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Taxing Agricultural Income in the Global South: Revisiting Uganda's National Debate

Summary of Working Paper 121 by Graeme Stewart-Wilson and Ronald Waiswa

The issue of agricultural taxation has almost completely disappeared from scholarly and policy agendas in recent decades. And, yet, agriculture continues to be taxed very lightly in much of the Global South – even though it contributes substantially to GDP. In some cases, light taxation of agriculture may be an intentional policy goal. Evidence from Uganda, however, suggests there are a substantial number of agricultural suppliers earning high incomes in the sector that are either: (1) protected by current tax legislation, or (2) not compliant with their existing tax obligations.

This working paper reviews the early literature on taxing agricultural income, and discusses some reasons for its near-disappearance from the policy agenda. The paper then investigates attempts to tax agricultural income in Uganda. Uganda's experience provides useful lessons for other Global South countries that may be considering revisiting the question of how best to tax agricultural income.

Why is agricultural income so hard to tax?

Following independence, agriculture in many African countries was taxed indirectly and implicitly through export taxes and monopoly marketing boards, respectively. These policies were intended to transfer a substantial proportion of agricultural surplus to industry in urban areas, to stimulate broader economic modernisation. These indirect and implicit taxes are highly distortionary, and were attacked in the early 1980s by many economists and multilateral lending institutions, such as the World Bank and IMF. Stabilisation and structural adjustment lending during the period was then made contingent on, among other things, 'getting the prices right' – which implied a substantial reduction in the indirect and implicit taxation of agriculture.

Mechanisms of direct taxation, such as income taxes, were proposed to fill the revenue gap. Income taxes, however, face major administrative challenges in identifying taxpayers and determining taxable income. Earned income in the agriculture sector is especially hard to measure because:

1. A large proportion of agriculture is conducted on a small scale.
2. A substantial proportion of agricultural production is consumed and not marketed.
3. Records are rarely kept for cost of inputs, quantity of outputs, or amount of marketed output.
4. Many Global South countries have multiple overlapping land tenure systems, making the appropriate distribution of input costs and outputs between farmers extremely complicated.
5. The cost of verifying self-reported income from agriculture is very high. In many countries tax collection and enforcement responsibilities are divided between different levels of government, producing a host of coordination and information-sharing problems.

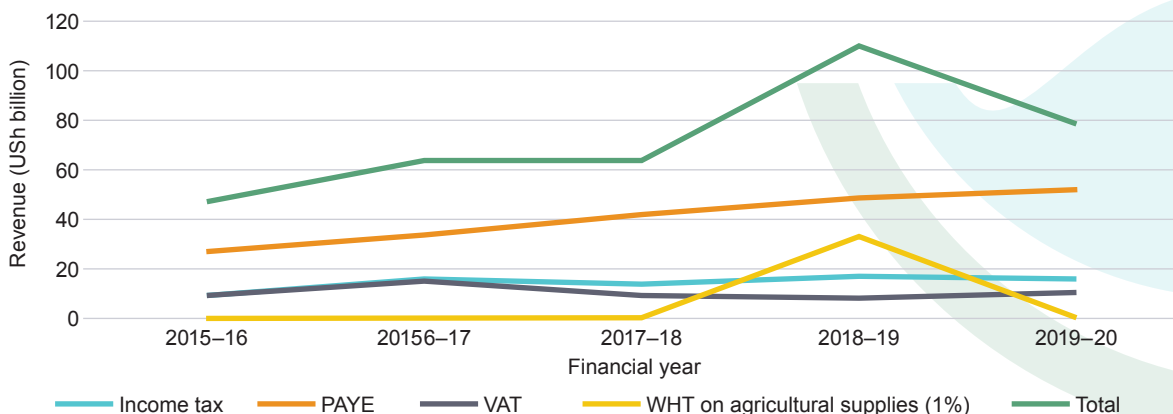
As a result of these challenges, few Global South countries successfully enforce income tax obligations in the agriculture sector.

What can Uganda's experience teach us about the challenges of taxing agricultural income?

In theory, agricultural income in Uganda is subject to all the same tax instruments as other sectors of the economy. Due to the challenges outlined above, in practice taxation of agricultural income is very light. In 2018/19 the agriculture sector accounted for 22 per cent of GDP, but contributed only 1 per cent to total tax revenue collected by the URA. In comparison, in 2018/19 the wholesale and retail sector contributed 29 per cent to tax revenue (with 8.7 per cent of GDP), and the manufacturing sector contributed 22 per cent of tax revenue (with 15.5 per cent of GDP). Internal URA investigations of sugarcane outgrowers and fish suppliers indicate that some individuals are making annual sales in excess of US\$250,000, although few are income tax compliant, or even registered with the Uganda Revenue Authority (URA).

In 2018, Uganda adopted a revised 1 per cent withholding tax (WHT) on agricultural supplies to target high incomes in

Figure 1 Revenue contribution by tax head in the agriculture sector (US\$ billion)



the sector, and pursued aggressive enforcement of the new rate. Under the withholding system, certain large purchasers of agricultural supplies are designated as ‘withholding agents’, with a legal mandate to remit a percentage of total sales value to the URA. In theory, the withheld amounts are credited to the income tax owed by those supplying the large purchasers. In practice this rarely happens, as so few agricultural suppliers actually file income taxes. WHT thus provides a useful short-term measure to collect income taxes from suppliers in the sector, without the need to engage in resource-intensive registration drives and enforcement measures.

Withholding tax raised almost double the total income tax raised from the sector in its first year (see Figure 1). Despite its strong performance the new WHT rate faced intense political backlash, and was abandoned in 2019.

What can Uganda do to improve taxation of agricultural income?

Interviews with URA officials suggest that improving taxation of agricultural income should focus on reinstating and upgrading the WHT regime, and putting the URA’s existing administrative data to better use.

Reinstate WHT on agricultural supplies

Because of the challenges in identifying taxpayers in the agriculture sector and encouraging income tax compliance, withholding taxes are one of the only ways to effectively tax agricultural income in Uganda.

Upgrade the withholding tax system

There are a number of persistence weakness in the URA’s overall withholding system that need to be addressed. The two main weaknesses are: (1) the taxpayer identification number (TIN) and name of suppliers from whom the tax is being withheld is not currently a mandatory field; and

(2) the system does not validate the TIN of suppliers that are specified in the return. As a result, there are a large number of suppliers declared in the URA system that cannot be traced.

Target highly profitable agricultural suppliers for registration

Those earning the highest profits from agriculture are often those further along the supply chain from direct production – for example, produce buyers that go on to fulfil supply contracts to large institutions, such as government. The URA could focus its income tax enforcement activities first on those firms fulfilling large supply contracts to government agencies.

Increase enforcement on non-compliant taxpayers

Some data already exists within the URA to help target enforcement efforts on profitable non-compliant taxpayers in the sector. Periodic investigations, such as those from the sugarcane and fishery industries, provide a starting point for identifying some high-earners in the sector.

Conclusion: making agricultural taxation a political reality

Ultimately, increasing taxation of high-income earners in the agriculture sector is a question of politics. Most MPs are accountable to rural constituencies. Interviews in Uganda suggest that many MPs and top government officials are themselves large agricultural land owners, with investments in cattle ranches, commercial farms and forestry production.

The URA can partly counter common objections to taxation of the agriculture sector by focusing on large suppliers that are not compliant with their current obligations, and emphasising the important contribution that taxing agricultural income can make to ensuring resilient and sustainable public revenue.

Further reading

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Credits

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