenues was not an objective in line with Korea’s small government budget strategy. Revenue targets and tax rates were intentionally kept low, which automatically resulted in a relatively high average operating cost-to-revenue efficiency ratio, at 1.8% in 1969. However, this low ratio, reflecting high level of operational resources, could be justified by a good performance on broadening the tax base. It is therefore incorrect to conclude from a high operating cost-to-revenue ratio that resources are inefficiently used and that resources should be reduced. Korea’s case clearly indicates that many of the measures required to broaden the tax base demand significant resources. In particular, staff was required to implement the many measures described in Chapter 3.3.3: creating a tax training institute, strengthening research, conducting on-site investigations, opening of decentralised offices, and registration of all small businesses. Many of these measures have already been undertaken by EAC countries but may require additional resources to yield the expected results.

Accountability and empowerment,

two sides of the coin

As explained in Chapter 3.3.1, accountability took three main forms: (i) close performance monitoring at the highest level; (ii) target revenue approach and incentives for performance; (iii) and zero-tolerance for corruption. To some extent, most EAC countries have implemented these forms of accountability. However, the fact that President Park personally monitored the performance of NTS sets Korea apart and illustrates the commitment for results at the highest level.

Empowerment and accountability should be viewed as two sides of the same coin. Providing large resources and protection from interference at the operational level could have resulted in efficiencies without a tight supervision. Reciprocally, the high pressure to deliver would have been fruitless without adequate means.

---

42 One should exert caution when directly comparing sizes of tax administrations across countries and time periods. For instance, a country with a larger population or economy should normally be able to achieve better economies of scale. In addition, information technologies, which were not available in the 1960s are now widely used and contributing to increased efficiency. In practice, adjusting for differences in these factors is difficult. However, in this specific case, the assumption of the authors is that the effect of adjustments would be marginal compared to the very large size difference between administrations in the EAC on the one hand, and South Africa and Korea on the other.
Conclusion

Tax reforms significantly contributed to Korea’s successful development. They helped Korea rapidly achieve fiscal balance and promoted savings and investment through incentives. However, one of the key reasons for the success of Korea’s tax reforms was their full integration into the broader national strategy. Indeed, fiscal balance was achieved largely because expenditure was reduced; and tax incentives for investment had a major impact because they complemented credit-based incentives.

This study found two lessons of particular relevance to EAC member countries. First, Korea achieved faster results by focusing its tax policies on a few priorities fully aligned with its national development strategy. Second, it broadened its tax base by making the tax administration both empowered and accountable.

One useful way of interpreting these lessons is that part of Korea’s success can be explained by a strong emphasis on implementation, beyond strategy and policies. In fact, many of Korea’s policies and strategies have been adopted in the EAC in one form or another. They include, among others, incentives to promote investment, simplified tax filings for small enterprises, and special initiatives for large payers. Korea therefore stands out for its emphasis on implementation rather than the nature of its policies. Indeed, focused and coherent strategies are a prerequisite for effective implementation. Empowered and accountable execution agencies are critical for efficient delivery. At the same time, implementation plays a central role in Korea’s experience in general, beyond the field of taxation. In this context, it is worthwhile to note that President Park allocated 20% of his time to decision making, and 80% to implementation. As a result, over his 18-year tenure, he spent 119 days a year crisscrossing the country, demonstrating his commitment for results, monitoring them and listening to practical feedback from the ground.
## Annex 3.1: Chronology: politics, economy and taxation

<table>
<thead>
<tr>
<th>Year</th>
<th>5YP</th>
<th>Politics</th>
<th>Economics</th>
<th>Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td></td>
<td>Republic of Korea pro proclaimed (split into North and South Korea)</td>
<td>Creation of modern tax system</td>
<td></td>
</tr>
<tr>
<td>1950</td>
<td></td>
<td>Invasion by North Korea</td>
<td>Major tax acts</td>
<td>Land and temporary tax revenue expansion acts, Land income tax replaces general income tax</td>
</tr>
<tr>
<td>1953</td>
<td></td>
<td>End of Korean war</td>
<td>Reestablishment of civil tax regime</td>
<td>Based on Wald’s report, Abolishment of war taxes, Textile tax absorbed in commodity tax, License tax transferred to local governments, Progressive income tax introduced, Corporate tax based on estimated results introduced</td>
</tr>
<tr>
<td>1958</td>
<td></td>
<td></td>
<td>Three new taxes to increase revenues</td>
<td>Education tax (surtax on personal income), Asset revaluation tax, Foreign exchange tax (targeting black market)</td>
</tr>
<tr>
<td>1960</td>
<td></td>
<td></td>
<td>Tax reform of the Democratic Party</td>
<td>Direct taxes reduced, indirect taxes raised, Introduction of tax exemptions for export and investment</td>
</tr>
<tr>
<td>1961</td>
<td></td>
<td>Glorious revolution - Park Chung Hee president</td>
<td>Economic Planning Board established First devaluation</td>
<td>Special measures to curb tax evasion, Temporary emasure for tax collection, Special measure for tax evasion punishment, Revision of income, corporation and business tax, New accounting system, General tax administration reform, Tax administration simplified, Regional tax offices reorganized, Tax officials screened</td>
</tr>
<tr>
<td>1962</td>
<td></td>
<td>First 5Y EDP: export manufacturing</td>
<td>First comprehensive tax reform</td>
<td>Focus: administrative efficiency, growth, Tax given a central role for growth promotion, Reduction of number of taxes (38 to 28, 15 national taxes), 10 tax laws revised, Adjustment law for national and local tax, National tax appellate application law</td>
</tr>
<tr>
<td>1963</td>
<td></td>
<td></td>
<td>Foreign exchange tax abolished</td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td></td>
<td></td>
<td>Second devaluation</td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td></td>
<td>Normalisation of relationships with Japan</td>
<td>Beginning of international borrowing (including from Japan)</td>
<td>Office of National Tax Administration created, Target revenue approach adopted</td>
</tr>
<tr>
<td>1966</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
<td>Details</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
<td>---------</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| 1967 | Second comprehensive tax reform | Focus: growth, equity, administrative efficiency  
Substantial expansion of tax exemptions for manufacturing export  
Reduction of taxes on capital gains from listed companies, and interests on bank deposits to promote savings  
Liquor and commodity tax raised to discourage consumption of target goods  
Investment 19 tax laws revised  
Real estate speculation control tax introduced  
Higher bracket income and inheritance tax rates raised, lower brackets lowered for equity |
| 1968 | | Measure to improve compliance  
tax penalties raised, tax credits for voluntary returns increased, acceleration of return of overpaid taxes, improvement of the tax appeal system |
| 1969 | | Revision of laws to improve voluntary submission (6 laws including corporate) |
| 1970 | | |
| 1971 | New Community policy (high grain prices). Before that, low grain prices were imposed. | Third comprehensive tax reform  
expansion of corporate and investment tax incentives. Special tax exemptions and depreciation up to 80% for strategic industries, including small and medium size businesses |
| 1972 | ThirdY EDP: diversification  
heavy and chemical industries, steel, machinery, shipbuilding, electronics, oil refining | Emergency decree for economic stability and growth  
generous investment tax credits abolished revenue sharing scheme for local governments |
| 1973 | First oil crisis  
Followed by a sustained inflation in the 70’s | January - Emergency tax reforms  
Focus: equity (protect poor from inflation)  
Tax relief for low wage earns  
December - Fourth Comprehensive tax reform  
Focus: equity and growth  
Comprehensive global income tax introduced  
Capital gains tax replaces real estate speculation control tax  
All incentives to promote key industries unified under one law: «Tax exemption and reduction control law». Strategic industries (shipbuilding, machinery) are given choice between one of three incentives: direct exemption, investment credit, special depreciation  
Business tax rates raised to prepare for VAT  
Withholding tax extended to manufacturers and wholesalers  
Reporting system reinforced  
Basic law for National Taxes: improve tax payers rights by prohibiting retroactive taxation, introducing assessment based on bookkeeping and establishment of the Tax tribunal as a special independent agency |
<p>| 1975 | | defence tax law introduced |</p>
<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>Fifth comprehensive tax reform</td>
<td>VAT and special excise tax introced 8 of 11 indirect tax laws revised</td>
</tr>
<tr>
<td></td>
<td></td>
<td>entertainment and food tax become national registration tax becomes local</td>
</tr>
<tr>
<td>1977</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>Recession following stabilisation measures to fight inflation</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>Park Chung Hee assassinated, followed by continued military rule</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>Second oil crisis</td>
<td>Major shift towards liberalization</td>
</tr>
<tr>
<td>1980</td>
<td></td>
<td>Reforms to reduce exemptions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Revision of the «Tax exemption and Reduction Control Law»</td>
</tr>
<tr>
<td>1987</td>
<td>First democratic elections</td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td></td>
<td>Global landholding tax introduced, to curb land speculation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Transfer of the tobacco tax from central taxes to local taxes</td>
</tr>
<tr>
<td>1990</td>
<td></td>
<td>Defence tax law abolished</td>
</tr>
<tr>
<td>1996</td>
<td></td>
<td>Global income tax includes financial revenues</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Self-assessment introduced</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Corporate tax reduced to improve competitiveness</td>
</tr>
<tr>
<td>1997</td>
<td>Esat-Asian financial crisis</td>
<td>Tax reforms to facilitate restructuring and attract FDI</td>
</tr>
</tbody>
</table>
Annex 3.2: Bibliography

Taxation General

Aizenman J., Jinjarak Y. (2005), The collection efficiency of the value added tax: theory and international evidence, Department of Economics, University of Santa Cruz
Bird R., Zolt E. (2005), Redistribution via Taxation: The Limited Role of Personal Income Tax in Developing Countries, University of Toronto Working Paper
Gallagher M. (2005), Benchmarking Tax Systems, Public Administration and Development 25,125–144 (2005), Published online in Wiley InterScience (www.interscience.wiley.com)

Korea's Development Experience

Bahl, Kim and Park (1986), Public finances during the Korean modernization process, Council on East Asian Studies, Harvard University
Kim K. (1991), The Korean miracle (1962-1980) revisited: Myths and realities in strategy and development, Kellogg Institute at the University of Notre-Dame
Chang H. J. (2006), The East Asian development experience: the miracle, the crisis and the future, Cambridge
Stiglitz J., Shahid Y. (2001), Rethinking the East Asian Miracle, World Bank
ZaghaR., Shvets O. (2004), Scaling up poverty reduction: lessons and challenges from China, Indonesia, Korea and Malaysia, World Bank
Kim Joon-Kyung (2010), Shared Growth: Korea’s experience during the take-off period, Presentation to the African Development Bank, KDI school of Public Policy and Management
KDB (Korean Development Bank)(1986), Nathan Report: the plan for reconstruction of Korean economy (in Korean)
South Korea’s Economic Development Plans
www.country-data.com/cgi-bin/query/r-12300.html
South Korea’s First Economic Development Plan
www.dwnam.pe.kr/102plan.html

Korea's taxation experience

Choi, K. (1990), Tax Policy and Tax reform in Korea, World Bank, Public Economic Division
Choi, K. (2004), Tax policy and Tax system in Korea, Korea Institute of Public Finance (KIPF)

Choi, K. (1990), Tax Policy and Tax reform in Korea, World Bank, Public Economic Division

Choi, K. (2004), Tax policy and Tax system in Korea, Korea Institute of Public Finance (KIPF)


Kwack Taewon (1986), Business Taxation and Industrial Policy in Korea, Korea Development Review, Spring: 77-97


Kwack T., Yoo I., (1984), Tax Incentives and Economic Development, (Korea Development Institute)


Kim H. (2004), Status and challenges of Korean National Tax Administration, Korea Institute of Public Finance (KIPF), Seoul (in Korean)

Kim Junghun (2005), Tax reform issues in Korea, KIPF

Lee H., Chun, S. (2003), Assessment on Tax and fiscal policy for 50 years, Korea Institute of Public Finance (KIPF), Seoul

NTS (1986), 20 years of the NTS, National Tax Service (NTS), Seoul (in Korean)


South Korea Tax Guide (brief history of Korea’s taxation page 33)

Randall Jones (2009), Reforming the tax system in Korea to promote economic growth and cope with rapid population ageing, OECD, Economics department working paper No. 671
Taxation in EAC and Africa


Part III

East Africa experience and lessons
Chapter 4

Burundi
Summary of Key Findings

Context-Political economy and fiscal legacies

Burundi’s economic recovery has been evident since 2005, but there are no signs that it will achieve high economic growth in the short-to-medium term. For instance, the IMF (2010) projects its real GDP growth will be 4.5% and 4.8% in 2011 and 2012 respectively. The projection indicates that, in the foreseeable future, the economy will remain dominated by agriculture and a large informal sector, which accounts “for 75% of urban employment”, predominantly in the capital city of Bujumbura (World Bank, 2010). This outlook suggests an economy with severe binding constraints to DRM. Until relative peace was restored in Burundi five years ago, the country, with a population of about one million, had been beset by ethnic conflict for many years, thwarting its march towards political stability and economic development. It is indeed a paradox that successive military coups and prolonged civil war did not seriously disrupt the tax administration system, or even undermines the tax efforts that could result in low tax-to-revenue GDP ratios. However, prolonged conflict and instability associated with the war spawned rampant corruption in all aspects of public sector management, including tax administration. It is against this background that the Government of Burundi (GoB) has recently established the Office Burundais Des Recettes (OBR – Revenue Authority of Burundi).

The demand for peace dividends by the people in terms of rapid improvements in public service delivery will probably be the primary fiscal driver in Burundi for the foreseeable future. International development organisations (IDOs) have also been key drivers of fiscal governance during periods of relative peace. Since 2005, Burundi has had an exceptionally high share of external development assistance in its public expenditure budget. On average, external assistance accounted for up to 62% of the budget a year, but in some years it fluctuated. For instance, in 2007, it covered 50% of the budget). Also, GoB anticipated considerable increase in the volume of external resources after the elections of June 2010. But it did not materialise as some donors cut their assistance due to the global recession. Furthermore, in the medium term, building the capacity of OBR is expected to result in improved tax revenue collection. Therefore, from a historical perspective, Burundi’s medium-to-long term fiscal governance trajectory holds promise.

Tax reforms: Sequencing, implementation and results

OBR has barely been in existence for more than a few months. Therefore, it is expected that with time, its management will map out a comprehensive reform strategy. In the mean time, GoB, with the support from its development partners, has accomplished the following:

- Promulgation of the Value Added Tax (VAT) law in 2009, which brings Burundi closer to ensuring that its tax regime is aligned with international practices, and its partner states in the EAC;
- Adoption of the EAC Customs Union protocol (and thereby common external tariffs (CETs)), which underscores Burundi’s commitment to regional integration, as well as improvement of the doing business environment within EAC; and
- Adoption of the new revenue authority digital data exchange system (RADDEX), whose implementation is almost complete, and, is expected to streamline clearance processes as well as minimise theft and fraud.
Domestic revenue performance

From 1998 to 2008, despite the legacy of prolonged civil war, Burundi’s domestic resources on average grew at 14.1% a year, contributing 19.1% of GDP. The highest contributor to domestic tax revenue has consistently been taxes on goods and services, whose share in 2008 stood at 42.9%. During that 10-year period, taxes on goods and services grew at an average annual rate of 17.6%. The next highest contributor, income taxes, which by 2008 also constituted 42.9% of the total taxes collected, grew at an average annual rate of 14.2%.

Revenue growth in future years is expected to improve with the establishment of OBR, introduction of VAT, and systems modernisation. However, in the medium term, there will probably be acute limitations on Burundi’s DRM growth for as long as the economy remains predominantly agriculture based.

Challenges and issues

There are several challenges and issues that GoB needs to tackle in the medium term, including the following:

- Managing the transition to an autonomous revenue authority: OBR will need to develop a strategic plan to guide its revenue mobilisation efforts, in particular to sustain, but also surpass previous revenue collection targets;

- Retaining staff with skills and integrity: To ensure that it can retain and motivate staff, OBR will be challenged to offer competitive salaries on a sustainable basis;

- Ensuring efficiency of tax incentives and exemptions: Burundi is yet another country plagued with the issue of tax incentives and exemptions, which need to be rationalised in order to widen the tax revenue base;

- Widening tax base: Key informants and the literature on Burundi indicate that several informal sector traders remain outside the tax net. So do several informal businesses because of GoB’s “complex and burdensome rules and regulations” (World Bank, 2009);

- Combating corruption effectively: High levels of corruption in Burundi constitutes a key challenge to DRM; and

- Ensuring harmonised, systematic and policy-led regional integration measures: For instance, it is noteworthy that Burundi’s top marginal personal and corporate income tax rates, at 60% and 35% respectively, remain the highest in the EAC.

Lessons learned

The establishment of OBR heralds the start of an era of reforms that other EAC countries have been implementing over the past decade. Against that backdrop and at this stage, there are only two lessons that can be derived from the Burundi DRM case study. They are:

- Inaccurate national statistics can translate into a misleading measurement of tax effort: It has been suggested that Burundi’s GDP figures may have been consistently understated through the years, which results in an exaggerated tax revenue-to-GDP ratio. This underscores the need to improve national statistics so as to enhance evidence-based policy making; and

- Major policy initiatives should be backed by rigorous assessment of outcomes: Burundi has demonstrated the benefits of rigorous assessments as a basis for major policy development, in
particular, risk mitigation associated with policy changes. For example, one of the key factors that determined Burundi’s VAT rate was the need to compensate for anticipated revenue losses from the adoption of CETs. The rest of the chapter is organised as follows: The first section discusses the political economy and fiscal legacies, the second section covers trends in the tax system, the third section explores domestic revenue performance, the fourth section highlights the challenges to increasing DRM, and the fifth section concludes with lessons learned.
Context – Political economy and fiscal legacies

A legacy of prolonged civil war and its impact on the economy

Almost from the time it attained independence in 1962, Burundi experienced political instability and violence. In 1966, following a military coup, Michel Micombero declared himself President after overthrowing King Ntare V Ndizeye. Ten years later, President Micombero was deposed by Pierre Buyoya in another coup. It was not until 1993 that Burundi held its first multi-party elections, which were won by President Melchior Ndadaye. His assassination four months later plunged Burundi into ethnic conflict, which resulted in the loss of an estimated 300,000 lives. Thereafter, Parliament appointed two Presidents in quick succession, Cyprien Ntaryamira (who was killed when an airplane he was travelling in was shot down in April 1994), and Sylvestre Ntibantunganya who ruled for about two years until he was overthrown in 1996 by President Pierre Buyoya (BBC, 2010). In response to this coup, the World Bank (1999) reports:

“Regional leaders imposed economic sanctions covering trade and transportation, with dramatic effect on growth, poverty, and social indicators. Many bilateral donors observed these regional sanctions, and aid levels fell from around US$300 million per year to US$27 million”.

From 1999, leaders from other African countries facilitated talks with the warring factions aimed at brokering a peace deal. In particular, the late former President Mwalimu Julius Nyerere of Tanzania initiated the process. Following Mwalimu’s death in 1999, former President Nelson Mandela of South Africa was instrumental in the signing of the Arusha Peace Agreement in 2000, which paved the way for the establishment of a transitional government. However, it was not until 26 August 2005 that President Pierre Nkurunziza became Head of State when his party, the National Council for the Defense of Democracy-Forces for the Defense of Democracy (CNDD-FDD), won the second ever democratic elections in Burundi (Bigirimana, 2005). These elections were held following a 2004 referendum in which voters endorsed a power-sharing constitution.

The new government was faced with the formidable challenge of rebuilding Burundi’s economy. In the decade following 1975, the economy grew at a modest rate of 0.5% a year. From the late 1970s to 1992, economy grew at a faster annual rate of almost 4%, largely due to a coffee boom. However:

“Economic prospects were significantly affected by the civil war which occurred between 1993 and 2000, during which the national capital stock depreciated by 44%, real GDP per capita fell by almost 27% (from US$137 to US$100), and by 2002 the number of people below the national poverty threshold increased from 35% to 68%...[From 1993 to 2000], average real GDP growth fell to -2.4% per annum” (IMF, 2006).

Peace and economic recovery efforts since 2005

From 2005, the new Government began to implement the “disarmament, demobilisation, and reintegration of former combatants and the armed forces” (GoB, 2005). With the support of the IMF and other development partners, it also embarked on implementing macroeconomic and fiscal reforms, including: improving governance and efficiency of the central bank; slowing monetary growth by reducing levels of credit made available to government; liberalising exchange rate system; strengthening public financial management systems; controlling public expenditure; reforming tax administration; and introducing structural reforms in the coffee sector. Furthermore, GoB “made good gover-
nance and combating corruption a primary objective of its administration” (IMF, 2006). To this end, it established an audit function and drafted anti-money laundering legislation.

To address poverty issues, following a consultative process, in 2006, GoB prepared its first full Poverty Reduction Strategy Paper (PRSP). The PRSP has four strategic objectives: (i) improve governance and security; (ii) promote sustainable and equitable economic growth; (iii) develop human capital; and (iv) combat HIV/AIDS. By late 2006, Burundi’s macroeconomic performance began to show signs of improvement: Monetary policy was stronger; inflation was down to single digit (but started to rise again thereafter due to high commodity prices before declining again in 2008/09); and the economy started to grow. “Real GDP growth increased to 4½% in 2008, up from 3.6% in 2007, mainly because of a good coffee harvest and more donor-financed investment projects” (IMF, 2009b).

Agriculture, until a few years ago, was the predominant contributor to Burundi’s economy. In 2003, according to the United Nations Conference on Trade and Development (UNCTAD), agriculture, services and industry contributed 42%, 32% and 19% respectively to Burundi’s GDP. A report by the United States Agency for International Development (USAID) in 2005 revealed that “agriculture employed 93% of the labour force”. Nonetheless, estimates for 2009 indicate a substantial shift in the composition of Burundi’s GDP with agriculture, services and industry contributing 33.3%, 45.8% and 21% respectively.

Within a few years of achieving relative peace and stability, Burundi’s social, political and economic prospects now look promising. In its first progress report on implementation of the PRSP, GoB (2008) reported the following:

- As “of end-December 2007, some 20,330 persons had been demobilised out of a total manpower of 55,000”;

- “A national decentralisation and development policy letter was adopted and the law organising the administration…revised”;

- Substantial expenditure on primary education by GoB and development partners facilitated access to free primary education for many Burundian children. The IMF (2010) reported a significant rise in net enrolment rates to 81% in 2008, up from 43% in 2000;

- Immunisation coverage was vastly expanded. By 2008, 75% of children, aged between 12 and 23 months, had been immunised against measles (IMF, 2010). GoB also accorded high priority to preventative and curative care to HIV/AIDS patients; and

- On 18th June 2007, at a ceremony in Kampala, Burundi signed the treaties of accession into the EAC.

### Development financing mix and challenges

Figure 4.1 shows trends in the overall development financing mix for Burundi. Between 2000 and 2007, the largest source of development financing was bilateral aid, which averaged at 36.5% of GDP and grew at an average rate of 26.9% a year. GoB also financed its expenditures from domestic revenues, the second source of development financing (see Section on Domestic revenue performance).

---


Exports of goods and services between 2000 and 2008 contributed on average 8.6% of GDP, and were the third largest source of development financing. Burundi’s exports are largely primary commodities – in particular, “coffee exports have accounted for about 75% of export revenues in recent years” (Basdevant, 2009). As a result, foreign exchange earnings are vulnerable to fluctuations in the international commodity prices. Burundi’s landlocked status and weak infrastructure also undermine its export competitiveness.

Between 2000 and 2008, direct investment in Burundi was negligible, at 0.2% of GDP. This happened despite the fact that GoB is open to foreign direct investment (FDI), especially in the mining, tourism and services sectors. Burundi has deposits of nickel, gold, uranium, cobalt, copper, platinum, among others, and “preliminary works with two drills have shown possibilities of finding oil resources in the depth of the base of Lake Tanganyika” (Davenport, 2008). However, a 2010 UNCTAD review indicates that “the challenge for Burundi to attract significant FDI inflows is considerable” as the nation still needs to strengthen its business environment, infrastructure and human capital. Nevertheless, in recent times, several international as well as African businesses have invested in Burundi, including Ecobank of Nigeria, and Diamond Trust and Bank of Africa from Kenya.

Compared to other EAC countries, Burundi’s total public expenditure and net lending since 2001 has been relatively high at 27.2% and 36.8% of GDP in 2001 and 2005 respectively. Military expenditure, ranging between 6.2% and 8.0%, constituted a large part of this expenditure. Burundi has financed a significant proportion of its public expenditure by borrowing. By 2005, the country’s external debt had reached unsustainable levels, at 189.3% of GDP (IMF, 2006). At that point, the IMF and World Bank worked closely with

---

3 Data on ODA for 2008 is not available.
GoB to ensure that Burundi met the criteria required to qualify for debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. In January 2009, Burundi had reached the completion point under HIPC. As a result, it qualified for debt relief in the amount of US$833 million, and was also “eligible for further debt relief from the IMF, IDA, and the African Development Fund (AfDF) under the Multilateral Debt Relief Initiative (MDRI)”

Political economy dynamics
underpinning domestic resource mobilisation

The synopsis of the political economy legacies that have impacted DRM, as presented in the subsections that following, is based on Brautigam’s (2008) analytical framework. It consists of five facets: (i) level of economic development and economic structure; (ii) societal factors: culture, values, trust and ‘tax morale’; (iii) war and taxes: bureaucratic modernisation as a response to threat; (iv) political institutions and tax systems; and (v) taxation and fiscal contract.

A small economy dominated by agriculture and a large informal sector

Burundi’s economy has always been predominantly agriculture based. It is mainly subsistence, but there are a few limited export commodities. Coffee and tea account for most of the foreign currency earnings. Many years of war ravaged the economy, but paradoxically, a significant level of modern business activities continued.

In the years of war, economic performance was erratic with an overall decline, but interspersed with some years of positive growth.

Economic recovery has been evident since 2005, but signs of particularly high economic growth are lacking in the short-to-medium term. For instance, IMF (2010) projects the real GDP growth will be 4.5% and 4.8% in 2011 and 2012 respectively. It indicates that, in the foreseeable future, the economy will remain small, an-continue to be dominated by agriculture and a large informal sector, which accounts “for 75% of urban employment” mainly in the capital city of Bujumbura (World Bank, 2010). This reflects an economy with severe binding constraints to DRM.

An evolving culture
of nationhood and social solidarity, but high levels of distrust remain and tax morale is virtually non-existent

Until relative peace was restored in 2005, the pronounced socio-culture characteristic for many years was conflict and fear among the population due to violence and the “unequal distribution of economic resources and political power” (Taabco, 2008). However, a sense of nationhood, social cohesion, as well as individualism is fast evolving. According to the USA’s Special Adviser to the Great Lakes Region: “If you go to Burundi today, though they still have many issues in front of them, you will no longer hear the dialogue framed in terms of Tutsi versus Hutu”.

---

5 Brautigam’s framework is adopted because compared to others that were examined; it is judged to be more comprehensive and elegant. However, like most others, its historical perspective derives too much from the emergence of the modern European state to be linearly applied to states that are legacies of colonial rule, such as Burundi.
7 In a society where “tax morale” is high, there are low levels of tax evasion and avoidance. It is only in a social culture where citizens generally appreciate their responsibility for sustaining state services and where they have a trust in their state institutions and leaders that a “tax morale” evolves.
Yet, a strong distrust of political leaders still persists. However, there is no questioning of the legitimacy of the government in power – “The [2005] elections were...judged to be free and transparent...[producing], a clear result which...gave legitimacy to the new institutions” (Umoya, 2009). However, politicians’ role in instigating hostilities in the past, coupled with public experience and perception of widespread corruption, has sustained a high-level of distrust of political leaders and government. In this environment, tax morale is virtually non-existent.

Following cessation of hostilities, peaceful co-existence is a treasured value all round. It appears that the vast majority of Burundians will go to any length to ensure that peace and stability prevail. They recognise “that their economy has been destroyed,...society [is] fragile and they can only manage with support from neighbours, the region and the international community” (The East African, 2010). This is an environment in which a government, with a clear vision and strong strategy for economic growth and poverty reduction, can propagate tax morale.

No attempt at bureaucratic modernisation until recently

Until the ongoing initiative to establish OBR, there has been no attempt at bureaucratic modernisation in Burundi. One of the paradoxes of the prolonged war in Burundi is that the bureaucracy (public service) remained largely intact, albeit, demoralised and with diminishing capacity. Thus, annual statements of central government operations throughout the years of conflict indicate that the public service bodies, including the revenue collection departments in the Ministry of Finance, continued to collect taxes and regularly pay both public servants and the military personnel. According to key informants to this case study, this comparatively solid state of public administration is largely attributed to the legacy of Belgian colonial administration. It is nonetheless paradoxical that, as the review of tax revenue performance will show, the military coups and prolonged civil war did not seriously disrupt the tax administration system or even undermine the tax efforts. It also explains why they didn’t result in low tax-to-revenue GDP ratios. On the contrary, the ratios, which ranged between 16% and 18% from 1998 and 2008 (see Section on Domestic revenue performance), have consistently been higher than in all the EAC countries, except Kenya, for most years where comparative statistics are available. Some key informants explained this paradox on the basis of the distinct possibility that there have been persistent measurement errors through the years, in particular, a gross underestimation of the GDP. This perspective is backed by the fact that in spite of high tax collection levels, Burundi is still heavily dependent on international development assistance. In any case, aside from the latter perspective, there is no ready explanation as to why the tax and other public administration systems did not collapse under the disruptive effects of civil war. Therefore, alternative hypotheses to explain the paradox are warranted. Three are proffered here. First, successive elites that captured power in Burundi over the years appreciated the need for preserving the tax administration institutions as instruments that could facilitate extractions from individuals as well as from the state. According to Nkurunziza and Ngaurko (2005), rent capture by a small group was the overarching objective of successive governments since the mid-1960s. The second alternative hypothesis, and they are not mutually exclusive, is that the public administrators were knowledgeable enough to keep paying adequate royalties to the ruling elite in return for preserving the system and retaining their jobs and associated perks. Whatever the factors, it is noteworthy that a robust tax administration system survived the wars in Burundi. The third perspective is that the elites who captured power made an effort to sustain the tax system because, until recently, there has not been any strong local motivation to recreate or reform the revenue collection institutions.
Limited political interference, but bureaucracy and corruption characterise public administration

As indicated above, the colonial administration bequeathed successive Burundi regimes a tax system that was embedded in public administration structures under conventional ministries. It would seem that Burundi’s political institutions did not, on the whole, interfere with either the public administrations or the tax systems. However, prolonged conflict and instability associated with the war spawned rampant corruption in all aspects of public sector management, including tax administration. A study commissioned by USAID (2006) reported that “tax collection is clearly lower than its potential; and customs duties are routinely evaded by deliberate misclassification and abuse of exemptions”. It would appear that the only restraint to total fraud in the tax administration was public service managers’ concern to ensure the availability of resources for salaries and rudimentary operating expenditures. Another USAID (2008) report suggests that:

“The problem [of corruption] is exacerbated by Burundi’s unstable political situation; when ministers and agency heads change frequently, there is little oversight and a strong incentive for incumbents to grab what they can while they can”.

The onset of peace does not seem to have abated fraud and corruption. It is against this background that the GoB has recently established OBR. The momentum to establish the revenue authority was also driven by Burundi’s accession to the EAC. The other four partner states already have autonomous revenue authorities (ARAs). The President of Burundi and other political leaders have expressed that: (a) OBR will be modelled along the lines of the best systems and practices of the other EAC ARAs; and (b) OBR will overcome the constraints around staff competence and morale, bureaucracy and corruption that characterised the legacy tax administration system.

A fiscal contract between the state and its citizenry was never a real prospect

In the absence of democratic practice during much of the period of Burundi’s post colonial existence, a fiscal contract between the state and its citizenry was never a real prospect. It could be argued that the bureaucracy enforced the legacy tax system because the associated revenue was critical to its own survival. In these circumstances, the tax base remained narrow, and focused on areas where enforcement was easy. This situation has continued until today. According to key informants, about 200 large taxpayers contribute 80% of total internally collected revenues, and 1,500 small and medium taxpayers pay the rest. “Indeed, one company—Brarudi, the brewery—contributes over 20% of non-customs tax revenues” (USAID, 2008).

The need for a fiscal contract has also been rendered somewhat irrelevant by the availability of substantial external resources to fund public service delivery and development activities. The IMF (2010) reports that in 2007 and 2008, government financing from external grants as a percentage of GDP was 20.9% and 24.9% respectively. In addition, government financing from external grants as a percentage of GDP was projected to rise to 90.3% in 2009, mainly as a result of debt relief through the HIPC initiative, but is expected to drop to 25.0% in 2012 (IMF, 2010).
Fiscal governance drivers, results and trajectory

Other than the public service sustaining the legacy fiscal frameworks and the tax administration system, there is some evidence of one other indigenous fiscal governance driver in the past – i.e., rent capture by an elite. As Nkurunziza and Ngaurko (2005) observed, rent capture by a small group was the overarching objective of successive governments since the mid-1960s.

Nevertheless, it would appear that IDOs have also been key drivers of fiscal governance in Burundi in periods of relative peace. Since 2005, Burundi has had an exceptionally high share of external development assistance in its public expenditure budget. In aggregate, development assistance is estimated to be between 55% and 60% of total public expenditure. However, prolonged war denied GoB and development partners the opportunity to develop a systematic policy dialogue. Following the 1996 coup, donor sanctions were only lifted in 2000 when:

“International assistance resumed..., demonstrated by the pledges of US$440 million made at the international donor conference held in Paris in December 2000, and the additional pledges at the Round Table donors meeting in Geneva in December 6-7, 2001, bringing the pledges to US$830 million” (World Bank, 2002).

Still, in the past four years, besides receiving conventional assistance, GoB has engaged in policy dialogue with IDOs, particularly the IMF and World Bank, leading to the write-off of its debts under the HIPC initiative. Concurrently, it has entered into a Poverty Reduction Growth Facility (PRGF) with the IMF. Both HIPC and PRGF commit GoB to macroeconomic and fiscal performance benchmarks, as well as to a more stringent fiscal discipline, including the reduction of subventions to loss-making enterprises. On the heels of HIPC and PRGF, GoB has also entered into consultative policy dialogue with other IDOs under the leadership of the World Bank. One significant benefit of these developments is access to budget support from five international development partners, including the AfDB. If the GoB can sustainably deliver on its policy commitments in the short term, it can expect to benefit from substantial additional budget and project support in the long run.

After five years, majority of Burundians are still waiting for peace dividends. Furthermore, “socio-economic instability has not been dealt with as a priority”, in particular, through creation of employment and income-generating activities for the redundant ex-combatants and large numbers of idle youth (Specker et al, 2010). In addition, the same authors state that “current patterns of economic governance do not appear well suited to a concerted, medium- to long-term project for development”.

GoB anticipated a considerable increase in the volume of external resources after the elections of June 2010. Furthermore, in the medium term, building the capacity of OBR is expected to result in improved tax revenue collection. Therefore, from a historical perspective, Burundi’s medium- to long-term fiscal governance trajectory holds promise.
Trends in the tax system

Key tax policies since 2005

In the years of political instability and violence, there was no proactive tax policy stance by successive governments. In 2005, GoB initiated reform of its tax systems with a focus on lowering and streamlining the tax regime. It was aimed at “raising domestic revenue, reducing smuggling, simplifying administration and boosting trade” (IMF, 2005). This sub-section highlights key developments with respect to the three major categories of taxes collected in Burundi: taxes on domestic goods and services; income tax; and taxes on international trade.

On 1 July 2009, GoB introduced VAT at a standard rate of 18%, except for exports which are zero rated, and imports for diplomatic and certain international organisations which are exempt. It replaced the transaction tax (Decree Law No. 1/04 of 1989 and 1/005 of 1994), which was levied at a rate of 17%\(^\text{10}\). The rationale for its introduction was twofold: “to raise the efficiency of tax collection, and offset potential losses on customs revenue due to [Burundi’s] accession to the EAC” (IMF, 2008). GoB also prepared an action plan to phase out the transaction tax.

The other tax levied on domestic goods and services is excise, which is levied on beer, soft drinks and tobacco in accordance with Decree Law No. 01/02. Products destined for export are exempt from excise tax.

Income taxes are levied in accordance with Part II of the General Tax Code, which was first enacted in 1963 and amended numerous times since then\(^\text{11}\). The highest marginal income tax rate on companies is 35%. The rate is levied on “all net profits received by domestic and foreign companies from Burundi sources” (IMF, 2004). Certain institutions are exempt from corporate tax (e.g., firms covered under the investment code, agriculture and livestock businesses). It is also noteworthy that loss-making companies are required to pay corporate tax equivalent to 1% of their turnovers. There is also a tax on capital income (of 35%) payable on dividends and equity ownership in companies. Personal marginal income tax rates range from 0% to 60%. However, exemptions are offered again, for example, to any income covered by international conventions (e.g., the Vienna convention).

In addition, a “rental income tax is [levied] based on…progressive tax brackets, ranging from 20% to 60%” (GTZ, 2009).

Burundi became a signatory to the EAC Customs Union protocol in July 2009, prior to which: import duties were levied in accordance with Preferential Trade Area (PTA) tariffs for goods emanating from PTA countries; customs duties were charged on goods from outside the PTA area; an ad valorem tax was payable on petroleum products; and a 6% services tax was charged on cost, insurance and freight (CIF) values. The Protocol is enshrined into the East African Community Customs Management Act of 2004, which underpins the establishment of CETs and elimination of internal tariffs. It also brought about the: harmonisation of customs principles and procedures; and removal of suspended duty.

It is noteworthy that in 2008, Burundi’s National Assembly promulgated a new investment code simplifying “existing legislation and [harmonising it] with frameworks applicable in the EAC” (De Backer and Binyingo, 2008). Under the code, an Investment Promotion Agency is to be established. The code also broadens eligibility criteria to allow existing firms as well as those requiring rehabilitation to receive incentives. In addition, the new legislation provides for “tax advantages for investors [to be granted automatically] rather than…[through] prior authorisation” (USAID, 2008). However, implementation of the in-

\(^{10}\) Previously there were three different transaction tax rates levied: (1) 7% (e.g., for agriculture, fishery and livestock products; meat and real estate sales); (2) 17% (e.g., on imports, manufacturers, services); and (3) 20% (e.g., on telecommunications, sales of cigarettes).

\(^{11}\) However, GoB has issued “additional laws as well as orders…and rules” (GTZ, 2009)
vestment code has been on hold as “provisions concerning tax incentives make reference to the tax code”, which has only recently been drafted (World Bank, 2009).

In an effort to streamline the tax system (particularly indirect taxes) and remove exemptions, the National Assembly, in its 2008 budget, promulgated a new tax on cable television, hotel and tourism. It also eliminated “the transaction tax on real property transfers; and [reduced] transfer tax [rate] on...property sales from 6% to 3%” (GoB, 2008).

Other institutional changes

In 2009, Parliament passed the OBR Law, which came into force on 14 July of the same year (IMF, 2010). OBR aims to: widen tax base and mobilise more revenue; narrow communication gap between taxpayers and the fiscal administration and, thereby improve relationships; provide better services to taxpayers including education; simplify tax administration procedures; and promote improved staff performance.

The authority did not become operational until 1 April 2010. Since then, the implementation momentum has picked up with the support of the Department for International Development (DFID). It appears that the establishment of the OBR is significantly influenced by the models and experiences of the other EAC ARAs, especially the Rwanda Revenue Authority.

At the time of writing this paper, OBR intended to hire 600 people through an open-recruitment process. The first two phases of recruitment for 21 executive and senior management team positions had been completed. Then a Commissioner General (CG), Deputy Commissioner General (DCG), Commissioners and Directors were recruited following: the screening and short-listing of over 400 applications; further candidate screening through assessment centres; and selection by the Board following assessment centres.

A Board of Directors, comprising eight members from the private and public sectors, and accountable to the Ministry of Finance, had been appointed. The Board is required by legislation to meet on a monthly basis. However, in the initial stages of OBR’s launch, it met every week.

Three Commissioners report to the CG: Customs and Excise; Domestic Tax and Non-Tax Revenue; and Investigations and Anti-corruption. In addition, CG is in-charge of various technical support functions such as: appeals; research and performance; taxpayer information; risk analysis; internal audit and assurance; and EAC matters. The DCG is responsible for functions such as finance, human resources, and ICT and electronic business.

Changes in administrative systems

The systems supporting the administration of inland revenues are largely manual. The study team was informed that in 2005, GoB procured a computer-based system, NIF, to generate and maintain tax identification numbers (TINs). However, the system has not been effective due to some technical defects. Therefore, GoB is looking to install a more reliable automated TIN system.

“A new customs code was promulgated in 2007 to make customs procedures more efficient [and to comply with the Kyoto protocol]” (IMF, 2008). This customs code has been incorporated in Automated System for Customs Data ++ (ASYCUDA++). This version of ASYCUDA allows for direct trader input so that importers can lodge declarations from their bases,
thereby facilitating a reduction in clearance times. OBR also uses ASYCUDA++ to generate trade statistics, which are exported to an ORACLE database that is used to convert data into formats, such as Excel and Access. At the time of writing this report, OBR was pilot testing the RADDEX system. It is also operational in Kenya, Rwanda, Tanzania and Uganda.

OBR recently launched a French language website http://obr-gouv.org/. Understandably, this website is still at the ‘bill-board stage’ – it currently provides news, information (e.g., on organisational arrangements, senior executives, vacancies etc.) and downloads (e.g., legislation). With time, OBR will presumably develop its website to provide various taxpayer services. Furthermore, given that Burundi is part of the EAC, the website will hopefully offer information and services in other languages, such as English and Kiswahili.

Fiscal decentralisation and taxation by local governments

Public administration in Burundi is, on the whole, characterised by weak capacity at the central and local government levels, including paltry local revenue collections. Decentralisation and the local finance system are in their infancy. Although the decentralisation process was started in 2005, it is still being discussed at Cabinet level and major progress is not expected before the completion of central and local elections in 2010 (Specker and Briscoe 2010).

Reform sequencing, implementation and results

OBR has barely been in existence for more than a few months. Therefore, it is expected that, with time, the agency’s management will map out a comprehensive reform strategy to support attainment of its objectives as outlined in Section on “Other institutional changes”. However, it is worth drawing attention to the fact that some of the tax policy measures and planned systems described earlier, constituted part of GoB’s immediate reforms under the PRGF. For example, the French Development Agency assisted GoB in the development of the new customs code. Furthermore, OBR is receiving financial and/or technical assistance support from: the IMF in the area of VAT; DFID through Trademark East Africa in establishing OBR; and the World Bank’s Financial and Private Sector Development, and Economic Management Support Projects in simplifying tax procedures.

At this stage, it is premature to gauge the impact of tax and administrative reforms on DRM. However, GoB with the support of its development partners, has accomplished the following:

• GoB undertook a “budgetary and economic impact study on Burundi’s entry into the EAC” (GoB, 2008). It also assessed the impact of introducing the VAT. In the medium term, both policy measures are expected to have a “positive impact on revenue...[however the], studies show that they could result in a loss of revenue amounting to about 0.4% of GDP in 2009” (IMF, 2009a);

• The VAT law which brings Burundi closer to ensuring that its tax regime is better aligned with international practices, and Burundi’s partner states in the EAC;

• By adopting the EAC Customs Union protocol (and thereby CETs), Burundi has contributed to simplifying the trading environment within East Africa. To cushion Burundi from initial revenue losses as a result of adopting the CET regime, it received
US$6.5 million from the Common Market for East and Southern Africa’s Compensation Fund. By adopting CETs, Burundi expects to lose Burundi Francs 2.7 to 3.1 billion (about US$2.2 million to US$2.5 million) a year. However, it anticipates that by widening the tax base and through increased production, any losses will be recouped.

- A new authority (OBR) is operational and offers significant promise in enabling GoB to increase and better administer domestic resources;
- The new RADDEX system is almost fully operational and should help to streamline clearance processes as well as reduce theft and fraud; and
- GoB has made a commitment to realign its fiscal year, which runs from 1 July to 30 June. This change will enable all five EAC member states to formulate policy, read their budgets and implement policy measures concurrently.

In addition to the above, initial reports from GoB suggest that the VAT performed well in the first quarter of its implementation. According to a source from the Ministry of Finance, “fiscal revenues grew 38% in the third quarter of 2009 compared with the same period… [in 2008] due to higher” VAT collections (Reuters, 2009).

---

Domestic revenue performance

Figure 4.2: Tax and non-tax revenue as a percentage of GDP (1998 to 2008)

Source: Various IMF staff reports

Domestic revenue performance trends

Figure 4.2 sets out Burundi’s tax DRM efforts for the 10-year period from 1998 to 2008. The domestic revenue ratios as a percentage of GDP are higher than most of the other EAC countries. Key informants suggest that these high levels of tax effort are due to GDP base figures being potentially understated. GDP figures have probably not been adjusted to allow for year-on-year comparisons.

Between 1998 and 2008, domestic revenue as a percentage of GDP ranged between 16.3% (1999) and 21.1% (2003) (see Annex 4.3: Table 3). During this period, domestic revenue grew at an average annual rate of 14.5%, bulk of which was tax revenues. On average, the tax to non-tax revenue split was 91.6% to 8.4%.

The highest contributor to domestic revenue has consistently been taxes on goods and services, which in 2008 stood at 42.9% (see Annex 4.3: Table 5). During the 10-year period, taxes on goods and services grew at an average annual rate of 17.6%. The next highest contributor -- income taxes, which by 2008, also constituted 42.9% of the total -- grew at an average annual rate of 14.2%. It is also noteworthy that during this period, taxes on international trade as a proportion of total taxes declined from 29.5% in 1998 to 17.7% in 2008 due to tariff reductions. In particular, in 2005 GoB: condensed the number of tariff bands into three; reduced maximum tariff rate from 40% to 30%; and folded the 12% tariff into the 10% rate (IMF, 2005).

Tax administration benchmarks

Performance efficiency

In the past, all taxpayers were handled by Inland Revenue and Customs Department within the Ministry of Finance. Also ministries, departments and agencies collected non-tax revenues. Given its recent establishment, there are no benchmarks available on OBR’s
operating costs as a percentage of total tax collected. Moreover, its management is yet to determine revenue collection targets from fiscal year 2011 onwards. Still, we are aware that the OBR plans to service the top 100 largest taxpayers through a large taxpayers department. It is also noteworthy that going forward, OBR has responsibility for collecting all non-tax revenues.

Again, unlike other ARAs in the EAC, there are no benchmarks available from secondary sources on: VAT gross compliance ratio (VATCGR); corporate income tax productivity (CITPROD); and personal income tax productivity (PITPROD). However, there are two available measures of performance efficiency. First, the World Bank’s Doing Business Survey of 2010 ranks Burundi 116th out of 183 countries in terms of ease of paying taxes (see Annex 4.3: Table 7)\(^\text{14}\). Second, the World Bank’s 2010 Paying Taxes report indicates that a company is required to make 32 payments a year, which are respectively less and more than the Sub Saharan Africa (SSA) and Organisation for Economic Cooperation and Development (OECD) averages of 37.7 and 12.8 a year.

### Allocated efficiency

According to Ndukimana (2001), a decade ago the authorities appeared to “be excessively lenient, granting widespread tax exemptions…often on questionable grounds”. A few years later, Nkurunziza and Ngaruko (2005) observed that “large firms are more likely to benefit from tax and duty exemptions provided for in the Investment Code than small firms”. It is also noteworthy that a study by Chambas and Laporte (2007) estimate that in 2006, 60% of imports were exempted from transaction tax, which contributed to a revenue loss of 103.7 billion Burundi Francs (about US$84 million), or 10.7% of GDP. In addition, “they are the root cause of the spread in fraud and corruption and thus contribute to distortions in the national economy” (IMF, 2007).

Moreover, Burundi has one of the least conducive business environments in the world, with an ease of doing business ranking of 176\(^\text{th}\) out of 183 countries (World Bank, 2010). This is largely because of the poor infrastructure in the country that discourage foreign investors, although it provides certain incentives like tax exemptions. Therefore, tax exemptions to attract investments are not only likely to be ineffective but also distortionary and allocatively inefficient\(^\text{15}\).

### Performance equity

Personal income tax rates are progressive. However, it is difficult to reliably assess the degree of progressivity because data on the distribution of taxpayers by tax brackets is not available. Nonetheless, there is a basis for observing that Burundi’s income tax regime is probably the most regressive among the EAC member states. For example, the minimum monthly taxable income, which is applicable to the lowest marginal tax rate of 27%, is for earnings over 40,000 Burundi Francs (US$33). Furthermore, the highest marginal income tax rate is 60% for a monthly taxable income over 331,667 Burundi Francs (US$270) (GTZ, 2009). “Income taxes and duties for Burundi are higher than those in neighbouring countries, putting Burundian businesses at a relative disadvantage” (USAID, 2008). In this regard, the World Bank’s Doing Business Survey of 2010 reveals that Burundi’s corporate tax rate as a percentage of profit totals a staggering 278.6% (see Annex 4.3, Table 9). As a matter of fact, its ‘total tax rate’ as a percentage of profit is substantially higher than the OECD average of 44.5%, and the SSA average of 67.5%. Until 2009, the transaction tax (of 250.4%) was the major contributor to this substantial

---


tax burden, largely because it was levied on a cascading sales tax basis. Following introduction of VAT, “the tax burden as measured by Doing Business is expected to fall substantially in future years” (World Bank, 2010).

Performance effectiveness

There were no readily available data on Burundi’s tax effort and gap. However, there are indications that corruption, tax evasion and the tax exemption regime are serious problems. For example, the East African Business Council’s (EABC’s) Business Climate Index survey of 2008 reports that out of the five EAC states, “the number of business leaders who stated that bribery at customs was a major obstacle in business was highest in Burundi at 68%”.

It can therefore be inferred that there is probably significant scope for Burundi to reduce its tax gap and increase tax effort, and thereby its performance effectiveness.

Summary of overall trends

In the 10 years, from 1998 to 2008, in spite of prolonged civil war, Burundi’s domestic resources on average grew at 14.5% a year, contributing 19.1% to GDP annually. There are no ready explanations for the paradox that the civil war did not result in the collapse of the tax administration. But some hypotheses to explain this have been offered in sub-section on “Political economy dynamics underpinning domestic resource mobilization”. OBR inherited a comparatively well-performing tax administration system. Growth in future years is expected to improve with the introduction of VAT, establishment of OBR, and systems modernisation. However, Burundi simultaneously needs to widen its tax base, further simplify tax regime, curb corruption and tax evasion, as well as manage tax exemptions/incentives more effectively. Still, in the medium term, there will probably be acute limitations on Burundi’s DRM growth for as long as the economy remains small.
Challenges and issues

According to our literature review and interviews with key informants, the potential for enhanced DRM is high in Burundi provided peace holds. However, there are several challenges and issues that GoB needs to tackle in the medium term.

Managing the transition to an ARA

Any major organisational restructuring and transformation initiative can be disruptive. In this context, setting up OBR, recruiting tax administration staff from scratch, and transforming ways of working all represent a significant departure from the past. OBR will therefore need to ensure that its tax collection efforts are fully implemented, and any targets agreed with the Ministry of Finance receive due attention.

Retaining staff with skills and integrity

Significant investments have been made, and are still underway, aimed at attracting honest and capable personnel into OBR. For some positions, GoB has even sought to recruit resources internationally. To ensure that it can retain and motivate them, OBR will be challenged to offer competitive salaries on a sustainable basis. A commensurate remuneration policy may also assist in reducing corruption. In this respect, a USAID (2006) report suggests that “a bonus system linked to actual customs duties collected might perhaps be considered”.

Ensuring efficiency of tax incentives and exemptions

Burundi is yet another country plagued with the issues of tax incentives and exemptions. This regime seems inequitable when one reviews the hefty overall tax burden placed on companies that are not eligible for any tax dispensations (see Section on “Domestic revenue performance”). This inequity “may ultimately be cause for tax evasion” (World Bank, 2009). Both these scenarios inevitably lead to loss of domestic resources. To this end, the IMF (2010) recently urged GoB to “continue efforts to broaden the revenue base by reducing exemptions”. These efforts will require firmness and resolve of the political leadership.

Widening the tax base

Key informants maintain that several informal sector traders operate businesses with significant turnovers but remain outside the tax net. Others pay minimal taxes through a single business, even when, they operate many more. In addition, according to one literature source, “small Burundian businesses often have a foot in the informal economy and are usually trying to minimize their exposure to scrutiny from the state” (USAID, 2008). Another source suggests that there are also informal businesses that are not able to comply with GoB’s “complex and burdensome rules and regulations” (World Bank, 2009). Therefore, there is a need to: (i) forge ahead with simplifying the tax system for the informal sector through the Financial and Private Sector Development project, which will help widen the tax base.
base and encourage formalisation of businesses; (ii) ap-
praise the informal sector to establish its size, and the
potential revenue that could be raised through taxes;
and (iii) offer taxpayer education to the informal sector.

There is legislation in place to collect property tax. 
However, there are challenges around its efficient
collection. The Registrar of Property Deeds operates a 
manual system. However, “computerization is under 
consideration” (USAID, 2008). It may well be that pro-
erty tax revenues will never be significant, but a well-
functioning land registry system is a potentially useful 
source of third party information for OBR.

Combating corruption 
effectively

As a nation, Burundi is flagged as having high levels 
of corruption. Specifically, its place in world corrup-
tion rankings has been on a decline, indicating that 
corruption is a worsening problem. In 2009, 2008 and 
2007, Burundi ranked 168th (out of 180), 158th (out of 
180) and 131st (out of 179) countries respectively in 
the Transparency International’s corruption percep-
tion index.

Furthermore, direct taxation is considered to be one of 
the main areas susceptible to corrupt practices as 
“paying taxes…is cumbersome and complicated by the 
multiplicity of taxes…[which] leaves room for uncer-
tainty and corruption” (World Bank, 2009).

Ensuring harmonised, 

effective, systematic and policy-led 

regional integration measures

Over and above the need to address non-trade 
barriers (e.g., corruption), there has been a proposal for 
a comprehensive survey and analysis of the tax 
systems (both direct and indirect) in the EAC partner 
states. It is aimed at ascertaining the need, extent and 
form of tax coordination required if the CommonMarket is to function properly. Once such a study is 
carried out, it would be easier to identify priorities in 
terms of key issues to address. However, at this stage, 
it is noteworthy that Burundi’s top marginal personal 
and corporate income tax rates, at 60% and 35% re-
spectively, remain the highest in the EAC.
Lessons learned

Burundi has no significant history of tax reforms, although it paradoxically sustained a fairly resilient tax administration system through the civil war years. The ongoing establishment of OBR heralds the start of an era of reforms that other EAC countries have been implementing over the past decade. Against that backdrop and at this stage, there are only two lessons that can be derived from the Burundi DRM case study.

Inaccurate national statistics can translate into a misleading measurement of tax effort

On the basis of statistics compiled by the IMF, Burundi’s tax effort seems high by EAC as well as SSA standards, even during the years of conflict and war. Going by the tax revenue to GDP indicator (which hovered around 16% to 18% between 1998 and 2008), Burundi has consistently outperformed all other EAC countries, except Kenya, for most years where comparative statistics are available. It has been suggested by some informants that Burundi’s GDP figures may have been consistently understated through the years, which results in an exaggerated tax-to-GDP ratio. If this is the case, then statistics are erroneous for planning purposes. Also, it is difficult to realistically benchmark DRM performance with other countries. This underscores the need to be cautious in the use of statistics generated from secondary national data to compare performance in tax administration, or indeed other national development outcomes between countries and their institutions.

Major policy initiatives should be backed by rigorous and systematic study

Burundi has demonstrated the benefits of rigorous and systematic study as a basis for major policy development in two instances. First, there was depth and rigor in the study of the implications of Burundi joining the EAC Customs Union. Second, a similar quality of analytical effort and results are reflected in the study of the transition from sales tax to VAT. Consequently, the policy decisions made catered for mitigation of the risks entailed as a result of policy changes. For example, VAT rate was set to compensate for anticipated revenue losses from the adoption of CETs.
Annex 4.1: Key informants

Agathe Nsengiyumva (Ms), Director, Non Fiscal Revenue, OBR
Beatrice Hamenyayo (Ms), Director, Budget, Ministry of Finance
Dave Beer (Mr), Head of Office, DFID Burundi
Emile Simzumisi (Mr), Acting Commissioner General, OBR
Eric Mabushi (Mr), Resident Economist, World Bank
Hermenegilde Ndikumasabo (Mr), President, Federal Chamber of Commerce and Industry of Burundi
Joas Katanga (Mr), Director, Large taxpayers, OBR
Joseph Ndarishikanye (Mr), Commissioner of Customs, OBR
Annex 4.2: Bibliography


Annex 4.3: Selected Indicators

### Table 1: Tax policy – Maximum marginal tax rates (2006 to 2009)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>PAYE</th>
<th>Corporate tax</th>
<th>VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>60%</td>
<td>35%</td>
<td>-</td>
</tr>
<tr>
<td>2007</td>
<td>60%</td>
<td>35%</td>
<td>-</td>
</tr>
<tr>
<td>2008</td>
<td>60%</td>
<td>35%</td>
<td>-</td>
</tr>
<tr>
<td>2009</td>
<td>60%</td>
<td>35%</td>
<td>18%</td>
</tr>
</tbody>
</table>


### Table 2: Ratio of tax staff per population (TAXSTAFF)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Burundi’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Low income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXSTAFF</td>
<td>-</td>
<td>0.82</td>
<td>0.37</td>
<td>0.20</td>
</tr>
</tbody>
</table>


### Table 3: National government revenue and fiscal deficit as a percentage of GDP

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Revenue (tax and non-tax revenue)</th>
<th>Fiscal deficit excluding grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>17.1%</td>
<td>-6.6%</td>
</tr>
<tr>
<td>1999</td>
<td>16.3%</td>
<td>-9.1%</td>
</tr>
<tr>
<td>2000</td>
<td>19.2%</td>
<td>-4.9%</td>
</tr>
<tr>
<td>2001</td>
<td>20.0%</td>
<td>-7.2%</td>
</tr>
<tr>
<td>2002</td>
<td>20.3%</td>
<td>-5.7%</td>
</tr>
<tr>
<td>2003</td>
<td>21.1%</td>
<td>-14.2%</td>
</tr>
<tr>
<td>2004</td>
<td>19.4%</td>
<td>-22.8%</td>
</tr>
<tr>
<td>2005</td>
<td>19.0%</td>
<td>-24.3%</td>
</tr>
<tr>
<td>2006</td>
<td>19.0%</td>
<td>-19.4%</td>
</tr>
<tr>
<td>2007</td>
<td>18.6%</td>
<td>-19.85</td>
</tr>
<tr>
<td>2008</td>
<td>18.5%</td>
<td>-23.5%</td>
</tr>
</tbody>
</table>

Source: Various IMF staff reports
Table 4: Split of total budgeted tax and non-tax revenue as a percentage of total domestic revenue (1998-2008)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Tax revenue</th>
<th>Non-tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>91.2%</td>
<td>8.8%</td>
</tr>
<tr>
<td>1999</td>
<td>95.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>2000</td>
<td>95.2%</td>
<td>4.8%</td>
</tr>
<tr>
<td>2001</td>
<td>93.6%</td>
<td>6.4%</td>
</tr>
<tr>
<td>2002</td>
<td>88.5%</td>
<td>11.5%</td>
</tr>
<tr>
<td>2003</td>
<td>88.6%</td>
<td>11.4%</td>
</tr>
<tr>
<td>2004</td>
<td>90.4%</td>
<td>9.6%</td>
</tr>
<tr>
<td>2005</td>
<td>90.8%</td>
<td>9.2%</td>
</tr>
<tr>
<td>2006</td>
<td>91.6%</td>
<td>8.4%</td>
</tr>
<tr>
<td>2007</td>
<td>92.5%</td>
<td>7.5%</td>
</tr>
<tr>
<td>2008</td>
<td>89.7%</td>
<td>10.3%</td>
</tr>
</tbody>
</table>

Source: Various IMF staff reports

Table 5: Composition of main taxes as a percentage of total revenues collected (1998 to 2008)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Income tax</th>
<th>Taxes on goods and services</th>
<th>Taxes on international trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>29.8%</td>
<td>40.7%</td>
<td>29.5%</td>
</tr>
<tr>
<td>1999</td>
<td>27.3%</td>
<td>48.4%</td>
<td>24.3%</td>
</tr>
<tr>
<td>2000</td>
<td>22.3%</td>
<td>52.2%</td>
<td>25.4%</td>
</tr>
<tr>
<td>2001</td>
<td>28.8%</td>
<td>49.2%</td>
<td>21.9%</td>
</tr>
<tr>
<td>2002</td>
<td>28.1%</td>
<td>49.7%</td>
<td>22.2%</td>
</tr>
<tr>
<td>2003</td>
<td>26.9%</td>
<td>48.5%</td>
<td>24.5%</td>
</tr>
<tr>
<td>2004</td>
<td>24.9%</td>
<td>50.9%</td>
<td>24.2%</td>
</tr>
<tr>
<td>2005</td>
<td>24.8%</td>
<td>52.0%</td>
<td>23.3%</td>
</tr>
<tr>
<td>2006</td>
<td>28.8%</td>
<td>52.4%</td>
<td>18.8%</td>
</tr>
<tr>
<td>2007</td>
<td>42.2%</td>
<td>42.2%</td>
<td>15.5%</td>
</tr>
<tr>
<td>2008</td>
<td>42.9%</td>
<td>42.9%</td>
<td>14.1%</td>
</tr>
</tbody>
</table>

Source: Various IMF staff reports

Table 6: CIT and PIT revenue productivity and VAT gross compliance ratio (2008/09)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Burundi’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Low income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>CITPROD</td>
<td>-</td>
<td>0.13</td>
<td>0.09</td>
<td>0.08</td>
</tr>
<tr>
<td>PITPROD</td>
<td>-</td>
<td>0.14</td>
<td>0.08</td>
<td>0.07</td>
</tr>
<tr>
<td>VATGCR</td>
<td>-</td>
<td>65.48</td>
<td>42.3</td>
<td>38.45</td>
</tr>
</tbody>
</table>

Table 7: World Bank Doing Business indicators on the tax burden (Burundi only)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td>Burundi’s global ranking</td>
<td>-</td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>32</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>140</td>
</tr>
</tbody>
</table>


Table 8: World Bank Doing Business indicators (2010) on the tax burden (Burundi vis-à-vis the OECD and SSA)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Region</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Burundi</td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>32</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>140</td>
</tr>
<tr>
<td>Total tax rate as % of profit</td>
<td>278.6%</td>
</tr>
</tbody>
</table>


Table 9: Breakdown of taxes as a percentage of profit

<table>
<thead>
<tr>
<th>Tax or mandatory contribution</th>
<th>Statutory tax rate</th>
<th>Tax base</th>
<th>Total tax rate as a % of profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales tax</td>
<td>17.0%</td>
<td>Purchase</td>
<td>250.4%</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>35% (1%)</td>
<td>Taxable profits (turnover)</td>
<td>17.7%</td>
</tr>
<tr>
<td>Social security contributions</td>
<td>3.9%</td>
<td>Gross salaries</td>
<td>4.4%</td>
</tr>
<tr>
<td>Health insurance contribution</td>
<td>3.0%</td>
<td>Gross salaries</td>
<td>3.4%</td>
</tr>
<tr>
<td>Capital gains tax</td>
<td>35%</td>
<td>Capital gains</td>
<td>1.8%</td>
</tr>
<tr>
<td>Building tax</td>
<td>BIF 36</td>
<td>Per square metre of developed land</td>
<td>0.5%</td>
</tr>
<tr>
<td>Vehicle tax</td>
<td>3900 BIF per trimester</td>
<td>Per truck operated</td>
<td>0.5%</td>
</tr>
<tr>
<td>Land tax</td>
<td>BIF 3</td>
<td>Per square metre of undeveloped land</td>
<td>0%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>278.6%</td>
</tr>
</tbody>
</table>

Source: http://www.doingbusiness.org/ExploreTopics/PayingTaxes/Details.aspx?economyid=32
Chapter 5

Kenya
Summary of Key Findings

Political economy and fiscal legacies

The pragmatic post-independence political economy choices of the Government of Kenya (GoK) worked quite well for much of the first one and half decades after independence. However, a series of adverse political and economic events in the second half of the 1970s, and first half of the 1980s, served to disrupt both political and economic trends. To offset the negative consequences, the Government introduced wide-ranging reforms by way of “Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth” in concert with an IMF-pushed Structural Adjustment Programme. However, the macro-economic and fiscal performance continued to deteriorate throughout the late 1980s and 1990s. The average economic growth rate between 1992 and 2001 was -0.3% (IMF, 2002).

The Economic Recovery Strategy for Wealth and Employment Creation, which was implemented by the new regime from 2003 to 2007, was successful in reversing the economic decline of the past two decades. In 2007, for the first time since the 1970s, the annual rate of real GDP growth reached 7%. While the post-2007 election violence and onset of the global financial crisis resulted in a slump in real GDP growth in 2008, to 1¼% (IMF, 2010), it is projected to reach about 5% in 2010.

In the short-to-medium term, the authors suggest that there are four key fiscal governance drivers. First, an expensive bureaucracy, as reflected in Kenya’s wage bill to GDP ratio compared to other countries in the region, needs to be sustained. In 2007/08 the wage bill to GDP ratio was estimated to be 7.4% (IMF, 2010), which was the highest amongst EAC countries. Second, there are ambitious social welfare goals that are reinforced in the Bill of Rights in Kenya’s new (2010) Constitution. Third, elite capture of fiscal governance, as depicted by two initiatives by Members of Parliament (MPs) in recent years – in terms of introduction of the Constituency Development Fund, which is under the control of individual MPs, and the arbitrarily high self-pay awarded to MPs. Fourth, the ambitious development goals for the country as aptly captured in Kenya’s Vision 2030. This underlies the recourse to using infrastructure bonds, amounting to about KShs 52 billion in 2009 and 2010 (equivalent to about US$650 million). Nonetheless, given the comparative resilience of DRM in Kenya over the years, barring any unforeseen adverse political or socio-economic developments, its fiscal governance trajectory is fairly solid.

Tax reforms: Sequencing, implementation and results

According to the authors, there are two main epochs in the reform of tax policies and administration in Kenya. The first one generally corresponds to the Tax Modernisation Programme (TMP) that was launched in 1986 and was under implementation until the new government took office in 2003. The main elements of the policy thrust under the first phase of the TMP included: raising and maintaining revenue as a ratio of GDP at 24% by 1999/2000; expanding the tax base; rationalising the tax structure to make it more equitable; reducing and rationalising tax rates and tariffs; reducing trade taxes and increasing them on consumption to support investment; and plugging leakage loopholes (Moyi and Ronge, 2006). It is noteworthy that during the TMP epoch, in terms of fiscal decentralisation, the Single Business Permit (SBP) is arguably the most progressive feature of Kenya’s local government system. It was introduced in 1999 to replace a number of local licenses and revenue-raising permits on local businesses. The other local tax is property rates. Local governments also receive a significant block grant (local authority transfer fund) and limited earmarked
funds for maintenance of rural and urban roads from the central government. Nonetheless, public services are predominantly provided through a decentralized system.

The second epoch is the ongoing Revenue Administration Reform and Modernisation Programme (RARMP), which was launched in FY2004/05 by the new KRA top management appointed by the NARC government (2003-2007). The goal is to transform “KRA into a modern, fully integrated and client-focused organization”. The strategic thrust is to harness Information and Communication Technology (ICT) applications for modernising the tax administration. In this regard, it is worth noting that the eFiling system and Simba 2005 online system in customs are working. Key changes to tax policy have revolved around: pursuit of equity; further widening the tax base; promoting increased investment; and reducing tax compliance burden.

The reforms under the RARMP epoch were not specifically anticipated in the TMP. In other words, there was no specific initiative to sequence between the two programmes. Furthermore, there are aspects of certain tax policy initiatives that transverse the two programmes, and elements of which can also be found in the pre-TMP period. In the latter context, two observations are pertinent. First, certain policy initiatives are not particular to any reform epoch. In this regard, it is noted that some tax policies cannot be located as once-off changes in a long-term strategic trajectory. Rather, they need to be monitored, evaluated and changes effected, where appropriate, on a regular basis. Thus, the issue of sequencing does not arise with respect to, for example: (i) widening the tax base; and (ii) aligning tax policies with the national development strategies and policies.

**Domestic revenue performance**

According to the IMF (2003), Kenya’s tax system has performed better than African average in the past three decades. In 1989/90, its tax revenue collection was 23.3% of GDP. Revenue collection peaked in 1995/96 at 30.4%, as a result of economic liberalisation. It, however, declined to 20.5% in 2002/03, before increasing to 22.0% in 2007/08. This uptick was attributed to a stronger tax administration system and a relatively large formal sector. The reforms of the 1970s and early 1980s, as well as the introduction of VAT in 1990, which widened the tax base, enabled GoK to cut revenue losses resulting from the reduction in -- and removal of-- import and export tariffs, which were imposed by WTO conventions, as well as by structural economic adjustment measures. Empirical analysis by Muriithi and Moyi (2003) suggests that tax reforms in Kenya under the TMP have led to improved productivity of direct taxes. In particular, through administrative reforms (e.g., lower tax rates, PIN) aimed at eliminating "avenues for evasion and corruption". However, Kenya’s performance effectiveness indicators suggest that whilst the tax collection effort is high, there is potential to increase tax revenue as a percentage of GDP by reducing the tax gap.

**Challenges and issues**

Going forward, Kenya’s tax system faces major challenges in the following aspects:

- **KRA has to cope with less than ideal policy, legal and other institutional environments:** One illustration of this challenge is underscored by significant gaps that exist between revenue targets set by Ministry of Finance and the KRA. The other is that KRA does not have a free hand to properly remunerate and motivate its staff;

- **Achieving an acceptable degree of tax compliance from a fast-growing and profitable, but, increasingly complex informal sector:** It is a fast-growing segment of Kenya’s economy, but tax evasion by the sector remains particularly high. The structural challenges of accessing the sector are exacerbated by populist politics, which seeks to shield some
constituencies of potential taxpayers from their tax obligations;

- **Rationalising tax exemptions**: There is an array of tax exemptions given by GoK. Yet, many studies on tax exemptions and incentives confirm the conclusion of a 2008 IMF assessment of the investment incentive regimes offered in Kenya and Tanzania, that they are not important in attracting foreign investment. Rather, such incentives create distortions and result in the loss of tax revenues;

- **Achieving enhanced equity and efficiency**: Indicators of Kenya’s tax revenue performance show there is considerable scope to improve in the areas of equity and efficiency;

- **Porous borders with a failed state – Somalia**: The combined effect of smuggling and insecurity in the region, arising from the dysfunctional Somali state, will remain obstacles to tax administration for quite some time;

- **Cultivating tax morale**: It is a daunting challenge and must begin with political leaders tackling the issue head on;

- **Effectively and sustainably combating corruption**: According to a researcher, corruption is a major factor that hindered KRA from meeting its collection targets in, for example, FY 2008/09. Yet, the problem is not exactly internal to KRA because businessmen seeking to evade tax are the primary culprits; and

- **Regional common markets pose challenges**: Kenya is a member of two regional blocks, the EAC and COMESA, which have not harmonised their tax regimes. An added problem is the comparability and ability of revenue authorities in member countries, and their capacity to enforce compliance. There is also the issue of exemptions granted under the EAC Customs Management Act to promote infant industries, which are not effectively monitored.

**Lessons learned**

The following lessons can be drawn from the Kenya case study:

- **Stability of leadership and management enhances capacity development**: The decade of the TM implementation was characterised by highly unstable management at both the Treasury and KRA. This instability is partly attributed to the failure in sustaining high domestic revenue performance, especially compared to results in the period from 2004 to 2009;

- **Tax exemptions and incentives may undermine equity and fairness**: In the past, GoK extended tax exemptions and incentives, especially on import duties to various taxpayers. Since there were no open criteria for these exemptions and incentives, they mostly favoured the well connected. This practice undermined equity and fairness of the tax system and revenue potential;

- **Enforcement with facilitation of paying taxes through modernised systems can be a win-win solution**: Introduction of Electronic Tax Registers (ETRs) in Kenya was initially controversial and faced strong resistance from the business people. But the KRA implementation strategy succeeded in undercutting their resistance, and ultimately, many traders acknowledged that ETRs are also useful in sales control in their businesses. Therefore, both KRA and the business community have emerged as winners;

- **Implementation of major ICT systems can, however, seriously disrupt revenue collection**: In 2005/06, there was a decline in the tax-to-GDP ratio in Kenya, which has been attributed to teething tech-
nical problems when implementing the Simba 2005 system, as well as resistance from some importers and customs clearing agents; and

- **Revenue authorities may be best placed to prosecute cases of tax evasion:** In 2009, KRA was allowed by the Attorney General, who is the Director of Public Prosecutions, to install six of its officers, who are legal professionals, as prosecutors in tax evasion cases. According to the authority, this arrangement has enabled more timely, effective and successful prosecutions.

The rest of the chapter is organised as follows: the first section discusses the political economy and fiscal legacies, the second section covers trends in the tax system, the third section explores domestic revenue performance, the fourth section highlights the challenges to increasing DRM, and the fifth section concludes with lessons learned.
Economic legacies of the four decades following independence

After independence in 1963, Kenya chose a “mixed economy” development strategy in which the Government would partner with the private sector, including not-for-profit organisations in both development and future service delivery. The national political economy vision and ideology was expounded in ‘Sessional Paper No: 10 of 1965 on African Socialism and its Application to Planning in Kenya’. That Paper emphasised the “diffusion of ownership to avoid concentration of economic power…; [and] progressive taxes to ensure equitable distribution” (Grillo, 1993).

The pragmatic post-independence political economy choices of the Government encouraged investment by multinational corporations while, at the same time, actively establishing public enterprises (parastatals) in virtually every productive sector of the economy. Furthermore, in order to deliver the “fruits of independence” to the indigenous population, GoK proactively implemented policies on: one prong, agrarian reform which facilitated rapid expansion of peasants’ entry into cash crops (mainly coffee, tea, pyrethrum, sugar and cotton) farming; and redistributing large tracks of farmlands that were owned exclusively by colonial settlers (‘white highlands’) to both landless peasants and the emerging “African” elite (most of them public servants).

On the other prong, Government pushed for the transfer to black race (African) Kenyans of retail businesses because “Africanisation” was one of the most emotive political slogans in the tumult before [Kenya’s] independence” (Ochieng, 1992). Moreover, by the end of the decade, GoK was so impatient to create a sizeable “African” elite that, on the basis of recommendations by a 1971 Commission (headed by a former Head of Public Service and then Central Bank Governor, Duncan Ndegwa), it lifted restrictions on public servants’ involvement in private business (Mohiddin, 1981).

Those policies worked quite impressively for much of the first two decades after independence. In a period of considerable socio-political and economic turmoil in most African countries, Kenya enjoyed peace and rapid economic development. As a result, its GDP grew “at an annual average rate of 7%, and substantial improvements in living standards were achieved” (IMF, 1995). While some fiscal imbalances, arising out of excessive expansion of public expenditures, were evident by mid-1970s, a coffee exports boom in 1976-78 sustained aggregate economic performance.

Nonetheless, a series of adverse political and economic events, in the second half of the 1970s and first half of the 1980s, disrupted Kenya’s development. First, the break-up of the EAC as a regional economic block in 1977 dealt a big blow to its economy. At that point, Uganda and Tanzania were absorbing about 30% of its total exports, and the collapse of the economic block cut those exports to just 10%. Second, the death of the country’s first president, Jomo Kenyatta in August 1978, shook investor confidence for a season or two. The adverse economic impact of these two developments was exacerbated by the 1979 global oil crisis. By 1980, the real GDP growth registered only 2.4%. Yet a third ominous development, an attempted military coup in 1982, further dampened investor confidence. Though the economy regained some momentum in 1983 to reach a real GDP growth of 3.6%, a severe drought in 1984 reduced the growth to less than 1%, further deepening the economic woes.

By mid-1980s, the imperative for major shifts in macroeconomic and fiscal policies were acknowledged by the GoK even as its major development partners, led by the IMF, pushed for a Structural Adjustment Programme (SAP). Government promulgated wide-ranging
reforms by way of “Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth”. Howe-
ver, economic recovery was never restored to the level of the 1960s and 1970s performance. Real GDP growth was an average of 5% between 1986 and 1990, and there was a marked deterioration in social indicators (IMF, 1995).

The Government’s initiatives in macroeconomic and fiscal reforms of late 1980s and 1990s were not successful either. In the 1991-1993 period, the economy slid further, from a real GDP growth of 2.1% to 0.2%, and from there it continued to plunge until a new government was elected in 2002. The average growth between 1992 and 2001 was -0.3% (IMF, 2002). Kenya’s economic performance not only slipped behind neighbouring Tanzania and Uganda, it is also performed worse “than most other developing countries” (IMF, 2009a).

Measures taken to enhance macroeconomic and fiscal policies did not bear fruit. These measures included: abolishing import controls (in 1993); repeal of the Exchange Control Act (in 1995); and tighter restriction over public expenditure by instituting budget ceilings and cash controls (in 1994/95 and 1997/98 respectively). Several factors combined to undermine the reform measures: (i) the nation suffered exogenous supply shocks such as droughts and floods; (ii) discord and intercommunity violence, following the reintroduction of multi-party elections in 1992, and again in 1997, undermined investor confidence; and (iii) Government’s “failure to implement [governance] reforms…led to the interruption of several” IMF programs (IMF, 2009c). Moreover, it is in this period that endemic corruption reached epic levels. “Most upsetting to donors was the Goldenberg International scandal” (Klopp, 2001), which resulted in loss of considerable external support.

Recent economic trends (post-2002)

Economic recovery was the top priority of the National Rainbow Coalition (NARC) government, elected in December 2002. The Economic Recovery Strategy for Wealth and Employment Creation (ERS), which was implemented from 2003 to 2007, targeted: (i) maintaining a stable macroeconomic framework; (ii) reforming the financial sector and strengthening its regulation to increase savings and investment; (iii) implementing mechanisms for private sector participation in the provision of infrastructure services; and (iv) establishing a competitive environment for attracting increased private investment in tourism, trade and industry. In 2007, as a result of these efforts, real GDP growth reached 7% for the first time since the 1970s.

However, the post-2007 election violence, which was accompanied by fuel and food shortages, and the onset of the global financial crisis in 2008, resulted in a slump in real GDP in 2008, to 1¾% (IMF, 2010). However, the economy appears to be recovering since then. Real GDP growth, for instance, was 2.6% in 2009, and it was projected to grow at 5% in 2010.

Development financing mix and challenges

Figure 5.1 shows trends in the overall development financing mix for Kenya between 1996 and 2008. Gross private savings (averaging at 13.6% of GDP between 2002 and 2008) were fairly low, which was below the Africa benchmark for the post-Monterrey period of 22.1%. Still, between 2002 and 2008, gross private savings grew at an annual average rate of 8.9%. Foreign
Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

Brautigam’s framework is adopted because compared to others that were examined, it is judged to be more comprehensive and elegant. However, like most others, its historical perspective derives too much from the emergence of the modern European state to be linearly applied to states that are legacies of colonial rule, such as Kenya.

Figure 5.1: Trends in Kenya’s overall development financing mix (1996 to 2008)

Source: Africa Economic Outlook (AEO) 2010 data

Direct investment between 1996 and 2008 was also low, averaging at 0.5% of GDP. According to UNCTAD (2005):

“Deteriorating infrastructure and a poor track record of policies in the 1980s and 1990s discouraged inflows of FDI...FDI inflows have nevertheless had a crucial impact on the development of the country’s export-oriented horticulture industry, contributed to the revival of Kenya Airways and accelerated the development of the mobile telecommunications network”.

From 1996 to 2008, domestic revenue (21%) and exports (24.1%), on average, constituted the largest share of financing as a percentage of GDP. In 2002-2008, domestic revenue and exports grew at an annual average rate of 17.4% and 15.6% respectively. Exports, over the decade, have benefited from easier access to the member states of the EAC and COMESA (see Annex 5.4). Remittances from the diaspora have been another major source of financing. It is estimated that in 2008 alone, the 1.8 million or so Kenyans, living and working abroad, remitted a total of about US$1,692 million (constituting about 5% of GDP).

From the early 1990s to 2008/09, Kenya’s public expenditure ranged between 23% and 36% of GDP. They were financed primarily from domestic revenues, and from both local and foreign debt. Over the past 20 years, Kenya’s reliance on international development assistance, by way of grants, has been minimal. Grants as a percentage of GDP provided to GoK to fund its fiscal operations between 1989/90 and 2007/08, ranged from a low of 0.6% to a high of 2.9%.

Public finance deficits have been funded largely through considerable borrowing. By 2006, Kenya’s domestic and external debts were estimated to be 17.9% and 21.9% of GDP respectively. It is also noteworthy that from 2001, GoK has “pursued a deliberate policy action to restructure domestic debt, with a view to developing a vibrant bond market for generating long-term finance” (Ndung’u, 2009). Although Kenya had to reschedule its debt servicing in certain years, a joint World Bank-IMF assessment recently concluded that Government’s “debt sustainability does not appear to be an imme-

---

1 Brautigam’s framework is adopted because compared to others that were examined; it is judged to be more comprehensive and elegant. However, like most others, its historical perspective derives too much from the emergence of the modern European state to be linearly applied to states that are legacies of colonial rule, such as Kenya.
diate concern provided it maintains a prudent approach to borrowing” (IMF, 2009b). This position is also upheld by the AfDB.

**Political economy dynamics underpinning DRM**

The synopsis of the political economy legacies that have impacted DRM, as presented in the sections below, is based on Brautigam’s (2008) analytical framework. It consists of the following five facets: (i) level of economic development and economic structure; (ii) societal factors: culture, values, trust and ‘tax morale’; (iii) war and taxes: bureaucratic modernization as a response to threat; (iv) political institutions and tax systems; and (v) taxation and the fiscal contract.

**A comparatively large modern and diversified economic structure**

Compared to other EAC countries, Kenya has a large modern and diversified economy. The composition of GDP in 2009 was: agriculture (21.4%); industry (16.3%); and services (62.3%). The modernisation of the economy is on track as exemplified by the significant decline in agriculture’s share of GDP, which stood at 31% in 1984 (IMF, 1995).

The country has, by regional standards, a well-established middle class. “A Kenyan economist estimates that... about four million are in the middle class, making between $2,500 and $40,000 a year” (Getelman, 2008). Moreover, Kenya has a vibrant private sector with many formalised enterprises. However, “strong economic growth [has] done little to reduce the country’s widespread poverty because distribution [is] skewed in favour of the already affluent. Between 1998 and 2002, the poorest 20 % of the population received only 6 % of the national income, while the richest 20 % took 49 %” (Sundet and Moen, 2009). This high income disparity explains the comparatively narrow tax base and possibly the difficulties in cultivating and sustaining compliance among the low-income groups, including the informal sector (Moyi and Ronge, 2006). Thus, the tax base remains narrow – “830 taxpayers contribute about 75% of all domestic tax revenue” (USAID, 2009). It is also worth noting that in a population of close to 40 million, the total number of registered taxpayers at the end of 2007 was just about 860,000.

**Building enabling social culture, values, trust and ‘tax morale’ has been elusive**

Jomo Kenyatta, Kenya’s founder, sought to cultivate a social culture of self-reliance and responsibility for development among its citizens by popularising the national motto ‘Harambee’ (“let us pull together”). On 1 June 1963, when Kenya gained self-rule, “he gave the term currency and declared” – ‘I give you the call: Harambee!’ (Orora and Spiegel, 1981). Thereafter, a key message to Kenyans in his independence speech was: “You and I must work together to develop our country, to get education for our children, to have doctors, to build roads, to improve or provide all day-to-day essentials”.

The “Harambee” culture, to a degree, was a success in significant sections of Kenyan society. By 1976, Harambee projects “accounted for forty percent of capital development in rural areas and voluntary cash contributions” (Orora and Spiegel, 1981).

However, Harambee initiatives fell victim of elite capture in the 1980s and 1990s, and the movement’s “social value... was relegated to the side” (Transparency Inter-

---

3 In a society where “tax morale” is high, there are low levels of tax evasion and avoidance. It is only in a social culture where citizens generally appreciate their responsibility for sustaining state services and where they have a trust in their state institutions and leaders that a “tax morale” evolves.
national, 2003). Also, pervasive corruption in the 1980s and 1990s deeply undermined tax morale. Moreover, the "weakening of state institutions, which were increasingly seen as serving the country’s elite rather than the people" is thought to have reduced the legitimacy of the state (Sundet and Moen, 2009). In this situation, citizens’ trust in the Government was undermined and tax morale eroded. There was, however, a temporary respite to this trend following the election of NARC in 2002. “Kenyans’ sense of patriotism was at its peak, fuelled by the euphoria of a new regime” (Ondari, 2009). It is suggested that as a result, “a total of 33,923 taxpayers and 33,141 taxpayers were recruited in 2003/04 and 2004/05, respectively” (Moyo and Ronge, 2006). However, the subsequent much-publicised grand corruption scandals of the new regime served to reverse the trend.

The goal of regime survival has ensured support for the tax administration bureaucracy and its modernisation

In Brautigam’s (2008) framework, historically, the threat of (conventional) war has been the common driver of bureaucratic modernisation for tax revenue mobilisation. Two complementary theoretical perspectives are proffered: first, a national political leadership can place a country on a non-conventional “war footing” to the same effect. Thus for example, when Kenya’s founding fathers proclaimed war against poverty, disease and ignorance on attainment of independence, the imperative to extensively mobilise domestic resources was clear. Consequently, for nearly two decades, the political leadership did not tinker with the bureaucracy that was inherited from the colonial East African Common Services Organisation and turned over to the EAC revenue administration. Second, in a competitive pluralistic environment, the threat of regime survival will persuade the political leadership to support bureaucratic modernisation. In this way, we may explain why Moi’s regime delayed the establishment of KRA until 1995 (three years following multiparty democracy), although it was proposed as early as 1986, when Government launched the Tax Modernisation Programme (TMP).

Patronage politics destabilised the tax system in the 1980s and 1990s

The patronage, and ultimately corruption, that became the hallmarks of Kenya’s political institutions in the 1980s, inevitably infected the tax system in the form of undue exemptions and tax evasion. In the late 1980s and early 1990s, for example, the ruling elite conspired to siphon billions of shillings of public resources through tax exemptions as well as through a scheme, famously known as the Goldenberg scandal, by which pre-export financing and export compensation were paid for fake exports. Consequently, as fiscal deficits became unsustainable, the need for measures to tighten tax administration was acknowledged. Also, the establishment of KRA in 1995 was, to a significant extent, expected to rid the tax system of the rampant corruption, which then pervaded the public administration system. However, competition among political constituencies for control of the tax system as an instrument for patronage continued. Consequently, for example, in the first decade after its launch, KRA experienced frequent changes to its leadership. The first two Commissioners General did not complete their three-year terms.

This problem was not confined to KRA only, but rather to all institutions dealing with significant public resources. Thus, for example, between 1988 and 2002, a total of 11 permanent secretaries had been appointed to the Treasury, with two of them serving less than two months each. During the same period, the Ministry of Finance had six ministers. It is under such circumstances that one of the conditionalities for the resumption of financing placed on Kenya by the IMF, was for KRA to be allowed to operate independently (Klopp, 2001). Its relative success in rapid and
successful implementation of reforms of the tax system since 2003/04 could not have been possible if the politics of patronage and corruption were still rampant. In this regard, it is noteworthy that KRA enjoyed relative leadership stability and autonomy during this period. The current Commissioner General, Michael G. Waweru, is in his third term, and it has been observed that, unlike his predecessors, the incumbent:

“No longer waits for … [a] phone call [through the direct line to State House] to know what the President expects of him and the Authority…[rather] the Head of State facilitates his work by urging Kenyans to honour their dues” (Ondari, 2009).

**Political leaders have failed to sustain a fiscal contract with the citizens**

It can be credibly argued that in the first decade following independence, a fiscal contract was evolving in Kenya. However, corruption, socioeconomic malaise, and the overall deterioration in public services and institutions in the intervening three decades, until the NARC regime of 2003, shredded that initial contract. In addition to the above, “most Kenyans seem to have lost trust in government institutions as impartial public service providers” (Miruka, 2010). Moreover, this trust is further undermined by public perception that GoK is not committed to the fight against graft as “corruption cases are dragging in court with those charged continuing to hold public offices” (Kanyongo, 2010). Therefore, the fiscal contract, which appears to have been built in 2002, seems to have lapsed.

**Fiscal governance drivers, results and trajectory**

There are four key fiscal governance drivers. First, an expensive bureaucracy— as reflected in Kenya’s wage bill to GDP ratio— compared to other countries in the region needs to be sustained. In 2007/08, the ratio was estimated to be 7.4% (IMF, 2010), which was the highest among the EAC countries. While the reformist NARC Government was expected by many economists to downsize the public service, it did not, as such a measure would have negated GoK’s policy objective of rapid employment creation. In fact, public sector employment has continued to grow, even in recent years. More significantly, the sustenance of this bloated bureaucracy may explain why even in the years of economic decline, the tax to GDP ratio remained at relatively high levels. There is no evidence of a reversal of this trend in the near future.

Second, ambitious goals for expanded services delivery and poverty reduction are best epitomised by the unplanned launch of an expensive free primary education programme in 2003. There is a significant constituency of the nation’s political class that seeks to achieve a welfare state. Such ambitions are reflected in the Bill of Rights in Kenya’s proposed new Constitution.

Third, elite capture of fiscal governance is reflected in two initiatives by Members of Parliament (MPs) in recent years. A case in point is the introduction of the Constituency Development Fund (CDF), which is under the control of individual MPs. It was done ostensibly as an element of fiscal decentralisation. But in practice, it became a vehicle for them to award themselves very high pay, making them amongst the best paid MPs in the world. Inescapably, other elite constituencies continue to fight for their ‘share of the cake’.

Fourth, the national elite shares ambitious goals for the country. They are aptly captured in Kenya’s Vision 2030 – Working together on the Path to Prosperity. While there are sections of the community who are sceptical of the vision and goals, there is evidence that a large and strong constituency is committed to the same. The ongoing high cost infrastructure initia-
tives underline that commitment. In 2008, “President Kibaki told...[a] meeting that [GoK] will spend more than...US$5 billion to finance infrastructure development projects in the country over the next five years” (Kapchanga, 2008). This explains the decision to float a series of infrastructure bonds, which resulted in the flotation of two bonds in 2009. For the first bond issue of KShs 18.5 billion, GoK received offers worth KShs 27 billion (Irungu, 2010). In the second bond issue, GoK “accepted 18.42 billion shillings worth of bids for the 12-year securities with a coupon of 12 %, and will use the proceeds to fund road, energy and water projects” (McGregor, 2009). In February 2010, the Central Bank of Kenya issued a third infrastructure bond offer worth KShs14.5 billion with an eight-year maturity date.

The role and influence of international development organisations (IDOs), in terms of fiscal governance, is minimal in Kenya. In the 1990s, they largely disengaged from supporting GoK except for a brief two-year interlude, when the World Bank and IMF entered into an agreement for a technocrat team, popularly known as the ‘dream team’, to take charge of Kenya’s governance. In that interval, Kenya secured a structural adjustment credit from the IMF and World Bank. But these credits lapsed before full maturity. Neither did the much anticipated engagement between the 2003 NARC Government and IDOs materialise for four reasons: (i) the outbreak of the Anglo-leasing scandal stifled dialogue; (ii) a significant constituency in the echelons of government continue to harbour a distrust of the intentions of Western governments and ‘their institutions’; (iii) the exemplary performance of KRA in revenue collection has strengthened the voice of this latter constituency; and (iv) Kenya’s access to international credit, especially from the rapidly growing Asian countries (India and China), provides an alternative source of development financing to grants from the West.

Kenya’s fiscal governance trajectory is basically predicated on three variables. First, can the tempo of DRM growth experienced in recent years be sustained? Second, will fiscal discipline prevail in spite of intense pressures from different directions to stretch the fiscal space? Third, what are the prospects for GoK to mobilise more external resources to bridge the gap between DRM and ambitious public expenditure plans? There are strong indications that the answers to all three questions are positive.

The resilience of DRM in Kenya over the years is well illustrated by comparatively good performance even when poor governance and weak economic condition prevailed. With regard to fiscal discipline, since the macroeconomic crisis of the early 1990s, political leaders have eschewed fiscal excesses. The proposed new Constitution will reinforce aggregate fiscal discipline. Already, the relative robustness of Kenya’s economy and sophistication of its capital market are enabling GoK to mobilise substantial debt financing to augment domestic resources. Furthermore, the performance outturns in recent times make it evident that revenue collection is resilient (IMF, 2010). In short, barring any unforeseen adverse political or socioeco-

Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration
Trends in the tax system

Changes in tax policies over the years

Kenya relied on unified tax policies and an administrative system jointly administered by the initial three members of the EAC. This was a legacy of British colonial administration that all the three countries inherited at independence. At that point, the Government’s three main sources of tax revenue were: income tax; customs and excise duties; and Inland Revenue. Changes in both policies and administration had been minimal and were collaboratively determined until early 1970s. Following a decision to assign responsibility for income tax to each EAC member state, Kenya adopted the community legislation and enacted the Income Tax Act of 1973. Thereafter, three distinct phases of major initiatives in tax policy reforms can be discerned for Kenya, and they are outlined below.

Initial efforts at widening the tax base

Following independence, the first major change to the tax system came through the introduction of a consumption tax - the sales tax in 1973. The impetus for this change derived from adverse effects on customs duty revenue receipts brought about by restrictions on imports associated with an import substitution industrialisation policy. Another measure to widen the tax base was the introduction of capital gains tax (CGT) in 1975 to cash in on high property prices fuelled by a coffee boom. But, in 1984, in an effort to jumpstart economic growth through the construction industry, GoK suspended the CGT and formed a commission to examine economic management and extend advice on possible changes.

Tax policies introduced under the TMP (1986 to 2002)

The policy thrust under the TMP (1986 to 1996) was to: raise and maintain revenue as ratio of GDP at 24% by 1999/2000; expand tax base; rationalise tax structure to make it more equitable; reduce and rationalise tax rates and tariffs; reduce trade taxes and increase them on consumption to support investment; and plug leakage loopholes (Moyi and Ronge, 2006).

With respect to income taxes, Government reduced the top marginal rates for: personal income tax from 65% in 1986/87 to 45% in 1993 to 35% in 1995/96 – by 1999/00 the top rate was 30%; and corporate income tax from 45% in 1987/88 to 30% in 1999/00.

Government launched the VAT in 1990 to increase “revenue through expansion of the tax base, which hitherto was confined to sale of goods at manufacturing and importation level under the sales tax system”7. Following its introduction, GoK undertook several measures to expand VAT coverage, gradually moving the tax point:

“From the manufacturer to the retail level, and as a result, the coverage of VAT on goods supplied at retail level expanded ‘tremendously’ from 1990 to 1995. From 1991 onwards, the coverage of the services sector was expanded to include: business services; hotel and restaurant services; entertainment; conferences; advertising; telecommunications; construction and transportation. The imposition of VAT [was] also simplified and improved with 15 bands being reduced to three, and the introduction of penalties for avoiders, those who did not maintain proper books of account and defaulters” (Cheeseman and Griffiths, 2005). When first introduced, VAT was levied at a standard rate of 17% which then rose to 18% before eventually declining to 15%, and then stabilising at 16%, and a 0% rate for the exempted items. However, there were also low and high rates for electricity and luxury goods respectively. Moreover, Schedule 8 of the Act provides for certain public bodies, privileged persons and institutions to be zero rated for VAT (e.g., the President of the Republic, the armed forces, diplomats, aid agencies, charitable organisations).

“Prior to the TMP, excise taxes were specific. However, from 1991/92, excise taxes were made ad valorem. Since 1991, the scope of excise duties was expanded from domestic production to include imports, thus changing its scope from being a tax on domestic production to a tax on consumption” (Moyi and Ronge, 2006). Luxury goods also became subject to excise duties.

GoK also reduced tariffs to encourage local industries to be more efficient and competitive both in domestic and export markets and, to ensure consistency with international trade obligations such as compliance with World Trade Organisation (WTO) commitments. In particular, import duty was reduced from 170% to 35%; rate bands reduced from 24 to 5; and simple tariff average dropped from 40% to 16% (Cheeseman and Griffiths, 2005). Furthermore, with respect to import duties, the Government:

- From 1991, legislated for the elimination of a wide range of import duty exemptions;
- From 1992, removed discretionary duty waivers, only leaving those relating to programme-based donor funding; and
- From 1995, abolished NGO exemptions, which played a key role, especially in election years. Thereafter, an NGO could only get exemption when donor funded.

To promote investment, GoK introduced export processing zones (EPZs) in 1990. Firms operating in EPZs benefit from a 10-year corporate tax holiday, exemptions on imports of inputs and capital equipment and a waiver on stamp duty on legal instruments. In return, a firm must export 80% of its produce (IMF, 2008).

Meanwhile, with a view to improving future revenue streams, GoK, in 1995, extended an amnesty which covered income taxes, PAYE and penalties and interest. A second amnesty in 1998 covered: penalties and interest in respect of VAT; and tax, penalties and interest relating to income tax.

**Tax policies introduced during the third phase: 2003/04 to 2008/09**

Key changes to tax policy made by the NARC Government (2003-2008) and coalition Government (2008-2009) have so far evolved around: ensuring equity; further widening the tax base; promoting increased investment; and reducing tax compliance burden. To promote equity:

- GoK widened income tax bands by 5% in 2004/05. Tax bands had remained unchanged since 2002. In the same year, it also increased personal relief by 10%;
- From 16 June 2006, GoK increased the threshold turnover for VAT from KShs 3 million p.a. to KShs5 million with a view to reducing the compliance burden for three quarters of registered taxpayers who: either file nil returns, or whose turnover is not substantial. GoK also zero rated certain supplies (e.g., wheat flour, nappies, agricultural tractors, treatment and supply of water by local authorities, computer equipment and parts).

In addition, as a means of widening the tax base, GoK introduced the following measures:

- An amnesty in 2004/05, covering fines, penalties and interest on: import duty (prior to 11 June 2004); excise duty on goods manufactured and sold (before 11 June 2004); VAT (where tax was due before 11 June 2004); and income taxes (for 2003 and prior years). Taxpayers were required to disclose and pay under-paid duties and taxes by 31 December 2004;

---

8 See: http://www.epzakenya.com/
• From 2004/05, employees of not-for-profit organisations became liable to pay tax on any retirement contributions made by their employers to schemes where contributions exceed the allowable limits;

• Transfer pricing guidelines with effect from 1 July 2006, which specify a wide range of transactions and may be subject to adjustment, including: sale, purchase and leasing of goods; other tangible and intangible assets; provision of services; and interest on loans. Taxpayers who engage in cross-border trade with related parties are required to document their policies and methodologies, and make them available to KRA;

• In 2006/07, in a further attempt to reach the informal sector income earners, GoK introduced an advanced tax payable for drivers and conductors of passenger service and commercial vehicles;

• A new turnover tax for small businesses with effect from 1 January 2008, intended to make it easier for them to comply with their tax obligations. The turnover tax is applicable for businesses with an annual turnover of below KShs 5 million\(^9\). The rate of tax is 3% of gross receipts. In 2008/09, the VAT Act was amended to exempt taxpayers who are subject to the turnover tax;

• From 1 January 2008, GoK introduced VAT on rent charged on non-residential property. When it was initially introduced in the year 2001, it faced resistance from taxpayers and thus was not passed by Parliament; and

• From 13 June 2008, dividends earned by financial institutions became taxable\(^10\). With this change, the withholding tax suffered by financial institutions is henceforth treated as an advance tax to be offset against its tax liability,

Some key policy measures aimed at fostering increased investment included the following:

• Introduction of tax incentives in 2005/06 to encourage firms to be listed on the NSE. Specifically, corporate tax for newly listed firms was reduced from 25% to 20%, on condition that they offer at least 40% of their issued share capital to the Kenyan public;

• Adjustment to tax incentives in 2006/07 to encourage private sector participation. Incentives include, for example: industrial building allowances for hostels and buildings used for educational purposes at an enhanced rate of 10%; and an income tax exemption on interest;

• “In the 2008/9 budget, the government removed the 15% withholding tax for investment in government bonds” (Irungu, 2010). Meanwhile, following introduction of common external tariffs (CETs) under the East African Community Customs Management Act of 2004, GoK no longer has scope to independently amend customs duties. In contrast, Government has considerable room to change excise duty rates. The protocol also brought about the following changes:

• elimination/phased elimination of customs duty originating from partner states;

• harmonisation of customs principles and procedures; and

• removal of suspended duty (see Annex 5.4 for details).

Institutional changes

The 1995 KRA Act (Chapter 469 of the Laws of Kenya) overhauled the legislative framework that had essen-
tially remained intact since independence, and under which the revenue departments of Customs and Excise, Income Tax, and Inland Revenue, operated as distinct entities. Still, it was necessary to amend the KRA Act in 1997 in order to clarify to the Commissioners in charge of revenue departments that they were directly under the authority of the Commissioner General (CG) as the top executive of a unitary organisation. The CG enjoys considerable executive authority, but the Commissioners of the respective revenue departments retain legal authority for the operational decisions.

The 1997 amendment to the KRA Act also served to spell out the non-executive but oversight role and functions of the KRA Board of Directors. However, like other parastatal organisations in Kenya, since 2006, the Commissioner General and other members of Board of Directors are joint signatories to a performance contract with the Ministry of Finance. More significantly, this contract is taken seriously by the KRA Board members.

**Changes in administrative systems**

The rationale for forming KRA is articulated under TMP, which revolves around: improving tax administration and “implementing organisational reforms that would modernise tax administration” (Cheeseman and Griffiths, 2005). It was done with the expectation that the new authority would institute efficient and effective systems “to seal the widespread loopholes in the tax system, bring down the vice of tax evasion, and enlist as many eligible taxpayers into the tax net as possible” (Muriithi and Moyi, 2003). To this end, “in the years since its inception, the KRA, through a series of corporate strategic plans, has laid out and followed a focused course for reform and modernisation”11. It is significant that KRA uses the state-of-the-art balanced scorecard (BSC) “as a performance measurement strategy [measuring] financial (to surpass revenue targets), internal processes (increasing efficiency), stakeholder (high quality service) and people (develop a highly motivated and professional work force)” targets (Cheeseman and Griffiths, 2005). In addition, KRA prepares and disseminates quarterly progress and annual reports.

However, the focus of KRA administrative reforms in the first 10 years of its existence was centred on achieving rationalisation and stabilisation of its organizational structure and general administrative systems, and coping with changes in tax policies. During that period KRA moved all its headquarters and Nairobi operations (other than border-related ones) to its new 30-storey headquarters, which was “donated” by the Central Bank. In addition, it also fully computerised its basic management support services (payroll, financial management, etc), and made initial attempts at computerising the tax administration.

Today, KRA employs about 4,300 staff. Of them, 56% of KRA staff are directly involved in revenue administration (KRA, 2009). The percentage is low compared to other countries. For instance, the number of staff directly involved in revenue administration in OECD countries range from 85% to 90% (OECD, 2009). KRA has invested heavily in building capacity of its staff. It operates the Kenya Revenue Authority Training Institute (KRATI) in Mombasa, which in partnership with institutions such as the Centre for Customs and Excise Studies at the University of Canberra, delivers specialised training to its staff. KRATI is also the World Customs Organisation’s (WCO’s) Regional Training and Capacity Building Coordinator for 21 countries in East and Southern Africa12– it “serves as a focal point for developing and implementing programmes to enhance the capability of customs”13. KRA also sponsors its staff to attend international training courses.

---

Under the Revenue Administration Reform and Modernisation Programme (RARMP), launched in FY 2004/05, whose goal is to transform “KRA into a modern, fully integrated and client-focused organization”, the authority has in effect launched an ICT-driven strategy for the modernisation of the tax administration\(^{14}\). The salient features of the strategy are presented in Annex 5.5. However, three of them deserve to be highlighted:

- First, the Integrated Tax Management System (ITMS) for domestic revenue. As part of the ITMS, “E-registration is fully operational and cumulatively, 60,310 new taxpayers had registered online by the end of May 2009” (KRA, 2009);

- Second, the electronic tax registers (ETRs) for VAT-registered taxpayers, which KRA introduced from 1 January 2005; and

- Third, the Simba 2005 system (S2005S) for customs operations. The S2005S “has enabled the automation of about 90% of customs operations”\(^{15}\). S2005S is able to obtain third party information from the Kenya Ports Authority systems and it is interfaced with the electronic cargo tracking system, and the Revenue Authority Digital Data Exchange (RADDEX), which is collaboratively operated by the EAC countries.

It is noteworthy that there was serious resistance from freight forwarders and customs clearing agents to the implementation of the both ETRs and the S2005s. In the case of the ETRs, businesses mobilised considerable support against the new system, even from MPs. In the case of the S2005S, “the Kenya International Freight and Warehousing Association initiated a court action because members felt that [modernisation] imposed unfair and costly requirements”\(^{16}\). However, with the support of the Government, and use of experienced legal counsels, KRAs position prevailed and the systems have been implemented. The successful implementation of the above initiatives, which is well on track, will enable the KRA to realise its vision. In this regard, the consolidation of these gains is integral to KRA’s fourth corporate plan covering the three years from 2009/10 to 2011/12. The plan specifies six goals and a number of strategic objectives under them. The plan also details a framework for monitoring and evaluating implementation progress.

### Fiscal decentralisation and taxation by local governments

Delivery of virtually all basic social public services in Kenya (including primary education, health and agricultural extension) have never been decentralised since they reverted to central government in the early 1970s. To finance the limited services under their jurisdiction, local authorities rely heavily on own local revenues but the Ministry of Local Government must approve most changes to local fees, taxes and other charges. Between 2003/04 and 2007/08, local government revenue as a proportion of tax and non-tax revenue collected by central government was comparatively low, at an average of 3.2% p.a. (see Table 14 in Annex 5.3). The two main local own revenue sources in Kenya are property rates and the Single Business Permit (SBP) (Kelly 2000; Grava 2009; Hugounenq, Rocaboy and Vaillancourt 2010). The central authority also provides local governments with a significant block grant (local authority transfer fund) and limited earmarked funds for maintenance of rural and urban roads.

Arguably, the most progressive feature of Kenya’s local government system is the SBP, which was introduced in 1999 to replace a number of local licenses and revenues-raising permits on local businesses. Under

---


\(^{16}\) www.bizcllr.com/galleries/.../01.128.08BP12_Kenya.pdf [Accessed 11 April 2010]
the SBP, local authorities are provided a range of pre-approved tariff schedules. The SBP serves the dual purpose of a regulatory instrument as well as a local tax on business activity (with the permit serving as an effective tax handle). Although the SBP has proven to be a sound revenue instrument with substantial revenue-raising power, there is considerable objection to using the issuance of a local business permit as a tax handle for local revenue-raising purposes, resulting in sustained pressure to eliminate the SBP.

Reform sequencing, implementation and results

Overview

There is no history of long-term planning for tax reforms before the TMP, which was launched in 1986. However, as discussed above, significant tax policy and administrative changes can be identified in the one and half decades preceding the TMP. Nevertheless, these changes were essentially reactive, and cannot qualify as reforms. In this regard, there are two epochs in the reform of tax policies and administration in Kenya, which generally correspond to the TMP and Revenue Administration Reform and Modernisation Programme (RARMP) periods (see earlier discussion). Yet, reforms under the RARMP were not specifically anticipated in the TMP. In other words, there was no specific initiative to sequence between the two programmes. Furthermore, there are aspects of tax policy initiatives that transverse the two programmes, and elements of which can also be found in the pre-TMP policy changes. Considering the latter observations, what follows below is: (a) a highlight of tax policies amenable to regular monitoring, evaluation and possible change; and (b) a discussion of sequencing of reforms and results of implementation through the TMP and the RARMP.

Sequencing does not arise for tax policies

Through the three distinct phases of tax policy changes as discussed above, it is clear that certain policy initiatives were not particular to any reform epoch. Rather, they were subject to periodic changes. Such tax policies cannot therefore be located as one-off changes in a long-term strategic trajectory. Rather, they need to be monitored, evaluated and changes effected, where appropriate, on a regular basis. In this regard, the issue of sequencing does not arise, with respect to: (i) widening the tax base; and (ii) aligning the tax policies with the national development strategies and policies.

Sequencing and implementation of reforms under the TMP

The initial reforms under TMP (1986 to early 1990s) focused on tax policy. On one hand, the policy reforms and strategies were driven by two main factors, the need to: (i) comply with Kenya’s obligations to rationalise tariffs under the WTO agreement; and (ii) introduce tax incentives to promote exports and attract foreign direct investment. These measures were to increase revenue losses, while the Government still aimed to raise tax collections as a percentage of GDP. Therefore, the policy reforms were accompanied by the introduction of measures to raise revenue. Specifically, GoK began to levy excise duty on items formally subject to high duties and sales tax—alcoholic beverages, soft drinks, tobacco and tobacco products, luxury cars, and petroleum products.

In 1992/93 the scope of reforms was extended and deepened to encompass structural adjustment measures that not only reduced protection of local industries, but also lowered their production costs. The structural adjustment measures also covered policies
to promote capital mobilisation, including credit for private sector investments and to improve competitiveness in a liberalised economy. The combination of these measures, policy adjustments under TMP and the virtual stagnation in economic growth led to a steady decline in the tax to GDP ratio in the 1990s and early 2000s (see discussion below).

The establishment of KRA and the rationalisation of staffing that followed were the hallmark reforms under the TMP. By 2000, KRA had reduced staff by 30%. It has been independently observed that the new organisational arrangements have “increased the professionalism of the tax agency’s staff and reduced, though not eliminated, the level of corruption” (Taliercio, 2004). KRA also then embarked on building capacity to enforce compliance, through: taxpayer awareness and education; and more targeted audits and detailed examinations. At the same time, it introduced self-assessment in filing income tax return to reduce burden of tax administration and facilitate early payment.

In second half of the period when the TMP was implemented (between 1993/94-2000/01), the tax to GDP ratio was comparatively high (in the range of 20%+), but this must be qualified in three respects (see Figure 5.2). One, the ratio was on a steady decline. Two, the economy (GDP) was in decline. Three, by 2001/02, the tax to GDP ratio was at its lowest for the two decades of 1980s and 2000s. Therefore, while TMP introduced extensive policy, institutional and administrative changes, it did not, in terms real growth in tax revenues, lead to an increase in the tax/GDP ratio. Instead, this ratio actually fell during the period that the TMP was being implemented. However, it must be emphasised that it is not necessarily the failure of either the TMP or KRA, but rather that of the wider governance systems. These were the days of rampant corruption, political tensions and unstable economic management (see first section).

Nevertheless, empirical analysis by Muriithi and Moyi (2003) suggests that tax reforms in Kenya under the TMP have led to improved productivity of direct taxes, and as a result, comparatively higher ratios for both Personal Income Tax Productivity (PITPROD) and Corporate Income Tax Productivity (CITPROD); in particular, administrative reforms (e.g., lower tax rates, PIN etc.) aimed at eliminating “avenues for evasion and corruption”. At the same time, Muriithi and Moyi (2003) suggest that there was considerable revenue leakage in the administration of VAT.

### Sequencing and implementation of reforms under the RARMP

As earlier indicated, the strategic thrust of the RARMP is to exploit ICT to modernise, and thereby enhance efficiency and effectiveness of KRA’s operations. However, streamlining the organisation structure and administrative systems were fast tracked. The measures included:

- Reorganisation and capacity building of KRA’s tax assessment and collection functions to better align them with the three main segments. To this end, for example: (i) KRA merged the various tax departments into the Domestic Tax Department and the LTO; and (ii) it embarked on the “continuous recruitment of management trainees, [and] up-scaling” of facilities at KRATI (KRA, 2009);

- The tax amnesty of 2004, which to a degree, was a success. KRA reports that it raked in “KShs 4.41 billion from 4,483 applications in the period to 31st December 2004 when it was in force”17;

- Educating and guiding taxpayers to settle taxes through banks and not KRA counters. Now, over 90% of taxes are paid through banks, and this arrangement has contributed to reducing “revenue leakages arising from handling of cash and cheques. Tax frauds involving incidents such as the

---

multiple usage of revenue cheques are now a thing of the past.\(^{18}\)

- Introduction of scanning of imported goods and goods destined for export. This process has significantly improved security of cargo and missed mis-declarations for tax purposes; and

- Getting KRA to be ISO 9001 certified, as a means for improving services to taxpayers. To maintain this certification, KRA has instituted regular quality management system audits and reviews (KRA, 2009).

Implementation of the ICT-driven modernisation strategy is a long-term pursuit. Nonetheless, there has been fast-tracking of some “quick wins”. The initiatives and successes already achieved in the key results areas of ICT applications have been outlined above. In terms of specific outcomes, the following are discernible indicators:

- The e-filing system is working. Returns, filed online, are processed in 30 minutes rather than 2 weeks.\(^ {19}\) This is no mean feat given the large and increasing volume of transactions it receives: 10,000 self-assessment, 1,000 VAT and 1,500 PAYE returns per month;

- “Simba 2005 online system which [is] interfaced with KWATOS…For the first time, KRA, through the Attorney-General’s office, has began prosecuting tax evasion cases through the Anti-Corruption and Economic Crimes Act, 2003, which entails hefty fines and harsh bail terms” (Daily Nation, 2010).

In the implementation of the RARMP, KRA management has also demonstrated that it can be proactive and creative - for example:

“KRA has put in place an elaborate plan to train cyber cafes in an endeavour to build their capacity to handle online services. The first training programmes brought together participants from across the country, representing over 400 cyber cafes.”\(^ {20}\)

Moreover, two years following the launch of the RARMP’s implementation in 2006/07, there was the onset of a sustained reversal of the decade-long decline in the tax to GDP ratio (see Annex 5.3 – Table 6 or Figure 5.2). It is also noteworthy that this was taking place when GDP growth was at its highest since 1970s.


\(^ {19}\) Ibid.

Domestic revenue performance

trends

Figure 5.2 presents domestic revenue collections for the period from 1989/90 to 2007/08. In 1989/90, Kenya’s domestic revenue collection was 23.3% of GDP. Revenue collection peaked in 1995/96 at 30.4% of GDP as a result of economic liberalisation, and thereafter, declined to 20.5% in 2002/03, before increasing to 22.0% in 2007/08. However, as earlier observed (see earlier discussion), for many of these years, the high tax to GDP ratio did not deliver any real increase in tax revenues because this was a period of steady decline and ultimately negative growth of GDP. This stagnation or real decline in revenues may also be partly attributable to a reduction in tax rates and tariffs (see earlier discussion). In addition, Ndulu et al (2007) indicate that structural weaknesses of the economy were another contributory factor – in particular, the narrow scope to expand the coverage of income taxes due to limited potential to increase the number of Kenya’s workforce in formal employment.

Nonetheless, on the whole, Kenya’s “tax system performed better than average for Africa. This is mainly attributable to a stronger tax administration system and a relatively large formal sector” (IMF, 2003). It is also noteworthy that, relative to other EAC countries, non-tax revenue contributions during the same period were fairly significant – averaging at 3.7% of GDP.

In recent years, the top revenue sources in order of their contribution are: taxes on income and profits; VAT; excise duties; and import duties (see Table 6 in Annex 5.3). Except in certain years, taxes on income and profits as a share of total revenue remained fairly constant throughout the 18-year period to 2007/08, but grew at an average rate of 16.9% in nominal terms. It is worth noting that as the economy went into recession, income tax revenues...
declined from a high of 9.8% of GDP in 1993/94 to 7% in 1998/99, and then dropping further to around 6% for the period 2000/01 to 2003/04.

In the first two or three years following its introduction, VAT was the largest contributor of tax revenue – with a peak contribution of 39.4% in 1991/92. By 1994/95, revenues from VAT had declined to 22.5% of total tax revenues, but thereafter rose to 30% in 2000/01 before dropping to 25.9% in 2007/08. According to the literature, VAT’s share of tax revenue initially increased as a result of the move by GoK to widen its coverage, but thereafter, reached a plateau (Cheeseman and Griffiths, 2005). In addition, the decline in collections can also be explained by VAT waivers given by GoK in years of drought, famine and other natural disasters, and revenue lost from incentives and exemptions offered to firms operating in Kenya’s EPZ.

As a result of GoK’s policy initiatives to reduce tariffs, there was a significant decline in the proportion of revenue generated from import duties, which fell from 16.8% in 1989/90 to 7.6% in 2007/08. According to literature sources, this measure enabled Kenya to enhance its “trade openness by moving away from the restrictive import substitution strategy towards export-oriented industrialization” (Moiy and Ronge, 2006). But it also spawned another problem: smuggling and illicit trade at Kenya’s borders contributed to revenue leakages.

Tax administration performance benchmarks

Performance efficiency

As one measure of performance efficiency, KRA’s administrative costs for the period from 1998/99 to 2007/08 averaged at 1.5% (see Table 3 in Annex 5.3), which is low compared to other EAC countries. However, administrative costs during the period grew at an average annual rate of 14.9% - but still remained within the 2% ceiling of operating costs as a percentage of total revenue collected, as specified by law. It is also noteworthy that the number of tax staff available for every 1,000 persons in Kenya is 0.12. This “tax staff per population ratio” is very low compared to World and Sub-Saharan African averages, which are 0.82 and 0.37 respectively. However, this ratio does not take into account the narrow taxable base. The size of the labour force in 2008 was 1.94 million people (around 5% of the nation’s population) (Kenya National Bureau of Statistics, 2009). In other words, there were 452 wage employees per full-time revenue authority staff, which is much lower than the corresponding ratios for South Korea and South Africa of 1,396 and 1,901 respectively.

Another disquieting feature is that the World Bank’s 2010 Doing Business survey ranks Kenya 164th out of 183 countries in terms of ease of paying taxes (see Annex 5.3: Table 10). On this benchmark, Kenya has the lowest score of all the five EAC member states. One contributory factor to this dismal ranking is the number of payments that a company is required to make in a given year. For instance, in 2010, cumulative payments totalled 41 against Sub-Saharan Africa (SSA) and OECD averages of 37.7 and 12.8 a year respectively. This number is particularly high in comparison to Mauritius, where a company only makes 7 payments a year (PwC, 2010). A separate survey cited “difficulties in filing and paying …as enormous” (USAID, 2009).

Kenya tax administration system is also comparatively inefficient in administration of refunds, especially of the VAT. Informants indicate that the elapsed number of business days for VAT refunds is 60 days. The time taken to pay refunds is relatively longer when compared to South Africa (21 days).

Kenya also has a low VAT gross compliance ratio (VATGCR) of 40.5 compared to World average of 65.48 (see Annex 5.3: Table 9). But its VATGCR is higher than SSA average of 38.45\(^2\). Measures from the same source compute corporate income tax productivity (CITPROD) and personal income tax productivity (PITPROD) of 0.15 and 0.11, which indicate that Kenya uses the taxes fairly efficiently in generating revenue when compared to World averages of 0.13 and 0.14 for CITPROD and PITPROD respectively. It is noteworthy that Kenya fares better than other EAC countries on all three measures. Still, a study by Anassi (2004) suggests that there are significant levels of tax evasion – in particular: under declarations are prevalent; and “many businesses in the informal sector that should be in the tax bracket…are not because of corruption”.

**Allocative efficiency**

As earlier pointed out earlier, researchers have suggested that tax reforms in Kenya under the TMP led to improved productivity of direct taxes. On the other hand, tax exemptions and incentives were considerable, and they would have undermined the allocative efficiency of the tax regime. So, for example, while EPZs have generated employment, especially in the area of garment manufacturing, Omolo (2006) contends that “the importance of EPZ exports to the national economy has remained dismal”. Furthermore, there are informants’ claims that: produce intended for export finds its way back into the local market; and benefits are not sustained because once EPZ investors exhaust their tax incentives, they relocate from Kenya to other destinations. This is consistent with a broader literature conclusion that tax holidays and other select incentives do not deliver in terms of sustainable investments (IMF, 2008).

**Performance equity**

One is inclined to agree with Moyi and Ronge (2006) that “Kenya has relied heavily on income tax [for] ease of collection rather than on the…principles of equity”. In this latter perspective, it is also significant that large corporations contribute about 75% of domestic tax revenue \(^3\). Moreover, the literature suggests that “the tax burden in Kenya remains higher than in most comparator countries…in Kenya complaints about the tax rates top all other constraints” (Larossi, 2009). Also, the ‘total tax rate’ as a percentage of profit of 49.7% is higher than those of Tanzania (45.2%), Uganda (35.7%) and South Africa (30.2%).

Kenya’s tax rate is also higher than the OECD average of 44.5%, but significantly lower than the SSA average of 67.5%\(^4\). According to the World Bank (2010), depreciation allowances offered to corporations in Kenya are lower than those available in Rwanda and Tanzania – “not surprisingly, with lower depreciation rates, the share of Kenya’s corporate tax in the total tax rate (33.1%) is higher than Tanzania’s (19.9%), for example”.

For corporate taxpayers, Kenya’s tax system has a high tax burden, which negates equity. In this regard, the 2010 World Bank paying taxes survey indicates that Kenyan companies spend 417 hours a year on this task, as opposed to 432 hours in 2008\(^5\). This result is significantly higher than the OECD average of 194.1 hours. Furthermore, interviews with key informants suggest that there are times when tax officers harass business operators, especially during post-clearance customs audits.


\(^5\) Ibid.
However, generally equity considerations are in-built in the Kenyan tax system. Some taxes are more progressive than others, but it is difficult to comparatively gauge equity between the different taxes. Direct taxes are definitely progressive to a degree. With respect to PIT, earnings below KShs 10,165 (US$124) a month are tax-free. Furthermore, for low-income earners, GoK introduced welcome incentives such as tax-free canteen staff meals (in 2007/08). The tax rates by bracket (beginning at 10%) are progressive up to a relatively low-income threshold of KShs 38,893 (US$477) per month (after which income tax is at a flat rate of 30%) (see Annex 5.3 – Table 2). However, the limited progressivity of the system has been dented by the failure to change tax bands and personal relief since 2004/05. It resulted in a comparatively higher tax burden over the years for the low-income groups, especially as their purchasing power falls. The latter effect is compounded by the burden of consumption taxes, which have not been adjusted downwards.

Kenya’s VAT system also enjoys a degree of progressivity in terms of zero rating and exemptions of basic social goods and services. Similarly, excise and import duties are generally levied on goods and services considered to be luxurious or in demand by high-income groups. On the other hand, excise duty is high on alcohol and tobacco, not only because it is readily collectable, but also to compensate for the negative public health issues arising from their consumption. In the latter perspective, it has been argued that the scope and socioeconomic merit of additional consumption tax revenue from these goods is considerable.

Performance effectiveness

KRA’s performance effectiveness is comparatively high in terms of both tax effort and tax gap (see Annex 5.3: Table 13). At 90.5%, in 2005, Kenya’s tax effort was far above levels prevailing in neighbouring countries, with the closest performance by Tanzania at 54.4%. It is also noteworthy that Kenya’s performance in 2005 represented a significant improvement from 2001 when its tax effort was 85.5%. Still, it was significantly below that of South Africa, which recorded an exceptionally high tax effort of 104% in 2005. In that year, Kenya’s tax gap stood at 2%, which was well below those of Rwanda, Tanzania and Uganda, which were 8.5%, 5.9% and 7.8% respectively. But yet again, compared to South Africa, which had -0.4%, there is still scope to reduce the tax gap.

At an operational level, to enhance its performance effectiveness and in particular raise levels of compliance, KRA has adopted a three-pronged approach. First, the ‘National Business Agenda’ constituted in 2008, is a consultative forum in which GoK interacts with the private sector on the business environment, which covers the tax system. Second, KRA commissions regular surveys. In this regard, “KRA reports an improvement in the service satisfaction rating from 40% in 2003/04 to 69% in 2004/05 (KRA, 2006). This reflects a shift in KRA’s approach towards service orientation. Third, KRA also champions studies to establish the efficacy of key processes. It is in this context that in 2004 and 2007, KRA charged teams to undertake a time release study in the area of customs.

Summary of the overall trends

Kenya’s domestic revenue collection is higher than the tax level in a representative sample of developing countries of 18% (Tanzi and Zee, 2001). Also its performance effectiveness indicators suggest that whilst the tax effort is high, there is potential to increase tax revenue collection as a percentage of GDP by reducing the tax gap.

The early reforms of the 1970s and early 1980s, as well as introduction of VAT in 1990, which widened the tax base, enabled GoK to cut revenue losses, resulting from the reduction in --and removal of-- import and export tariffs,
which were imposed both by WTO conventions as well as the structural economic adjustment measures.

The extensive tax policy and administrative reforms under the TMP (1986-2002), including the establishment of the KRA, may not have delivered the desired outcome in terms of real growth in tax revenues for most of the years, especially because the macro economy was generally on the decline. Nonetheless, among other benefits, these reforms built a solid policy, and institutional and administrative platform on which the RARMP could yield quick and significant gains in tax revenue generation in subsequent years.

Implementation of the RARMP, which prioritised rapid and significant tax revenues increase (in real terms), has produced considerable results, including the reversal, in a period of real GDP growth (2004-2007), of the decade-long decline in tax to GDP ratio. The programme has already accomplished significant outputs and outcomes in such areas of ICT applications as eFiling and full computerisation of the customs operations, placing KRA on a firm modernisation trajectory. However, as pointed out in the assessment of performance benchmarks above, and synthesised hereafter, significant challenges still lie ahead for Kenya’s taxation system.
Challenges and issues

Compared to most countries in SSA, especially those whose economies are not predominantly mineral-export dependent, Kenya’s tax administration has done fairly well, for its tax to GDP ratio has never been below 18% for the past three decades. However, going forward, the tax administration faces major challenges on two fronts. First, the need to raise its tax to GDP ratio towards the target set way back in 1992 of 28%. There was no subsequent policy decision to revise this target downwards. Second, the analysis of performance indicators in the last section shows a number of important areas--in terms of efficiency, effectiveness, and equity--on which scope for significant improvements exists. The significant challenges and surrounding issues are highlighted in this section.

Coping with less than ideal policy, legal and other institutional environments

In Kenya, as indeed in most African countries, there is a disconnect between fiscal policy-making and development of realistic targets and strategies for revenue collection. So, it is not uncommon to see a significant gap between revenue targets set by the Ministry of Finance and KRA. For example, according to the Commissioner General, in 2006/07 the Ministry of Finance set a revenue growth target of 19.6%, which KRA considered to be ambitious given its own target of 17% (Waweru, 2007). In the same presentation, the Commissioner General pointed out some other disabling institutional constraints, which include:

- The ministry still determines the level of VAT refunds, although the demand for refunds will change with economic circumstances;
- The ministry may provide incentives, waivers, etc. without factoring these into the revenue targets, which undermines the ability of the authority to meet these targets;
- Varying policy objectives - the need to facilitate trade for example - may run counter to the need to meet Customs revenue targets;
- The ministry fails to take into account the role of other parties whose actions and efficiency impacts on KRA performance results - e.g., the Kenya Bureau of Standards; and
- KRA does not have a free hand to properly remunerate and motivate its staff. At the time of compiling this paper, there were salary arrears for some years due to KRA staff, following adjustments to pay made by the KRA’s Board of Directors, but for which the necessary additional resources have not been released by the Treasury.

Achieving an acceptable degree of tax compliance from a fast-growing and profitable, but increasingly complex informal sector

The informal sector is a fast-growing segment of Kenya’s economy, but tax evasion remains particularly high. “According to the 2006 Kenya economic survey, the informal sector constitutes 72% of the working population. The sector has grown by 32.7% during the past four years to 6.5 million workers” (Iarossi, 2009). The informal segment of the agricultural sector constitutes the bulk of the economy, and employs the largest number of people. However, it presents unique challenges to tax administration for several reasons. First, it is a high risk and uneven source of income for its operators. As a consequence, for example, past efforts to
tax it through presumptive income tax failed due to: many unrecorded open air markets; delays and a failure to make payments to producers by many government-controlled marketing boards; unpredictable profit and cash flows for growers of export crops arising from global market variations; and a high reliance on rain-fed agriculture, which exacerbates the unpredictability of farmers’ incomes. Second, most of the labour is provided by the family and therefore it is hard to audit revenue streams and costs. Third, it attracts much politics which often blurs the real issues, and results in resistance to required policy and legislative changes.

The trade segment of the informal sector has also been booming. But again, there are particular challenges to bring this segment into the tax net. In one respect, informal trading businesses increasingly operate through small scale outlets, popularly called Buzaars (i.e., many operators trading in a big store), where the identity of individual operators is difficult to confirm. In another but related respect, many such outlets may be operated by an individual using different PINs. This way, for example, it is easy for the individual to avoid paying even turnover tax.

Rationalising tax exemptions

There is an array of tax exemptions given by GoK. The more prominent ones are around the EPZ; once-off capital investment deductions; the 150% capital deduction, exemptions given on withholding tax; and the zero rating of VAT payable for goods and services procured by public bodies, privileged persons and institutions. Many studies on tax exemptions and incentives confirm the conclusions of a 2008 IMF assessment of the investment incentive regimes offered in Kenya and Tanzania, that these are not important in attracting foreign investment. Rather, such incentives create distortions and result in the loss of tax revenues. In addition, the socioeconomic rationale for VAT zero rating is questioned, because in most instances, it does not result in lowering consumer prices for the targeted beneficiaries. In the latter perspective, it has been argued that zero rating of local products may benefit business people as windfall profits. Nonetheless, it can be expected that, at least politically and diplomatically, cases of tax exemptions and incentives will arise. Therefore, a key challenge is in rationalising them.

Achieving enhanced equity and efficiency in tax administration

As expounded earlier, Kenya’s indicators of performance efficiency, equity and effectiveness can be significantly improved. Examples of major flaws in equity and efficiency include: a failure to regularly review tax brackets; and an excessive number of tax payments in Kenya vis-a-vis the neighbouring countries. There is also the issue of comparatively inordinate delays in making VAT refunds. All this needs to be addressed and there is considerable scope to improve performance equity and efficiency.

Porous borders with a failed state - Somalia

Kenya has an unstable porous eastern border with Somalia, where no government has been in control for over 20 years. The region poses problems with respect to smuggling of non-taxed imports such as sugar and other merchandise, as well as small arms. The combined effect of smuggling and insecurity in the region will remain as major obstacles to tax administration for quite some time.

Cultivating tax morale

beginning with political leaders

“Tax morale” must be presumed to be low in Kenya. Cultivating it is a daunting challenge, because a series
of events have indicated MPs’ tendency to take populist positions when they are required to support new policies to enforce tax compliance. For example, MPs have actively resisted the following key tax policy proposals: (i) reintroduction of CGT in 2008; (ii) introduction of ETRs. Some MPs joined business people in public demonstrations against the enforcement of ETRs, but the resistance was overcome; (iii) taxation of MPs’ allowances; and (iv) taxation and restriction of the use of plastic papers.

**Effectively and sustainably combating corruption in tax administration**

Onyango (2009) suggests that “corruption still tops the list of impediments that hindered KRA from meeting its targets during the 2008/2009 financial year”. Yet, the problem is not exactly internal to KRA. As one of its officers observes: “You know that we have never shied away from admitting that we have a problem… We have sacked people at KRA, we have changed management but the vice is still with us. Therefore, what is it that is the problem? It is those business people and they need to begin changing. These people will foster corruption as long as they are not arrested. Therefore, we all need to work together to eradicate this costly vice” (Wambui, 2009).

**Regional common markets pose challenges**

Kenya is a member of two regional blocks, the EAC and COMESA, but the two trading blocs have not harmonised their tax regimes. This poses a serious challenge to the determination of origin of goods for tax purposes. With CETs between EAC member states, it will be particularly difficult to control leakage of goods which originate from non-EAC countries entering Kenya through other countries of EAC. There is also the issue of exemptions. Kenya is eligible under the EAC Customs Management Act to grant exemptions of import duty to promote infant industries. The value of goods that qualified for such exemptions increased in 2006 by 71.2% to US$1,370.8 million, resulting in revenue loss of US$289.5 million, which was about 14.20% of total trade taxes. In this regard, no monitoring mechanism is in place “to ensure that goods benefiting from exemptions are not exported” or that duty is paid in full (Mugisa et al, 2009). An added problem is the comparability and ability of the revenue authorities in member countries, and their capacity to enforce compliance. With a common market and free movement of goods, there are increased risks that goods will be channelled through the country with weaker revenue enforcement tax administration to countries with more efficient administrations. This is especially possible when consumption taxes are different. Kenya, for example, has a lower VAT rate than Burundi, Rwanda, Uganda and Tanzania and may experience increased volume of transit goods, some of which may be diverted into the domestic market.
Lessons of experience

This section highlights the lessons learned in dealing with the tax issues in Kenya.

Stability of leadership and management enhances capacity development

As discussed earlier, the TMP was characterised by highly unstable management at the Treasury, which was extended to KRA. Consequently, although revenues as a ratio of GDP rose to exceed the target of 24% set by Sessional Paper No.1 of 1986, this could not be sustained, and ultimately in real terms tax revenues were in the decline for most of the 2000s. It has been observed that stability of leadership has enabled effective implementation of the RARMP. It also led to the achievement of the positive results in terms of reform outputs and outcomes, and especially with regard to real growth in tax revenues since 2003/04.

Tax exemptions and incentives may undermine equity and fairness

In the past, GoK extended tax exemptions and incentives, especially on import duties, to various taxpayers. Since there were no open criteria for these exemptions and incentives, they translated into favours for the well connected. This practice undermined equity and fairness of the tax system and revenue potential. At the same time, evidence from independent studies generally shows that these exemptions and incentives have minimal economic benefits.

The EAC Customs Management Act of 2004 has restricted the range and quantum of tax exemptions and incentives by member states. However, GoK has circumvented this restriction by paying duties on behalf of select institutions, such as faith groups and other charities that provide public services. Furthermore, exemptions from domestic taxes remain, but are subject to an internal criterion, which guides processing and approval of such requests. Still, there is no guarantee of equity and fairness in the distribution of these exemptions.

Enforcement with facilitation of taxpayers to modernise systems can be a win-win solution

The introduction of ETRs in Kenya was initially controversial and strongly resisted by business people. Traders had argued that: (a) ETRs are an extra burden on the taxpayer – especially for those with other systems to account for sales and VAT; (b) others argue that implementation costs are high and not recoverable for tax purposes; and (c) some ETRs malfunction and suppliers are not responsive. KRA responded with determination, but also with an aggressive information, education and communication campaign to promote ETR use, and a facilitation scheme under which taxpayers acquired ETRs, and then obtained refunds through the VAT system. Today, many traders acknowledge that ETRs are useful in their businesses. Therefore, both KRA and the business community have emerged as winners.

Implementation of major ICT systems can seriously disrupt revenue collection

In 2005/06, there was a decline in the tax to GDP ratio in Kenya, which has been attributed to teething
problems with S2005S. In addition, “when the S2005S system was introduced… and did not immediately ease the backlog and hasten clearance procedures at the port, it encountered opposition from some stakeholders”26. Therefore, possible resistance should be anticipated in the implementation of major changes in tax administration systems, and consequent disruptions in revenue collection.

Revenue authorities may be best placed to prosecute cases of tax evasion

Over the past year, KRA has been allowed by the Attorney General, who is the defacto Director of Public Prosecutions, to appoint six of his officers, who are legal professionals as prosecutors in tax evasion cases. According to the authority, this arrangement has enabled more timely, effective and successful prosecutions. Furthermore, KRA’s prosecutors are in a position to apply the legislative framework, knowledge and other capacities for combating corruption and other crimes, to “register substantial wins in court cases”27.

## Annex 5.1: Key informants

<table>
<thead>
<tr>
<th>Name</th>
<th>Position and Office</th>
</tr>
</thead>
<tbody>
<tr>
<td>Betty Maina (Ms)</td>
<td>Chief Executive Officer, Kenya Association of Manufacturers (KAM)</td>
</tr>
<tr>
<td>J. S. Ogai (Mr)</td>
<td>Senior Deputy Commissioner, Research and Corporate Planning, Kenya Revenue Authority</td>
</tr>
<tr>
<td>Justus Nyamunga (Mr)</td>
<td>Director, Department of Economic Affairs, Treasury</td>
</tr>
<tr>
<td>Karen Nginda (Ms)</td>
<td>Deputy Commissioner, Research and Corporate Planning, Kenya Revenue Authority</td>
</tr>
<tr>
<td>Kubai Khasiani (Mr)</td>
<td>Director, Public Financial Management Reform Secretariat</td>
</tr>
<tr>
<td>Phyllis N. Makau (Ms)</td>
<td>Principal Budget Officer, Parliament (Kenya National Assembly) Budget Office</td>
</tr>
<tr>
<td>Stephen Wainaina (Mr)</td>
<td>Economic Planning Secretary, Ministry of State For Planning, National Development And Vision 2030</td>
</tr>
<tr>
<td>Wa Nyambura Mwambia (Mr)</td>
<td>Deputy Director, Economics Affairs, Treasury</td>
</tr>
</tbody>
</table>
Annex 5.2: Bibliography


Daily Nation (2009); Investment in Tanzania Now at Sh160 Billion. Daily Nation 02/09/09, [online].

Daily Nation (2010); KRA Probe Confirms 22 Containers Sneaked From Port. Daily Nation 13/03/10, [online].


Karingi, S. (2000); Macro models of the Kenyan economy. KIPPRA, 2000. Discussion paper no. 2


Kinyanjui, K (2010); Mobile Money turns Kenya into Global Transfers Hub Business Daily 10/01/10, [online].


Mankiw, N.G. (1994); Macroeconomics Worth Publishers Inc.


Mugambi, K. (2010); Horticulture Earns Kenya Sh71.6 Billion. Daily Nation 18/03/2010, [online].


Ndung’u, N. (2009); Kenya’s Ksh. 18.5 billion Infrastructure Bond. Address by the Governor of the Central Bank of Kenya during the Launch of the Ksh. 18.5 billion Infrastructure Bond Issue Nairobi, Kenya, 28 January 2009.


Tanzi, V. and Zee, H. (2001); Tax Policy for Developing Countries Economic Issues 27.


Wambui, S. (2009); Corruption is Rife at KRA, says Taxman. Capital Business 28/1109, online.


Annex 5.3: Selected indicators

Table 1: Tax policy – Maximum marginal tax rates (1994/95 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>PIT</th>
<th>CIT</th>
<th>VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994/95</td>
<td>37.5%</td>
<td>35.0%</td>
<td>18.0%</td>
</tr>
<tr>
<td>1995/96</td>
<td>35.0%</td>
<td>35.0%</td>
<td>15.0%</td>
</tr>
<tr>
<td>1996/97</td>
<td>35.0%</td>
<td>35.0%</td>
<td>15.0%</td>
</tr>
<tr>
<td>1997/98</td>
<td>32.5%</td>
<td>32.5%</td>
<td>17.0%</td>
</tr>
<tr>
<td>1998/99</td>
<td>32.5%</td>
<td>32.5%</td>
<td>16.0%</td>
</tr>
<tr>
<td>1999/00</td>
<td>30.0%</td>
<td>30.0%</td>
<td>15.0%</td>
</tr>
<tr>
<td>2000/01</td>
<td>30.0%</td>
<td>30.0%</td>
<td>18.0%</td>
</tr>
<tr>
<td>2001/02</td>
<td>30.0%</td>
<td>30.0%</td>
<td>18.0%</td>
</tr>
<tr>
<td>2002/03</td>
<td>30.0%</td>
<td>30.0%</td>
<td>18.0%</td>
</tr>
<tr>
<td>2003/04</td>
<td>30.0%</td>
<td>30.0%</td>
<td>18.0%</td>
</tr>
<tr>
<td>2004/05</td>
<td>30.0%</td>
<td>30.0%</td>
<td>16.0%</td>
</tr>
<tr>
<td>2005/06</td>
<td>30.0%</td>
<td>30.0%</td>
<td>16.0%</td>
</tr>
<tr>
<td>2006/07</td>
<td>30.0%</td>
<td>30.0%</td>
<td>16.0%</td>
</tr>
<tr>
<td>2007/08</td>
<td>30.0%</td>
<td>30.0%</td>
<td>16.0%</td>
</tr>
</tbody>
</table>

Source: TMP document, Institute of Economic Affairs and Kenya Legislation

Table 2: Tax brackets – PIT

<table>
<thead>
<tr>
<th>Monthly taxable income</th>
<th>Tax on taxable income</th>
<th>Tax rate in each shilling</th>
</tr>
</thead>
<tbody>
<tr>
<td>For taxable income under KShs 10,165</td>
<td>KShs 1,016 on taxable income of KShs 10,164</td>
<td>10%</td>
</tr>
<tr>
<td>For taxable income from KShs 10,165 but under KShs 19,741</td>
<td>KShs 1,016 plus KShs 1,436 tax on taxable income of KShs 9,576</td>
<td>15%</td>
</tr>
<tr>
<td>For taxable income from KShs 19,741 but under KShs 29,317</td>
<td>KShs 2,452 plus KShs 1,915 tax on taxable income of KShs 9,576</td>
<td>20%</td>
</tr>
<tr>
<td>For taxable income from KShs 29,317 but under KShs 38,893</td>
<td>KShs 4,367 plus KShs 2,394 tax on taxable income of KShs 9,576</td>
<td>25%</td>
</tr>
<tr>
<td>For taxable income from KShs 38,893 and above</td>
<td>KShs 6,761 plus tax calculated at 30% on taxable income over KShs 38,892</td>
<td>30%</td>
</tr>
</tbody>
</table>

Source: KRA
### Table 3: Tax administration costs (1998/99 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Operating cost (KShs million)</th>
<th>Operating cost as a percentage of tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998/99</td>
<td>2,084</td>
<td>1.3%</td>
</tr>
<tr>
<td>1999/00</td>
<td>2,208</td>
<td>1.3%</td>
</tr>
<tr>
<td>2000/01</td>
<td>2,202</td>
<td>1.2%</td>
</tr>
<tr>
<td>2001/02</td>
<td>2,927</td>
<td>1.6%</td>
</tr>
<tr>
<td>2002/03</td>
<td>3,313</td>
<td>1.6%</td>
</tr>
<tr>
<td>2003/04</td>
<td>3,546</td>
<td>1.5%</td>
</tr>
<tr>
<td>2004/05</td>
<td>4,519</td>
<td>1.6%</td>
</tr>
<tr>
<td>2005/06</td>
<td>5,697</td>
<td>1.9%</td>
</tr>
<tr>
<td>2006/07</td>
<td>6,299</td>
<td>1.7%</td>
</tr>
<tr>
<td>2007/08</td>
<td>6,989</td>
<td>1.6%</td>
</tr>
</tbody>
</table>

*Source: KRA audited accounts*

### Table 4: Ratio of tax staff per population (TAXSTAFF)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Kenya’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Upper income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXSTAFF</td>
<td>0.12</td>
<td>0.82</td>
<td>0.37</td>
<td>0.88</td>
</tr>
</tbody>
</table>

Table 5: National government revenue and deficit as a percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue (tax and non-tax)</th>
<th>Deficit excluding grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989/90</td>
<td>23.3%</td>
<td>-6.9%</td>
</tr>
<tr>
<td>1990/91</td>
<td>23.7%</td>
<td>-9.1%</td>
</tr>
<tr>
<td>1991/92</td>
<td>25.9%</td>
<td>-4.8%</td>
</tr>
<tr>
<td>1992/93</td>
<td>24.6%</td>
<td>-11.0%</td>
</tr>
<tr>
<td>1993/94</td>
<td>28.6%</td>
<td>-7.5%</td>
</tr>
<tr>
<td>1994/95</td>
<td>29.6%</td>
<td>-2.3%</td>
</tr>
<tr>
<td>1995/96</td>
<td>30.4%</td>
<td>-1.5%</td>
</tr>
<tr>
<td>1996/97</td>
<td>25.9%</td>
<td>-3.9%</td>
</tr>
<tr>
<td>1997/98</td>
<td>27.3%</td>
<td>-2.5%</td>
</tr>
<tr>
<td>1998/99</td>
<td>26.9%</td>
<td>-0.7%</td>
</tr>
<tr>
<td>1999/00</td>
<td>22.1%</td>
<td>0.2%</td>
</tr>
<tr>
<td>2000/01</td>
<td>22.6%</td>
<td>-4.8%</td>
</tr>
<tr>
<td>2001/02</td>
<td>21.6%</td>
<td>-3.4%</td>
</tr>
<tr>
<td>2002/03</td>
<td>20.5%</td>
<td>-5.4%</td>
</tr>
<tr>
<td>2003/04</td>
<td>21.7%</td>
<td>-1.7%</td>
</tr>
<tr>
<td>2004/05</td>
<td>21.4%</td>
<td>-4.1%</td>
</tr>
<tr>
<td>2005/06</td>
<td>20.5%</td>
<td>-4.7%</td>
</tr>
<tr>
<td>2006/07</td>
<td>21.6%</td>
<td>-2.7%</td>
</tr>
<tr>
<td>2007/08</td>
<td>22.0%</td>
<td>-5.2%</td>
</tr>
</tbody>
</table>

Source: Various IMF staff reports

Table 6: Total budgeted tax and non-tax revenue as a percentage of GDP (1989/90 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Tax revenue</th>
<th>Non-tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989/90</td>
<td>19.5%</td>
<td>3.8%</td>
</tr>
<tr>
<td>1990/91</td>
<td>20.1%</td>
<td>3.6%</td>
</tr>
<tr>
<td>1991/92</td>
<td>19.4%</td>
<td>4.6%</td>
</tr>
<tr>
<td>1992/93</td>
<td>19.3%</td>
<td>4.0%</td>
</tr>
<tr>
<td>1993/94</td>
<td>24.5%</td>
<td>3.0%</td>
</tr>
<tr>
<td>1994/95</td>
<td>24.6%</td>
<td>3.8%</td>
</tr>
<tr>
<td>1995/96</td>
<td>24.7%</td>
<td>4.5%</td>
</tr>
<tr>
<td>1996/97</td>
<td>22.4%</td>
<td>3.5%</td>
</tr>
<tr>
<td>1997/98</td>
<td>22.6%</td>
<td>4.7%</td>
</tr>
<tr>
<td>1998/99</td>
<td>21.6%</td>
<td>5.3%</td>
</tr>
<tr>
<td>1999/00</td>
<td>20.3%</td>
<td>2.8%</td>
</tr>
<tr>
<td>2000/01</td>
<td>19.8%</td>
<td>2.8%</td>
</tr>
<tr>
<td>2001/02</td>
<td>17.6%</td>
<td>4.0%</td>
</tr>
<tr>
<td>2002/03</td>
<td>18.0%</td>
<td>2.5%</td>
</tr>
<tr>
<td>2003/04</td>
<td>18.2%</td>
<td>3.5%</td>
</tr>
<tr>
<td>2004/05</td>
<td>17.8%</td>
<td>3.6%</td>
</tr>
<tr>
<td>2005/06</td>
<td>17.3%</td>
<td>3.3%</td>
</tr>
<tr>
<td>2006/07</td>
<td>18.1%</td>
<td>3.6%</td>
</tr>
<tr>
<td>2007/08</td>
<td>19.0%</td>
<td>3.1%</td>
</tr>
</tbody>
</table>

Source: Various IMF staff reports
### Table 7: Composition of national government tax revenues (1989/90 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Taxes on income and profits</th>
<th>VAT</th>
<th>Excise duties</th>
<th>Import duties</th>
<th>Total taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989/90</td>
<td>33.4%</td>
<td>35.7%</td>
<td>8.3%</td>
<td>16.8%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1990/91</td>
<td>34.0%</td>
<td>36.7%</td>
<td>8.8%</td>
<td>15.2%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1991/92</td>
<td>36.0%</td>
<td>39.4%</td>
<td>14.0%</td>
<td>10.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1992/93</td>
<td>34.6%</td>
<td>38.4%</td>
<td>13.5%</td>
<td>12.4%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1993/94</td>
<td>40.0%</td>
<td>31.7%</td>
<td>12.3%</td>
<td>16.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1994/95</td>
<td>33.6%</td>
<td>22.5%</td>
<td>17.8%</td>
<td>17.1%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1995/96</td>
<td>39.1%</td>
<td>23.1%</td>
<td>18.4%</td>
<td>17.7%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1996/97</td>
<td>38.1%</td>
<td>22.5%</td>
<td>20.0%</td>
<td>17.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1997/98</td>
<td>37.7%</td>
<td>24.2%</td>
<td>18.8%</td>
<td>16.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1998/99</td>
<td>35.7%</td>
<td>25.3%</td>
<td>18.6%</td>
<td>18.4%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1999/00</td>
<td>34.8%</td>
<td>26.2%</td>
<td>18.2%</td>
<td>18.3%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2000/01</td>
<td>33.3%</td>
<td>30.0%</td>
<td>16.9%</td>
<td>17.2%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2001/02</td>
<td>29.9%</td>
<td>25.7%</td>
<td>16.2%</td>
<td>10.9%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2002/03</td>
<td>33.4%</td>
<td>26.6%</td>
<td>16.9%</td>
<td>8.8%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2003/04</td>
<td>32.2%</td>
<td>24.4%</td>
<td>15.9%</td>
<td>9.2%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2004/05</td>
<td>33.3%</td>
<td>26.4%</td>
<td>15.8%</td>
<td>7.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2005/06</td>
<td>36.6%</td>
<td>24.5%</td>
<td>16.2%</td>
<td>6.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2006/07</td>
<td>33.8%</td>
<td>24.8%</td>
<td>14.5%</td>
<td>7.1%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2007/08</td>
<td>38.3%</td>
<td>25.9%</td>
<td>14.3%</td>
<td>7.6%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: Various IMF staff reports

### Table 8: Analysis of tax arrears (2002/03 to 2007/08)

<table>
<thead>
<tr>
<th>Item</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt (KShs millions)</td>
<td>9</td>
<td>31</td>
<td>4</td>
<td>416</td>
<td>831</td>
<td>880</td>
</tr>
<tr>
<td>Total tax revenue(millions)</td>
<td>229,276</td>
<td>274,252</td>
<td>297,699</td>
<td>360,191</td>
<td>433,915</td>
<td>480,569</td>
</tr>
<tr>
<td>Debt revenue (%)</td>
<td>8.3%</td>
<td>4.7%</td>
<td>3.4%</td>
<td>2.6%</td>
<td>5.5%</td>
<td>2.1%</td>
</tr>
</tbody>
</table>

Source: KRA

### Table 9: CIT and PIT revenue productivity and VAT gross compliance ratio (2008/09)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Kenya’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Upper income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>CITPROD</td>
<td>0.15</td>
<td>0.13</td>
<td>0.09</td>
<td>0.15</td>
</tr>
<tr>
<td>PITPROD</td>
<td>0.11</td>
<td>0.14</td>
<td>0.08</td>
<td>0.14</td>
</tr>
<tr>
<td>VATGGR</td>
<td>40.5</td>
<td>65.48</td>
<td>42.3</td>
<td>70.82</td>
</tr>
</tbody>
</table>

Table 10: World Bank Doing Business indicators on the tax burden (Kenya only)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Year</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
<td>2009</td>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>Kenya’s global ranking</td>
<td>-</td>
<td>159</td>
<td>164</td>
<td></td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>41</td>
<td>41</td>
<td>41</td>
<td></td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>432</td>
<td>417</td>
<td>417</td>
<td></td>
</tr>
</tbody>
</table>


Table 11: World Bank Doing Business indicators (2010) on the tax burden (Kenya vis-à-vis the OECD and SSA)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Region</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Kenya</td>
<td>OECD</td>
<td>SSA</td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>41</td>
<td>12.8</td>
<td>37.7</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>417</td>
<td>194.1</td>
<td>306.0</td>
</tr>
<tr>
<td>Total tax rate as % of profit</td>
<td>49.7%</td>
<td>44.5%</td>
<td>67.5%</td>
</tr>
</tbody>
</table>


Table 12: Registered tax payers based on returns for 2007

<table>
<thead>
<tr>
<th>Type of taxpayer</th>
<th>Numbers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Civil servants</td>
<td>337,683</td>
</tr>
<tr>
<td>Private employees</td>
<td>408,477</td>
</tr>
<tr>
<td>Self-employed</td>
<td>72,961</td>
</tr>
<tr>
<td>Partnerships</td>
<td>5,543</td>
</tr>
<tr>
<td>Company</td>
<td>29,531</td>
</tr>
<tr>
<td>Trust</td>
<td>933</td>
</tr>
<tr>
<td>Club</td>
<td>901</td>
</tr>
<tr>
<td>Total</td>
<td>856,029</td>
</tr>
</tbody>
</table>

Source: KRA
Table 13: Tax gap and tax effort for select EAC countries and South Africa (select years)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Tax revenue (A)</th>
<th>Estimated potential tax revenue (B)</th>
<th>Tax gap (B) – (A)</th>
<th>Tax effort (A)/(B) as a %</th>
<th>Tax effort (A)/(B) as a % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td>2001</td>
<td>17.8</td>
<td>20.8</td>
<td>3.0</td>
<td>85.5</td>
<td>190.2</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>18.6</td>
<td>20.6</td>
<td>2.0</td>
<td>90.5</td>
<td>190.2</td>
</tr>
<tr>
<td>South Africa</td>
<td>2001</td>
<td>24.8</td>
<td>26.7</td>
<td>1.9</td>
<td>92.9</td>
<td>200.1</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>27.4</td>
<td>27.0</td>
<td>-0.4</td>
<td>101.4</td>
<td>201.5</td>
</tr>
<tr>
<td>Rwanda</td>
<td>2001</td>
<td>10.7</td>
<td>20.9</td>
<td>10.2</td>
<td>51.2</td>
<td>186.7</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>12.2</td>
<td>21.4</td>
<td>9.9</td>
<td>57.0</td>
<td>187.8</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>13.5</td>
<td>22.0</td>
<td>8.5</td>
<td>61.4</td>
<td>187.0</td>
</tr>
<tr>
<td>Tanzania</td>
<td>2001</td>
<td>9.7</td>
<td>20.0</td>
<td>10.3</td>
<td>48.5</td>
<td>186.7</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.2</td>
<td>20.5</td>
<td>9.3</td>
<td>54.4</td>
<td>186.7</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>15.0</td>
<td>20.9</td>
<td>5.9</td>
<td>71.6</td>
<td>187.4</td>
</tr>
<tr>
<td>Uganda</td>
<td>2001</td>
<td>10.4</td>
<td>19.2</td>
<td>8.8</td>
<td>54.3</td>
<td>187.4</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.8</td>
<td>19.5</td>
<td>7.8</td>
<td>60.3</td>
<td>187.4</td>
</tr>
</tbody>
</table>

Source: IMF (2009e)

Table 14: Aggregate local revenues in Kenya – 2004/04 to 2007/08 (KShs millions)

<table>
<thead>
<tr>
<th>Revenue Source</th>
<th>03/04</th>
<th>04/05</th>
<th>05/06</th>
<th>06/07</th>
<th>07/08</th>
<th>08/09</th>
<th>09/10</th>
<th>10/11</th>
<th>11/12</th>
<th>12/13</th>
</tr>
</thead>
<tbody>
<tr>
<td>LATF</td>
<td>3,719</td>
<td>3,930</td>
<td>4,986</td>
<td>7,461</td>
<td>8,232</td>
<td>35%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RMLF</td>
<td>323</td>
<td>524</td>
<td>506</td>
<td>869</td>
<td>1,485</td>
<td>6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CILOR</td>
<td>365</td>
<td>270</td>
<td>300</td>
<td>327</td>
<td>327</td>
<td>1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subtotal CG transfers</td>
<td>4,407</td>
<td>4,724</td>
<td>5,792</td>
<td>8,657</td>
<td>12,140</td>
<td>43%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SBP</td>
<td>1,572</td>
<td>1,674</td>
<td>1,736</td>
<td>1,963</td>
<td>2,232</td>
<td>10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property rates</td>
<td>2,028</td>
<td>1,840</td>
<td>2,497</td>
<td>2,986</td>
<td>3,067</td>
<td>13%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market fees</td>
<td>706</td>
<td>701</td>
<td>832</td>
<td>950</td>
<td>1,092</td>
<td>5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vehicle parking</td>
<td>615</td>
<td>973</td>
<td>1,128</td>
<td>1,300</td>
<td>1,452</td>
<td>6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>House rents</td>
<td>386</td>
<td>314</td>
<td>314</td>
<td>308</td>
<td>160</td>
<td>1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plot rents</td>
<td>166</td>
<td>163</td>
<td>169</td>
<td>202</td>
<td>198</td>
<td>1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total cess Receipts</td>
<td>440</td>
<td>494</td>
<td>569</td>
<td>569</td>
<td>755</td>
<td>3%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Game park fees</td>
<td>458</td>
<td>688</td>
<td>729</td>
<td>1,011</td>
<td>884</td>
<td>4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water &amp; sewerage fees</td>
<td>1,767</td>
<td>535</td>
<td>472</td>
<td>518</td>
<td>392</td>
<td>2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>604</td>
<td>843</td>
<td>1,367</td>
<td>2,156</td>
<td>3,157</td>
<td>13%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subtotal LA Revenues</td>
<td>9,132</td>
<td>8,225</td>
<td>9,813</td>
<td>11,963</td>
<td>13,390</td>
<td>57%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total central and local</td>
<td>13,538</td>
<td>12,948</td>
<td>15,604</td>
<td>20,619</td>
<td>23,432</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local as a % of tax and non-tax revenue</td>
<td>3.6%</td>
<td>2.8%</td>
<td>3.1%</td>
<td>3.2%</td>
<td>3.1%</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Local Government, as cited by Hugounenq, Rocaboy et Vaillancourt (2010)
Annex 5.4: The EAC Customs Union

The East Africa Community (EAC) was reborn on 20th November 1999 and the Treaty, establishing the EAC became effective on 7th July 2000, with Kenya, Tanzania and Uganda as its founding members. Four years later, in March 2004, the founding members signed a customs union protocol, which became effective in January 2005. This protocol is enshrined into the East African Community Customs Management Act of 2004. The Act has been legislated in each of the member countries.

The protocol establishes common external tariffs (CETs), eliminating internal tariffs. It also brought about the following changes:

- elimination/phased elimination of customs duty originating from partner states;
- harmonisation of customs principles and procedures; and
- removal of suspended duty.

Furthermore, in 2004/05, to harmonise Kenya’s exemption regime with those of the other EAC partner states, and to reduce the abuse of exemptions by undeserving organizations, GoK abolished the discretionary customs duty waiver. However, Government still retained powers to grant exemptions in the national interest. The implications of the customs union are further elaborated in Box 5.1.

It is also noteworthy that with the EAC Customs Union protocol in place, GoK no longer has scope to independently amend customs duties. In contrast, Government has considerable flexibility to change excise duty rates. It has therefore made many changes to excise duty rates over the years – including increases in rates levied on beer, alcoholic spirits, tobacco etc. Furthermore, in a move to curb the environmental menace caused by plastic bags and sacks, in 2007/08, the Minister of Finance proposed to levy an excise duty of 120% on these items. Also, in 2008/09, all wireless telephony services became subject to excise duty at 10%. In the same year, imports of second-hand computers were subject to excise duty of 25%.

As a result of the formation of regional trading blocs, Kenya has, over the past decade, been able to increase

Box 5.1: Implications of the EAC Customs Union

The formation of the EAC Customs Union has provided major momentum to Kenya’s trade reform process. Since the signing of the protocols in January 2005, the EAC Customs Union has gone into high gear to address critical areas of reform. They include: documentation rationalization and standardization, information communications technology, port services facilitation, border post cooperation, third-party insurance, transit charges harmonization, tariff reforms (common external tariff), and standards harmonization. The reforms will install the risk management procedures needed to build this expanded “domestic market” (originally signed by Kenya, Uganda, and Tanzania; Rwanda and Burundi have also been accepted for membership). Kenya’s need to comply with the requirements of the new Customs Union will continue to be a major driver for trade reform and customs modernisation.

Concern is expressed about the capacity of the EAC Customs Union to move forward successfully. A number of those interviewed remarked on the fact that participating countries remain suspicious of each other. There is also the view that the EAC needs to be restructured so that it can act more quickly and spend less time talking.

Source: www.bizclir.com/galleries/.../01.128.08BP12_Kenya.pdf [Accessed 11 April 2010]
its volumes of exports to member states of the EAC and COMESA. In particular, it exports food and beverages, industrial supplies, machinery and transport supplies and consumer goods to these countries (McCormick and Pedersen, 1999). However, horticulture products and tea are Kenya’s highest export earners, and in 2009 contributed KShs71.6 and KShs69.0 billion respectively (Mugambi, 2010). The highest share of horticultural exports is from flowers, fresh fruits and vegetables. Kenya is one of the World’s largest tea producers – its major buyers are Egypt, the United Kingdom, Afghanistan, Pakistan and Yemen.

Annex 5.5: KRA’s ICT-based comprehensive tax administration reform strategy

Since 2004/05, KRA has embarked on more fundamental reforms under the Revenue Administration Reform and Modernisation Programme. RARMP seeks to transform “KRA into a modern, fully integrated and client-focused organization”\(^\text{29}\). It consists of seven projects: (i) customs reforms and modernisation; (ii) domestic taxes reform and modernization; (iii) road transport reform and modernisation; (iv) investigation and enforcement reform and modernisation; (v) KRA infrastructure development; (vi) KRA business automation; and (vii) human resource revitalisation. RARMP is sequenced into phases, which are incorporated in KRA’s successive corporate plans.

In line with the vision underlying the RARMP, KRA’s current (fourth) corporate plan (2009-2013) has set the following goals:

- a professional team that is well remunerated;
- an enabling work environment;
- a fully automated authority allowing for a single view of the taxpayer and full utilisation of ICT to promote compliance;
- a transformed and fully functional organisation;
- compliance costs are minimised and customer service is enhanced; and
- revenue targets achieved.

More significantly, through the RARMP, KRA has in effect launched an ICT-based strategy for modernisation of tax administration\(^\text{30}\). According to KRA’s Commissioner General, the objectives of the system are to:

- enhance efficiency of the tax collection process;
- strengthen responsiveness of systems in terms of their accuracy and timeliness;
- minimise contact between taxpayers and tax officials as a means of reducing corruption;
- facilitate sharing of information with third parties;
- enable KRA to have a single-view of the taxpayer; and
- reduce transaction and administration costs for taxpayers and KRA respectively\(^\text{31}\).

The strategy covers five key ICT systems. First, there is an Integrated Tax Management System (ITMS) in place for domestic revenue. As part of the ITMS, KRA automated the unique personal identification numbers (PINs) from 30 March 2009. Using an electronic registration (e-Registration) module, taxpayers can register to obtain PINs online for the purposes of: pay as you earn (PAYE); VAT; land rent; income tax; and withholding tax. KRA also discontinued the manual distribution of PIN certificates. As a result, the “issuance of multiple tax registration numbers has been discontinued and replaced with a generic PIN certificate”\(^\text{32}\). “e-Registration is fully operational and cumulatively, 60,310 new taxpayers had registered online by the end of May 2009” (KRA, 2009).

The ITMS initially enabled registered taxpayers to file their tax returns for VAT and PAYE online – subsequently, the system has been extended to cover the filing of corporate income tax returns. The system was first piloted in December 2008; three firms-- East African Portland Company, Safaricom and Kenya Breweries-- were the pioneer users. KRA provides taxpayer software and a user manual, both of which

---


can be downloaded from its website. Taxpayers can call-in to a dedicated help centre for further assistance.

Second, from 1 January 2005, KRA introduced electronic tax registers (ETRs) for VAT registered taxpayers. Key features of ETRs include: the ability to maintain fiscal memory – they contain “read only memory…to store tax information at the time of sale”; and in-built security features (e.g., seal memory, special technical specifications etc.) (KRA, 2005). KRA finances the “purchase of ETRs and other fiscal devices. However taxpayers are required to install the machines and claim the cost from KRA”.

Third, in the area of customs, the Simba 2005 system (S2005S) has been implemented. The S2005S replaced a legacy “Bishops Office Freight Forwarders Integrated Network”. It is based on the GAINDE system developed in Senegal. The S2005S “has enabled the automation of about 90% of customs operations”. The S2005S facilitates clearance of shipments by enabling importers and exporters to submit declarations through direct input, provides readily accessible information on tariffs and regulations and is linked to banks. It also operates at most of Kenya’s border posts via a wide area network. S2005S is able to obtain third party information from the Kenya Ports Authority systems – Cargo Management Information System (CAMIS) and Kilindini Water Front Operating System (KWATOS). S2005S is also interfaced with the electronic cargo tracking system, and the Revenue Authority Digital Data Exchange. RADDEX is operational in Rwanda, Uganda and Tanzania, and being piloted in Burundi (see Box 5.2).

Fourth, KRA has automated the management of drivers’ licences, and the Vehicle Management System (VMS). The VMS and S2005S are linked to allow “for payment of motor vehicle registration fees with import duty. The integration process enables vehicle importers

Box 5.2: The rationale for setting up RADDEX within the EAC

At a meeting of Commissioners General of the East African Revenue Authorities held on 21 April 2006, it was agreed that measures be taken for quick confirmation of goods by customs administrations in importing countries. The logical method for achieving this lies in creating a seamless and efficient customs network by providing interconnectivity among the Revenue Authorities’ computerized systems.

EAC Revenue Authorities in partnership with the East and Central Africa Global Competitiveness Hub (ECA Hub) [discussed] the interconnectivity of… ASYCuda++ and KRA’s Simba 2005 Customs IT Systems. These discussions have given rise to the RADDEX system.

RADDEX intends to greatly benefit trade and trade stakeholders by further reducing the time and cost of cargo clearance at East African borders through the introduction of an electronic communication channel… This channel will effectively allow Kenya’s Simba 2005 customs system to exchange data with…ASYCUDA++ system.

Data communicated through RADDEX… consist of exports, re-exports and transit declarations that have been cleared by customs in the country of departure and reconciliation data from goods accepted in the country of entry. Data security has been addressed at every level of the RADDEX system to ensure confidentiality and integrity among the trade stakeholders. RADDEX is expected to benefit all stakeholders with particular positive impact on importers/exporters, shippers and freight forwarders, transporters and Revenue Authorities.


to...[more easily] pay for registration along with other relevant customs duties online” (KRA, 2009). The VMS is also integrated with the PIN system in ITMS.

Fifth, KRA is implementing Free Open Source Software. FOSS is an enterprise resource planning (ERP) system. It merges “the support administrative functions to enable efficiency, effectiveness and transparency. It will provide an integrated application with a unified database” (KRA, 2009). Currently, FOSS is used “for on-line staff leave applications, request for purchase orders, which are approved on-line, and stationery requests among others”.

It is noteworthy that there was serious resistance from freight forwarders and customs clearing agents to the implementation of both ETR and the S2005s systems. In the case of the ETRs, businesses mobilised considerable support against the new system from even members of Parliament. In the case of the S2005S, “The Kenya International Freight and Warehousing Association initiated a court action because members felt that [modernisation] imposed unfair and costly requirements”36. However, following, “an agreement made on 21st July 2005 between KRA’s advocates and advocates for Chivalo Investments and 790 others (clearing agents)37, KRA implemented the Simba system in 2005. It is with the support of the Government, and by use of experienced legal counsels that KRA’s position prevailed and the systems have been implemented.

---

36 www.bizdir.com/galleries/.../01.128.08BP12_Kenya.pdf [Accessed 11 April 2010]
Chapter 6

Rwanda
Summary of Key Findings

Context-Political economy and fiscal legacies

As expounded in an Africa Capacity Building Foundation (2003) sponsored review, at independence, in 1962, Rwanda inherited weak human, institutional and societal capacity to cope with the challenges of development management. The economic crisis of the mid-1980s, followed by genocide and war in the 1990s, further undermined the limited progress that had been made in the previous years (Rugumamu and Gbla, 2003). The 1994 genocide not only resulted in the unprecedented loss of human lives and disruption of the social fabric, it also led to the virtual destruction of the already weak economy and socioeconomic institutions. For instance, real GDP in 1996 remained at only 72% of its 1990 level. Five years later, over 60% of the population lived below the poverty line, compared to about 40% in 1985.

The post-genocide government committed to rapid economic recovery through prudent fiscal and monetary policies, economic liberalisation and institutional capacity building. The measures produced spectacular results: The economy rapidly rebounded - growing by about 80% between 1994 and 1998. After a temporary setback in 2003 (when the real GDP growth fell to 2.9%), high growth rates have been recorded since 2004. Since 2005, Rwanda’s annual real GDP growth has exceeded 9% every year (except in 2007 when it dropped to 7.7%). In 2008, the economy experienced its first double-digit growth in over five years, at 11.6%.

Three political economy factors underpin the Government of Rwanda’s (GoR’s) zeal to maximise DRM. First, Rwanda’s defense budget, which cannot be supported by Official Development Assistance (ODA), will remain comparatively high because the country remains in a state of defensive “war” since the genocide. Second, while the ODA contribution to the budget is substantial, there have been intermittent threats, including two incidences of actual withdrawal or cut-back of aid by European countries because of Rwanda’s involvement in the conflicts in the DRC. Rwanda has justified its involvement in the conflicts by its need to fend off the continued insecurity posed by genocide perpetrators operating from across the border in DRC. Third, substantial and sustained increases in development financing are needed to achieve the ambitious goals of Rwanda’s Vision 2020.

Tax reforms: Sequencing, implementation and results

The history of tax reforms in Rwanda is comparatively short. From a sequential perspective, six distinct, albeit short, phases of reforms can be identified:

- First: institutional reforms and capacity building, which correspond to the period beginning with the establishment of Rwanda Revenue Authority (RRA) in 1997 and the subsequent three years;

- Second: widening the tax base. The hallmark development in this phase was introduction of the VAT in 2001;

- Third: streamlining the tax regime and administration. This was effected by widening the mandate of RRA to cover non-tax revenues, and rationalisation of income tax rates, in 2003 and 2005 respectively;

- Fourth: aligning the tax system with development policy priorities through introduction of a new income tax law, investment and export promotion legislation and tax code in 2005;

- Fifth: strengthening the compliance enforcement regime by enacting Law No 25 of 2005 to cater for, among other measures, tax audits, appeals and
penalties for evasion; and introducing penalties for taxpayers who fail to comply with provisions for consumption taxes (in 2006); and

- Sixth: harmonising Rwanda’s tax regime and administration with that of the EAC (in 2009 and 2010).

In short, Rwanda’s tax system has undergone several reforms since 2001. Nonetheless, they have been systematic and sequenced. More significantly, through the reforms, Rwanda has made major strides in efficiency improvements and modernisation of the tax administration system. Highlights of the results include:

- The ongoing major initiative to widen the tax base by establishing the Small and Medium Taxpayers Office and embarking on implementation of the block management system;

- Timely auditing of refund claims by the RRA. Also, unlike some EAC countries, in Rwanda, RRA has the full mandate to administer the refunds;

- Compliance levels have significantly improved with as many as 97% compliant large taxpayers (who contribute approximately 75% of total domestic taxes);

- Over 90% of revenue is collected by banks;

- In 2010, Rwanda and Uganda launched a 24/7 one-stop border service at Gatuna;

- RRA has contributed to the dramatic improvement in Rwanda’s 2010 “Doing Business” ranking by spearheading a number of tax legislation reforms; and

- RRA received the International Standards Organisation 9001 certification in 2009.

Although Rwanda faces the same fiscal decentralisation challenges encountered by other countries in Africa, its social context sets it apart from others in the region. For instance, the Government’s Fiscal and Financial Decentralisation Policy (2006) is not only aimed at improving efficiency in the provision of services at the local level, but it also focuses on sustainable development, economic growth and poverty reduction. The Law on the Organization and Functioning of the District (2006) assigns local governments a series of tax and non-tax revenue sources. However, while local governments have a degree of discretion in determining tax rates, they are not permitted to create new taxes or define the tax base for local revenue sources. This ensures coordinated implementation of tax policy and minimises distortion/disruption of economic activity.

**Domestic revenue performance**

Rwanda’s total domestic revenue as a percentage of GDP rose from 8.4% in 1993 to 14.2% in 2008. In 1994, however, total domestic resources as a percentage of GDP fell to a dismal 3.6% on account of the genocide. Tax growth has ranged between 0.25% and 0.3% of GDP every year from 1997 (IMF 2009c).

Over the years, taxes on goods and services have formed the bulk of total domestic revenues – at about 48% of the total tax revenue. Since 2001, and with the exception of 2004, contribution to total taxes from direct taxes has been on a steady rise – in 2008 the share of direct taxes peaked at 37.5%. The share of taxes on international trade to total tax revenues has steadily decreased from a high of 41% in 1995 to just over 10% in recent years. This is attributed to an initial reduction in import duty rates – “with the maximum rate declining from 60% to 40%” (IMF, 2000). Furthermore, “Rwanda’s weighted average tariff rate was 11.3% in 2008”.

---

Challenges and issues

In the short-to-medium term, significant increase in real tax revenue growth is more likely to come from measures to raise and sustain compliance by existing taxpayers and improve administration efficiency. In this regard, the main challenges and issues to be addressed include the following:

- **Achieving a cost-effective strategy to widen the tax net:** It entails enlisting small and micro enterprises that are largely in the informal sector, and getting them to pay taxes. This can be associated with high administrative costs in the short term;

- **Rationalising collection of central and local government taxes:** In line with GoR’s decentralisation policy, property and rental income taxes are collected by local government authorities. However, experiences from countries, such as Kenya and South Africa, suggest that RRA would be more effective than local governments in collecting those taxes. Furthermore, in some countries such as Tanzania, the revenue authority collects property taxes on behalf of local governments;

- **Developing and maintaining capacity for tax policy management:** The tax policy function is much weaker relative to tax administration. This, to a significant extent, is explained by the fact that the organisation and staff in tax policy remain mired in red tape and poor incentive environment;

- **Building and sustaining management capacity in RRA, especially technical and professional skills:** This will remain a major challenge to RRA well into the long run. RRA’s capacity to develop and retain the required human resources remains contingent upon its ability to offer competitive remuneration packages; and

**Putting a cap on tax incentives and exemptions:** In pursuit of the policy goal of making Rwanda a preferred foreign investment destination, and to attract particular investors to Africa, GoR has offered tax incentives and granted tax exemptions to some businesses. Yet, there is a body of knowledge that suggests that these incentives can be counter-productive.

Lessons learned

In confronting the challenges of design and implementation, three major lessons are worth sharing. They are:

- **Explicit and strong support of top political leadership matters:** There is a shared view that strong support from the country’s top political leadership, especially the President, and successive Ministers of Finance, was the most crucial driver for change;

- **Developing effective capacity is a long-term undertaking:** In spite of decade-long consistent and determined efforts of RRA’s top management to rapidly achieve required capacity, considerable gaps still persist. The IMF (2009b) suggests the priority gaps to be closed are strengthening audit and enforcement capacity, as well as management support functions such as ICT systems, human resource and financial management; and

- **Long-term and flexible technical assistance support enables rapid and sustained capacity development:** DFID has provided substantial support to the RRA since 1998. Although its support has dropped significantly in recent years and now being phased out, there is no doubt that the long-term orientation, pre-
dictability and flexibility of this support has enabled RRA to rapidly and sustainably improve its capacity.

The rest of the chapter is organised as follows: the first section discusses the political economy and fiscal legacies, the second section covers trends in the tax system, the third section explores domestic revenue performance, the fourth section highlights the challenges to increasing DRM, and the fifth section concludes with lessons learned.
Colonial legacies and the 1994 genocide

Rwanda has had uniquely chequered colonial, as well as post-colonial legacies. It was part of the German-East African colony from 1890 until it was occupied by Belgium in 1916, which, in 1923, was given a League of Nations mandate to govern Ruanda-Urundi. Rwanda became independent in 1962. However, French neo-colonial influence was not only more pronounced than Belgian in the immediate post-independence period but preeminent, until the 1994 genocide. Throughout Rwanda’s years of subjugation the colonial powers did little to develop its economy and institutions. Instead, they accentuated the ethnic divide and promoted tensions that created the conditions for the genocide (Mamdani, 2001).

As expounded in a 2003 Africa Capacity Building Foundation (ACBF)-sponsored review, Rwanda inherited weak human, institutional and societal capacity to cope with the challenges of development. It faced severe capacity constraints in virtually all sectors, characterised by a shortage of skilled manpower, under-utilisation of available resources, weak institutional environments, and inadequate incentive structures, as well as a lack of capacity retention strategies. Despite various efforts to promote the social sector, neither institutional nor human capacity grew fast enough to keep pace with the requirements of rapidly changing socioeconomic circumstances. The advent of the economic crisis of the mid-1980s, as well as war and genocide, undermined the limited progress that had been made since the early 1980’s (Rugumamu and Gbla, 2003).

The 1994 genocide did not only result in the unprecedented loss of human lives and fraying of the social fabric, it also led to the virtual destruction of the already fragile economy and weak socioeconomic institutions. Per capita GDP dropped to less than US$200, and poverty levels worsened significantly. Real GDP in 1996 remained at only 72% of its 1990 level. Five years later, over 60% of the country’s nearly 10 million people lived below the poverty line, compared to about 40% in 1985. In economic terms, Rwanda saw its GDP fall by 50% in 1994, and the rate of inflation increase by 64%. Today, Rwanda remains one of the poorest countries in the world, with a per capita GDP of just under US$500 in 2008.

Post-genocide economic recovery and development drive

The post-genocide government made a commitment to ensure rapid economic recovery through prudent fiscal and monetary policies, economic liberalisation and institutional capacity building. Backed by substantial external assistance, the new government successfully delivered on its commitment: The economy rapidly rebounded, growing by 7% between 1994 and 1997, and 8.9% in 1998. The growth was fuelled by large inflows of external aid for relief and reconstruction, and supported by the stabilisation and liberalisation of the economy. At the same time, inflation dropped from a whopping 17% at the end of 1997, to an average of 6.8% in 1998.

After a temporary setback in 2003 when the real GDP growth fell to 2.9% (IMF, 2004), high growth rates have been recorded since 2004. Yet, as observed by Rugumamu and Gbla (2003), the pre-1994 structural economic problems still persist and will take decades to resolve. Weakness in the Rwandan economy stems from a lack of natural resources, poor human resources, high population density, antiquated agricultural practices, environmental degradation and difficulties in economic management. In addition, both private and public sectors remain small and neither has been developed to meet the population’s needs.
But despite all the pitfalls, things are looking up. In 2008, for instance, the economy experienced its first double-digit real growth in over five years, at 11.6%. The strongest contribution came from export crops, which grew at 29%. The industry and service sectors also yielded high growth rates of 15% each.\footnote{http://statistics.gov.rw/images/PDF/GDP%20FINAL%20REPORT.pdf [Accessed 4 June 2010].}

On the whole, there has been an acceptable degree of macroeconomic and fiscal stability since the late 1990s. Over the same period, for example, an overall fiscal surplus was recorded. This steady progress was interrupted in 2007, first, by a steep rise in prices of imported petroleum products and other commodities, which impacted negatively on budget execution. Second, there was an earthquake in February 2008. The disaster and the reconstruction needs afterwards, together with the policy to provide additional emergency assistance as well as resources to improve food security, increased expenditures significantly (see Table 6.1).

According to GoR’s Budget Framework Paper for 2009 to 2012, by early 2009, there were signs that the global financial crisis was beginning to have an impact on Rwanda. Whilst inflation had begun to decline, due to falling world commodity prices and domestic policies, the economy experienced other problems. The balance of payments projections for 2009 (as a result of performance seen in early 2009) were not good. The fiscal deficit was set to rise to 1.7% of GDP before shrinking “to 0.5% in 2011/12” (GoR, 2009).

### Development financing mix and challenges

Figure 6.1 shows trends in the overall development financing mix for Rwanda between 1996 and 2008. The largest source of financing during that period was Official Development Assistance. Following the genocide, Rwanda received large injections of external aid. As would be expected, much of this was meant for emergency food aid and other humanitarian needs. However, by about 1998, humanitarian aid was considerably reduced, and external resources were increasingly focused on economic development and institution building. Between 2000 and 2008, total annual ODA to Rwanda averaged around US$460 million. Still, as noted in a 2005 review of Rwanda’s international relations, donor support remained largely uncoordinated (Killick 2005). Furthermore, when compared to several other countries in Eastern Africa

<table>
<thead>
<tr>
<th>Table 6.1: Fiscal performance indicators (in percentage of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Revenues and Grants</strong></td>
</tr>
<tr>
<td>Total Revenues</td>
</tr>
<tr>
<td>Tax Revenues</td>
</tr>
<tr>
<td>Grants</td>
</tr>
<tr>
<td>Expenditure and Net Lending</td>
</tr>
<tr>
<td>Current Expenditure</td>
</tr>
<tr>
<td>Capital Expenditure</td>
</tr>
<tr>
<td>Overall Deficit including grants</td>
</tr>
<tr>
<td>Overall Deficit excluding grants</td>
</tr>
</tbody>
</table>

Source: GoR (2009)
Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

Data on ODA for 2008 is not available.

Figure 6.1: Trends in Rwanda’s overall development financing mix (1996 to 2008)

Source: Africa Economic Outlook (AEO) 2010 data

(Ethiopia, Mozambique, Tanzania, and Uganda), Rwanda’s external assistance remained transitional and its effectiveness constrained by institutional weaknesses. In 2006, in consultation with its development partners, GoR promulgated “Rwanda’s Aid Policy - Implementing Change to Maximise the Impact of Aid on Poverty Reduction and Economic Growth”. In that year, Rwanda received US$586 million in ODA, representing about 21% of GDP.

From 2006 onwards, Rwanda has benefited from debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. Since then, use of debt in budget financing is on the whole confined to project loans on concessional terms, and the sale of treasury bills (domestic borrowing). In the backdrop of a combination of debt relief and more predictable commitments by development partners, in 2007, Rwanda raised its total annual budget by 33%, to Rwf528 million. Also, the budget for FY2009/10 was 20% above that of 2008/09. The reduction in external debt and the overall increase in available resources have enabled GoR to allocate a higher proportion of its resources to pro-poor expenditures.

Domestic revenues and exports of goods and services constitute Rwanda’s second and third largest sources of development financing respectively. Revenues from exports grew at an average rate of 11.3% from 2002 to 2008, “with the share of traditional exports, coffee and tea, declining to about 50%” (AfDB, 2008). Coffee and tea are two export commodities, which, over the years, have been exposed to unwieldy fluctuations in global commodity prices. And the situation is unlikely to change in future. At the moment, World prices for both commodities are high. In this context, as well as in pursuit of more rapid and broad-based economic growth, GoR has an array of initiatives for the diversification of its export base to cover areas such as tourism, mining and business process outsourcing. These initiatives will again serve to consolidate Rwanda’s gains from globalisation.

The Government is aggressively promoting Rwanda as a lucrative destination for foreign direct investment (FDI). As a result, for the post-Monterrey period (2002-2008), FDI grew at an average rate of 112%. Coffee and tea are two export commodities, which, over the years, have been exposed to unwieldy fluctuations in global commodity prices. And the situation is unlikely to change in future. At the moment, World prices for both commodities are high. In this context, as well as in pursuit of more rapid and broad-based economic growth, GoR has an array of initiatives for the diversification of its export base to cover areas such as tourism, mining and business process outsourcing. These initiatives will again serve to consolidate Rwanda’s gains from globalisation.

The Government is aggressively promoting Rwanda as a lucrative destination for foreign direct investment (FDI). As a result, for the post-Monterrey period (2002-2008), FDI grew at an average rate of 112%. In a 2009 interview, President Paul Kagame was quoted to have stated that “investment is the key to developing our

6 Data on ODA for 2008 is not available.
industrial and service sectors” (Kitaoka, 2009). This initiative is bearing fruit. In 2009, Rwanda attracted a record US$600 million in FDI, surpassing Rwanda Development Board’s (RDB) target of US$200 million (Oluoch-Ojiwah, 2009). This was also the year when Rwanda was ranked the best performer in the EAC in the World Bank’s Doing Business ranking – in particular it was ranked: 67th out of 183 countries in terms of ease of doing business; and as the top reformer globally. In addition, significant efforts have gone into improving Rwanda’s regulatory and legislative environment. “For example, the passing of the Company Law has reduced [the time taken to start a] business from 14 to 2 days” (Ruburika, 2009).

Political economy dynamics
underpinning domestic
resource mobilisation

The synopsis of the political economy legacies that have impacted DRM, as presented in the following subsections, is based on Brautigam’s (2008) analytical framework. It consists of five facets: (i) level of economic development and economic structure; (ii) societal factors: culture, values, trust and ‘tax morale’; (iii) war and taxes: bureaucratic modernisation as a response to threat; (iv) political institutions and tax systems; and (v) taxation and fiscal contract.

High economic growth in recent years but poverty levels remain high

Since 2005, Rwanda’s annual GDP growth has exceeded 9% every year (except in 2007, when it dropped to 7.7%). In 2009, GDP growth was expected to slow down to 6%. In the previous decade, the average growth rate was more than 5% (GoR, 2009). Despite the impressive performance since late the 1990s, the vast majority of Rwandans remain poor, and the expected diversification of the economy has not gained much momentum as it remains predominantly agriculture-based. Real GDP per capita is still below US$500. However, the economic structure is changing (see Annex 6.3: Table 14). In other words, there are encouraging signs of economic modernisation. For instance, the manufacturing and construction sectors’ contribution to real GDP growth is steadily rising, while that of agriculture is shrinking.

In the medium term, GoR projects an annual growth rate of at least 8%, which will be fuelled by great strides in modernisation of the economy, especially through intensive exploitation of ICT. Still, the economy will remain largely agricultural based in the foreseeable future, ostensibly because it remains the largest provider of employment in the country. This is borne by the fact that although agriculture contributes only about 35% of GDP, it provides more than 90% of employment. The large rural (agricultural) informal sector constitutes a vast reservoir of potential taxpayers but one that is not readily accessible. Therefore, for the foreseeable future, Rwanda will rely on a comparatively narrow tax base.

Seeds of trust in government
as a basis for a ‘tax morale’ are now evolving

The 1994 genocide was a culmination of decades of intense ethnic distrust, tensions and hatred among sections of Rwanda’s population – which also contributed to a non-compliant tax culture. Mamdani (2001) and Gourevitch (1998) argue that, while colonialists had a major influence on these developments, the traditional (pre-colonial) culture had feudal strains that also contributed to the distrust and conflict just before in-

---

6 Brautigam’s framework is adopted because compared to others that were examined; it is judged to be more comprehensive and elegant. However, like most others, its historical perspective derives too much from emergence of the modern European state to be linearly applied in states that are legacies of colonial rule, such as Rwanda.

7 In a society where “tax morale” is high, there are low levels of tax evasion and avoidance. It is only in a social culture where citizens generally appreciate their responsibility for sustaining state services and where they have a trust in their state institutions and leaders that a “tax morale” evolves.
dependence in 1959, and in the next three and a half decades. It has also been suggested by Rugumamu and Gbla (2003) that Rwanda’s past monarchical and authoritarian regimes promoted a culture of fear, sectarian hatred and other negative social values that are inimical to tax morale.

An independent review by the AfDB/OECD (2007) suggests that the new regime:

“Has chosen the path of reconciliation, unity, social cohesion and development as national priorities. In October 2008, steps were taken to strengthen all Rwandan political parties to enable them to engage in interparty dialogue and improve their capacity to organise, communicate, and reach out to constituents at the grassroots level. ... the ruling RPF won 78.6% of the vote, with the Social Democratic Party and Liberal Party sharing the remainder of the seats. The elections also resulted in women taking 56% of all parliamentary seats, making Rwanda’s Chamber of Deputies the first in the world with a female majority. The elections were endorsed by international observers, and will enable the incumbent president to pursue other pressing social development matters if he is re-elected in 2010”.

In addition, “a study commissioned by the Regional Centre on Small Arms has shown 96% and 94% respectively of Civil Society and the General Public declare high level of trust and satisfaction about security organs and their effectiveness in providing security to citizens” (Kagire, 2009). It is this kind of citizen experience which eventually builds trust and confidence in a government, and thereby enhances its legitimacy, and stimulates tax morale among the citizens. However, as recently as in 2007, the Rwanda Revenue Authority (RRA) Commissioner General is cited in a local daily to have observed that most of the potential taxpayers evade paying taxes (The New Times, 2007).

Continuing threat of war and reduced external aid impel bureaucratic modernisation for growth in DRM

Since the genocide, Rwanda has remained in a state of “war” because a large number of those responsible for the genocide killings fled into the jungles of neighbouring Democratic Republic of Congo (DRC), and the threat of reprisals from them remain real. At the same time, while external aid contributions to the budget are substantial, Rwanda has faced intermittent threats of withdrawal of aid by European countries because of its involvement in the conflicts in the DRC. It argues that it does so to fend off attacks from genocide perpetrators operating from across the border. Also, the IMF (2009a) underscores the need for GoR to formulate “an exit strategy from aid dependence over the long term”. These factors underpin the Government’s zeal to maximise DRM, especially by ensuring the capacity, efficiency and effectiveness of the RRA.

Top political leadership keenly follows developments in the tax system

On assuming power, the RPF regime immediately realized that major institutional reforms, beginning with the establishment of an autonomous revenue collection agency, RRA in 1997, were crucial to strengthening and developing its fiscal framework. In recent years, it has been observed that the ‘National Taxpayers Day’ is one of the two most important national events that the President of Rwanda must personally grace. The other is the annual leadership retreat. According to Torero et al (2006):

“From the outset, the RRA has been able to count on the personal support of the President, who has gone on to play a major part in the campaign to change public attitudes towards paying taxes and related challenges such as corruption. The President has
underlined the importance of the RRA as enabling the country to finance poverty reduction expenditure, and to reduce its dependence on outside assistance. ... The President has also publically stressed the importance of creating an enabling environment for investment, which has stimulated the RRA in making considerable effort at outreach to the private sector”.

Government leaders are promoting the principle of a “fiscal contract”

According to Torero et al (2006), the principle of the “fiscal contract” is well upheld by Government leaders in Rwanda, who advocate for RRA to be seen to “contribute to developing a culture of participation and citizenship as part of a wider process of establishing the norms and practices of democratic governance, and of bringing government closer to the people”. In this regard, the leaders are proactively seeking to persuade the public to buy into the latter’s motto, “taxes for growth and development”.

Fiscal governance drivers, results and trajectory

The authors suggest that there are four key fiscal governance drivers for Rwanda in the medium-to-long term. First, GoR has an ambitious vision to transform the nation into a middle-income country, free of poverty by 2020. To this end, besides achieving the MDGs, there are grand plans to modernise the physical economic structure and institutions, and make Rwanda the ICT hub of East and Central Africa. According to the IMF (2009b), although Rwanda has made significant progress in achieving universal primary education, gender equality and women’s empowerment, and reducing child mortality, it may not meet some of the MDG targets. Still, Rwanda’s leadership does not waiver on its commitment to achieving the MDGs. It can therefore be expected to sustain high levels of public expenditure allocations to social services. GoR is also geared to making high investments in infrastructure development. To this end, it looks to RRA’s improved tax effort to close any fiscal shortfalls.

The second driver is international development organisations’ influence, given the comparatively high level of ODA in the budget. Total grants are shown at Rwf285.2 billion (about US$485 million) in 2008/09 and rising to Rwf405.7 billion (about US$690 million) in 2011/12 (subject to additional donor commitments). Fiscal expansion has allowed increases in priority spending, especially in the areas of: infrastructure; and the social sectors, particularly education, health as well as social protection. It is expected that this scaling-up will continue despite the global financial crisis. However, support from international development organisations (IDO$s) is problematic, in particular, due to the unpredictability of forward commitments. For instance, the fiscal projections in the budget framework paper for 2009/10 to 2011/12 show a gap of Rwf168.5 billion (US$294.5 million) in grants over the medium term (GoR, 2009).

The third one, which relates to the second driver, emanates from the conditionalities imposed on Rwanda by IDOs to continue to access debt relief under HIPC. Specifically, its access to non-concessional borrowing is restricted. Moreover, given the macroeconomic and fiscal regimes that GoR has agreed with the IMF, which serve to confirm compliance with HIPC conditionalities, the fiscal space is quite restricted. This therefore implies that fiscal expansion can only be achieved with increased DRM.

Finally, although Rwanda’s accession to the EAC is expected to yield considerable economic benefits in the long run, and even facilitate the timely achievement of the Vision 2020, this membership imposes fiscal

---

6 Fiscal contract has its genesis in agreements between European monarchies and the propertied class and merchants that the latter would contribute to state coffers especially to fund war in return for specific benefits. In modern times a fiscal contract would be characterised by government pledges of specific socio-economic benefits to justify taxation. This is a more realistic proposition in a democratic dispensation.
restraints. The EAC members are expected to observe monetary and fiscal convergence. Furthermore, in the medium term, Rwanda will experience a reduction in customs revenue arising from lower external tariffs. These have been estimated at Rwf23.3 billion (US$41.2 million) for the three-year period.

Although a high rate of economic growth and a substantially improved tax effort are projected in the medium term, there are pointers which suggest that GoR’s fiscal governance trajectory could be precarious in the medium-to-long term (IMF, 2009b). Tax to GDP ratio is projected to reach 15% by 2013. But, the level of grants is expected to decrease from a peak of 13.6% of GDP in 2009 to as low as 7.4% in 2013. At the same time, as earlier indicated, HIPC conditionality will limit Rwanda’s options for alternative resource mobilisation. In this scenario, it may not afford a fiscal framework that is consistent with achieving its development goals, especially as anchored to the Vision 2020, unless tax effort is raised rapidly and considerably.
Trends in the tax system

Changes in tax policies over the years

The rudimentary legacy tax system of the 1960s

Rwanda inherited a rudimentary tax legislative and institutional structure at independence. The first legislation included the Ordinance of August 1912, which established graduated tax and tax on real property. In November 1925, there was another Ordinance, adopting one issued in Belgian Congo in June 1925 to establish a profits tax. After independence, taxes were formally introduced in Rwanda by a law of June 1964 concerning profit tax. Customs and excise duties were introduced later in July 1968.

Apparently, there were minimal improvements until the RPF regime was installed in 1994.

Tax policies immediately following the genocide and RRA formative years

When the RPF assumed power, it introduced an export tax on coffee as a temporary measure. GoR also took steps to reduce the level of tax exemptions (e.g., around imports and waivers given to public enterprises, NGOs and faith groups), and curb tax evasion. In 1996, it imposed a “presumptive income tax of 3% of annual turnover on all enterprises…[and increased] specific consumption taxes on alcohol, petroleum and soft drinks” (IMF, 2000).

The establishment of RRA in 1997 was underpinned by the policy objective to maximise domestic revenue so as to reduce Rwanda’s dependence on foreign aid. There were no immediate major tax policy measures for the next three years and focus was apparently on building administrative capacity as GoR:

“Benefited from a long-term [IMF] resident adviser in tax policy, legislation and administration. Particular emphasis was placed on the establishment of the Large Enterprise Unit (in MINECOFIN), taxpayer registration and identification, including the introduction of taxpayer identification numbers, arrears collection, tax audits, and the introduction of presumptive taxation” (IMF, 2000).

Major developments in tax policies beginning 2001

The first major policy initiative of the post-genocide regime was the introduction of the Value Added Tax (VAT) in 2001. VAT replaced the sales tax (ICHA) through Law No. 6 of 2001. ICHA was considered to offer too many exemptions and was difficult to administer. The standard rate of VAT levied was initially 15% in 2001 but it is now 18%. Purchases by privileged persons (e.g., diplomats) as well as IDO-financed projects are zero rated. Furthermore, certain supplies are exempt from VAT, such as agricultural products, health services and supplies, education materials and services, transport services and water supplies.

In 2003, another major policy move was made when RRA was assigned responsibility for collecting non-tax revenues such as: fines and fees; revenue from public property and assets; and proceeds from sale of government vehicles. This was expanded with the addition of administrative fees in 2007.

Two years later, in 2005/06, further major policy and legislative measures were taken, comprising:

- New income tax legislation, through Law No. 16 of 2005. The top marginal corporate and personal income tax rates are 30%. Personal income tax (PIT) rates are progressive with income categorised into three brackets with marginal rates of 0%, 20%
and 30%\(^{11}\). The law also provides for a 4\% annual turnover tax on ‘intermediate’ business owners; and dividend withholding tax. Also, depreciation allowances on capital assets were rationalised and simplified in the Income Tax Law of 2005;

- A new tax code and investment and export promotion code, as well as a new schedule for investments under customs were introduced through legislation. “These laws provide fiscal incentives to investors…There is a high threshold to meet this classification – US$250,000 for foreigners and US$100,000 for local investors” (USAID, 2008);

- Law No. 25 of 2005 was enacted to: improve tax collection; set-up audit procedures, and a tax appeals process; and introduce speedy sanctions and penalties for tax evasion; and

- Law No. 26 of 2006 was passed “determining and establishing consumption tax on some imported and locally manufactured products [and] provide penalties to taxpayers [who] fail to observe the required provisions”\(^{12}\)– in other words excise duties. Soft and alcoholic drinks, cigarettes, telephone communication, fuel, and vehicles are all subject to varying excise duty rates.

After a lull of another 4-5 years, the following tax policies were introduced:

- Rwanda became a signatory to the EAC Customs Union protocol in July 2009. The Protocol is enshrined into the East African Community Customs Management Act of 2004. It establishes common external tariffs (CETs), eliminating internal tariffs;

- Tax incentives for liquefied petroleum gas and energy saving devises. The policy objective is to make these devises more affordable in order to deepen penetration of their use by households and industries. GoR estimates that this policy will result in a temporary revenue loss of Rwf300 million;

- The removal of the sugar surcharge in Law No. 71 of 2008. This surcharge was removed in tandem with the provisions of the EAC Customs Union, leading to an estimated revenue loss of Rwf2.2 billion per annum;

- A reversal of the VAT charge on transport. This was a tax on foreign trucks, transporting goods in and out of Rwanda. It was introduced to ensure the competitiveness of Rwandan transporters. However, research has shown that the current capacity of Rwandan transporters is insufficient to satisfy demand. Furthermore, this tax was applied to transporters from Uganda, Tanzania and Kenya, which increased the comparative cost of doing business in Rwanda. Therefore, the Government reversed it, although about Rwf370 million revenue per annum will be lost; and

- A specific-value fuel tax replaced the flexible ad-valorem levy. This policy removed an implicit subsidy on fuel pump prices, and an intervention aimed at keeping pump prices stable. Also, the change in tax policy was due to the desire to align Rwanda’s tax system with EAC practices. This entailed a shift from a flexible ad-valorem taxation rate to a specific tax set at a nominal Rwandan Franc value per litre. A key benefit of the new policy is that the Government can have guaranteed revenue per litre sold, which is independent of the international oil price (GoR, 2009).

**Institutional changes**

The establishment of the RRA as an autonomous agency in 1997, coupled with the wide-ranging policy and legislative measures effected since 2001, has gone a long way to transforming and modernising the insti-


tutional environment for DRM in the country. RRA enjoys strong political support for both its mandate and autonomy. Government has provided an ultra-modern building for RRA, which it shares with the National Electoral Commission and the Auditor General. RRA is allowed to retain 3% to 3.5% of its total revenue collection to meet its administrative costs. The actual budget is determined by the Board of Directors and approved by the Minister of MINECOFIN.

The RRA staff have been completely delinked from the civil service. They are better remunerated than civil servants, and their compensation includes a performance bonus of 5% of total revenue collected in excess of the target agreed with MINECOFIN. So far, each staff member has regularly received it in three or four instalments every year. The bonus is equal to 80% to 100% of individual staff salaries. This ratio is generally higher for junior staff and lower for the senior. It is considered to be a critical element of staff compensation because, according to RRA staff, it ensures retention of staff, and reduces any temptation on their part to resort to corrupt practices.

More significantly, RRA has the full mandate for tax administration. Direct strategic leadership and oversight of the operations and performance of the authority is exercised by a Board of Directors comprising: a Chairman appointed by the Prime Minister with the approval of the Cabinet; a Vice-Chairperson who is the Permanent Secretary (PS), MINECOFIN; Governor of the National Bank of Rwanda (BNR); three professionals from the private sector; the PS, Ministry of Trade and Industry; and the PS, Ministry of Public Service and Labour. The chief executive (Commissioner General) and his/her deputy are appointed by the Cabinet. The Commissioner General, like the Chairman of the Board, is required to sign a performance contract with the Minister. Under the contract, both officers are required to submit quarterly performance reports to the Minister. The role and mandate for policy-making and progressing of legislative measures for DRM remain with the MINECOFIN.

Structural reforms in RRA started in earnest in 2003. Until then, the tax administration was organised on the basis of tax categories, (i.e., Income tax and VAT departments). In that year, the Domestic Taxes Department (DTD) was established to further improve tax administration.

Today, the RRA has offices in all the five provincial headquarters, and in 11 out the 30 districts. In addition, it operates 32 customs offices and eight border posts, and employs 875 staff, most of whom are based at RRA’s headquarters. At headquarters, the authority has two main operational departments:

- The Customs and Excise Department (CED): Its mission is to contribute to the achievement of RRA objectives by maximising the collection of all revenues due on imports, at minimum cost; and to facilitate trade through providing a responsive and efficient service to stakeholders. The department works to ensure that all legally chargeable revenues are paid through effective application of the relevant laws. Specifically, CED is mandated to facilitate both international and national trade so as to support local and foreign investment, while ensuring that hazardous and contraband material/goods do not enter the country;

- The DTD was established in order to create a one-stop, efficient and customer-oriented tax office. The basic objective is to increase and coordinate control over the largest taxpayers and improve large taxpayers’ compliance and revenue yield to the government. The DTD is comprised of two offices - the Large Taxpayers’ Office (LTO) and Small and Medium Taxpayers’ Office (SMTO). The LTO accounts for over 50% of total RRA revenue collections. In July 2009, RRA assumed responsibility
for the audit, collection and enforcement of social security contributions from employers. The discharge of this function by RRA commenced in July 2010.

In addition to the two main departments, RRA has the following supporting departments: Revenue Protection Department (RPD); Quality Assurance; Taxpayer Services; Planning and Research; Legal and Board Secretariat; Human Resources and Administration; Information Technology; Finance Department; and RRA Training Centre.

It is noteworthy that fraud prevention and investigation support functions and activities at RRA are carried out by the RPD outside the core operations of the authority. The focus is on cases of complex tax fraud. The department’s initiatives and activities respond to either the results of its risk research and analysis, or cases of suspected fraud identified by the DTD and CED, or to its “intelligence agents” (informers). Informers are paid 10% of the revenue collected/recovered on any case they report on.

Prior to the establishment of RRA, fraud prevention and investigation functions were handled purely as “military surveillance” and were carried out under MINECOFIN’s Audit department. Then, all staff were seconded from the armed forces but they were not under the command of MINECOFIN. Following the establishment of the RRA, armed forces members seconded to the fraud prevention unit are accountable to the RRA management.

Changes in administrative systems

Since its establishment, RRA’s modernisation and development of its administrative systems have been guided by strategic planning. This planning has recently been elevated to a state-of-the-art structure through adoption of a balanced score card. The strategic vision of RRA is “to become a world class efficient and modern revenue agency, fully financing national needs. The current plan, which has been prepared with a focus on the integration of Rwanda into the EAC, comprises 34 strategic objectives, and includes the following key targets:

- Assume the collection and audit of social security contributions by January 2010—RRA started collecting these contributions in July 2010;
- Support the Government to widen the tax base with a target to achieve tax revenue collections of 15% of GDP by June 2010 — with a long-term goal of 18%;
- Implement an anti-smuggling strategy, especially in the area of evasion of customs and excise duties;
- Substantially increase staff productivity, in terms of revenue per employee, and improvement in the overall cost-of-collection ratio;
- Strengthen RRA’s presence in the regions and computerise all regional offices. Also, provide a 24/7 service at the border posts;
- Obtain the International Standards Organisation (ISO) 9001 certification by 2010.

Modernisation of administrative systems has been at the core of the changes pursued by RRA since it was established. In 2004, RRA commenced with the modernisation of its revenue collection systems. Computerisation focused on piloting systems with large taxpayers. The initiative covered the implementation of:

- The Standardized Integrated Government Tax Administration Systems (SIGTAS) in DTD. SIGTAS is a
business analysis software introduced in 2003. It supports data management for each taxpayer, and facilitates tax returns processing, enforcement and audit;

- Automated System for Customs Data ++ (ASYCUDA++) for customs operations developed by the United Nations Conference on Trade and Development (UNCTAD). ASYCUDA allows for direct trader input so that importers can lodge declarations from their bases, and to minimise the build up of documents;

- PEODESY for human resources management and an enterprise resource planning system, Sage-Pastel Evolution for financial management;

- ‘I.D.E.A’ software for taxpayer audit purposes. According to key informants, RRA has a comparatively strict and punitive regime for enforcing tax collection from both large and small taxpayers, when the latter have been identified;

- A Revenue Authorities Digital Data Exchange (RADD) system – which has been jointly developed by the revenue authorities of East Africa to support coordinated management of transit of goods; and

- E-doc for internal correspondences and a “one-to-one” laptop project for RRA staff.

The end-stage in the modernisation process will be the introduction of electronic filing (eFiling). However, according to RRA management, 80% of the computerisation of the large taxpayers’ processes and systems is complete. The remaining and planned areas of modernisation include:

- eFiling-- preparations for which started in early 2010, and should be complete by 2011;

- Electronic tax registers – funds for this initiative have not yet been identified; and

- Social security funds collections, which commenced in July 2010.

Fiscal decentralisation and taxation by local governments

Rwanda’s National Decentralisation Policy, officially adopted in May 2000, sets out a new course of citizen participation through elected organs at the local level. Territorially, the subnational government structure of Rwanda is unlike its neighbours in East Africa: the country is divided into 30 districts, plus the City of Kigali. The district level is led by elected District councillors and forms the main platform for subnational service delivery. Over the past 10 years, districts have been accorded a greater role for service delivery across all sectors. It is the Government’s intention for sub-district Secteurs (of which there are 416) to increasingly become the nodes for subnational public service delivery. The Secteurs will enhance service delivery by assisting the district leadership in identifying, coordinating, and implementing development plans and programmes.

Although Rwanda faces the same fiscal decentralisation challenges as others in Africa, the social context for decentralisation reform in the country provides a degree of vibrancy and innovation in its reform efforts that set it apart from other countries in the region. The goal of the Government’s Fiscal and Financial Decentralisation Policy (2006) is not only to pursue efficiency in the provision of services at the local level, but also sustainable development, economic growth and poverty reduction (Republic of Rwanda 2006).

The Law on the Organization and Functioning of the District (2006) assigns local governments in Rwanda a series of tax and non-tax revenue sources. The main local tax sources include the property tax, trading license tax, and rental income tax, which were formerly...
collected by the central government and subsequently devolved to the local level. While local governments have a degree of discretion in determining tax rates, they are not permitted to create new taxes or define the tax base for local revenue sources. This ensures coordinated implementation of tax policy and less distortion/disruption of economic activity.

Thus, local governments are funded by a combination of conditional and unconditional grants, as well as by an assortment of local revenue sources. Between 20% and 25% of all public expenditures take place at the subnational level; this is similar to the share of the budget provided to the local government level in Tanzania, but below the level in Uganda. In contrast to either Uganda or Tanzania, local governments in Rwanda contribute a larger share in local resources through own source revenues (see Annex 6.3: Tables 15 and 16).

A 2004 assessment of alternative local revenue sources identifies numerous unexploited local user fees and charges, as well as public-private partnerships that could generate revenue benefits at the local government level (ARD, 2004). However, concern has been raised about the capacity of local governments to engage in substantial broad-based revenue mobilisation (Tumukunde, Kiessel, and Khawar, 2008). Tumukunde et al. also observed numerous innovative community-based local revenue generation initiatives, whereby community contributions were linked closely to improvements in public service delivery.

**Reforms sequencing, implementation and results**

The history of tax reforms in Rwanda is comparatively short. From a sequential perspective, six distinct, albeit short, phases of reforms’ implementation can be identified:

- **First**: *institutional reforms and capacity building*, which correspond to the period beginning with the establishment of RRA in 1997 and the subsequent three years;
- **Second**: *widening the tax base*. The hallmark development in this phase was introduction of VAT in 2001;
- **Third**: *streamlining the tax regime and administration*. This was effected by widening the mandate of RRA to collect non-tax revenues, and rationalisation of income tax rates in 2003 and 2005 respectively;
- **Fourth**: *aligning the tax system with development policy priorities* through introduction of a new tax, investment and export promotion legislation and tax code in 2005;
- **Fifth**: *strengthening the compliance enforcement regime*; by enacting Law No. 25 of 2005 to cater for, among other measures, tax audits, appeals and penalties for evasion; and introducing penalties in 2006 for taxpayers who fail to comply with provisions for consumption taxes; and
- **Sixth**: *harmonising Rwanda’s tax regime and administration with that of the EAC* (in 2009 and 2010).

In a nutshell, the Rwanda tax system has undergone several reforms since 2001. Nonetheless, the reforms have been systematic and sequenced.

On the whole, RRA and, thereby DRM efforts of GoR are a success story. Tax revenue collected has considerably improved over the past decade, from 9.7% of GDP in 2000 to a projected 13.8% in 2010. The aim is for this ratio to grow at 0.2% or higher annually in the medium-to-long term.
While the tax revenue to GDP ratio shows a comparatively modest performance, there are independent indicators that RRA has, over the decade, made commendably steady progress in capacity development. One such indicator is the uniquely sustained support that RRA has received from DFID over the years. RRA is currently benefiting from the sixth successive DFID technical assistance and other capacity building support. At the end of each tranche, a comprehensive evaluation has been undertaken, and it is on the basis of the results of such evaluation that subsequent support has been provided. This support has been broad-based and flexible. It has been driven by RRA’s strategic plans and reflects the priorities of MINECOFIN’s and RRA top management, and consistent with the Economic Development and Poverty Reduction Strategy. By 2005, DFID was funding as much as 34% of RRA’s total budget. But it was reduced to about 10% in 2009.

RRA has also made noteworthy strides in modernisation and efficiency improvements in its tax administration system. Highlights include:

- The ongoing major initiative to widen the tax base by establishing the Small and Medium Taxpayers Office (SMTO) and embarking on implementation of the block management system (BMS) to facilitate “the registration of more taxpayers through education, close monitoring and audit from their proximity” (Kiregu, 2009). In 2007, RRA reports that the SMTO had registered 9,662 taxpayers, undertook 455 audits (compared to 480 planned) and raised Rwf3.2 billion (about US$5.4 million) in tax revenues. However, “the average compliance rate in SMTO for returns filing during 2008 was about 49%. Filing compliance for SMTO remains below the average and requires more efforts” (RRA, 2008);

- RRA is also credited with a comparatively efficient system for the administration and payment of tax refunds.

There is timely auditing of refund claims. Also, unlike its counterparts in some EAC countries, RRA has the full mandate to administer the refunds. In other countries, such as Kenya, the refunds require approval of their ministries of finance, and sometimes specific budgetary allocations. In the latter cases, payment of refunds sometimes takes more than a year after validation by the revenue authority. In Rwanda, refunds are usually paid within 30 days for claims below certain thresholds (see Section on “Tax administration performance benchmarks”);

- Compliance levels have significantly improved with as many as 97% compliant large taxpayers (who contribute approximately 75% of total domestic taxes). Compliance rates are lower in the medium and small taxpayer category;

- Improved administration of collection and cash management - Collection of revenues is mainly undertaken by commercial banks. Over 90% of revenue is collected by banks;

- In 2010, Rwanda and Uganda launched a 24/7 one-stop border service at Gatuna. Rwanda’s PS in the Ministry of East African Community Affairs is cited as having said, “The one-stop border point shall benefit the private sector by providing quality and quick service delivery of goods and services across EAC” (Gahene, 2010);

- RRA has contributed to a dramatic improvement in Rwanda’s ranking in the World Bank’s 2010 global “Doing Business Index” by spearheading the introduction of a number of tax legislation reforms. Rwanda’s ranking rose to 67 in the latest ranking (2010) from 143 in 2009; and

- RRA became ISO 9001 certified in 2009. According to RRA Commissioner General, Mary Baine,

---

13 The large taxpayer segment constitutes less than 5% of the total tax paying community (Musoni, 2009).

ISO certification demonstrates RRA’s ability to enhance customer satisfaction through effective application of quality systems15.

On the other hand, there are suggestions that Rwanda could have done significantly better in tax revenue generation if it did not extend the kind of tax incentives and exemptions it introduced from 2005 aimed at attracting foreign investors to the country. In this regard, for example, the IMF (2007a) observed that tax incentives may be counterproductive or ineffective because: (i) they distort the investment climate and discriminate against investments by domestic and/or small and medium enterprises; (ii) there is evidence that such other factors as infrastructure, property and commercial legal system, efficiency and integrity of the public service are ranked higher by investors in the choice of their investment locations; and (iii) what the investors’ host country fails to tax ends up being taxed in the country of their domicile. In other words, the tax policies of the investor’s country of origin may cancel out the presumed local tax advantage.

Domestic revenue

**Domestic revenue performance trends**

Rwanda’s total domestic revenue as a percentage of GDP rose from 8.4% in 1993 to 14.2% in 2008 (see Figure 6.2). In the year that the genocide took place (1994), however, total domestic resources as a percentage of GDP fell to 3.6%. Between 1993 and 2008, on average the split between tax and non-tax revenues was 93.3% to 6.3%. According to the IMF (2009c), tax growth has ranged between 0.25% and 0.3% of GDP every year from 1997. Furthermore, the mission team indicates that in line with GoR’s aspirations contained in Vision 2020 to be less dependent on IDOs, “tax effort needs to be scaled up”\(^\text{16}\). It is also noteworthy that when GoR embarked on tax reforms in 1998, it aimed to increase “the revenue-to-GDP ratio by 0.5% p.a.” (IMF, 2000).

There are three main categories of domestic revenue sources: taxes on goods and services (comprising VAT and excise duty); direct taxes (including PAYE, corporate income tax, personal income tax and tax imputed on turnover); and tax on international trade. As shown in Fig. 6.2, taxes on goods and services have formed the largest proportion of total domestic revenues – at about 48% of the total tax revenue (see also Annex 6.3: Table 6). Since 2001, and with the exception of 2004, contribution to total taxes from direct taxes has been on a steady rise – in 2008, the share of direct taxes peaked at 37.5%. The share of taxes on international trade in total tax revenues has steadily decreased from a high of 41% in 1995 to just over 10% in recent years. This reduction is explained by an initial reduction in import duty rates – “with the maximum rate declining from 60% to 40%” (IMF, 2000). Furthermore, “Rwanda’s weighted average tariff rate was 11.3% in 2008”\(^\text{17}\).

A key reason for comparative underperformance of domestic revenue in Rwanda is that whilst agriculture is a significant contributor to GDP, farmers and other traders operate on an informal basis and are largely not captured within the tax net. “According to the Private Sector Federation [PSF], about 0.3% of taxpayers contribute 48% of Rwanda’s tax revenue” (Godbout,
The IMF (2009c) estimates that between 2002 and 2009, the informal sector contributed an average of 6.25% of GDP. The IMF (2009c) also suggests that by formalising such enterprises and monetising the economy, there would be huge pay-offs in terms of increased levels of DRM. Therefore, RRA’s “onus should be on widening the tax net to the informal sector and ensuring that tax laws are applied evenly and fairly” (IMF, 2007b).

In recent years, there have been continuous efforts by the RRA to extend its reach of the informal sector, and small and medium enterprises (SMEs). In 2008, for example, RRA pronounced changes in the system of taxing commercial vehicles. The change was aimed at bringing fairness in tax collection, whereby taxes on a vehicle would be paid according to its load capacity by tonnage or number of passengers. Also, in 2009, the Minister of Finance and Economic Planning, talking of the potential of the informal sector and SMEs to contribute to revenue, is quoted to have stated that, “we are closing in on this very large and yet elusive informal sector. The large taxpayer segment constitutes less than 5% of the total tax-paying community but from which over 75% of the total tax revenues are collected” (Musoni, 2009).

Tax administration performance benchmarks

Performance efficiency

Cost of collection. Between 2003/04 and 2007/08, RRA’s operating costs (including capital expenditure) as a percentage of total revenue collected averaged at 3% (see Annex 6.3: Table 2). The IMF rates this result as comparatively higher than what is considered typical for modern revenue administrations, which would be less than 2% (IMF, 2007a). In particular, in the same IMF review, Rwanda’s collection costs as percentage of total tax revenues were observed to be higher than that of other countries in the region – Kenya (1.7%), Malawi (2.8%), Tanzania (2.8%) and Uganda (2.8%). Furthermore, during the four-year period to 2007/08, RRA’s tax administrative costs grew at an average annual rate of 27%.

Organisational structure. RRA is organised along functional lines. It established a LTO in 2006. In 2010, the LTO served 307 large taxpayers. They comprise individuals, corporations, government bodies and ministries, who meet one or more of the following criteria: (i) their activities are complex and turnover exceeds Rwf200 million p.a.; (ii) they pay excise duties; (iii) they are registered with RDB and have invested over Rwf300 million; (iv) they are gauged to have growth potential; and their PAYE costs exceed Rwf600 million p.a. In the same year, the SMTO was established, and by 2007, had 9,662 registered taxpayers who contributed 16% of total revenue collections (RRA, 2008).

Ease of paying taxes. Rwanda has the best rating among the EAC countries in terms of the World Bank’s Doing Business Ranking, and with respect to ease of paying taxes – ranking 59th out of 183 countries in 2010. However, Rwanda dropped one place in 2009 to 58. According to the World Bank’s 2010 Paying Taxes report, a company is required to make 34 payments a year, which are below the SSA average of 37.7 p.a., but above the OCED average of 12.8.

Tax arrears. Information on tax arrears was only available for 2006/07 and 2007/08. Tax arrears as a percentage of total tax collections in 2007/08 amounted to 16.4%. According to the IMF (2007a), “significant progress was made by the RRA in 2006 to reduce the stock of tax arrears, particularly for corporate profits tax where Rwf17,334 million was collected during the year. The number of debtors at the end of 2006 was less than 400, with around Rwf8,500 million outstanding (i.e., 4.4% of total 2006 collections)”.

VAT payment system. In 2008, RRA streamlined the VAT refund process. It set various monetary refund limits in which small (below Rwf 50,000), medium (below Rwf 100,000) and large (below Rwf 200,000) taxpayers can automatically deduct refunds from their next month’s VAT return. In other words, VAT refunds for eligible amounts are made within 30 days. Refunds above the prescribed thresholds are subject to further conditions. They include the need: to have deposited a payment at the Treasury; for a taxpayer to submit honest and accurate returns; and for an audit over a prescribed threshold.

Tax compliance. Rwanda has a low VAT gross compliance ratio (VATGCR) of 30.30 in comparison to World and SSA averages of 65.48 and 38.45 respectively. Measures from the same source compute corporate income tax revenue productivity (CITPROD) and personal income tax revenue productivity (PITPROD) of 0.06 and 0.09. They indicate that Rwanda uses the taxes less efficiently in generating revenue than World averages of 0.13 and 0.14 for CITPROD and PITPROD respectively.

Compliance by large taxpayers is generally high because the LTO closely monitors each of them. There is continuous audit of large taxpayers whose monthly dues of VAT, PAYE and withholding tax are audited and agreed before payment. The audits are also comparatively quick but thorough. To this end, RRA has its audit staff literally camped out at taxpayers’ premises. However, compliance by others remains weak. According to the IMF (2007a), about a third of corporate and non-corporate tax returns were filed late, and 15% of VAT payers failed to file returns on time.

Allocative efficiency

In 2006, a review of tax incentives highlighted “revenue losses of about 3% of GDP” (IMF, 2006). Furthermore, IMF (2007a) raised concerns about potential allocative ineffi-

---

**Box 6.1: The IMF’s rationale for avoiding tax holidays**

“Tax holidays as a policy instrument should be avoided for three main reasons. First, such instruments are in direct conflict with goals to increase tax revenues and therefore place greater pressure on tax-base broadening in the medium and small taxpayer segments where greater effort is required for much lower yields. Second, tax is generally a second order issue to investors eclipsed by such factors as the rule of law, a working judicial system, security of property ownership, good infrastructure and as little bureaucracy in doing business as possible. Third, and closely connected to the second point (in the sense that tax is not a factor) is that most investor countries’ tax systems operate on a residence basis, and hence perversely, where taxable income is subject to no tax in Rwanda as a result of a tax holiday, the businesses’ country of residence acquires a taxing right to this income instead…It is important for the RRA to ensure that it adequately records revenue forgone by ensuring that businesses subject to tax holidays file tax returns, like any other business, so that the quantum of lost revenues can be reported to the ministry of finance. Equally important is the need to ensure that investors already established in Rwanda do not have access to this regime and that businesses cannot qualify for renewed tax holidays for substantially the same investment through restructured business entities or convoluted schemes”.

**Source:** IMF (2007a)
ciencies arising from use of tax holidays and other incentives to attract foreign investors. The same review observed that for Rwanda they should be avoided (see Box 6.1).

Performance equity

Rwanda has a regressive income tax regime by any standards. The 2009 personal income tax rates show that the minimum monthly taxable income attracting the highest PAYE rate of 30% is as low as RwF100,000 (equivalent to US$175). This is about a third of threshold levels for Kenya (US$523) and Tanzania (US$542). Yet, even the latter two countries fall in the category of the majority of African countries that have been described as having regressive tax rates on income. For instance, thresholds for the maximum PIT rate in the Republic of South Africa and Botswana are about US$1,318 and 1,515 respectively (Institute of Economic Affairs, 2010).

However, as with other countries in the region, Rwanda’s VAT system does provide for tax concessions for certain basic goods and services consumed by poor households. Similarly, excise and import duties are generally levied on luxury items or goods, which contribute to negative public health externalities.

In the case of corporate business income, the World Bank’s 2010 Paying Taxes report indicates that the ‘total tax rate’ as a percentage of profit of 31.3% is significantly lower than the OECD average of 44.5%, and is lower than the SSA average of 67.5%. However, RRA is reputedly tough with taxpayers. It has forced the closure of businesses where tax evasion went on for a long time. Furthermore, we understand that there have been many instances in the past, when MINECOFIN has had to restrain the RRA from taking coercive action against delinquent taxpayers.

Another indicator of the tax burden has to do with the amount of time taken by taxpayers to comply with major types of taxes. In this regard, the 2010 World Bank paying taxes survey indicates that the time taken by companies in Rwanda to comply with major taxes is 160 hours, which is much lower than the OECD and SSA averages of 194.1 hours and 306.0 hours respectively.

Performance effectiveness

RRA’s performance effectiveness is modest in terms of tax effort and tax gap (see Annex 6.3: Table 13). At 61.4% in 2008, Rwanda’s tax effort was lower than that in Tanzania (71.6%), but higher than in 2001 (51.2%). However, Rwanda’s tax gap was 9.9% in 2005, and higher than that of Kenya, Tanzania and Uganda at 2.0%, 5.9% and 7.8% respectively during the same period.

At an operational level, RRA’s management considers that it has been successful in establishing a good relationship with the main taxpayers. It has enabled regular dialogue with representatives of the private sector. There is a quarterly Tax Issues Forum, which is jointly chaired by the RRA Commissioner General and the Chief Executive of the PSF. Participants comprise taxpayers and senior staff of RRA. The Forum has a standing technical committee with representation from both taxpayers and RRA staff, which facilitates collaborative dialogue and analysis of the issues prior to the quarterly forum. In addition, RRA welcomes taxpayer feedback through an online customer satisfaction questionnaire.

However, there is an independent perspective that RRA has not been responsive to the specific needs of small taxpayers; this sentiment is especially cited in terms of outreach and education. From a study on the informal sector in Rwanda, 53% respondents mentioned tax as the most troublesome regulation. In any case, it is not easy to reach many of the SMEs because they are rural-based and thus have limited access to urban in-
PSF members have previously complained that RRA does not pay attention to small businesses, which account for over 80% of employment (Torero et al, 2006). However, a study by the federation also confirmed the difficulties in bringing the SMEs and other informal sector entities into the tax bracket. It was also noted that, in Rwanda, as in most African countries, most SMEs are run by illiterate and semi-literate owners/families.

**Summary of overall trends**

Rwanda has a relatively short history of policy, institutional, legislative and capacity development, and reforms, which began after the 1994 genocide. The implementation of changes has been rapid but systematic and quite successful. Rwanda’s total domestic revenue as a percentage of GDP rose steadily from 9.7% in 2000 to 14.2% in 2008. The ratio is projected at a lower 13.8% in 2010, but this is generally explained by failure of tax revenue growth to keep pace with the high real GDP growth rate, as discussed in the Section on “Political economy and fiscal legacies”.

Although the tax to GDP ratio for Rwanda is significantly lower than that of, for example Kenya, Tanzania and South Africa, target growth rate for this ratio is also fairly low, at about 0.2 annual percentage points. This comparative underperformance of domestic revenue and conservative target growth rate is explained by the fact that the economy remains agriculture-based, with dominance of smallholding farmers. The other significant potential pool of taxpayers constitutes of small-time traders, who largely operate informally. Such farmers and traders are not easily captured into the tax net. However, RRA has an aggressive programme to draw several of the informal market participants into the tax net through implementation of the BMS.
Challenges and issues

Introduction

At the end of the previous section, it was pointed out that the structure of the Rwandan economy today (i.e., preponderance of smallholding farmers and informal traders) poses a near-binding constraint to rapid enhancement in the overall tax revenue base. Therefore, in the short-to-medium term, significant increase in real tax revenue growth is more likely to come from measures to raise and sustain compliance by existing taxpayers and improve administration efficiency. With a long-term perspective, efforts to widen the tax net will also continue to be implemented. Nonetheless, on both prongs, there will be challenges and issues to be addressed. Significant challenges are highlighted below.

Achieving a cost-effective strategy to widen the tax net

Widening the tax net entails capturing small and micro enterprises that are largely in the informal sector, and getting them to pay taxes. This will not be easy. As a survey by PSF reports, “small and micro business operators in Rwanda generally have low literacy and numerical skills, and have limited understanding of both the tax system and business record keeping…and understanding of tax matters is weak” (Hategeka, 2009). Furthermore, it can be costly to apply conventional approaches such as audits to bring these enterprises into the tax net, and to enforce compliance. Therefore, RRA needs to develop strategy, knowledge and other capacity to successfully and cost-effectively implement alternative interventions, for instance as would be the case with a risk-based compliance management approach. The approach to adopt should be considered on a case-by-case basis. In particular, RRA has done well to study the experiences of Tanzania in the implementation of the BMS. It may also benefit from Kenya’s experiences, for instance, with electronic tax registers for VAT. Moreover, relevant taxpayer education will remain a critical feature of whatever strategy or modality is identified or designed.

Rationalising the collection of central and local government taxes

In line with GoR’s decentralisation policy, the mandate for collecting taxes from property and rental income lies with the local government authorities (Kigali City Council and districts councils). However, experiences from countries such as Kenya and South Africa suggest that RRA could be more effective than local governments in collecting property taxes and taxes on rental income because of its expertise, resources and institutional arrangements. Also, in some countries such as Tanzania, the revenue authority collects property taxes on behalf of local government authorities. There is a distinct prospect that in some districts the local elites will collude with tax staff in councils to evade taxes. There is also a risk that some councils will not handle taxpayers with any courtesy. Nor are the councils likely to undertake any taxpayer education. Furthermore, given that local governments have been assigned a range of taxes (i.e., property tax, tax on rental income, fees and levies on quarries, markets, etc), there is a risk that the need to file taxes to multiple tax collection agencies could increase taxpayer compliance costs, and potentially increase the temptation to avoid and evade taxes. Therefore, the challenge to rationalise the tax collection functions between RRA and local governments can be anticipated.
Developing and maintaining capacity for tax policy management

One important consideration in the establishment of RRA and the transfer of the tax administration function out of MINECOFIN was the imperative to minimise red tape, low staff morale and poor performance in the discharge of functions. Under a quasi-autonomous revenue agency: processes and procedures are restructured and re-engineered to eliminate resource- and time-wasting routines; salary and incentive frameworks are put in place so as to attract, retain and motivate revenue collection officers; and enhance their integrity. On the basis of the latter, substantial and reliable institutional and human resources capacity for rapid growth and efficient revenue collection could be developed.

There is still another very important factor that should have underscored the creation of RRA out of the revenue collection departments of MINECOFIN. It concerns the case for separating tax policy from administration (DFID, 2008a). The institutional and organisational developments are in the right direction. However, it appears that the tax policy function is much weaker relative to tax administration. This, to a significant extent, is explained by the fact that the organisation and staff in tax policy remain in the bureaucratic and poor incentive environment of MINECOFIN. Therefore, only a strategic and deliberate effort to build capacity for tax policy functions will ensure that the necessary capacity is installed.

Building and sustaining management capacity in RRA

Building and sustaining adequate capacity, especially technical and professional skills, will remain a major challenge to RRA well into the long run. Land (2004) observed that:

“The RRA is no longer the employer of choice, and is finding it increasingly difficult to remain competitive in the labour market. Once the standard bearer for conditions of service, a growing number of private and quasi-public institutions as well as international agencies now offer more competitive remuneration packages. It is therefore becoming more difficult to attract and retain good personnel. Constrained by budget ceilings, the RRA will have to work at improving efficiency so that resources can be freed up to offer more attractive salaries linked to performance”.

The difficulties entailed in human resources capacity development and retention is exacerbated by the proliferation of ICT applications for both core business processes as well as management support services. The technologies for these applications keep changing with short time spans, and the competition for the skills is ever intense, because the market is not confined to the boundaries of Rwanda. It is definitely regional and increasingly global. In this regard, RRA will need technical assistance to sustain the modernisation momentum in key areas, such as: (i) risk management for tax and customs administration; (ii) an assessment of SIGTAS and ASYCUDA ++ to support risk management approaches, particularly automatic profiling of taxpayers; (iii) developing a “super” green/gold card trader facilitation programme, including an importer self-assessment instrument and guidelines; and (iv) developing RRA processes and procedures in readiness to collect social security contributions.

Putting a cap on tax incentives and exemptions

In the pursuit of the policy goal of making Rwanda a preferred foreign investment destination, and to attract particular investors to establish business in Africa, GoR
has legislated tax incentives (see Sections on “Trends in the tax system” and “Domestic revenue performance”). It has also granted tax exemptions to some businesses. Available data suggests that the impact of these exemptions and incentives in terms of tax revenues foregone is significant. Moreover, there is a body of knowledge that suggests that these incentives are counter-productive in terms of: (i) distorting the investment climate and discriminating against investments by domestic and/or small and medium enterprises; (ii) there is evidence that such other factors as infrastructure, property and commercial legal system, efficiency and integrity of the public service, among others, are ranked higher by investors in the choice of their investment locations; and (iii) what the investor’s host country fails to tax ends up being taxed in country of the investors’ domicile. In other words, the tax policies of the investor’s country of origin may cancel out the presumed local tax advantage. Despite such arguments, however, political leaders may not be easily persuaded to grant tax favours in their courting of brand international investors. This remains a challenge for Rwanda.

The outcomes and impact of the wide-ranging policy and capacity development measures that Rwanda in general, and RRA in particular, have implemented since its establishment in 1997, are yet to yield the expected results. Nonetheless, in confronting the challenges of design and implementation, three major lessons, which are presented below, are worth sharing.
**Lessons learned**

**Explicit and strong top political leadership support matters**

Rwanda has gone through a marathon of policy, institutional, legislative and capacity development changes aimed at achieving rapid growth in tax revenues over the past decade or so. Many of the key informants to this study were emphatic in sharing the view that strong support from the top political leadership, especially the President, and successive ministers of finance was the most crucial driver for change. This is corroborated by Land (2004):

“The RRA was granted a clear and unequivocal mandate and a strategic role to play within government’s wider strategy of national reconstruction, poverty reduction and good governance. As the centrepiece of the country’s domestic revenue generation effort, it has been expected to play a key role in meeting the aspirations of the Rwandan government and its international partners to reduce dependency on aid and to shift towards a country-driven transformation process. Accordingly, from the outset the RRA enjoyed a high degree of legitimacy and backing from official circles - there were equally high expectations placed on the nascent organisation to perform”.

**Developing and retaining effective capacity is a long-term undertaking**

RRA has benefited from strong government as well as IDO (especially DFID commitment) to provide the resources needed to rapidly develop its capacity. Furthermore, the authority’s strategic plans reflect that there has also been determination to expeditiously develop capacity, and improve performance on the part of the top RRA management. Yet, considerable gaps in capacity persist, even after a decade of consistent efforts. The IMF (2009b) suggests the priority gaps to be closed are strengthening audit and enforcement capacity. It also suggests that management support functions such as management of ICT applications, human resource management and finances deserve as much attention, especially because technical and professional staff in the latter skills areas are in high demand in the local, regional and global markets.

**Long-term and flexible technical assistance support enables rapid and sustained capacity development**

DFID has provided substantial support to the RRA since 1998. As mentioned earlier, by 2003, it was 34% of the total RRA budget, and for the subsequent four years ranged between 31% and 20%, before dropping to about 11% in 2008 (DFID, 2008b). While that support is now being substantially phased out, the following observation by a DFID independent review mission is noteworthy:

“There is a clear and direct link between DFID’s support and RRA’s revenue collection performance. The major share of the funding has been invested in IT hardware and software, primarily for installation and the development of SIGTAS and ASYCUDA-- the
main IT systems - supporting the improvement of the operations at the RRA. Furthermore, the spending on training has strengthened the skills across a broad range of RRA’s operations. Although DFID’s share of the total annual funding of the RRA has reduced over the years, the contribution remains significant in the context of the non-salary expenditures” (DFID, 2008b).
Annex 6.1: Key informants

Charles Lwanga (Mr), Head of Planning and Research, Rwanda Revenue Authority

Christopher Nzenyaremwe, Acting Director General for national Budget, Ministry of Finance and Economic Planning

Denis Mukama (Mr), Head of Research, Rwanda Revenue Authority

Eugene Mugnai Torero (Mr), Deputy Commissioner General & Commissioner for Customs Services, Rwanda Revenue Authority

Francis Nsengimuya (Mr), Acting National Coordinator, Institutional Support Project (ISP), Ministry of Finance and Economic Planning

Gaudence Uwimana (Ms), Principal Statistics Analyst, Rwanda Revenue Authority

Gerard Nkusi Mukubu (Mr), Director of Taxpayer Services Department, Rwanda Revenue Authority

Jeremy Armon (Mr), Senior Governance Adviser, UK Department for International Development

Michael Minega Sebera (Mr), International Legal and Agreements expert, Ministry of Finance and Economic Planning

Mugo W. Maringa (Mr), Country Manager, Tourism Promotion Services (Rwanda) Limited

Noah Oluoch (Mr), Chief Accountant, Tourism Promotion Services (Rwanda) Limited

Obald Hakizimana (Mr), Head of Macroeconomic Policy, Ministry of Finance and Economic Planning

Pierre Celestin Bumbakare (Mr), Commissioner Domestic Taxes, Rwanda Revenue Authority

Richard Dada (Mr), Deputy Commissioner of Small and Medium Taxpayers Office, Rwanda Revenue Authority

Seth Muhirwa (Mr), Director of Revenue Protection Department, Rwanda Revenue Authority
Annex 6.2: Bibliography


DFID (2008a): Good Taxes Reduce Poverty in Rwanda, DFID 10/01/2008, [online].


Annex 6.3: Selected indicators

Table 1: Tax policy – Maximum marginal tax rates

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>PIT</th>
<th>CIT</th>
<th>VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000/01</td>
<td>-</td>
<td>-</td>
<td>35%</td>
</tr>
<tr>
<td>2001/02</td>
<td>-</td>
<td>-</td>
<td>18%</td>
</tr>
<tr>
<td>2002/03</td>
<td>-</td>
<td>35%</td>
<td>18%</td>
</tr>
<tr>
<td>2003/04</td>
<td>-</td>
<td>35%</td>
<td>18%</td>
</tr>
<tr>
<td>2004/05</td>
<td>-</td>
<td>35%</td>
<td>18%</td>
</tr>
<tr>
<td>2005/06</td>
<td>30%</td>
<td>30%</td>
<td>18%</td>
</tr>
<tr>
<td>2006/07</td>
<td>30%</td>
<td>30%</td>
<td>18%</td>
</tr>
<tr>
<td>2007/08</td>
<td>30%</td>
<td>30%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Source: RRA

Table 2: Tax administration costs (1998/99 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Operating cost (RWF)</th>
<th>Operating cost as a percentage of tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003/04</td>
<td>4,343,432,497</td>
<td>3.2%</td>
</tr>
<tr>
<td>2004/05</td>
<td>4,919,010,000</td>
<td>2.8%</td>
</tr>
<tr>
<td>2005/06</td>
<td>6,996,670,000</td>
<td>3.4%</td>
</tr>
<tr>
<td>2006/07</td>
<td>7,575,300,000</td>
<td>3.0%</td>
</tr>
<tr>
<td>2007/08</td>
<td>9,418,400,000</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

Source: Various RRA annual reports

Table 3: Ratio of tax staff per population (TAXSTAFF)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Rwanda’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Low income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXSTAFF</td>
<td>-</td>
<td>0.82</td>
<td>0.37</td>
<td>0.20</td>
</tr>
</tbody>
</table>

### Table 4: National government revenue and deficit as a percentage of GDP (1993-2008)

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue (tax plus non-tax)</th>
<th>Total revenue including grants</th>
<th>Budget deficit before grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>8.4%</td>
<td>9.1%</td>
<td>-14.5%</td>
</tr>
<tr>
<td>1994</td>
<td>3.6%</td>
<td>3.6%</td>
<td>-12.4%</td>
</tr>
<tr>
<td>1995</td>
<td>6.1%</td>
<td>6.9%</td>
<td>-13.3%</td>
</tr>
<tr>
<td>1996</td>
<td>8.4%</td>
<td>9.1%</td>
<td>-13.1%</td>
</tr>
<tr>
<td>1997</td>
<td>9.8%</td>
<td>10.3%</td>
<td>-9.9%</td>
</tr>
<tr>
<td>1998</td>
<td>9.9%</td>
<td>10.4%</td>
<td>-10.8%</td>
</tr>
<tr>
<td>1999</td>
<td>11.8%</td>
<td>19.8%</td>
<td>-12.3%</td>
</tr>
<tr>
<td>2000</td>
<td>12.1%</td>
<td>25.3%</td>
<td>-12.5%</td>
</tr>
<tr>
<td>2001</td>
<td>13.8%</td>
<td>25.7%</td>
<td>-12.5%</td>
</tr>
<tr>
<td>2002</td>
<td>15.0%</td>
<td>19.4%</td>
<td>-11.9%</td>
</tr>
<tr>
<td>2003</td>
<td>13.5%</td>
<td>21.6%</td>
<td>-10.3%</td>
</tr>
<tr>
<td>2004</td>
<td>13.9%</td>
<td>25.9%</td>
<td>-12.1%</td>
</tr>
<tr>
<td>2005</td>
<td>15.1%</td>
<td>29.2%</td>
<td>-13.4%</td>
</tr>
<tr>
<td>2006</td>
<td>13.3%</td>
<td>24.0%</td>
<td>-11.1%</td>
</tr>
<tr>
<td>2007</td>
<td>13.6%</td>
<td>23.4%</td>
<td>-11.3%</td>
</tr>
<tr>
<td>2008</td>
<td>14.2%</td>
<td>27.1%</td>
<td>-11.0%</td>
</tr>
</tbody>
</table>

*Sources: Various IMF staff reports*

### Table 5: Split of total budgeted tax and non-tax revenue as a percentage of total domestic revenue (1993-2008)

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax revenue</th>
<th>Non-tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>92.3%</td>
<td>7.7%</td>
</tr>
<tr>
<td>1994</td>
<td>100.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>1995</td>
<td>93.9%</td>
<td>6.1%</td>
</tr>
<tr>
<td>1996</td>
<td>91.9%</td>
<td>8.1%</td>
</tr>
<tr>
<td>1997</td>
<td>94.7%</td>
<td>5.3%</td>
</tr>
<tr>
<td>1998</td>
<td>94.8%</td>
<td>5.2%</td>
</tr>
<tr>
<td>1999</td>
<td>95.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>2000</td>
<td>95.2%</td>
<td>4.8%</td>
</tr>
<tr>
<td>2001</td>
<td>92.2%</td>
<td>7.8%</td>
</tr>
<tr>
<td>2002</td>
<td>93.5%</td>
<td>6.5%</td>
</tr>
<tr>
<td>2003</td>
<td>93.7%</td>
<td>6.3%</td>
</tr>
<tr>
<td>2004</td>
<td>91.6%</td>
<td>8.4%</td>
</tr>
<tr>
<td>2005</td>
<td>90.2%</td>
<td>9.8%</td>
</tr>
<tr>
<td>2006</td>
<td>93.0%</td>
<td>7.0%</td>
</tr>
<tr>
<td>2007</td>
<td>94.0%</td>
<td>6.0%</td>
</tr>
<tr>
<td>2008</td>
<td>86.3%</td>
<td>13.7%</td>
</tr>
</tbody>
</table>

*Sources: Various IMF staff reports*
## Table 6: Composition of national government tax revenues (1993 to 2008)

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct taxes</th>
<th>Taxes on goods and services</th>
<th>Taxes on international trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>26.8%</td>
<td>43.1%</td>
<td>30.1%</td>
</tr>
<tr>
<td>1994</td>
<td>26.2%</td>
<td>37.7%</td>
<td>36.1%</td>
</tr>
<tr>
<td>1995</td>
<td>13.4%</td>
<td>45.6%</td>
<td>41.0%</td>
</tr>
<tr>
<td>1996</td>
<td>28.5%</td>
<td>39.8%</td>
<td>31.8%</td>
</tr>
<tr>
<td>1997</td>
<td>26.5%</td>
<td>39.8%</td>
<td>33.6%</td>
</tr>
<tr>
<td>1998</td>
<td>29.2%</td>
<td>45.5%</td>
<td>25.2%</td>
</tr>
<tr>
<td>1999</td>
<td>26.2%</td>
<td>55.6%</td>
<td>18.2%</td>
</tr>
<tr>
<td>2000</td>
<td>28.3%</td>
<td>53.9%</td>
<td>17.8%</td>
</tr>
<tr>
<td>2001</td>
<td>30.8%</td>
<td>51.6%</td>
<td>17.6%</td>
</tr>
<tr>
<td>2002</td>
<td>32.2%</td>
<td>50.1%</td>
<td>17.7%</td>
</tr>
<tr>
<td>2003</td>
<td>30.6%</td>
<td>50.1%</td>
<td>19.3%</td>
</tr>
<tr>
<td>2004</td>
<td>28.4%</td>
<td>52.1%</td>
<td>19.5%</td>
</tr>
<tr>
<td>2005</td>
<td>31.2%</td>
<td>51.0%</td>
<td>17.8%</td>
</tr>
<tr>
<td>2006</td>
<td>33.3%</td>
<td>49.3%</td>
<td>17.4%</td>
</tr>
<tr>
<td>2007</td>
<td>36.1%</td>
<td>50.9%</td>
<td>13.0%</td>
</tr>
<tr>
<td>2008</td>
<td>37.5%</td>
<td>49.2%</td>
<td>13.4%</td>
</tr>
</tbody>
</table>

Sources: Various IMF staff reports

## Table 7: Contribution of major direct, consumption and international taxes to overall tax revenue collections in Rwanda (2006 to 2008)

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax on profit</th>
<th>PAYE</th>
<th>VAT</th>
<th>Excises</th>
<th>Customs duties</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>14.1%</td>
<td>17.7%</td>
<td>33.9%</td>
<td>11.7%</td>
<td>15.5%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2007</td>
<td>13.5%</td>
<td>18.1%</td>
<td>32.2%</td>
<td>11.1%</td>
<td>14.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2008</td>
<td>16.1%</td>
<td>18.0%</td>
<td>33.2%</td>
<td>10.6%</td>
<td>11.4%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: RRA annual reports

## Table 8: Amount of previous year’s arrears collected as a percentage of total amount of tax arrears at beginning of year

<table>
<thead>
<tr>
<th>Year</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax arrears at the end of the financial year as a percentage of fiscal collections</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>16.4%</td>
</tr>
</tbody>
</table>

Source: RRA annual reports
### Table 9: CIT and PIT revenue productivity and VAT gross compliance ratio (2008/09)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Rwanda’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Low income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>CITPROD</td>
<td>0.06</td>
<td>0.13</td>
<td>0.09</td>
<td>0.08</td>
</tr>
<tr>
<td>PITPROD</td>
<td>0.09</td>
<td>0.14</td>
<td>0.08</td>
<td>0.07</td>
</tr>
<tr>
<td>VATGCR</td>
<td>30.30</td>
<td>65.48</td>
<td>42.3</td>
<td>38.45</td>
</tr>
</tbody>
</table>


### Table 10: World Bank Doing Business indicators on the tax burden (Rwanda only)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Year</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
<td>2009</td>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>Rwanda’s global ranking</td>
<td>-</td>
<td>58</td>
<td>59</td>
<td></td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>34</td>
<td>34</td>
<td>34</td>
<td></td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>168</td>
<td>160</td>
<td>160</td>
<td></td>
</tr>
</tbody>
</table>


### Table 11: World Bank Doing Business indicators (2010) on the tax burden (Rwanda vis-à-vis the OECD and SSA)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Region</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rwanda</td>
<td>OECD</td>
<td>SSA</td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>34</td>
<td>12.8</td>
<td>37.7</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>160</td>
<td>194.1</td>
<td>306.0</td>
</tr>
<tr>
<td>Total tax rate as % of profit</td>
<td>31.3%</td>
<td>44.5%</td>
<td>67.5%</td>
</tr>
</tbody>
</table>


### Table 12: Growth of registered taxpayers (2002/03 to 2007/08)

<table>
<thead>
<tr>
<th>Registered for</th>
<th>Total number</th>
<th>Percentage increase (2006 to 2008)</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT</td>
<td>2,637</td>
<td>3,741</td>
</tr>
<tr>
<td>PAYE</td>
<td>4,495</td>
<td>9,285</td>
</tr>
<tr>
<td>Profit taxes</td>
<td>4,205</td>
<td>11,842</td>
</tr>
<tr>
<td>Large taxpayers</td>
<td>284</td>
<td>289</td>
</tr>
</tbody>
</table>

Source: RRA annual reports
Table 13: Tax gap and tax effort for select EAC countries and South Africa (select years)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Tax revenue (A)</th>
<th>Estimated potential tax revenue (B)</th>
<th>Tax gap (B) – (A)</th>
<th>Tax effort (A)/(B) as a %</th>
<th>Tax effort (A)/(B) as a % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td>2001</td>
<td>17.8</td>
<td>20.8</td>
<td>3.0</td>
<td>85.5</td>
<td>85.5</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>18.6</td>
<td>20.6</td>
<td>2.0</td>
<td>90.5</td>
<td>90.5</td>
</tr>
<tr>
<td>South Africa</td>
<td>2001</td>
<td>24.8</td>
<td>26.7</td>
<td>1.9</td>
<td>92.9</td>
<td>92.9</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>27.4</td>
<td>27.0</td>
<td>-0.4</td>
<td>101.4</td>
<td>101.4</td>
</tr>
<tr>
<td>Rwanda</td>
<td>2001</td>
<td>10.7</td>
<td>20.9</td>
<td>10.2</td>
<td>51.2</td>
<td>51.2</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>12.2</td>
<td>21.4</td>
<td>9.9</td>
<td>57.0</td>
<td>57.0</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>13.5</td>
<td>22.0</td>
<td>8.5</td>
<td>61.4</td>
<td>61.4</td>
</tr>
<tr>
<td>Tanzania</td>
<td>2001</td>
<td>9.7</td>
<td>20.0</td>
<td>10.3</td>
<td>48.5</td>
<td>48.5</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.2</td>
<td>20.5</td>
<td>9.3</td>
<td>54.4</td>
<td>54.4</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>15.0</td>
<td>20.9</td>
<td>5.9</td>
<td>71.6</td>
<td>71.6</td>
</tr>
<tr>
<td>Uganda</td>
<td>2001</td>
<td>10.4</td>
<td>19.2</td>
<td>8.8</td>
<td>54.3</td>
<td>54.3</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.8</td>
<td>19.5</td>
<td>7.8</td>
<td>60.3</td>
<td>60.3</td>
</tr>
</tbody>
</table>

Source: IMF (2009c)

Table 14: Value added by sector as a percentage of GDP

<table>
<thead>
<tr>
<th>Sector</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>37%</td>
<td>37%</td>
<td>37%</td>
<td>35%</td>
<td>38%</td>
<td>39%</td>
<td>38%</td>
<td>38%</td>
<td>36%</td>
<td>32%</td>
<td>34%</td>
</tr>
<tr>
<td>Industry</td>
<td>15%</td>
<td>14%</td>
<td>14%</td>
<td>14%</td>
<td>13%</td>
<td>14%</td>
<td>14%</td>
<td>14%</td>
<td>14%</td>
<td>15%</td>
<td>14%</td>
</tr>
<tr>
<td>Services</td>
<td>42%</td>
<td>44%</td>
<td>43%</td>
<td>44%</td>
<td>42%</td>
<td>41%</td>
<td>41%</td>
<td>42%</td>
<td>45%</td>
<td>46%</td>
<td>46%</td>
</tr>
<tr>
<td>Adjustments</td>
<td>6%</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>7%</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: GoR
Table 15: Aggregate provisional local revenue budget for Rwanda, 2008 (in Rwandan Francs)

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
<th>Percent of total</th>
<th>Percent of total own revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Own revenues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property tax</td>
<td>4,225,191,332</td>
<td>4.1</td>
<td>31.0</td>
</tr>
<tr>
<td>Administrative fees</td>
<td>6,602,246,477</td>
<td>6.4</td>
<td>48.4</td>
</tr>
<tr>
<td>Concessions for mines</td>
<td>313,533,408</td>
<td>0.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Other revenues</td>
<td>2,452,826,228</td>
<td>2.4</td>
<td>18.0</td>
</tr>
<tr>
<td>Interest</td>
<td>42,524,160</td>
<td>0.0</td>
<td>0.3</td>
</tr>
<tr>
<td><strong>Total own revenues</strong></td>
<td><strong>13,636,321,605</strong></td>
<td><strong>13.2</strong></td>
<td><strong>100.0</strong></td>
</tr>
<tr>
<td><strong>Transfers from central government</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Block grants</td>
<td>11,507,008,328</td>
<td>11.2</td>
<td></td>
</tr>
<tr>
<td>Conditional grants</td>
<td>77,972,942,498</td>
<td>75.6</td>
<td></td>
</tr>
<tr>
<td>Total transfers</td>
<td>89,479,950,826</td>
<td>86.8</td>
<td></td>
</tr>
<tr>
<td>Grand total</td>
<td>103,116,272,431</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Note: The financial data covers Rwanda’s 30 Districts, excluding the City of Kigali.

Source: Computed by author based on data from MINECOFIN. 21

Table 16: Key fiscal decentralisation indicators

<table>
<thead>
<tr>
<th>Functional assignment: local government level responsible for delivery of national social services (education and health)?</th>
<th>Kenya</th>
<th>Rwanda</th>
<th>Uganda</th>
<th>Tanzania</th>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Functional assignment: local government level responsible for basic municipal functions?</th>
<th>Yes</th>
<th>Yes</th>
<th>Yes</th>
<th>Yes</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of centrally collected revenue transferred to local government level</td>
<td>2.2</td>
<td>27.1</td>
<td>36.0*</td>
<td>29.1</td>
<td>5.5</td>
</tr>
<tr>
<td>Percentage of public revenues represented by local own source revenues</td>
<td>2.8</td>
<td>3.5</td>
<td>1.2*</td>
<td>2.1</td>
<td>13.7</td>
</tr>
<tr>
<td>Percentage of local financed represented by local own source revenues</td>
<td>57.1</td>
<td>11.7</td>
<td>5.0</td>
<td>7.0</td>
<td>74.3</td>
</tr>
<tr>
<td>Is there a constitutionally (or legally) established agency/mechanism for vertical revenue sharing?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Is there a fixed horizontal revenue sharing formula for the main transfer schemes?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes*</td>
<td>Yes*</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Note: An asterisk (*) reflects a partial or qualified finding.

Source: Various governments

21 Note: The financial data covers Rwanda’s 30 Districts, excluding the City of Kigali.
Chapter 7

Tanzania
Summary of Key Findings

Context-Political economy and fiscal legacies

After independence in 1961, GoT embarked on transforming the economy through industrialisation and rural development schemes. Several years later, in 1967, it adopted socialism ("Ujamaa") as its development ideology. Initially, "social indicators improved, and Tanzania made important progress in building a nation-state" (IMF, 1999). However, the oil crisis in the 1970s and early 1980s, and other external shocks set the country on the path of an economic downturn, which was not reversed until the late 1990s.

Economic liberalisation and other major policy measures implemented from the mid-1990s heralded sustained economic recovery. By the end of the 1990s, Tanzania made major strides in public sector reform and other indicators, resulting in marked improvement in economic growth. In particular, real GDP growth rate consistently exceeded 5% annually during this period. At the same time, the economy had undergone a significant transformation, largely because of phenomenal investment in the mining sector. Still, Tanzania’s economy remains dominated by agriculture and a large informal sector.

While domestic tax revenues have grown considerably since the mid-1990s, international development assistance has remained a significant fiscal driver in Tanzania. Except for the one and a half decade beginning in the early 1980s, Tanzania has consistently been one of the largest recipients of development assistance in the EAC. It has been suggested, both in the literature and by key informants, that this extensive external assistance may have undermined ‘tax morale’ among Tanzania’s elite. However, in recent times, its political leaders, in particular, Members of Parliament have become sensitive to the country’s heavy reliance on aid and the excessive influence of the donors.

Both the aggregate fiscal position and tax revenue generation for Tanzania appear to be in an exponential trajectory in the medium-to-long term. However, in the medium term, tax effort will be constrained by two factors; (i) continued elite resistance to abolition of the prevailing extensive tax exemptions; and (ii) threat of increased high-level corruption in government agencies. Nonetheless, there are two motivating forces that should sustain and possibly enhance the tax effort in future. First, the political economy fundamentals are in place to sustain the momentum for economic growth, diversification, and poverty reduction. The second factor in favour of stepped up tax effort in future is the combination of a developing national consciousness of loss of fiscal sovereignty and associated risks of high dependency on foreign aid.

Tax reforms: Sequencing, implementation and results

Major policy changes to the tax system were initiated by the recommendations of the Presidential Commission on Taxation and Expenditure (1989-1991). These changes included: (i) simplification of the customs tariff structure in 1992 as a means of curbing tax evasion; (ii) establishment of Tanzania Revenue Authority (TRA) in 1996; and (iii) introduction of the Value Added Tax (VAT) in 1998, replacing the sales tax. There were further changes in tax policy between 2000 and 2008, including, for example, promulgation of a new Income Tax Act in 1996; and revisions to customs policies and administration have been driven by the East African Community Customs Management Act of 2004.

Since its establishment, TRA has undergone three waves of reforms centering on: (i) institution building; (ii) improving services delivery; and (iii) enhancing TRA’s specialisation. Under the first wave, besides increased levels of revenue collection, TRA reports the following results: (a) both the Board of Directors and Management
Team were appointed; (b) a taxpayer identification number (TIN) system was established; (c) ASYCUDA++ system was implemented; (d) the Large Taxpayers’ Department (LTD) was established in 2001; and (e) the tax appeals system was unified. The second wave contributed to: (a) increased revenue collections; (b) a growth in the large taxpayer population of 370; (c) systems improvements; and (d) electronic tax payments and refunds.

The implementation of the third wave reforms is still underway. Some of the main achievements to date include: (a) institutionalisation of tax-based risk management operations; (b) achievement of the International Standards Organisation 9001:2000 certification in October 2008; (c) implementation of a compliant traders scheme for importers; (d) opening of seven Tax Centres to register taxpayers, assess and examine returns and collect revenue; and (e) completion of a second time release study in 2009/10.

### Domestic revenue performance

From the establishment of TRA in 1995/96 to 2007/08, Tanzania achieved a 2.7 percentage point increase in domestic revenue collections. Tax revenue between 1996/97 and 2007/08 grew at an average annual rate of 15.7%\(^1\). It is noteworthy that the average annual public revenue growth rate between 2004/05 and 2007/08 was even higher, at 20.9%. This increase was due to extensive tax reforms undertaken between 2003/04 and 2006/07. Interestingly, VAT was the best-performing revenue source throughout the period from 1998/99 to 2007/08, growing at an average rate of 22.9% a year.

Income tax revenues were the second largest contributor to domestic tax collections in the 11 years to 2007/08. Revenues grew at an average annual rate of 22.3%, partly as a result of a buoyant macroeconomic environment, increased coverage of large taxpayers, other efficiency gains in tax administration and pay rises, particularly for public servants (IMF, 2004). Also, considerable gains were made by establishing the LTD. However, high levels of tax exemptions contributed to substantial revenue loss, probably accounting for most of Tanzania’s tax gap.

### Challenges and issues

Significant challenges will need to be addressed so as to attain and sustain the tax-to-GDP ratio target of at least 20% in the long term. Key challenges are listed below:

- **Ensuring efficiency of tax incentives and exemptions:** Reduction of tax exemptions could raise tax effort by several percentage points;
- **Widening the tax base:** Binding constraints appear to evolve around: (a) the absence of systems and mechanisms to reach many taxpayers; and (b) limited TRA knowledge about potential taxpayers in the informal sector economy;
- **Effectively exploiting ICT systems to enhance efficiency:** At present, these systems are not being implemented using an integrated framework. Hence, in the absence of integration, the systems’ use will remain sub-optimal;
- **Building and sustaining managerial capacity:** Recruitment and retention of specialists in areas such as ICT, accounting and finance, audit, legal, among others, remain a challenge;
- **Minimising corruption in tax collection:** An independent external integrity and transparency review commissioned by TRA in 2007 concluded that there seemed to be an endemic tax avoidance culture in Tanzania; and
- **Ensuring harmonised, systematic and policy-led regional integration measures:** Tanzania’s multiple

---

\(^1\) During that period, Tanzania mainland collections constituted over 95% of total tax collections in the United Republic of Tanzania.
memberships to regional economic communities such as the EAC and SADC need to be harmonised. Further, import duty exemptions granted to promote development of infant industries need to be monitored aimed at minimising abuse and consequent revenue loss.

Lessons learned

There are six key lessons that can be drawn from Tanzania DRM experience. They are:

• Policy shifts can seriously disrupt revenue collection efforts: It is critical to rigorously assess the implications of policy changes prior to their implementation;

• Participatory tax forums can support effective policy formulation: The process of tax policy formulation is comparatively participatory and transparent;

• The Block Management System (BMS) is highly potent for widening the tax base and tax net: The BMS initiative has been very successful in capturing new taxpayers and evaders;

• Comprehensive and in-depth sector studies should inform risk management of tax-based operations: In the absence of knowledge gained from comprehensive and in-depth sector studies, risk management cannot be fully effective;

• Risk-based profiling of VAT payers for refunds enhances efficiency: TRA has exemplary performance in managing its VAT refunds, which has been enabled by the introduction of taxpayer profiling; and

• Tax incentives and exemptions can negate DRM results: Exemptions and incentives could account for up to 6% of GDP. Therefore, in targeting tax efforts, and the outcomes and impacts of tax reforms, it is appropriate to factor in the impact of tax incentives and exemptions.

The rest of the chapter is organised as follows: the first section discusses the political economy and fiscal legacies, the second section covers trends in the tax system, the third section explores domestic revenue performance, the fourth section highlights the challenges to increasing DRM, and the fifth section concludes with lessons learned.
The legacy of socialism and economic liberalisation

After independence in 1961, Tanzania embarked on transforming the economy through industrialisation and rural development schemes. Six years later, in 1967, GoT announced a new approach to development through what is popularly known as the Arusha Declaration, which outlined a shift in policy towards state-dominated interventions aimed at attaining "self-reliance". In effect, GoT adopted socialism ('Ujamaa') as its ideology and called for major socio political and economic adjustments consistent with the new dispensation, including, public ownership.

Initially, "social indicators improved, and Tanzania made important progress in building a nation-state" (IMF, 1999). However, the oil crisis in the 1970s and early 1980s, and other external shocks marked the beginning of an economic downturn, demonstrated by large fiscal deficits, high inflation rates and low foreign exchange reserves. Mismanagement and inefficiencies in public enterprises further exacerbated the situation. “Between 1984/85 and 1994/95, there was a net transfer from the government to the parastatal sector. In real terms, the net transfers increased from TShs6.3 billion in 1984/85 to TShs50.3 billion in 1993/94” (Moshi, 1998). These inappropriate policies and structural defects, coupled with the 1979/80 war to dethrone the Idi Amin regime in Uganda, led to a near collapse of Tanzania’s economy in the 1980s. Between 1980 and 1985, real GDP growth averaged 1% per annum (World Bank, 2002). As GDP shrank, shortages of basic consumer goods appeared, and agricultural exports collapsed (Treichel, 2005). Furthermore, Tanzania experienced a serious shortage of foreign exchange.

Economic recovery and transformation since the mid-1990s

From the mid-1990s, the above measures heralded a major economic recovery, including: reduced inflation, a sustained moderate economic growth, and a vastly improved fiscal situation. By 1998, inflation had dropped to 12.9% from 32.3% in 1985. By the mid-1990s, growth ranged between 3% and 4% – “Private invest-
ment, domestic and foreign, fuelled economic growth, which in turn boosted tax revenues" (Nord et al, 2009). The fiscal deficit before grants fell from 8.9% of GDP in 1986 to 2.3% in 1995 (World Bank, 2002).

By the end of the 1990s, Tanzania’s performance in most sectors, including the public sector, improved markedly, leading to positive economic growth. At the same time, it adopted the poverty reduction strategy backed by the World Bank-IMF prescribed structural adjustment programmes (SAPs). Tanzania also espoused the ‘Vision 2025’, which outlined the country’s long-term targets on poverty eradication and human development, as well as on good governance and stability. Over the years, more focused strategy documents have set out GoT’s objectives and targets for reducing poverty within the medium-term macroeconomic framework. Despite all this, poverty levels in Tanzania remain high.

In the last decade, construction, mining and services have been the main sectors of growth in Tanzania. As a result, agriculture makes a lesser but still significant contribution to GDP of 26.6%, compared to services, at 50.8% and industry 22.6% respectively. Between 2006 and 2008, annual growth in agriculture, industry and services sectors was around 4%, 9% and 8% of GDP respectively. However, in spite of many years of comparatively moderate-to-high growth rates (about 5% of GDP) since the mid-1990s and the heightened level of investments in the mining sector, a major part of Tanzania’s economy remains in the informal sector.

**Development financing mix and challenges**

Figure 7.1 presents the trends in the overall development financing mix between 1996 and 2008. Exports of goods and services accounted for the largest share of development financing, contributing 19.4% of GDP in the period. Tanzania’s exports include agricultural produce (e.g., cotton, coffee), and non-traditional items (such as gold). Between 2002 and 2008, exports grew at an average annual rate of 16.3%.

![Figure 7.1: Trends in Tanzania’s overall development financing mix (1996 to 2008)](image)

Source: *Africa Economic Outlook (AEO)* 2010 data

---


3 Data on ODA for 2008 is not available.
Private savings are the second largest form of development financing. Between 2002 and 2008, private savings averaged at 17.8% of GDP, which is higher than the levels for Kenya and Uganda for the same period, at 13.6% and 14.6% respectively, but lower than the Africa benchmark for the post-Monterrey period of 22.1%. The growth in private savings was highest following liberalisation of the financial services sector.

Domestic revenue is the third largest source of development finance (see Section on “Domestic revenue performance”). However, domestic financing capacity is insufficient to meet Tanzania’s needs. Therefore, GoT relies heavily on foreign aid, which averaged at 13.2% of GDP between 1996 and 2007. About 34% of the budget is estimated to be financed by aid.

Tanzania has also benefited from some foreign direct investment (FDI), which averaged at 3.4% of GDP between 1996 and 2007. It is noteworthy that South Africa is reported to have contributed to 35% of Tanzania’s FDI between 1994 and 2003 (Page and de Velde, 2004). Its other major investors include: Australia, Canada, Ghana, Kenya, UK, and USA. On Tanzania mainland, “based on 2003 figures, FDI is relatively diversified in mining (39%), followed by manufacturing (22%), tourism (13%) and agriculture (7%)” (MIGA, 2007).

Political economy dynamics

underpinning DRM

The synopsis of the political economy legacies that have impacted DRM, as presented in the following sub-sections, is based on Brautigam’s (2008) analytical framework. It consists of five facets: (i) level of economic development and economic structure; (ii) societal factors: culture, values, trust and ‘tax morale’; (iii) war and taxes: bureaucratic modernisation as a response to threat; (iv) political institutions and tax systems; and (v) taxation and fiscal contract.

The economic structure is largely agrarian with high levels of poverty

The Tanzanian economy remains agrarian with high poverty levels. However, in recent years, sectors associated with enhanced monetisation of the economy such as mining, construction, financial services and manufacturing have recorded comparatively higher growth. At the same time, poverty levels have recorded a modest decline. GoT’s Poverty and Human Development Report (2009) indicates that in the six year period from 2001 to 2007, household poverty rate in rural areas fell by 1.1 percentage points -- to 37.6%, compared with a 1.7 percentage points drop to 24.1% in urban areas. Still, in the evolving economic structure, growth in employment in the modern sectors and in urban areas is comparatively rapid – “the number of Tanzanians employed grew by an average of 630,000 per year between 2001 and 2006” (GoT, 2009). Therefore, the scope for DRM has considerably and steadily improved over the past one and a half decade, and there are bright prospects of this being sustained in future.

An egalitarian and camaraderie culture with high levels of trust but low tax morale

Tradition and the enduring impact of the Ujamaa era have left Tanzanian society with a significantly egalitarian and camaraderie culture. Until recently, conspicuous affluence was generally frowned upon in the society. Trust among members of the society has been high. In that culture, corruption remained comparatively low and
although a worsening trend is widely perceived, the latest Transparency International Corruption Perception Index suggests that among the five EAC countries, only Rwanda ranks better than Tanzania.

Except for the one and a half decade beginning in the early 1980s, Tanzania has consistently been one of the largest recipients of development assistance in the EAC. This phenomenon has undermined ‘tax morale’ among Tanzania’s elite. The authors have, for example, been informed that most of the elite generally do not pay taxes on non-salary income. In recent years, rising frequency of reported levels of high-level corruption has further eroded this morale.

**Nation-building deviated from the normative**

In the decade following independence, Tanzania benefited from a robust revenue mobilisation bureaucracy, jointly developed by the defunct EAC (1967-1977) -- foundations of which were inherited from the colonial East African Common Services Organisation. The collapse of the EAC in the late 19970s proved disruptive to the development of the revenue administration system. By then, however, both development strategy and development financing mix of the Nyerere regime were not exclusively dependent on the conventional domestic resources mobilisation bureaucracy.

In conventional terms, Tanzania has fought only one war since independence. This was against the regime of Idi Amin in Uganda. However, father of the nation, the late Mwalimu Julius Nyerere, actively sought, with some degree of success, to place Tanzania on a war footing in two other fronts. Soon after independence, he declared a war against hunger, disease and ignorance. Following the Arusha Declaration of 1967, the Ujamaa drive was also put on a similar war footing. Indeed, it was in that spirit that Nyerere eventually transformed the ruling party to a revolutionary one (Chama Cha Mapinduzi, ‘the revolutionary party’), which still dominates Tanzania’s political scene.

It is worth noting here that Nyerere did not fall back on poor Tanzanians to mobilise resources for his wars. Rather, he cultivated a unique and paradoxical relationship with the international community, which, for two decades, provided him considerable resources for nation-building. While the West provided him considerable aid, he could still persuade the Chinese to finance the Tanzania-Zambia railway line. At the same time, as observed above, his success probably underlies a low tax morale culture.

**There was political support for establishing TRA as a professional institution insulated from political interference**

The launch of TRA in 1996 was an early milestone of the “Third Phase” Government of Tanzania (Mkapa regime) in heralding economic recovery. Thus, from the outset, TRA was established as a semi-autonomous technocratic instrument for strengthening DRM efforts. In this regard, recruitment of management and staff was based on professionalism. A large proportion of staff from the former revenue departments, who were considered inept or corrupt, were retrenched and those who remained were transferred to TRA. At the same time, there was a strong drive to recruit and develop new professionals.

A few years later, TRA was to be an important source of technocrats that former President Mkapa relied on to spearhead consolidation of macroeconomic and fiscal reforms in the Ministry of Finance. In particular, TRA provided the Ministry with fiscal policy and management experts. As a result, at the technical level, a very close working relationship grew between TRA and its parent ministry.
More significantly, since its inception, TRA is one public organisation that has generally been insulated from political interference. Others could argue that this absence of political intervention is not unique to TRA. According to Mukandala et al. (2005), first, DRM and allocation processes are “depoliticised” in Tanzania, giving a free hand to bureaucrats, donors, investors and external consultants. Civil society and parliamentary control of these processes is still very marginal. Second, all “demand side” state institutions in Tanzania are controlled by the executive, and not politicians. This reinforces TRA’s insulation from political interference.

There is no fiscal contract in place at present

Neither the process of state-building, nor the imperatives of development financing have so far enabled a fiscal contracting process to effectively evolve in Tanzania. Over the years, government revenues have mainly come from a few large taxpayers and international development organisations (IDO’s). About 400 large taxpayers, who are mainly privatised public companies and subsidiaries of multi-national organisations, contribute 80% of domestic tax revenues. IMF (2009a) statistics show that external development financing, at about 10% of GDP, was nearly 40% of total public expenditure in 2008/09. In other words, vast majority of Tanzanians do not pay tax, and so far, there have been no serious efforts to make them pay.

Furthermore, according to Fjeldstad (2009), while there are indications that majority of the population may be willing to engage in a fiscal contract with the state, no such contract is in place at present. This explains why surveys of citizens in 2003 and 2006, cited by the same author, show they are not ready to pay taxes and fees, and this may be a major obstacle to enhancing government revenues in Tanzania.

Fiscal governance drivers, results and trajectory

Historically, Tanzania’s socio-political predisposition for an egalitarian society has been the major internal driver of fiscal governance. The launch of a programme in the 1960s to provide education for all had a positive impact in that regard. Following the interlude era of economic liberalisation (second phase government), national programmes to rapidly extend social services to all sections of the society were re-launched under the ‘third phase’ government. Despite all this, country’s DRM remains comparatively low. Therefore, the need for external resources to bridge the resource gap has been a permanent feature. It is in the latter context that there may be validity in Hyden’s (2005) assertion that donors are more proactive, and probably the dominant driver of fiscal governance.

In recent times, Tanzania’s political leaders, in particular, MPs have become sensitive to the country’s high dependency on aid and the excessive influence of the donors. In this regard, during the debate of the 2008/09 budget, partly in response to growing donor pressure for curbing corruption in public expenditure, many MPs vigorously advocated for weaning Tanzania away from its aid dependency. In response, the Minister of Finance pledged to accelerate growth in domestic resources.

In addition, there is no doubt that foreign investors have been significant fiscal governance drivers in Tanzania, especially over the past decade. Wangwe (2005) suggests that while tax measures taken in the early 2000s were generally directed to stimulating investment and production, large-scale investors were given greater tax relief. Mining companies were predominant among these investors, and there have been concerns that the
exemptions and incentives they received had the effect of reducing the potential to maximise revenues from corporate income tax.

Until aid dependency is significantly reduced, it is difficult to anticipate how influence of the IDOs on Tanzania’s economy can be reduced. Furthermore, according to Nord et al (2009), this is only a realistic prospect in the long term, because it is dependent on a stronger domestic revenue base, growing private FDI, and eventual access to sovereign bond markets and Tanzania’s capacity to manage debt.

Furthermore, the tax effort in the medium term will be constrained by two factors. One is the continued elite resistance to abolition of the prevailing extensive tax exemptions. The other factor is the prospect of increase in high-level corruption, which could ultimately infect TRA. While the increasing vigilance of Parliament and other national watchdog institutions could be expected to effectively address the second factor, the national socio-culture may sustain the former well into the future. Still, there are two motivating forces that should sustain and possibly enhance the tax effort in future. First, the political economy fundamentals are in place to sustain the momentum for economic growth, diversification, and poverty reduction. In 2009, IMF projected that Tanzania’s growth will return towards the 7% level in the medium term. The benefits of recent and ongoing substantial investments in the mining sector, and a renewed focus on the agriculture sector should serve to accelerate growth, employment and poverty reduction. Also, the drive, led by the President, to improve the investment climate and rapidly raise Tanzania’s World Bank Doing Business ranking, will help to sustain the growth of Foreign Direct Investment (FDI). The second factor in favour of raised tax effort in future is the combination of a developing national consciousness of loss of fiscal sovereignty caused by the current high level of aid dependency, and the decision by development partners in May 2010 to withhold budget support worth US$220 million.
Trends in the tax system

Changes in tax policies over the years

Following independence, Tanzania depended on unified policies and an administrative system jointly operated by the EAC founding members. However, in the early 1970s a decision was made to “place the responsibility of income tax in the hands of each national government” (Osoro, 1993). Later, GoT enacted the Income Tax Act of 1973, and expanded the sales tax base (introduced in 1969) “to compensate for the abolition of the excise tax” (Levin, 2001). Thereafter, several studies were undertaken in the 1980s, which recommended that the tax system be simplified and rationalised – leading to the abolition of export taxes and income tax rate changes. The key tax policy changes, however, did not take place until two decades later as elaborated below.

Key changes to tax policy in the 1990s

There were two key changes to the tax system from 1991 onwards that were informed by recommendations of the Presidential Commission on Taxation and Expenditure (1989-1991). First, in 1992, GoT simplified the customs tariff structure to five rates from over 50 in 1986, anticipating that there would be a decline in evasion (Morrissey, 1995). Second, in 1998, VAT was introduced, which replaced “the highly distortionary sales tax..., the hotel levy, and receipt-based stamp duty” (Nord et al, 2009). Two VAT rates were applicable at 20% and 0%. In addition, there are several VAT exemptions including: food, crops and livestock; health services; pesticides and fertilisers, education materials; and transport services.

In addition, from 1990, to enhance workers’ take-home pay, which “had been declining throughout the decade”, GoT reduced the top personal income tax rate from 40% to 30% (Osoro, 1993). It also reduced the top marginal corporate tax rate to 30% from 35%. It is worth noting that in 1996, the Ministry of Finance established a Task Force on Tax Reform. Comprised of stakeholders from government, private sector, research institutions and civil society, it provides opinions on tax policy. The Task Force’s recommendations are reviewed by a Think Tank for Tax Reform chaired by the Minister of Finance.

In 1998, GoT promulgated the Mining Act, which subjected miners to mining royalties on a net back value at a: 3% standard rate for gold and rough gemstones; 5% for diamonds; and 0% on polished and cut stones. This legislation was replaced by the Mining Act of 2010, which levies royalties of 4% for precious and base metals, 5% to 6% for diamonds and gemstones, and 7% for uranium on a gross value basis.

Major tax policies from 2000 to 2008

In 2000-2008, GoT introduced the following policy changes to the VAT regime:

- To raise revenue, in 2003/04, an amendment was made to the VAT regime aimed at excluding zero-rating from almost all services supplied to businesses/consumers overseas;
- To reduce compliance costs, regulatory burdens and red tape for small size enterprises, GoT, in 2004/05, increased the VAT registration threshold from an annual taxable turnover of TShs20 million to TShs40 million;
- To reduce transportation costs and enable the public railways system to meet its regular maintenance needs, GoT, in 2005/06, exempted locomotives, rolling stock, spare parts, and acces-

---

9 “In the area of income taxation, marginal tax rates were reduced from a range of 20-95% to 15-75% in 1986/87...[and] further to a range of 10-50% in 1989” (Osoro, 1993).
12 This policy measure is not in line with international practice.
In addition, under the new Act the withholding tax on dividends was reduced to 10%, whereas previously the rate was 20% for non-residents and 15% for residents.

To qualify, the original threshold was that at least 35% of the company’s equity had to be issued to the public. From 2009/2010 this threshold was reduced to 30%.

Changes in customs policies and administration have been driven by the EAC Customs Management Act of 2004, which underpins the establishment of common external tariffs (CETs) and elimination of internal tariffs. It also brought about the harmonisation of customs principles and procedures, and removal of suspended duty.

Excise duties are regulated under the Excise (Management and Tariff) Act. In Tanzania, “apart from the traditional excisable goods [alcohol, tobacco and petroleum products], soft drinks and motor vehicles are excisable for revenue generation purposes”\(^{15}\). In addition, GoT charges excise duty on mobile airtime. Excise duty rates are subject to regular increases, for example, to adjust for inflation.

Institutional changes

The 1989-91 Presidential Commission of enquiry into public resources also recommended creation of an autonomous revenue administration to include the Department of Inland Revenue and Department of Customs and Excise in the Ministry of Finance. However, it was not until 1995 that the National Assembly enacted the TRA Act No. 11 of 1995. Since its establishment in 1996, TRA’s operations have been funded by annual allocations appropriated by the Parliament.

TRA is headed by a Commissioner General who reports to a Board of Directors, although the Minister of Finance and Economic Affairs retains overall responsibility for TRA. The Board is required to meet on a monthly basis. It has two committees: a Standing Committee, which

---

\(^{13}\) In addition, under the new Act the withholding tax on dividends was reduced to 10%, whereas previously the rate was 20% for non-residents and 15% for residents.

\(^{14}\) To qualify, the original threshold was that at least 35% of the company’s equity had to be issued to the public. From 2009/2010 this threshold was reduced to 30%.

\(^{15}\) [http://www.tanzania.go.tz/tra.html](http://www.tanzania.go.tz/tra.html) [Accessed 20 March 2010].
handles organisational and human resource issues; and an Audit Committee that tackles operational and control matters.

Each of TRA’s revenue functions (i.e., domestic revenue, large taxpayers, customs and excise and tax investigations) is headed by a Commissioner. Its support functions (internal audit, legal services, taxpayer services and education, ICT, finance and human resources and administration) are headed by Directors. TRA has presence in all the 23 administrative regions of Tanzania mainland and in Zanzibar. TRA also has a tax training centre, the Institute of Tax Administration (ITA), which offers both short- and long-term courses. ITA operates as a semi-autonomous cost centre.

Changes in administrative systems

According to TRA’s 2007/08 annual report, as of 30th June 2008, it employed 3,413 staff. More than half of them were deployed in Customs and Excise (30%) and Domestic Revenue (55%). Under the Act, TRA is empowered to pay its staff competitive salaries. To that end, it undertakes salary surveys every two years. In recent years, TRA has implemented the recommendations of independent salary surveys undertaken in 2004/05 and 2007/08 (TRA, 2008).

In 2004/05, TRA developed an information systems policy and strategy to guide its ICT-based modernisation plans. Since then, it has introduced: the Automated System for Customs Data ++ (ASYCUDA++) and Revenue Authority Digital Data Exchange (RADDEX) system in customs; an automated Central Motor Vehicle Registration System (CMVRS); ITAX (a bespoke system) in domestic revenue; Epicor and PEODESY systems to support management of its finances and human resource functions respectively; TRA Monitoring and Evaluation Database (TRAMED); a data warehousing system; and an integrated data communication network (see Annex 7.4).

Fiscal decentralisation and taxation by local governments

Since 1999, Tanzania has been pursuing a local government reform process based on the concept of devolution of power. There are 133 local government authorities, which account for roughly 21% of public sector spending in Tanzania (PMO-RALG, 2007). Local authorities are responsible for the delivery of primary education, basic health services, agricultural extension, rural water supplies, local roads and public infrastructure, as well as typical local functions, such as refuse collection, street cleaning, managing local markets, and so on.

Local governments receive bulk of their resources through intergovernmental fiscal transfers (see Annex 7.3: Table 7). Almost two-thirds of these transfers are provided in the form of formula-based sectoral block grants, whereas the remainder is given in the form of subventions and development grants (PMO-RALG, 2007). In terms of own source revenues, local governments depend extensively on fees, permits and charges and other minor revenue sources (see Annex 7.3: Table 8). In addition, local governments rely relatively heavily on taxes on local business activity, including produce cesses (turnover taxes on agricultural production of up to 5%) and the service levy (a turnover tax of 0.3% for firms with turnover in excess of TShs20 million).

Tanzania has seen a considerable reduction in the relative importance of own source revenues as a local source of financing. For instance, in 2002/03, almost one-fifth of local recurrent expenditures were funded from local revenues, but by 2006/07, this percentage
had declined to 9.3% (PMO-RALG, 2007). This sharp relative decline was caused in large part by the abolition of the development levy (a local poll tax) in 2003, and a decision that sharply limited local authorities’ ability to collect local business licenses in 2004 (Boex and Martinez-Vazquez, 2006). In addition, due to poor local revenue collection efforts, in June 2007, the Prime Minister instructed TRA to assist local government authorities towards collecting local property taxes. This arrangement became effective in 2009.

In addition to the above, the crop cess (in Tanzania and elsewhere in the region) has long been identified as an inefficient local revenue source (see Hicks 1960; Bird 1974; Boex and Martinez-Vazquez 2006). Indeed, it would be easy to abolish this tax, and there have been voices advocating for this. However, the appropriate path would be to pursue a revenue-neutral reform and to identify and put in place an appropriate alternative local revenue instrument to tax rural agricultural production – for instance, a local tax on land used for commercial production – prior to eliminating the crop cess.

Reform sequencing, implementation and results

Tax reforms in the 1990s were motivated by Tanzania’s fiscal crisis (see Section on “Political economy and fiscal legacies”). It is against this rationale that the Presidential omission on Taxation and Expenditure was established – specifically to propose ways in which GoT could expand its tax base and increase collection efficiency (Fjeldstad, 1995). The Commission’s recommendations were presented earlier in this section.

Sequencing and implementation of reforms

The range of tax policy reforms initiated at the beginning of the 1990s heralded the modernisation of the tax system (IMF, 2003). The next critical reform was initiated to build the necessary managerial and technical capacity within TRA to ensure efficient and effective tax administration.

Since its establishment, TRA has undergone three waves of reforms centering on: (i) institution building; (ii) improving services delivery; and (iii) deepening the authority’s specialisation. These reforms are contained in successive TRA corporate plans. The first corporate plan was implemented in 1998/99 and remained in force until 2002/03; the second plan continued from 2003/04 to 2006/07; and the third one runs from 2008/09 to 2012/13.

The first wave of reform received extensive financial support from various development partners including the European Union, Germany, Sweden, UK, USA and the World Bank. The reform’s thrust was on enhancing revenue and capacity. Under the first wave, besides increased levels of revenue collection, TRA reports the following results: (i) both the Board of Directors and Management Team were appointed; (ii) buildings were rehabilitated and working tools upgraded; (iii) TIN system was established; (iv) ASYCUDA++ was implemented; (v) LTD was established in 2001 with an initial 100 taxpayers; and (vi) the tax appeals system was unified.

Development partners continued to support the second wave of reform. However, pooled funding arrangements under TRA were introduced instead of the project-based approach during the first wave. The second wave, which ran from 2003/04 until 2006/07, sought to achieve five objectives: (i) increase revenue collection in a cost effective way; (ii) integrate TRA operations; (iii) provide high quality and responsive customer services; (iv) promote tax compliance through a fair, equitable and transparent application of tax laws; and (v) improve staff competence, motivation, integrity and accountability.

Wave 2 reforms contributed to the following key results: (i) increased revenue collections; (ii) growth in large
taxpayer population to 370; (iii) systems improvements; (iv) electronic tax payments and refunds through the Tanzania Inter Banking Settlement System; and (v) an enhanced tax refund system. In addition:

- In 2004, TRA started to consult stakeholders through a quarterly forum;

- In 2004, TRA introduced new risk-based VAT refund arrangements “under which repayment claimants are separated into three categories (gold, silver and non-gold-silver)”, which are subject to different checks (Child, 2008);

- A balanced scorecard (BSC) performance management system was introduced in 2006 aimed at “improving effectiveness and efficiency of the performance” at organisational and staff levels (TRA, 2008); and

- Implementation of a Block Management System (BMS), which “focuses on the physical identification and mapping of taxpayers,” (TRA, 2008). As a result, in 2007/08, TRA registered an additional 13,300 new taxpayers.

The third corporate plan, which is aligned to Tanzania’s development objectives, underscores five goals during the third wave of reforms to run from 2008/09 to 2012/13. Its goals are similar to those in wave 2 reforms. The implementation of wave 3 reforms is still underway. Some of the main achievements to date include the:

- Institutionalisation of risk management tax-based operations such as: building specialist audit capacity in specific areas (e.g., construction, cash traders and tourism); self-assessment by large taxpayers; and risk assessment studies for risky sectors (e.g., petroleum, wholesale and retail);

- Attainment of the International Standards Organisation (ISO) 9001:2000 certification in October 2008. This certification will be valid until 2011;

- Implementation of a compliant traders scheme (CTS) for importers. As of 30 June 2008, around 60 traders had been registered under the CTS;

- Opening of seven Tax Centres in Dar es Salaam to register taxpayers, assess and examine returns and collect revenue; and

- Completion of a second time release study in 2009/10. The study was undertaken by various institutions involved in the tax clearance process.

Both tax and administrative reforms resulted in improved revenue performance in 1996/97, and from 2004/05 (see Section on “Domestic revenue performance”). However, revenue performance relative to GDP was not sustained throughout the period from TRA’s establishment (in 1995/96) to 2007/08. Ndulu et al (2007) attribute this outcome to emanate “chiefly from fiscal corruption”. Excessive tax exemptions may also have significantly cancelled out the prospective impact of the reforms on tax revenue performance. The IMF (2003) concludes that GoT “overestimated the speed at which institutional capacities could be strengthened”. In addition, the same author suggests that “policy sequencing also contributed to the revenue decline…tariffs were lowered too quickly before compensatory tax broadening measures including a strengthened administration were in place”. 

Domestic revenue performance

Trends

By fiscal year 1988/89, Tanzania's domestic revenue as a percentage of GDP had declined to 9.9% (World Bank, 2002). Following the establishment of TRA, revenue performance did not meet expectations in the initial years. Even though actual collections against budget averaged 99% between 1997/98 and 2002/03, tax revenue as a percentage of GDP hovered around 10.7% of GDP. Some of the reasons for this result are provided in Section on “Trends in the tax system”. In addition, key informants indicate that during this period GDP was revised upwards, lowering revenue to GDP ratios.

By 2007/08, Tanzania’s tax as a percentage of GDP had risen to 14.7%. However, non-tax revenues remained consistently low from 1991/92 (1.6%) to 2007/08 (1.2%). Tax revenue, between 1996/97 and 2007/08, grew at an average annual rate of 15.7%. It is noteworthy that the average annual revenue growth rate between 2004/05 and 2007/08 was even higher, at 20.9%. This increase was due to extensive reforms undertaken between 2003/04 and 2006/07 aimed at broadening the tax base.

VAT was the best-performing system throughout the period from 1998/99 to 2007/08 (see Annex 7.3: Table 6). It grew at an average annual rate of 22.9%. In 2007/08, VAT collection as a percentage of GDP was 4.6% (IMF, 2009a); and constituted 31.7% of total revenue collected on Tanzania mainland. It is noteworthy that raising the threshold for VAT registration from 2004/05 resulted in increased collection, because: several traders actually increased their revenue declarations so as to be able to remain VAT registered (and thereby were able to reclaim VAT inputs); and there

---

16 During that period, Tanzania mainland collections constituted over 95% of total tax collections in the United Republic of Tanzania.
was the deregistration of traders below the threshold (where VAT input claims were no longer reclaimable). However, there is a view that VAT’s contribution to tax effort would be much higher if there were fewer exemptions “and zero ratings since the original law was passed” (Nord et al, 2009).

Income tax revenues were the second largest contributor to domestic tax collections in the 11 years up to 2007/08. Revenues grew at an average annual rate of 22.3%, partly as a result of a buoyant macroeconomic environment, increased coverage of large taxpayers, other efficiency gains in tax administration and pay rises, particularly for public servants (IMF, 2004). In 2007/08: income tax revenue as a percentage of GDP was 4.3% (IMF, 2009a), constituting 26.6% of total revenue collected on Tanzania mainland. By 2007/08, the best-performing income tax was PAYE with a contribution of 14.8% of total revenue.

Tanzania is dependent on international trade taxes. In this regard, VAT on imports (19.0%), import (10.8%) and excise (7.8%) duties, and other import charges (4.0%), on average, constituted 41.6% of total tax revenue collected on mainland Tanzania between 1996/97 and 2007/08. The combined average annual growth rate of import and excise duties and charges between 1996/97 and 2007/08 was 23.6%. However, the proportion of international trade revenue from import duty declined from 15.4% in 1996/97 to 8.8% in 2007/08, partly due to reduction in trade tariffs.

**Tax administration benchmarks**

**Performance efficiency**

Cost of collection. Between 2003/04 and 2007/08, tax administration costs (excluding capital expenditure), as a percentage of revenue collected, averaged at around 3% a year (see Annex 7.3: Table 2). During that period, tax administration costs, as a percentage of tax revenue, declined from 3.8% (2003/04) to 2.8% (2007/08), but grew at an average annual rate of 21.9%. The largest expenditure by far was on personnel emoluments, which on average consumed around 57% of the total budget. However, it is significant that the number of tax staff available for every 1,000 persons is 0.05. This ‘tax staff per population’ ratio is very low compared to the World average of 0.82, but higher than the SSA average of 0.037.

Organisational structure. TRA is organised along functional lines. A Large Taxpayer Department (LTD), established in 2001, serves around 380 taxpayers (0.1% of all taxpayers). The Domestic Revenue Department (DRD) provides services to all other domestic revenue taxpayers. DRD taxpayers are segmented into large, medium and small taxpayers. The 1,600 large taxpayers within the DRD are served by Large Taxpayer Units in nine regions.

**Ease of paying taxes.** Judged by the World Bank’s Doing Business Survey, the ease of paying taxes in Tanzania is quite low. The survey ranks Tanzania 131st and 120th out of 183 countries in terms of ease of doing business and paying taxes respectively. According to the World Bank’s 2010 Paying Taxes report, a company is required to make 48 payments a year, which are much more than the SSA and OECD averages of 37.7 and 12.8 a year respectively.

**Tax arrears.** TRA has been fairly proactive in collecting tax debt. As of 30 June 2008, it reported that the LTD and DRD had collected 100% and 68% of the previous year’s debts as a percentage of the total amount of tax arrears at the beginning of the year respectively.
**VAT payment system.** Under TRA’s new VAT refund system, 72% of qualifying claims are paid within 30 days from the date of lodgement\(^{20}\). However, Tanzania has a very low VAT gross compliance ratio of 27.0 in comparison with the World and SSA averages of 65.48 and 38.45 respectively (see Annex 7.3: Table 10\(^{21}\)). This low rate may be due to the significant number of exemptions. From an economic efficiency perspective, a moderate VAT rate with a broad consumption base and few exemptions is always preferred to a high rate with many exemptions. A low VATGCR is also associated with “weak compliance and enforcement” (Brondolo et al, 2008).

**Tax compliance.** Tanzania’s corporate income tax revenue productivity (CITPROD) and personal income tax productivity (PITPROD) measures of 0.05 and 0.08 indicate that taxes are used less efficiently in generating revenue than World averages of 0.13 and 0.14 for CITPROD and PITPROD respectively. The Policy Forum (2009) attributes low productivity figures to ‘transfer pricing and trade mispricing’, especially by multinationals.

**Allocative efficiency**

Research and analysis undertaken by TRA suggests that the tax revenue effort could be considerably higher, if exemptions estimated at 20% of total tax revenue collections were eliminated. An analysis of the exemptions, given between July 2008 and April 2009, indicates that a total of TShs283.5 billion (US$180.7 million), or 48% of the total waivers, was granted to Tanzania Investment Centre (TIC). Under the Tanzania Investment Act of 1997, TIC offers investors: import duty and VAT exemptions on project/capital goods; and refunds of duty charged on imported inputs used for producing goods for export and goods sold to foreign institutions under a duty draw back scheme\(^22\). Similar incentives are offered in export processing and special economic zones\(^23\). A 2008 assessment by the IMF of this regime in Kenya and Tanzania asserts that investment incentives offered to firms in special economic zones “are not an important factor in attracting foreign investment”. Rather, they create distortions and result in the loss of tax revenues.

**Performance equity**

Tanzania has, by regional comparisons, progressive income tax rates for PIT ranging from 14% to 30% (effective 1 July 2010)\(^24\). Furthermore, GoT has steadily increased the lowest monthly personal income tax threshold from TShs60,000 (about US$40) in 2005/06 to TShs135,000 (about US$90) in 2009/10. GoT also reduced the lowest marginal tax rate from 18.5% in 2007/08 to 15% in 2008/09. In addition, in 2008/09, GoT widened the tax bands with the top tax rate of 30%, applying on income exceeding TShs720, 000.

**Box 7.1: Quantifying the level of incentives and exemptions**

Revenue loss arising from tax exemptions is estimated at TShs 587 billion (US$ 403 million) by the TRA between July 2008 and April 2009. Projects under the TIC accounted for the largest percentage of the total exemption. Other beneficiaries included state-owned institutions, the Government of Zanzibar, religious and non-religious NGOs. In 2008, it is estimated that the government lost TShs1.8 trillion (US$1.23 billion) or 6% of GDP through tax exemptions.

*Source: Policy Forum (2009), TRA and author’s calculations*

---


\(^{22}\) http://www.tic.co.tz/ [Accessed 30 June 2010].

\(^{23}\) GoT has issued 29 licences to firms operating in such zones. In 2008 firms had exported products worth US$ 40 million, and employed around 6,522 people.

(about US$473) per month as against TShs 540,000 before.

However, low income tax earners are also compelled to pay excise duty for tobacco and alcohol to compensate for negative health externalities, and are subject to VAT which has some elements of regressivity. Specifically, whilst several goods and services are exempt from VAT, a study reports that as other inputs needed by farmers (e.g., transport) are not VAT exempt, this tax contributes to an increase in production costs of 10% to 20%. As a result, “it has been claimed that the introduction of the VAT system is one of the main reasons why the realised economic growth has not benefited the poor” (OECD, 2007).

According to TRA’s Annual Report, as of 30 June 2008, 39 large taxpayers contributed 80% of tax revenues. However, the World Bank’s 2010 Paying Taxes report indicates that the ‘total tax rate’ as a percentage of profit of 45.2% compares to the OECD average of 44.5%, and is lower than the SSA average of 67.5% (see Annex 7.3: Tables 11 and 12). Another indicator of the tax burden for corporate taxpayers has to do with the amount of time taken by them to comply with major tax types. In this regard, the 2010 World Bank paying taxes survey indicates that the time taken by companies in Tanzania to comply with major taxes is 172 hours, which is much lower than the OECD and SSA averages of 194.1 hours and 306.0 hours respectively.

Performance effectiveness

In 2008, TRA’s tax effort of 71.6% improved considerably from 48.5% in 2001 (see Annex 7.3: Table 14). In 2008, the tax gap also narrowed by 4.4 percentage points to 5.9% of GDP. Also, in 2008 Rwanda’s tax effort of 61.4% was lower; and tax gap higher, at 8.5% of GDP. However, significant scope remains to further reduce the tax gap and increase Tanzania’s tax effort.

Summary of overall trends

In the 11 years since the creation of TRA in 1995/96, Tanzania achieved a 2.7 percentage point increase in domestic revenue collections. Considerable gains were made by establishing the LTD. There has also been fairly rapid growth in revenues from VAT and income tax. However, the level of exemptions not only contributed to undermining efficiency and effectiveness of gains resulting from administrative reforms, but also to the substantial revenue loss, probably accounting for most of Tanzania’s tax gap.
Challenges and issues

Until the global economic crisis, Tanzania had made steady progress in DRM as reflected in its tax collections from 2000/01 to 2007/08 (see Figure 7.2). The setback suffered in 2008/09, due to the impact of the global recession, is projected to be reversed in 2010/11. It is estimated that a tax-to-GDP ratio of at least 20% will be achieved by 2015. However, significant challenges will need to be addressed for this target to be attained and sustained in the long term. The key challenges and issues are highlighted below.

Ensuring efficiency of tax incentives and exemptions

The evidence gathered by the study team suggests that achieving efficiency in the tax system, especially through reduction of tax exemptions, could raise the tax effort by several percentage points. However, as the reversal of the measures to remove tax exemptions, announced by the Minister of Finance and Economic Affairs in his 2009/10 budget speech, show that achieving efficiency may remain a major challenge in the foreseeable future. Some shift in socio-cultural traits among the main beneficiaries -- elite, political leaders and organisations-- will be necessary. Also, strong will and commitment of the political leadership is a pre-requisite to achieving this shift in culture.

Widening the tax base

The more binding constraints to widening the tax base appear to evolve around: (i) the absence of systems and mechanisms to reach many taxpayers because the TIN system is not sufficiently robust and the national ID system is not yet in place; and (ii) the limited knowledge of potential taxpayers who fall in the informal sector economy, which, in 2002/03, Schneider (2004) estimates contributed 60.2% of Tanzania’s GDP.

TRA has initiated measures to address these challenges. For example, pending implementation of an electronic national ID card system, it is set to introduce a biometric system, which will encompass automated finger printing identification to prevent issuance of more than one TIN to a taxpayer. Furthermore, TRA is due to commission a comprehensive study of the informal sector in Tanzania. These initiatives will serve to widen the tax base in the medium-to-long term. Still, considerable and sustained efforts will be necessary before Tanzania’s tax base can be significantly broadened.

Effectively exploiting ICT to enhance efficiency

TRA has an array of initiatives to exploit ICT with a view to enhancing efficiency in tax administration. These include: the ASYCUDA++ for customs; iTAX and eFiling for domestic revenue; computerised registration of motor vehicles and drivers; and introduction of electronic cash registers for VAT, among others. These initiatives are at different stages of implementation. The effectiveness of these systems will, however, depend on building and maintaining their technical and professional capacity. Currently, these systems are not being implemented using an integrated framework, because this approach poses technical and managerial challenges. Yet, in the absence of integration, use of the systems will remain sub-optimal. In particular, it is difficult to have a single view of the taxpayer outside an integrated system.

Focusing reforms on strategic priorities

As with other autonomous revenue authorities (ARAs) in the region, TRA’s reform initiatives are strongly focused on achieving state-of-the-art technology. There is nothing inherently wrong with this orientation. However, in any organisation, it poses the challenge of ensuring
that the reforms target strategic priorities. In this regard, for example, the Time Release Studies of 2005 and 2009 pointed out the need for reforms in customs clearance and a risk-based approach to checking of documentation. But according to stakeholders, these reforms are yet to be given due attention. On a more general point of conjecture, it is not obvious that the correct balance has been struck between: expansion of the tax base; compliance; and enforcement.

Building and sustaining management capacity

Some key informants have shared the perspective that TRA is the paragon of excellence among Tanzania’s public sector institutions. There is no doubt that TRA, during its short lifespan, has succeeded in recruiting, developing and retaining well-qualified technical and professional personnel. Some of them have been seconded to key central government institutions, and in particular, the Ministry of Finance and Economic Affairs, and to good effect. Nonetheless, as the TRA management readily acknowledges, the challenge to recruit, retain and motivate high-level professionals persists. This is because, although the TRA staff compensation system is delinked from that of the general public service, it is still sensitive to the evolving gap with the latter. Therefore, the recruitment and retention of specialists in such areas as ICT, accounting and finance, audit, and legal, which are critical for the effective implementation and maintenance of the new systems, remains a challenge.

Minimising corruption in tax collection

An independent external integrity and transparency review, commissioned by TRA in 2007, concluded that the authority was well on its way to ensuring that all the right building blocks are in place to enhance integrity in its organisation and curb unethical behaviour. However, the critical tasks for the authority are to ensure that the systems, policies, regulations and procedures are not only established but filtered down throughout the organisation to be fully functional and effective (PwC, 2007). Nevertheless, the same review concluded that there seemed to be an endemic tax avoidance culture in Tanzania, and some of the TRA officials seem to encourage or fall victim to this culture. Therefore, continuous vigilance on the part of TRA leadership will be crucial in minimising corruption in tax collection.

Ensuring harmonised, systematic and policy-led regional integration measures

Regional integration at both EAC Customs Union level and SADC appears to be predominantly politically-driven initiatives. Evidently, many of the integration measures promulgated by regional political forums have been made before any rigorous assessment of both the feasibility of implementation, and DRM implications. Thus, for example: (i) there is still a lot of haggling over common external tariffs (CETs), which were pronounced on the eve of the EAC Customs Union launch; (ii) there is an absence of clarity on the appropriate classification of manufactured and semi-manufactured goods; (iii) “the value of goods which [qualify] for exemptions and remissions has been growing” (Mugisa, 2009); and (iv) weak and poorly coordinated controls over the rules of origin continue to pose major problems for all the ARAs in the EAC member states. Furthermore, in the case of Tanzania, there is the challenge of both policy and management of its membership in EAC and SADC. As Nord et al (2009) observe: “overlapping memberships in... trade groupings will complicate harmonization; [and] common standards across different regional groupings”.
There is also the issue of exemptions. Although Tanzania is eligible under the EAC Customs Management Act to grant exemptions on import duty to promote infant industries, the value of goods that qualified for exemptions increased in 2006 by 36% to US$1,225.9 million, with an equivalent growth in revenue foregone of US$405.5 million. In this regard, no monitoring mechanism is in place “to ensure that goods benefiting from exemptions are not exported” or that duty is paid in full (Mugisa et al, 2009).
Lessons learned

The previous section highlighted the challenges that GoT and TRA will have to confront in order to sustain the performance of the past decade. The major lessons that are outlined below must be read in that context.

Policy shifts can seriously disrupt revenue collection efforts

In the three years immediately following the introduction of VAT and the abolition of sales tax, revenue collections in Tanzania significantly declined. As previously observed, revenue as a percentage of GDP fell from about 13% in 1997 to about 8.5% in 2002 (see Figure 7.2). Therefore, it is critical to rigorously assess the implications of policy changes.

Participatory tax forums can support effective policy formulation

GoT has adopted a comparatively participatory and transparent process of tax policy formulation. The Tax Forum and Tax Policy Think Tank enable taxpayers a unique opportunity to effectively contribute to policy development. Independent policy think tanks, research institutions and tax advisory services firms are also active in this forum. Therefore, policy development is informed by a wide cross-section of resourceful players. In this regard, for example, civil society, through these participatory forums, contributed to the revision of the Income Tax Act of 2004 and VAT thresholds25

The BMS is highly potent for widening the tax base and tax net

The pilot Block Management System (BMS) initiative in Dar es Salam by TRA was very successful in capturing new taxpayers and evaders (see Section on “Trends in the tax system”). This explains why the decision to roll out the system across the whole country had been taken. This pioneering initiative has attracted the interest of other ARAs in the region.

Comprehensive and in-depth sector studies should inform risk management of tax-based operations

TRA’s comprehensive and in-depth study of the construction, petroleum, wholesale and retail sectors has apparently yielded critical information and knowledge on how to go about risk management of tax-based operations. In the absence of such knowledge, risk management is informed by guess work and therefore can not be fully effective. For this reason, TRA plans to undertake such studies in other areas including the informal sector.
Risk-based profiling of VAT taxpayers for refunds enhances efficiency

TRA has exemplary performance in managing its VAT refunds, with a turnaround of payment within 30 days of lodgement of returns. This performance has been achieved through introduction of taxpayer profiling in the categories of gold, silver and non-gold silver (see Section on “Trends in the tax system”).

Tax incentives and exemptions can negate DRM results

TRA has made impressive gains in institutional capacity building and tax administration reforms. The impact of these reforms is not fully reflected in the outturns of tax effort and performance efficiency measures (see Section on “Domestic revenue performance”).

The main explanation for these shortfalls lies in tax exemptions and incentives.

“Such incentives not only shrink the tax base but also complicate tax administration and are a major source of revenue resource leakage from the taxed economy” (Gupta and Tareq, 2008).

As already pointed out in this paper, exemptions and incentives could account for up to 6% of GDP.

Therefore, in targeting tax efforts, and the outcomes and impacts of tax reforms, it is appropriate to factor in the impact of tax incentives and exemptions.
Annex 7.1: Key informants

Alan Kiula (Mr), Taxpayer Education, Tanzania Revenue Authority
Albert Birnbaum (Mr), First Secretary, Embassy of Denmark
Bohela Lunogelo (Dr), Executive Director, Economic and Social Research Foundation
Christian Karstensen (Mr), First Secretary, Governance/Political Issues, Embassy of Denmark
David Robinson (Mr), Senior Resident Representative, International Monetary Fund
Diana Masalla (Ms), Manager, Taxpayer Education, Tanzania Revenue Authority
Joannes Mally (Mr), Commissioner for Domestic Revenue Department, Tanzania Revenue Authority
Jos Verbeek (Mr), Lead Economist, The World Bank
Mary Ngelela Maganga (Ms), Planning and Modernisation Programme Manager, Tanzania Revenue Authority
Mugisha Kamugisha (Mr), Tanzania Revenue Authority
Otieno Igogo (Mr), Chairman, Tanzania Taxpayers Association
Steven Lee (Mr), Senior Economist, Department for International Development
Tonedeus Muganyizi (Mr), Director of Research and Policy, Tanzania Revenue Authority
Vitalis Mbilinyi (Mr), Assistant Research Fellow, Economic and Social Research Foundation
Annex 7.2: Bibliography

Boex, J. and Martinez-Vazquez, J. (2006); Local Government Finance Reform in Developing Countries: The Case of Tanzania Palgrave Macmillan: New York.


Havnevik, K. (1993); Tanzania: The Limits to Development from Above Motala Grafiska: Motala.


IMF (2003); Fiscal Adjustment in IMF-supported Programs IMF: Washington.


Tanzania Revenue Authority (No date); Annual Report for 1996/97, TRA.
Tanzania Revenue Authority (No date); Annual Report for 2004/05, TRA.
Tanzania Revenue Authority (No date); Annual Report for 2005/06, TRA.
Tanzania Revenue Authority (No date); Annual Report for 2007/08, TRA.
Tanzania Revenue Authority (No date); Half Year Implementation Report of TRA’s Third Corporate Plan for the Period Ending 31st December 2009, TRA 2009.

Treichel, V. (2005); Tanzania’s Growth Process and Success in Reducing Poverty, IMF Working Paper WP/05/35.


Annex 7.3: Selected indicators

Table 1: Tax policy – Maximum marginal tax rates (1999/00 to 2009/10)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>PIT</th>
<th>CIT</th>
<th>VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999/00</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2000/01</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2001/02</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2002/03</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2003/04</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2004/05</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2005/06</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2006/07</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2007/08</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2008/09</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>2009/10</td>
<td>30%</td>
<td>30%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Source: TRA

Table 2: Tax administration costs (2003/04 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Operating cost (TShs)</th>
<th>Operating cost as a percentage of tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003/04</td>
<td>48,125,283,052</td>
<td>3.8%</td>
</tr>
<tr>
<td>2004/05</td>
<td>49,678,317,135</td>
<td>2.9%</td>
</tr>
<tr>
<td>2005/06</td>
<td>66,515,154,779</td>
<td>3.3%</td>
</tr>
<tr>
<td>2006/07</td>
<td>85,859,315,095</td>
<td>3.2%</td>
</tr>
<tr>
<td>2007/08</td>
<td>95,554,407,260</td>
<td>2.8%</td>
</tr>
</tbody>
</table>

Source: Various TRA annual reports

Table 3: Ratio of tax staff per population (TAXSTAFF)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Tanzania’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Low income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXSTAFF</td>
<td>0.05</td>
<td>0.82</td>
<td>0.37</td>
<td>0.20</td>
</tr>
</tbody>
</table>

Table 4: National government revenue, debt and deficit as a percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
<th>Budget deficit before grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991/92</td>
<td>14.1%</td>
<td>-1.7%</td>
</tr>
<tr>
<td>1992/93</td>
<td>10.6%</td>
<td>-9.1%</td>
</tr>
<tr>
<td>1993/94</td>
<td>12.0%</td>
<td>-5.8%</td>
</tr>
<tr>
<td>1994/95</td>
<td>12.5%</td>
<td>-5.9%</td>
</tr>
<tr>
<td>1995/96</td>
<td>13.2%</td>
<td>-4.4%</td>
</tr>
<tr>
<td>1996/97</td>
<td>13.5%</td>
<td>-1.6%</td>
</tr>
<tr>
<td>1997/98</td>
<td>12.2%</td>
<td>-2.9%</td>
</tr>
<tr>
<td>1998/99</td>
<td>11.3%</td>
<td>-3.4%</td>
</tr>
<tr>
<td>1999/00</td>
<td>11.3%</td>
<td>-7.8%</td>
</tr>
<tr>
<td>2000/01</td>
<td>12.0%</td>
<td>-5.3%</td>
</tr>
<tr>
<td>2001/02</td>
<td>11.8%</td>
<td>-5.4%</td>
</tr>
<tr>
<td>2002/03</td>
<td>12.1%</td>
<td>-7.8%</td>
</tr>
<tr>
<td>2003/04</td>
<td>12.9%</td>
<td>-9.1%</td>
</tr>
<tr>
<td>2004/05</td>
<td>13.3%</td>
<td>-11.1%</td>
</tr>
<tr>
<td>2005/06</td>
<td>12.5%</td>
<td>-10.3%</td>
</tr>
<tr>
<td>2006/07</td>
<td>14.1%</td>
<td>-8.9%</td>
</tr>
<tr>
<td>2007/08</td>
<td>15.9%</td>
<td>-6.9%</td>
</tr>
</tbody>
</table>

Sources: Various IMF staff reports

Table 5: Total budgeted tax and non-tax revenue as a percentage of GDP (1991/92 to 2007/08)

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax revenue</th>
<th>Non-tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991/92</td>
<td>12.5%</td>
<td>1.6%</td>
</tr>
<tr>
<td>1992/93</td>
<td>9.5%</td>
<td>1.1%</td>
</tr>
<tr>
<td>1993/94</td>
<td>11.0%</td>
<td>1.1%</td>
</tr>
<tr>
<td>1994/95</td>
<td>11.3%</td>
<td>1.2%</td>
</tr>
<tr>
<td>1995/96</td>
<td>11.3%</td>
<td>1.9%</td>
</tr>
<tr>
<td>1996/97</td>
<td>12.1%</td>
<td>1.4%</td>
</tr>
<tr>
<td>1997/98</td>
<td>11.1%</td>
<td>1.0%</td>
</tr>
<tr>
<td>1998/99</td>
<td>10.1%</td>
<td>1.2%</td>
</tr>
<tr>
<td>1999/00</td>
<td>10.1%</td>
<td>1.2%</td>
</tr>
<tr>
<td>2000/01</td>
<td>10.7%</td>
<td>1.3%</td>
</tr>
<tr>
<td>2001/02</td>
<td>11.0%</td>
<td>1.2%</td>
</tr>
<tr>
<td>2002/03</td>
<td>11.0%</td>
<td>1.1%</td>
</tr>
<tr>
<td>2003/04</td>
<td>11.7%</td>
<td>1.1%</td>
</tr>
<tr>
<td>2004/05</td>
<td>12.2%</td>
<td>1.2%</td>
</tr>
<tr>
<td>2005/06</td>
<td>11.5%</td>
<td>1.2%</td>
</tr>
<tr>
<td>2006/07</td>
<td>13.0%</td>
<td>1.1%</td>
</tr>
<tr>
<td>2007/08</td>
<td>14.7%</td>
<td>1.2%</td>
</tr>
</tbody>
</table>

Source: Various IMF staff reports
In 1996/97 and 1997/98 the sales tax was in force not VAT.

Table 6: Composition of national government tax revenues (1996/97 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Sales tax and VAT</th>
<th>Income tax</th>
<th>Other domestic taxes</th>
<th>Import duty</th>
<th>Excise duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996/97</td>
<td>24.1%</td>
<td>20.2%</td>
<td>15.3%</td>
<td>15.4%</td>
<td>18.1%</td>
</tr>
<tr>
<td>1997/98</td>
<td>24.6%</td>
<td>21.8%</td>
<td>14.3%</td>
<td>14.6%</td>
<td>18.1%</td>
</tr>
<tr>
<td>1998/99</td>
<td>35.6%</td>
<td>21.1%</td>
<td>9.9%</td>
<td>14.2%</td>
<td>13.6%</td>
</tr>
<tr>
<td>1999/00</td>
<td>33.4%</td>
<td>19.8%</td>
<td>8.5%</td>
<td>12.4%</td>
<td>12.6%</td>
</tr>
<tr>
<td>2000/01</td>
<td>37.4%</td>
<td>17.7%</td>
<td>2.6%</td>
<td>11.2%</td>
<td>18.0%</td>
</tr>
<tr>
<td>2001/02</td>
<td>38.4%</td>
<td>19.2%</td>
<td>2.6%</td>
<td>9.2%</td>
<td>18.2%</td>
</tr>
<tr>
<td>2002/03</td>
<td>39.5%</td>
<td>20.4%</td>
<td>2.3%</td>
<td>9.4%</td>
<td>16.4%</td>
</tr>
<tr>
<td>2003/04</td>
<td>38.6%</td>
<td>22.4%</td>
<td>2.3%</td>
<td>9.5%</td>
<td>15.4%</td>
</tr>
<tr>
<td>2004/05</td>
<td>43.1%</td>
<td>24.5%</td>
<td>1.5%</td>
<td>6.3%</td>
<td>14.1%</td>
</tr>
<tr>
<td>2005/06</td>
<td>41.4%</td>
<td>25.9%</td>
<td>1.5%</td>
<td>8.8%</td>
<td>12.9%</td>
</tr>
<tr>
<td>2006/07</td>
<td>33.8%</td>
<td>27.0%</td>
<td>1.4%</td>
<td>9.4%</td>
<td>18.6%</td>
</tr>
<tr>
<td>2007/08</td>
<td>31.7%</td>
<td>26.6%</td>
<td>2.1%</td>
<td>8.8%</td>
<td>19.1%</td>
</tr>
</tbody>
</table>

Source: RRA annual reports

Table 7: Summary of Local Government Finances in Tanzania, FY 2007-08 (in Tanzanian Shillings)

<table>
<thead>
<tr>
<th>Budget item</th>
<th>Annual budget plan</th>
<th>Cumulative outcome</th>
<th>Cumulative outcome (in percent of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own source Revenues</td>
<td>80,136,598,991</td>
<td>79,770,210,999</td>
<td>7.0</td>
</tr>
<tr>
<td>Intergov. transfers</td>
<td>1,305,926,992,865</td>
<td>1,059,226,293,823</td>
<td>92.8</td>
</tr>
<tr>
<td>Local borrowing</td>
<td>895,788,000</td>
<td>2,931,500,708</td>
<td>0.3</td>
</tr>
<tr>
<td>Total revenues</td>
<td>1,386,959,379,856</td>
<td>1,141,928,005,530</td>
<td>100.0</td>
</tr>
<tr>
<td>Recurrent expend.</td>
<td>892,397,359,363</td>
<td>780,268,304,171</td>
<td>75.2</td>
</tr>
<tr>
<td>Development expend.</td>
<td>458,614,929,946</td>
<td>256,746,235,967</td>
<td>24.8</td>
</tr>
<tr>
<td>Total expend.</td>
<td>1,351,012,289,309</td>
<td>1,037,014,540,138</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: PMO-RALG, LGA Finance Statistics, FY 2007/08 (LOGIN)

26 In 1996/97 and 1997/98 the sales tax was in force not VAT.
### Table 8: Summary of Local Own Source Revenues in Tanzania, FY 2007-08 (in Tanzanian Shillings)

<table>
<thead>
<tr>
<th>Budget item</th>
<th>Annual budget plan</th>
<th>Cumulative outcome</th>
<th>Cumulative outcome (in percent of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property taxes</td>
<td>9,111,691,462</td>
<td>5,756,532,158</td>
<td>7.2</td>
</tr>
<tr>
<td>Land rent</td>
<td>1,259,110,907</td>
<td>1,513,956,254</td>
<td>1.9</td>
</tr>
<tr>
<td>Produce cess</td>
<td>17,196,826,621</td>
<td>18,533,415,691</td>
<td>23.2</td>
</tr>
<tr>
<td>Service levy</td>
<td>15,710,711,169</td>
<td>19,049,030,343</td>
<td>23.9</td>
</tr>
<tr>
<td>Guest house levy</td>
<td>1,616,126,009</td>
<td>1,572,255,283</td>
<td>2.0</td>
</tr>
<tr>
<td>Licenses</td>
<td>5,669,251,339</td>
<td>5,400,312,870</td>
<td>6.8</td>
</tr>
<tr>
<td>Fees, permits &amp; charges</td>
<td>13,235,667,166</td>
<td>13,250,323,825</td>
<td>16.6</td>
</tr>
<tr>
<td>Other own revenues</td>
<td>16,337,214,118</td>
<td>14,694,384,575</td>
<td>18.4</td>
</tr>
<tr>
<td><strong>Total own revenues</strong></td>
<td><strong>80,136,598,991</strong></td>
<td><strong>79,770,210,999</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

As a percentage of central government tax revenues: **2.4%**

Source: PMO-RALG, LGA Finance Statistics, FY 2007/08 (LOGIN)

### Table 9: Amount of previous year’s arrears collected as a percentage of total amount of tax arrears at beginning of year

<table>
<thead>
<tr>
<th>Large taxpayers: Amount of previous year’s arrears collected/Total amount of tax arrears at beginning of year</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
</tr>
</thead>
<tbody>
<tr>
<td>49%</td>
<td>15%</td>
<td>33%</td>
<td>83%</td>
<td>100%</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

Source: TRA Annual Reports

### Table 10: CIT and PIT revenue productivity and VAT gross compliance ratio (2008/09)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Tanzania’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Low income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>CITPROD</td>
<td>0.05</td>
<td>0.13</td>
<td>0.09</td>
<td>0.08</td>
</tr>
<tr>
<td>PITPROD</td>
<td>0.08</td>
<td>0.14</td>
<td>0.08</td>
<td>0.07</td>
</tr>
<tr>
<td>VATGCR</td>
<td>27.00</td>
<td>65.48</td>
<td>42.3</td>
<td>38.45</td>
</tr>
</tbody>
</table>


### Table 11: World Bank Doing Business indicators on the tax burden (Tanzania only)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td>Tanzania’s global ranking</td>
<td>-</td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>48</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>172</td>
</tr>
</tbody>
</table>

### Table 12: World Bank Doing Business indicators (2010) on the tax burden (Tanzania vis-à-vis the OECD and SSA)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Region</th>
<th>Tanzania</th>
<th>OECD</th>
<th>SSA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of tax payments a year</td>
<td></td>
<td>48</td>
<td>12.8</td>
<td>37.7</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td></td>
<td>172</td>
<td>194.1</td>
<td>306.0</td>
</tr>
<tr>
<td>Total tax rate as % of profit</td>
<td></td>
<td>45.2%</td>
<td>44.5%</td>
<td>67.5%</td>
</tr>
</tbody>
</table>


### Table 13: Growth of registered taxpayers (2002/03 to 2007/08)

<table>
<thead>
<tr>
<th>Registered for</th>
<th>Total number</th>
<th>Percentage increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>TIN</td>
<td>190,000</td>
<td>259,794</td>
</tr>
<tr>
<td>VAT</td>
<td>13,634</td>
<td>15,320</td>
</tr>
</tbody>
</table>

Source: TRA Annual Reports

### Table 14: Tax gap and tax effort for select EAC countries and South Africa (select years)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Tax revenue (A)</th>
<th>Estimated potential tax revenue (B)</th>
<th>Tax gap (B) – (A)</th>
<th>Tax effort (A)/(B) as a %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>As a % of GDP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kenya</td>
<td>2001</td>
<td>17.8</td>
<td>20.8</td>
<td>3.0</td>
<td>85.5</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>18.6</td>
<td>20.6</td>
<td>2.0</td>
<td>90.5</td>
</tr>
<tr>
<td>South Africa</td>
<td>2001</td>
<td>24.8</td>
<td>26.7</td>
<td>1.9</td>
<td>92.9</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>27.4</td>
<td>27.0</td>
<td>-0.4</td>
<td>101.4</td>
</tr>
<tr>
<td>Rwanda</td>
<td>2001</td>
<td>10.7</td>
<td>20.9</td>
<td>10.2</td>
<td>51.2</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>12.2</td>
<td>21.4</td>
<td>9.9</td>
<td>57.0</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>13.5</td>
<td>22.0</td>
<td>8.5</td>
<td>61.4</td>
</tr>
<tr>
<td>Tanzania</td>
<td>2001</td>
<td>9.7</td>
<td>20.0</td>
<td>10.3</td>
<td>48.5</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.2</td>
<td>20.5</td>
<td>9.3</td>
<td>54.4</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>15.0</td>
<td>20.9</td>
<td>5.9</td>
<td>71.6</td>
</tr>
<tr>
<td>Uganda</td>
<td>2001</td>
<td>10.4</td>
<td>19.2</td>
<td>8.8</td>
<td>54.3</td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.8</td>
<td>19.5</td>
<td>7.8</td>
<td>60.3</td>
</tr>
</tbody>
</table>

Source: IMF (2009b)
Annex 7.4: Changes to the administrative systems at TRA

In 2004/05, TRA developed an information systems policy and strategy to guide its modernisation effort. Since then, TRA has introduced the following information systems:

- The Automated System for Customs Data ++ (ASYCUDA++) in customs for direct trader input. In addition, to support the effective sharing of information and intelligence between the revenue authorities of the EAC, in 2007/08 TRA commenced the implementation of the Revenue Authority Digital Data Exchange system. RADDEX is operational in Kenya, Rwanda and Uganda, and being piloted in Burundi;

- An automated Central Motor Vehicle Registration System (CMVRS);

- ITAX (a bespoke system) in domestic revenue, which has been strengthened and enhanced over the years. ITAX is used for: revenue accounting and reporting; debt management; audit; electronic registration of taxpayers; and more recently, electronic filing (eFiling). In its 2007/08 annual report, TRA reports that it received around 1,500 taxpayers’ VAT returns through the eFiling system. In 2008/09, the total number of electronic submissions rose to around 4,300;

- To support management of its finances and human resource function, TRA uses Epicor and PEODESY systems respectively;

- To manage storage and retrieval of data collected for each of the measures, TRA has developed the TRA Monitoring and Evaluation Database (TRAMED);

- To inform policy analysis and research, a data warehousing system with data from ASYCUDA++, CMVRS, ITAX, Peodesy, and Epicor has been developed.

- All regional offices are able to access systems through an integrated data communication network.

TRA has, in place, a five-year corporate plan with clear goals, strategies and specific balanced scorecard measures of performance. To manage storage and retrieval of data collected for each of the measures, TRA has developed the TRA Monitoring and Evaluation Database (TRAMED). In addition, to inform policy analysis and research, a data warehousing system with data from ASYCUDA++, CMVRS, ITAX, Peodesy, and Epicor has been developed.

---

27 In its 2007/08 annual report, TRA reports that it received around 1,500 taxpayers’ VAT returns through the eFiling system. In 2008/09, the total number of electronic submissions rose to around 4,300.
Chapter 8

Uganda
Summary of Key Findings

Context-Political economy and fiscal legacies

The first two and a half decades of Uganda’s independence in 1962 were marked by political turmoil and war, including the nine-year rule of the dreaded dictator Idi Amin from 1971 to 1979. During that period, economic performance was either dismal or negative. Things, however, began to change for the better after the National Resistance Movement (NRM) regime of President Yoweri Museveni came to power in 1986. Since then, the NRM Government ushered in an era of peace, political and economic reforms, and sustained socioeconomic development. After assuming power, the regime quickly focused on fixing the moribund economy by embracing Structural Adjustment Programmes (SAPs). The programmes’ implementation extended into and dominated the 1990s (AFRODAD, 2007), entailing wholesale economic liberalisation. In return, the regime was lavished with generous assistance by the Bretton Woods Washington twins and its development partners.

From the late 1980s, Uganda entered its current trajectory of macroeconomic and fiscal stability, and poverty reduction. From 1987 to 2000, per capita GDP grew at an average annual rate of just over 3%, and it rose to about 4% in 2001 and 8.7% in 2007/08. According to the IMF (2009a), aggregate economic growth in the past five years has been at a particularly higher rate - approaching an annual average of 9%. Yet, according to the same source, in spite of two decades of steady growth, Uganda’s economy remains more reliant on subsistence agriculture and correspondingly, less on high-productivity manufacturing. It appears that one major obstacle to Uganda’s economic development has been its limited investments in infrastructure in the past.

As elaborated below, DRM in Uganda has clearly lagged well behind both economic growth and far reaching tax administration reform efforts for many years. A review of political economy legacies suggests that despite strong support from the NRM regime for DRM, its leadership may have undermined tax revenue collection through ad hoc decisions relating to tax policies and administration. Also, the tax base remains narrow. Furthermore, “tax morale” is undermined by widespread public perception that public services are predominantly funded with external resources, and a prevailing sense that due to corruption and mismanagement, Government of Uganda (GoU) has not been delivering value for money with resources made available to it.

The commercial production of newly discovered oil reserves, which are projected to commence by 2015, will be the most critical variable in Uganda’s fiscal governance trajectory in the medium-to-long term. Needless to say, oil revenues will vastly enhance domestic resources. This development will, in turn, generate four significant outcomes: (i) whether or not these revenues are managed by the Uganda Revenue Authority (URA), it will impact either positively or negatively on its capacity and performance to collect other revenue; (ii) oil revenues may also serve to reduce Uganda’s reliance on external resources, which will redefine relationship between Uganda and the international development organisations (IDOs), (iii) there is a distinct prospect that new revenue streams will, in all probability, accelerate economic modernisation and poverty reduction; and (iv) availability of this new resource and the concurrent modernisation efforts may, in the long run, dampen the political leadership’s propensity for making ad hoc awards of tax incentives and exemptions. Therefore, barring the unforeseen or the tragedy of the so called “oil curse”, Uganda’s fiscal governance trajectory looks exponential.

Tax reforms: Sequencing, implementation and results

In the early years of independence, Uganda relied on unified tax policies and an administrative system jointly
Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

administered by the three EAC founding members. Following the enactment of the Income Tax Decree No. 1 of 1974, there were no major changes to the tax system until the 1990s and 2000s when GoU:

- Established URA (in 1991) in an attempt to better coordinate tax administration and enhance tax revenue collection;
- Introduced the Value Added Tax (VAT) in 1996 despite popular resistance;
- Promulgated a new Income Tax Act in 1997 with the objectives of levying tax on a residence basis, ensuring simplicity and promoting a flat tax rate scale;
- Abolished export taxes and embarked on tariff reform whose policy objectives evolved around simplification of the tax structure; and
- Introduced major policy changes in the decade up to 2007/08, primarily around VAT and income tax.

A series of administrative reforms took place following the establishment of URA. The reform focus in these early years was on breaking the culture of corruption by screening staff, strengthening URA’s capacity (Fjeldstad, 2005) and, to a limited extent, modernising systems (IMF, 1999). However, corruption remained pervasive, leading to the appointment of an independent inquiry into URA led by Justice Julia Sebutinde in 2002. The inquiry’s report was, however, questioned by Parliamentarians, and quashed by the High Court in 2004 (Fjeldstad, 2005). Still, in 2004/05 GoU appointed a new Commissioner General and Board. Since then the URA has undergone: (i) structural and further institutional reforms; and (ii) a modernisation programme. As part of its post-2005 reforms, structural changes evolved around streamlining URA’s structure, which had become top heavy as well as hierarchical. Thereafter, URA’s management also addressed the problem of staff integrity, and embarked on modernising the agency. Key results under the modernisation phase include:

- Business processes in customs and domestic tax have been reengineered, new procedures drawn up, and staff retrained;
- Certain aspects of URA’s corporate services have been modernised;
- To enhance integrity, a revised staff code of conduct and whistle-blowing policy were developed in 2009;
- URA has disseminated a taxpayers’ charter with clear standards of service; and
- Various publications on tax have been translated into eight languages, and Public and Taxpayer Education services regularly hold tax clinics to obtain feedback on taxpayers’ needs.

It is noteworthy that the post-2005 reforms have focused primarily on tax administration. This is not surprising because Uganda is yet to undertake rigorous and comprehensive research and analysis of the tax system, as was the case with the work of the Katz Commission in South Africa.

Domestic revenue performance

Uganda made considerable improvements in domestic revenue generation in the first seven years following URA’s creation -- with tax and non-tax revenue collections rising by 5.1 percentage points to 11.9% of GDP in 1998/99. The reform of tax administration, as well as introduction of VAT and Income Tax legislation contributed to a significant increase in domestic revenue collections in the late 1990s.

In addition, since 1991/02, non-tax revenues have contributed an average of 7% of total domestic revenue...
collected each year. It is noteworthy that from 2002/03, URA started to collect some non-tax revenues on behalf of ministries and departments including: passport and migration fees; company regulation fees; and mining fees and royalties.

Still, in the current decade, domestic revenue growth has not been as high as anticipated, levelling at 12.8% of GDP in 2007/08; and revenue collections stagnated due to smuggling and tax evasion. The growing level of incentives and exemptions granted in recent years has further undermined Uganda’s revenue potential, which perhaps explains the sizeable tax gap.

Challenges and issues

Considerable efforts have been made to modernise the URA, with a view to realising its vision “to be a model for best practices and innovation in revenue services”. However, the following major challenges will need to be addressed for this vision to be realised and sustained:

- Ensuring efficacy of tax incentives and exemptions: According to some key informants, tax revenue as a percentage of GDP could easily go up to 16%, if some of the revenue negating measures, particularly incentives and exemptions, were removed;

- Widening the tax base: Predominance of a large informal sector outside the tax net, coupled with under declarations, evasion and smuggling, is a big challenge;

- Developing and maintaining capacity for tax policy management: There is a view that more could be done to build and sustain tax policy capacity in Uganda. Key informants proposed that one way of achieving this would be to promote knowledge sharing in the region. Another approach would involve transferring staff between the Ministry of Finance, Planning and Economic Development (MoFPED) and URA;

- Building and sustaining management capacity in URA: Senior managerial positions have fixed term limits. Also remuneration has not been adjusted for senior staff and personnel in professional and technical positions since 2004/05. As a result, URA has not been able to retain institutional knowledge and specialised skills;

- Minimising corruption in tax collection: In 2009, URA was ranked as the second and seventh most corrupt public institution in Uganda, and in the three EAC countries (Kenya, Tanzania and Uganda), respectively (Transparency International, 2009). Furthermore, the URA-commissioned 2008 integrity baseline survey, suggests that corruption is still a daunting challenge; and

- Ensuring harmonised, systematic and policy-led regional integration measures: It is noteworthy that there are demands by Uganda-based businesses to extend the duty exemption period beyond 2010 for importation of key inputs and materials under the Duty Remission Scheme. In addition, Uganda’s tax regime is not fully in sync with the systems in other EAC partner states.

Lessons learned

There are three key lessons that can be drawn from Uganda DRM experience:

- It is crucial to insulate the Autonomous Revenue Authority (ARA) from politics: It would seem that URA’s staff remuneration has been politicised in recent years, and therefore pay has not kept up with packages offered by other organisations in the market seeking to recruit similar skills. Therefore, URA has suffered staff losses in critical areas:
Restructuring, reengineering and automation can facilitate reduction collection cost: Since 1996/97, URA has been able to bring down the cost of collecting tax and non-tax revenues. This reduction in cost of collection demonstrates a key benefit from the restructuring, reengineering and automation initiatives; and

Tax incentives and exemptions can negate DRM results: It is therefore important to quantify, and if significant, reverse the effects of this and other negating factors.

The rest of the chapter is organised as follows: the first section discusses the political economy and fiscal legacies, the second section covers trends in the tax system, the third section explores domestic revenue performance, the fourth section highlights the challenges to increasing DRM, and the fifth section concludes with lessons learned.
Context – Political economy and fiscal legacies

NRM’s drive for economic recovery and liberalisation

The first two and a half decades of Uganda’s independence were marked by political turmoil and war, including a military coup in 1971 that installed Idi Amin in power. His nine-year rule (1971-1979) was considered the worst era, as he “became known as the ‘Butcher of Uganda’” (The Independent, 2003). Thereafter, following the 1979-80 war with Tanzania, Amin was deposed, and the Uganda National Liberation Front under President Binaisa seized power. He ruled for two years and was overthrown by President Milton Obote, who helmed for five years (1980-1985). He too was ousted by a military junta led by the National Resistance Movement (NRM), which seized power in 1986.

The NRM, under President Yoweri Kaguta Museveni, has ruled Uganda ever since virtually unchallenged. Since assuming power, NRM’s 10-point agenda, which until recently was the main ideology behind the movement, placed a strong focus on economic recovery and liberalisation. However, only a year after taking over, NRM embraced the IMF-World Bank prescribed structural adjustment programmes (SAPs) and economic liberalisation policies as it recognised “the need for increased external support” (APRM, 2009). Accordingly, GoU embarked on rebuilding the economy, which had virtually collapsed as a result of prolonged economic mismanagement and wars.

Macroeconomic, fiscal stability and steady growth from the 1980s

“The NRM and President Museveni provided the leadership and governance discipline that helped turn around the fortunes of the country” (Tumushabe, 2009). The regime embraced SAPs, “whose implementation extended into and dominated the 1990s” (AFRODAD, 2007). Under SAPs, GoU liberalised: prices and trade in the domestic market; foreign exchange; and payments. These measures enabled Uganda to diversify its exports. Furthermore, under SAPs, GoU restructured and divested its holdings in private enterprises. It was also able to contain inflation and promote a rise in interest rates through prudent monetary policies (IMF, 1999). In return, Bretton Woods Institutions and its development partners lavished the regime with generous assistance.

By the mid-1990s, Uganda entered into a trajectory of macroeconomic and fiscal stability. From: 1987 to 1996, per capita GDP grew at an annual average rate of 3%; and 1996 to 2000, average GDP per capita remained at around the same level. It is noteworthy that between 2001 and 2007, Uganda’s average GDP per capita rose to around 4%. According to the IMF (2009a), in the last five years, its average annual growth has been almost at 9%.

Between 1990/91 and 2005/06, the structure of Uganda’s economy had undergone significant changes. The services sector overtook the agriculture to become the largest contributor to the economy. Industry’s share in GDP also rose, but since 2001/02 its share in total output has remained flat. Available estimates indicate that the contributions by the three sectors remained at around the same levels in 2009 – agriculture (22.2%), industry (25.1%) and services (52.8%)\(^1\). Selassie (2008) suggests that industry’s contribution could be much higher if more investment had been made in infrastructure – in particular, “cheap and effective infrastructure is a pre-requisite for industrialization”. To this end, GoU is championing the Bujagali hydropower project scheduled to be commissioned in 2011.

Uganda’s economic “growth has contributed to a sharp decline in poverty from 56% of the population in 1992/93 to 31% in 2005/06” (IMF, 2009a). This decline is attribu-

Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

Table to the GoU’s concerted efforts towards combating poverty through the Poverty Eradication Action Plan. *PEAP defines the framework through which [GoU] provides public goods and services needed to support economic growth and development* (GoU, 2004). PEAP was succeeded by a National Development Plan (NDP), covering a five-year period from 2010/11. The plan targets a national growth rate of 8% to 9% a year, and incorporates interventions aimed at rapidly reducing poverty on a sustainable basis. Enhancing the quality of life of disadvantaged and vulnerable groups by financing initiatives in social services and infrastructure forms the core of the plan.

**Development financing mix and challenges**

Figure 8.1 shows trends in the overall development financing mix for Uganda between 1996 and 2008. The three largest sources of financing during the period were gross private savings, exports and domestic revenue. Gross private savings (averaging at 14.6% of GDP between 2002 and 2008) were fairly low, remaining below the Africa benchmark for the post-Monterrey period (after 2002) of 22.1%. This paltry rate of saving is partly attributable to low household income levels and interest rates offered for deposits (World Bank, 2007). However, between 2002 and 2008, savings grew at a fairly rapid rate of 19.9%.

Liberalising Uganda’s economy has facilitated growth of its exports. According to the IMF (2009a), “the volume growth of major export commodities …was either in line or above the average volume growth of world exports”. In 2008 and 2009, Uganda’s largest foreign exchange earnings came from export of coffee, fish and fish products, and tobacco.

On its part, GoU, for most years, has played a proactive role in its dealings with international development orga-
Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

Between 1996 and 2008, official development assistance (ODA) was a significant source of development financing, accounting for an average of 10.7% of GDP. Most ODA financing went towards supplementing domestic resources and debt to finance public expenditure, which hovered around 17.5% to 17.8% of GDP between 1992/93 and 2007/08, except in select years when it rose above 20% (e.g., 23.8% in 2002/03). Through creation of the Poverty Action Fund, Uganda convinced its development partners to provide substantial funding for its socio-development programmes for many years. In addition, Ugandapioneered access to poverty reduction support credits and other substantial support in the decade just ending.

Uganda’s fiscal deficit rose in the early years (e.g., to 11.5% in 2003/04 from 6.5% in 1997/98) due to “the absolute expansion in the size of the government budget”, which was financed largely by external borrowing (Ayoki et al, 2008). However, it is noteworthy that Uganda was a front runner in accessing debt relief under the Heavily Indebted Poor Country (HIPC) initiative. Therefore, the country has not run short of resources to finance its development agenda.

Also, Uganda, to a limited extent, benefited in recent years from foreign direct investment (FDI), which accounted for an average of about 3% of GDP between 1996 and 2008. More recently, the discovery of oil near Uganda’s Lake Albert, is being described as the most important development in recent times with prospects for high FDI flows in the medium term.

Political economy dynamics underpinning DRM

The synopsis of the political economy legacies that have impacted DRM, as presented in the following subsec-

ions (IDOes). Between 1996 and 2008, official development assistance (ODA) was a significant source of development financing, accounting for an average of 10.7% of GDP. Most ODA financing went towards supplementing domestic resources and debt to finance public expenditure, which hovered around 17.5% to 17.8% of GDP between 1992/93 and 2007/08, except in select years when it rose above 20% (e.g., 23.8% in 2002/03). Through creation of the Poverty Action Fund, Uganda convinced its development partners to provide substantial funding for its socio-development programmes for many years. In addition, Ugandapioneered access to poverty reduction support credits and other substantial support in the decade just ending.

Uganda’s fiscal deficit rose in the early years (e.g., to 11.5% in 2003/04 from 6.5% in 1997/98) due to “the absolute expansion in the size of the government budget”, which was financed largely by external borrowing (Ayoki et al, 2008). However, it is noteworthy that Uganda was a front runner in accessing debt relief under the Heavily Indebted Poor Country (HIPC) initiative. Therefore, the country has not run short of resources to finance its development agenda.

Also, Uganda, to a limited extent, benefited in recent years from foreign direct investment (FDI), which accounted for an average of about 3% of GDP between 1996 and 2008. More recently, the discovery of oil near Uganda’s Lake Albert, is being described as the most important development in recent times with prospects for high FDI flows in the medium term.

Political economy dynamics underpinning DRM

The synopsis of the political economy legacies that have impacted DRM, as presented in the following subsec-

ions, is based on Brautigam’s (2008) analytical framework. It consists of five facets: (i) level of economic development and economic structure; (ii) societal factors: culture, values, trust and “tax morale”; (iii) war and taxes: bureaucratic modernisation as a response to threat; (iv) political institutions and tax systems; and (v) taxation and fiscal contract.

The economic structure is predominantly agrarian-driven and hard to tax

In spite of two decades of steady growth, Uganda’s economy “remains more reliant on subsistence agriculture and correspondingly less on high-productivity manufacturing” (IMF, 2009a). Furthermore, as observed in a DIFD (2008) publication:

“Agriculture by nature is difficult to tax, and so far the sector has not made any significant contribution to government revenue. Even with the commercialisation drive that is underway, it is not expected that agriculture can be relied on for tax revenue in near future. There are also views that taxing [farmers] will cripple agriculture (discourage investment) and have disastrous economic fallout for farmers who are already facing hardship”

It appears that one major obstacle impeding Uganda’s economic recovery has to do with limited investments in infrastructure development. In spite of liberalisation, only a few large corporations have invested significantly in the economy. For many years, investments in physical infrastructure were limited to relatively small projects in social services delivery, and rehabilitation and maintenance of the pre-existing energy and transport infrastructure. Large investments in transport, energy, property development, agricultural production and agro-processing have lagged behind for most of the years. Indeed, it is

3 Brautigam’s framework is adopted because compared to others that were examined, it is judged to be more comprehensive and elegant. However, like most others, its historical perspective derives too much from the emergence of the modern European state to be linearly applied to states that are legacies of colonial rule, such as Uganda.

4 Although over 70% of Uganda’s population is employed directly or indirectly in agriculture, in 2009, the services sector contributed close to 50% of GDP.
only in the past five years that substantial investments in energy, mining, tourism and roads have been made. However, Uganda has just entered a threshold of fiscal transformation, following discovery of substantial oil deposits, which have attracted considerable investments in the last few years. Initial oil production is anticipated in 2011, and full commercial potential, and thereby revenue streams for government financing, are expected in 2015. “The country expects to earn US$2 billion a year from oil by 2015” (The Economist, 2010). It is, however, not clear at the moment what the full implications for Uganda’s economic structure and development financing mix will be, given the imminent substantial oil revenues.

A culture of conflict and distrust, which contributes to low ‘tax morale’

Many important facets of traditional culture among Uganda’s diverse communities have withstood the onslaught of western culture. In this regard, it has been suggested that the well-entrenched native culture constrains its transition to consumerism associated with economic development in the same way, as it has been observed in neighbouring Kenya.

As a consequence, many wealthy Ugandans have resisted full entry into the modern monetary system. In other words, a reliance on informal institutions for business transactions remains comparatively high. Furthermore, years of civil war and ethnic tensions have given rise to a culture of conflict and distrust among various communities. For instance, certain sections of the society consider the ruling NRM to be autocratic. In addition, over the past decade, GoU has been intermittently bedeviled by high-profile cases of public expenditure scandals and corruption in the public service. As a result, trust in government, and between communities, is low. This perhaps explains why tax morale in the society is low.

Modernisation of the tax administration was a high priority following the wars that brought NRM to power

In the decade following independence, Uganda benefited from a robust revenue mobilisation bureaucracy, jointly developed by the defunct EAC (1967-1977). The foundations of these structures were inherited from the colonial East African Common Services Organisation. The collapse of the EAC in the late 1970s proved to be disruptive to the development of the revenue administration system. The decade of civil war that followed further exacerbated that disruption.

The final days of the Amin regime were epitomised by his declarations of war against both Kenya and Tanzania. “He clashed with President Jomo Kenyatta after making absurd territorial claims to western Kenya and in 1978 made the mistake of declaring war on Tanzania” (The Independent, 2003). To finance these wars, Amin had strived to enter into alliances with rich Arab regimes, and, to an extent, the then Soviet Union. Therefore, his regime did not give due attention to DRM, and development of an enabling bureaucracy. Therefore, subsequent short-lived regimes, as well as, the NRM did not inherit a viable tax administration.

After its victory, NRM accorded high priority to resource mobilisation aimed at modernising the economy. Also, since the NRM was not democratically elected, the expansion and intensification of basic social services were central to its quest for earning legitimacy among the people. It is therefore no wonder that the NRM

---

5 In a society where “tax morale” is high, there are low levels of tax evasion and avoidance. It is only in a social culture where citizens generally appreciate their responsibility for sustaining state services and where they have a trust in their state institutions and leaders that “tax morale” evolves.
regime was a trail blazer among the countries in the region in establishing the Uganda Revenue Authority (URA), as an autonomous revenue authority (ARA) in 1991, for accelerating rapid growth in DRM.

**Political support for URA’s autonomy has waivered in recent years**

Apparently, the NRM political elite, led by President Museveni, strongly backed the establishment of URA as an autonomous and integrated agency (Fjeldstad, 2005). The NRM leadership collaborated closely with, and took advice, from the Bretton Woods Institutions and the British Government, which provided substantial initial technical support. At that point, there was a general consensus about the need to insulate URA from both bureaucratic and political interference. This explains why two Commissioners General of URA (1991-1997, 2001-2004) were expatriates. In addition, several top management positions were also filled by expatriates and funded by donors. President Museveni is cited to have openly hailed the role of the expatriates in ensuring professionalism of the agency.

However, there were serious distrust and conflict between URA and the top political leadership, including those in MoFPED. When VAT was introduced, URA staff were suspected of encouraging resistance by the general public (Therkildsen, 2004). Subsequently, with an explicit order from the President in 1998, MoFPED moved to curtail the mandate and administrative autonomy of the URA’s Board (Fjeldstad, 2005). Since then, URA has remained prone to close oversight and patronage by the political leadership.

In the latter context, it is also significant that political leadership in Uganda has, over the years, intervened on an ad hoc basis in matters relating to tax policies and administration. In particular, many tax incentives and exemptions have been imposed on URA by political leaders, who have nothing to do with formal tax policy formulation and administration processes.

**There is lack of a fiscal contract between GoU and its citizens**

The opportunities for even a semblance of a fiscal contract between Uganda’s taxpayers and the Government/URA have been severely curtailed in at least three respects. First, so far, the tax base remains narrow, and taxpayers are largely confined to a relatively small number of private sector enterprises, government and importers. The popular resistance to the introduction of VAT in 1996 reflected the absence of a fiscal contract. Yet since then, there is no evidence of any concrete initiatives to develop one. Such an initiative would have to be led by the political leadership.

A second factor is the success of the NRM regime in financing a large proportion of public expenditure with external resources. Over the past two decades, donor support has accounted for about 20% to 50% of the public expenditure budget.

A third factor arises from a prevailing sense amongst taxpayers and potential taxpayers that due to corruption and mismanagement, Government has not been delivering value for money with resources made available to it. According to a publication by the Private Sector Foundation of Uganda (2009), “85% of both taxpayers and professionals believe [low compliance is] …the key cause of low [DRM]… Most respondents… were generally pessimistic [about] how funds are used”. It is no surprise therefore that the Minister of Finance, Planning and Economic Development in her 2009/10 budget speech mentioned the problem of compliance. Specifically, “compliance remains a challenge, as we undertake reforms in tax administration”.

---

6 Fiscal contract has its genesis in agreements between European monarchies and the propertied class and merchants that the latter would contribute to state coffers, especially to fund war in return for specific benefits. In modern times, a fiscal contract would be characterised by government pledges of specific socioeconomic benefits to justify taxation. This is a more realistic proposition in a democratic dispensation.
Fiscal governance drivers, results and trajectory

The NRM regime’s legitimacy has remained predicated more on development results than on liberal democratic ideals. Accordingly, President Museveni has been preoccupied with expanding access to public service delivery (including infrastructure development) and economic modernisation. Thus, on one hand, the demand for ever expanding fiscal space to meet public service delivery targets has been sustained over the years. On the other, the President is personally involved in the extensive award of tax incentives and exemptions to potential investors on an ad hoc basis (Mwenda and Atuhaire, 2006); (Sseppuya, 2005)). Fortunately for Uganda, external resources have been available to close the financing gap in successive years.

The persistent large gap between domestic revenues and the public expenditure framework has given ample room for IDOs to exercise considerable influence in Uganda’s fiscal governance. For example, according to Therkildsen (2004), in addition to their involvement in economic policy:

“Donors’ fingerprints on tax policy and administration are obviously numerous and deep... [they] participate in setting revenue targets...[This involvement] has [forced] URA to concentrate on the larger known taxpayers”.

Ayoki et al (2008) suggest that “high levels of development aid [could] be a... disincentive to making full use of domestic resources for revenue generation”. The recent African Peer Review Mechanism (APRM) (2009) report on Uganda is another source that confirms that excessive reliance on external financing is an important fiscal governance driver in Uganda in that it “impinges on the sovereignty of the country and constrains its economic budgetary choices”. This concern has been previously raised by Uganda’s Members of Parliament, prompting GoU to initiate a reduction in aid contributions to its budgets, and ambitious targets to grow domestic resources.

The discovery of oil has injected a new dynamic into Uganda’s fiscal governance. Already, there is clamour for control or influence on access and use of the oil revenues. Also, aspirations for the rapid growth in public service delivery and poverty reduction have been considerably raised by the prospect of oil wealth – “Oil executives and loyalists of Uganda’s President...say the bonanza offers a chance to overhaul the country’s rickety infrastructure and to train a professional workforce” (The Economist, 2010). As the IMF (2009a) observes, there is a case for fiscal restraint to curtail pressure to spend when GoU starts to receive revenues from oil. Therefore, to counter this risk “a specific line on oil will be introduced in the National Accounts and incorporated into the Medium Term Fiscal Framework”.

The management of the imminent substantial oil revenues will be the most critical variable in Uganda’s fiscal governance trajectory in the medium-to-long term. There appears to be little doubt that in five years time, these revenues will vastly enhance domestic resources. This development will, in turn, spawn four major outcomes. First, whether or not these revenues are managed by URA will impact either positively or negatively on its capacity and performance to collect other revenue. Second, oil revenues may also serve to reduce Uganda’s reliance on external resources. As a consequence, relationship between Uganda and IDOs will be redefined. Third, there is a distinct prospect that new revenue streams will, in all probability, accelerate economic modernisation and poverty reduction efforts. Fourth, availability of this new source of resources, and the concurrent modernisation efforts may, in the long run, dampen the prevailing propensity of political leaders to make ad hoc awards of tax incentives and exemptions7.

Therefore, the fiscal governance trajectory for Uganda holds a lot of promise.

7 There is a view that the discovery of oil could, in the short term, lead the scaling-up of exemptions (through concessions).
Trends in the tax system

Changes in tax policies over the years

In the early years of independence, Uganda relied on unified tax policies and an administrative system jointly administered by the three EAC founding members. However, there were changes even before the collapse of the EAC. In 1971 and 1972, the three governments held discussions “on how to improve income tax collection in a manner equitable” to all, leading to a decision to “place the responsibility of income tax in the hands of each national government” (Osoro, 1993). As a consequence, Uganda legislated its own Income Tax Decree No. 1 of 1974 “which [over the next twenty years] was frequently and extensively amended” (Holmes, 2006). There were no major changes to the tax laws until the 1990s. Thereafter, there were two main episodes in tax policy reforms as presented below.

Fundamental changes to tax policy in the 1990s

Despite popular resistance, Uganda was one of the first EAC countries to introduce VAT in July 1996 at a rate of 17%, replacing the sales tax and commercial transaction levy (CTL). According to the IMF (1999), copies of the sales tax and CTL legislation were in limited supply. Furthermore, legislation had undergone numerous amendments, and only a few were conversant with their requirements. The new VAT law: was “generally easier to understand and interpret, [and therefore] huge strides were made to help compliance and improve transparency”; and curtailed the Finance Minister’s power to grant exemptions on a discretionary basis (IMF, 1999). Under the Act, certain supplies were VAT exempt (e.g., milk, maize, dental, medical, financial and insurance services, passenger transportation etc.).

It was not until 1997 that the GoU promulgated a new Income Tax Act with the objectives of levying tax on a residence basis, ensuring simplicity and promoting a flat tax rate scale (Holmes, 2006). Again, this new act cut the Minister’s power to grant discretionary exemptions. It also: provided for accelerated and simplified depreciation allowances on productive assets; removed tax holidays offered under the investment code; introduced a presumptive tax for businesses with a turnover of less than UShs50 million; eliminated exemptions (e.g., for public servants and parastatals) and/or made them more stringent; introduced a capital gains tax on certain business transactions; and streamlined the withholding tax regime (IMF, 1999).

During the 1990s, as a means of promoting trade, GoU gradually abolished export taxes (Cawley and Zake, 2010). It also embarked on tariff reform whose policy objectives evolved around simplification of the structure, reducing the number of rates, removal of exemptions and elimination of bans on importation of certain goods (e.g., cigarettes, beer, sodas etc.). “However, as import duty rates were being lowered, ad valorem excises were imposed…with the dual objective of allowing some degree of protection” for local firms and recouping revenue foregone (IMF, 1999).

Major tax policies from 2000 to 2008

The major tax policy changes in the decade until 2007/08 have primarily evolved around VAT and income tax. During this period, the main policy changes around VAT were the following:

- To encourage development of Information and Communications Technology (ICT) services, GoU removed VAT on computers and computer software in 2002/03 and 2003/04 respectively;
- To minimise any revenue leakages arising from tax evasion, a new rule, requiring GoU to only issue contracts to suppliers who are VAT registered, became effective in 2002/03;
• To widen tax base: accommodation in hotels and tourist venues, which were previously exempt from VAT, became taxable at the standard VAT rate from 2003/04;

• In 2004/05, the VAT Act was amended to exempt constructors of roads and bridges, and providers of consulting services to such construction works. This had the effect of reducing prices charged to GoU for road construction, as there was no longer any VAT element;

• In line with GoU’s deliberate policy of increasing the proportion of national budget that is financed by domestic revenue, the standard VAT rate went up to 18% with effect from 1 June 2005;

• In 2006/07, GoU zero rated VAT on Liquid Petroleum Gas to increase its affordability, given its use as an alternate energy source for lighting and cooking. To promote use of condoms in the fight against HIV/AIDS and animal husbandry, GoU also exempted contraceptive sheaths and acaricides; and

• To promote tax morality and enhance revenue collections, GoU in 2007/08 also offered non-compliant taxpayers an amnesty on penalties and interest for principal taxes (i.e., under the Customs and Excise, Income Tax, VAT and Stamps Acts). Taxpayers were required to voluntarily disclose and pay their taxes by 31 December 2007.

The major changes to income tax policy since then include the following:

• In 2001/02, to widen the tax base, interest payable on Treasury bills became taxable. Likewise, to promote development of a stock exchange, expenses relating to initial public offerings became an allowable tax expense;

• In 2003/04, to promote exports, GoU indicated it would provide firms operating in export processing zones with various incentives such as a 10-year corporate tax holiday, duty exemption on raw materials, plant and machinery and other inputs;

• In 2005/06, to expand access to finance, interest earned by financial institutions on loans granted to persons engaged in the agriculture sector was exempted from income tax; and

• The tax amnesty of 2007/08 also covered income tax. Also, to promote exports and thereby stimulate economic growth in 2007/08, GoU offered various incentives, including a 10-year tax holiday to companies engaged in value added exports, which is limited to export of finished consumer and capital goods.

Changes in customs policies and administration have been driven by the EAC Customs Management Act of 2004, which underpins the establishment of common external tariffs (CETs) and elimination of internal tariffs. It also brought about the harmonisation of customs principles and procedures, and removal of suspended duty.

Excise duties are regulated under the Excise Management Act of 1970. The duties are levied on beer, wines, spirits, soft drinks, cigarettes and fuel, which are manufactured in or imported into Uganda, as well as mobile airtime. Over the years, there have been modest increases and decreases in the rates levied on certain goods and services.

**Institutional changes**

URA was the second revenue authority to be established in Africa in 1991, following the enactment of the URA Act, Cap. 196. URA’s creation was “an attempt to integrate central government taxes under one manage-
ment, and to improve revenue collection through enhanced autonomy, acquisition of skilled staff, increased integrity and effective use of automated systems” (Ayoki, 2008). Since its launch, URA’s operations have been financed by Parliamentary appropriations.

The Authority is led by a Commissioner General who reports to a Board of Directors. The Board “is [URA’s] policy-making body and has general oversight” responsibility, and is accountable to the Minister of Finance. MoFPED sets URA’s revenue targets on an annual basis.

Following a restructuring of the URA in 2004, six departments have been created, which oversee the day-to-day operations: (i) the Commissioner General’s office, which, in addition to maintaining executive control, is charged with managing research and planning, and corporate and public affairs; (ii) Board and legal affairs; (iii) collecting and accounting for international trade taxes; (iv) registration, audit, assessment, collection and accounting for domestic revenues; (v) provision of various corporate services (e.g., finance, administration, human resources, ICT); and (vi) internal audit and tax investigations. Also, URA has a training school, which conducts both technical as well as ICT courses.

**Changes in the administrative systems**

URA employs around 2,000 staff. Under the Act, it has the freedom to pay its staff competitive salaries. At its launch, “substantial salary increases to staff that moved to the URA meant that they were relatively well paid to start with – by a factor of 8 to 9 – compared to most public-sector employees” (Therkildsen, 2004). Also, “bonuses as a percentage of their salaries were a potential lure when URA exceeded tax collection targets, but this was only done once, with a 10% bonus in 1998/99” (Robinson, 2004). Furthermore, there have been no substantial salary increments for managerial staff since 2004/05.

The development of URA’s administrative systems has been guided by a tax modernisation initiative (see Section on “Reform sequencing, implementation and results”). The systems that are now operational (also see Annex 8.4) include:

- A bespoke developed Integrated Tax Administration System (eTax) in the Domestic Tax Revenue Department covering all taxes and non-tax revenues collected by URA. The eTax’s functionality was recently extended to cover electronic filing (eFiling) and payments;
- The Automated System for Customs Data ++ (ASYCUDA++) for direct trader input so that importers can lodge declarations from their bases. Further, to support effective cargo tracking between the revenue authorities of the EAC, URA has implemented the Revenue Authority Digital Data Exchange (RADDEX) system;
- URA has also recently introduced a call centre with a toll free line, which operates on weekdays and responds to any queries lodged at the authority’s new interactive website (http://ura.go.ug/ura-web/index.jsp); and
- URAnet for internal communications among staff.

**Fiscal decentralisation and taxation by local governments**

Uganda was widely seen as one of the forerunners of decentralisation in Africa during the 1990s. Decentralisation in Uganda is based on the devolution of powers, functions and responsibilities to popularly elected local
Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration

Governments. Devolution is not only aimed at the current 112 districts in the country (as of August 2010), but also at the sub-county and other sub-district levels (including village). Local governments are assigned responsibility to deliver key social and economic services, including primary and secondary education; public health; agricultural extension; roads; and water and sanitation. Corresponding with the importance of the functions assigned to them, local governments receive almost one-third of the country’s public financial resources (Bitarabeho, 2008; Ministry of Local Government 2009).

In principle, local governments in Uganda are highly autonomous. In practice, however, they are constrained by inadequate resource discretion and administrative re-centralisation. Own source revenues have declined considerably over the past 10 years, in large part due to the abolition of the main local revenue source—the graduated tax. As a result, local governments now receive 90% of their resources in the form of intergovernmental fiscal transfers, overwhelming majority of which are in the form of conditional grants.

Available local revenue data indicate that own source revenues for the district level (excluding sub-country revenues) have decreased not only in relative terms, but also declined considerably in nominal terms—from UShs80.1 billion in 2003/04 to UShs39.5 billion in 2006/07 (Steffensen 2008). The main contributing factor to the drop in local revenue collection was the abolition of the graduated tax on 1 July 2005. Also, the rest of Uganda’s local government revenue system has been performing poorly, in part due to the tax structure; for instance, the many tax exemptions in the property rates have added to the funding gaps amongst the urban authorities (Steffenson 2008).

A new Local Service Tax (LST) and Local Government Hotel Tax (LGHT) system was adopted in FY 2008/09, but implementation of these new revenue sources has been stymied by numerous technical and political obstacles. Even when fully implemented, the revenue yield from these new sources is expected to be limited compared to the graduated tax system. A Local Government Finance Commission survey in 2009/10 established that local governments collected UShs4.8 billion from LST and LGHT in 2008/09 compared to the projected UShs67 billion that the taxes were estimated to contribute to local government revenues annually. Reforms sequencing, implementation and results

A series of administrative reforms took place following the establishment of URA. The reform focus in the early years was on breaking the culture of corruption by screening staff, strengthening URA’s capacity (Fjeldstad, 2005) and, to a limited extent, modernising systems (IMF, 1999). However, corruption remained pervasive, leading to the appointment of an independent inquiry into URA led by Justice Julia Sebutinde in 2002. The inquiry report was, however, questioned by Parliamentarians, and quashed by the High Court in 2004 (Fjeldstad, 2005). Still, in 2004/05, GoU appointed a new Commissioner General and a Board. Since then, URA has undertaken two measures involving: (i) structural and further institutional reforms; and (ii) a modernisation programme.

Sequencing and implementation of reforms

As part of its post-2005 reforms, structural changes evolved around streamlining URA’s structure, which had become top heavy as well as hierarchical (the new structure is described in Section on “Institutional changes”). Thereafter, URA’s management also continued to address the problem of staff integrity. In particular, in 2006, it launched an Integrity Enhancement Programme (IEP), which: introduced an internal process for investigating reported cases of misconduct; sensitised staff on ethics; and instituted a code of conduct.

9 Whereas previously, the Chief Administrative Officer was appointed by the District Service Commission, the appointment and supervision of CAOs was re-centralised by the central government during the Constitutional reforms adopted in July 2005.
From 2006, URA’s reforms are specified in its ‘Modernisation Plan’, covering the period from 2006/07 to 2009/10. The reforms have received support (US$15 million) from development partners, including: Belgium; China; DANIDA; DFID; IMF; JICA, Netherlands; SIDA; and the World Bank. The modernisation programme is comprehensive, and seeks to achieve the following 10 objectives (URA, 2009):

- a strategy development process backed by a disciplined “plan-implement-monitor-review” cycle to ensure achievement of results;
- User-friendly, simplified, cost effective and transparent processes;
- Quality client service characterised by open, responsive and proactive customer care programmes;
- a dynamic organisational structure that adapts to operational demands;
- a highly skilled and motivated workforce committed to delivering highest professional standards;
- Application of ICT and other productivity tools in a manner that integrates people, process and technology for greatest value;
- a safe and healthy working environment;
- a regulatory and policy framework that supports continuous improvement;
- Use of analytical tools and other modern management techniques to enhance compliance and minimise resource wastage; and
- a corporate culture across all levels of URA that values service excellence.

Substantial modernisation reforms have been completed. Key results under the modernisation phase include:

- Business processes in customs have been reengineered, new procedures drawn up, and staff retrained. ASYCUDA++ and RADDEX are functioning (see Annex 8.4);
- Business processes in domestic tax have been reengineered, new procedures drawn up, and staff retrained. The eTax system is in operation (see Annex 8.4), however, work is ongoing to extend its functionality (e.g., to cover audits, refunds, investigations etc);
- Certain aspects of URA’s corporate services have been modernised. For example, URA has a corporate plan in place. M&E of the plan is supported by the corporate scorecard system (see Annex 8.4);
- To enhance integrity, a revised staff code of conduct and whistle blowing policy were developed in 2009. Furthermore, URA is proactive in communicating issues centering on integrity both internally and externally;
- URA has disseminated a taxpayers’ charter with clear standards of service; and
- To improve access to information, various literature on tax have been translated into eight languages. Further, Public and Taxpayer Education services regularly hold tax clinics to obtain feedback on taxpayers’ needs.

It is noteworthy that the reforms pursued by URA have been primarily administrative in nature. In other words, they have been short on policy innovations and prescriptions. This is not surprising because there is apparently no rigorous and comprehensive research and analysis of the tax policy environment and system, such
as the Katz Commission work in South Africa, which lasted for five years. This may in part explain the minimal impact of the reforms on tax revenue as a percentage of GDP, tax effort and tax gap (see Section on “Tax administration benchmarks”).

Furthermore, while URA’s reforms were, in general, administratively comprehensive, they were neither focused nor driven by specific performance outcomes, such as improved enforcement and a wider tax base. “The main focus was on meeting revenue targets and not enough was done to embed non-revenue performance objectives and indicators” (Cawley and Zake, 2010). Excessive tax exemptions may also have significantly cancelled out the prospective impact of the reforms on tax revenue performance. In addition, Ndulu et al (2007) attribute a slow growth in tax revenue in both Uganda and Tanzania as a percentage of GDP to emanate “chiefly from fiscal corruption”.
Domestic revenue performance

Figure 8.2: Tax and non-tax revenue as a percentage of GDP (1991/92 to 2008/09)

Source: Various IMF staff reports. Also see Table C4 in Annex C

Domestic revenue performance trends

In 1991/92, when URA was established, domestic (tax and non-tax) revenue as a percentage of GDP was 6.8% (IMF, 1997). The reform of tax administration, as well as the introduction of VAT and Income Tax legislation contributed to a significant increase in domestic revenue collections in the late 1990s. By 1998/99, total domestic revenue as a percentage of GDP stood at 11.9% (see Figure 8.2). In addition, since 1991/92, non-tax revenues have accounted for an average of 7% of total domestic revenue collected each year. It is noteworthy that from 2002/03, URA started to collect some non-tax revenues on behalf of ministries and various departments including: passport and immigration fees; company regulation fees; and mining fees and royalties. Immigration fees registered the highest growth between 2002/03 and 2007/08, averaging 33.5% a year. Still, in the current decade, domestic revenue growth has not been as high as anticipated, levelling at 12.8% of GDP in 2007/08.

The lower-than-expected growth in domestic revenue as a percentage of GDP is explained by five main factors. First, it is claimed that a large chunk of the informal sector falls outside the tax net. “It is estimated that the 35 highest tax payers in the country alone account for about 50% of all tax revenue, an indication of how narrow the tax base is in the country” (Sennoga et al, 2009). Second, there is a common view that tax evasion in Uganda is widespread, and is “a serious constraint to Uganda’s ability to raise resources” (Matovu, 2008). Third, smuggling of various products has also contributed to revenue leakages (Cawley and Zake, 2010). Fourth, “the slowing of revenue growth is partly explained by the erosion of institutional autonomy… and deficiencies in URA’s governance and management structures” (Robinson, 2004). Fifth, the growing level of exemptions, given by GoU to businesses over the years, has negated any DRM effort. Many exemptions appear to “have been granted in an ad hoc fashion over the past years” (IMF, 2010); and with no specific deadline or details about who they apply to (see Section on “Tax administration benchmarks”).
It is therefore not surprising that Uganda is still heavily reliant on revenue from international trade taxes (e.g., import and excise duties, especially on petroleum imports). Table 6 (see Annex 8.3) indicates that whilst the proportion of customs and excise revenue as a percentage of total domestic resources fell from 53% in 1996/97 to 36% in 2007/08, it still remains the largest revenue source. Nonetheless, it is significant that since its introduction in 1996/97 until 2007/08, VAT revenue (the second largest revenue source) grew at an average annual rate of 16.3%. In the initial years, increase in VAT revenue was attributed to the “entry into the Uganda market of a number of international telecommunications and supermarket operators – large payers with more transactions – and some administrative improvements” (Cawley and Zake, 2010). However, according to the same authors, there was scope for further expansion of the VAT base if GoU had not extended the number of items eligible for exempt or zero rating status.

Likewise, by 2007/08, inland revenue (PAYE, corporate income and local excise taxes), the second largest source, comprised almost 30% of total revenues collected by the URA, a marked increase from its contribution in 1996/97 of 17%. Throughout the period, PAYE was the largest contributor to inland revenue (accounting for almost 50% in 2007/08), growing at an average annual rate of 29% between 1996/97 and 2007/08 despite reduction in tax rates (see Annex 8.3: Table 1). This uptick is due to: economic growth, especially in the manufacturing and service sectors, which led to an increase in formal employment; the fact that all government employees began to make PAYE contributions from 1998/99; and “improvements in tax administration and compliance” (Cawley and Zake, 2010). Corporate tax contributions constituted 12% and 20% of inland revenues in 1996/97 and 2007/08 respectively, and grew at an average rate of 30%, due partly to expansion of the telecommunications and banking sectors.

Another tax policy that proved to be a success was the tax amnesty offered by GoU in 2007/08. The amnesty not only registered new taxpayers but it also realised UShs41 billion (about US$18 million) from voluntary disclosures. To further encourage entities to clean up their books, in 2008/09, the Minister of Finance proposed to write off arrears of duty and tax relating to the principle, interest and penalties that had accrued up to 30th June 2002. The rationale for this proposal was to encourage taxpayers to start from a clean slate. Also, it was in line with the Income Tax Act, which dictates URA that it cannot go beyond five years back in its audit coverage.

**Tax administration benchmarks**

**Performance efficiency**

**Cost of collection.** Between 1995/96 and 2007/08, the average cost of collection as a percentage of total domestic revenues was 3.4% a year. The tax collection cost has been on the decline since 1995/96, except in years when URA had incurred high capital expenditures (e.g., in 2003/04, when it procured heavy duty scanners for the Customs and Excise Department) (see Annex 8.3: Table 2). However, between 1995/96 and 2007/08, tax administration costs grew at an average annual rate of 15.1%.

**Organisational structure.** URA is organised along functional lines. It established a large taxpayers’ office (LTO) in November 1998. The LTO currently serves 667 large taxpayers. In 2008, they constituted 1% of the entire taxpayer base, but contributed 72% of tax revenues. 10

**Ease of paying taxes.** Uganda has the second best rating among the EAC countries (after Rwanda), in terms of the World Bank’s Doing Business Ranking with respect to ease of paying taxes – ranking 61st out of 183 countries in 2010. It is a marked improvement from...
According to the World Bank’s 2010 Paying Taxes report, a company is required to make 32 payments a year, which are below the SSA average of 37.7, but above the OCED average of 12.8 (see Annex 8.3: Table 11).

**Tax arrears.** URA reports that tax arrears at the end of 2007/08 were UShs162 billion (or 4.8% of total revenues). Key informants indicate that tax arrears increased by 439.8% between 2006/07 and 2007/08, due partly to the zealous charging of penalties by some URA officers. URA is addressing this issue to ensure that penalties are only levied when warranted. Also, in 2006/07, GoU wrote off tax arrears of UShs120 billion, arising from Government’s commitment to pay tax on donor-funded projects.

**Tax compliance.** Uganda has a very low VAT gross compliance ratio (VATGCR) of 26.50, compared to World and SSA averages of 65.48 and 38.45 respectively. This low rate may be due to the significant number of exemptions. From an economic efficiency perspective, a moderate VAT rate with a broad consumption base and few exemptions is always preferred to a high rate with many exemptions. Cawley and Zake (2010) also indicate that VATGCR has remained low because “administration capacity and compliance did not improve as much as expected”.

Further, Uganda’s corporate income tax revenue productivity (CITPROD) and personal income tax productivity (PITPROD) measures of 0.03 and 0.11 respectively, indicate that Uganda uses these taxes less efficiently in generating revenue than World averages of 0.13 and 0.14, respectively. The low revenue yields are partly attributable to low levels of voluntary compliance by taxpayers.

**Allocative efficiency**

Between 1991/92 and 1997/98, corporate tax collection levels were reduced as a result of the investment code, which was subsequently abolished and replaced with depreciation and tax allowances (e.g., for depreciation). Furthermore, there have been various exemptions offered over the years, such as the 10-year tax holiday introduced in 2007/08 (see Section on “Changes in tax policies over the years”). Although the associated loss in tax revenues has not been determined through rigorous study, key informants suggest Uganda could be foregoing revenue of at least 2% of GDP due to such incentives and exemptions.

**Performance equity**

The World Bank’s 2010 Paying Taxes report indicates that the ‘total tax rate’ as a percentage of profit of

<table>
<thead>
<tr>
<th>Households</th>
<th>Income tax (UShs millions)</th>
<th>Total income (UShs millions)</th>
<th>Total collected %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural farm</td>
<td>50,106</td>
<td>4,695,186</td>
<td>1.07%</td>
</tr>
<tr>
<td>Rural non-farm</td>
<td>33,670</td>
<td>954,396</td>
<td>3.53%</td>
</tr>
<tr>
<td>Kampala metro</td>
<td>234,007</td>
<td>1,249,676</td>
<td>18.73%</td>
</tr>
<tr>
<td>Urban farm</td>
<td>35,768</td>
<td>882,176</td>
<td>4.05%</td>
</tr>
<tr>
<td>Urban non-farm</td>
<td>41,706</td>
<td>711,087</td>
<td>5.87%</td>
</tr>
</tbody>
</table>

Source: Sennoga et al (2009)

12 www.cabri-sbo.org/ [Accessed 7 July 2010].
35.7% is significantly lower than the OECD average of 44.5% and the SSA average of 67.5%. Furthermore, a study by Matovu et al (2009) intimates that PAYE rates are relatively progressive for most individuals – “this perhaps explains why PAYE is one of the taxes where government collects a lot of revenue”. However, another study by Sennoga et al (2009) reports that the highest PAYE burden falls on households based in Kampala, suggesting there is scope to spread the burden by taxing households, which are based upcountry and in rural areas, in particular those engaged in profitable economic activities (see Table 8.1).

It is also noteworthy that the PAYE threshold has been stagnant at UShs130,000 (US$ 57) per month for over 10 years, suggesting that GoU has not taken into account the inflationary effects on wages for low-income workers. As a result, low- and fixed-income earners are unlikely to be able to save. At the same time, tax rates by bracket are progressive up to a relatively low threshold of UShs410,000 (US$182) per month (after which income tax is levied at a flat rate of 30%).

In addition to PAYE, low-income earners are also burdened with VAT, which was adjusted upwards by 1 percentage point in 2005 to 18%. However, many basic items and services are zero rated (see Section on “Changes in tax policies over the years”). Furthermore, excise duties are highest for cigarettes (130%), beer (60%) and spirits (45%), which reflect the health risks and social costs associated with their consumption. High tax rate for such items is common in many countries as it is argued that there is merit and considerable scope for collecting additional tax revenue to cater for externalities.

Another indicator of the tax burden for corporate taxpayers (i.e., time taken to comply with major taxes) suggests that Uganda’s tax system promotes equity. In this regard, the 2010 World Bank paying taxes survey indicates, the time taken by companies in Uganda to comply with major taxes is 161 hours, which is much lower than the OECD and SSA averages of 194.1 hours and 306.0 hours respectively (see Annex 8.3: Table 11).

**Performance effectiveness**

URA’s performance effectiveness is comparatively low in terms of both tax effort and tax gap (see Annex 8.3: Table 13). At 60.3%, in 2005, Uganda’s tax effort was well below Kenya (90.5%), but better than those of Rwanda (57%) and Tanzania (54.4%). However, its tax effort increased by 6 percentage points between 2001 and 2005. During the same period, Uganda also managed to reduce its tax gap by 1 percentage point – to 7.8% of GDP. Still, there is considerable scope to further reduce the tax gap.

URA has been proactive in soliciting feedback on its performance with a view to improving tax administration effectiveness. Feedback on perceptions about service delivery, and the integrity of URA, appears to have been of particular importance in recent years. An independent integrity survey of 444 taxpayers, commissioned by URA in 2008, confirms views expressed in the literature, and by key informants on revenue performance (RDC, 2009). For example, “tax evasion in general was perceived to be a major problem in tax collection”.

**Summary of overall trends**

Uganda achieved considerably improved levels of domestic revenue in the first seven years following establishment of URA - with tax and non-tax revenue collections rising by 5.1 percentage points to 11.9% of GDP in 1998/99. Much of this increase is attributable to economic growth following years of conflict, and effective collection measures by URA. However, in subsequent years, revenue collections stagnated as a
result of smuggling and tax evasion. The growing level of incentives and exemptions granted in recent years has further undermined Uganda’s revenue potential, which perhaps explains the sizeable tax gap.
Challenges and issues

An introduction to the challenges and issues

The section on “Trends in the tax system” sought to demonstrate the considerable efforts that have gone into modernising the tax system in URA with a view to realising its vision “to be a model for best practices and innovation in revenue services”. However, major challenges will need to be addressed for this vision to be realised and sustained. These challenges and issues are discussed in this chapter.

Ensuring efficacy of tax incentives and exemptions

According to some key informants, tax revenue as a percentage of GDP could easily go up to 16%, if some of the revenue negating measures, particularly incentives and exemptions, were removed. GoU has drawn up “a register of all existing incentives and exemptions…their cost [computed]—in terms of lost revenue—and net economic impact quantified” (IMF, 2010). It is anticipated that GoU will abolish unproductive tax expenditures from 2010/11. The elimination of non-value adding incentives and exemptions will, however, demand the resolve and commitment of Uganda’s political leadership.

Widening the tax base

The predominance of a large informal sector outside the tax net, under declarations, evasion and smuggling are challenges that commonly arise in the literature and discussions on Uganda’s tax system. The problem of smuggling is being addressed through measures such as heightened intelligence (e.g., RADDEX), and introduction of customs clearance facilities at specific border points. However, issues surrounding the informal sector, under declarations and evasion are best addressed through one or more of the following: (i) a mechanism to quantify the size of the informal economy; (ii) enforcing compliance; (iii) availability of a functioning land registry system, which provides URA with third party information; and (iv) introduction of a national ID system. Of these options, development of a land registry system is ongoing under a World Bank-financed Private Sector Development Project. In addition, there are indications that the national ID project is back on track.

Developing and maintaining capacity for tax policy management

In light of the weak tax reform mechanism and functions, there is a view that more could be done to build and sustain tax policy capacity in Uganda. Key informants proposed that one way of building and sustaining this capacity would be to promote knowledge-sharing in the EAC region. Another approach would include transfer staff between MoFPED and URA. But when this approach was trialled in the past, large differences in salaries between the two institutions created a problem in terms of motivation. In this regard, an anonymous source at MoFPED said:

“The salary disparities paid by the same government to its workers is creating discontent among the lowly paid workers in the civil service, although they do almost the same work and are equally qualified. According to this source, there is no justification in paying workers in statutory bodies higher salaries (which are nearly 70% higher) compared to their counterparts working in ministries” (Habuti and Masinde, 2009).
Building and sustaining management capacity in URA

There are two potential obstacles to building and sustaining management capacity in URA. First, the positions of Commissioner General, Commissioners and Assistant Commissioners have fixed term limits, which bar incumbents from serving any longer. There is therefore a danger that specialised skills and institutional knowledge are lost each time such staff depart from the organisation. Second is the issue of remuneration, which has not been adjusted for senior staff and personnel in professional and technical positions since 2004/05. As some key informants indicated, this perhaps explains why URA has been unable to retain specialised skills in such areas as ICT and audit. It is worth noting here that although URA salaries are perceived to be higher than those offered to public servants, they often lag behind the private sector. As such, URA skilled staff often get lured to the private sector.

Minimising corruption in tax collection

In 2009, URA was ranked as the second and seventh most corrupt public institution in Uganda, and in the three EAC countries (Kenya, Tanzania and Uganda) respectively (Transparency International, 2009). URA “was the only tax authority in the region to appear among the top five institutions in their respective country index” (Transparency International, 2009).

In its corporate plan, URA acknowledges that “there is a perception among the public that to some extent corruption still exists within the organisation”. Furthermore, the 2008 URA-commissioned integrity baseline survey indicates that “a good number of respondents reported that they had experienced or seen URA officers engage in improper behaviour” (RDC, 2009). Furthermore, the report suggests that URA still needs to strengthen its efforts to curb corruption. To this end, URA continues to actively collaborate with anti-corruption bodies and the public, and will shortly implement its whistle-blowing policy.

Ensuring harmonised, systematic and policy-led regional integration measures

Regional integration at EAC Customs Union level is apparently a predominantly politically-driven initiative. Evidently, many of the regional integration measures promulgated by regional political forums have been made before any rigorous assessment of both the feasibility and its implications for DRM implementation. Thus, for example: (i) common external tariffs (CETs) were pronounced on the eve of the EAC Customs Union launch and a lot of haggling over them still persists; (ii) there is an absence of clarity on the appropriate classification of manufactured and semi-manufactured goods; (iii) “the value of goods which [qualify] for exemptions and remissions has been growing” (Mugisa, 2009); and (iv) weak and poorly coordinated controls over the rules of origin continue to pose major problems for all the ARAs in the EAC member states.

It is noteworthy that there are demands by Uganda-based businesses to extend the duty exemption period beyond 2010 for importation of key inputs and materials (225 tariff numbers) given to 94 companies under the Duty Remission Scheme. Yet, businesses in other EAC member states are required to pay import duty at the applicable CET rate. “This is contrary to the spirit of the agreed position, and naturally, there is opposition to this from other members and, even in Uganda, there is no unanimous support on this matter” (Mugisa et al, 2009).
addition, Uganda’s tax regime is not fully in sync with the systems in other EAC partner states. For example, VAT and excise duty are not harmonised, which could negatively impact cross-border trade.
Lessons learned

Box 8.1: Political leader tirade against salary adjustments for URA staff

Despite the global economic downturn, the URA is moving to increase staff salaries in a bid to improve its ‘operational efficiency’. The tax body, which has some of the highest paid employees on the government payroll, submitted a proposal to the Ugandan parliament last week in which it seeks a 16% increment to its employees’ salaries.

Members of parliament... last week threatened to block the proposal. “Our economy is doing badly and we are collecting less revenue, not due to lack of skilled staff, but because of the financial crisis... It will be irrational for us to increase URA salaries by Shs7.8 billion yet we are collecting less and our people have no drugs in hospitals. We cannot fix the realities of the financial crisis by rewarding URA executives.” [one Member of Parliament] argued.

Ironically, as the URA asks for staff salary increments, the National Health Service Commission will not be able to recruit the 1,000 health workers it needs this financial year [FY 2008/09] for lack of funding. Furthermore, the national budget this year slashed about Shs3.4 billion off the main national hospital (Mulago Hospital) budget, yet the hospital is in dire need of these funds.

Source: Anyoka (2009)

It is clear that URA, like other ARAs in the region, has embarked on extensive reforms and capacity building initiatives. This synthesis of lessons is based on an assessment of outputs from the reform efforts and policy measures for which specific outcomes can be identified. At the same time, this chapter captures lessons learned in terms of what decisions, and actions, affect tax efforts.

It is important to insulate

an ARA from politics

In line with the original envisioning of the relevance of URA’s autonomy, the authority should have the institutional environment and incentives that allow it to attract and retain the talent necessary to build, operate and maintain an efficient and effective tax administration system. However, as indicated earlier in this paper, it would seem that URA’s staff remuneration has been politicised in recent years, and therefore pay has not kept up with packages offered by other organisations in the market seeking to recruit similar skills (see Box 8.1). Therefore, URA has suffered staff losses in critical positions. Furthermore, freezing URA’s pay levels may serve to undermine its image in the market. For example, it may be perceived to be less professional due to its reduced ability to attract and retain the best skills available in the market. The remuneration aspect “of autonomy has [therefore] become less significant over time as pay and conditions move more closely in line with civil service norms” (Robinson, 2004).

Restructuring, reengineering

and automation can facilitate

reduction in collection cost

Table 2 Annex 8.3 indicates that since 1996/97, URA has been able to bring down the cost of collecting tax and non-tax revenues. This reduction demonstrates one benefit of the restructuring, reengineering and automation initiatives that URA has implemented. When all the new processes and systems are fully functioning,
there is a distinct possibility that the collection cost as a percentage of total revenue collected will be even lower. Then also, URA should start “harvesting” from its massive investment in IT systems, for example, through data matching, enhancing compliance management capabilities, use of third party information, and sharing of information across departments.

Tax incentives and exemptions can negate DRM results

URA has made noteworthy advancements with its modernisation agenda. However, the effect of its reforms are not fully discernible in domestic revenue performance indicators (See Section on “Domestic revenue performance”), especially collections as a percentage of GDP. The key factors for this lower-than-expected performance appear to be: (a) large proportion of the informal sector that falls outside the tax net; (b) the common view that tax evasion in Uganda is widespread; and (c) growing level of exemptions – which “not only shrink the tax base but also complicate tax administration and are a major source of revenue resource leakage from the taxed economy” (Gupta and Tareq, 2008). It is therefore important to quantify, and if possible, significantly reverse the effects of these three negating factors.
Annex 8.1: List of Key informants

Jack Grigg (Mr), Economist – Tax Policy Division – Fiscal Affairs Department, International Monetary Fund
Jeroen de Lange (Mr), Senior Economist, World Bank Country Office
John Ogol (Mr), Senior Finance Officer – Legal, Ministry of Finance, Planning and Economic Development
Kalyebbi Magoola (Mr), Assistant Commissioner – Research, Planning & Development, Uganda Revenue Authority
Keith Muhakanizi (Mr), Deputy Secretary to Treasury, Ministry of Finance Planning and Economic Development
Lawrence Bategeka (Mr), Senior Research Fellow, Economic Policy Research Centre
Lawrence Kiiza (Mr), Director Economic Affairs, Ministry of Finance, Planning and Economic Development
Luke Okumu (Dr), Senior Research Fellow, Economic Policy Research Centre
Moses Kajubi (Mr), Commissioner Domestic Taxes, Uganda Revenue Authority
Moses Kibirige (Mr), Adviser Financial and Private Sector Development, World Bank Country Office
Moses Ogwal (Mr), Director Policy and Advocacy, Private Sector Foundation Uganda
Moses Sabiiti (Mr), Manager – Modernisation, Uganda Revenue Authority
Patrick Khaemba (Mr), Resident Representative - Uganda, African Development Bank
Paul Wade (Mr), Poverty Reduction and Economic Management Cluster Lead, The World Bank
Peter Malinga (Mr), Commissioner Customs, Uganda Revenue Authority
Rob Rudy (Mr), Pro-Poor Growth Adviser, Department for International Development
Sarah Babalanda (Ms), Supervisor Tax Education – Public and Corporate Affairs, Uganda Revenue Authority
Sarah Birungi Banage (Ms), Assistant Commissioner, Public and Corporate Affairs Management, Uganda Revenue Authority
Sarah Ssewanyana (Dr), Executive Director, Economic Policy Research Centre
Thomas Richardson (Mr), Senior Resident Representative, Uganda. International Monetary Fund
Annex 8.2: Bibliography

BBC (2002): Uganda Roots Out Tax Corruption. BBC News 15/03/02, [online].


Annex 8.3: Selected indicators

### Table 1: Tax policy – Maximum marginal tax rates (1991/92 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>PAYE</th>
<th>Corporate tax</th>
<th>VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991/92</td>
<td>50%</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1992/93</td>
<td>40%</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1993/94</td>
<td>30%</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1999/00</td>
<td>30%</td>
<td>30%</td>
<td>17%</td>
</tr>
<tr>
<td>2000/01</td>
<td>30%</td>
<td>30%</td>
<td>17%</td>
</tr>
<tr>
<td>2001/02</td>
<td>30%</td>
<td>30%</td>
<td>17%</td>
</tr>
<tr>
<td>2002/03</td>
<td>30%</td>
<td>30%</td>
<td>17%</td>
</tr>
<tr>
<td>2003/04</td>
<td>30%</td>
<td>30%</td>
<td>17%</td>
</tr>
<tr>
<td>2004/05</td>
<td>30%</td>
<td>30%</td>
<td>18%</td>
</tr>
<tr>
<td>2005/06</td>
<td>30%</td>
<td>30%</td>
<td>18%</td>
</tr>
<tr>
<td>2006/07</td>
<td>30%</td>
<td>30%</td>
<td>18%</td>
</tr>
<tr>
<td>2007/08</td>
<td>30%</td>
<td>30%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Source: Budget speeches, IMF (1999) and Doing Businesses

### Table 2: Tax administration costs (1995/96 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Operating cost including capital expenditure (UShs)</th>
<th>Operating cost as a percentage of tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995/96</td>
<td>24,773,779,106</td>
<td>3.9%</td>
</tr>
<tr>
<td>1996/97</td>
<td>27,070,834,505</td>
<td>3.6%</td>
</tr>
<tr>
<td>1997/98</td>
<td>29,441,017,509</td>
<td>3.6%</td>
</tr>
<tr>
<td>1998/99</td>
<td>36,530,777,177</td>
<td>3.8%</td>
</tr>
<tr>
<td>1999/00</td>
<td>36,638,290,073</td>
<td>3.6%</td>
</tr>
<tr>
<td>2000/01</td>
<td>37,867,361,311</td>
<td>3.4%</td>
</tr>
<tr>
<td>2001/02</td>
<td>47,431,452,746</td>
<td>3.7%</td>
</tr>
<tr>
<td>2002/03</td>
<td>47,052,693,855</td>
<td>3.2%</td>
</tr>
<tr>
<td>2003/04</td>
<td>71,399,654,482</td>
<td>4.2%</td>
</tr>
<tr>
<td>2004/05</td>
<td>70,644,656,503</td>
<td>3.5%</td>
</tr>
<tr>
<td>2005/06</td>
<td>74,767,060,318</td>
<td>3.2%</td>
</tr>
<tr>
<td>2006/07</td>
<td>78,153,461,190</td>
<td>2.8%</td>
</tr>
<tr>
<td>2007/08</td>
<td>100,885,309,949</td>
<td>3.0%</td>
</tr>
</tbody>
</table>

Source: Various URA audited accounts
Table 3: Ratio of tax staff per population (TAXSTAFF)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Uganda’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Low income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXSTAFF</td>
<td>-</td>
<td>0.82</td>
<td>0.37</td>
<td>0.20</td>
</tr>
</tbody>
</table>


Table 4: National government revenue and fiscal deficit as a percentage of GDP

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Revenue (tax and non-tax revenue)</th>
<th>Fiscal deficit, excluding grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991/92</td>
<td>6.8%</td>
<td>-</td>
</tr>
<tr>
<td>1992/93</td>
<td>7.8%</td>
<td>-</td>
</tr>
<tr>
<td>1993/94</td>
<td>8.9%</td>
<td>-</td>
</tr>
<tr>
<td>1994/95</td>
<td>10.7%</td>
<td>-</td>
</tr>
<tr>
<td>1995/96</td>
<td>11.3%</td>
<td>-</td>
</tr>
<tr>
<td>1996/97</td>
<td>12.1%</td>
<td>-6.4%</td>
</tr>
<tr>
<td>1997/98</td>
<td>11.2%</td>
<td>-6.1%</td>
</tr>
<tr>
<td>1998/99</td>
<td>11.9%</td>
<td>-6.0%</td>
</tr>
<tr>
<td>1999/00</td>
<td>11.7%</td>
<td>-10.1%</td>
</tr>
<tr>
<td>2000/01</td>
<td>10.9%</td>
<td>-11.0%</td>
</tr>
<tr>
<td>2001/02</td>
<td>12.2%</td>
<td>-12.3%</td>
</tr>
<tr>
<td>2002/03</td>
<td>12.3%</td>
<td>-11.5%</td>
</tr>
<tr>
<td>2003/04</td>
<td>12.6%</td>
<td>-9.6%</td>
</tr>
<tr>
<td>2004/05</td>
<td>12.9%</td>
<td>-7.2%</td>
</tr>
<tr>
<td>2005/06</td>
<td>13.1%</td>
<td>-7.1%</td>
</tr>
<tr>
<td>2006/07</td>
<td>12.6%</td>
<td>-6.0%</td>
</tr>
<tr>
<td>2007/08</td>
<td>12.8%</td>
<td>-5.1%</td>
</tr>
</tbody>
</table>

Sources: Various IMF staff and PRSP progress reports
Table 5: Split of total budgeted tax and non-tax revenue as a percentage of total domestic revenue (1991/92-2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Tax revenue</th>
<th>Non-tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991/92</td>
<td>93%</td>
<td>7%</td>
</tr>
<tr>
<td>1992/93</td>
<td>92%</td>
<td>8%</td>
</tr>
<tr>
<td>1993/94</td>
<td>93%</td>
<td>7%</td>
</tr>
<tr>
<td>1994/95</td>
<td>92%</td>
<td>8%</td>
</tr>
<tr>
<td>1995/96</td>
<td>94%</td>
<td>6%</td>
</tr>
<tr>
<td>1996/97</td>
<td>94%</td>
<td>6%</td>
</tr>
<tr>
<td>1997/98</td>
<td>94%</td>
<td>6%</td>
</tr>
<tr>
<td>1998/99</td>
<td>93%</td>
<td>7%</td>
</tr>
<tr>
<td>1999/00</td>
<td>92%</td>
<td>8%</td>
</tr>
<tr>
<td>2000/01</td>
<td>95%</td>
<td>5%</td>
</tr>
<tr>
<td>2001/02</td>
<td>92%</td>
<td>8%</td>
</tr>
<tr>
<td>2002/03</td>
<td>93%</td>
<td>7%</td>
</tr>
<tr>
<td>2003/04</td>
<td>93%</td>
<td>7%</td>
</tr>
<tr>
<td>2004/05</td>
<td>94%</td>
<td>6%</td>
</tr>
<tr>
<td>2005/06</td>
<td>94%</td>
<td>6%</td>
</tr>
<tr>
<td>2006/07</td>
<td>95%</td>
<td>5%</td>
</tr>
<tr>
<td>2007/08</td>
<td>95%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Various IMF staff reports

Table 6: Composition of national government tax and non-tax revenues as a percentage of total revenues collected by URA (1996/97 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Customs and excise duties</th>
<th>VAT</th>
<th>Inland revenues</th>
<th>Non-tax revenues collected by URA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996/97</td>
<td>53%</td>
<td>30%</td>
<td>17%</td>
<td>-</td>
</tr>
<tr>
<td>1997/98</td>
<td>49%</td>
<td>32%</td>
<td>18%</td>
<td>-</td>
</tr>
<tr>
<td>1998/99</td>
<td>46%</td>
<td>34%</td>
<td>20%</td>
<td>-</td>
</tr>
<tr>
<td>1999/00</td>
<td>45%</td>
<td>35%</td>
<td>20%</td>
<td>-</td>
</tr>
<tr>
<td>2000/01</td>
<td>42%</td>
<td>36%</td>
<td>22%</td>
<td>-</td>
</tr>
<tr>
<td>2001/02</td>
<td>40%</td>
<td>35%</td>
<td>25%</td>
<td>-</td>
</tr>
<tr>
<td>2002/03</td>
<td>37%</td>
<td>36%</td>
<td>27%</td>
<td>1%</td>
</tr>
<tr>
<td>2003/04</td>
<td>37%</td>
<td>34%</td>
<td>29%</td>
<td>1%</td>
</tr>
<tr>
<td>2004/05</td>
<td>35%</td>
<td>33%</td>
<td>31%</td>
<td>1%</td>
</tr>
<tr>
<td>2005/06</td>
<td>35%</td>
<td>34%</td>
<td>31%</td>
<td>1%</td>
</tr>
<tr>
<td>2006/07</td>
<td>35%</td>
<td>34%</td>
<td>30%</td>
<td>1%</td>
</tr>
<tr>
<td>2007/08</td>
<td>36%</td>
<td>34%</td>
<td>29%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: Various URA audited accounts
Table 7: Major sources of tax revenue as a percentage of total revenues collected by URA (1996/97 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Petroleum imports</th>
<th>Import and excise duties</th>
<th>Excise duty – local</th>
<th>VAT on imports</th>
<th>VAT local</th>
<th>CIT</th>
<th>PAYE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996/97</td>
<td>27%</td>
<td>14%</td>
<td>11%</td>
<td>18%</td>
<td>12%</td>
<td>2%</td>
<td>5%</td>
</tr>
<tr>
<td>1997/98</td>
<td>23%</td>
<td>13%</td>
<td>12%</td>
<td>18%</td>
<td>14%</td>
<td>3%</td>
<td>4%</td>
</tr>
<tr>
<td>1998/99</td>
<td>20%</td>
<td>14%</td>
<td>11%</td>
<td>19%</td>
<td>14%</td>
<td>5%</td>
<td>7%</td>
</tr>
<tr>
<td>1999/00</td>
<td>19%</td>
<td>13%</td>
<td>10%</td>
<td>19%</td>
<td>16%</td>
<td>4%</td>
<td>8%</td>
</tr>
<tr>
<td>2000/01</td>
<td>18%</td>
<td>14%</td>
<td>9%</td>
<td>20%</td>
<td>16%</td>
<td>5%</td>
<td>9%</td>
</tr>
<tr>
<td>2001/02</td>
<td>17%</td>
<td>11%</td>
<td>9%</td>
<td>19%</td>
<td>17%</td>
<td>5%</td>
<td>11%</td>
</tr>
<tr>
<td>2002/03</td>
<td>16%</td>
<td>11%</td>
<td>8%</td>
<td>19%</td>
<td>17%</td>
<td>6%</td>
<td>12%</td>
</tr>
<tr>
<td>2003/04</td>
<td>16%</td>
<td>12%</td>
<td>8%</td>
<td>0%</td>
<td>14%</td>
<td>7%</td>
<td>12%</td>
</tr>
<tr>
<td>2004/05</td>
<td>16%</td>
<td>11%</td>
<td>7%</td>
<td>18%</td>
<td>15%</td>
<td>8%</td>
<td>12%</td>
</tr>
<tr>
<td>2005/06</td>
<td>16%</td>
<td>11%</td>
<td>7%</td>
<td>19%</td>
<td>15%</td>
<td>8%</td>
<td>13%</td>
</tr>
<tr>
<td>2006/07</td>
<td>-</td>
<td>-</td>
<td>6%</td>
<td>19%</td>
<td>15%</td>
<td>7%</td>
<td>13%</td>
</tr>
<tr>
<td>2007/08</td>
<td>17%</td>
<td>10%</td>
<td>6%</td>
<td>19%</td>
<td>14%</td>
<td>6%</td>
<td>13%</td>
</tr>
</tbody>
</table>

Source: Various URA audited accounts

Table 8: Major sources of non-tax revenue collected by URA as a percentage of total non-tax revenues collected by URA (2002/03 to 2007/08)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Passport and migration fees</th>
<th>Company regulation fees</th>
<th>Mining fees and royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002/03</td>
<td>57%</td>
<td>12%</td>
<td>22%</td>
</tr>
<tr>
<td>2003/04</td>
<td>57%</td>
<td>15%</td>
<td>18%</td>
</tr>
<tr>
<td>2004/05</td>
<td>42%</td>
<td>9%</td>
<td>16%</td>
</tr>
<tr>
<td>2005/06</td>
<td>43%</td>
<td>8%</td>
<td>20%</td>
</tr>
<tr>
<td>2006/07</td>
<td>49%</td>
<td>9%</td>
<td>21%</td>
</tr>
<tr>
<td>2007/08</td>
<td>57%</td>
<td>9%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: Various URA audited accounts

Table 9: CIT and PIT revenue productivity and VAT gross compliance ratio (2008/09)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Uganda’s measure</th>
<th>World’s measure</th>
<th>SSA’s measure</th>
<th>Low income economies’ measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>CITPROD</td>
<td>0.03</td>
<td>0.13</td>
<td>0.09</td>
<td>0.08</td>
</tr>
<tr>
<td>PITPROD</td>
<td>0.11</td>
<td>0.14</td>
<td>0.08</td>
<td>0.07</td>
</tr>
<tr>
<td>VATGCR</td>
<td>26.50</td>
<td>65.48</td>
<td>42.3</td>
<td>38.45</td>
</tr>
</tbody>
</table>

Table 10: World Bank Doing Business indicators on the tax burden (Uganda only)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td>Rwanda’s global ranking</td>
<td>-</td>
</tr>
<tr>
<td>Number of tax payments a year</td>
<td>33</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>237</td>
</tr>
</tbody>
</table>


Table 11: World Bank Doing Business indicators (2010) on the tax burden (Uganda vis-à-vis the OECD and SSA)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Uganda</th>
<th>OECD</th>
<th>SSA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of tax payments a year</td>
<td>32</td>
<td>12.8</td>
<td>37.7</td>
</tr>
<tr>
<td>Time taken to comply with the major tax types</td>
<td>161</td>
<td>194.1</td>
<td>306.0</td>
</tr>
<tr>
<td>Total tax rate as % of profit</td>
<td>35.7%</td>
<td>44.5%</td>
<td>67.5%</td>
</tr>
</tbody>
</table>


Table 12: Number of registered taxpayers (2002/03 to 2007/08)

<table>
<thead>
<tr>
<th>Registered for</th>
<th>Aug-05</th>
<th>Jun-06</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT</td>
<td>13,485</td>
<td>16,410</td>
<td>21.7%</td>
</tr>
<tr>
<td>Corporate</td>
<td>15,639</td>
<td>19,218</td>
<td>22.9%</td>
</tr>
<tr>
<td>Individual</td>
<td>20,936</td>
<td>25,051</td>
<td>19.7%</td>
</tr>
<tr>
<td>PAYE</td>
<td>4,575</td>
<td>5,399</td>
<td>18.0%</td>
</tr>
<tr>
<td>Rental income</td>
<td>4,607</td>
<td>6,524</td>
<td>41.6%</td>
</tr>
</tbody>
</table>

Source: URA audited accounts
Table 13: Tax gap and tax effort for select EAC countries and South Africa (select years)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Tax revenue (A)</th>
<th>Estimated potential tax revenue (B)</th>
<th>Tax gap (B) – (A)</th>
<th>Tax effort (A)/(B) as a % of GDP</th>
<th>Tax effort (A)/(B) as a % as a % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td>2001</td>
<td>17.8</td>
<td>20.8</td>
<td>3.0</td>
<td>85.5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>18.6</td>
<td>20.6</td>
<td>2.0</td>
<td>90.5</td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>2001</td>
<td>24.8</td>
<td>26.7</td>
<td>1.9</td>
<td>92.9</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>27.4</td>
<td>27.0</td>
<td>-0.4</td>
<td>101.4</td>
<td></td>
</tr>
<tr>
<td>Rwanda</td>
<td>2001</td>
<td>10.7</td>
<td>20.9</td>
<td>10.2</td>
<td>51.2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>12.2</td>
<td>21.4</td>
<td>9.9</td>
<td>57.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>13.5</td>
<td>22.0</td>
<td>8.5</td>
<td>61.4</td>
<td></td>
</tr>
<tr>
<td>Tanzania</td>
<td>2001</td>
<td>9.7</td>
<td>20.0</td>
<td>10.3</td>
<td>48.5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.2</td>
<td>20.5</td>
<td>9.3</td>
<td>54.4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>15.0</td>
<td>20.9</td>
<td>5.9</td>
<td>71.6</td>
<td></td>
</tr>
<tr>
<td>Uganda</td>
<td>2001</td>
<td>10.4</td>
<td>19.2</td>
<td>8.8</td>
<td>54.3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2005</td>
<td>11.8</td>
<td>19.5</td>
<td>7.8</td>
<td>60.3</td>
<td></td>
</tr>
</tbody>
</table>

Source: IMF (2009b)
Annex 8.4: Changes to the administrative systems at URA

The development of URA’s administrative systems has been guided by a tax modernisation initiative. A bespoke developed Integrated Tax Administration System (eTax) is used in the Domestic Tax Revenue Department, covering all taxes and non-tax revenues collected by URA. An important feature of the eTax is that it generates a unique taxpayer identification number (TIN). eTax is interfaced with the URA’s accounting system – Sun Systems. Its functionality was recently extended to cover eFiling and payments, and is targeted at around 2,000 medium and large firms. The eFiling feature of eTax was piloted in December 2009, and became fully operational in 2010.

Between 2002 and 2004, the Customs and Excise Department adopted the Automated System for Customs Data ++ (ASYCUDA++), which was rolled out from 2005 to 2007. ASYCUDA++ runs at 30 out of 38 customs offices and border stations. This version allows for direct trader input so that importers can lodge declarations from their bases and minimise the build up of documents.

Furthermore, to support the cargo tracking between the revenue authorities of the EAC, URA has implemented the Revenue Authority Digital Data Exchange system. RADDEX is also operational in Kenya, Rwanda and Tanzania. According to a status report on the implementation of URA’s modernisation plan, “the introduction of RADDEX has further provided cargo details in standardised electronic format –minimising data errors and saving time”.

URA has also recently introduced a call centre with a toll free line, which operates from 8am to 5pm on weekdays. In addition, the centre responds to any queries lodged at the authority’s new interactive website (http://ura.go.ug/uraweb/index.jsp). It is also worth mentioning that, at this new website, taxpayers can register as an individual, non-individual or a group, and obtain a TIN from eTax.

Since December 2007, internal communications among URA staff have been enabled through the use of URA-net. “URA, in partnership with Uganda Telecoms Limited (UTL), launched the URAnet upgrade, which now allows members of URA to communicate among themselves on intercom network, irrespective of where they are (in Uganda)” (DFID, 2008).

URA had had, in place, a corporate plan covering the period from 2006 to 2010, which specified four goals: (i) maximise taxpayer compliance; (ii) maximise quality of service delivery; (iii) modernise URA through its people, processes and systems; and (iv) enhance URA’s corporate image13. To facilitate monitoring and evaluation (M&E) of the achievement of performance indicators and targets contained in URA’s corporate plan, a corporate scorecard was developed in 2009. It maintains a record of actual results against baseline indicators.

13 A new corporate plan based on the balanced scorecard framework has been developed to run until 2014.
Chapter 9

Proceedings from Domestic Resource Mobilization Stakeholder Workshop
Introduction

The African Development Bank (AfDB) in partnership with the Korea-Africa Fund for Economic Cooperation (KOAFEC), African Tax Administration Forum (ATAF) and the East African Community (EAC) Secretariat undertook a project between November 2009 and October 2010 aimed at sharing lessons learned from studying Domestic Resource Mobilisation (DRM) efforts among the EAC countries, South Korea and South Africa. Its particular focus was on tax policy and administration. The project’s objective had been to make recommendations on the priority tax policy reforms in the EAC and ways to sequence and implement them for enhancing their DRM. The production of all technical reports and background materials related to the project as well as the stakeholders’ workshop in Kampala were made possible from a generous grant from the KOAFEC.

The project was carried out through case studies of the EAC partner states, South Africa, and South Korea. For this work, DRM is defined to include only tax policy and administration; excluding other possible components of DRM, such as domestic financial markets. In particular, the project sought to answer the question: “What key factors have contributed to or inhibited DRM in the EAC countries, South Africa, and South Korea?” The case studies were based on an extensive review of available literature, interviews with key informants in the respective countries, collection of quantitative data, and analysis of both primary and secondary data. The core principle of the methodological framework used for the case studies is to analyse tax performance as a result of both tax systems and reforms. The framework underscores the central role played by tax systems as primary determinants of tax performance, but it also emphasises the dynamic interaction between tax systems and performance through reforms.

The case studies’ findings were presented at a stakeholders’ workshop held at the Commonwealth Speke Resort Munyonyo, Kampala on Tuesday 9th and Wednesday 10th November 2010. The workshop attracted representatives from the Ministries of Finance in the EAC and Sudan; Revenue Authorities of EAC partner states, Nigeria and South Africa; Central Banks of Kenya and Uganda; AfDB, KOAFEC, ATAF, EAC secretariat, GTZ, KfW, IMF, World Bank, EPRC, and others. This report summaries the key outcomes and emerging messages from this workshop. More specifically, it sought to answer the following questions: “What are the priority reforms for EAC partner states and the EAC?” and “How should these reforms be sequenced and implemented?”
Background

For decades EAC partner states have been plagued by widespread poverty, chronic unemployment, uneven development and political upheaval. Not surprisingly, mobilising domestic resources to confront these issues has proved to be a daunting challenge. This perhaps explains why these countries have been unable to generate enough domestic resources, forcing them to rely heavily on foreign aid, foreign direct investment, export earnings and other external resources. In this context, DRM needs to be given more emphasis since international experience shows that high-growth economies typically save 20-30% or more of their income in order to finance public and private investment necessary for achieving sustained economic growth and accelerating poverty reduction. Furthermore, DRM enhances domestic ownership of the reform agenda since external resources invariably entail restrictions and conditionality. For instance, Official Development Assistance (ODA) is usually oriented to the commercial interests of the investor, as is the case with Foreign Direct Investment (FDI). DRM is also more predictable and less volatile than foreign aid, export earnings, or FDI; and is critical to domestic integration (strengthening economic linkages between domestic sectors and regions), which is a prerequisite for successful integration into the global economy.

Moreover, although external resources can bridge the fiscal gap, they ultimately cannot substitute for well-established mechanisms for generating domestic revenue. The EAC partner states have been implementing various tax reforms since the 1990s, mostly geared towards broadening tax bases, rationalising taxes to improve investment climate, enhancing compliance and improving other aspects of tax revenue administration. However, DRM via taxation is still below its potential. For example, between 2006 and 2008, tax-to-GDP ratios in the sub-region ranged from 12.3% to 22.1%, compared to an average of 35.6% and 25.4% for the Organisation for Economic Cooperation and Development (OECD) countries and South Africa respectively. Following the reduction in ODA commitments to developing countries on account of the recent global financial crisis, there is renewed urgency for the EAC partner states to improve public resources mobilisation.

Emerging issues from the DRM Workshop

This section summarises the key emerging issues from the consultative workshop and seeks to provide examples and additional evidence/information where necessary. These issues are presented under three broad areas: (i) tax policy and legislative framework; (ii) tax administration; and (iii) general enabling environment under which tax administrators collect taxes. They are intertwined and reinforce each other in the scheme of domestic resource mobilisation efforts. Nevertheless, we expound on each separately for purpose of clarity, while bearing in mind their interconnectedness. Further, where necessary, we provide international experience on the emerging issues.

Tax policy and legislative framework

The main issues raised under the tax policy and legislative framework included the: (i) need to broaden the tax base; (ii) benefit of effectively implementing existing tax legislation prior to introducing new legislation (iii) additionality of an optimally selected tax-mix; (iv) importance of linking tax revenue mobilisation to expenditure utilisation; (v) need for tax harmonisation in the EAC; (vi) importance of rationalising tax incentives and exemptions; (vii) objective of the tax policy; (viii) voluntary tax compliance; (ix) local government tax revenue mobilisation; and (x) taxing the informal sector. We expound on each of these issues based on proceedings from the workshop.
Need to broaden the tax base

The tax base in all the EAC countries has consistently remained narrow as evidenced by the less than 20% tax/GDP ratio for each of them, which is less than the Sub-Saharan Africa average of about 28%. This low ratio further highlights the fact that some of the economic activities eligible for taxation are not being captured by tax administrators. It also resonates well with workshop participants’ concern that the current tax system is not in tandem with the structure of the EAC economies. For instance, each of these countries has in the recent past experienced sustained economic growth (except Burundi), while their share of tax revenue to GDP has stagnated during the same period. This therefore calls for efforts towards expanding the tax base. They should be geared towards making the tax system simple, efficient, neutral, as well as broadening the tax base while addressing the equity issues. In principle, simpler taxes are easier to collect and comply with, as are taxes that do not pick winners or distort production choices and allocation of resources (e.g., VAT in Uganda). In addition, more equitable taxes enhance tax morale and encourage savings and investments. Participants at the workshop identified several under-utilised taxes, including capital gains tax (CGT), property and other asset-based taxes that EAC countries can explore in the meantime in a bid to widen the tax base. For instance, Rwanda has successfully introduced property tax, which other EAC countries can emulate. Needless to mention though, introduction or adoption of any new taxes ought to be done only after rigorous assessment of its implication(s) on saving and investment behaviour, as well as labour supply choices.

Effective implementation of existing legislations

Participants raised concerns about the current implementation level of existing tax legislations within the EAC region. They cited selective implementation of existing laws and/or complete non-implementation. For instance, enforcement of existing tax laws on capital gains is being carried out arbitrarily. Likewise, tax exemptions and holidays are being granted on an ad hoc basis, coupled with a high level of non-compliance and non-remittance of personal income tax from consultancy works. This situation not only narrows the tax base but also increases additional revenue loss due to ineffective implementation of current tax laws. In this context, the South African experience on CGT implementation is instructive. In South Africa, CGT not only provided additional revenues, but also enhanced efficiency of the income tax system by discouraging taxpayers from categorising ordinary income into tax-free capital gains. It also promoted equity by ensuring that taxpayers with the same levels of income bear comparable tax burdens, irrespective of their income sources. Participants also pointed out that if local government legislation on property tax, hotel tax, and other levies are effectively implemented, it will enhance local revenue collections. In short, they strongly recommended the need to devise ways of ensuring effective implementation of existing tax laws and legislations, rather than introducing new ones.

Tax mix: Direct or indirect tax

Participants were non-committal on which type of taxation is appropriate for the EAC region; that is whether to adopt direct or indirect taxation. Rather the discussion focused on merits and demerits of each of the tax, and the prevailing conditions in each country. It emerged that whereas indirect taxes, such as VAT, are easy to collect and administratively cheap because selling units act as points of administration for this tax, it also has a downside as it mainly targets consumption, leaving out production. Direct taxes, on the other hand, target both consumption and production, and hence tends to capture a large share of economy but require an elaborate administrative system for assessment, collection and supervision. However, the choice of a tax mix may depend on the objectives of a
particular tax regime; and requires examining the additionality of the preferred tax structure in achieving the stated tax policy objectives. Furthermore, that choice necessitates balancing both the theoretical and practical considerations. They include country-specific circumstances; like ease of collection, extent of the informal sector, and revenue requirements, among others. As would be expected, cross-country comparisons reveal striking differences in the choice of tax mix. For instance, the Andean community (Bolivia, Colombia, Ecuador, Peru, Chile, and Venezuela) has shown preference for indirect taxes, particularly VAT, with considerable achievements in the tenets of neutrality, simplicity, and progressiveness of a tax system. Currently, in the EAC region, both direct and indirect taxes have been embraced at varying degrees in each country. However, considering the large GDP share of consumption and the burgeoning informal sector, coupled with the ease of collection, emphasis needs to be put on indirect taxes in the EAC region.

Linking Tax Revenue Mobilisation to Expenditure Utilisation

Citizens are more receptive to paying taxes when they can make a direct linkage between taxes paid and receiving public services in return. However, participants noted that there was a mismatch between revenue collection and service delivery in the EAC region. Thus, whereas the level of tax collection is increasing within the region, government-rendered services are falling short of what is collected by the tax authorities. This discourages citizens from meeting their tax obligation as they see no or little reason for compliance, because they don’t receive the desired services. Therefore, governments within the region need to improve the efficiency and effectiveness of public spending. They ought to link additional public revenues to achievement of national development objectives by publicising what past additional revenues managed to achieve in quantitative terms (say, 100 km of road rehabilitated in a particular financial year as a result of increased tax revenue). This will enhance tax morale and compliance among the public. For instance, in South Korea, improved public expenditure efficiency and publication of the uses of public revenues enhanced its revenue mobilisation efforts. The same can be said for Botswana, South Africa, and Ghana, where explicit linkage between public expenditure utilisation and tax mobilisation has increased tax compliance, leading to increased tax revenue effort.

Harmonisation of tax policy

The lack of convergence on tax policy in the East African region constitutes a bottleneck to revenue mobilisation efforts as each country tends to pursue its own tax policy. In some instances, such a policy tends to be counterproductive as it might stifle trade among members. It might also degenerate into unhealthy tax rate competition as member states begin to use it for attracting investors, resulting in ‘race to the bottom’. Therefore, participants agreed that EAC member countries need to expedite tax policy harmonisation in order to avoid such occurrences by undertaking the following measures: (i) strengthen capacity of the EAC secretariat to coordinate and advise on tax harmonisation; (ii) harmonise tax legislation to avoid wasteful tax rate competition; and (iii) draw lessons on tax harmonisation from other economic blocs. This view on tax harmonisation seems to be shared by scholars as well. For instance, Hans-Georg Petersen (2010) recommends development of a common EAC VAT model, reduction of zero-rated transactions to exports only, harmonisation and reduction of exempt transactions, and harmonisation of the tax base in his study. He further recommends specific rates over ad vorellem, definition of lower and upper ceilings for the national tax rates, determination of specific tax rates in the national excise tax laws, abolition of discriminatory rates for imported goods, and harmonisation of excise tax rates and tax bases for levying excise taxes.
Rationalising tax incentives and exemptions

Participants generally agreed that the current tax incentives and exemptions are ad hoc with no clear guidelines and procedures for awarding them. They tend to be granted based on political rather than economic considerations, thereby benefiting only politically-connected investors. Their duration and coverage also tends to be vague with the tax authorities left in the dark as such decisions are taken by politicians, which complicates tax administration matters with such investors. In fact, participants cited examples in Uganda where the Uganda Revenue Authority (URA) Commissioner General had been sued by such investors in the tax tribunal court for levying taxes on ‘politically’ exempted transactions. Therefore, whereas tax incentives can potentially promote investment in the short-to-medium term, their overall economic effectiveness might be limited due to the resulting reduction in tax effort. Furthermore, excessive use of tax incentives has complicated tax administration, facilitated evasion and encouraged corruption. Thus participants want EAC countries to grant tax incentives and exemptions based on rigorous assessment of costs and benefits in line with international practices. For instance, in Canada and South Africa, a full cost-benefit analysis for any major piece of legislation including tax legislation aimed at attracting foreign investors -- is first carried out before passing it. The analysis assesses the associated financial and economic costs as well as benefits and impact on the various stakeholders, particularly on a country’s long-term tax revenues. In addition, participants suggested that the responsibility for setting tax rates and offering tax concessions should not be fragmented among several agencies, rather be centralised under the Ministry of Finance with clear and transparent guidelines on beneficiaries.

Objective of the tax policy

Tax policy should focus primarily on developing an efficient and neutral system of easily-administered taxes with broad bases and moderate marginal rates; while the expenditure side of the budget addresses income redistribution. Nevertheless, governments can endeavour to design tax systems that are seen to be consistent with society’s perception of an equitable burden of taxation. For instance, the dual income tax system, established in the Nordic countries in the 1990s, taxes personal capital income at low and proportional rates, while labour income tax rates are sustained at high and progressive levels. This dual personal income tax regime has proved to achieve horizontal equity in the taxation of capital and labour income. Furthermore, lower tax rate on capital income tends to reduce the incentives for capital exports, as well as tax avoidance and evasion. However, a major short-coming of the dual tax system is that it treats taxpayers with a diverse mix of capital and labour income differently and hence does not promote tax neutrality. On the other hand, flat tax regimes emphasise reducing the tax rate schedule to a single rate and eliminating tax allowances, with a view to broadening the tax base. It is also a simpler and easier system to administer even though flat personal income tax system, in particular, limits the scope for an equitable sharing of the tax burden. From the foregoing, both the flat and dual tax rate systems have advantages and disadvantages and the choice between the two is not that straightforward. Thus, whereas the workshop participants deliberated on the two systems-- flat and dual tax system -- they did not pronounce themselves on any one of them.

Nevertheless, Sarejeev Gupta (Deputy Director, Financial Affairs Department of IMF) suggested that the EAC region should adopt the dual tax system, reasoning that its advantages outweigh those of the flat tax system.
Voluntary tax compliance

During the workshop, participants also deliberated on how tax compliance can be improved within the region and in each of the EAC countries. A number of suggestions cropped up—some hinged on strengthening the administration, monitoring and supervisory roles of the Autonomous Revenue Authorities (ARAs), while others drifted towards achieving voluntary compliance. The notion of voluntary tax compliance was further discussed with presentations on South Korea’s experience. South Korea has been encouraging voluntary tax compliance since the 1960s by granting preferential treatments to those who comply. Based on this experience, participants made the following recommendations in order to promote and improve voluntary tax compliance within the EAC region: (i) tax simplification so that all tax payers understand each of tax heads easily; (ii) increase tax system efficiency and transparency, for instance, via the rationalisation of tax exemptions; (iii) tax payer education by holding tax clinics and also incorporating tax education in secondary curriculum; (iv) publically rewarding compliant taxpayers; and (vi) facilitating tax payment, for instance, by teaching small firms and businesses on how to maintain account books and allowing them to purchase point of sale machines that they can claim as inputs when they file their VAT refunds.

Local government tax revenue mobilisation

Participants agreed that local governments in the region are resource constrained and therefore, there is an urgent need to come up with innovative ways of mobilising domestic resources if they are to deliver their mandated services. Currently, local governments in the EAC region rely on irregular central government transfers as their major source of funding. The key question that emerged from the workshop was: What are the major constraints to local government efforts at mobilising domestic resources to supplement central government transfers? Participants identified a number of constraints that can be broadly summarised as: (i) economic or fiscal reasons such as poorly-defined tax bases, absence of tax handles, and inadequate local government tax enforcement mechanisms; (ii) impact of intergovernmental fiscal transfers in the sense that whereas “matching grants” can encourage local revenue collections, discretionary transfer system negatively affects local tax collection efforts; and (iii) political economy considerations— for instance, limited accountability of national and local politicians that discourage local tax effort, coupled with absence of explicit linkages between local taxation and public service provision. If the above constrains can be overcome, participants observed, local governments will be in a better position to realise substantial amounts of additional revenue. At the same time, besides overcoming these constraints, other options of revenue mobilisation need to be explored. For instance, participants considered the option of introducing or expanding local property taxes and broadening local taxes on income and business activity as alternative avenues of mobilising local revenue.

Taxing the informal sector

A major contributor to low tax effort in the EAC partner states is the large, often hard-to-tax informal sector. Tax authorities in the EAC region have achieved minimal success at drawing the informal sector into the tax net, consequently constraining efforts at expanding the tax base. A key question that arose during the workshop was how the informal sector can be brought into the tax net. Possible suggestions pointed towards recognition and legitimisation as well as punitive measures. In Box 9.1, we provide an overview of international practices on how to bring the informal sector into the tax net.
Tax administration

The key tax administration issue that arose during the workshop was inadequate operational capacity within the EAC ARAs. Other issues included: (i) regularity and timeliness of VAT refunds; and (ii) a case for new tax administration model.

Operational capacity for ARAs

All participants agreed that there are operational issues in the region as far as tax administration is concerned. The issues hinged on low remuneration in comparison to the private sector, poor working conditions as well as lack of capacity. Participants therefore concurred that implementing successful reforms in tax administration will necessitate marked improvements in efficient use of available financial, human, and other supportive resources, such as Information and Communication Technology (ICT). Innovations in ICT, they argued, ought to be utilised to support specialisation in the ARA by freeing up resources to target high revenue, high risk, and emerging taxpayer niches. Therefore, participants

| Box 9.1: Possible ways of taxing the informal sector |

**Legitimising the informal sector:** According to Bird and Wallace (2003), one way to draw the shadow economy into the tax net is to legitimise the sector by allowing tax holidays and/or exemptions for certain sectors, like agriculture, from taxation, which would significantly reduce the cost of tax administration. This system has been applied in India where the agricultural sector is constitutionally excluded from central income tax. It encourages the farm owners to register their business, which draws them into the formal sector. Consequently, it allows them to grow and eventually graduate into sizable and taxable non-agricultural businesses.

**Indirect taxation approach:** This is ideal for economies where final consumption taxes significantly capture many of the informal sector activities and where proportion of the informal sector to the entire economy is relatively large. This approach has been applied in Guatemala and Jamaica on small tax-avoiding manufacturers and found to be effective. However, it is important to note that indirect taxation will not bring the underground businesses into the formal sector. It only increases the equity in tax treatment between the formal and informal sectors.

**Presumptive taxation approach:** Following Bulutoglu (1995), presumptive taxation methods can be classified into four categories: (i) methods that estimate taxpayer’s income based on the nature of the business and information on sales, employees, assets, and location; (ii) methods that impute a return on business assets; (iii) methods that apply a gross receipts or turnover tax; and (iv) methods that estimate taxpayer’s income on the basis of external indicators, such as personal expenditure and wealth. They are often advocated in the taxation of informal sectors with the aim of reducing the cost of compliance and to educate taxpayers to deal with the tax system. At the same time, it is hoped that this may reduce the incentive to operate in the underground economy. However, the choice of the method of assessing presumptive tax is determined by the country’s policy objective (such as to reduce tax evasion in general or to simplify the tax system for small taxpayers); as well as complexity of the tax administration system and data availability. Bird and Wallace (2004) showed that simplified tax systems are widely used for the informal sectors, particularly Small and Medium Enterprises (SMEs) in developing countries in Central and Latin America (Mexico, Bolivia and Uruguay).

Source: Clyde (2010)
submitted that the following priority areas should be considered to enhance operational capacity of the EAC tax administration authorities:

(i) Enhanced and efficient utilisation of available organisational capacities: identifying sectors with the highest risks to revenue collection will allow EAC ARAs to fill the most critical skills gaps, particularly in the areas of tax investigations, internal audit and compliance, operations research, planning, and data management. Collaboration, especially in sharing information between ARA departments and other government agencies (such as land and company registries and financial institutions) could allow ARAs to maximise operational capabilities;

(ii) Effective utilisation of ICT: to maximise returns from ICT investments, ARAs should ensure that the next generation of ICT reforms focus on the following: (i) integrating core tax systems to engender single-view of the taxpayer; (ii) integrating ARA ICT systems with third party source data systems, such as land and company registries; (iii) optimising ICT systems usage by providing incentives to taxpayers to file taxes in off-peak periods; and (iii) optimising utilisation of data generated by ICT systems for evidence-based decision making; and

(iii) Operational research capacity: In addition to the utility of enhancing tax policy research, it is also important for the EAC ARAs to develop operational research capacity. Such capacity would regularly and reliably provide useful indicators of the efficiency and effectiveness of interventions in such aspects of performance as: taxpayer feedback on ARA staff attitudes and services (e.g., the ease using ICT systems on eFiling); and voluntary compliance. Also, operational research would seek to understand emerging trends in particular sectors and industry groups so as to inform the design of more appropriate interventions for improving compliance management and enforcement.

Regularity and timeliness of VAT refunds

Participants noted that currently VAT refunds are irregular and not issued on a timely basis, thereby negatively impacting tax compliance. They cited numerous challenges within the region relating to VAT refunds, such as the long period it takes to refund claimants (about 60 days in Kenya, 6 months in Tanzania), discriminatory tax refund policy (e.g., in Rwanda), and ad hoc principle on deduction of input tax. Box 9.2 summarises VAT refund challenges within the EAC region. The delay in tax refunds affects company cash flows and has the potential of slowing business processes and expansion with the worst case scenario being insolvency. However, participants suggested the use of ICT-based risk filters in order to improve the timeliness of tax refunds. This would provide ARAs with information on taxpayer risk profile, which could go a long way in improving tax audits and other verifications.
New tax administration model: Is there a need for one in the EAC region?

Over the years, tax revenue collections as share of GDP have not grown in tandem with economic performance within the region. That is why EAC countries have undertaken a number measures to enhance tax collection. These measures, however, have highlighted some important issues. One such issue relates to the fact that tax audits may not be the best response to non-compliance, especially if it is caused by ignorance of the law. It may also indicate that taxpayer education is not the best response to deliberate tax evasion. Moreover, it may show that imposition of strong penalties may not be appropriate where voluntary compliance with tax obligations is made difficult by inadequate administrative policies and procedures. This calls for an integrated compliance programme that will deliver the optimal mix of responses, such as tax education, audit, and enforcement to mitigate identified tax system risks. It also calls into question the current tax administration model being pursued by the ARAs. So the obvious question was whether there is a need for a new tax administration model within the region. The answer to such a question can only be provided by empirical analysis.

General enabling environment

Key issues that arose at the workshop regarding the general enabling environment for tax administration included: (i) better use of taxpayer information and identification; and (ii) enabling legislation to allow for the sharing of third party information.
Taxpayer information and identification

EAC countries have under-developed national identification (ID) systems or have only recently embarked on their implementation. Rwanda and Kenya have national IDs and are in the process of upgrading their systems to allow for real-time data transmission and sharing with other national agencies. Tanzania and Uganda have taken initiatives to introduce biometric national ID cards. They can facilitate information-sharing across public institutions (including ARAs) and help in the tracking of taxpayers' transactions. Therefore, participants suggested full adoption of national biometric IDs in order to improve tracking of taxpayers. In addition, financial sector information on depositors and public sector data bases can be a good step to begin with on tracking taxpayers. The Deputy Governor of the Bank of Uganda, however, sounded a warning note on the use of financial sector information to monitor taxpayers. He reasoned that such a practice might actually discourage people from using financial services. Moreover, it could undermine efforts to broaden the use of financial services and has the potential to discourage savings. Nevertheless, financial sector information can potentially supplement other data sources, such as TINs in expanding the tax net. Participants, however, agreed that for the moment, public sector databases, including land and company registries, present the most viable options to enhance tracking of current and potential taxpayers.

Sharing of third party information: Is there an enabling legislation?

Participants noted that there is a need for collaboration, especially in sharing of information between ARA departments and other government agencies (such as land and company registries and financial institutions). Currently, such effort is either minimal or non-existent in the EAC region. For instance, only Kenya uses third party information, primarily from the property and business registries, to support its compliance management interventions. However, utilisation of this avenue by other EAC partner states is hampered by the absence of both supporting legislation and the quality of national databases. Furthermore, while all EAC ARAs maintain basic taxpayer identification information, only Kenya and Rwanda have national identifiers, which are also linked to other public and private information infrastructure.

Conclusion

Based on discussions and emerging issues from the workshop, it was concluded that the following need to be addressed in order to enhance domestic resource mobilisation in the EAC.

The tax base needs to be broadened. First, there is a need for streamlining tax exemptions and incentives, with clear procedures, duration and a coordinating unit within the country and across the region. This will avoid the current chaos that has been caused by the ad hoc manner in which such exemptions are extended to business people – normally putting tax administrators at logger heads with potential tax payers and the general public. Moreover, tax exemptions and incentives within the EAC region need to be harmonised in order to ensure that member countries do not use them for attracting investors to their country. This might cause a ‘race to the bottom’ and unnecessary concessions being extended to would-be investors. In fact, workshop participants agreed that investors value other things more highly, such as reliable infrastructure and a consistent policy environment. Second, existing policies and laws should be enforced before introducing any new ones. This will help in reducing the pervasive tax evasion problem in the region. Third, addressing the areas highlighted below will also help in bringing more taxpayers into the net, which will lead to broadening the tax base and an increase in tax collection.
An appropriate tax mix needs to be developed Further research is required on the appropriate level of direct/indirect taxes, and where the emphasis should be for the most efficient revenue yield. In addition, efficiency and neutrality concerns should supersede equity concerns, as equity can be managed on the expenditure side of fiscal policy.

Improve linkage between revenue mobilisation and expenditure utilisation Governments in the EAC should link tax effort to service delivery in order to demonstrate what is collected by government as revenue and the public goods and services they provide. This will help in improving tax compliance and, thus, tax revenue collection. Compliance can also be enhanced through education and general taxpayer communication campaigns.

Build capacity in Revenue Authorities Participants agreed that this could be a key area for development partner support. This capacity needs to align with the structure of the economy, its key sectors and the development path going forward (e.g., a budding oil industry in Uganda). ICT can be used appropriately to supplement RA capacity and efficiency.

Revenue Authorities require strong political leadership and support This point was emphasised by the Commissioners General and other ARA staff. They argued that ARAs need to have clear targets as well as managerial and operational autonomy to achieve this. At the same time, performance criteria need to be expanded to include issues like client services and staff training. Such support will help encourage taxpayer compliance and reduce tax evasion. At the moment, evasion in the EAC region seems most common among well-established firms with close links to the political class.

Strengthen linkages between institutions Participants were in agreement that the linkages, especially between public sector institutions, are weak. Thus, the quality of their databases must be improved and expanded, and ultimately linked for a more comprehensive view of taxpayers.

Policies and tax rates in EAC member countries need to be harmonised Member countries must not use tax rates as a way of competing and attracting investors to their respective countries.

This would have negative consequences for the integration and economic success of the whole region. Participants noted that this is another area where development partner assistance would be very welcome.
References


The Context and Role of Presumptive Taxes. A preliminary document circulated for comments and discussion at Joseph Rotman School of Management, University of Toronto, Canada. Website: http://w.w.w.rotman.uto ronto.ca/iib/


Daniel Platz (2009), Infrastructure finance in developing countries—the potential of sub-sovereign bonds:


IMF conference on: Economic policy and Equity: IMF Headquarters, Washington, DC, June 8–9, 1998

Fernando Velayos, Alberto Barreix and Luiz Villela (n.d) Regional Integration and Tax Harmonization: Issues and Recent Experiences


Annex 9.1

List of participants

<table>
<thead>
<tr>
<th>Country/Organization</th>
<th>Name</th>
<th>Job Title</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi</td>
<td>Mme Clotilde Nizigama</td>
<td>Minister of Finance</td>
<td><a href="mailto:josentirandekura@yahoo.fr">josentirandekura@yahoo.fr</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Emile Sinzumusi</td>
<td>Deputy Commissioner General, Burundi Revenue Authority</td>
<td><a href="mailto:esinzumusi@yahoo.fr">esinzumusi@yahoo.fr</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Niminya M</td>
<td>Burundi Revenue Authority</td>
<td><a href="mailto:mniminya@yahoo.fr">mniminya@yahoo.fr</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Niyonzia Sebastian</td>
<td>Director, Burundi Revenue Authority</td>
<td><a href="mailto:nzimalonce@yahoo.fr">nzimalonce@yahoo.fr</a></td>
</tr>
<tr>
<td>Kenya</td>
<td>Prof. Njuguna Ndung'u</td>
<td>Governor, Central Bank of Kenya</td>
<td><a href="mailto:Gaciciocw@centralbank.go.ke">Gaciciocw@centralbank.go.ke</a></td>
</tr>
<tr>
<td></td>
<td>Mr. John Njiraini</td>
<td>Commissioner, Domestic Tax Department, Kenya Revenue Authority</td>
<td><a href="mailto:john.njiraini@kra.go.ke">john.njiraini@kra.go.ke</a></td>
</tr>
<tr>
<td>Nigeria</td>
<td>Mr. Fashola, N. A</td>
<td>Deputy Director, Federal Inland Revenue Services</td>
<td><a href="mailto:nafash2010@yahoo.com">nafash2010@yahoo.com</a></td>
</tr>
<tr>
<td>Rwanda</td>
<td>Mr. Torero Eugene</td>
<td>Deputy Commissioner General, Rwanda Revenue Authority</td>
<td><a href="mailto:eugene.torero@rra.gov.rw">eugene.torero@rra.gov.rw</a></td>
</tr>
<tr>
<td>South Africa</td>
<td>Mr. Mbongiseni Ngcobo Brandley</td>
<td>Senior Manager, Capacity Development, South African Revenue Services</td>
<td><a href="mailto:BNgcobo@sars.gou.za">BNgcobo@sars.gou.za</a></td>
</tr>
<tr>
<td>Sudan</td>
<td>Ms. Amna Ahmed Saad Abdullah</td>
<td>Director, National Revenue General Directorate, Ministry of Finance and National Economy</td>
<td><a href="mailto:annasaad30@hotmail.com">annasaad30@hotmail.com</a></td>
</tr>
<tr>
<td>Tanzania</td>
<td>Mr. Bedason Shallanda</td>
<td>Commissioner, Ministry of Finance</td>
<td><a href="mailto:bshallanda@mof.go.tz">bshallanda@mof.go.tz</a></td>
</tr>
<tr>
<td></td>
<td>Mrs. Nema Mrema</td>
<td>Ag. Commissioner, Tanzania Revenue Authority</td>
<td><a href="mailto:nrema@tra.go.tz">nrema@tra.go.tz</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Patrick Kassera</td>
<td>Commissioner, Domestic Tax Department, Tanzania Revenue Authority</td>
<td><a href="mailto:pkassera@tra.go.tz">pkassera@tra.go.tz</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Tonedeus K. Muga nyizi</td>
<td>Director, Tanzania Revenue Authority</td>
<td><a href="mailto:tmuganyizi@tra.go.tz">tmuganyizi@tra.go.tz</a></td>
</tr>
<tr>
<td>Uganda</td>
<td>Hon. Syda Bbumba</td>
<td>Minister of Finance, Planning and Economic Development</td>
<td><a href="mailto:mohammed.kabaale@finance.gov.ug">mohammed.kabaale@finance.gov.ug</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Patrick Ocailap</td>
<td>Director Budget, Ministry of Finance, Planning and Economic Development</td>
<td><a href="mailto:patrick.ocailap@finance.go.ug">patrick.ocailap@finance.go.ug</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Lawrence Kiiza</td>
<td>Director Economic Affairs, Ministry of Finance, Planning and Economic Development</td>
<td><a href="mailto:lawrence.kiiza@finance.go.ug">lawrence.kiiza@finance.go.ug</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Gerald Sendawula</td>
<td>Chairperson, Private Sector Foundation Uganda &amp; Uganda Revenue Authority</td>
<td><a href="mailto:ssendaulag@yahoo.com">ssendaulag@yahoo.com</a></td>
</tr>
<tr>
<td></td>
<td>Mrs. Allen Kagina</td>
<td>Commissioner General, Uganda Revenue Authority</td>
<td><a href="mailto:akagina@ura.go.ug">akagina@ura.go.ug</a></td>
</tr>
<tr>
<td></td>
<td>Dr. Louis Kasekende</td>
<td>Deputy Governor, Bank of Uganda</td>
<td><a href="mailto:ikasekende@bou.or.ug">ikasekende@bou.or.ug</a></td>
</tr>
<tr>
<td></td>
<td>Dr. Wilberforce Kismab Mugerwa</td>
<td>Chairman, National Planning Authority</td>
<td><a href="mailto:wksambamugewa@npa.ug">wksambamugewa@npa.ug</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Wamibu Michael</td>
<td>Ag. Commissioner Tax Policy Department, Ministry of Finance, Planning and Economic Development</td>
<td><a href="mailto:michael.wamibu@finance.go.ug">michael.wamibu@finance.go.ug</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Moses Ogwupus</td>
<td>Ag. Assistant Commissioner Tax Policy Dept, Ministry of Finance, Planning and Economic Development</td>
<td><a href="mailto:moses.ogwupus@finance.go.ug">moses.ogwupus@finance.go.ug</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Francis Twinamatsiko</td>
<td>Senior Economist, Ministry of Finance, Planning and Economic Development</td>
<td><a href="mailto:francis.twinamatsiko@finance.go.ug">francis.twinamatsiko@finance.go.ug</a></td>
</tr>
<tr>
<td>Name</td>
<td>Affiliation</td>
<td>Email</td>
<td></td>
</tr>
<tr>
<td>-------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
<td>--------------------------------------</td>
<td></td>
</tr>
<tr>
<td>Ms. Susan Nakagolo</td>
<td>Economist, Ministry of Finance, Planning and Economic Development</td>
<td><a href="mailto:susan.nakagolo@finance.go.ug">susan.nakagolo@finance.go.ug</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Gerald Namoma</td>
<td>Economist, Ministry of Finance, Planning and Economic Development</td>
<td><a href="mailto:gerald.namoma@finance.go.ug">gerald.namoma@finance.go.ug</a></td>
<td></td>
</tr>
<tr>
<td>Ms. Jennifer Muwuliza</td>
<td>Ag. Commissioner ALD, Ministry of Finance, Planning and Economic Development</td>
<td><a href="mailto:jennifer.muwuliza@finance.go.ug">jennifer.muwuliza@finance.go.ug</a></td>
<td></td>
</tr>
<tr>
<td>Mr. H. Opondo</td>
<td>Director, Bank of Uganda</td>
<td><a href="mailto:hopondo@bou.or.ug">hopondo@bou.or.ug</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Kalyeebi Magoola</td>
<td>Research Planning and Economic Development</td>
<td><a href="mailto:kmagoola@ura.go.ug">kmagoola@ura.go.ug</a></td>
<td></td>
</tr>
<tr>
<td>Ms. Sarah Banage</td>
<td>Assistant Commissioner, Public &amp; Corporate Affairs Management, Uganda Revenue Authority</td>
<td><a href="mailto:sbanage@ura.go.ug">sbanage@ura.go.ug</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Moses Kajubi</td>
<td>Commissioner, Domestic Tax Department, Uganda Revenue Authority</td>
<td><a href="mailto:mkajubi@ura.go.ug">mkajubi@ura.go.ug</a></td>
<td></td>
</tr>
<tr>
<td>Prof. Moses Golola</td>
<td>Deputy Executive Secretary</td>
<td><a href="mailto:mgolola@iucea.org">mgolola@iucea.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Moses Ogwal</td>
<td>Director Policy and Advocacy, Private Sector Foundation Uganda</td>
<td><a href="mailto:mogwal@psfuganda.org.ug">mogwal@psfuganda.org.ug</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Kavuma John Bosco</td>
<td>Economic Analyst, National Planning Authority</td>
<td><a href="mailto:jkavuma@npa.ug">jkavuma@npa.ug</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Twimera Evarist</td>
<td>Senior Research Fellow, Economic Policy Research Center</td>
<td><a href="mailto:evarist@eprc.or.ug">evarist@eprc.or.ug</a></td>
<td></td>
</tr>
<tr>
<td>Dr. John Mary Matovu</td>
<td>Principal Research Fellow, Economic Policy Research Center</td>
<td><a href="mailto:jmatovu@eprc.or.ug">jmatovu@eprc.or.ug</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Jeff Alumai. G</td>
<td>Research Fellow, Economic Policy Research Center</td>
<td><a href="mailto:galumai@eprc.or.ug">galumai@eprc.or.ug</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Keneth Bagamu-hunda</td>
<td>Director Customs</td>
<td><a href="mailto:kbagamuhunda@eachq.org">kbagamuhunda@eachq.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Aloysious Ordu</td>
<td>Vice President, Regional and Country Programmes</td>
<td><a href="mailto:a.ordu@afdb.org">a.ordu@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Steve Kayizi-Mugerwa</td>
<td>Director, Operational Policy Resources and Policy</td>
<td><a href="mailto:s.kayizi-mugerwa@afdb.org">s.kayizi-mugerwa@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Nimpe Boaz</td>
<td>Senior Advisor to Executive Director</td>
<td><a href="mailto:b.nimpe@afdb.org">b.nimpe@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Ms. Diarietou Gaye</td>
<td>Director, Regional Department East 'A'</td>
<td><a href="mailto:d.gaye@afdb.org">d.gaye@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mrs. Catherine Baumont</td>
<td>Lead Economist, Regional Department East 'A'</td>
<td><a href="mailto:c.baumont@afdb.org">c.baumont@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Ms. Patience Kuruneri</td>
<td>Social Sector Specialist</td>
<td><a href="mailto:p.kuruneri@afdb.org">p.kuruneri@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Ms. Belinda Chesire</td>
<td>Senior Cooperation Officer, Partnerships and Resource Mobilization Unit</td>
<td><a href="mailto:b.chesire@afdb.org">b.chesire@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Ms. Jean Shirley</td>
<td>Economist, Regional Department East 'A'</td>
<td><a href="mailto:s.jean@afdb.org">s.jean@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Myeongjoo Kim</td>
<td>Senior Advisor to Executive Director</td>
<td><a href="mailto:m.kim@afdb.org">m.kim@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Patrick Khaemba</td>
<td>Resident Representative, Uganda</td>
<td><a href="mailto:p.khaemba@afdb.org">p.khaemba@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Ms. Peninah Kariuki</td>
<td>Country Economist</td>
<td><a href="mailto:p.kariuki@afdb.org">p.kariuki@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Edward Sennoga</td>
<td>Country Economist</td>
<td><a href="mailto:e.sennoga@afdb.org">e.sennoga@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mrs. Furaha Bishota-Folquet</td>
<td>Country Programme Officer</td>
<td><a href="mailto:f.bishota@afdb.org">f.bishota@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Development Partners</td>
<td>Ms. Sylvia Namuli</td>
<td>Research Assistant</td>
<td><a href="mailto:elistel2005@yahoo.com">elistel2005@yahoo.com</a></td>
</tr>
<tr>
<td>----------------------</td>
<td>------------------</td>
<td>--------------------</td>
<td>-----------------------</td>
</tr>
<tr>
<td>Ms. Buzingo Domina</td>
<td>Resident Representative, Kenya</td>
<td><a href="mailto:d.buzingo@afdb.org">d.buzingo@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Richard Walker</td>
<td>Country Economist</td>
<td><a href="mailto:r.walker@afdb.org">r.walker@afdb.org</a></td>
<td></td>
</tr>
<tr>
<td>Mr. Bhakta Prajesh</td>
<td>Officer in Charge, Tanzania</td>
<td><a href="mailto:p.bhakta@afdb.org">p.bhakta@afdb.org</a></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>IMF</th>
<th>Mr. Sarajeev Gupta</th>
<th>Deputy Director, Fiscal Affairs Department</th>
<th><a href="mailto:sgupta@imf.org">sgupta@imf.org</a></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mr. Tom Richardson</td>
<td>Senior IMF Resident Representative, Uganda</td>
<td><a href="mailto:trichardson@imf.org">trichardson@imf.org</a></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>World Bank</th>
<th>Ms. Kundhavi Kadiresan</th>
<th>Country Manager</th>
<th><a href="mailto:kkadiresan@worldbank.org">kkadiresan@worldbank.org</a></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mr. Paul Wade</td>
<td>Senior Economist</td>
<td><a href="mailto:pwa@worldbank.org">pwa@worldbank.org</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Asumani Guloba</td>
<td>Economist</td>
<td><a href="mailto:aguloba@worldbank.org">aguloba@worldbank.org</a></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>UNDP</th>
<th>Mr. Sebastian Levine</th>
<th>Senior Economist</th>
<th><a href="mailto:sebastian.levine@undp.org">sebastian.levine@undp.org</a></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mr. David Marcos</td>
<td>Program Officer</td>
<td><a href="mailto:DAVID.MARCOS@UNDP.ORG">DAVID.MARCOS@UNDP.ORG</a></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>KfW</th>
<th>Ms. Carmen Schickinger</th>
<th>Senior Economist</th>
<th><a href="mailto:carmen.schickinger@kfw.de">carmen.schickinger@kfw.de</a></th>
</tr>
</thead>
</table>

| GTZ | Dr. Christiane Schuppert | Advisor | christiane.schuppert@gtz.de |

<table>
<thead>
<tr>
<th>Missions and Agencies</th>
<th>Mr. Johannes van Niekerk</th>
<th>Counsellor, High Comission of South Africa</th>
<th><a href="mailto:vanniekerk@dirco.gov.za">vanniekerk@dirco.gov.za</a></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mr. Simon Kamanu</td>
<td>Commercial Attache, Kenya High Commission</td>
<td><a href="mailto:simonkamanu@yahoo.com">simonkamanu@yahoo.com</a></td>
</tr>
<tr>
<td></td>
<td>H. E. Mr. Gaspard Musavyarabona</td>
<td>Ambassador, Embassy of Burundi</td>
<td><a href="mailto:josentirandekura@yahoo.fr">josentirandekura@yahoo.fr</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Marlon Gilbert</td>
<td>Second Secretary, Trinidad and Tobago</td>
<td><a href="mailto:Hhckampala@gmail.com">Hhckampala@gmail.com</a></td>
</tr>
<tr>
<td></td>
<td>Mr. Anisa Mbega</td>
<td>First Secretary, Tanzania High Commission</td>
<td><a href="mailto:anisambega@hotmail.com">anisambega@hotmail.com</a></td>
</tr>
</tbody>
</table>

| Pricewaterhouse-Coopers | Ms. Kariuki Elizabeth | Director, Advisory Services | elizabeth.kariuki@tz.pwc.com |

| African Development Professional Group | Mr. Kithinji Kiragu | Director | kithinjikiragu@adpgroup.org |
Annex 9.2

Presentations


