



Taxing High Net Worth Individuals: Lessons from the Uganda Revenue Authority's Experience

Jalia Kangave, Susan Nakato, Ronald Waiswa, Milly. I. Nalukwago and Patrick Lumala Zzimbe

Introduction

Low-income countries have, on average, reduced their reliance on foreign aid in the past two decades. This has been achieved in part by collaborating with high-income countries and donor agencies to strengthen the capacity of tax authorities to collect revenue. While significant progress has been made, various revenue sources remain untapped. Many low-income countries continue to rely heavily on indirect taxes, such as Value Added Tax, and customs and excise

duties. Income taxes contribute a very small percentage to total tax revenue, and are paid mainly by people in formal employment and large companies. It is estimated that on average, personal income taxes (PIT) contribute only 2 per cent of GDP in sub-Saharan Africa, which is low when compared to the 10 per cent collected in high-income countries.¹

In Uganda, for example, in FY 2014/2015, taxes on goods and services constituted 66 per cent of total tax revenue, while PIT constituted 25 per cent.² 68 per cent of

¹ Moore, M. and Prichard, W. (2017), *How can Governments of Low-Income Countries Collect More Tax Revenue?* Working Paper 70, Brighton: IDS

² OECD/ATAF/AUC (2017) *Revenue Statistics in Africa 2017*, Paris: OECD Publishing <http://dx.doi.org/10.1787/9789264280854-en-fr>

the PIT was collected from people in formal employment. Wealthy individuals in Uganda contribute very little to PIT. In FY 2013/2014, for example, only 5 per cent of the directors of the top taxpaying companies were paying PIT.³ Similarly, a sample of the top 60 lawyers in the country revealed that less than a third of them were remitting PIT for the period between FY 2011/2012 and FY 2013/2014. There was also a mismatch between the payment of import duties and compliance with income tax obligations. Some individuals were paying billions of Uganda shillings in import duty, but not paying income taxes. Lastly, an analysis of the compliance of 71 top government officials over the period 2011/2012 to 2013/2014 revealed that although all of them had stakes in commercial enterprises, the majority were not paying PIT. The companies that they were associated with were also not complying with their tax obligations.

The under-taxation of wealthy individuals (also commonly known as High Net Worth Individuals – HNWI) is not confined to Uganda or low-income countries more generally. Globally, the tax affairs of these individuals have been put under scrutiny for various reasons. First, they could contribute significantly to revenue collection. Second, they are likely to engage in aggressive tax planning. Third, their compliance behaviour is likely to have a bearing on the behaviour of other taxpayers, and thus on the integrity of the tax system as a whole.

Challenges to taxing wealthy individuals in Uganda

Our research into why wealthy individuals in Uganda are under-taxed revealed that the problem is not the lack of appropriate legislation. There is a robust legal framework to support the Uganda Revenue Authority's (URA) efforts in taxing these individuals. Rather, the challenge is one of implementation. HNWI have historically been under-taxed because:

- a) URA has focused its tax efforts on large companies and people in formal employment.
- b) HNWI are politically influential either because they are politicians or because they are powerful business people with political connections.
- c) URA has a wealth of information which, for various reasons, is not fully utilised. Sometimes this is because the URA systems fail to detect inconsistencies in different databases. There is also the problem of departments operating in silos, and competing with each other to meet targets. Lastly, there is limited capacity to analyse the information.
- d) Sharing information between URA and other government organisations is also still a challenge. First, the information systems in the various government organisations are not interfaced. Second, some government organisations still use manual systems. Third, some of these organisations do not have a good working relationship with the URA.

³Kangave et al. (2016) *Boosting Revenue Collection through Taxing High Net Worth Individuals: the Case of Uganda*, ICTD Working Paper 45, Brighton: IDS

How has the URA gone about taxing HNWI's?

In 2015, the URA established an HNWI unit as part of the Large Taxpayer Office (LTO) in the Domestic Taxes Department. To begin their work, officials in the unit generated a list of potential HNWI's, comprising directors of large companies under the LTO and individuals whose wealth was publicly known. The list was scrutinised by top management in the Domestic Taxes Department, who made revisions on the basis of their knowledge. Since most of the individuals selected were not filing income tax returns, the URA did not at that point have records that it could use to ascertain the accuracy of the list. Similarly, it did not have formal criteria for defining HNWI's.

The initial list comprised 117 individuals. The HNWI unit gathered as much information as they could from the URA databases about the economic transactions of these individuals. They then contacted them by telephone and set up appointments to talk about their tax affairs. At the meetings, the URA was often represented by the supervisor of the unit and a tax officer. In some cases, the Commissioner General and the Commissioner of Domestic Taxes accompanied the team. The meetings were intended to serve two broader purposes: to educate taxpayers on their rights and obligations, and to signal that the URA was looking into their tax affairs.

Because the HNWI list also included politicians, the URA approached the Electoral Commission before the 2016 presidential and parliamentary elections and requested that it made tax clearance

certificates a prerequisite for vying for political office. While the Electoral Commission had no legal authority to make such a request, the URA made public announcements to the same effect. As a result, many political candidates went to the URA to file tax returns and, in the process, made some payment towards their tax obligations.

Also in a bid to deal with the political sensitivity of taxing these individuals, in 2017 the HNWI unit was moved from the LTO to the Public Sector Office (PSO), which has experience in dealing with politicians. After being transferred to the PSO, the HNWI unit was merged with the VIP unit that had been established to deal with individuals who are considered to be politically influential.

Who is a High Net Worth Individual for Uganda's purposes?

HNWI's are defined differently by different tax authorities. However, a number of tax authorities identify these individuals using a single threshold, which is often based on aggregate income and/or wealth. In URA's case there are multiple thresholds, which depend on the parameter being used. It is difficult to use a single threshold for Uganda's purposes for a number of reasons. First, information about economic activities is sometimes not officially recorded. Second, even when such information is recorded, the information systems in different government organisations are rarely interfaced. In some cases, particularly outside Kampala, government organisations still use manual records. Third, many transactions are

undertaken using cash, and are thus difficult to trace. All these factors make it difficult for the URA to aggregate the wealth/income of taxpayers, at least at present.

The URA classifies HNWI's using multiple income and wealth thresholds, comprising both core and non-core parameters. A core parameter is an indicator that is individually sufficient to trigger classification as an HNWI. The core parameters consist of:

- a) Land and buildings: Uganda is largely a 'real property economy'. Many individuals invest in physical structures such as land and buildings instead of keeping their money in bank accounts or investing in instruments such as shares and bonds. In other words, land and buildings are the most common assets used to amass and retain wealth. A person is classified as an HNWI if they generate more than USD142,000 annually in rental income, or if they engage in the buying and selling of land over the value of USD285,000 in a five-year period.
- b) Shareholding in large companies or groups of companies with a high turnover: companies that are managed by the URA's LTO are controlled by a small group of individuals. Similarly, there are a few individuals who control groups of companies that fall under the Medium Taxpayer Office. Shareholders in private companies whose annual turnover is more than USD14.3 million or shareholders in multiple companies with a turnover between USD4.3 million and USD14.3 million are considered HNWI's for URA's purposes. In establishing the interests of these individuals,

the URA also considers shares held by their associates (including children, spouses and business partners).

- c) Loans and bank transactions: it is difficult, if not impossible, to get a huge loan from a bank if one does not have sufficient assets to act as collateral. While wealthy individuals in Uganda rarely declare their wealth and income to the URA and other government agencies, many of them provide this information to commercial banks. Loans thus serve as a useful proxy for income and assets. Similarly, large deposits in bank accounts are a useful indicator of wealth. A person is classified as an HNWI if they have a loan portfolio of over USD1.5 million in a five-year period or have bank transactions of over USD1 million annually.

A minimum of two non-core parameters are required for one to be classified as an HNWI.

The non-core parameters include:

- a) Publicly known wealthy individuals: the identity of many HNWI's is publicly known. This information can be gleaned from URA officials, members of the public, newspapers and lifestyle magazines.
- b) Importers and exporters: international trade is central to Uganda's economy. In FY 2016/2017, exports constituted 11 per cent of GDP, while imports made up 17 per cent of GDP. All those importing or exporting goods exceeding USD142,000 annually are potential HNWI's.
- c) Individuals maintaining commercial forests, plantations and huge ranches.

Achievements of the HNWI/VIP unit

Since its establishment in 2015, the HNWI unit has registered various achievements:

- a) There is now a register of wealthy individuals. Before the unit was established, wealthy individuals were managed as part of the LTO, with no separate register for them. There were only 17 individuals, most of whom declared only employment income. The current register has 117 HNWI and 239 VIPs covering all tax heads.
- b) There has been great improvement in the filing of income tax returns. Only about 13 per cent of the individuals on the LTO register were filing returns. By FY 2015/2016, at least 78 per cent of HNWI and 65 per cent of VIPs were filing returns.
- c) The revenue collected from HNWI has increased significantly. Before the unit was established, the LTO collected only USD390,000 from wealthy individuals in FY 2014/2015. Within less than a year of its establishment (by June 2016), the unit had collected over USD5.5 million in rental tax, personal income tax, VAT and stamp duty. In total, as at June 2017, the unit had collected USD 11.4 million. This amount was collected before any audits were undertaken. In FY 2016/2017, the URA conducted comprehensive audits on the accounts of five individuals on the HNWI register. Over USD490,000 was assessed and agreed upon with the taxpayers.
- d) The URA has observed some improvement in the attitudes of HNWI/VIPs towards paying

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taxes. This has largely been as a result of the tax education that is provided to the individuals.

What can the URA learn from other tax authorities?

There are two main lessons that the URA can learn from other tax authorities, in addition to some of the strategies that it has already borrowed:

- a) Staffing requirements: currently, the HNWI/VIP unit has 6 staff members serving 326 individuals. This puts the staff to taxpayer ratio at 1:54, and it is certain to increase given the newly developed criteria. Other revenue authorities have not only a lower staff to taxpayer ratio, but also have relationship

managers. URA also needs to invest in the professional development of its staff members through a mixture of short courses, on-the-job training, secondments to other tax authorities and informal networking events. Lastly, it should learn from other tax authorities how to strike a balance between staff continuity, and guarding against compromising the independence of staff members.

- b) Encouraging voluntary compliance: tax authorities, such as the UK's Her Majesty's Revenue and Customs, the South African Revenue Services and the Australian Tax Office, encourage compliance of their HNWIs using a number of strategies, including educating the HNWIs, engaging with them before they submit their tax returns and resolving points of disagreement. When this fails, they assess the individual to determine whether they are low-risk or high-risk. High-risk individuals are audited and/or investigated.

What lessons can be drawn from the URA's experience?

A number of lessons can be drawn from the URA's experience:

- To tax a segment of the population that is economically and politically influential, it is important to have support from top management of the revenue authority. Both the URA's Commissioner General and the Commissioner for Domestic Taxes have been committed to ensuring that the decision to tax HNWIs is implemented.

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- The identity of most HNWIs is publicly known. It has not been difficult for the URA to identify many of the most prominent. Initial information is cross-checked to ensure that people are not wrongly labelled as HNWIs.
- Sometimes it is important to simply start with the little information available, without waiting until one has good definitions and comprehensive lists. The learning process is continuous, and definitions and lists can be revised along the way.
- With will and intelligence, a tax authority can go ahead and make real progress without focusing too much on what other countries do.
- Technical expertise is important. But communication skills are even more important

in a country where the majority of HNWI's engage more in tax evasion than avoidance, and where they wield a lot of political influence. Officials in the HNWI unit are chosen for their ability to balance between being assertive and being respectful. They are also able to communicate tax matters in a simplified manner.

- Initially, emphasis is placed on educating taxpayers about their rights and obligations. Enforcement comes later.
- Identifying HNWI's requires close collaboration between the research function and the operational function. This allows for research findings to be tested in real time, and for the research, in turn, to be informed by what is happening in practice.
- Government is one of the biggest consumers of goods and services. HNWI's are likely to be engaged – directly or through their associates – in the provision of goods and services to government. The URA's Public Sector Office, which monitors the award of government contracts, has been a good source of information on contracts entered into between the government and these individuals.
- Elections may have an effect on revenue collection. HNWI's who are politicians are more likely to pay their taxes during election periods. Whether these payments continue after election periods cannot be guaranteed.

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Further reading

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Credits

Jalia Kangave is a Research Fellow at the Institute of Development Studies, and Capacity Building Manager of the International Centre for Tax and Development (ICTD). She also leads the Gender and Tax programme at ICTD.

Susan Nakato is a supervisor in Corporate Performance, Monitoring and Evaluation at the Uganda Revenue Authority's (URA) Research, Planning and Development Division. She is one of the economists behind the African Tax Outlook publications, and a lecturer at Kyambogo University, Uganda.

Ronald Waiswa is a supervisor in Research and Policy Analysis at URA's Research, Planning and Development Division. He also heads research and training at Lida Africa.

Milly Nalukwago Isingoma is the Assistant Commissioner Research, Planning and Development at URA. She is also the URA head of Delegation to the East African Revenue Authorities' Technical Committee, and a member of ICTD's Centre Advisory Group.

Patrick Lumala Zzimbe is an officer in Enterprise Risk Management at the URA's Research, Planning and Development Division. He is a statistician and researcher in the areas of taxation, gender, food security, demographics and health, agriculture, and child labour in the mineral and energy sector.

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International Centre for Tax and Development
 at the Institute of Development Studies
 Brighton BN1 9RE, UK

T +44 (0)1273 606261 F +44 (0)1273 621202 E info@ictd.ac W www.ictd.ac