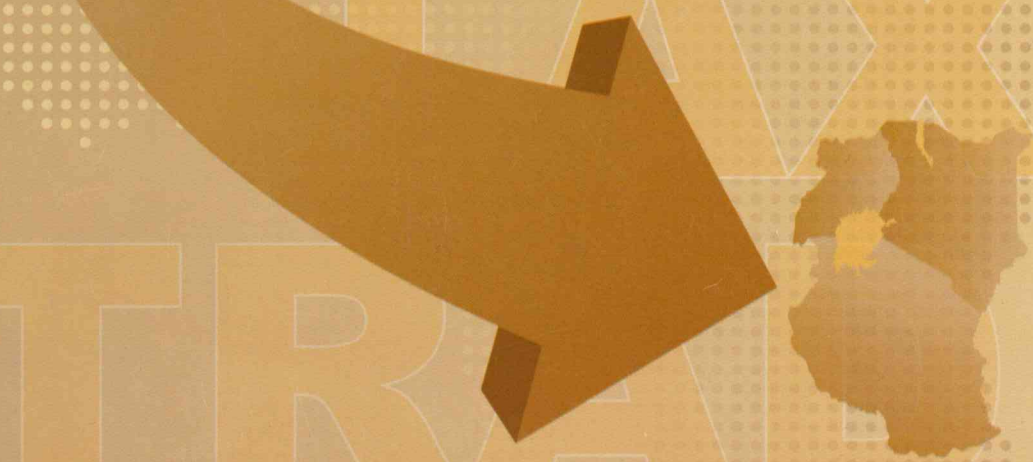
THE NEXUS BETWEEN INTERNATIONAL TRADE AND TAX GOVERNANCE:

An Assessment of Taxation Regulations in the East African Community



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Acronyms and Abbreviations

ACP	African, Caribbean and Pacific
CMP	Common Market Protocol
COMESA	Common Market for Eastern and Southern Africa
CSOs	Civil Society Organizations
EAC	East African Community
EC	European Commission
EPA	Economic Partnership Agreement
EU	European Union
FDI	Foreign Direct Investment
FEPA	Framework Economic Partnership Agreement
FOB	Free on Board
GATS	General Agreement on Trade in Services
LDC	Least Developed Countries
MFN	Most Favoured Nation
NTBs	Non-Tariff Barriers
OECD	Organization for Economic Co-operation and Development
PS	Partner States
RCA	Revealed Comparative Advantage
REC	Regional Economic Community
RTAS	Regional Trade Agreements
RTFP	Regional Trade Facilitation Program
SADC	Southern African Development Community
SEATINI	Southern and Eastern Africa Trade Information and Negotiation Institute
SSA	Sub Saharan Africa
TRIPS	Trade Related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
WDI	World Development Indicators
WTO	World Trade Organization

Executive summary

In analysing the nexus between trade and tax, it must be acknowledged that both are a prerequisite for socio-economic development in the EAC. Therefore, it is imperative that policy makers come up with a win- win situation between tax governance and trade liberalisation, because the essence of the establishment of the World Trade Organization (WTO) was to increase market access through gradual reduction of trade barriers, chief being tariffs or tax.

The paper seeks to analyse trade and tax policy reform in the EAC(hence the nexus) and further give policy recommendations for the EAC now that the region is especially being called upon to have a strong tax governance system with a view of curbing illicit financial outflows and capital flight.

The rhetoric is therefore pegged on the fact that is it really factual to state that reduction of tariffs and increased trade liberalization could actually make the EAC a socio- economic hub in the near future, and was this principle applied initially by developed countries during the agrarian and industrial revolution? By the same token is it a truism to state that having restrictive trade measures through sufficient tax governance, will take the EAC where it ought to be socio-economically?

Background

In theory, the relationship between trade liberalization and tax revenue is considered to be an indirect outcome derived principally from the response of consumption and production decisions to price changes occasioned by trade policy changes. Typical trade liberalization measures entail replacement of non-tariff barriers (NTBs) with tariffs, reduction and unification of tariffs, capital and current account liberalization, and exchange rate devaluation. In practice, however, the nexus is direct and symbiotic because you cannot have trade liberalization in the strict sense without addressing the issue of tariffs (tax) and tariff reduction or tariff escalation as a protectionist measure according to Article XIX and XX of the General Agreement on Tariffs and Trade (GATT 94).

From a trade regulatory perspective, you will find that even the agreement establishing and governing the rules of the World Trade Organization (WTO) addresses the issue of Tariffs and Trade hence the General Agreement on Tariffs and Trade.

Replacement of NTBs with import duties theoretically results in increased revenue though the ultimate revenue outcome is eventually determined by the change in value of imports in response to tariff changes. Reduction in import duties erode the base of trade taxes as well as other indirect taxes and should intuitively result in lower trade tax revenues particularly if import values remain unchanged at their pre-reform levels. It is also possible, however, for tax revenue collection to increase if lower tax rates enhance voluntary compliance. Trade tax revenue collections can also increase with lower import tariffs if the aggregate import elasticity are greater than unity. Theoretically, the revenue effects of lower tariffs may be reinforced or even offset depending on the response of import competing industries to tariff (and the implied price) reduction. A lesser supply elasticity would imply a small reduction in output due to reduced import price and hence small increase in import values.

International Trade is about the exchange of goods and services across borders with the primary purpose of maximizing benefits amongst the parties involved. For this exchange to be seamless on the one hand, there is need to reduce a number of barriers (according to the WTO), at least, gradually, and one of the barriers that WTO Member States have over the years negotiated passionately about their reduction, is tariffs or taxes, because it has been felt that taxes hinder market access especially for developing countries whose socio-economic growth is primarily pegged on trading of their primary commodities.

Historically, the General Agreement on Tariffs and Trade (GATT) - the predecessor to the World Trade Organization (WTO) was established with the primary purpose of reducing tariffs amongst member states and increasing trade, this was evident in the very many rounds from the Uruguay Round, Tokyo Round and even the Marrakesh Round which saw the birth of the WTO. However, it would suffice to note that new issues arose in these rounds such as handling of Non-Tariff Barriers (NTBs), but the primary purpose of the WTO is to create a win-win situation amongst member countries when it comes to tariff reduction and trade liberalization.

Despite these, and in addition, to member countries acceding to the WTO, there are still situations in which tariff reduction is not fully realized, and this could be pegged on various legal provision within the GATT '94 framework that allow members to impose tariffs. For instance, Article XXIV of the GATT gives members the privilege of establishing Regional Economic Blocks (RECs), this is an exemption to tariff reduction, because whenever there is a

Customs Union - a stage in regional integration, members to that REC, will impose a Common External Tariff (CET) to members outside that REC but will trade at almost zero tariffs within the REC. At the multilateral trading system, the WTO recognizes the principle of asymmetry and Variable Geometry and that is why within a REC, there are certain members who will be required to reduce more tariffs than the others, while others will be required to maintain but phase them off after a certain period due to variance in developmental needs.

The infant industry' concept recognized by the WTO is another reason why member countries are allowed to impose tariffs even though they are meant to gradually reduce them so as to minimize a sudden surge in imports and encourage more exports through the development of local industries. The concept is fronted by developing countries before the WTO as a mechanism of introducing import duties (taxes) and more often than not because of the principle of Preferential Treatment and Aid for Trade (AFT); the WTO will exempt some developing countries for a while.

The key issues in addressing the nexus between trade and tax governance may be summarized as follows:

1. Does Tax Governance Promote Fair Trade? For instance tariffs and or tax is currently being perceived as a policy tool by developing countries to ensure gains from trade. The question is whether this will promote fair trade given the fact that the GATT '94 solely advocates for minimal protectionist measures to enhance market access through trade liberalization?
2. Would it be practical for the EAC, at the very rudimentary stages of socio-economic development, to advocate for complete tariff reduction? And where does that leave the much progressed debate of tax governance to curb illicit financial flows through transfer mispricing and the misused tax haven incentive?
3. Is it premature for the EAC to negotiate complete tariff reduction within numerous trade negotiation agendas? Key example being the just concluded EAC-EU EPA negotiations where tariff reduction has been the debate to gain market entry into the EU and vice versa.
4. Protection of key industries and sectors in the EAC, such as agriculture; to ensure value addition, trade diversification and maximum trade gains through imposition of (the much protested by - developed countries), export taxes and subsequent protection of infant industries to avoid dumping - a direct phenomenon of trade liberalization.

The balance is two - fold therefore, on the one hand there is need to address the issue of revenue loss from tariff reduction and its implication for the EAC, on the other hand there lies the need to rethink the trade liberalization process in the EAC and what it could mean in terms of Partner States' tax remittance with a view to enhancing development.

ANALYSIS AND FINDINGS

Having identified the link between Trade and Tax vide the WTO regulations, there is need to analyse on how to come up with a win- win situation between tax governance and trade liberalisation because both contribute to socio –economic growth in one way or another. The paper seeks to suggest policy recommendations for the EAC now that the region is especially being called upon by CSOs and other players to stop illicit financial outflows and capital flight through closing of tax loopholes.

In doing so the paper will be looking at revenue loss from tariff reduction and its implications and concurrently look at trade liberalization in the EAC and what it means in terms of the respective governments' collection of taxes to inject into socio-economic development targets. The rhetoric is therefore pegged on the on the call to reduce tariffs and increase liberalization

while at the same nerve advocate for a sound tax governance in the EAC. Would this principle applied mould EAC into the desired socio-economic hub in the near future, as it turned Europe and other developed countries during the agrarian and industrial revolution? By the same token is it a truism to state that having restrictive trade measures through sufficient tax governance[1], will take the EAC where it ought to be socio-economically?

RATIONALE OF RESEARCH

This research is timely because historically tariffs have been the main source of revenue in many developing countries, the EAC region included. However, the structure of the economies in these countries coupled with administrative weaknesses such as inadequate capacity to enforce tax laws and limited coverage of taxpayer registration has exacerbated the problem of non- compliance.

In addition, with the substantial shift by the EAC towards a more liberal trade regime (has signed EPA); as part of the policy-based lending regime of the World Bank and the World Trade Organization. With liberalization of tariffs and minimization of non – tariff barriers to facilitate trade, comes a shift in the tariff and revenue regime in the region, which in one way or another affects the general trade policy of the EAC region.

The research is therefore justified because it seeks to bring out the implications of the ongoing trade liberalization processes to the tax regime in the EAC with particular focus on trade tax revenue which is a direct result of effective and equitable taxation. For example, under the liberalization regime, reduction of import taxes is likely to erode the base of trade taxes as well as other indirect taxes which would automatically result in lower trade tax revenues particularly if import values remain unchanged.

1 WTO Regulation on tariff reduction

RELEVANCE OF RESEARCH

The research will influence the ongoing discourse on trade and tax governance in the region within the purview of the EAC Customs Union, Common Market and the emerging East African Monetary Union which will have direct implications on fiscal and tax regulations in the region with the main focus on Customs Union and the Common Market.

RESEARCH QUESTION

The EAC has embraced trade liberalization as tool for socio-economic development. It is also arguable that, the clamor for tax governance, as a tool for socio-economic development is evident in the region[2] .Against this background, would it be a preemptive to state that a strong tax regime will boost or diminish the regions trade competitiveness internally and externally. In other words is taxation a primary factor which determines FDI flows in the region, or as some trade analysts would put it, is it likely to go against trade liberalization rules as per the WTO, if so, what fallback measures can the EAC rely on?

RESEARCH METHODOLOGY

Being a desktop study this research relied on secondary data to analyse its findings. The study employed both descriptive and quantitative approaches. The descriptive analysis is premised upon earlier findings that tariff rates and trade tax revenues are positively correlated. The tariff code also continues to offer a higher than average level of protection to some sections of the domestic industry. Those findings also posit that the discretionary exemptions on dutiable imports are a significant source of revenue leakage.

1 Through revenue collection and curbing of illicit financial flows

LITERATURE REVIEW ON TRADE AND TAX GOVERNANCE

The impact of the recent trade policy reform measures on trade tax revenue in particular and total tax revenue in general has attracted considerable attention both in the theoretical and empirical literature. Empirical assessment of the effect of liberalization on trade tax revenue has largely been undertaken in the context of simple specifications of the trade tax effort model augmented by proxies of trade liberalization. Standard ex-post approaches have been employed to explain cross country variation and changes in tax revenue shares as well as trade tax revenue.

Paul Mc Daniel briefly explores how trade agreements and a nation's income tax system do and should interact. Upon examining the WTO decision in the challenge by the European Union (EU) to the Foreign Sales Corporation (FSC) provisions of the code, and draws the following conclusions;

1. A normative income tax structure and free trade principles are not in conflict with each other.
2. The normative provisions of a country's tax system should be outside the scope of trade agreements and procedures.

Hisali in his book on trade policy reforms and international trade tax revenue observes that the relative ease with which international trade taxes are collected has historically made them to be the main source of revenue in many developing countries.[3] The structure of the economies in these countries coupled with administrative weaknesses such as inadequate capacity to enforce tax laws and limited coverage of taxpayer registration which exacerbates the problems of non-compliance are less rampant in trade taxes as entry and exit of goods into and from the country is generally straight forward. He observes that the last two decades, however, have seen a substantial shift by many developing countries towards more liberal trade regimes as part of the policy based lending programme of the World Bank and World Trade Organization (WTO) rules. The World Bank and WTO programmes are informed by theoretical links that exist between a liberal trade regime and economic growth as espoused by both the classical and new trade theories. Liberalization of tariffs and minimization of non-tariff barriers to facilitate trade and exchange rate depreciation have been at the heart of these programmes. Many developing countries are also increasingly participating in regional trading arrangements with preferential tariffs. Theoretically, the trade revenue effects of these policies are difficult to determine ***a priori*** because, ultimately, they are the result of interaction of the revenue effects of the individual measures. There are usually concerns, though, that these measures reduce international trade tax revenue in the long run.

Lehman and Coelho[4], et.al provide a comprehensive review on the fundamental elements of the conceptual background that explain how and under which circumstances taxation may be a significant factor underlying Foreign Direct Investments(FDI) decisions. They arrive at three major findings concerning the effect of taxes on FDI. First it is clear that both FDI and taxes are concepts covering heterogeneous phenomena, and therefore to compare studies, results or to make judgments on the relationship between taxes and FDI, the working definitions of FDI and taxes that are being used needs to be clearly established and understood, it is clear, according to the authors that while taxes are an important aspect of FDI decisions among managers, they are probably not the main driver of the decision. Moreover, taxes may only play a 'marginal' role compared with other determinants of FDI. Summarily the author is disabusing the mind of trade policy makers from assuming that having

[3] Hisali, 2012 pg 2144-2155

[4] Pg 89-117

a strict tax governance system (restricted trade liberalization) will limit the inflow of FDI, as a matter of fact most industrialized developing countries in particular the Asian tigers and the BRICs (Brazil, India China and South Africa) have a fairly air tight tax governance system and still attract FDI especially in the industrial sector.

Bird[5] et al. in their book assess tax assignment in decentralized countries. Ideally, own-source revenues should be sufficient to enable at least the richest subnational governments to finance from their own resources all locally provided services that primarily benefit local residents. Subnational taxes should also not unduly distort the allocation of resources. Most importantly, to the extent possible subnational governments should be accountable at the margin for financing the expenditures for which they are responsible. Although in reality most countries inevitably fall far short of these ideals, nonetheless there are several taxes that subnational governments in developing countries could use to help ensure that decentralization yield more of the benefits it appears to promise in theory. At the local level, such taxes include property taxes and, especially for larger cities, perhaps also a limited and well-designed local business tax. At the regional level, in addition to taxes on vehicles, governments in some countries may be able to utilize any or all of the following- payroll tax; as simple surcharge on the central personal income tax; and a sales tax, in some cases perhaps taking the form of a well-designed regional value added tax. The best package for any particular county or subnational government is likely to be not only context-specific and path-dependent, but also highly sensitive to the balance struck between different political and economic factors and interest.

Nada and Jack[6] in their article further observe that Kenya's tax system has undergone more or less continual reform over the last twenty years.

On the policy side, rate schedules have been rationalized and simplified, a new value-added tax introduced and external tariffs brought in line with those of neighboring countries in East Africa. At the same time, administrative and institutional reforms have taken place. Kenya has the trappings of a modern tax system, including, for example, a credit-invoice VAT, a PAYE individual income tax with graduated but arguably moderate rates and a set of excise taxes focused on alcohol, cigarettes and gasoline.

Khattry and Mohan (2002), and Ebrill et.al., (1999) employed the fixed effects approach to a panel data modeling to assess the effect of trade policy reform on tax revenue. Both developed and developing countries were included as part of the samples they considered. Ebrill et.al. (1999) conclude that tariff reforms did not result in lower trade tax revenue. They also show that exchange rate depreciation had resulted in increased trade tax revenue for countries in their sample. Nashashibi and Bazoni (1994) find that in 28 countries in sub-Saharan Africa, devaluation of the exchange rate, declining terms of trade, and import liberalization undermined the tax base.

In as much as the approach employed by these studies is helpful in minimizing the omitted variable bias, it is limited by its failure to capture the lagged effects that are inherent in such settings. Recent methodological developments particularly the dynamic approach to panel data modeling have made it possible for researchers to capture both dynamics and endogeneity of the macroeconomic relationships. Agbeyegbe, Stotsky and Woldemariam (2006) used the GMM technique to a panel of 22 sub-Sahara African countries. Their results show that trade liberalization had resulted in a loss of revenue. Adam, Bevan and Chambas (2001) use dynamic GMM technique on a sample of countries in sub-Saharan Africa and show that openness raises trade tax revenue.

5 The World Bank , 2010

6 Tax Reform in Kenya – Policy and Administrative issues

Empirical studies of the relationship between trade liberalization and trade tax revenue are generally faced with problems of choosing appropriate proxies of trade policy reform. Studies by Agbeyegbe, Stotsky and Woldemariam, 2006 and Ebrill et. al., 1999 use the standard openness index as well as the collected tariff (defined in the literature as ratio of import duties to the value of imports). Khattry and Mohan Rao (2002) use the ratio of international trade taxes to international trade, which includes the export components of taxes and trade. However, this measure is less likely to be correct since changes in exports are less closely linked to trade liberalization than changes in imports. An alternative approach makes use of episodes of trade liberalization as in Ebrill et al. , (1999). Some studies start with the premise that trade policy reforms reduce government revenue and instead focus their attention on simulating the required domestic tax reforms that would compensate the revenue loss using standard ex ante techniques (Abe, 1995; Hatzipana Yotou et. al., 1994; Michael et. al., 1994; Keen and Ligthart (2002). Naito (2006) uses a dynamic general equilibrium model and macroeconomic calibrations to elucidate how the government can coordinate tariff and tax reforms while maintaining government revenue.

1. Disciplining International Trade

The rules governing International Trade are covered by the World Trade Organization (WTO) agreements, which are a set of rules binding on Member Countries that must be strictly followed by their governments in formulating their policies and laws in the areas of international trade in goods and services, intellectual property, and investment measures.

The essence, therefore, of the WTO is to ensure gradual and to some extent reciprocal, reduction of trade barriers amongst member states to enhance trade liberalization. Ideally, barriers to trade are policies and practices that thwart the free flow of goods and services amongst member states. These may include but are not limited to Tariffs (taxes, duties and surcharges), licensing, quotas and standards just to mention but a few.

The rules are implemented through constant negotiations and the outcomes are pegged primarily on the economic standing of a member country globally, that is to say developed countries are encouraged to give more concessions to developing countries to allow them time to catch up. This is commonly referred to as Special and Differential Treatment (SD&T) and it cuts across the board on all the Agreements governing Trade in the WTO. Note that although this is the case the developed countries are yet to implement SD&T properly.

The provisions of SD& T include;

- Longer time periods for implementing Agreements and commitments,
- Measures to increase trading opportunities for developing countries
- Provisions requiring all WTO members to safeguard the trade interests of developing countries
- Support to help developing countries build the capacity to carry out WTO work, handle disputes and implement technical standards, and
- Provisions related to least- developed country (LDC)Members

The major principles of the trading system are outlined as:

Most Favoured Nation (MFN)

Under this principle, Member Countries cannot treat each other in a discriminatory manner during their trade transactions. Whatever concessions or privileges are accorded to one Member Country has to be accorded to all, and this governs both trade in goods under the GATT[7], as well as trade in services under the GATS[8]. Thus, a tariff benefit extended by a member to a product of another country (whether Member or not) is to be availed for the like product to Members immediately and unconditionally. The coverage of this principle goes beyond tariff concession and applies to:

- Charges of any kind related to import or export;
- The method of levying tariff and such charges;
- The rules and formalities in connection with import and export;
- Internal taxes and other internal charges; and
- The rules and requirements affecting sale, purchase, transportation, distribution or use of the product.

This principle applies to both imports and exports and exceptions only apply to tariff concessions to developing countries under Generalised System of Preferences (GSP); benefits and concessions extended to geographically adjacent countries in order to

7 Article 2
8 Article 4

facilitate frontier traffic; members of the same customs union or free trade area; restrictive measures against imports from specific sources on the basis of health, morality or environment.

National Treatment (NT)

This principle provides that imported and locally-produced goods should be treated equally- at least after foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents. There are three main elements of this principle, namely:

- The imported product must not be subject to internal taxes or other charges in excess of those applied to a domestic product of its likeness;
- The imported product must be accorded treatment no less favourable than that accorded to a like domestic product in respect of rules and requirements relating to sale, purchase, transportation, distribution or use of the product; and
- No Member Country can have a regulation laying down that in use of a product, a certain amount or percentage must be from domestic sources.

The principle is found in Article 3 of the GATT, Article 17 of GATS and Article 3 of TRIPS. National treatment only applies once a product, service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment principle even if locally produced products are not charged an equivalent tax.

Gradual Free Trade

The primary mandate of the WTO is lowering trade barriers as a means of ensuring free flow of goods and services amongst member states. The barriers concerned include customs duties and measures such as import quotas, red tape and exchange rate policies.

Since the creation of GATT[9] there have been at least eight rounds of trade negotiations, with the ninth being the Doha Development Agenda. The primary focus in the beginning was lowering of tariffs on imported goods, however by the 1980s, the negotiations had expanded to cover non- tariff barriers on goods, and to other new areas such as services and intellectual property.

Predictability

In the WTO, when countries agree to open their markets for goods or services, they bind their commitments. For goods, these bindings amount to ceilings on customs tariff rates. Sometimes countries tax imports at rates that are lower than the bound rates. Frequently this is the case in developing countries. In developed countries the rates are usually charged and the bound rates tend to be the same. A country can also change its bindings, but only after negotiating with its trading partners, which could mean compensating them for loss of trade.

One of the ways of improving predictability and stability is by discouraging the use of quotas and other measures used to set limits on quantities of imports. Another way is to make countries' trade rules as transparent as possible, you will find that many WTO agreements require governments to disclose their policies and practices publicly within the country or by notifying the WTO, and also through the regular surveillance of the national trade policies through the Trade Policy Review Mechanism (TPRM) which provides a means of transparency both domestically, regionally and multilaterally.

Promoting Fair Competition

Though the multilateral trading regime does allow tariffs and, in exceptional circumstances, other forms of protection, it is still a system of rules dedicated to open, fair and undistorted competition.

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9 1947-1948

These are envisaged in the rules on non – discrimination - being MFN and National Treatment, which are designed to secure fair conditions of trade. In addition to the foregoing, the rules on dumping and subsidies also cover undistorted competition (minimises monopolies and restrictive trade practises)

The WTO is sometimes described as a "free trade" institution, but that is not entirely accurate. The system does allow tariffs and, in limited circumstances, other forms of protection. More accurately, it is a system of rules dedicated to open, fair and undistorted competition.

Other WTO Agreements that aim to support fair competition are the Agreement on Agriculture (AoA), TRIPS, GATS, and the Agreement on Government Procurement[10], which extends competition rules to, purchases by thousands of government entities in many countries.

i) International Trade in the Context of the East African Community- Analysing Trade Policy Reform

The trade policy reform process in all the Partner States of the East African Community embarked on in the late 1980s to early 1990s mainly as part of the economic liberalisation imposed by Structural Adjustment. The key features of this process have been reduction and harmonization of tariffs, exchange rate devaluation and removal of restrictions on the capital account, and removal of quantitative trade barriers.

The central focus of the tariff reform process has for the most part been to reduce the average MFN rates and the number of bands. The maximum rates were reduced from about 60%in 1992 to 30% in 1996 and to 25% in 2005.

The average MFN rate declined from 19% in 1994 to 11% in 2005 before rising to 15% in 2008 following the implementation of the CET in the East African Community. There has also been an increase in the number of tariff lines in the lower bands (of 0 and 1-10) and a reduction in the higher bands over the reform period.

10 A Plurilateral Agreement

ii) Tabular Summary of Tax Regime in the EAC

	Regulations	Summary of the Coverage in the Regulations
Kenya	Income tax act 2012. Value added tax act 2013 No. 35 of 2013. Stamp duty cap 480. Tax appeals tribunal act 2013	**Section 3** of the income tax act provides that income tax shall be charged upon all the income of the person whether resident or non-resident. **Section 3(2)** gives the income to be taxed in respect to dividends on interest, pensions, charge, annuity; Part III of the act is a provision based on the exemption of tax. **Section 13** of the act allows the minister by way of notice to provide the exemption of tax for a certain class of income. **Section 14** exempts tax on interest government loans **Section 3** of this act gives the functions and the powers of the commissioners and other officers According to section 5 of the act the VAT is to be charged on. A taxable supply made by a registered person in Kenya. Importation of taxable goods. A supply of imported taxable services. **Section 5(2)** of the act gives the rate of tax as 16 % **Section 6** of the act allows the cabinet secretary of finance to amend the rate of the VAT by making an order that is to be published in the gazette on the increase or decrease of the VAT. The act limits this power in the sense that the increment cannot be more than 25% **Section 14** of the act allows for the appointment of a tax representative. This is for persons who do not have a fixed place of business. The appointment must be in writing and the representative must be a resident in Kenya. **Section 14** of the act gives the sum of the taxable value of imported goods as the sum of the value of the goods ascertained for the purpose of custom duty in accordance With the East Africa Community Custom Management **Section 5** of this act imposes a stamp duty on any instrument that has been executed. This includes those instruments that relate to property or any other matter. **Section 7** of the act provides for the means of payment of any instruments charged and it is by stamps. **Section 12** makes a provision that for every instrument that is chargeable with duty must be in English. Part II of this act provides for the establishment, membership and the functions of the tax appeal tribunal. The main function of this tribunal is to appeal against a decision made by the commissioner. The tribunal consists of members not less than 15 and not more than 20 and has a chairperson. This part of the act also provides for the tenure of the members of the tribunal. The chairperson has tenure of 5 years and is not eligible for re-election the members on the other hand have tenure of 6 years and are eligible for reappointment for another term.

	Regulations	Summary of the Coverage in the Regulations
		During the hearing the panel must have a quorum of at least 3 members and 1 of them must be an advocate of the high court. Part III of this act gives the procedure that must be used in the appeal process and it includes a written notice within 30 days after the decision of the commissioners. It is then followed by submission of the memorandum of the appeal, statements of the facts and the tax decision which must be made within 14 days after the notice. **Section 20** gives various powers to the tribunal and they include power to take evidence on oath, proceed with the hearing in the absence of one of the parties, adjourn the hearing and issue summons for someone to appear before the tribunal.
Uganda	Income Tax Act Cap 340.	**Section 4** of the act is a provision for the imposition of income tax **Section 5** allows for the imposition of rental tax. The act provides for some of the various rates of tax that will be imposed on individuals, companies, trustees and retirement funds. Part IV of the act gives a list of what is considered to be chargeable income. **Section 15** defines chargeable income as the gross income of the person for the year less the total deductions allowed under the act The chargeable interests may arise from Insurance businesses Gross income Business income Employment income Property income
	Value Added Tax (VAT) Act Cap 349.	**Section 21** provides a list of incomes that are exempted from tax and they include: any capital gain that is not included in business income, income of an investor compensation fund, interest earned by a financial institution on a loan granted to any person for the purpose of fish farming, forestry, farming, bee keeping or any similar operation. **Section 80(1)** exempts an individual from paying tax if the individual has already paid foreign tax. **Section 100** provides for a tribunal for appeals against the decision of a commissioner Part VII of the act lists some of the offences related to tax and they include: offences related to failure to lodge a return, improper use of a tax identification number, giving of false and misleading statements.

	Regulations	Summary of the Coverage in the Regulations
Tanzania	Income Tax Act Cap 332	Part II of the act allows for the imposition of tax **Section 6** provides for what income will be considered to be chargeable income and it includes income from employment, business and investment. **Section 10** of the Act gives the minister power to make a list of individuals or organizations that are exempted from tax. **Section 77** of the act is a provision on foreign tax reliefs. A resident in this case may make a claim for foreign tax credit income for a period of a year. The person is also given a chance to relinquish a foreign tax credit and is allowed to make a claim of a deduction for the amount for foreign income tax. Part V of the act provides for the procedure that will be used for the payment of tax. **Section 78** states that the tax shall be paid to the commissioner **Section 79** gives a timeframe for which payment of tax will be made
Burundi	VAT Law	Article 1 of the law establishes VAT in Burundi CHAPTER II of the law provides for the scope to which the law will apply and they include: Taxable transactions Taxpayers. Territoriality. Tax exemptions
East Africa Customs Management Act 2004		Article 111 of the act allows goods originating from any of the EAC partners to be accorded the community tariff treatment provided that a certificate of origin or any other document is submitted as proof of the origin. Article 113 exempts duty on goods that are remaining on board whether it is an aircraft or vessel in which they were imported. Article 115 exempts import duty of the goods entered for exportation. Article 116 allows for the exemption from import duty of certain reimports Import duty for temporary imports has been exempted in article 117.
Customs Union Protocol		Article 11 of the protocol makes provision that the internal tariffs under that article will not exceed the common external tariffs with regard to any of the specified product. Article 13 this provision is with regard to the removal of all existing non-tariff barriers to the importation into their respective territories It also places a responsibility on the partner states to formulate a mechanism for identifying, monitoring and removing of the non-tariff barriers. Article 14 contains the provision on rules of origin where only goods from the customs union are to be accorded the EAC tariff.

iii) Trade, Tax and Fiscal Regime under the EAC Common Market and Customs Union

In 2010, the East African Community (EAC) Partner States started implementing the Common Market Protocol. This implies Rwanda, Uganda, Kenya, Tanzania and Burundi entered into a single market with free movement of factors of production based on the principles of non-discrimination, most favoured nation and transparency. Some of these rights include free movement of goods, persons and labour.

The EAC citizens also have the rights of establishment and residence as well as free movement of services and capital. This is not the case however; as taxes on international trade will remain save for import duty, which remains at 0% on goods from the community that comply with the rules of origin criteria.

If a trader for example imports into Rwanda products manufactured in Uganda (an EAC member state) and has a valid certificate of origin, The Rwanda Revenue Authority (RRA) will not collect import duty (a tax levied on goods imported into the country) on such products as long as it is proved that the goods are originating from the region. While import duty is inapplicable, traders will continue to pay other domestic taxes due on goods including Value Added Tax (VAT) of 18%, consumption tax (excise duty) as well as withholding tax of 5%. However, the withholding tax mentioned herein is exempt for people who have a tax clearance certificate.

The Common Market Protocol stipulates that "The free movement of goods between the Partner States shall be governed by the Customs Law of the Community as specified in Article 39 of the Protocol on the Establishment of the East African Community Customs Union".

Customs Union

Beginning January 2005, Partner States commenced the implementation of the EAC Customs Union and started levying zero per cent import duty tariff on goods originating from the Partner States, applying the Common External Tariff and the East African Customs Management Act and Regulations. The implementation of the Customs Union was progressive. For example, for Burundi and the internal tariff elimination on intra-regional trade took 5 years that is to say, from January 1, 2005 to December 31, 2009.

The five Partner States have strived to realise the benefits of a customs union through the formation of the East African Customs Union. The Customs Union is provided for under Chapter Eleven of the Treaty establishing the East African Community and established under the Protocol establishing the Customs Union (the "Protocol"). The Customs Union came into force on January 1, 2005. It is the first stage in the economic integration of East African states under the East African Community. It is intended that the Customs Union and the common market shall be transitional stages towards the establishment of the proposed East African monetary union and ultimately an East African political federation. The East African Community Customs Management Act is an Act of the Community, which is applied across the EAC as the main legal instrument for the operationalization of the Custom Union.

The broad objectives of the Customs Union include elimination of internal tariffs and non-tariff barriers in order to facilitate the formation of a large single market and investment area, harmonisation of trade policies between partner states and other countries (such as by way of the Common External Tariff (CET) and creation of a single customs territory to enable partner states to enjoy economies of scale with a view to supporting economic development in the region.

The Protocol requires the partner states to co-operate in adopting uniform tariff classification of goods, establish common terms and conditions governing temporary importation procedures and adopt common procedures

for establishment and operation of export promotion schemes and free ports.

Other requirements under the Protocol include:

i. Internal tariff

The Protocol requires partner states to eliminate all internal tariffs (that is, tariffs in relation to goods from a partner state which are being traded into another partner state) and other charges of equivalent effect, subject to the principle of asymmetry. The asymmetry principle is, in simple terms, a recognition that the partner states may be at different levels of advancement and development, and as such, those partner states at a less advanced level are entitled to a measure of protection of their domestic industries in order to spur growth. In this regard, under the Protocol, goods from Uganda and Tanzania into Kenya were granted duty-free status as at the effective date of the Protocol, whilst goods from Kenya into Uganda and Tanzania were grouped into two categories – Category A goods, which were eligible for immediate duty free treatment and Category B goods, which were eligible for gradual tariff reduction over a period of five years.

ii. Common External Tariff

In addition to the internal tariff, a common external tariff (CET) (a tariff to be imposed on all goods originating outside the Customs Union and imported into the Customs Union) was imposed by the Protocol. The CET is in three bands, with a minimum rate of zero%, a middle rate of 10% and a maximum rate of 25%. The maximum rate is subject to review after five years from the effective date of the Protocol. In any event the entire CET structure is capable of review by the partner states to remedy any adverse effects experienced by any partner states by reason of the implementation of the CET or to safeguard Community interests. The Protocol further prescribes a harmonised customs commodity description and coding system for purposes of implementation of the CET which was achieved in 2005.

iii. Non-tariff barriers

The partner states agreed to remove all existing non-tariff barriers to importation of goods from other partner states and not to impose any new non-tariff barriers.

iv. Rules of origin

Rules of origin are regulations for determination of the country of origin of goods. Such determination is necessary in order to assess the tariff applicable to the goods (that is, whether the CET or the internal tariff shall apply). For the purposes of the Protocol, goods shall be considered to originate in the partner states if they meet the criteria set out in the Rules of Origin annexed to the Protocol. The EAC has published a manual to guide officers and other users in the application of the rules of origin.

v. Subsidies and countervailing measures

A subsidy is a financial contribution by a governmental authority (whether direct financial contribution or a forbearance of revenue by the governmental authority in such a manner as to confer a benefit on producers of goods in that jurisdiction). Whilst subsidies can be a meaningful tool in promoting domestic production, in the international trade context, subsidies have the potential to distort trade by making goods produced by a beneficiary of subsidies cheaper than goods of a producer who is not the beneficiary of such subsidies. Consequently, in order to curtail such trade distortion, regional economic organisations will typically impose countervailing measures. A partner state is required to notify the other partner states in writing if it grants or maintains any subsidies in favour of domestic producers. The Community may levy a countervailing duty for the purposes of offsetting the effects of subsidies.

vi. Safeguard measures

Safeguard measures are reliefs against imports under specified circumstances. The safeguard measures may take the form of higher tariffs,

tariff quotas, or quantitative restrictions against imports. Under the Protocol, partner states may apply safeguard measures to situations where there is a sudden surge of a product imported into a partner state, under conditions which cause or threaten to cause serious injury to domestic producers of like or directly competing products. In addition, where a partner state demonstrates that its economy will suffer serious injury as a result of imposition of the common external tariff on industrial inputs and raw materials, the partner state concerned can inform the EAC Council and the other partner states and the Council then examines the merits and takes appropriate decisions.

vii. Export promotion schemes and special economic zones

The Protocol permits creation and operation of export promotion schemes by partner states, provided that the goods thereby produced are primarily for export. If such goods are sold in the customs territory then the goods shall attract full duty as provided in the CET. Sale of such goods in the customs territory shall be subject to the approval of the competent authority and shall be limited to 20% of the annual production of a company.

The Protocol also permits the establishment of free ports by the partner states to facilitate and promote international trade and accelerate development within the Customs Union. The functions of free ports include facilitation of trade in goods imported into free ports, the provision of facilities relating to free ports including storage, warehouses and simplified customs procedures and provision for the establishment of international trade supply chain centres. Goods entering a free port shall be granted total relief from duty and other import levies except where the goods are removed from the free port for domestic use.

In conclusion, the Customs Union presents an opportunity for businesses to access a large common market with harmonised market entry rules and procedures thus facilitating less bureaucratic market access. Businesses established within the Community as well as those seeking to expand into this region should seek to harness this opportunity.

Removal of VAT, Consumption tax (excise duty) and Withholding tax will be effected upon realization of a fully-fledged customs union, which is yet to materialize. The following will be envisaged under a fully-fledged Customs Union:

- Shifting of borders between Partner States to the peripheral
- Collection of duties and taxes at the point of entry into the Customs Union Territory
- Agreeing on the revenue sharing mechanism;
- Establishment of a regional authority to administer the Customs Union
- Elimination of rules of origin on intra-regional trade. In a fully-fledged Customs Union, goods from Nairobi to Kigali will not attract any duties and taxes will be considered just as goods coming from inside Rwanda. In the same manner, goods from Dodoma to Mombasa will be treated in the same manner as goods from Naivasha in Kenya.

The EAC Common Market Protocol provides that "The Partner States undertake to progressively harmonize their tax policies and laws to remove tax distortions in order to facilitate the free movement of goods, services and capital to promote investment within the Community".

Harmonization of domestic taxes is being handled under EAC Framework by the Fiscal Affairs Committee (Technical Committee on tax harmonization) the Fiscal Affairs Committee has established Technical Working Groups on Value Added Tax, Excise Tax and Income Tax. They developed a harmonized legal framework on tax laws and a roadmap for the harmonization process.

2. Nexus Between Trade and Tax Governance

Trade is primarily governed by tariffs. A country applies customs duty (tariff) on an imported product at the time of import of the said product and (usually) at the port of entry. Countries impose tariff primarily for the following reasons:

- As a revenue tool: Tariff provides a country with revenue. For the majority of Developing and Least Developed Countries, it is an important source of national revenue and the most convenient to collect.
- Protection Measure: It provides protection to local industry, as the like imported product may become more expensive in the market after the imposition of tariff.
- Foreign Exchange: In situations of foreign exchange shortages, a country may resort to differential tariff so as to promote rational utilization of the limited foreign exchange. For instance, imposition of high tariffs on luxury goods and low tariffs on industrial raw materials may be used to discourage the import of the former while encouraging raw materials' importation.

Normally three types of tariff are used. These are:

a) *Ad valorem* tariff. This is levied in terms of percentage of the value of the imported products.

b) *Specific tariff.* This is levied in terms of rate per unit of quantity.

c) *Combined tariff.* This has two components – ad valorem and specific.

The theory of international trade starts from the observation that trade is balanced over time, meaning that the present value of a country's imports must equal the present value of its exports. Trade balance reflects the simple notion that countries are not unable to sustain long-run deficits with the rest of the world, nor do they have incentives to maintain long-run surpluses. One consequence of trade balance is that policies, such as tariffs, discourage imports thereby indirectly reducing exports.
Taxation is an integral part of nations' development policies, interwoven with numerous cross cutting issues like good governance and formalising the economy, to spurring growth through, for example, promoting small and medium sized enterprises (SMEs) and stimulating export activities.

Among other things, taxation therefore:

- Provides governments with the funding required to build the infrastructure on which economic development and growth are based;
- Creates an environment in which business is conducted and wealth is created; Shapes the way government activities are undertaken
- Plays a central role in domestic resource mobilisation.

Taxation provides a predictable and stable flow of revenue to finance development objectives. In fact, the 2002 Monterrey Consensus recognised taxation's key role in domestic resource mobilisation, an acknowledgement sentiment echoed at the 2008 United Nations Doha conference on Financing for Development. Indeed, taxation shapes the environment in which international trade and investment take place. Certainty and consistency of tax treatment, the avoidance of double taxation, and efficient tax administration are all important considerations for business.

Tax revenue is central to the development agenda of all the EAC Partner states. It provides a stable flow of revenue to finance development priorities, such as strengthening physical

infrastructure, and is interwoven with numerous other policy areas, from good governance and formalizing the economy, to spurring growth. Fundamentally, tax policy shapes the environment in which international trade and investment take place. Thus, a core challenge for EAC Partner States is finding the optimal balance between a tax regime that is business and investment friendly, and one which can leverage enough revenue for public service delivery.

To achieve an optimal tax policy, EAC policymakers are challenged by the need to balance the following imperatives:

- **Mobilising domestic resources and broadening the tax base** to secure steady revenue streams for development financing and to diversify the revenue sources, especially in a context of tariff liberalisation that impacts strongly on tax revenue;
- **Fighting Tax evasion,** spurred by tax havens, regulatory weaknesses, and some corporate practices;
- **Improving the investment climate for enterprise development,** largely shaped by the tax regime; and
- **Promoting good governance,** underpinned by effective taxation that promotes the accountability of governments to citizens and the investment community.

Tax administration systems have undergone some major changes since the mid-1990s, and the reform-process is expected to continue. Some of the important changes expected are:

- A simplification of the tax-regime, including broadening of the tax- base;
- Rationalization of the exemption-system to avoid further erosion of the tax-base; and
- Review/change of tariff-rates and introduction of revenue- raising measures to compensate for possible losses arising from further liberalization of the trade-regime.

Another important change is to improve the efficiency of the tax administration itself. All the five Partner States of the EAC have implemented comprehensive reforms of their tax administration. Part of the exercise has been to establish autonomous revenue authorities, which would be less vulnerable to political intervention and tax evasion practices. Although the empirical evidence is mixed, it seems that these 'independent' authorities in some countries have not helped to reduce tax evasion and corruption (Fjeldstad and Rakner, 2003).

According to the Transparency International Corruption Perception Index Tanzania is ranked as number 88 and Kenya as number 144 out of 158 rankings in 2005 (Transparency International (TI), 2005). In the Kenyan case, a more detailed analysis shows that the overall bribery index has declined over the years (TI-Kenya bribery reports, various issues). The Kenya Revenue Authority (KRA) has improved its overall index over the period 2009 – 2010 and is considered one of the most efficient organizations in the country. Corrupt practices have also been reported within the tax administration in Tanzania (Ehrhart and Mwaipopo, 2003 and Fjeldstad and Rakner, 2003).

In recent years, economies in the East African Community (EAC) have under- taken substantial efforts to improve their tax governance systems—to make it easier to do business while also increasing tax revenue. For example, the Tanzania Revenue Authority established tax service centers in Dar es Salaam, intensified risk-based and quality tax audits and encouraged greater use of electronic filing and payment systems. These administrative measures helped improve compliance, and tax revenue rose relative to GDP in each of the past 2 years. Similarly, in Burundi tax revenue has almost doubled since the 2009 reform of the revenue administration, which included the establishment of the Office Burundais des Recettes which focused on good governance, a streamlined tax environment and stronger taxpayer services.

Beyond measures by individual EAC economies, initiatives are also taking place at the regional level. The EAC has identified regional tax harmonization and greater cooperation on tax matters among its members as key to economic prosperity. The goal of the EAC members in establishing the common market is to enable businesses to operate unhindered by national borders and to tap the huge potential arising from the regional efforts to make it easier to do business. The EAC has organized many activities toward this end in recent years, including technical workshops on income tax, value added tax (VAT) and the exchange of information among EAC members' revenue authorities. Effective information exchange is essential to ensure the correct application of tax laws while maintaining sovereignty over the application and enforcement of these laws. And the development of regional strategies and frameworks for both tax policy and administrative procedures is crucial for the realization of the common market because it creates synergies and removes obstacles to cross-border trade within the EAC.

i) Assessing Taxation and Investment Policies in the EAC and the Implications to Development

The Customs Management Act (CMA)

Implementation of the CMA began on 1st January 2005 in the three EAC Partner States and is therefore in its fifth year. Significant progress so far includes the development and adoption of the EAC customs management regulations, duty remission regulations and regulations for the working relationship between the Directorate and Customs administrations. Since its implementation, a number of reviews have been undertaken in some provisions to ensure that they suit the current trade and customs environment. Nonetheless, the administration of the CMA faces a number of challenges.

1. At the national level, the main focus by Revenue Authorities as obligated by their Partner States is to maximize revenue while the regional focus is on trade facilitation. Modern Customs practices are now focusing on trade facilitation as a means to increased revenue collection. In the application of the EAC - CMA officials normally lay emphasis on areas that have punitive dimension in the law rather than the trade facilitative provisions resulting into complaints against some provisions by some stakeholders in the private sector.

2. Some of the provisions of the CMA have not yet been implemented. For example, among others, the appeals system has not been implemented in Kenya despite the existence of appropriate provisions. Kenya has not established an independent appeals system hence the absence of a harmonized system for efficient and effective settlement of customs disputes.

3. There are limited capacities in both the Directorate of Customs in terms of staff to effectively steer the implementation. Implementing agencies in some Partner States are also faced with technical interpretation issues.

4. Except for the import declaration forms, the application of other relevant regulations and forms is not uniform throughout the region. Other areas include procedures for licensing clearing and forwarding agents and other agents which are yet to be harmonized for effective operations of the customs union.

The Common External Tariff (CET)

The EAC Partner States have continued to apply uniformly the EAC common external tariff without serious hindrances since the launch of the customs union in 2005. Consistent with the CU Protocol, the Council has reviewed duty rates of some tariff items in order to address identified inconsistencies and appropriately align the applicable rates to the economic environments of the Community. The Ministers

of Finance, through a pre-budget consultation process, jointly agree on tariff policy changes to suit the economic environment prior to reading their national budgets. In the 2007/08 budget, the Ministers of Finance of the three Partner States agreed on specific tariff measures, including updating of the EAC CET 2007 Version in conformity with the World Customs Organization instrument of the Harmonized Commodity Description and Coding System, Version 2007.

The adoption of the EAC CET has brought about a number of advantages to the region. First, it has greatly liberalized the EAC region. For instance, the average applied tariff presently is 11.6% compared to 16.8% for Kenya and 13.5% for Tanzania before the customs union came into force.

However, in the case of Uganda there was an increase in the average applied tariff from 9% prior to the customs union. Secondly, it has enhanced predictability to exporters and investors into the region alike. In addition, it has also facilitated the locking-in of trade policy and the regional integration process.

Establishment of an Exemptions and Remissions Regime

This instrument has greatly facilitated harmonization of exemptions at the regional level which in turn boosted investment confidence in the EAC region. This partly explains the increased trends and expanded scope of industries benefiting from the scheme. For instance, the value of goods that qualified for exemptions and remissions in all the three countries has been growing. In Kenya, it increased by 71.2% to US$ 1,370.8 million in 2006 up from US$ 588.8 million in 2004.

In Tanzania, it rose by 36% from US$ 798.0 million in 2004 to US$ 1,225.9 million in 2006. In Uganda, it grew from US$ 109.8 million to US$ 178.8 million in 2005 before falling slightly to US$ 174 million in 2006.

On the other hand, however, in all the three countries, the revenue foregone increased in the same period. In Kenya it rose to US$ 289.5 million in 2006 up from US$ 201.4 million in 2005, representing an increase of 14.3%. In Tanzania, the revenue foregone increased by 36% to US$ 405.4 million in 2006. In Uganda, revenue foregone increased by 9.9% to US$ 36.4 million in 2006 compared to US$ 33.1 million in 2005 and US$27.2 million in 2004. The revenue foregone represented 5.1% of total revenue collections down from 5.3% in 2005.

Removal of Non-Tariff Barriers on intra-EAC trade

Consistent with Article 13 [2], in June 2007 national monitoring committees were inaugurated in all the member states for the purpose of monitoring the removal of NTBs. The committees are made up of specific government ministries, government departments, public agencies, local authorities and private sector organizations. They are mandated to monitor progress in the elimination of NTBs. Consequently, they meet quarterly under the chairmanship of the ministries responsible for EAC or trade, industry and investment. Issues that are not resolved at this level are referred to the Council.

While the Customs Union (CU) has covered some ground in its implementation, there are, however, indications that in spite of the commitments made by the member states to remove NTBS, they remain a serious obstacle to trade within the region. They continue to increase the cost of doing business in the region and have negatively impacted on trade and cooperation. The most notable NTBs reported have been:

1. **Customs and administrative documentation procedures** e.g. limited customs working hours, varying systems for imports declaration and payment of applicable duty rates, different interpretation of rules of origin,

application of discriminatory taxes, cumbersome procedures for verifying containerized imports, diversion of transit goods, problems in blocking marketing of counterfeit products etc.

2. **Immigration procedures**: Varying application of visa fees and work permits, cumbersome and duplicated immigration procedures, lack of an East African passport.

3. **Cumbersome inspection requirements**: Long inspection queues during inspection of gross vehicle mass and axle loads, cumbersome and costly quality inspection procedures, quality inspection of even products that are certified by accredited laboratories, quality inspection of imports originating from amongst the EAC countries even when they have marks issued by Bureau of Standards, varying procedures for issuance of certification marks.

4. **Varying trade regulations among EAC countries**: Use of harmonized COMESA axle load specifications of 16 tonnes for double axel by Kenya and Uganda whereas Tanzania uses 18 tonnes, and the gross vehicle mass (GVM) for commercial vehicles, use of different parameters on weights, labeling and quality, tolerance in measurements and the type and technology used in packaging, which limits the ability of goods to cross borders.

5. **Varying, cumbersome and costly transiting procedures in the EAC countries**: Varying requirements on types of commercial trucks to be used for transit traffic, bottlenecks in offloading imports at Mombasa, unrealistic short grace periods given on imports before they start attracting demurrage, application of insurance bonds on goods destined to the region.

Other Impacts of the Customs Union on EAC Trade

While regional trade has increased, nonetheless, overall it has been affected by the CU through a rise in import duty on some inputs, removal of exemptions on foods of economic importance, and trade facilitation.

1. **Rise in import duty on raw materials and inputs:** It will be recalled that before the CU the tax structures were able to support investments and value addition to manufactured export products. The CU brought about a number of changes, especially in the tax rates. While for some imported goods these rates declined, for others they went up - i.e. including those that fall within the category of sensitive products. The increase for import duties (especially for inputs and raw materials), has had the effect of raising the cost of production and ultimately the price of the final product, rendering it less competitive on the market (both local and foreign).

2. **Harmonization of taxes:** Although the customs union was launched in 2005, the main taxes affecting the business community (e.g. VAT, withholding tax, excise, etc), the definition of tax laws, assessment procedures, dates of implementation clauses, etc – have all not been harmonized. For example, while Uganda charges a VAT of 18%, in Kenya it stands at 16%, while in Tanzania it is at 20% (and 18% in Rwanda) Uganda charges *ad valorem* (whereby the tax chargeable is a percentage of the value/ price of the product, while Kenya charges specific taxes. Similarly, Uganda imposes excise duty on cement, while Kenya and Tanzania do not; Uganda also offers no tax incentives, while Kenya and Tanzania do not, etc. These disparities in the tax regimes result into distortions and have a negative impact on cross-border business activities. In particular, they increase the cost of compliance; affect the decisions by investors with regard to where to invest and where to source finance. This is a contradiction of the goals of the EAC Treaty since no efficient allocation of resources is guaranteed.

3. **Customs facilitation:** With regard to customs, the main concern has to do with claiming of duty drawback. According to the respondents, the process of claiming the duty drawback remains quite cumbersome and unnecessarily long. This has the impact of tying up working capital and affecting business cash flow. In this regard, even the Customs Union Management Act has not been helpful. Provisions on duty drawback, for example, do not indicate a period within which a refund can be received. Similarly, there is no provision for interest payable in the event of delays in effecting refunds.

ii) Revenue Performance in the Customs Union

Prior to the launching of the CU, there were concerns that the application of the CU provisions would lead to imbalances in the performance of the economies of the Partner States. It will be recalled that Articles 75 and 76 of the EAC Treaty provide for introduction of measures to address the imbalances that may arise from the application of the provisions of the Treaty.

Similarly, the second Development Strategy casts the problem of imbalances in terms of costs and benefits and underlines the need for measures to address these imbalances arising from the process of establishing a CU and a Common Market.

Total tax revenues have been increasing despite the initial fears that implementation of the CET would affect government revenues. Available statistics indicate that although the contribution of import duties to total revenues has marginally declined the value of import duties increased from US$ 274 million in 2001/02 to US$ 408.8 million in 2006/07. Import duties increased by 34% between 2005/06 and 2006/07 (CBK, 2008). This may be attributed to improved economic performance and reforms in revenue administration, including the introduction of electronic tax registers as well as the increased trading activities with the rest of the world, following the tariff reductions initially averaging 35% for Kenya. In addition, recent reforms have seen greater reliance by Kenya on income, VAT and excise duties for revenue generation as opposed to import duties.

iii) Impact on Investment Flows

The Policy Framework

The EAC Partner States have put in place national statutory agencies, which are mandated with promotion and facilitation of investment in their respective countries. These investment promotion agencies (IPAs) were established by appropriate legislation (Acts of Parliament) in each Partner State and follow similar basic requirements for approval of investments.

Inward Investment Flows and Cross-border investments

Foreign direct investment (FDI) continues to be one of the cornerstones of economic development in the EAC. Although FDI has flowed to the region over the years, it is only recently that the Partner States have increased their focus on its growth.

Investors are increasingly responding to the unfolding single market and investment area. However, Kenya has been experiencing a dismal performance over the years despite being the strongest and most diversified economy in the region. For instance, FDI flows into Kenya stood at US$ 51 million in 2006 compared US$ 522 million for Tanzania and US$ 400 million for Uganda. However, in 2007 Kenya received significantly higher inflows (US$ 728 million) due mainly to large privatization sales in the telecommunications sector and investment in the railways. In Uganda, there was a marginal decline to US$ 368 million (UNCTAD, 2008).

At the same time, there are indications that cross-border investments are beginning to pick up and firms are now increasingly basing their business plans on the regional market, rather

than the local national markets, in order to be able to enjoy economies of scale. Cross-border investments within the region are important for three reasons (i) the transfer of skills and technology (ii) the counteracting of regional trade imbalances and (iii) the increasing of extra-regional export capacity. These factors are not unique to cross-border investments, but equally apply to other foreign capital flows.

In spite of these factors, the level of cross-border investment in the EAC is still low, standing at 5-10% of total FDI (EAC, 2006). It has been primarily from Kenya to the other Partner States (mainly Uganda and Tanzania) and is concentrated in the manufacturing, tourism and transport sectors. Kenyan companies have increased investments across the region. This is mainly attributed to high production costs occasioned by poor infrastructure, high energy, relatively high corporate tax regime, administrative and regulatory red-tapes and high levels of insecurity.

Tanzania has also been slow in investing in the other Partner States. This can be partly explained by the restrictive policies deterring external investments from Tanzania. Again Kenya has taken the lead in investing in Tanzania. It is only second to the UK in trade with, and investment into, Tanzania. About 270 Kenyan companies operate in the country, providing more than 100,000 jobs. Only 3 Tanzanian companies have invested in Kenya.

Cross-border investments have suffered mainly due to set-backs relating to poor infrastructure and high cost of doing business, insecurity and low investor confidence, among others. The challenge therefore is to address this unhealthy situation and the emerging imbalances.

3. Current Tax Reforms in East Africa

Kenya

The tax system in Kenya has undergone various reforms since independence. After Kenya gained its independence for quite some time the public spending was financed through a somewhat uncoordinated set of taxes and fees that were inherited from the British rule and supplemented by foreign aid inflows.

The oil shock in the early 1970s led to Kenya's first significant fiscal crisis and as a measure to counter the crisis some minor tax reforms were undertaken. Some of the measures that were undertaken included the introduction of the sales tax as a means of generating extra revenue and imposition of trade taxes were used in the attempt to reduce the increasing balance of payment deficit.

In the 1970s the imposition of the Corporate and income taxes were seen as serving primarily redistributive roles.

In the early 1980 there was a high increase in the budget deficit which was as a result of the second oil price shock and the uncontrolled public spending as a result two major programs were approved by the Kenyan government they included

a. Tax modernization program

b. Budget rationalization program

The tax modernization program which was aimed at broadening the tax base was approved by the Kenyan government in 1986.The following year the government of Kenya adopted the budget rationalization programme that was intended to control the public spending.

An important organizational change came when the Kenya Revenue Authority (KRA) was formed. The KRA centralized the tax collection activities which had been previously undertaken by a department in the ministry of finance.

On the policy side rates, schedules have been rationalized through the enactment of the various acts of parliament that include:

- Income tax act 2012.
- Value added tax act 2013 No. 35 of 2013.
- Stamp duty cap 480.
- Tax appeals tribunal act 2013.

Uganda

Uganda has managed to implement various tax policies. Article 152 of the Ugandan constitution has made a provision for all taxes that are to be imposed by an act of parliament should be in accordance to the constitution.

There are various statutes and laws that have been enacted and have provided for the imposition of the different types of taxes they include:

- Local Governments Act 1997 that provides for the local government revenues.
- Income tax act cap 340 that imposes income tax.
- The East African community customs management act 2005 that is used for the management of import duty.
- Value added tax act cap 349 for the imposition and enforcement of the VAT.
- Stamp Duty Act cap 342 that imposes duty on the various commercial and legal papers.
- Traffic and road safety act 1998 cap 361 makes provisions for motor vehicle licences and fees

In 1991 the Uganda Revenue Authority was formed. The URA gets its mandate from the Ugandan constitution as amended in 1995 and its main responsibility is to collect taxes in Uganda.

In addition to the policy reforms that Uganda has made it has also managed to make some reforms on the tax administration. The former tax administration regime was characterized by corruption, limited computerization, and inadequate specialized skills, after being reformed it became characterized by improved URA/Taxpayer relationship, computerization of the revenue management, introduction of the tax identification numbers.

Tanzania

The imposition of the progressive income tax was introduced in 1973. It was imposed with the aim of broadening the tax base so as to raise revenue .In 1976 the 1969 sales tax act was repealed and it was replaced with a new sales tax act 1976.During the 1970 decade the import duty rates were increased. The increment was used as a tool for raising capital. In the late 1970s the excise duty was abolished and it resulted in the substantial rise in sales tax.

The economic crises in 1980s contributed to the imposition of indirect tax, and the rates of import duty and sales tax were raised annually, which led to very high taxes and a very complex indirect tax system. In 1985 all export taxes were abolished in order to reduce the tax burden that was being imposed on the producers and it also acted as an incentive to produce. This measure was also imposed so as to enable the country to sell exports at competitive prices

Burundi

The onset and end of the 15 year civil war in Burundi posed a great challenge to tax reforms in this nation due to low transparency, and limited willingness to tackle corruption and tax evasion. This was coupled with an out of date legislation, weak governance structures, corrupt tendencies, excessive bureaucracy and low skill levels.

With the help of development partners, governance reform was prioritised as well as acceleration of drafting better –practice legislation and procedural manuals. The project also involved establishing an operational, unified revenue and customs agency to fulfil Burundi's commitment to facilitate trade and to participate in the East African Community (EAC) Common Market. Other major reforms that have been put in place since 2011 include;

- Designing and implementation of new revenue collection and management systems and new legislation for large and medium sized tax payers
- The establishment of new and improved audit practices and skills
- The roll out of new financial management and budget procedures
- The procurement of a new IT tax system
- The establishment of a code of conduct

As a result of these reforms it was reported that revenue collected in 2011 amounted to 200 million pounds representing an increase of 30% over 2010. Real tax revenue growth increased ten times from 2008 to 2009 and more than doubled from 2009 to 2010.

Rwanda

In November 1997 the Rwanda Revenue Authority was formed so as to spearheaded reforms across the entire spectrum of taxation and it included the moving of the sales tax to Value Added Tax.

In 2003 the Rwanda Revenue Authority was given the responsibility of collecting non tax revenue.

The classifying of the taxpayers into medium and small taxpayer and issuing every single taxpayer a single identification number are some of the tax reforms Rwanda has been able to implement

Through the various reforms that Rwanda has succeeded in implementing it has made many achievements and they include.

1. Increased tax revenues
2. Increased GDP-shares of collected revenue have increased and a desire has been expressed for the ration to grow at 0.2% or higher per annum in the medium and long term.

TAX EVASION AND TRANSFER PRICING

Uganda

Transfer pricing regulations have now been published and have been in effect since July 2011. The regulations are modelled on the OECD Model Tax Convention. Businesses in Uganda are now required to determine their income and expenditures arising from transactions with related parties in a manner that reflects the arms' length principle. Documentation showing the evidence of the arms' length principle should be in place at the time of filing the company's income tax return for the year in which the transactions were conducted. The URA has however not yet issued guidelines on what documentation should be put in place.

Rwanda

The Rwandan law on direct taxes on income stipulates that where conditions are made or imposed between related persons carrying out their commercial relationship which differ from those which would be applied between independent persons, the Commissioner General, may direct that the income of one or more of those related persons be adjusted to include profits that would have been made if they operated as independent persons. The tax legislation empowers the Commissioner General to make arrangements in advance with persons carrying out business with related persons to ensure efficient application of the Transfer Pricing provision.

The 2011/2012 Finance Bill has enacted provisions to give effect to Tax Information Exchange Agreements (TIEA) which the Kenyan government intends to enter with other governments. The TIEA will allow the KRA to exchange information which will enable them to enforce domestic tax laws more effectively especially as regards to Transfer Pricing.

Tanzania

The Income Tax Act 2004 contains a provision which deals with transfer pricing. The provision refers to the arm's length principle, a requirement which applies not only to transactions with non- resident associates but also to transactions with resident associates.

4. Policy Recommendations

The research suggests ways of maneuvering through this process by proposing that the EAC should have a strong regional taxation and compliance regime so as to increase tax revenue collection despite the lower tax rates, or give recommendations on how to increase trade tax revenue collections with lower import tariffs.

Although much progress has been made in the EAC to ensure a more streamlined tax governance system while also increasing trade volumes and FDI , there is still much more that needs to be done to ensure seamless implementation of the already existing policies. To that extent, the paper recommends as follows;

Legal and Policy Harmonization

Due to the variance of the legal systems within the EAC Partner States, it is evident that there is existence of wide differences in the respective tax regimes which eventually create unequal revenue collection .There is therefore need to harmonize, as a matter of priority, the various tax regimes of the Partner States, as having a varied system is likely to distort the functioning of the Common Market and also the Monetary Union.

Establishing an Efficient Tax System

It is therefore an underlying shared commitment for both the private and public sectors within the Common Market to advocate for the establishment of a fair and efficient tax system and administration. Article 32 of the Common Market acknowledges that harmonisation is expected to facilitate the free movement of goods and services and capital, and the promotion of investments within the community, which is expected to directly benefit the people.

Regional Dialogue

For the tax regime in the region to be development focused, first there has to be regional dialogue with a view of incorporating or formalising the informal sector, especially the micro, small and medium enterprises in the region. It would also be good for instance to create a simple regional tax structure which is applied across the entire economies and allowing for limited exceptions, small business need to have a unique taxation regime to ensure compliance and formalization.

Increased Policy Space

On tax issues under the onslaught of developed counties such as Export Taxes, the EAC must fight for the policy space so that they may retain the requisite policy space to retain the discretion for present and future industrialization.

5. Conclusion

The paper attempted to bring out the balance of having an effective tax governance system on the one hand by assessing the current legal and policy regime in the EAC, and international trade on the other hand by giving an expose on the WTO principles and the trade policy reforms that have taken place so far in the EAC. It was observed, based on the research question that having an effective tax and trade governance system would still boost socio-economic development in the region.

Therefore trade liberalization – which ideally advocates for the gradual reduction of barriers primarily tariff (tax) barriers cannot be affected by having an air tight tax governance system. It was observed through the selected literature in the paper that increased FDI flows are not determined by taxation, a lot of factors are drivers behind increased FDI flows in a country; increased taxation therefore is not directly correlated to the FDI performance or improvement of a country. A classic example was given of the Asian Tigers and the BRICS, who have well established tax structures, yet their trade volumes and FDI flows seemingly increase.

The paper concludes that having full trade liberalization in the EAC may not necessarily increase revenue through trade gains, however, having a strong tax governance system is the way forward in achieving EACs socio-economic development targets.

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