



Economic Policy Paper Series

Paper #1

November 2019

Adrienne Lees
Max Walter
Ronald Mukasa

What's in it for SMEs?

Rethinking small business taxation



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About the Economic Policy Paper Series:

The Economic Policy Paper Series (EPPS) is a series of papers that make concrete policy recommendations that contribute to a key driver of inclusive economic transformation in Uganda. EPPS aims to address two gaps in the Ugandan economic policymaking process: the lack of strong evidence-based economic policy proposals on the one hand and the lack of civil society lobbying outside of large corporate interests on the other hand. The outcome is thus a series of evidence based policy papers that have the potential to have a transformational impact on the Ugandan economy by arming key policymakers and influencers with strong proposals that they can use to drive policy change at the highest levels. Each policy paper is produced in partnership with a Ugandan research or practitioner organisation and delivered to a policymaking body whose interest in receiving and applying evidence-based recommendations is established before the work commences.

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Contents

In brief	2
Recommendations at a glance	3
Introduction	4
Context	4
Methodology	5
Effects of Taxation on Small Firm Growth and Formalisation	6
Tax Regime Reform	11
1. Simplify the presumptive tax structure	13
2. Reform the “nuisance” business licence regime	17
Tax Administration Reform	20
3. Provide tailored and tested taxpayer education to the small firms that need it most	20
4. Reward tax compliance through the provision of business development services to compliant firms	24
5. Simplify the filing process	27
6. Enhance MSME access to tax justice	29
Bibliography	32

List of Figures

Figure 1: Percentage of small firms identifying the problem as their main obstacle	6
Figure 2: Trends in Presumptive Tax Collection	14

List of Tables

Table 1: Taxes, fees, charges, and levies typically paid by a small business	8
Table 2: Small business tax schedule	11
Table 3: Special presumptive regime for businesses with annual turnover between UGX 10 - 50 million	16

What's in it for SMEs?

Rethinking small business taxation

In brief

- Stimulating small business growth and innovation is a road to economic prosperity, the creation of decent employment, and improved tax revenues
 - Alleviating the high perceived burden of taxation and business regulation is central to incentivising the establishment and growth of MSMEs
 - A heavy tax burden suppresses the growth and formalisation incentives of the same MSMEs that would significantly contribute to tax revenues if they grew, “killing the goose that lays the golden egg”
 - The focus of small business taxation should move away from short-term revenue collection and towards incentivising growth and formalisation, building a compliance culture, and improving accounting capabilities
 - The Government of Uganda can achieve this through reforms to the rates and thresholds applied to MSMEs and the way in which tax is administered
 - In this year's programme of work, the Government of Uganda should consider (1) thoroughly simplifying the presumptive tax structure, and (2) reforming the business registration and licencing system
 - Future research and reform efforts should target: (3) improving taxpayer education and outreach, (4) pairing tax compliance with business development services, (5) simplifying the filing process, and (6) enhancing MSMEs' access to tax justice
-

Recommendations at a glance

Tax regime reform	
1. Simplify the presumptive tax structure	<p>1A. Re-examine the tiered rate structure of the presumptive regime.</p> <p>1B. Raise the threshold at which presumptive tax takes effect.</p> <p>1C. Consider removing the “special” presumptive regime applied to firms with turnover of UGX 10-50 million.</p>
2. Reform the “nuisance” business licencing regime	<p>2A. Undertake a mapping exercise to identify all business licences currently in force and establish a comprehensive electronic registry.</p> <p>2B. Reduce the number of unnecessary licencing requirements to improve simplicity.</p> <p>2C. Ensure that revised licence rates accurately reflect the cost of the licence’s regulatory function.</p>
Tax administration reform	
3. Provide tailored and tested tax education to the small firms that need it most	<p>3A. Carry out rigorous action research (in partnership with external experts and researchers) to identify the most effective ways of delivering tax education to small firms in the presumptive regime.</p> <p>3B. Rigorously test the most promising tax education content, delivery methods and channels.</p> <p>3C. Make a rigorously designed and tested tax education programme free, automatically available, easily accessible, and potentially mandatory, to business owners upon registering for a TIN, especially those in the presumptive bracket.</p>
4. Reward tax compliance through the provision of business development services (BDS) to compliant firms	<p>4A. Make BDS a highly visible and attractive benefit of being tax compliant.</p> <p>4B. Study the feasibility of a BDS Fund to finance free or subsidised BDS that only tax compliant MSMEs can qualify for.</p> <p>4C. Commission or carry out further research into experiences from other countries on the cost of BDS and its impact on compliance, growth and revenue collected in the short- and medium-run.</p>
5. Simplify the filing process	<p>5A. Consider allowing less frequent filing requirements for small firms.</p> <p>5B. Study the possibility of introducing a simplified VAT remittance calculation.</p> <p>5C. Make e-filing training a standard part of the wider tax education programme.</p> <p>5D. Consult with relevant representative bodies to properly identify binding constraints to on-time and accurate filing.</p>
6. Enhance MSME access to tax justice	<p>6A. Conduct a comprehensive review of the tax disputes mechanism to fully understand the process and procedures in accessing tax justice for MSMEs. As part of this review, assess the impartiality of URA’s Objections and Appeals Unit (OAU) and its impact on access to tax justice for MSMEs.</p> <p>6B. Allocate appropriate resources to MSME tax appeals in OAU by case profiling and explore setting up a separate Small Taxpayers team within OAU.</p> <p>6C. Explore options for setting up a Small Claims Court within the Tax Appeals Tribunal to reduce administrative and transaction cost for MSMEs.</p> <p>6D. Explore options for setting up a Taxpayer Ombudsman to handle service-related and non-assessment complaints.</p>

Introduction

Context

Micro, small, and medium enterprises (MSMEs) have large untapped potential to drive job-rich economic transformation in Uganda. These enterprises are typically characterised as capital-constrained, operating in highly competitive markets, dealing predominantly in cash, and able to evade the authorities (International Labour Organisation, 2016). The Global Entrepreneurship Monitor (2015) ranked Uganda as one of the most entrepreneurial countries in the world, with the highest proportion globally of youth involved in nascent, new, or established small businesses. These kinds of businesses account for approximately 90% of the private sector and employ some 2.5 million people (Uganda Investment Authority, 2016).

Formalising informal firms and employment has a range of benefits for government, workers, firms, and wider society. These include increased tax receipts, improved access to finance and business development services, increased output and income for firms, reduced unfair competition from informal firms (which do not pay taxes and so have different operating margins), and improved working conditions (International Labour Organisation, 2017). Indeed, the recent budget delivered by the Hon. Minister of Finance recognised the importance of MSMEs and developing a simplified tax regime that preserves Uganda's entrepreneurial spirit while ensuring an equitable contribution to revenues.

However, despite this opportunity, **MSMEs struggle to grow and formalise, show weak survival rates, and have a limited impact on employment.** Stimulating the formalisation and growth of informal businesses will require policymakers to address a range of constraints, including few benefits from formalising, a burdensome business registration and licencing process, poor access to capital markets, and a limited social security net. In addressing this complex set of factors, it is imperative that policymakers adopt an integrated, holistic strategy involving a wide range of stakeholders.

This paper focuses on one of the most binding constraints on MSMEs with a strong potential for growth: the high perceived tax burden and associated compliance costs. A destructive cycle exists between the tax burden and informality – non-compliance and poor financial records prevent small firms from accessing formal finance, government and large corporate contracts, and entrepreneurs artificially remain small, growing sideways and splitting-out businesses rather than growing upwards. **There is a need to shift the approach to MSME taxation in Uganda** – concentrating on creating an enabling growth environment, rather than short-term revenue generation. The Government should aim to raise revenues by fostering the growth and expansion of high-potential small businesses, rather than pursue strategies that over-tax businesses. It is through growth that these firms will become capable of making meaningful contributions to tax revenues through corporate income tax and VAT, while also creating decent jobs, which further grow the tax base through personal income tax.

Methodology

The research process behind this paper drew on previous primary and secondary research carried out under Phase I of the Uganda Entrepreneurial Ecosystems Initiative (see ANDE, 2018), including interviews with 168 high-growth-potential MSMEs and over 80 MSME ecosystem stakeholders (including financial institutions, universities, investors, business development service providers, government bodies, media, and influencers).

The authors also employed the following information gathering approaches specifically for this paper:

- A literature review specific to the theory and practice of small business taxation in Uganda and globally;
- Qualitative interviews with the Tax Policy Department, MFPED, the Uganda Revenue Authority, selected MSMEs, MSME tax lawyers, small business taxation specialists, and development partners working on tax issues in Uganda; and
- Limited analysis of data provided by the Tax Policy Department.

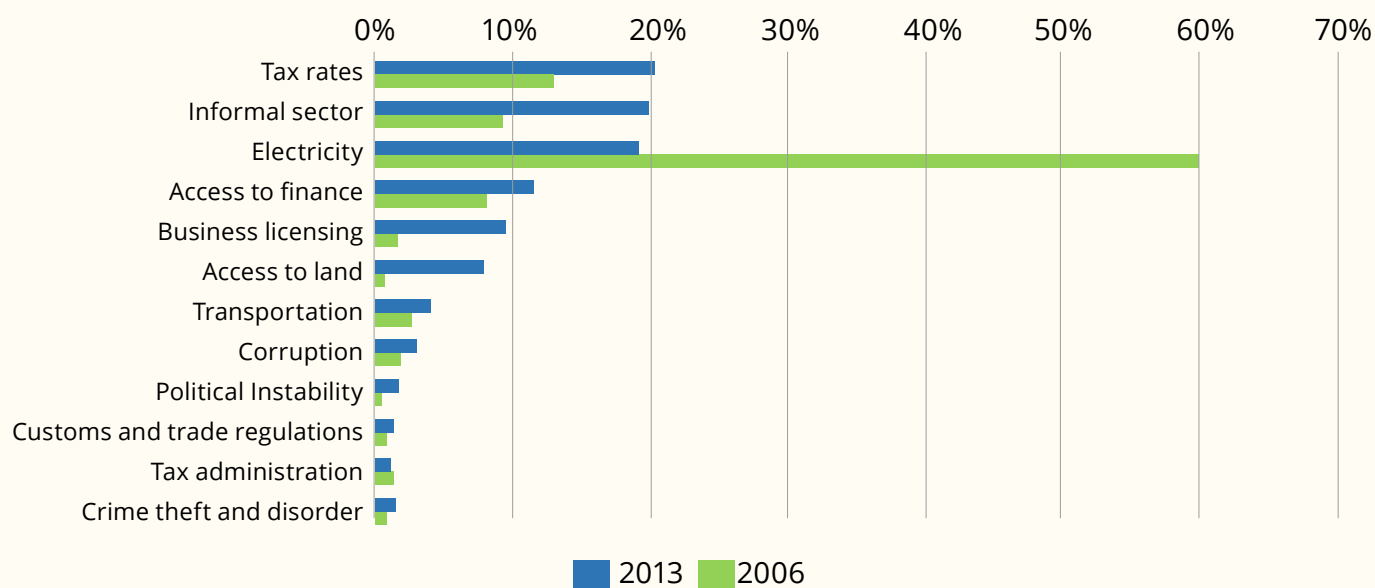
The process from inception to publication of the paper was as follows:

- Initial meeting with Deputy Secretary to the Treasury and Tax Policy Department to agree on research objective, approach and outputs;
- Information gathering through above mentioned methods;
- Brainstorming and research to generate “long-list” of policy and administration reform options;
- Selection of a short-list with the Tax Policy Department and MSME tax specialists, against criteria including the likely impact and cost, the experiences of other countries, and the technical, political and economic feasibility;
- Presentation and discussion of a first draft paper with Tax Policy Department and other selected stakeholders;
- Presentation of a final draft paper at a roundtable chaired by the Deputy Secretary to the Treasury, attended by other MFPED officials and several of Uganda’s development partners;
- Finalisation and publication of paper; and
- Presentation of final paper in a public roundtable to a broader set of public and private stakeholders.

Effects of Taxation on Small Firm Growth and Formalisation

The 2018 Uganda Entrepreneurial Ecosystems Initiative (UEEI) survey of high-growth MSMEs found that **“tax and tax administration” was the most-cited constraint to growth** (ANDE, 2018). Similarly, the most recent World Bank Enterprise Surveys (2013a) found that small firms in Uganda say taxation and undercutting by informal firms are the two largest business environment obstacles. A study of informality in Greater Kampala agreed, finding that high tax rates and aggressive or unfair tax administration practices constrained small businesses growth (Hobson, Sameh & Kathage, 2017).

Figure 1: **Percentage of small firms⁴ identifying the problem as their main obstacle⁵**



Recent research suggests that **the incentives facing MSMEs are stacked on the side of tax avoidance rather than compliance** (ANDE, 2018). Tax compliance naturally comes with several benefits, including access to formal finance, larger corporate or government contracts, the ability to carry out high-visibility marketing without fear of being noticed by the revenue authority, and the trust of consumers who prefer buying from “legitimate” suppliers (For & Murray, 2013). But these benefits are outweighed by a number of disincentives that small firms face. These include (1) a disproportionately high cost of compliance, (2) a high degree of informal competition, (3) a lack of understanding of the tax system, (4) a relationship of fear and animosity with the tax authority, and (5) low tax morale due to a general distrust of government. These five factors are elaborated below.

4. A “small firm” in this case was defined as having between 1 and 19 employees, both formal and informal.

5. Data taken from the World Bank Enterprise Surveys, 2013 and 2006.

First, **small firms face disproportionately high compliance costs in a tax system that tends to favour large firms.** While the standard Corporate Income Tax (CIT) regime offers various deductions and incentives to firms, the presumptive income tax regime does not currently provide any similar incentives. MSMEs which graduate into the CIT regime rarely benefit from these deductions, largely due to a lack of awareness and ability to effectively manage their tax liabilities (ANDE, 2018). The recently developed Domestic Revenue Mobilisation Strategy (MFPED, 2019) presents evidence that smaller taxpayers bear a higher effective tax rate than large firms, who pay in the region of 1% of turnover in tax, despite a 30% nominal tax rate on profit. This divergence can partially be explained by the exploitation of allowable deductions and exemptions to reduce chargeable income. Furthermore, research into tax compliance costs across several developing countries⁶ indicates that a high degree of regressivity is common, with smaller businesses spending a larger percentage of their turnover on meeting tax requirements (Coolidge, 2012). This was attributed to significant capacity constraints among small businesses, given low education levels, poor book-keeping, and difficulties understanding tax forms. While a comparable survey has not been conducted in Uganda, anecdotal evidence suggests that small business owners face similar challenges, while larger businesses can afford to employ tax accountants or outsource their tax filing.

Second, **most MSMEs compete in an environment of high informality, making compliance a major competitive disadvantage.** The compliance burden is magnified in an environment where the vast majority of firms operate informally, since a tax compliant MSME faces serious price competitiveness and margin disadvantages over its non-compliant competitors. In fact, among small firms, practices in the informal sector was the second most-cited constraint to growth in the most recent World Bank Enterprise Survey (World Bank, 2013a). Moreover, the percentage of small firms in Uganda competing against informal firms is increasing – in 2013, 95% of small firms reported that they compete against informal or unregistered businesses, compared to 73% in 2006. This is much higher than the average of 64% for low-income countries (World Bank, 2013a).

Third, **small businesses have a limited understanding of the tax system and knowledge of their true tax obligation.** A *Tax Compliance Cost Survey* conducted in Kenya revealed that 94% of informal businesses knew that they were legally obliged to have a trading licence, while just 24% responded that they were liable to pay taxes, despite a legal requirement for both (Coolidge, 2012). While a similar survey has not been undertaken in Uganda, a World Bank study of informality in Greater Kampala found that firms have an unclear understanding of tax regulations, with significant confusion as to what VAT refunds they might be entitled to, if any, and some firms believing that the trading licence covered all tax obligations (World Bank, 2017).

6. These findings are based on the World Bank's Tax Compliance Cost Surveys conducted in South Africa, Vietnam, Ukraine, Yemen, Peru, Uzbekistan, Armenia, Georgia, Laos, Kenya, India, and Burundi.

Table 1: **Taxes, fees, charges, and levies typically paid by a small business**

Starting a business			
1	Company name reservation fee	URSB	UGX 20,000 + UGX 2,200 bank fee
2	Registration of company documents	URSB	UGX 20,000
3	Filing of company resolutions and forms	URSB	UGX 20,000 per form
4	Stamp duty on transfer of shares	URSB	1.5% on amount transferred
5	Registration of transfer of shares	URSB	UGX 20,000 + 1% of amount of shares transferred
Local government taxes and charges (e.g. KCCA)			
6	Trading licence, required by all businesses and renewed annually	Municipal authority	Varies depending on location and nature of business, business size not relevant
7	Local service tax	Municipal authority	Depends on monthly turnover, up to UGX 100,000
8	Property tax	Municipal authority	Minimum charge of UGX 2,000, but usually between 1-12% of rate-able value
9	Market charges (paid by market vendors for stalls, shops and stores)	Municipal authority	Varies, paid monthly
Central government taxes			
10	Presumptive income tax	URA	Depends on gross annual turnover, up to UGX 2,062,500 ¹
11	VAT on inputs (below threshold for VAT registration so ineligible for refunds)	URA	18% on value of good/service
12	Import duties (although most MSMEs would not import goods directly themselves)	URA	Varies, 0-60%
13	Excise duties	URA	Varies depending on the good
Employee-related taxes and charges			
14	Employee social security contributions	NSSF	5% on gross salaries
15	PAYE withholding	URA	Depends on salary bands, 10-40%
Other “regulatory” charges			
16	Annual returns filing	URSB	UGX 50,000
17	PPDA provider registration	PPDA	Works: UGX 187,500 Services and supplies: UGX 150,000 Annual renewal: UGX 50,000
18	Stamp duty on contracts	URSB	Various rates
Taxes on typical business expenses			
19	Motor vehicle registration	URA	UGX 1,018,00 – UGX 1,718,000, depending on size of vehicle
20	Motor vehicle transfer	URA	UGX 84,000
21	Mobile money levy on withdrawals	URA	0.5% of value
22	Mobile money transfer excise duty	URA	Varies according to transaction value

1. See tables with tax rates for more detail.

Fourth, **there is a strong perception among MSMEs of harassment rather than encouragement by tax officials.** In UEEI focus groups, many examples were cited of URA officials being heavy-handed or aggressive towards small firms, rather than supporting them on matters of tax compliance (ANDE, 2018). Practices such as locking up the machinery or premises of businesses whose tax payments are overdue (which reportedly occurs in Kampala, although the extent is unknown) are perceived as draconian and result in the unnecessary loss of livelihood (Hobson, Sameh, & Kathage, 2017). Some MSMEs have noted improvements, with one saying, “It used to be scary to visit the URA offices, but now if there is something unfair, they will rectify it and help you.” Still, MSMEs struggle to access the knowledge, skills and support needed to become fully tax compliant and benefit from provisions that can reduce the tax burden, such as deductions.

Fifth, various stakeholders reported **a deep mistrust of government among the business community, with a particular perception that taxes are not translated into services to help MSMEs succeed,** but rather line the pockets of corrupt officials (ANDE, 2018). Many stakeholders, not only MSMEs, lament that there is little evidence of government spending to strengthen the MSME operating environment (ANDE, 2018). More generally, the Transparency International Global Corruption Barometer (2019) found that 46% of public service users in Uganda had paid a bribe in the previous 12 months, and 78% of respondents felt that government was not effectively tackling corruption. One interviewee commented that “We are paying tax to finance people’s political agendas. We don’t see the services.”

“

URA says that they are going to install a chip on shops’ PCs so that they can see their accounting systems. So, we are even considering removing the PCs. Our competitors are not using computer-based systems.”

Furthermore, the assessment of certain local-level taxes (such as trading licences) depends on observation of the business by the authority, creating opportunities for discretion and corruption (Hobson, Sameh & Kathage, 2017). Some efforts have been made by URA to improve perceptions. One such example is the Taxpayers’ Appreciation Week, where different government agencies showcase the initiatives that they have implemented using taxpayers’ money. Despite such initiatives, the predominant view of URA remains relatively poor. One factor may be that such events tend to “preach to the converted”, in the sense that the audience is a small, privileged group of already-compliant taxpayers.

“

GOU reap what they
don't sow”

“

URA are a shark, ready
to swallow us”

“

URA, those guys
are thieves”

Finally, a disincentive to formalise is a disincentive to grow. Many entrepreneurs operating informally (or partially in the formal economy and partially outside it) essentially grow sideways rather than upwards: when their first venture reaches a size where informality and non-compliance becomes a binding constraint on growth, the entrepreneur starts a second venture, and so on (ANDE, 2018). Thus, none of the entrepreneur's ventures are able to grow into medium or large companies. In addition, many MSMEs avoid the maintenance of strong records for fear that URA will use them to extract tax, which in turn makes it difficult for these MSMEs to access formal finance and corporate or government contracts. Those businesses that are compliant report feeling “victimised” by the authorities and continue to pay for fear of government “retribution”, rather than as a fair exchange for services or from a sense of obligation.

This paper proposes a reform and research agenda towards a pro-growth, pro-formalisation small business taxation system that:

- seeks to maximise revenue collection in the medium- and long-term by fostering small business formalisation and growth in the short-term;
- eases the tax and compliance burden for small businesses;
- equips small businesses with the information and skills needed to effectively manage compliance; and
- increases the incentives to formalise and reduces the disincentives to formalise.

Tax Regime Reform

Reducing the complexity of the presumptive tax structure and improving the business regulatory environment are two major areas where policy reform could promote firm growth. Firm proposals to address these issues should be developed in consultation with the MSME sector, which has historically been excluded from the policy-making process.

In principle, the objective of any simplified regime for micro and small businesses is to remove tax-related obstacles to formalisation and growth, and to encourage voluntary compliance (Coolidge & Yilmaz, 2016). While the short-term revenue potential from taxing small businesses is low, other benefits have been posited. Taxing the informal sector may be an important part of sustaining “tax morale” and tax compliance among larger, more profitable firms (Joshi et al, 2014). There is also some evidence that taxation can pave the way to formalisation, which may then accelerate growth for informal firms (De Mel, McKenzie & Woodruff, 2012). With respect to governance, the payment of taxes by small, largely informal businesses may be a method of engaging with the state, promoting legitimacy, political accountability, and better governance (Prichard, 2009). From the perspective of firms, research conducted in South Africa found that 75% of small businesses perceived that tax compliance benefits exist (Smulders et al, 2012). In particular, firms believed that paying taxes was an incentive to keep better, more accurate records, and that this led to better knowledge about the financial position and profitability of their businesses.

Uganda has sought to draw the informal sector into the tax system through a simplified *presumptive regime*, where a business’s tax liability is determined by its turnover, instead of profits as in the regular corporate income tax regime. This reduces reporting requirements, theoretically easing compliance. Businesses with an annual turnover below UGX 10 million are exempt from taxation, while businesses with turnover between UGX 10 and 50 million are taxed a lump sum across three brackets according to their sector and location. Between UGX 50 and 150 million, the effective tax rate is either a lump sum or 1.5% of turnover, whichever is lower, across four brackets (shown below).

Table 2: Small business tax schedule⁷

Gross Annual Turnover	Tax Payable
0 – 10 million	Exempt
10 – 50 million	<i>*Special regime depending on location and nature of business (see Table 3)</i>
50 – 75 million	UGX 937,500 or 1.5% of gross turnover, whichever is lower
75 – 100 million	UGX 1,312,500 or 1.5% of gross turnover, whichever is lower
100 – 125 million	UGX 1,687,500 or 1.5% of gross turnover, whichever is lower
125 – 150 million	UGX 2,062,500 or 1.5% of gross turnover, whichever is lower

7. URA, Simplified Guide on Taxation of Small Businesses, 2016.

However, as noted above, **Uganda's presumptive tax regime** is not currently achieving its aims: informality remains high, tax morale low, and both the cost of compliance and cost of collection are high, stymieing small business growth and formalisation, and making tax collection from the small business sector hard to justify for URA.

Considering central government taxes only does not give the full picture of the tax relationship between small enterprises and the state. From a firm perspective, all taxes, fees and licences are all perceived as payments due to the same state. Even the smallest enterprises are obliged to pay various fees to local governments, including registration and trading licences paid annually, user fees such as market dues, and other operating permits determined by business activity. This does not include payments for utilities, such as electricity and garbage collection, which are collected separately by the provider. While small businesses have great potential to grow, the current process of formalising one's business, registering for tax, and obtaining a number of different licences increases the cost of doing business, lowers income and productivity levels, and creates opportunities for corruption and collusion through numerous interfaces with government.

The case for change is clear. This paper proposes two areas for reform: (1) the presumptive tax structure, and (2) the business licence regime.

1. Simplify the presumptive tax structure

The principal goal of the presumptive regime should not be revenue collection, but rather to build a culture of tax compliance. The amount of revenue collected from small firms is negligible: while small businesses represent 90% firms in the private sector, they account for less than 0.05% of total revenue. Presumptive tax collection in FY2018/19 was UGX 7.2 billion, against total revenue collection of over UGX 16 trillion (see Figure 2). While presumptive tax collection has been growing, the potential for substantial growth is small – the vast majority of firms in the informal sector are micro-enterprises, with turnover of less than UGX 10 million per annum, and are thus under the taxable threshold (Hobson, Sameh & Kathage, 2017). Furthermore, URA staff indicated that firms above this threshold tend to stop paying after one year, either due to closure or avoidance, weakening the potential for revenue growth and requiring further administrative effort to determine the cause of non-payment.

Although the Ugandan presumptive tax structure is fairly progressive, the high number of brackets, and the large number of separate fees, create complexity for small firms and perverse effective tax rates. Given their size and diversity, small businesses pose a significant challenge for the tax administration. In principle, a presumptive tax should lower compliance costs for taxpayers while also lowering collection costs for the revenue authority. However, the current mixture of percentage and lump sum amounts may be creating regressivity and counterproductive incentives. For instance, a Kampala-based general trade business with a turnover of UGX 10 million would pay UGX 250,000 in tax, or 2.5% of turnover, while the same business with a turnover of just under UGX 50 million would pay only 1% of turnover (or 1.5% if the business turned over just over UGX 50 million).⁸

The presumptive regime appears to be duplicating some licences and local taxes, creating further complexity and an excessive burden for small firms. Taxpayers have raised concerns about double taxation on the same business activity and overlap between central and local government taxes. The first part of the presumptive regime (UGX 10-50 million) operates in almost the same way as a trading licence – levying a charge on businesses based on their location, nature, and size. The second part of the regime operates in the same way as the local service tax – levying a charge based on turnover alone. Taxpayers often report being “squeezed”, paying an array of taxes and fees without receiving any services to support their businesses in return. The number of permits and approvals a business needs to obtain creates a time-consuming and expensive process (summarised in Table 1).

The large number of highly dispersed, very small firms in Uganda makes tax collection disproportionately expensive and complex for the tax authority. Many MSMEs report a low risk of being caught, prosecuted, and penalised for tax evasion, pointing to weaknesses in tax enforcement. A survey of 938 small businesses in Katwe (Pimhidzai & Fox, 2012) found that only 7% of businesses paid income tax to the central government, while 70% met the threshold. Investigating this non-compliance revealed that the majority (65%) intended to avoid payment, either because they felt taxes were too high or that their firms were too small to pay.

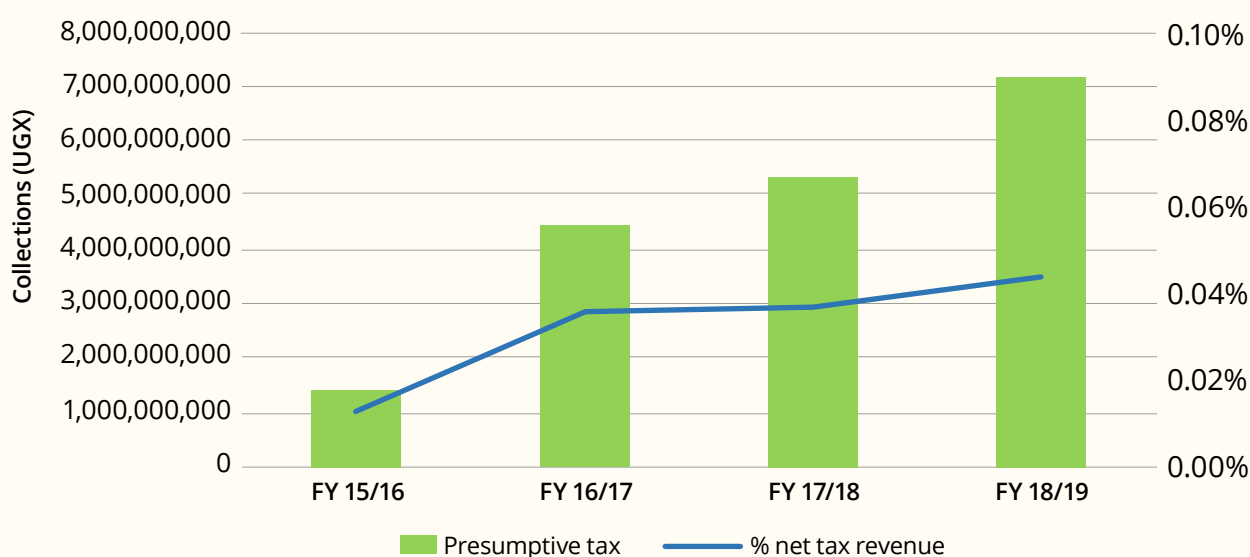
“

Many companies have two receipt books - one for declaration to URA and a separate one for internal accounting.”

8. Refer to the tax rates in Table 2 and Table 3.

Cost of compliance and collection is further driven up by poor information about earnings, which makes it difficult for entrepreneurs to determine their tax obligation, while also undermining URA's efforts to establish the correct presumptive tax. This often gives rise to accusations of "arbitrary" assessments by URA which do not reflect the taxpayer's reality (Verberne & Arendsen, 2019). A study on small firms' tax behaviour in Rwanda found that a reform, which lowered the tax liability of small firms by 40% on average, resulted in a persistent average increase in the amount of taxes paid by 75% (Tourek, 2019). The author found that entrepreneurs have a low ability to accurately estimate their revenue, with only half of firms keeping a form of accounts or receipts, overwhelmingly in handwritten logs, and very few employing accountants. Uncertainty about taxable income leads firms to rely on "rules of thumb", predominantly targeting past liability and paying identically what was paid in previous years (Tourek, 2019). When reforms lowered firms' tax liability, they responded by erring on the side of paying more, relying on a salient payment point rather than accounting records.

Figure 2: Trends in Presumptive Tax Collection⁹



This presents a **compelling argument for radically simplifying the presumptive tax regime**, which would have the following **positive impacts**:

- **Lower compliance costs**, thereby reducing small firms' disincentives to formalise, reducing the regressivity of the tax compliance costs, and encouraging more firms to enter the formal system and grow.
- **Increase formalisation**, thus widening the tax base and allowing the presumptive regime to play its role as a tool for tax education and enhancing tax morale.
- **A reduction URA's cost of collection** from a segment whose contribution to total revenue is negligible, by simplifying the determination of tax liability. Any revenue loss is likely to be outweighed by administrative efficiency gains as resources currently dedicated to small business taxation can be redeployed.

9. Data provided by the Tax Policy Department, "Ministry of Finance, Planning and Economic Development".

- **Improve the perception of URA and government** among a very large set of citizens and voters.
- **Increase small firms' ability to understand the tax system and their own tax liabilities**, and thus their ability to plan ahead and predict cashflows.
- **Make the benefits of compliance more salient**, including enhanced quality of record-keeping and better knowledge of the business's financial affairs
- **Remove avenues for discretion, and thus corruption**, on the part of tax collection officers, thus enhancing the impartiality of the system. "Equity theory" suggests that individuals are more likely to comply with rules if they perceive the system that determines those rules to be impartial (Fjeldstad et al, 2012).

Recommendations

- 1A. Re-examine the tiered rate structure of the presumptive regime.** A tiered rate structure like Uganda's introduces complexity, although it may encourage compliance amongst young firms by applying a low rate to low turnover. Furthermore, the number of discontinuities or "kinks" in the structure might encourage bunching under thresholds. Boonzaaier et al (2019) find sizeable bunching of small firms in South Africa, largely driven by under-reporting of sales and legal tax-planning activities to avoid crossing into a higher tax bracket. Under-reporting of sales is relatively easy for small traders dealing predominantly in cash. The responsiveness of MSMEs to presumptive tax kink points should be studied, and the rates set should be more closely aligned with business activities to avoid over-taxation. The recent simplification effort in Rwanda could be informative. In 2012, the turnover tax was reformed to effectively allocate firms into two groups: if the firm had business accounts, they paid tax according to a linear schedule; if the firm did not have accounts, they paid a lump sum schedule, easing compliance (Tourek, 2019). An analysis of the structure should include determining whether the current presumptive top tax rate is set to avoid large upward adjustments in the tax burden when a firm graduates from the presumptive into the regular CIT regime.
- 1B. Raise the threshold at which presumptive tax takes effect.** This threshold was last adjusted in 2015/16 and is likely to have been eroded by inflation since – recent annual inflation rates have exceeded 5% (BOU, 2018). A more appropriate threshold should be determined through a careful analysis of the interaction between business income tax, VAT, and personal income tax. Furthermore, an appropriate threshold would consider the national small business development strategy and the level of turnover at which small businesses are capable of keeping suitable records. Best practice is to adjust thresholds periodically to account for inflation and avoid fiscal drag – without adjustments, as incomes rise, a higher proportion of income is paid in tax.
- 1C. Consider removing the "special" presumptive regime applied to businesses with turnovers of UGX 10 – 50 million.** This would exempt any business with annual turnover below UGX 50 million from income tax, raising the effective threshold. Removing taxes applied to the smallest businesses would both simplify the regime and reflect the reality that the vast majority of these firms are

“subsistence” in nature and already pay a vast array of fees, charges, licences, and indirect taxes, so will not escape taxation completely. This adjustment would also reduce the perception of “over-taxation”, improving tax morale, and substantially ease the administrative burden of small businesses. Indeed, there is a substantial risk that the total cost of administering the presumptive regime amounts to more than the revenue collected.

Table 3: **Special presumptive regime for businesses with annual turnover between UGX 10 - 50 million**

Location	Business sector	Turnover	Turnover	Turnover
		10 – 20 million	20 – 35 million	35 – 50 million
Kampala	General trade	250,000	400,000	500,000
	Carpentry/metal workshops	250,000	400,000	500,000
	Garages	300,000	450,000	550,000
	Hair & beauty salons	300,000	450,000	550,000
	Restaurant & bars	300,000	450,000	550,000
	Clinics	300,000	450,000	550,000
	Pharmacies	100,000	350,000	500,000
	Other	200,000	300,000	450,000
Municipalities	General trade	150,000	300,000	400,000
	Carpentry/metal workshops	150,000	300,000	400,000
	Garages	200,000	350,000	450,000
	Hair & beauty salons	200,000	350,000	450,000
	Restaurant & bars	200,000	350,000	450,000
	Clinics	200,000	350,000	450,000
	Pharmacies	150,000	300,000	400,000
	Other	150,000	350,000	400,000
Towns and trading centres	General trade	100,000	200,000	300,000
	Carpentry/metal workshops	100,000	200,000	300,000
	Garages	100,000	250,000	350,000
	Hair & beauty salons	100,000	250,000	350,000
	Restaurant & bars	100,000	250,000	350,000
	Clinics	100,000	250,000	350,000
	Pharmacies	100,000	200,000	300,000
	Other	100,000	250,000	300,000

2. Reform the “nuisance” business licence regime

In principle, licences should be introduced solely to ensure that businesses comply with certain standards to safeguard the public interest (guaranteeing the health, safety, or security of consumers and to protect the natural environment) and to manage limited natural resources (such as in the extraction of minerals). Revenue generation is an inappropriate motivation and often leaves the public uncertain about the purposes of licencing (World Bank, 2006). International best practice indicates the following key characteristics for sound licencing laws (World Bank, 2006):

- Licences should be valid in all local government jurisdictions, such that businesses do not have to acquire separate licences for every jurisdiction in which they operate;
- Licence rates should reflect the administrative cost of collecting and processing applications, rather than serve as a fiscal tool;
- The frequency of licence renewal should be minimised, unless this is strictly necessary to ensure the public interest; and
- The requirements for licence acquisition should be contained in the law, including the exact supporting documentation to submit.

Licencing of businesses was originally introduced for regulatory purposes; however, revenue-raising objectives have increasingly eroded this intention. Until recently, 790 different business licences, permits, and user charges were issued by central and local government authorities in Uganda (Jonkheer, 2017). In 2012, a review of business licences led to several legal and administrative reforms. However, many of these appeared to expand the licencing regime to further increase revenue, rather than streamline the regime to facilitate business. Ultimately, the licencing reforms implemented between 2012 and 2017 were found to increase overall compliance costs by 8%. An assessment of this effort concluded that “the Government of Uganda seems not primarily interested in business licencing simplification” (Jonkheer, 2017). The majority of licences are granted or denied merely on the basis of producing the requisite documents, including a certificate of incorporation, tenancy agreements, and a TIN, rather than by satisfying, for example, health and safety inspections. This reinforces the view that licences are simply a tool for local government revenue generation, rather than used for regulatory purposes.

Despite the 2012 reform efforts, governmental authorities still apply over 500 licences and similar instruments, with KCCA alone levying over 100 different trading licences. In the World Bank (2019) Doing Business report, Uganda performed particularly poorly on indicators for “starting a business”, ranking 164th out of 190 countries, below Rwanda at 51, Kenya at 126, and South Africa at 134. This is partly due to the high number of procedures required (13, versus a Sub-Saharan African average of 7.4), and the lengthy process required to file registration documents with the Uganda Registration Services Bureau (URSB), register for taxes, obtain a Taxpayer Identification Number (TIN), and acquire the correct trading licences. Starting a business in Uganda typically takes 24 days, with registering for taxes taking between 4 and 6 days alone (World Bank, 2019).

The multitude of government charges small firms face appears inconsistent and are not always mutually exclusive. Each local government has its own tariff structure for licences, differentiated according to the type of business, and the resulting structure across the country does not appear logical, with an opaque rationale for rate progression across business types and districts. In addition, a particular business might require several different licences, depending on the range of activities undertaken, creating undue complexity (for instance, a hotel might require separate hotel, bar, and swimming pool licences). These difficulties are accentuated by numerous overlaps at local and central government levels.

Kenya's Business Regulation Guillotine

In 2004, a report on administrative barriers to investment in Kenya concluded that the licencing regime was "archaic, inefficient, costly, and unreliable", with over 1300 licences and permits in effect (World Bank, 2006). In response, the Kenyan government established a committee tasked with streamlining the regulatory environment, reducing the number of licences, and making the regime more transparent and focused on legitimate regulatory purposes. The committee reviewed Kenya's licences using the "guillotine approach", whereby all licences which cannot satisfy predetermined criteria are recommended for removal.

The criteria used were straightforward: (i) is the licence legal; (ii) does it advance an appropriate environmental, health or safety objective; and (iii) is a licence the most efficient way to achieve that objective. Remaining licences were reviewed against additional criteria, covering the frequency of renewal, the possibility of amalgamation, time-limits for government responses, and reducing the number of target groups. The working committee recommended the elimination of over 400 licences and the simplification of a further 600. Special attention was paid to the top 26 licences perceived as the most burdensome for the private sector – 16 of these were identified for elimination. In 2009 Kenya was identified as a top reformer in the World Bank's Doing Business report.

Cross-country research indicates fairly robust evidence that **reforms to simplify regulation in developing countries are associated with increases in investment and faster growth**. Haidar (2012)¹⁰ finds statistically significant evidence for economic growth in response to regulatory reforms from the World Bank's Doing Business Index, across 172 countries. Similarly, Eifert (2009)¹¹ finds a relationship between reduced regulatory barriers and increased investment rates, particularly for countries which were relatively poor but well-governed. Against this background, the case for substantial business licencing reform is clear – licences constitute a critical barrier for entrepreneurship, business development and investment and simplifying business licences can generate quick wins by cutting down transaction costs for firms.

10. The paper uses the World Bank Doing Business indicators as proxies of business regulations. A positive "reform" was defined as one that made it faster, cheaper, or administratively easier for domestic businesses to start and run operations. For example, this might include reducing the number of days required to get an industry licence or eliminating capital requirements for start-ups.

11. Similar to the above, the paper uses data on regulatory burdens from the Doing Business project, including indicators for business registration, contract enforcement, labour regulations, property registration, and import-export.

Recommendations

- 2A.** Undertake a **mapping exercise to identify all business licences currently in force in Uganda and establish a comprehensive electronic registry of all licences.** This will significantly enhance transparency and reduce regulatory uncertainty for businesses. While a similar mapping exercise was attempted in 2012, as noted above, this did not substantially reduce or streamline the licencing regime.
- 2B.** Substantially **reduce the number of unnecessary licencing requirements to improve simplicity.** After mapping all licences, a consultative reform effort should be undertaken to remove licences which do not satisfy predetermined criteria, including necessity, efficiency, and business-friendliness.
- 2C.** Ensure that **revised licence rates accurately reflect the cost of the licence's regulatory function,** covering administrative costs rather being used to generate revenues. This will make the function of a licence more transparent.

Tax Administration Reform

Much of the literature on improving small business taxation focuses on the tax policy, while MSME tax administration is paid little attention. This section sets an agenda for further research into other parts of the tax ecosystem. These issues cannot be resolved with simple policy adjustments and require a holistic approach from government, acknowledging that tax compliance among MSMEs is more likely to be motivated by “carrots” than “sticks”. Four areas are considered: taxpayer education, rewarding tax compliance, filing simplification, and access to tax justice.

3. Provide tailored and tested taxpayer education to the small firms that need it most

Effective tax education supports voluntary compliance and reduces small taxpayers’ cost of compliance. There is an increasing recognition that lack of tax education and knowledge is one of the key obstacles to voluntary tax compliance (Kira 2017; Nalishebo & Halwampa 2014; Tanui 2016). Conversely, a lack of understanding of the tax system can lead to higher compliance costs and even overpayment (Mascagni & Santoro, 2018). According to the Tax Administration Diagnostic Assessment Tool (TADAT, 2019), a tax system best supports voluntary compliance if it provides taxpayers with up-to-date information “to explain, in clear terms, their obligations and entitlements for each core tax” and if taxpayers are given “guidance from the tax administration”.

URA and MFPED both recognise the importance of taxpayer education and outreach. This is reflected in URA’s existing efforts, including URA’s call centre, taxpayer days, tax literature, radio talk shows, and tax clinics, among others. In addition to these initiatives, taxpayer education is normally one of the central functions of a presumptive tax regime such as Uganda’s. The idea is to bring small firms into the formal system through a simplified format in which they can learn how to pay taxes and develop a culture of compliance before “graduating” into the general tax regime.

However, existing efforts appear not to be having the desired effect. Based on interviews with high-growth MSMEs and other key players in the MSME ecosystem, current taxpayer education is not achieving its goals (ANDE, 2018). All MSMEs interviewed for this paper called for better education on how to identify, manage, and pay their tax liabilities effectively and efficiently. Most new taxpayers have very little tax knowledge and MSMEs often incur penalties which would have been avoided if they received the right information. Many informal sector MSME players have low levels of education and are not comfortable with English, which is the predominant language in which tax information is available and tax education is delivered. Finally, several tax services are currently provided online and the IT literacy levels of MSMEs are also still relatively low.

Current taxpayer education efforts are at risk of missing the very businesses that need it the most. Low attendance at tax trainings has been widely observed in countries with large informal sectors. This can be due to practical issues such as transport costs but is often linked to low perceptions of the usefulness of tax training, a lack of willingness to pay taxes at all, or a preference to avoid any engagement with tax-related authorities (Mascagni & Santoro, 2018). For instance, in interviews carried out for this paper, many MSMEs explained that they choose not to attend tax education workshops held by URA. Some MSMEs even fear that tax education delivered by URA is actually a scheme to capture taxpayers or gain access to information for audit purposes.

“

I don't go to URA tax education workshops – that's too close to the lion!”

There is evidence that effectively designed and targeted tax training for small firms improves compliance. An ICTD study (Mascagni et al, 2019) on the Rwanda Revenue Authority's (RRA) tax education programme, targeted at newly registered taxpayers through half-day sessions repeated throughout their first year of formal operation, found positive effects on tax knowledge, perception of tax complexity, and compliance. The programme increased the probability to declare by 27% compared to the control group. The study also found that “if a taxpayer files in his first year he is 55% and 86% likely to file again in the second and third year, while those who fail to declare are 99% likely to fail to file in the following years”. Thus, “a one-time educational input can push taxpayers into the habit of declaring, which in turn builds a culture of compliance and may bring positive revenue gains down the line” (Mascagni et al, 2019). Similar positive effects have been found from municipal-level taxpayer sensitization programmes through radio, newspapers, television and other channels in Mwanza, Tanzania (Machogu & Amayi, 2013).

Because of small firms' widespread fear and/or refusal to engage directly with the tax collecting authority, it may be necessary to explore alternative bodies whose mandate could be expanded to include taxpayer education. These could include business associations, universities, business development services providers, or civil society organisations. Fjeldstad and Heggstad (2012) report “success stories from Tanzania, where tax workshops are implemented by actors closer to the target audience: churches, in particular, are seen as effective partners to reach broader segments of the population, since they are present all over the country, enjoy a high degree of legitimacy and are able to communicate in a way that is closer to the general public” (Mascagni & Santoro, 2018).

Tax education is often underfunded compared to traditional enforcement functions such as audit or risk management (Mascagni & Santoro, 2018). This manifests itself in an inadequate number of staff being thinly stretched over many tax education and outreach activities, and ultimately hurts the quality of the service (Lubua, 2014; Mascagni & Santoro, 2018). This underfunding comes from a general perception among tax authorities that the proven impact of tax education on revenue collection is weak.

Scarce resources should be used on the activities that have the greatest desired impact. The immediate success metrics for MSME tax education should focus on firms' understanding of the tax system (including understanding their own liabilities, how to comply, how to avoid over- or underpaying, how to seek tax justice, and so on), their understanding of why it is important to pay taxes, and what their tax contributions are used for. Compliance and actual revenue collected are more indirect measures that depend on a multitude of factors of which tax education is just one.

In order to ensure scarce resources for tax education are used on the most effective activities, **tax education initiatives should be rigorously designed and tested before being rolled out at scale.** Some emerging evidence from the literature can guide the design process. **According to recent academic research, tax education for small firms is most effective when** (Mascagni & Santoro, 2018):

- **Tax clinics are delivered to a clearly segmented and targeted audience and smaller groups.** Training targeted at specific segments, such as farmers or traders, in smaller groups, can more effectively respond to that group's particular needs and knowledge gaps.
- **Delivered at pivotal points in time.** There is evidence that "trainees tend to forget what they have learned fairly quickly" and that "even relatively intensive programmes have barely any impact after eighteen months". This suggests that tax education should be delivered at specific salient moments, such as filing deadlines, when the recipient is faced with decisions and the advice carries immediate relevance.
- **The training is personalised and/or accompanied by individualised coaching.** The tax-related challenges that small firms face are often very specific to the firm. Recent impact studies of tax education initiatives have shown that more personalised trainings lead to better results, "as theory becomes more relevant to trainees' lives, who in turn pay more attention and retain more of the content".
- **Individuals who are trusted by and close to the target firms are involved.** For instance, "the involvement of local authorities and traders' representatives has been shown to be particularly useful in sensitising taxpayers and reaching a broader audience" (see Fjeldstad and Heggstad 2012; OECD 2015).
- **Coupled with training in other related areas.** Small firms' tax knowledge constraints are intimately linked with other constraints such as financial management. Trainings that tackle these constraints simultaneously are often more effective than narrowly targeted initiatives.
- **It highlights the fiscal contract that underpins taxation. Linking tax education to information about public services, budget transparency and government accountability** can play a crucial role in encouraging taxpayers to voluntarily comply with tax laws.

Individualised tax education and outreach in India and Zambia

In India, general training combined with visits by tax coaches to provide individual counselling improved financial behaviour more than training alone (Mascagni & Santoro, 2018). In Zambia, a radio call-in programme, where taxpayers can discuss issues they are grappling with and receive feedback on-air, also provides instructive real-life examples to other listeners who may be facing similar challenges.

Recommendations

- 3A. Carry out rigorous action research** (in partnership with external experts and researchers) **to identify the most effective ways of delivering tax education to small firms in the presumptive regime.** This research should identify the content, delivery methods and channels that are most likely to reach small firms, build a culture of voluntary compliance, and empower them to effectively identify, manage and pay their tax liabilities. Human-centred design methodologies¹² offer helpful approaches for developing solutions that respond to the contexts, needs and capabilities of small firms. The URA call centre could be used to gather data on which taxation issues firms struggle with most.
- 3B. Rigorously test the most promising tax education content, delivery methods and channels.** Because resources are scarce, tax education initiatives should be carefully tested before being rolled out at scale. Partnerships with academics and research funders to undertake Randomized Controlled Trials may be an effective strategy to achieve this.
- 3C. Deliver a rigorously designed and tested tax education programme for free in an easily accessible and potentially mandatory way to firms upon registering for a TIN, especially those in the presumptive bracket.**

South Africa's Mobile Tax Units

One of the ways in which the South African Revenue Service (SARS) delivers tax education is through Mobile Tax Units (MTUs). MTUs allow officers to reach taxpayers where they live, especially in rural areas. MTUs offer to help citizens when paying taxes and explain why taxes should be paid, with the dual goal of increasing filing and tax compliance as well as tax literacy. Services offered by MTUs include completion and submission of tax returns, submission of PAYE statements of account, general queries, and changes in banking and registration details. After a trial run in 2009, three MTUs were launched for the filing season of 2011, and an additional six have been provided since 2013.

A total of 350 staff with varying skills have been involved since the launch of the programme. SARS estimate monthly operating costs (satellite, fuel, equipment, maintenance) to be around USD 30,000. A total of 77,367 taxpayers have visited the MTUs at 601 centres over a two-year period (2011 - 2013), with an average of 128 taxpayers per location. Those visiting the MTUs mainly did so to register as taxpayers, submit tax returns, check their tax status and reconcile companies' PAYE accounts. According to SARS's website, even if a causal claim cannot be established, in 2015 '5.94 million declarations were submitted to SARS, an 11.52 per cent increase with respect to 2014. The proportion of taxpayers filing on time exceeded 90% for the third consecutive year since 2013, the year in which the programme started to run at its full capacity. (Mascagni & Santoro, 2018).

12. See for example Design Kit: <https://www.designkit.org/human-centered-design>.

4. Reward tax compliance through the provision of business development services to compliant firms

Increasing the “carrots” (direct benefits) that come with tax compliance, rather than only relying on “sticks” (fear of punishment for non-compliance) could contribute to building trust between the state and the small business sector and foster a culture of voluntary compliance among MSMEs in Uganda (Verberne & Arendsen, 2019).

MSMEs currently perceive large disadvantages and few advantages of being fully tax compliant. MSME taxpayers predominantly report that they are tax compliant due to fear of being “punished” if they were not compliant, rather than for the benefits of being compliant. Many tax compliant MSMEs question the benefits of tax compliance amidst a predominantly informal business sector which largely receives the same public services from the government. One businessman is quoted as saying “URA is only interested in the money, not the success of my business – if I disappear one day, no one comes to check on what happened to my business and why I am struggling”.

Rewards for compliance: Japan, Tanzania and Pakistan

Under Japan’s *Blue Return-White Return system*, introduced in 1950, taxpayers with proper books and records were allowed to submit Blue Returns, which were accompanied by reduced sanctions, special provisions like loss carry-forwards and carry-backs, deductions for family employees, and less stringent audits. Taxpayers submitting White Returns were denied these benefits. The system led to substantial improvement in compliance and significant growth in the share of Blue Returns.

In more recent examples, Tanzania and Pakistan have each implemented a “carrot” compliance model under the VAT whereby traders in good standing are given accelerated refunds. In Tanzania, taxpayers with good compliance histories are granted Gold and Silver status and receive expedited VAT refunds compared to all others, and are exempted from audit before refunds are approved, while all others are subject to audit.

One potential “carrot” that could make tax compliance more attractive to MSMEs is offering free or subsidised Business Development Services (BDS) to tax compliant MSMEs. BDS refers to a wide array of non-financial services critical to the entry, survival, productivity, competitiveness and growth of MSMEs. It includes training, consultancy and advisory services, marketing assistance, information services, technology development and transfer, and business linkage promotion, among others. “Operational” BDS are those needed for day-to-day operations, such as information and communications, management of accounts and tax records, and compliance with labour laws and other regulations. “Strategic” services, on the other hand, are aimed at improving medium- to long-term firm performance, access to markets and competitiveness, for instance by helping client businesses identify and service markets, design products, set up facilities, and seek financing. (World Bank, 2001).

The lack of accessible, affordable and patient management training and BDS provided through accelerators, incubators and other BDS channels available to MSMEs is likely to be a binding constraint on their growth (ANDE, 2018). MSMEs are severely growth-constrained by capacity skills gaps in bookkeeping, costings, market identification and customer segmentation, marketing, and financial modelling, business strategy and growth strategy (Open Capital Advisors, 2017; World Bank, 2017). Management skills shortages have serious effects on entrepreneurs' growth ambitions and capabilities. While several accelerators and incubators exist, they serve a small fraction of high-growth firms. Enterprise Uganda serves a larger number of MSMEs with heavily subsidized BDS, but even their outreach is a drop in the ocean compared to the number of MSMEs active in the country. Beyond these channels, there is a supply of private BDS, including professional services such as accountancy and legal advice, but this supply is limited both in quantity and quality. Organisations offering management training outside the universities also lack supervisory oversight which bring the quality and adequacy of the training they offer into question.

At the root of this constraint is the issue that quality BDS for small firms is not seen as commercially viable in Uganda, as in many similar markets. All organisations providing quality BDS to small firms (e.g. those seeking less than USD 100,000 in growth capital) are leveraging grant money to subsidise these services. This is a clear case of market failure that warrants intervention from the Government and its development partners.

There are multiple potential impacts of providing BDS as a “carrot” for tax-compliant small firms:

- Building MSMEs' administrative literacy and record-keeping skills is valuable. Learning how to keep simple records reduces costs for both the firms and for URA, as proper records make it less burdensome for an entrepreneur to make informed management decisions and for the tax authority to carry out a fair and accurate tax assessment;
- Improved tax compliance and management capacity would reduce MSMEs' effective tax rates and their fear of the tax burden;
- BDS provides MSMEs with improved management skills for growth, giving them the confidence and ability to grow, thus also encouraging formalisation (which becomes necessary at a certain size);
- MSMEs would be better incentivised to become tax-compliant due to more attractive compliance “carrots”;
- Immediate and direct public goods for compliant MSMEs would also foster a perception among MSMEs that their tax money is being spent on services that are useful to them. There is significant research under the fiscal exchange theory showing that tax compliance increases with (perceptions of) the availability of public goods and services (see Fjeldstad et al, 2012).

There is evidence that BDS provided to small firms raises firm growth and medium-term revenue collection. Under the Mauritius SME Development Scheme (SME Mauritius, 2019), SMEs with a turnover below USD 1.4 million in priority sectors qualify for certain incentives including business support solutions from *SME Mauritius. The Mentoring and Hand-holding Programme* provides free assistance from industry experts to SMEs that are duly registered and incorporated and hold a valid trade licence. Assistance to each SME starts with a “growth diagnostic” that identifies the areas most critical to the specific firm’s growth. Mentors with extensive industry experience then provide tailored advice on areas including financial management, accounting, marketing, operational management and IT.

Recommendations

- 4A. Make BDS a highly visible and attractive benefit of being tax compliant.** Government should consider partnering with key stakeholders to design and test a programme linking tax compliance with access to premium BDS. Ideally, the BDS should not be delivered by URA, but rather a well-placed and trusted organisation sympathetic to the needs of small businesses. One option might be to allow a tax credit for any fees paid against the final tax liability of businesses that participate in the programme. Another option to consider is the provision of a subsidy from Government to financial institutions that formalise their informal clients through the provision of BDS. This subsidy would be an investment providing returns in the form of increased tax collection, while the financial institutions would be able to partially recover the cost of providing BDS. This would also make BDS available at an affordable price for informal firms.
- 4B. Study the feasibility of establishing a BDS Fund to finance free or subsidised BDS that only tax compliant MSMEs can qualify for.** This would involve conceptualising a scheme that is highly responsive to the needs of MSMEs and to the incentives of BDS providers and MSMEs, estimating the willingness-to-pay of MSMEs for BDS to determine a reasonable level of subsidisation, and estimating the cost of the scheme. Such a fund could be financed by a percentage (say 5%, similar to the Member Education Fund amongst cooperatives) of tax collected from MSMEs and could be accessed by business associations and other BDS providers to provide training and advisory services to tax compliant MSMEs.
- 4C. Commission or carry out further research into experiences from other countries** on the cost of BDS and its impact on compliance, growth and revenue collected in the short- and medium-run.

5. Simplify the filing process

A new electronic filing system for presumptive tax returns was introduced in July 2015. This moved tax filing from an Excel-based form to a simpler, online tax declaration, removing the need for taxpayers to have access to (and know how to use) Excel. In principle, the new system should automatically calculate the presumptive tax due when taxpayers fill in their incomes. The online return also gives payment instructions and generates a receipt which taxpayers should print and submit at the bank when making a payment. The adoption of e-government initiatives by URA is commendable, as this is a promising way to improve service delivery, reduce the compliance burden, and increase efficiency. E-government initiatives also work to combat corruption by reducing the frequency of interactions between taxpayers and tax officials.

However, weaknesses remain. MSMEs interviewed for this paper reported that the URA website is not easy to navigate for a layman, guidance manuals offered online are outdated and difficult to find, and certain filing forms are written in a way that is inaccessible even to highly educated taxpayers. This is especially true where tax filing is not fully online and requires downloading and modifying an Excel sheet (with macros enabled), such as a VAT return. In addition, many MSMEs are required, under the Pay-As-You-Earn withholding system, to remit personal income tax on wages paid to employees. Some firms with these obligations have resorted to using tax consultants to ensure that filing is done correctly, adding another expense. Furthermore, many firms reported limited computer and internet access, rendering e-filing inaccessible. Anecdotal evidence suggests that help cannot always be found at a URA office: queues are long during the filing season, taxpayers are told to refer to the tax laws when trying to determine their obligation, and there is a perception that URA staff can be disingenuous, seeking to increase the tax assessment rather than inform taxpayers about available deductions.

There is a learning curve associated with e-filing: as firms become better acquainted with the e-filing system, their cost of compliance decreases. However, the learning curve is steep: e-filing might require computer skills which small business owners have not cultivated, and learning the system requires a significant initial time investment. These patterns were found when studying the e-filing experience of small firms in South Africa, Nepal, and Ukraine (Coolidge & Yilmaz, 2013), and are likely to hold in Uganda. There is limited international literature studying the impact of e-filing systems, although a study of e-filing adoption by SMEs in Tajikistan is instructive (Okunogbe & Poulighen, 2018). The authors' experiment provided a group of randomly selected firms with in-depth training on e-filing and logistical help on registration. Within this treatment group, 93% of firms adopted e-filing, compared to 60% in the untreated group. Treated firms that adopted e-filing enjoyed a 15% reduction in total time spent on tax-related activities (Okunogbe & Poulighen, 2018).

Recommendations

- 5A. Consider allowing less frequent filing requirements for small firms.** Many smaller enterprises are obliged to file VAT returns, whether because they are above the VAT threshold, or because they voluntarily elect to file VAT returns to access refunds. Full compliance currently requires firms to file VAT returns monthly, no matter their size. The same applies to those firms who withhold PAYE on behalf of employees. One approach to reducing compliance costs, while simultaneously providing firms with a cash-flow advantage, is to allow small firms to file and remit VAT and PAYE less frequently (quarterly or bi-annually). Cash-flow savings through “delayed” tax payments can be viewed as a form of subsidy and has helped to reduce compliance costs in several countries (OECD, 2007). However, implementing quarterly or bi-annual filing periods has the potential to encourage procrastination and worsen filing challenges. More work needs to be done to weigh up the costs and benefits of changing the VAT periods.
- 5B. Study the possibility of introducing a simplified VAT remittance calculation for small businesses.** Some countries have experimented with allowing small firms to apply a single flat rate to turnover to determine their VAT liability, instead of requiring a detailed, full VAT calculation (OECD, 2007). In some cases, these vary by sector. For instance, the UK allows eligible small businesses to calculate the amount of VAT to remit to government as a percentage of their VAT-inclusive turnover. Under such a scheme, the VAT rate charged on sales is unchanged from the standard system, but the method for calculating a small business’s VAT remittance is simplified.
- 5C. Make e-filing training a standard part of the wider tax education programme.**
- 5D. Conduct a consultation with relevant representative bodies to properly identify binding constraints to on-time and accurate filing.** Returns should be designed to be as simple as possible, using “plain language” instructions. URA’s e-Tax system should be appropriately designed to ensure that small firms can comply without needing tax consultant services. There is anecdotal evidence that firms are affected by complicated terminology and processes across tax heads. However, this should be more thoroughly examined through focus-group discussions, incorporating taxpayer feedback into the re-design. Designing adjustment through consensus-building would improve taxpayer sentiment towards taxation, as well as reduce the compliance burden.

6. Enhance MSME access to tax justice

The average time taken to resolve tax disputes in Uganda is longer than standard practice, with no clear mechanism for case profiling and prioritisation. TADAT (2019) scores Uganda “D” for the time taken to resolve disputes for both 2015 and 2019. During 2017/18, 79.5% of cases were finalised within 90 days, meaning that 21.5% of cases were finalised after more than three months. For MSMEs, a delay of three months or more in the tax disputes resolution process is very costly and can have serious negative impacts on business cash-flow. According to the World Bank’s (2013b) tax disputes guideline, an internal administrative review procedure should resolve tax disputes on time and should cost the taxpayer less than the formal court route. Slowness and inefficiencies in the internal administrative review process can discourage and disengage MSMEs in accessing tax justice in the early stages. Even if MSMEs do engage, the delay to finalise tax disputes is a cost to small business sustainability and can result in business closure.

Furthermore, **information on the criteria used to review objections and appeals is not available and it is not clear whether a mechanism for case profiling does exist.** It is reasonable to imagine that without case profiling or a prioritization mechanism, unequal time and resources are allocated to resolving MSMEs’ tax disputes.

There are concerns about the impartiality and objectivity of the internal administrative review process of URA’s Objections and Appeals Unit (OAU). Both TADAT (2019) and World Bank (2013b) recommend the internal administrative review procedure (OAU) to be located within the national tax authority as the first stage procedure. While this recommendation is what is in place in Uganda, there are concerns regarding the perception of impartiality of the OAU. OAU is independent of the audit process and audit department (TADAT, 2019), but there are occasions in the four upcountry Appeals and Objections Units where auditors are invited to be members of the objection committee. These auditors are different from those who review the cases, but the process is applied unevenly between OAU in central Kampala and offices upcountry. The inconsistency and lack of uniformity of procedures across different OAU objection committees raise questions about the credibility of OAU.

Escalating appeals to the Tax Appeals Tribunal (TAT) is a burdensome and costly procedure for MSMEs. TAT gives taxpayers access to an impartial and independent tax dispute resolution process and helps to ensure equal treatment under the law (Sserunjogi and Lakuma, 2019). However, for taxpayers to access a formal hearing at TAT, they are required to pay a mandatory 30% of their assessed tax liability and provide documentation such as books of accounts and business registration certifications (Sserunjogi and Lakuma, 2019). In practice, taxpayers are also required to hire a tax legal counsel to represent them at the formal hearing at their own cost. As a result, many MSMEs are discouraged from pursuing disputes through TAT that may have resulted in their favour and fear approaching the tax court because of perceptions of harassment from the tax authority. According to Sserunjogi and Lakuma (2019), a large proportion of tax disputes in Uganda is filed by large taxpayers, even though small taxpayers account for the largest share of the tax base. This suggests that small taxpayers struggle to pursue tax justice because they cannot overcome the high barriers to access. [What’s in it for SMEs?](#) Rethinking small business taxation 29

Information on appeals procedures is difficult to find and the process lacks transparency. Information on appeals procedures available to taxpayers is found on the URA website in the Frequently Asked Questions (FAQs) section, although with some difficulty and time navigating. However, the information from FAQs only includes instructions on how to appeal to Income and VAT Tax assessments and does not explain the procedures for TAT or the High Court. Information on how to appeal through electronic services or online is also found on the URA website with a PDF document, although once the documentation is opened it is found blank. Given that the information is provided electronically through PDF, most small taxpayers and MSMEs are excluded and cannot access it unless they have an internet connection and a computer. There is a lack of clarity and transparency on the information and guidance regarding appeals procedures.

Recommendations

- 6A. Conduct a comprehensive review of the tax disputes mechanism to fully understand the process and procedures in accessing tax justice for MSMEs.** As part of this review, assess the impartiality of OAU and its impact on access to tax justice for MSMEs. The ability of MSMEs to access tax justice does not appear to have been comprehensively studied or assessed in Uganda. A comprehensive review of the tax disputes mechanism is recommended to fully understand the process smaller businesses go through in accessing tax justice and the challenges they face. There is scope for further work on the effectiveness of division of labour within OAU by separating the office into two teams; small division and large division - as is the case in the Zambia Revenue Authority (TADAT, 2016).
- 6B. Allocate appropriate resources to MSME tax appeals in OAU by case profiling and explore setting up a separate Small Taxpayers Team within OAU.** We recommend introducing or reviewing the existing case profiling mechanism within OAU as suggested by World Bank (2013b). OAU can establish a mechanism and criteria to fast-track simpler cases and prioritise their review to reduce delay time and increase efficiency. This can ensure that MSMEs get access to tax justice through equal time and resources in tax disputes resolution processes and prevent damaging effects on MSMEs' cash-flow.
- 6C. Explore options for setting up a Small Claims Court within the Tax Appeals Tribunal to reduce administrative and transaction costs for MSMEs.** Australia's Small Business Taxation Division located in the Australian Appeals Tribunal (AAT) may provide a case to be drawn from. AAT incorporates a dedicated supporting case manager to the division for resolving small business appeals. AAT also relaxes the requirement for legal representation, unless the small business elects to have one, in which case the tax authority covers the cost. A Small Claims Court in Uganda could be designed with more simplified requirements to allow smaller taxpayers and MSMEs fairer access to tax justice. The simplified requirements could include i) minimising legal documentation needed, ii) a smaller mandatory fee upfront, iii) freezing interest and fees on the disputed tax liabilities, and iv) allowing taxpayers to represent themselves or use other agents. The setup of a Small Claims Court can be costly; therefore, it should be subject to a thorough appraisal of the need for a Small Claims Court and its sustainability, and consultation with the MSME community is recommended.

6D. Explore options for establishing a Taxpayer Ombudsman to handle service-related and non-assessment complaints. Uganda currently does not provide a credible avenue for taxpayers to vent their unresolved service, procedural, and administrative complaints, such as a Taxpayer Ombudsman or Advocate. Taxpayers' perceptions regarding the transparency and fairness of revenue administration operations are critical in fostering voluntary compliance. These perceptions are often formed by frustrations with systems and processes, or belligerent application of these processes by URA officers. However, this does not amount to unethical or corrupt behaviour, so it cannot be reported to URA's Internal Audit or the Compliance Unit of the Inspector General of Government.

A Taxpayer Ombudsman could either be established within TAT, as is the case in Australia (Australian Financial Review, 2019), or as an agency independent of the tax administration and appeals tribunal, as is the case in Mexico (United Nations, 2019). The Australian Small Family Enterprise Ombudsman's office is set up in the Australian Appeals Tribunal and its function is to support MSMEs' concerns on tax disputes and other non-assessment issues. In Mexico, the *Procuraduria de la Defensa del Contribuyente (PRODECON)* was established as an independent entity and its function is to address both taxpayer-specific disputes and general concerns related to the operation of the tax administration (United Nations, 2019). In Uganda, a Taxpayer Ombudsman set up with a civil society organisation as an independent advocate for MSMEs would be more likely to win MSMEs' trust than one based at the tax authority. The legal authority to access taxpayer-specific and confidential information would need to be guaranteed to the Taxpayer Ombudsman. This is to ensure the complete independence and impartiality of the ombudsman from URA, particularly if the intention is to mediate and facilitate communication in resolving disputes between taxpayers and OAU (United Nations, 2019).

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