POLICY BRIEF 011

Heavy Taxes a Hindrance, to Business and Economic Freedom in Uganda

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Executive summary

Ugandans are currently experiencing an unfair tax policy system where utilities such as electricity, internet, water and fuel are charged with exorbitant taxes that have increased the cost of doing business.

Domestic taxes play an important role in supporting the provision of public services. Among the canons of a good taxation system include; flexibility, productivity, fairness, affordability among others. Ugandans are currently experiencing an unfair tax policy system where utilities such as electricity, internet, water and fuel are charged with exorbitant taxes that have increased the cost of doing business. Currently a unit of electricity costs Ugx 749.2 for domestic users exclusive of monthly charges. 75% of businesses both in the formal and the informal sector now depend on electricity in their operation. A mere increase in taxes per unit of power automatically increases the costs of operation and goods produced. Uganda currently has 850 megawatts (MW) of installed capacity of which approximately 645 MW is hydro and 101.5 MW is thermal generating capacity. This implies that the power generated can satisfy the local demand and at a low cost. Today, internet has become an essential necessity if at all Uganda is to enjoy the digital technology. However, the high taxes on internet data has proved this to be a myth.

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The government imposed a 12% internet data tax plus the 18% value added tax (VAT) which makes internet unaffordable for Ugandans. During the covid-19 pandemic, the government instituted a lockdown that restricted movement of people, closure of education institutions which forced them to resort to online studying. However, most of the parents could not afford the cost of data to enable their children access online studies while others could not afford internet enabling gadgets such as smartphones, computers or Ipads. This made studying online a difficult option while those in business where unable to make online orders or advertise their products via social media platforms such as face book.

This policy brief recommends a reduction in taxes on fuel to allow access at an affordable rate. There is need to construct fuel reserves to provide an alternative in periods of scarcity or fuel crisis. The ministry of energy and natural resources should institute a price ceiling above which is illegal to sell fuel.

In relation to unfair internet data tax, the Ministry of Finance together with the parliament of Uganda needs to revise the 12% internet data tax to zero if the country aims at achieving a global digital technology

Introduction and Background

Tax regimes in Uganda have been changing over time on imported and locally manufactured goods. ***In terms of domestic financing, Uganda's national budget is largely funded through tax revenue with an overall goal of financing the entire national budget by 100%.*** There are various domestic taxes including but not limited to; Taxes on internet data, electricity, and water. These would be some of the major utilities to be exempted from taxes or charge lower tax rates to increase affordability to the citizens. However, all of them have been witnessed to be high and unaffordable.

In the FY 2018/2019, a daily Over the Top Tax (OTT) of Ugx 200 was subjected on social media users such as Facebook and Whatsapp in addition to the Value Added Tax (VAT) of 18% making it rather expensive for internet users. To evade OTT, social media users, especially youth, adopted virtual private network (VPN) since it hides the user location from the face of tax authorities. ***Besides other macroeconomic factors such as unemployment and poverty, the introduction of OTT equally catalyzed a drop in the number of internet subscribers from 8 million in July 2018 to 6.8 million by September (UCC, 2018)[1].*** In June 2018, a month before the introduction of OTT, internet penetration rate in Uganda stood at 47.4% (18.5 million internet users) but three months later, it fell to 35% (13.5 million users) (UCC,2018). Monthly OTT tax revenue equally declined, from Ugx 5.6 billion (USD 1.5 million) in July 2018, to Ugx 4.09 billion (USD 1.1 million) in August 2018, and further to Ugx 3.96 billion (USD 1.08 million) in September 2018 (UCC, Market Performance Annual Report, 2018). The data from UCC imply that many internet users may have stopped accessing internet since July 2018. ***OTT thus undermined internet access and affordability by inhibiting access to information and freedom of expression among Ugandans.***

A big population especially in rural areas have limited access to power and this is attributed to heavy tariffs, charges and connection fee by UMEME.

Similarly, electricity usage in Uganda has been threatened by heavy taxes. Access to electricity stood at 56.7% in FY2019/20 (UBOS, 2020)[1]. By 2020, access to electricity in Uganda stood at 42.07% according to the World Bank collection of development indicators. A big population especially in rural areas have limited access to power and this is attributed to heavy tariffs, charges and connection fee by UMEME.

The tariffs and charges associated with electricity have forced most of the manufacturing industries to close down. Industries that consume more than 60 per cent of the country's electricity have since the lockdown reduced production causing an increase in commodity prices due to scarcity.

[1] http://bit.ly/2Bazspe

The increase in connection fee from Ugx 98,000 to Ugx 720,883 has made power theft inevitable among domestic and industrial users (UMEME, 2021)[2].

To a low income earner, raising Ugx 720,883 for electric power connection is too expensive in addition to monthly charges by UMEME and 18% VAT.

Comparably, unfair tariffs and charges on piped water have made it impractical for people to access and pay for the monthly water bills. ***Over 21 million people in Uganda, (51%) are living without basic access to safe drinking water*** (Life water, The Uganda water crisis, 2020). ***Although the highest percentage of Ugandans (33.5%) use borehole water for drinking, if the catchment area is not well protected, then boreholes become liable to contamination thereby rendering the water unsafe for human consumption.*** Additionally, boreholes and other point water sources are designed to serve 100 to 300 households hence during peak hours, the time taken for water collection is prolonged.

The government invests huge sums of money in the construction and distribution of piped water supply systems in rural and urban areas; however, very few of the households use piped water. ***In Uganda, 41% of people live in poverty*** (opportunity international report; where we work Uganda, 2020) ***and unable to pay for piped water required for household use.*** Additionally, households earning a monthly income of less than Ugx shs 500,000 and are connected to piped water supply struggle to pay their monthly water bills, even with the NWSC tariff plan for the different consumer categories. ***Hence persons unable to access reliable piped water supply resort to other water sources which are vulnerable to dangerous consequences like water bone diseases.***

Taxes on internet data in Uganda

The government later introduced Over-The-Top (OTT) tax on the use of social media platforms which many Ugandans did not welcome.

In June 2019, Uganda recorded 18,502,166 internet users out of the 40.5% population penetration. The Uganda Communications Commission (UCC) research in 2018 stated that the impact of Over the Top (OTT) reduced Internet users by five million in three months after the introduction of OTT in July, 2018 yet internet penetration rate stood at 47.4% before the introduction of the tax.

Before the introduction of internet data tax of 12% and Over the Top (OTT) tax, internet service providers used to charge an 18% Value Added Tax (VAT) on data purchased.

[2] https://www.umeme.co.ug/what-you-need-to-get-connected

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Unfortunately the government failed to raise the projected revenues of Ugx 486 billion and instead substituted it with a new tax of a 12% on internet data.

The infamous OTT tax, widely known as 'social media tax', required Ugandans to pay a daily levy of (Ugx) 200 (USD 0.05) in order to access social media platforms including Facebook, Twitter, Whatsapp etc. From inception, sections of civil society and the public saw the tax as an attempt to suffocate free speech and access to information and they warned that the tax would have disastrous effects on the country's young digital economy and digital civic space.

However, by the end of July 2018, the projections had been revised downwards to Ugx 284 billion (USD 78 million) annually. ***In July 2019, one year after the introduction of the tax, the revenue body reported that it had experienced an annual shortfall of 83%, having collected only Ugx 49.5 billion (USD 13.5 million). In the second year, the social media tax fetched a paltry USD 16.3 million.***

Beginning July 1, 2021, the government replaced the OTT tax with a direct 12% levy on internet data, after which a Value Added Tax (VAT) of 18% applies.

Within the first year of the social media tax, Uganda lost five million internet subscriptions due to the negative effects of the tax. Although the tax was envisioned as small and manageable, it did not meet the fairness and proportionality requirements for a country whose average phone subscriber spends just Ugx 10,500 (about USD 2.8) per month on all their voice calls, data, SMS, and access taxes, according to Uganda Communications Commission (UCC) figures. ***The 12% has therefore increased the cost of data and slowed business operation in Uganda. It is from this background that Gateway Research Centre is advocating for such unfair internet taxes that have made business operations expensive.***

Taxes and charges on electricity in Uganda

Taxes on electricity consumption and production are a common international method of energy and environmental taxation. However, in most countries they were created not to reduce pollutant emissions and resource use but to generate domestic revenues. In particular, the increasing concerns over climate change and the need to reduce dependence on foreign energy have been powerful motivators to contain energy usage.

The Electricity Regulatory Authority (ERA) has since its establishment presided over a steadily growing sub-Sector that has eliminated load shedding due to increased generation and accelerated Electricity Access for Ugandans.

To ensure sustainable power supply, ERA has over the years created a conducive regulatory environment and incentives aimed at diversifying the Country's Generation Mix. Uganda's Power generation is mainly diversified across Four (4) different sources as follows: -Hydro - 1,023.59 MW, Thermal - 100 MW, Cogeneration - 63.9 MW and Grid-connected Solar - 60 MW.

Uganda's Electricity sub-sector has grown from three (3) Generation Plants in 2001 to over 40 Plants and is still growing. The Total Installed Generation Capacity has grown from 60 MW in 1954, 400 MW in 2000 to over 1837.49 MW as of October 2021. UMEME increased the power connection fees from Ugx 98,000 to Ugx 720,883 for No pole and Ugx

2,387,472 for one pole. This made it difficult and expensive for people to continue accessing electricity like it was before the increments.

Many businesses today in rural and urban settings operate largely on electricity. Enterprises such as wielding, carpentry, small scale industries such as maize milling, flour milling, hotels and restaurants etc all need power in running of their businesses. ***The high charges and taxes related to electricity have pushed many Ugandans out of businesses thus worsening the unemployment levels in the country.***

Table 1: Annual Average Weighted Domestic Tariffs (Ugx shs/kwh), 2014-2021

Source: Electricity Regulatory Authority (Domestic tariffs 2014-2021)

UMEME charges the first 15 units at shs 250 while the proceeding units costs shs 747.5 (ERA 2021)[3] in addition to shs 3650/= monthly charge which proves a burden to a final user and a cost to business operations. Such heavy charges have caused a drop in business operation amidst other inconveniences caused by power outages especially during peak hours and vandalism.

Taxes on Petroleum Products (Petrol, Diesel)

Fuel prices in Uganda have been skyrocketing since 2019 to date with a litre of petrol going for as high as Ugx 6,350 while diesel was quoted at Ugx 6,250 from Ugx 4,400 to Ugx 3,900 respectively. Fuel Prices keep increasing as you drive away from the city centre to far upcountry districts as a result of increase in transport costs. The increase in fuel prices was said to be a global challenge though neighboring countries like Kenya and Tanzania are not too much affected as it is the case in Uganda. This implies there could be other unidentified internal factors either by fuel dealers to hike prices or inefficient government policies to regulate fuel prices.

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Fuel being a major economic lubricant, the country is now experiencing rampant closure and collapse of many sectors/businesses. The increasing fuel prices have made public transport business unaffordable and unsustainable. Those in the public transport business have now abandoned the sector and now searching for opportunities elsewhere but failed to meet a neutral ground due to poor performance of the economy.

By December 2021, a litre of petrol cost Shs 4,580 while diesel was at Shs 4,100 yet the demand was low due to restrictions of certain sectors of the economy as a result of the Covid-19 lockdown. During the 2021/2022 financial year, the government increased excise duty on fuel from Shs 1,350 to Shs 1,450 per litre of petrol while diesel rose from Shs 1,030 to Shs 1,130 per litre.

Today fuel prices have almost doubled yet public transport means have not increased transport fares up to date (Daily monitor, Tuesday, April 2022). “Even when we try to increase transport fares, people cannot afford. The economy is down all our clients do not have money” one of the taxi driver on Kampala-Masaka road. A journey that used to take 10 liters of petrol has now doubled the price and to business people this is not sustainable thus many have decided to park their cars until when fuel prices stabilizes to normal. However, the question remains;

[3] https://www.era.go.ug/index.php/media-centre/what-s-new/362-era-reduces-electricity-tariffs-for-the-third-quarter-of-2021

will Uganda's fuel prices drop? and where will these business entrepreneurs be before fuel price stabilization. With personal vehicles mainly the low fuel consuming cars, it required Ugx 170,000 to fill up the fuel tank in the past when a litre cost Ugx 4,350. But today, one needs Ugx 340,000 to fill up the same tank. ***With such increments, many people are being forced to resort to public transport means such as the use of bodaboda as a way of coping up with the hiking fuel prices.*** However, even boda-boda operators especially in cities and urban centers across the country have decided to hike the transport fares to enable them remain in business. A combination of factors, including the effects of COVID-19 on the supply chain, the resurgence of the global demand and new tax regimes in East Africa are said to have led to this rapid change in fuel prices in Uganda. New tax measures also saw a Ugx 100 increase in the excise duty per litre, although this did not take immediate effect on the prices, at least in the first two months of 2021/2022 financial year. The Country was enjoying a stable fuel supply according to Frank Tukwasibwe, the commissioner for petroleum distribution, implying that the causes are internal. The global energy demand has shot up in the last few months during the opening up of global economies from the covid-19 pandemic. However, the supply has remained unchanged, leading to pressure on prices. This explains why some of the fuel stations have closed down while others may have only diesel or petrol or none.

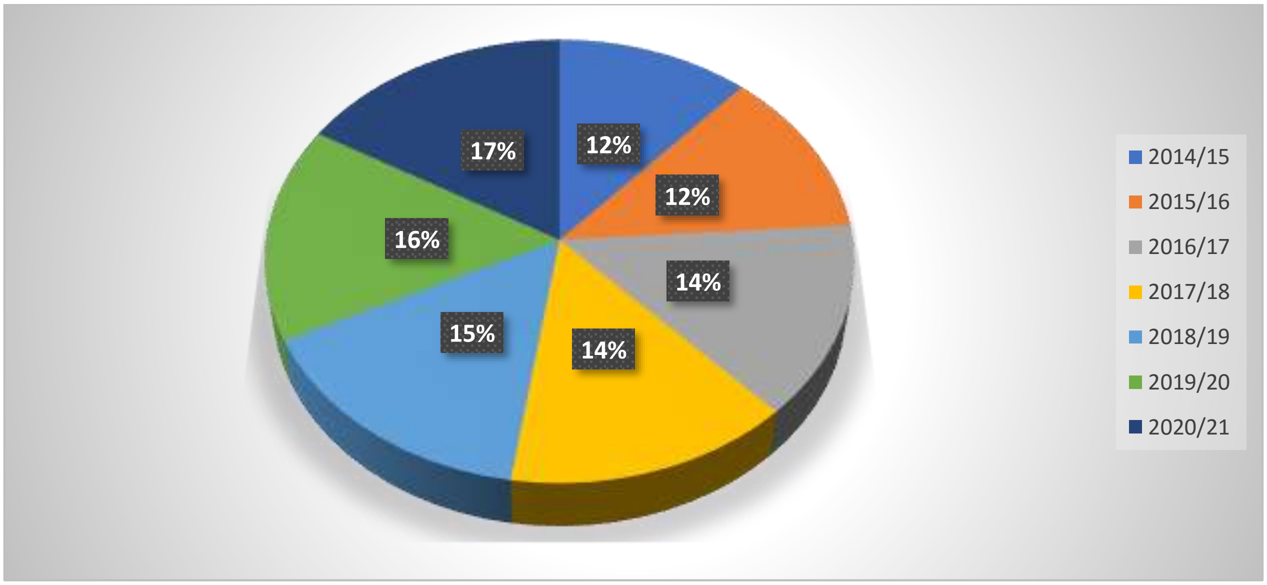
Currently, the war between Ukraine and Russia has got lesser effect on Uganda's increasing fuel prices thus there are internal factors that are heavily pushing fuel prices to where they are. Reports indicate that at least 130 countries are experiencing sharp fuel price increments due to the high global demand, although countries like the United Kingdom faced extra problems like transportation. In Kenya, the oil prices were recently pushed up when the country raised taxes and lifted all subsidies, pushing the prices to at least 4,430 per litre of fuel.

The government of Uganda has completely failed to intervene in the rambling fuel prices. This has seen motorists demonstrating on streets about the ever increasing fuel prices in parts of Jinja and Mukono due to failure by the government to find a lasting solution to fuel crisis yet it has the capacity to engage their global partners. The transport sector is becoming meaningless, yet the cost of living is too high all attributed to hiking fuel prices.

Affordability is an essential part of improving access to water, sanitation and hygiene products and services in Uganda. ***The cost of access, to clean water whether on a monthly bill or an investment for households should be attractive if the country is to realize an equal distribution of safe water both in urban and rural areas.*** There is uneven distribution of clean piped water in Uganda. Most households have no access to clean water and it is fairly distributed in trading centers, towns and cities while rural areas have little or no access to clean water. Access to an improved water source is a prerequisite for improved health. ***Although the highest percentage of Ugandans (33.5%) use wells and borehole water for drinking, if the catchment area is not well protected, then these water sources are likely to become liable to contamination thereby rendering the water unsafe for consumption.*** Additionally, boreholes and other point water sources are designed to serve 100 to 300 households hence during peak hours, the time taken for water collection is prolonged which time could be used for other economic activities. Women, girls and children being the main water collectors are at risk of rape, kidnap and defilement as a result of having to travel long distances to fetch water especially during dry seasons from other sources (BMAU paper, piped water supply in Uganda, 2016).

The government invests huge sums of money in the construction and distribution of piped water supply systems in rural and urban areas; however, only 20.7% of households use piped water. This is because of the high connection fee charged by National Water and Sewage Corporation (NWSC). In Uganda, 41% of people live in poverty (opportunity international report; where we work Uganda, 2020) and unable to pay for piped water required for household use. NWSC charges a minimum of Ugx 300,000 for connection of piped water depending on the distance from the source. Additionally, households earning a monthly income of less than Ugx shs 500,000 and are connected to piped water supply struggle to pay their monthly water bills, even with the NWSC tariff plan for the different consumer categories. Hence persons unable to access reliable piped water supply resort to other sources which may lead to diseases and other dangerous consequences. Currently NWSC charges Ugx 3727 per m3 for domestic users. The monthly water charge based on the domestic tariff by NWSC would be Ugx 7,594.5 and this cost is inclusive of 18% VAT and Ugx 1,500 service charge making a total of Ugx 10,461.51. Basing on the private operator fee of Ugx 4,000 per cubic meter, the monthly cost estimate for the household would be Ugx 12,200. Such heavy charges and taxes have made access to water very difficult yet water is an essential item that every citizen cannot live without.

Figure 1: Water produced and supplied (million m^3) by NWSC in Uganda, 2014/15 – 2019/20



Source: Uganda Bureau of Statistics, different financial years, modified by the author

Key Policy Recommendations

a) Policy Recommendations on unfair internet data charges:

- *The Parliament of Uganda to dialogue with Uganda Revenue Authority and Ministry of Finance, Planning & Economic Development to revise the current internet data tax from 12% to between 1% to 5% or at worst to be below 10%.* This would match the new paradigm shift to digital technology of virtual management, digital marketing, and digital service delivery moreover in the unprecedented Covid-19 period.

b) Policy recommendations on electricity tariff rates

- *The Parliament of Uganda and Cabinet to discuss with Umeme Uganda to lower the monthly Yaka service fee by 50% from Ugx 3,360 to Ugx 1,680*
- The Parliament of Uganda and Cabinet dialogue Uganda Revenue Authority, Electricity Regulatory Authority and Ministry of Finance to ***lower VAT on electricity from 18% to between 10% -14% to lower the cost of living and cost of doing business***

- ***The Parliament of Uganda and Cabinet dialogue with Umeme to increase the quantity of the first monthly domestic electricity units chargeable at Ugx 250 from 15Kwh to 30Kwh or more.***
- The Parliament of Uganda and Cabinet dialogue with Umeme to reduce the current average electricity charges for both domestic and commercial consumers to lower the cost of doing business and reduce the cost of living

c) Revise the National Water & Sewerage Corporation charges

- ***Parliament of Uganda and cabinet to dialogue with National Water & Sewerage Corporation to lower the water charges***
- Parliament of Uganda and cabinet to dialogue with Uganda Revenue Authority to lower VAT on National Water & Sewerage Cooperation services to less than 10%.

d) Policy Recommendations on hiking fuel prices:

- There is need for price legislation by the government to reduce consumer exploitation. ***The government should set a maximum price above which fuel companies must not exceed.*** This implies that all fuel dealing companies must sell below the set and agreed price ceiling.
- ***The government should refill and construct more fuel reserves which can supply fuel especially in periods of crisis.*** Currently the available fuel reserves are completely empty and some of them are in sorrow state.
- ***The government should invest in electrified transport means to reduce the usage of fuel in the transportation of goods and movement of people.*** This will also indirectly help in sustainable environment through reduction of dangerous emission gases.
- ***Subsidizing/reduce taxes on fuel imports.*** Fuel companies have always complained about taxes hence if the government reduces on the taxes on fuel, prices are likely to come down and eventually economies will boost again
- The government should quicken the exploitation of fuel reserves in Mubende and Albert flats such that we reduce on dependence on fuel imports which are characterized by many unforeseen circumstances.

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