S4 COMMERCE
(Copy down these notes in the book used for Business Calculations)

TAXATION

A tax is a compulsory payment or levy imposed by the Government or any other competent authority on individuals or business entities in order to finance government activities.

Taxation is the process through which government obtains money to finance its expenditure by imposing taxes on individuals or business firms.
In Uganda taxes are collected by Uganda Revenue Authority (URA) for the central government revenue and local administration for local government revenue.

Tax base refers to any item or economic activity that is subject to tax by the tax payer i.e sources from which tax is imposed.

Reasons for imposing taxes in Uganda/why do government imposes taxes? / reasons for taxation

- To raise revenue for the government in order to finance its expenditure on education, defence, health, development of Infrastructure, provision of social services, providing security, paying civil servants etc.
- To reduce income inequalities in society especially where the rich are more taxed than the poor and the revenue generated is used to subsidise the services consumed by the poor.
- To restrict the consumption of certain harmful commodities e.g high taxes imposed on spirits, alcoholic drinks, cigarettes etc to make them more expensive thus discouraging the buyers from consuming them.
- To discourage importation of certain goods in order to protect infant domestic (home) industries from stiff competition of cheap commodities from other countries. This is done by increasing import duties to discourage importation of goods.
- To check on inflation by reducing the money available to people for consumption thus reducing peoples' purchasing power. This is achieved by increasing taxes on people's income so as to reduce their disposable income.
- Taxation can be used to redistribute income and wealth.
- To control monopoly by reducing their abnormal profits through taxation.

- To improve the balance of payment position/to correct balance of payment deficit through imposing high import duties/ taxes on imports to make them more expensive and discourage their consumption while charging less taxes on exports.
- Taxation can be used to reduce dumping in the country. This is done by imposing high taxes on imports being dumped into the country and thus reduce their inflow.

IMPORTANCE OF TAXES IN UGANDA

- **Taxes are used to acquire public revenue**. Such revenue enables the government to perform its duties to the public.

- **Taxes are used to ensure equitable distribution of income**. This is through imposing heavy taxes on the more prosperous rich people while increasing government expenditure on the poor.

- **Taxes are used to improve on the balance of payments position**. This is through imposition of high taxes on imported commodities and reduced taxes on exports.

- **Taxes are used to protect domestic producers/firms.** Domestic producers are protected from foreign competition through imposition of high taxes on imported commodities.

- **Taxes are used to control inflation.** This is through imposition of high taxes on people's income to reduce their disposable income and thus reduce excessive demand over supply (reduce the people's purchasing power).

- **Taxes are used to discourage the production and consumption of undesirable/harmful goods such as cigarettes, alcohol, spirits etc**

- **Taxes are used to control dumping**. This is through imposing high taxes on imports being dumped into the country and thus reduce their inflow.

- **Taxes are used to regulate/control monopoly power.** This is through imposition of high taxes on profits of monopolists.

TYPES OF TAXES

There are two types of taxes namely Direct tax and Indirect tax.

DIRECT TAXES

Direct taxes are taxes imposed directly on the **incomes** and **property** of Individuals or business entities.
The burden of the tax is directly borne by the individual or business entity and cannot be shifted to another person.

Types of Direct taxes

(a) Income tax.
This refers to tax imposed by the government on the income earned by an individual or business entity e.g Pay as You Earn (PAYE) i.e Tax deducted from employees by employer at the source on behalf of the government.

(b) Corporation tax
Tax imposed on the profits of corporations or companies.

(c) Wealth tax
Tax Levied on accumulated stock of wealth, capital or savings of Individuals or business entity e.g it may be imposed on land, buildings, shares or other investments.

(d) Gift tax
Tax imposed on gifts acquired property (Property or income given freely to an individual). It covers assets given by a living person to another living person.

(e) Death duty
Tax/duty imposed on the estate of the deceased person. This is normally done before the property in the estate is shared out to different beneficiaries.

(f) Inheritance tax
Tax paid by the beneficiary from the estate of the deceased. i.e a tax imposed on inherited property and it's paid by the beneficiaries.

(g) Capital gains tax
This is the tax levied on profits received from the sale of fixed capital assets.

(h) Stamp duty
This is a tax imposed when there is transfer of property from one person to another.

(i) Land tax
Tax imposed to promote development of land sites.

INDIRECT TAXES

These are taxes that are imposed on goods and services and a person who pays the tax can shift it to another person in form of high prices and paid by the final consumer. The tax payer does not directly feel the burden of the tax. You can only pay these taxes if you opt to buy the goods or consume services on which they are imposed.

Examples of Indirect taxes

Excise duty
Tax imposed on any Locally produced goods within the country eg soap, sugar, airtime, Over The Top (OTT) imposed tax on use of Internet services, tobacco, soft drinks, alcoholic drinks, cooking oil, masks, sanitizers etc.

Custom duty
Taxes imposed either on imports or exports. Tax on imports is referred to as import duty while tax on exports refers to export duty.
Import duty can be **ad-valorem tax** basing on **value** of a good or **specific tax** basing on **physical unit**/volume/quantity of a good.

Sales tax
Tax imposed as a percentage on goods or services sold in the country whether imported or locally produced.

Value added tax (VAT)
VAT is a tax on consumption of goods and services. VAT is a tax imposed on the value added to a commodity at every stage in the chain of production or distribution of goods and services.
In Uganda VAT is rated at 18 %.

VAT is calculated by subtracting the cost of all material inputs used in production from total output of a business.
VAT = Output VAT - Input VAT

Output VAT: *It is a tax charged on the sale of goods. It is charged on the selling price of the goods.*

Input VAT: *It is the tax paid on the purchase of goods. It is paid at the cost price of the goods.*

Sumptuary tax
Tax imposed to discourage consumption and production of undesirable commodities eg spirits, cigarettes, pornographic films/materials, cosmetics etc on grounds of health, morality or economic consideration.

Octroil tax
Tax imposed on goods in transit from one country through the territory of another country e.g goods from Kenya to Rwanda through Uganda.

Classification of Taxes

Classification of taxes refers to how taxes affect the tax payer. Taxes are categorized into three classes namely **proportional tax, progressive tax and regressive tax.**

(a) Proportional tax

A proportional tax is one where the tax rate is constant regardless of the different levels of income.

Illustration of proportional tax

Income (shs)	Tax rate (%)	Tax liability (shs)
50,000	10	5,000
200,000	10	20,000
500,000	10	50,000

(b) Progressive tax

Refers to the tax where the tax rate increases as the income increases. For example the PAYE (Pay As You Earn) scheme.

(c) Regressive tax

Refers to a tax where the tax rate decreases as a person's income increases.

Illustration of a regressive tax

Income (shs)	Tax rate (%)	Tax liability (shs)
10,000	20	2000
20,000	15	3000
30,000	12	3600
40,000	10	4000

Principles of Taxation.

These refer to the rules and regulations which govern tax assessment, collection and administration of taxes.

(i) Principle of Simplicity.
The type of tax and the method of assessment and collection must be simple enough to be understood by both the tax payer and the tax collector to avoid misunderstanding and corruption.

(ii) Principle of Fairness/equity
Tax should be levied fairly so that all tax payers proportionally bear equal burden. Therefore, those individuals with high incomes should pay more tax than those with low incomes.

(iii) Principle of Convenience
The place, time, method and season in which tax dues are collected should be convenient to the tax payer.

(iv) Principle of Certainty
The tax payers and tax collectors should be certain of time of payment, place and the amount to be paid.

(v) Principle of Economical
The cost of collection and administration of the tax must be much lower than the total tax collected.

(vi) Principle of Ability to pay
The tax payer should be able to pay the tax assessed on him/her without much difficulty.

(vii) **Principle of Elasticity**
A tax should change directly with the change in the income i.e if the income increases, the tax imposed on that income should also increase.

(viii) **Principle of Flexibility**
The tax system should be able to accommodate changes in the socio-economical environment of a country.

(ix) **Principle of Productivity**
A good tax system should generate enough revenue to the government and it should not discourage investment.

(x) **Principle of diversity/comprehensiveness**
A good tax should have a wider source or base so as to increase revenue to the government.

Characteristics/Features of a good tax system.

Whereas canons/principles are guidelines to be followed in tax assessment, the characteristics of a good tax system looks at what it should be in order to yield the tax revenue desired by the government, these include the following.

- It **should be consistent** i.e it should be in line with the government's objectives.
- It **should be comprehensive** i.e a good tax system should cover a variety of tax bases, should have a wider source/cover many areas.
- A good tax system **should be simple** i.e it should be easily calculated and understood.
- It **should be impartial/neutral** i.e it should not be discriminative amongst the tax payers.
- It **should be flexible/elastic** i.e a good tax should be altered/adjusted according to the prevailing economic conditions.
- A good tax system **should be productive** i.e should be able to encourage effort, initiative and hard work and should not discourage investment.

- A good tax system **should be efficient** i.e tax assessment and collection should be effected with a lot of administrative ease.
- A good tax system **should be economical/cheap/efficient** i.e the cost of tax administration, assessment and collection should be low.
- A good tax system **should avoid double taxation** i.e individuals should not pay a tax twice under one tax base.
- A good tax system **should be certain** i.e one whose base, time of payment, amount to be paid etc are known.
- A good tax system **should be convenient** i.e when and where to pay a tax should be convenient to the tax payer.
- It **should be equitable/fair/ability to pay** i.e the burden of payment of a tax should fall equitably on all tax payers.

THE UGANDA REVENUE AUTHORITY (URA)

URA was formed by the Government in 1991 to modernize the process of tax Administration and reduce the revenue leakages and corruption in the tax administration.

Roles of URA in Administration of taxes

- Assess and collects tax revenue.
- Advises government on issues relating to public revenue, expenditure and tax policy.
- Identifies tax payers.
- Ensures that tax compliance is observed through tax Education by providing information to tax payers on their responsibility of paying taxes.
- It facilitates trade and investment.
- Penalizes tax offenders i.e cracks down on all tax defaulters.
- Accounts to the Ministry of Finance and Public for all revenue collected.
- Controls bonded ware houses before taxes on them are collected.
- Increases tax revenue through coming up with different taxes i.e it expands the tax base.

Measures used by URA to encourage traders to pay taxes.

- Tax education through media e.g Radio, Newspapers by sensitizing the masses on benefits of paying taxes.
- Giving rewards to traders/companies that contribute highest taxes e.g MTN, Airtel etc.
- Ensuring proper accountability for taxes collected.
- Using efficient and highly trained personnel.
- Controlling smuggling of goods.
- Easing the method of paying taxes by using electronic methods i.e Internet e.g E – tax.
- Ensuring the principle of equity/fairness.
- Simplicity i.e making tax rules easily understood.
- Consistence and fairness of tax laws and rules e.g by fighting corruption in assessing and collecting taxes.
- Encouraging traders to keep business records.
- Penalizing traders who evade taxes i.e imposing heavy fines to tax evaders.

TAXES COLLECTED BY URA

(a) International Trade Taxes

These are taxes collected on goods entering (imports) or leaving the country (exports)

These taxes include;

- Import duty
- Export duty
- Value added tax (VAT)
- Withholding tax
- Excise duty

(b) Domestic taxes

Collected by URA under the domestic taxes department

These taxes include;

- Income tax e.g PAYE
- Value added tax
- Excise duty
- Stamp duty

- Gaming tax charged on betting firms
- Rental income tax
- Environmental tax
- Corporation tax
- Capital gains tax

Taxes collected by local authorities (Local Government Administration)
- Property tax in cities or towns
- Sign post fees
- Licenses or fees
- Market dues
- Park fees
- Street parking fees
- Fines and penalties

Problems that face tax authorities in Uganda.

1. Some taxes are difficult to understand therefore people tend to be reluctant to pay taxes especially indirect tax.
2. Inadequate record book keeping by the tax payers which makes it hard to assess them.
3. Corruption among the tax officials which fails URA to reach their target collection of the taxes.
4. Low tax base which limits the amount of money collected in form of taxes.
5. Some parts are not easily accessible for tax collection.
6. High level of illiteracy and ignorance among would be tax payers.
7. High level of poverty existing in the country makes it difficult to meet the tax obligations.
8. Tax evasion by the tax payers.

SOME COMMON TERMS USED IN TAXATION

1. **Taxable income.** This is the amount of income which is subject to taxation.

2. **Taxable capacity.** This is the ability of the tax payer to pay the tax assessed on him/her.

3. **Taxable base**. This refers to an economic unit or activity (income, person, firm, institution, property) on which tax is levied.

4. **Tax revenue** is the money raised by the government through imposition of taxes.

5. **Tax holiday or concession** refers to a specific period of time given to a tax payer during which he is not supposed to pay tax. It is aimed at enabling a firm to cover initial costs of production.

6. **Tax exemption** is the act of fleeing a tax payer from paying tax. Tax exemption can be made on commodities either produced locally or imported from outside the country.

7. **Pay as you earn** is a scheme for collecting income tax due from individual's earnings. It is done by deducting that amount before the individual is paid his wage or salary.

8. **Tax threshold** refers to the income level at which a person becomes liable to income tax after all his allowances have been calculated e.g Ug shs 235,000 is the threshold for PAYE in Uganda.

9. **Tax liability** refers to the total amount of money a tax payer is supposed to pay to tax authority in a given period of time.

10. **Withholding tax** is tax paid to the customs authority until import duties have been assessed and paid. In some cases, a tax refund is made to a trader if withholding tax paid is more than the tax assessed.

11. **Tax burden** is the effect of a tax on tax payers' welfare in form of sacrifice of goods and services and loss of money.

12. **Tax compliance**

    This is the degree to which the taxpaying community meets the tax obligations as set out in the appropriate legal and regulatory provisions.

13. **Compliant tax payers** make timely, proper and accurate declarations to the tax authority and voluntarily settle all the due tax liability.

14. **Tax evasion**: Refers to deliberate refusal by a tax payer to pay taxes imposed on him and its illegal e.g smuggling of goods, under declaring of goods, falsification of documents e t c.

15. **Tax avoidance**: Refers to a situation where a tax payer dodges a tax by exploiting the existing loop holes within a system and its legal e.g avoiding consumption of a taxed product.