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EAC tax harmonization code: which way after 10 years of existence?

...there are tax disparities among the bloc's partner states, with big impact on investment and regional integration, because provisions of the EAC Treaty remain general, with no specific laws created to help their implementation.

It has emerged that the East African Community (EAC) remains a long way from achieving full tax harmonisation, as partner states continue to apply disparate tax incentives, capital gains, VAT (Value Added Tax) and personal income tax rates which make some partner states friendlier to investors while rendering others uncompetitive.

A study by tax justice advocacy organisations covering the financial years 2018/19, 2019/20 and 2020/21 has established that efforts to harmonise tax have stalled for more than 10 years since the regional bloc instituted a code of conduct to eliminate harmful tax competition.

This emerged during the post-EAC tax and budget dialogue for financial year 2021/22, held in Kampala on June 22 to assess the bloc's progress towards a harmonised fiscal regime, at a time the regional grouping is working to admit more members with different tax regimes that present new harmonisation challenges.

SEATINI Uganda and partners organised the dialogue, which brought together experts from Uganda's Ministry of Finance, which initiates tax laws and policy, Uganda Revenue Authority, which is the main implementer of tax laws and policy in Uganda, the EAC Secretariat, which is the executive Organ of the Community, and leading civil society organisations in the advocacy for tax justice and budget transparency in EAC.

In 2011, the EAC – hailed globally as Africa's fastest integrating regional economic community –drafted a code of conduct against harmful tax competition in the bloc, but to date, it remains on paper, not yet adopted and therefore not implemented, officials concede.

"The code of conduct against harmful tax competition was negotiated a long time ago, but it wasn't implemented," said Moses Kaggwa, the Director of Economic Affairs at the Ministry of Finance.

"As you know initially we were three partner states, but then we brought in more partner states including Rwanda, Burundi and now South Sudan. So the process somehow stalled because of the new states that joined the bloc and the need to accommodate them," he explained.

The EAC Treaty provides for domestic tax harmonisation under Article 83(2) (e), which calls for domestic tax policies with a view to removing tax distortions in order to

Jane Nalunga
Executive Director, SEATINI Uganda

bring about a more efficient allocation of resources within the Community.

Article 80(1) (f) also seeks to harmonise and rationalise investment incentives in order to promote the Community as a single investment area, while the same article also addresses double taxation.

While presenting the study findings, Jane Nalunga, the Executive Director of SEATINI Uganda, said that there is some level of domestic tax harmonisation.

She however added that while the fees and tax rates vary among the EAC partner states, the researchers found out that Uganda charges more fees than her peers in the regional bloc.

The study, titled Analysis of Tax Measures in the East African Community Member States: Are We Moving Towards a Harmonised Tax System was commissioned by SEATINI Uganda, East African Tax and Governance Network (Kenya), Policy Forum (Tanzania), Transparency International (Kenya), Governance for Africa (Rwanda), Dukingire Isi Yacu (Burundi), Diakonia and Tax Justice Network Africa.

It notes that the region has made strides in harmonising tax laws including developing the East African Customs Management Act (2004), EAC Double Taxation Agreement (2011) and EAC Mining Bill (2017) in addition to Uganda, Kenya, Tanzania and Rwanda adopting a unified budget approach and synchronised presentation on the same day.

However, Ms. Nalunga says these that strides notwithstanding, there are tax disparities among the bloc's partner states, with a big impact on investment and regional integration, largely because provisions of the EAC Treaty remain general, with no specific laws created to help their implementation.

"The provisions on tax harmonisation in the EAC Treaty are still very general…they haven't been unpacked and the common complaint among partner states [is] that there are no guiding principles," she said, quoting the study findings.

Tax justice advocates argue that the domestic revenue measures put in place often differ and might not necessarily speak to the budget themes, citing the varied tax systems among the partner states that hamper the enjoyment of the freedom granted by the Treaty, the Common Market Protocol, and the Monetary Union Protocol.

Abel Kagumire, the Commissioner for Customs at URA admits, for instance, that despite a two percentage difference between the 18 percent VAT rate applied by Uganda and that of Kenya, which is 16 percent, the impact is huge, creates distortions and often complicates compliance enforcement, undermining the principles of the Common Market.

"We are already feeling the impact of their goods inflow because they charge 16 percent VAT. Like for their wheat, charged at that rate, it's cheaper. Our millers Mandela and Bakhresa will find it hard to compete. So the 2 percent difference is big because it is already impacting us at the borders," he explained.

However, the experts who analysed EAC's tax harmonisation study fault Kenya which applies a VAT rate of 8 percent on petroleum products.

"Maybe 16 percent VAT isn't a big problem but we saw a problem on the petroleum oils, and it has implications on trading in petroleum products by companies from other partner states because the 8 percent that Kenya charges is very low," Ms. Nalunga says.

The study highlights the greater level of harmonisation on corporate income tax, which is at 30 percent by Uganda, Kenya, Tanzania and Rwanda, although Kenya also has a separate rate of 37.5 percent that is applied on branches of foreign companies and private equity.

However, there are big disparities where tax rates vary in the treatment of Capital Gains Tax (CGT) and allowable deductions, with Uganda's fixed at 30 percent while Tanzania applies a 20 percent rate for a foreign resident and 10 percent for nationals.

In Kenya, CGT was suspended in 1985 and only reintroduced on January 1 2015; the country applies a rate of 5 percent of the gain, and is paid by the seller or the transferor of the property, as a final tax and not subject to further taxation after payment.

"At 5 percent, that's very low compared to its peers. And that's what we call harmful tax competition. It needs to be revised upwards," argues Ms. Nalunga, adding that with effect from January 1 2016, there is no CGT arising from sale of securities listed on the stock exchange in Kenya.

Mr Kagumire, who boasts of 20 years' experience in customs tax administration argues that it is important to appreciate that "we are at different levels of development in EAC" hence the different rates that partner states apply.

However, he agrees that tax harmonisation is one of the enablers for integration of EAC because once the bloc's partner states harmonise,

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they avoid harmful competition.

The study also established that Personal Income Tax rates in EAC partner states greatly vary especially for low income earners, while they are harmonised for large income earners; the threshold in Rwanda and Uganda is $30 and $67 respectively, while in Kenya and Tanzania it is fairer, at $233 and $117 respectively.

"Thresholds for income tax are very low for Uganda and Rwanda – that's what you call a policy choice at country level, and we are discussing to see what should actually be the optimum. Should it be as high as Kenya? What are the considerations for this threshold?" says Mr Kaggwa.

There have been suggestions that the personal income tax threshold for Uganda should start at $100, but Mr Kaggwa explains that the Treasury is forced to levy low income earners because there are few employers in the country that pay their workers a monthly salary that is the equivalent of $100, to enable the government raise the threshold.

The study also delves into disparities in incentives and tax exemptions for investors, noting that significant differences exist in regard to how they are applied as countries outdo each other to attract investors, a cutthroat rivalry that the study describes a "a race to the bottom".

For instance, Kenya and Uganda have an automatic tax exemption regime where the taxpayer meets the criteria, while Tanzania requires the minister to exercise discretion to grant the exemption.

However, in Uganda there are executive exemptions that are non-statutory; Tanzania uses reduced Corporate Income Tax rate in some cases while Uganda and Kenya only have the 10 year exemption. Uganda favours local and EAC citizens for exemptions.

"On incentives we have a lot of differences, I admit and that's a race to the bottom. We have decided to undertake some serious research on this matter, to see what we are losing," explains Mr Kaggwa.

Kenneth Apollo Bagamuhunda, the Director General of Customs and Trade at the EAC Secretariat explains that the underlying motive of economic integration based on the EAC perspective was the need to promote trade through market expansion and the whole concept was premised on the aspect of bringing countries and leveraging on the population and economies of scale that are created through market expansion.

According to Sheila Kawamara-Mishambi, the Executive Director at Eastern African Sub-Regional Support Initiative for the Advancement of Women (EASSI), there is need to create an enabling environment that promotes local industrialists by extending capital/tax incentives to locally owned industries as opposed to foreign owned enterprises disguising as local enterprises yet they end up repatriating profits.

"Furthermore, we need tax laws and tax administration to be harmonized to ease trade and make the EAC work for all people," she adds.

Civil Society Views and Voices on Domestic Resource Mobilisation and Tax Harmonisation in the EAC Region

Sheila Masinde

Prime Nkezumukama

Chenai Mukumba

Allan Murangira Muhereza

Leonard Wanyama

"Effective mobilization of domestic resources requires transparent and accountable systems of tax collection, as well as sealing loopholes that allow for pilferage of resources out of the East African region. As it is, our tax systems, especially in Kenya are weak, and tax incentives are more inclined towards supporting foreign investments, leaving out local businesses, hence the need to rethink our tax policies. In developing strong tax system and achieving tax harmonization, it is important for partner states within the East African region to establish robust tax administration that invests in human, financial and technological resources to aid with information on revenue collection and to avoid tax evasion," **Sheila Masinde, Executive Director, Transparency International Kenya (TI-Kenya)**

"I am convinced that Domestic Resource Mobilisation is the best way to fund sustainable development of our respective Countries. The budget process in Burundi is really inclusive for all stakeholders contribute actively. We do really miss the strong CSOs coalitions on these issues, so we need to strengthen our local networks. We are still working under stress due to the lack of funds to support all the Tax Harmonisation Process, and advocacy reason why there is a strong need to call for support to different stakeholders working on Tax and Tax Related Issues," **Prime Nkezumukama, Executive Director, DUKINGIRE ISI YACU – Burundi**

"On 23 June, the world commemorated Public Services Day. This day is celebrated every year to draw our attention to the role and contribution of public service in development processes all over the world. This year, as the world continued to grapple with the devastating impacts of the pandemic, the importance of this day could not have been overemphasized.

One key issue that the pandemic has highlighted has been the importance of public investment in key social sectors. Evidence shows that the most sustainable way to do so is by investing domestically mobilized resources into these sectors. As we seek to rebuild our economies, it is imperative that East African Community (EAC) countries prioritize raising domestic resources through progressive taxation and investing it into key social sectors including health, education, and social protection.

Working to achieve our pledges to commitments such as the Abuja Declaration will go a long way in addressing some of the existing systemic inequalities in the region that have the most severe negative impacts on the most marginalized and vulnerable populations in our communities," **Chenai Mukumba, Policy Research and Advocacy Manager, Tax Justice Network Africa (TJNA) – Kenya**

Whereas it is commendable that the governments are trying to make deliberate efforts to invest in sectors that are key to youth development and recovery (especially health, education, trade and ICT) during this era of COVID-19 pandemic, the proposed investments fall short of the required resources to bring back young people fully on their feet. [For example, the proposed youth development funds in both the Kenya and Ugandan budgets of KES 2 Billion and UGX 165 billion respectively are all less that 0.0005% of their GDP and yet these are meant to get the youth back to work and 'jump-start' the economies]. Just like Uganda and Kenya have done with reforms on beneficial ownership aimed a closing revenue leakages in DTAs, governments in East Africa must also agree that giving out harmful tax incentives (to corporations that do not need them) is not the best way to raise resources, especially within the context of COVID-19 where production and trade have reduced and have seen increased borrowing. We should all be making efforts to have everyone pay their fair share of tax and rigorous accountability for the resources raised. **Allan Murangira Muhereza, Team Leader at Youth for Tax Justice Network (YTJN) - Uganda**

"Considering increasing debt and the impact of the COVID-19 pandemic, East African Community (EAC) countries need to ensure that budget processes do not harm their citizens further. This is because the pandemic has significantly disrupted livelihoods of many people, particularly low-income wage earners. In relation to this, tax proposals should first and foremost not result in a reduction in economic activity. This is likely to happen if the measures are punitive and not well thought out. Secondly, taxation should be applied in an equitable and fair manner so that an unjustified burden is not placed on the poor. Lastly, tax procedures should not allow for arbitrary applications because it results in the loss of scarce resources through unnecessary pursuits that are justified as attempts at improving domestic revenue mobilization. Further afield the EAC should work in concert to finalize implementation of the regional double taxation agreement for its implementation," **Leonard Wanyama, Coordinator, East African Tax and Governance Network (EATGN)- Kenya**

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