

Small nets for big fish? Tax enforcement on the richest – evidence from Uganda

Summary of Working Paper 143 by Fabrizio Santoro and Ronald Waiswa

Taxing the richest individuals is a priority goal for every tax administration, and even more so in Africa, where tax revenues are insufficient to fund development. Due to tax evasion and limited fiscal capacities, personal income tax is largely underperforming across the continent (Moore 2020). Evidence of widespread evasion by the richest in the developed world – through sophisticated and aggressive avoidance schemes – has been well established in the academic literature. Whereas very little is known about policies that might be effective for taxing the wealthy in Africa, likely because so few countries have set up dedicated units for taxing the richest. In collaboration with the Uganda Revenue Authority, this study is the first of its kind studying the impact of the launch of a specific unit in the Uganda Revenue Authority (URA) for the richest taxpayers.

The HNWI-VIP office at URA

In September 2015, the URA launched a dedicated unit aimed at monitoring and enforcing compliance on the wealthy. These consist of high net-worth individuals (HNWIs), i.e. the wealthiest in terms of capital, equity and property, and Very Important Persons (VIPs), i.e. prestigious and popular figures in the political and business world. A remarkable first effort consisted in identifying these individuals, using available data and third-party reports (Kangave et al. 2016; 2018). The URA produced a priority list of 393 individuals (157 HNWIs and 236 VIPs). Following the launch of the unit, we observe an exogenous increase in the scrutiny these taxpayers received from URA, in terms of targeted client relationship and assistance, as well as in enforcement. Importantly, we find a total of 847 companies owned by the 393 individuals.

In addition to the priority list, the URA also identified as many as 1,731 “potentially wealthy” – and 1,903 owned companies. However, due to limited capacity and inadequate resources in the unit, these additional wealthy were left out of the unit’s radar. We exploit these

two groups in a quasi-experimental design by matching our newly identified HNWIs and VIPs (treatment) with our potentially wealthy individuals (control). We then measure the impact of the reform through a difference-in-difference estimation, considering a range of outcomes in filing and payment, as well as spillover effects on controlled companies.

Mixed responses with filing and payment

How do the treated wealthy react to reform? We found mixed evidence on the effectiveness of the unit. In terms of filing, the unit effectively boosts the filing probability for VIPs – a 37 per cent increase – but not HNWIs. This is in a context where only a third of the untreated wealthy submit their returns. However, treated taxpayers respond (if they file at all) with an aggressive ‘appearing small’ strategy through which they substantially reduce their income, expenses and final tax liability for income tax, VAT and land transactions. In particular for PIT, the tax declared falls by 27 per cent, mostly due to HNWIs’ backfiring response.

In terms of payment, we observe quite an erratic and disconnected response. Total domestic tax payments slightly increase (for HNWIs only), but there are many offsetting responses. For instance, HNWIs reduce their income tax payment while increasing payments on other taxes, and VIPs pay more income tax but cut down on withholding taxes. Customs payments remain unaltered. Such payment responses, coupled with the ‘appearing small’ strategy when filing, indicate that these individuals may be exploring tax planning schemes, and enjoy a high degree of discretion when deciding what to contribute.

Spill-over effects on controlled companies

We find a similarly confusing and concerning reaction from companies owned by treated individuals. On one hand, treated companies are less likely to file a corporate income tax (CIT) return. On the other, they’re also less likely to zero file (filing nothing at all), even if they don’t report

significantly more income or tax liability. Again, payment patterns do not follow the same trend of filings and remain unaffected overall, with considerably different responses to each tax head. For instance, VIPs' companies pay more CIT, in line with VIPs paying more individual income tax (PIT) payment. Likewise, while rental income tax payments (i.e., renting out land or properties) fall at the individual level, they increase at the company level, through often-complex transmission mechanisms from individual to corporate tax accounts, which we leave for future research.

Policy recommendations

There are some clear positive outcomes of this policy. Above all, the effort the URA put into carefully identifying and tracking the wealthy in the country, through a rigorous data-driven classification – in a context where only a handful of African countries have dedicated HNWI units – was unprecedented. We also unveiled a range of entrenched issues, both political and technical, which obstructed successful reform. On the political side, it is clear that the richest taxpayers still enjoy a high degree of discretion in deciding how to comply, often due to their political power. Relatedly, the tax administration often prioritises payment extraction to meet the targets, without considering filing behaviour.

On the technical side, the unit suffers from a lack of staffing (one head and two to four officials) and adequate

technical capacity. The e-tax system is probably not best suited for capturing the economically diverse holdings of the wealthy. And the list of HNWI-VIPs is not routinely updated.

With this in mind, our recommendations point to the following:

- The unit should be strengthened and equipped with higher-skilled staff and resources
- The tax administration should embrace a more holistic approach to monitoring their filing and payment behaviour and to consider the individual and corporate tax profiles as highly intertwined.
- The government should focus attention on ensuring they have access to data from third parties i.e. banks and other financial institutions.
- Once again, higher-level political commitment from management in adequately taxing the wealthy is required and should reverberate throughout the URA as a whole.

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Further reading

Kangave, J., Nakato, S., Waiswa, R. and Lumala Zzimbe, P. (2016) *Boosting Revenue Collection through Taxing High Net Worth Individuals: The Case of Uganda*, ICTD Working Paper 45, Brighton: ICTD

Kangave, J., Nakato, S., Waiswa, R., Nalukwago, M. and Lumala Zzimbe, P. (2018) *What Can We Learn from the Uganda Revenue Authority's Approach to Taxing High Net Worth Individuals?*, ICTD Working Paper 72, Brighton: ICTD

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Credits

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