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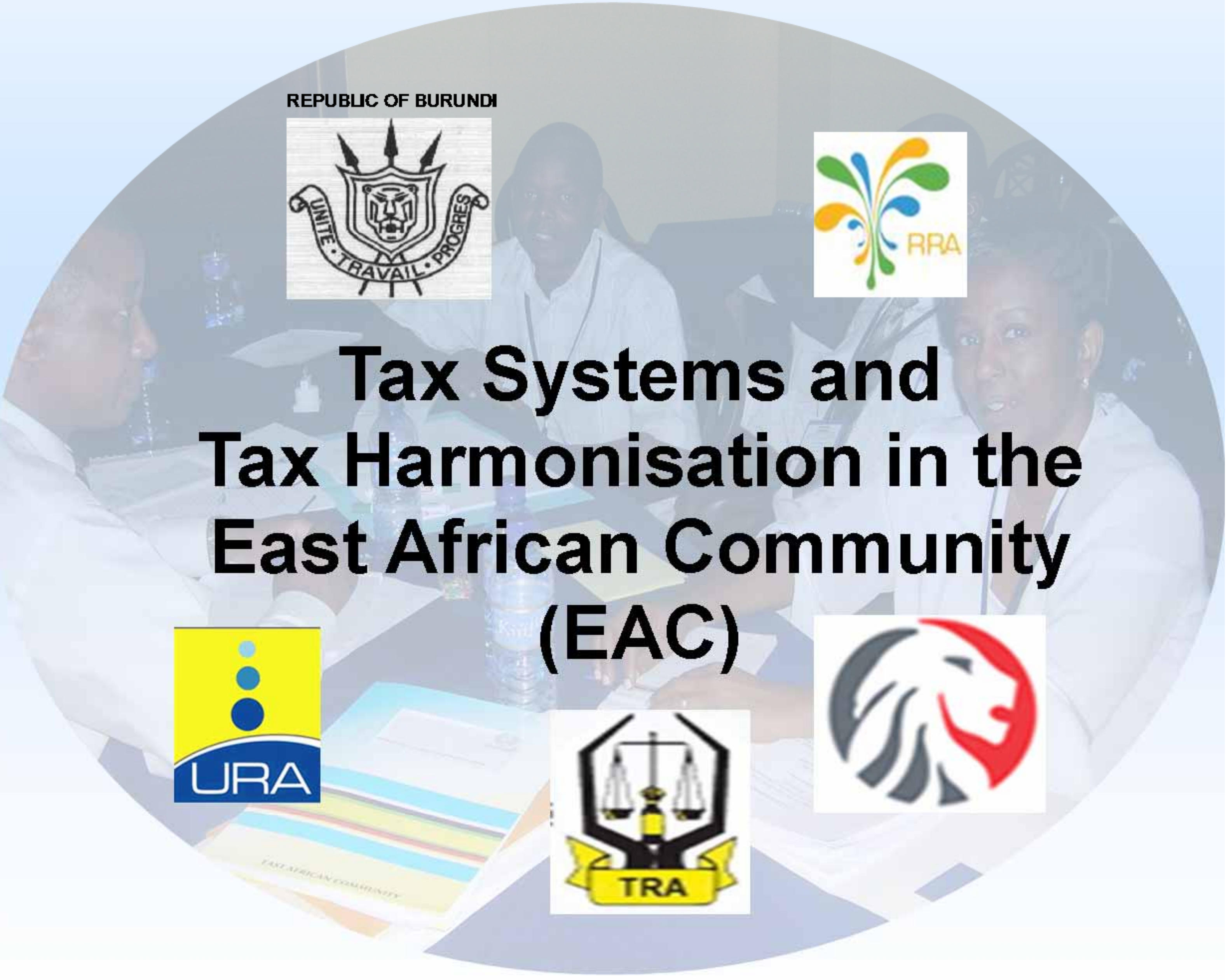

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Tax Systems and Tax Harmonisation in the East African Community (EAC)

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COOPERATION
EAST AFRICAN COMMUNITY
FEDERAL REPUBLIC
OF GERMANY

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Executive Summary

In the first part of the report of the GTZ expert group an overview on the basics of integration and tax harmonisation within a common market is given. Chapter II. concentrates on the problems of national and international tax law regarding double taxation before the harmonisation process within the EU is described in detail. This process is not a best practice example but at least the experiences made in the course of the last five decades are interesting enough and might contribute important information for regions, which more or less recently have started a similar endeavour. The harmonisation needs are discussed for value added taxation (VAT), excise taxation, and income taxation. The problems of tax administrations, procedures laws, taxpayers' rights and obligations as well as tax compliance are also taken into consideration.

The second part of the study reviews the national tax systems within the EAC member countries. Before the single taxes are described in more detail, the macroeconomic situation is illuminated by some basic figures and the current stand of the inner-community integration analysed. Then the single tax bases and tax rates are confronted to shed some light on the necessities for the development of a common market within the near future. Again the value added tax laws, excise taxes and income taxes are discussed in detail, while regarding the latter the focus is on company taxation. For a better systematic analysis the national tax laws are confronted within an overview, which is presented in the tables A3 to A5 in the appendix 4 of this report. The chapter is closed with a summary of the tax rates applied and a rough estimation of the tax burdens within the Partner States.

The third part of this report contains the policy recommendations of the expert group following the same structures as the chapters before and presenting the results for the VAT, the excises and the corporate income tax (CIT). Additionally the requirements for tax procedures and administration as well as problems of transparency and information exchange are discussed in detail before the strategic recommendations are derived in close relation to the experiences made within the EU harmonisation process. The recommendations are based on the following normative arguments: (1) Tax harmonisation is a basic requirement for economic integration. (2) Equality of taxation is an imperative of tax justice and demands the avoidance of double taxation as well as the combat of tax evasion and corruption. (3) The avoidance of harmful tax competition between the Partner States. (4) The strengthening of taxpayers' rights in tax procedures. Hence, all kinds of income, goods and services should be taxed once and only once.

Therefore, the expert group has made the following recommendations:

RECOMMENDATIONS

VAT Systems Harmonisation

1. Develop a common EAC VAT Model.
2. Reduce zero-rated transactions to exports only.
3. Harmonise and reduce exempt transactions.
4. Maintain the border controls in a mid-term perspective.
5. Harmonise the tax bases.
6. Define the place of services in every detail (EU model).
7. Apply harmonised rules and practices for the VAT refunds.
8. Equalise the administration and the tax procedures in all Partner States.

Excise Taxes Harmonisation

1. Develop a harmonised legal basis for excise taxation:
    - define the exclusive categories of taxable goods;
    - define the particular taxable items in a uniform way;
    - replace the ad valorem rates by specific rates;
    - define lower and upper ceilings for the national tax rates.
2. Determine the specific tax rates in the national excise tax laws.
3. Abolish discriminatory rates for imported goods.
4. Harmonise tax bases for levying excise taxes.
5. Harmonise excise tax rates.

PIT and CIT Systems Harmonisation

1. Review and harmonise all tax incentive schemes in the CIT system, especially EPZs and SEZs.
2. Harmonise initial capital allowances of more than 50%.
3. Treat capital gains from asset sales as normal profit, but allow for inflation adjustment.
4. Harmonise the treatment of losses (carry forward) including foreign losses.
5. Harmonize the withholding taxes on dividends, interest payments, royalties and service fees.
6. Enact national laws and harmonise rules on transfer pricing and thin capitalisation in addition to general anti-avoiding clauses regarding profit shifting.
7. Develop an EAC Model Convention for DTAs with third party countries.
8. Create special units for international taxation and tax harmonisation in the MoFs and RAs.

Administration and Procedures Harmonisation

1. Exchange national administrative staff between the Partner States to create the "spirit of harmonisation".

2. Develop and enact a harmonised Tax Procedure Act:
   - which describes taxpayers' rights and obligations;
   - defining rules for adjustments of tax assessments, types of adjustments and time frames;
   - defining common sanctions for non-compliance;
   - defining the procedures of appeal;
   - defining the procedures of enforced collection.

3. Develop an indicator system to evaluate the RAs performance and efficiency.

4. Develop and apply a harmonised field audit manual.

5. Develop a code of conducts for all Revenue Authorities (RAs).

Transparency and Information Exchange

Within the single member countries but also in the EAC Secretariat more efforts have to be made to improve the information base and the statistics as fast as possible before the harmonisation details mentioned above should be realised.

Strategic Recommendations (Sequencing and Priorities)

The expert group emphatically supports the completion of the multilateral DTA as soon as possible.

The VAT is the second important component to be harmonised.

The excise taxes have to be reformed and harmonised, too.

Harmonisation of company and profit taxation.

Harmonisation of administration and procedures.

Strengthening and modernising the national tax authorities is a further prerequisite for a successful harmonisation strategy. A code of conduct not only for the national administration is necessary but also such code for the harmonisation itself.

Reforms in the national tax laws are necessary and recommendable

General Recommendations

Evaluate integration and harmonisation more optimistic

Convey the spirit of harmonisation into the consciousness of the administration and people.

The report has been discussed on a validation workshop in Arusha on 30th July 2009 with Delegates from the Partner States and the EAC Secretariat. The text has been rephrased according to the recommendations given by the Delegates and the Group of Consultants (see Appendix 2). Additional inputs given by the Partner States have been included into the final version.

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List of Abbreviations

Art.	Article
ASYCUDA	Automated System for Customs Data
BMF	Bundesministerium der Finanzen/Germany
BIF	Burundi Franc
CAP	Capital
CEPGL	Communauté Economique des Pays des Grands Lacs
CG	Commissioner General
CIA	Central Intelligence Agency
CIF	Cost Insurance Freight
CIT	Corporate Income Taxation
CMP	Common Market Protocol
COMESA	Common Market for Eastern and Southern Africa
CPA	Certified Public Accountant
CPI	Corruption Perception Index
DTA	Double Taxation Agreement
DTD	Domestic Tax Department
EAC	East African Community
EARA	East African Revenue Authorities
EC	European Commission
ECCAS	Economic Community for Central African States
ECJ	European Court of Justice
ECOFIN	Economic and Finance Ministers of the EU member states
EEC	European Economic Community
EFTA	European Free Trade Association
EMCS	Excise Movement and Control System
EPZ	Export Processing Zone
EU	European Union
f.o.b.	free on board
FBU	Franc Burundi
FRW	Franc Rwanda
G20	Group of Twenty
G8	Group of Eight
GDP	Gross Domestic Product

GNP	Gross National Product
GST	Goods and Services Tax
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
IAS	International Accounting Standards
IDEA	Interactive Data Electronic Applications (audit software)
IFRS	International Financial Reporting Standards
IGAD	International Governmental Authority on Development
IMF	International Monetary Fund
IT	Information Technology/Income Tax
ITAS	Integrated tax administration system (used in RA Uganda)
ITAX	Integrated Taxation Management-System (used in RA Tanzania)
KRA	Kenya Revenue Authority
KES	Kenya Shilling
LTO/LTU	Large Taxpayers Office/Unit
MoF	Ministry of Finance
MoU	Memorandum of Understanding
MTC	Model Tax Convention
n/a	not available
OECD	Organisation for Economic Cooperation and Development
PAYE	Pay-as-you-earn System
PIN	Personal Identification Number
PIT	Personal Income Tax
PPP	Purchasing Power Parity
PWC	Price Waterhouse Coopers
RA	Revenue Authority
RRA	Rwanda Revenue Authority
RWF	Rwanda Franc
SADC	Southern African Development Community
SEZ	Special Economic Zones
SIGEFI	Sistema de Gestion Financiera (RA Burundi)
SIGTAS	Standard Integrated Government Tax Administration System (RA Rwanda)
SME	Small and Medium Enterprises
SMTO	Small and Medium Taxpayers Office

TIN	Tax Identification Number
TPC	Tax Procedure Code
TRA	Tanzania Revenue Authority
TZS	Tanzania Shilling
TVA	taxe sur la valeur ajoutée
UN	United Nations
URA	Uganda Revenue Authority
USD	United States Dollar
UGX	Uganda Shilling
VAT	Value Added Tax

I. Introduction

The East African Community has far reaching plans to introduce a common market in 2010 and a currency union within the coming years. As further the integration process is moving as more policy areas have to be investigated regarding possible discriminatory effects against the partner countries. Especially the tax system but also transfers (subsidies, state aid) may cause distortions for the cross-border transactions, capital flows and the regional labour division. While a certain competition between the national tax systems may have positive effects on the factor mobility, substantial differences within the tax systems, especially regarding tax basis and tax rates, might negative dubious impacts on single member states. Especially in cases where taxation and subsidies are used as strategic instruments to strengthen the national position in the international competition on location advantages, unfair competitive processes within the member states might be caused that seriously reduce the national tax revenue needed to finance the appropriate infrastructures for the further development process.

As long as effective border controls and mobility restrictions exist, such differences play only a minor role. Because of long-lasting adaptation processes within the different national regulations it is necessary to analyse the tax systems with respect to substantial differences and to define the areas where a certain harmonisation of legislation, decrees, administration, enforcement, and practical implementation seems to be necessary. The introduction of a common market has already far-reaching consequences for trade flows and factor allocation within a community. Deeper integration in the direction of a single market and an economic and monetary union (see table 1) also implies the free movement of capital, labour, goods and services (the four freedoms).[1] In the final stage of the adaptation process border controls have to be abolished. From this point onwards, all member states have to have a partially harmonized tax regime, which does not produce special incentives or disincentives for the location decisions of citizen and enterprises within the community.[2]

[1] These four freedoms form part of the *substantive law* of the EU. Although it is not easy to summarize compactly the activities of the European Union, one can define them as the free flow of economic factors, in pursuit of greater prosperity of the states and their citizens. The law of the single market plays a key role there by removing the barriers that member states might otherwise impose on trade originating in other member states. For more details see Barnard (2007). Since 2007, the European Commission has started to advocate making the free movement of *knowledge* the fifth freedom, in addition to the established Four Freedoms; see http://cordis.europa.eu/fetch?CALLER=NEWSLINK_EN_C&RCN=27454&ACTION=D.

[2] Then all directly or indirectly discriminating rules have to be abolished. Discriminating factors are investigated by the European Court of Justice (ECJ).

Table 1: Forms of Real and Monetary Integration

	Preference zone	Free trade zone	Customs union	Common market	Single market	Economic union	Currency union
Trade liberalization on some markets	X						
Trade liberalization on all markets		X	X	X	X	X	X
Common external customs policy			X	X	X	X	X
Factor mobility					X	X	X
Harmonizing economic policies						X	X
Single currency area							X

Source: Machlup (1977), Beckmann et al. (2000: 4), Basseler et al. (2006: 663 f.).

Single market and economic union are a more advanced form of a *common market*.[3] A single market envisions more efforts towards removing the physical (borders), technical (standards) and fiscal (taxes) barriers among the member states than economic unions. These barriers obstruct the freedom of movement of the factors of production (labour and capital). To remove these barriers the member states need political will, and they have to formulate common economic policies. Partial tax harmonisation is at least one element of such a common policy, which also includes a control of other forms of governmental aid to national entities.

The EAC has clearly expressed the political aim to widen and deepen the economic cooperation between the Partner States. On 1 January 2005 a customs union was implemented as stated in article 75 of the EAC Treaty. While article 76 alludes to a Common Market Protocol to be concluded by the Partner States, article 83 refers to the "Monetary and Fiscal Policy Harmonisation" and also mentions in 2(e) the intention to "harmonise their tax policies with a view to removing tax distortions in order to bring about a more efficient allocation of resources within the Community".[4] The draft version of the Common Market Protocol (CMP)[5], which is expected to come into effect in the course of the year 2009, again underlines this target:

"The Partner States undertake to progressively harmonize their tax policies and laws on domestic taxes with a view to removing tax distortions in order to facilitate the free movement of goods, services, and capital, and the promotion of investments within the Community".

Because the East African integration movement has always been inspired by the EU example[6], the following chapters draw parallels to the EU development to demonstrate which steps taken and time frames needed.

[3] For more details see Petersen (2008) and for download http://lsfiwi.wiso.uni-potsdam.de/publikationen/diskuss/index-diskuss.html.

[4] See EAC-Treaty 1999,
http://www.eac.int/, Treaty Establishing the East African Community, pp. 64.

[5] See CMP Drafters Version (Annex III), Article 37.

[6] See Cnossen (2008, p. 1).

Part A: Basics of Harmonisation

II. National and International Tax Law

II.1. Principles of Direct Taxation

The international tax law consists of all directives (laws, norms, decrees, guidelines, orders, etc.) with direct or indirect impacts on foreign countries. Such an international impact is given in case a taxpayer or the tax base is located in different sovereign territories or if different sovereign territories have access to the same tax base. The international tax law is not uniformly codified. Its sources are the single national tax laws (or tax codes) and the double taxation law. The national tax law usually has far reaching consequences regarding the liability to taxation. Regarding the tax liability each country has the right to establish an entitlement on specific taxes if personal or factual arguments are given. There is no ban of double taxation within the international law.

Regarding personal tax liability, there are three principal types:

(1) The *residence principle* determines that an individual person or a corporate body is liable to taxation in the residence country.

(2) The nationality *principle* defines that an individual person is liable to taxation in the country of his citizenship.

(3) The source *principle* regulates that an individual person or corporate body is subject to taxation in the state where the tax base is located.

Most states have implemented the residence and the source principle in their tax laws.

Regarding the demarcation of the factual tax liability two principles are commonly used:

(1) The *world-wide income principle* determines that the taxpayer is liable to income (property, inheritance) taxation with his world income.

(2) The *territoriality principle* limits the tax liability to the territory in which the income (property, inheritance) has been created.

In the course of the last century the world-wide income principle became dominant. In many countries residents (unlimited tax liability) are taxed according to the residence and world-wide income principles with regard to direct taxation. Non-resident people with tax bases within the inland (limited tax liability) are predominantly taxed with their inland income following the source and territoriality principles. Therefore, almost each state tries to define the tax liability as broad as possible to secure a broad tax base and high tax revenue. The outcome is double taxation and collision of national tax interests. Consequently collision avoidance becomes a matter of fact in international taxation. If all states would apply just one of the three principles of personal tax liability, collision would be totally avoided. If such a unanimous solution is not achievable, double taxation negotiations are necessary to prevent negative developments within international tax coordination.

II.2. Problem of Double Taxation

Double taxation takes place if two countries are burdening a similar tax base by the same type of tax. If cross-border realised incomes are taken into consideration, dependent on the principles applied in the residence and source state both is possible: double taxation and total tax exemption (see table 2). The double taxation law has the purpose to avoid both situations and to safeguard the principle that a tax base should be burdened strictly once only.

Table 2: Double Taxation and Tax Exemption

Tax Base	Taxed in the residence state	Not taxed in the residence state
Taxed in the source state	Double taxation	Source principle
Not taxed in the source state	Residence principle	Tax exemption

Single taxation within international (direct as well as indirect) taxation can be assured if one of the following principles is applied in cross-border transactions (see table 3):

(1) In case of the *credit method* the residence state credits the tax paid in the source state against the inland tax yield (tax credit).[7] The parentheses indicate that the tax credit method does not generally meet the principles; this is only the case if the residential country completely credits the tax paid in the source state. In such case the taxpayer is imposed with the same burden on his world income as if he had earned his entire income in his residential state. Regarding the distribution of tax revenue to the two countries there is a difference to the exemption in the source state because in case of the tax credit method the source state partly or totally gets the tax revenue.

(2) If the *exemption method* is applied, the residence state defines the tax base located in the source state as tax exempt or the source state exempts the tax base from inland taxation.[8]

(3) The *deduction method* allows the tax paid in the source state to be deducted from the inland tax liability in the residence state.

(4) In other cases the tax basis generated abroad is taxed on a *lump sum base* or *tax abatements* are applied. The latter are no methods but ad hoc measures in case of more or less negligible matters.

[7] Regarding the credit method full and ordinary crediting is applied. In case of the latter double taxation might only partially be avoided.

[8] The full exemption method or the exemption method with progression can be applied. In the latter case the tax base earned abroad is tax exempt but the average tax rate is increased for the inland tax base due to the degree of progression within the residence state.

Table 3: Prevention of Double Taxation

Method	Personal tax liability	Factual tax liability
Tax credit	(Residence principle)	(World-wide income principle)
Tax exemption residence state	Source principle	Territoriality principle
Tax exemption source state	Residence principle	World-wide income principle

The methods to prevent double taxation are bilaterally negotiated or unilaterally applied. Double taxation agreements (DTA) or treaties are part of the public international law.[9] At least with income and capital taxation especially the high developed industrial countries have negotiated DTAs, often based on the "Model Tax Convention on Income and on Capital" (MTC) developed by the OECD.[10] This convention defines the term "person", which consists of individual persons, corporate bodies (companies) and business partnerships (non-incorporated firms or "any other body of persons"[11]). Only persons in this sense are allowed to draw advantages from the DTA. For the purpose of the DTA a person living in two (or more) states is considered to be resident of only one state. The residence state is determined by the fixed sequence of the following terms: permanent residence, centre of vital interests, habitual abode, citizenship or agreement of the respective body.[12] Contrary to a person in the sense of this convention a permanent establishment cannot claim advantages from the DTA.[13] Hence, *person*, *residence* and *permanent establishment* are the key components of that convention.

The following sections of that convention define rules for the right of taxation of source and residence state. These rules determine the distribution of the tax revenue to the contracting states. The following table 4 demonstrates for some examples how the problem of double taxation can be avoided by implementing the OECD-MTC.

[9] If any double taxation should be avoided, in a world with n states $(n^2-n)/2$ DTA would be necessary. If n = 2, one DTA is necessary, for n=3 three DTA, for n=4 six and for n=5 ten DTA are necessary.

[10] See OECD (Ed): Model Tax Convention on Income and on Capital. Condensed Version, 17 July 2008, OECD Committee on Fiscal Affairs, Paris 2008.

[11] See ibid., Art. 3, pp. 23.

[12] See ibid., Art. 4, pp. 24 in which is stated: "For the purpose of this convention, the term "resident of a Contracting State" means any person who, under the law of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof."

[13] The conventions define permanent establishment as following: "1. The term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. 2. The term of "permanent establishment" includes especially: a) a place of management, b) a branch, c) an office, d) a factory, e) a workshop, and f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources." See Art. 5 ibid., pp. 25.

Table 4: Prevention of Double Taxation within the OECD-MTC

Income from	Taxation in the source state	Taxation in the residence state
Immovable property, agriculture, industry, Income from self-employed or employment	Full taxation	Exemption method or credit method
Dividends and interest payments	Limited taxation	Exemption method
Licence fees etc.	Exemption method	Full taxation

Source: OECD (2008)

International company taxation is dependent on the company's residence. The profit is taxed in the source state independently from the legal form of the entity and the fact that parts of the goods and services of the company are sold abroad. In case a company is operating a permanent establishment in the other contracting state, the residence state of the (mother) company (then in accordance with the OECD-MTC) applies the exemption method or is crediting the tax paid in the other contracting states. The profit of the permanent establishment is defined as derived from an independent enterprise.

Other important regulations are the non-discrimination of persons of a contracting state in the other contracting state (Art. 24), and the mutual agreement procedure in case of disagreement and dissonance between the contracting states (Art, 25). Of utmost importance is the exchange of information (Art. 26), which regulates the obligation to exchange the necessary information for the enforcement of the DTA. Information exchange is the most important prerequisite to prevent tax evasion.[14] Art. 27 finally determines the assistance with the collection of taxes in the contracting states. the United Nations Model Double Taxation Convention between Developed and Developing Countries is often applied,[15]l between industrial and developing countries. Here the tax liability in the residence states plays a more prominent role than in the OECD-MTC.

The national foreign transaction tax provisions are regulating matter of facts, which partially restrict the double taxation arrangements, are designed to prevent malpractices in the DTA or are directed against investments in tax havens. The *arm's length principle* or *third party comparison* has the purpose to prevent the relocation of profits into low tax countries. This principle is of special relevance in the case of the *transfer pricing problem* between an inland company and its external permanent establishments (foreign subsidiaries).[16] The *extended non-residence taxation* is another instrument to avert tax avoidance by the change of residence as long as the former residents do still have economic interests in the inland. Then they do not profit from the lower withholding or source taxes but are still taxed by the progressive national tax schedule. Other regulations tackle the problems of the taxation of capital appreciations on taking up residence abroad, the taxation of capital gains and of gains as

[14] The fight against tax evasion has been high on the international development policy agenda since 2008. See Nerré / Kundt (2008).

[15] For details see United Nations (2001).

[16] See OECD (2009).

consequence of a business closure. Other specific rules apply in case of conduit companies or base companies located in tax havens.[17]

II.3. Indirect Taxation

As already mentioned above, single taxation is the prerequisite to neutral taxation; in case of indirect taxation similar problems emerge and often cause double taxation because of the revenue interests of the involved states. The country of origin is the state in which a certain good has been produced. If such a good is burdened with an indirect tax and exported to a foreign country (called country of destination), the good is burdened twice in case the country of destination imposes a similar indirect tax on the same good. The result would be double taxation. Thus, the national indirect tax systems within an economic union have to be coordinated. Like in the case of direct taxation (table 2) two approaches exist regarding the taxation of consumption goods (table 5).

Table 5: Avoidance of Double Taxation

Tax Base	Import state taxes	Import state does not tax
Export state taxes	Double taxation	Origin principle
Export state does not tax	Destination principle	Zero taxation

In case of the *destination principle* the export state allows a tax relief at border crossing while the import state levies the indirect tax with its national tax rate. This procedure is called *border equalisation*. If the origin principle is applied, the import state allows a tax relief for imported goods. A border equalisation does not take place. If imports and exports differ in volume between the member states, the destination or origin principle results in a different distribution of the tax revenue within the member states. Hence, the destination principle favours net-importing members whilst the origin principle benefits net-exporters.

II.3.1. Excise Taxes

An excise tax (or duty) is a tax charged on goods produced within a country. Customs duties are levied on imported goods (not produced in the own country). Excise taxes contribute tax revenue to the state budget, but they also have a steering impact on the consumption structures. Different from forms of turnover taxation (which burdens all goods and services), the specific taxes on single products lead to substitution effects and a connected excess burden so that the consumption of such taxed goods is reduced. With other words specific taxes are non-neutral regarding the consumption structures. The reduction of consumption itself is a political target, e.g., in case of the taxation of goods being dangerous to health and polluting goods (health promotion and ecological taxation). Because the demand for such goods is often more or less price inelastic, beside the steering impacts such goods often produce high revenue.

[17] See, for example, the German foreign tax act (Gesetz über die Besteuerung bei Auslandsbeziehungen, http://bundesrecht.juris.de/astg/index.html).

The most common specific taxes are those on tobacco, alcohol (beer, wine, spirits, champagne, etc.) and gasoline.[18] Often the motor vehicle tax is taken as such a type of tax but also subsumed under the specific property or traffic taxes. The name “excise duty” points to the fact that excise taxes and customs duties have a quite similar character. Gasoline, for example, may be produced within the country by using crude oil bought in other (oil producing) countries. Therefore, indirectly the gasoline tax has the same price-increasing impact as an import duty on crude oil.

Excise taxes can be imposed in the form of a fixed monetary amount on a technical or quantity unit (litre, hectolitre, ton, cubic metre, etc.) called specific tax or on an ad valorem basis (a certain percentage of the price). The specific tax bases are dominating and have the advantage to be easily controlled especially for combating tax evasion and the quality of the product is clearly defined (e.g. the alcoholic content) and difficult to be manipulated.[19] While in highly developed countries (with the exception of the gasoline tax) excises play only a minor role regarding the total tax revenue, within the EAC excise taxes and value added tax (VAT) play an important role. In Kenya, Tanzania and Uganda excise taxes alone produce a share of the total tax revenue of 22.8 to 33.8 % of total tax revenue. Together with the VAT revenue in these three states and the sales tax revenue in Rwanda and Burundi, indirect taxation contributes 58.9 % in Kenya and up to 73.7 % in Tanzania.[20] These figures alone demonstrate that high transparency in indirect taxation is one of the main pillars for tax harmonisation in the EAC.

II.3.2. Value Added Tax (VAT)

Different from the excise taxes, VAT is levied on an ad valorem basis on all consumption goods and services, so that principally all prices are increased by the same tax rate. Therefore, the consumption structure (at least for goods and services burdened with the same tax rate) stays unchanged so that the VAT produces no excess burden. This neutrality is often named as the most important advantage. Compared to a gross turnover tax levied on all production stages, the VAT as a net turnover tax on all production stages avoids the so-called cascade effects and is also neutral regarding national competition. Because the final consumption price easily and clearly expresses the whole effective tax burden, VAT makes border equalisation easy and controllable and is especially suitable for the promotion of trade within an economic union. Therefore, the VAT – also called Goods and Services Tax (GST)[21] – has been gaining favour over the formerly prevailing gross turnover or sales taxes (which is a net turnover tax levied on the last trade level) world-wide.

[18] There exist several others like energy, electricity, coffee, etc. taxes.

[19] This is the reason why Cnossen has proposed that Uganda and Rwanda should convert their excise duties on alcohol to a specific tax (based on alcohol content and quantity); see Cnossen (2008, p. 13). A similar proposal was made by the IMF’s Fiscal Affairs Department in an internal report of the IMF mission on tax incentives in the EAC (see IMF, 2003). The World Bank contributed a report on the non-tax incentives.

[20] For the figures see Cnossen (2008, table 1, p. 6). This table also demonstrate the importance of the customs duties, which are not included in this analysis. If the customs duties should be abolished and their revenue then gained by excise taxes or increased VAT tax rates, harmonisation of the tax systems becomes even more important. The investigations of the expert group have rendered results, which are quite different to the figures of Cnossen (see table 9 below); The causes of these differences are to be seen in the different definitions of the single components of the total tax revenue.

[21] This term is especially used in Australia, New Zealand and South Asia.

The prevailing VAT system is a consumption type net turnover tax levied on each production stage with input tax deduction, so that investment goods remain untaxed. Compared with sales taxes the involvement of several production stages is a certain guarantee that tax evasion under such a regime is much more difficult and practically possible only on the final stage (especially in the handicrafts sector, where due to the high wage costs the value added is considerably high).[22] The method of collection is predominantly invoice based. The timing of collection can be accrual or cash based. The latter is a very simple form and has considerable advantages especially for small and medium enterprises (SME) in developing countries with a just emerging banking system.[23] Of utmost relevance for the revenue is that even the SME are registered for tax liability, which due to shadow economy activities is often not the case. Additionally, because of its particular mechanism of collection, VAT becomes quite easily the target of specific frauds like carousel fraud,[24] which can be very expensive in terms of loss of tax revenue for states. Appropriate control mechanisms especially regarding the input tax deductions have to be implemented to combat such criminal behaviour.

Different from most other taxes, VAT was not the result of a long historical evolution, but has had an inter- or supranational background from the very beginning. It was implemented in the European Economic Community (EEC), the forerunner of the European Union (EU), already in 1967 with the resolution on the 1st and 2nd VAT Directive.[25] These directives were based on the preparatory work of the Tinbergen Commission (1953) and the Neumark Committee (1962). VAT was invented by a French economist in 1954 as *taxe sur la valeur ajoutée*.[26] Maurice Lauré, joint director of the French tax authority, the *Direction générale des impôts*, was the first to introduce VAT with effect from 10 April 1954 for large businesses, and it was extended over time to all business sectors.

In the EEC VAT was based on the destination principle and border controls for cross-border trade as well as a border equalisation system. This construction guaranteed that all goods were burdened with their inland VAT rates and secured competitive neutrality within the

[22] Because of this fact in many countries a reverse charge method has been implemented. For details see http://www.bundesfinanzministerium.de/nn_39846/DE/BMF__Startseite/Service/Glossar/R/007__Reverse-Charge.html and below.

[23] The primary focus is on the amount of cash in the bank, and the secondary focus is on making sure all bills are paid. Little effort is made to match revenues to the time period in which they are earned, or to match expenses to the time period in which they are incurred. Accrual basis accounting matches revenues to the time period in which they are earned and matches expenses to the time period in which they are incurred. While it is more complex than cash basis accounting, it provides much more information about the underlying business and, therefore, is especially reasonable for high developed tax administrations.

[24] VAT fraud, in the form of carousel fraud, occurs where fraudsters obtain VAT registration to acquire goods such as chips and mobile phones VAT-free from other member states. They then sell on the goods at VAT inclusive prices and disappear without paying over the VAT paid by their customers to the tax authorities. For more details see http://www.out-law.com/page-5320.

[25] A *directive* is a legislative act of the European Union which requires member states to achieve a particular result without dictating the means of achieving that result. It can be distinguished from European Union *regulations*, which are self-executing and do not require any implementing measures. Directives normally leave member states with a certain amount of leeway as to the exact rules to be adopted. Directives can be adopted by means of a variety of legislative procedures depending on its subject matter.

[26] It should be mentioned that already in 1949 an American tax mission to Japan led by Carl S. Shoup had proposed the implementation of a VAT (designed as a local tax). However, this proposal was never enacted by the Japanese parliament and turned down once and for all in 1954. See Nerré 2006 for details.

common market. With the implementation of the Schengen Treaty in 1985, the single market[27] (1993) and the union the border controls became obsolete. The border equalisation system was substituted by an interim arrangement (Transitional VAT System), which until today is the base of the European VAT system: (1) Deliveries of an EU resident firm to firms outside the EU are zero taxed so that exports are released from the VAT of the state of origin. (2) Imports from a third party country (outside the EU) are burdened with the import VAT, with rates corresponding to the national VAT rates. In relation to third party countries the country of destination principle is applied. (3) Imports from member countries of the EU are burdened with the *Tax on the Inner-community Purchase*, with rates also coinciding with the national VAT rates. Prerequisite is that the deliverer is a firm or incorporate entity. (4) In case of inner-community pick up deliveries by consumers, the country of origin principle is applied in principle. But the purchase of new motor vehicles is burdened with indirect taxes (VAT and factually licence fees) in the country of destination. For inner-community mail order selling similar regulations exist so that the VAT rates of the destination country apply.[28]

The reason for this complex mix of principles is that the EU, due to the political will of its member states, still relies upon the destination principle as the dominant rule, in spite of the fact that it has long maintained an intention to move to the origin principle of taxation. The destination principle guarantees the traditional revenue distribution between the member states. But in case of cross-border shopping of the consumers this principle cannot be applied. The abolition of border controls has shifted the control procedures into the firms and the administrative complexity of the system has been drastically increased. The main criticism is now expressed regarding the burden which has been put on the enterprise sector.

Hashimadze/Khodavaisi/Myles (2006) investigated the country characteristics and the preferences over tax principles incorporating asymmetries in efficiency and size. They demonstrate that economic integration does not overcome the size differences in the member countries. Therefore, country size remains a more fundamental source of disagreement over the choice of tax principle. Especially the smaller member countries do have disadvantages regarding the revenue distribution over the member states in case of the origin principle. Because the enlargement of the EU has increased the asymmetries within the EU, a political agreement of the origin principle seems to be less likely than before.

[27] In comparison to common market a single market envisions more efforts geared towards removing the physical (borders), technical (standards) and fiscal (taxes) barriers among the member states. These barriers obstruct the freedom of movement of the factors of production (labour, capital and enterprises). To remove these barriers the member states need political will and they have to formulate common economic policies.

[28] See also the Council Directive 2001/115/EC on electronic commerce and invoicing (http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:015:0024:0028:EN:PDF), now incorporated in the VAT Directive 2006/112/EC, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do? uri=OJ:L:2006:347:0001:0118:EN:PDF.

III. Range of Tax Harmonisation

The literature on tax systems competition and tax harmonisation is heterogeneous and does not yield simple results. Two opposing positions are to be mentioned: (1) Proponents of the *race-to-the-bottom approach* argue that any competition between tax systems leads to a permanent decline of national tax rates, reducing the revenue capacity, jeopardizing the ability of states to finance the necessary public goods and services. Especially with regard to corporate taxation fears are expressed that the competitive tax rate would be zero with the result that all tax burdens are laid on employees and consumers. (2) Proponents of the Leviathan-hypothesis stress the fact that especially in representative democracies there is a tendency due to principal-agent-problems that politicians behave as budget maximizers and will constantly increase the tax burden, eventually causing the destruction of economic efficiency and democratic society. In real life rational positions between the two extremes largely prevail, and it becomes necessary to differentiate and to show that there are pros and cons, as will be done in the following chapters.

III.1. Approach of the European Union

In the second half of the 1990ies the EU member states were confronted with increasing international tax competition, which was further enhanced by internal competition resulting from the enlargement of the EU. In the large member states, and especially in Germany and France, political fears were expressed that such competition could jeopardise the internal budgetary structures. The ECOFIN sessions in December 1997 drew conclusions on *harmful tax competition*,[29] which have determined the further harmonisation strategies until today. In the Commission Communication on “Tax Policy in the European Union - Priorities for the Years Ahead” (2001)[30] the content of the terms and the strategy for combating harmful competition measures were described in more detail. A code of conduct was set out in the 1998 ECOFIN conclusions, which determined that the member states have to roll back tax measures that constitute harmful tax competition and refrain from introducing any such measures in the future ("standstill"). Additionally a criteria catalogue defining harmful tax competition was implemented. Harmful tax competition was defined as:

- an effective level of taxation which is significantly lower than the general level of taxation in the country concerned;
- tax benefits reserved for non-residents;
- tax incentives for activities, which are isolated from the domestic economy and therefore have no impact on the national tax base;
- granting of tax advantages even in the absence of any real economic activity;
- the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD;
- lack of transparency.

[29] See the Council Information in Official Journal of the European Communities, C 2/1, 6.1.1998, http://ec.europa.eu/taxation_customs/resources/documents/COC_EN.pdf.

[30] Commission of the European Communities (2001), http://eur-lex.europa.eu/LexUriServ/ LexUriServ.do?uri=COM:2001:0260:FIN:EN:PDF.

Parallel to the EU, the OECD (mentioned in the catalogue above) through its Centre for Tax Policy and Administration, started a campaign on harmful tax competition in 1998 and worked with both member and non-member countries to address harmful tax practices. The main focus of this work is on improving transparency and exchange of information so that countries can fully and fairly enforce their tax laws. In 2000, 2001 and 2004 progress reports were published by the OECD's Forum on Harmful Tax Practices. This strategy has found wide support within the G8 and G20 in 2004[31] and also in many later statements.

In 2005 the EU Commission adopted a Communication on Preventing and Combating Financial and Corporate Malpractice and proposed a strategy for co-ordinated action in the financial services, company law, accounting, tax, supervision and enforcement areas, to reduce the risk of financial malpractice.[32] As for taxation the commission suggests more transparency and information exchange in the company tax area so that complex corporate structures can be better controlled. In addition, coherent EU policies concerning offshore financial centres should be assured, to encourage these jurisdictions as well to move towards transparency and effective exchange of information.[33]

In turn and also in 2005 the OECD "Forum on Harmful Tax Practices" has focussed its work on three areas:

- harmful tax practices in member countries;
- tax havens;
- involving non-OECD economies.

Beside the three progress reports mentioned above, together with cooperative tax havens the Forum has produced a "Model Tax Agreement on Exchange of Information in Tax Matters".

After some new tax scandals in early 2008 the G8 heads of state urged "all countries that have not yet fully implemented the OECD standards of transparency and effective exchange of information in tax matters to do so without further delay, and encourage the OECD to strengthen its work on tax evasion and report back in 2010." Similarly, the action plan issued by the G20 following its meeting in November 2008 recognised the importance of the OECD work in this area and urged that failures to implement the standards should be "vigorously addressed". All these activities have also influenced the discussion processes within the United Nations (UN). In October 2008 the UN Committee of Experts on International Cooperation in Tax Matters implemented the standards developed by the OECD's Global Forum on Transparency and Exchange of Information so that the G8, EU and OECD strategy has really been globalised. These standards require:

- exchange of information on request where it is foreseeably relevant to the administration and enforcement of the domestic laws of the treaty partners;

[31] See for reference http://www.g20.org/Documents/2004_g20_statement_transparency_tax_ purposes.pdf.

[32] See Comission (COM (2004) 611); http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM :2004:0611:FIN:EN:PDF..

[33] See press release IP/04/1164; http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/1164&format=HTML&aged=0&language=en&guiLanguage=en and http://europa.eu/rapid/pressReleasesAction.do? reference =IP/04/1164&format=HTML&aged=0&language=en&guiLanguage=en.

- no restrictions on exchange caused by bank secrecy or domestic tax interest requirements;
- availability of reliable information and powers to obtain it;
- respect for taxpayers' rights;
- strict confidentiality of information exchanged.[34]

The UN published the first convention on double taxation in 1980[35]. This was the basis for several later conventions and the focus was on the relation between developed and developing countries. The UN model was then adapted to the running discussion processes (see especially the 2001 UN Model Double Taxation Convention between Developed and Developing Countries) and in 2008 (Doha conference) the convention was amended by the transparency and information exchange elements.

Hence, harmful tax competition has become a global topic and due to that development the pressure on the so-called uncooperative countries has been substantially increased. Due to the financial crisis in 2008/9 the finance ministers of the EU intensified their efforts, and on 29 April 2009 they initiated a "Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee" with the title "Promoting Good Governance in Tax Matters".[36] The communication identifies how – in view of the leading European member states, many smaller states expressed deep reservation, e.g. Austria, Luxembourg, the Baltic states – good governance could be improved within the EU. It also lists the tools the EU and its member states have at their disposal to ensure that good governance principles are applied on an international level. Finally, it calls on member states to adopt an approach that is more coherent with good governance principles in their bilateral relations with third countries and in international fora. The communication is based on the existing EU policy on good governance and the 2 April 2009 G20 conclusions concerning uncooperative tax jurisdictions.

These discussions, intensified after the 2008 scandals, have motivated many of the uncooperative states to surrender. Since autumn 2008 many of the "uncooperative" countries have signed bilateral agreements for the exchange of information in tax purposes[37] and in March 2009 the last three (Andorra, Liechtenstein and Monaco) also explained their readiness to negotiate such agreements. Since then these three countries have been removed from the OECD List of Uncooperative Tax Havens.[38] It is unquestionable that this is an enormous success for the initiating countries and the OECD; but considering that the initiators are mainly high tax countries with highly inefficient tax systems this success has also critical perspectives. This holds especially true if those countries take the success as incentive not to reform their own tax systems. Therefore, in the following the cons of tax harmonisation have to be mentioned briefly.[39]

[34] See OECD (2009); http://www.oecd.org/dataoecd/32/45/42356522.pdf.

[35] For the history see Kosters (2004, p. 4).

[36] See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0201:FIN:EN:PDF.

[37] See the OECD list of Tax Information Exchange Agreements (TIEAS) on http://www.oecd.org/document/7/0,3343,en_2649_33745_38312839_1_1_1_1,00.html.

[38] See under http://www.oecd.org/document/57/0,3343,en_2649_33745_30578809_1_1_1_1,00.html.

[39] For a concise overview see Mitchell (2001).

Opponents of tax harmonisation are arguing that it is impossible to separate harmful tax competition from effective and necessary tax competition like it is almost impossible to differentiate between fair and ruinous competition policies. While the proponents fear a race-to-the bottom regarding corporation tax rates the opponents argue that with reduced competition the pressure on an efficient economic and social policy is reduced and the budget-maximising behaviour could lead to the Leviathan state.[40] The opponents fear that tax harmonisation will lead (1) to higher taxes and, therefore, (2) to lower growth rates. It might (3) undermine the incentive in the high tax countries to reform their budgetary and tax systems. It is a threat for (4) free trade because countries outside the OECD are pressed to increase trade barriers against uncooperative states. Consequently it (5) violates national sovereignties and is perceived as an (6) attack against privacy because information exchange is the backdoor of tax harmonisation. Beyond that it might be (7) a threat to low tax countries, which are pressed to increase tax rates above the levels which correspond with the preferences of the own citizen. Furthermore, it might be a (8) disadvantage for the developing countries because at higher tax level they are confronted with increased comparative disadvantages in relation to the developed countries. And last but not least it might be a (9) threat for the world if the low income developing countries become disintegrated from the world markets, which would increase poverty and create more migration. Because of those negative impacts the opponents propagate the territoriality principle instead of the world-wide income principle, which is especially supported by the large high-tax countries and outflow of the direct progressive income tax schedules within these countries.[41] In this view the high and inefficient tax countries form a cartel in the interests of their own revenue, thus pressing the low tax countries to abandon their comparative advantages.

Some of the arguments may be exaggerated but one should bear them in mind and reduce the range of harmonisation to the really necessary extent. Differences in the tax systems express different preferences of the citizens and different cultural conditions.[42] All that has to be taken into consideration because the fight of harmful tax competition should not yield new forms of egalitarianism or even imperialism regarding the tax systems. Therefore, some academics prefer the term “tax coordination” instead of “tax harmonisation”.[43] Whatever semantic position one takes, two coordinating or harmonising steps are inevitable: (1) transparent tax bases and (2) a certain convergence in the tax rates.[44] Both measures simplify administration and cross border trade, alleviate border controls and reduce inefficient waiting times at the borders and diminish incentives for purely tax avoiding cross border shopping activities.

[40] See Petersen (2004 and 2006) and the literature cited there.

[41] If the world-wide income principle is applied and direct progression does exist (increasing marginal tax rates with increasing income) foreign country income is added to the inland income, thus leading to an increase in the average tax rate. If double taxation is avoided by crediting the foreign tax burden and the average tax rate abroad is lower (or even zero) than the inland rate, a positive inland tax yield emerges. Even in case of world-wide flat taxes such differences would remain until the national marginal tax rates would have been totally harmonised. Under an international tax regime following the territoriality principle, such burden differences would be accepted and – following the Tiebout model – lead to a regional competition because the citizen would vote by feet on the relation of the benefits of the supply of public goods and services and the regional tax burden due to their preferences.

[42] For more details see Nerré (2002, 2006).

[43] See for instance Cnossen (2008).

[44] For Velayos/Barreix/Villela (2008) tax harmonisation can be described as a sequence of the following terms: standardization – compatibility – coordination – cooperation – convergence; http://siteresources.worldbank.org/INTTPA/Resources/Velayos-Villela-Barreix.pdf.

However, a certain coordination and harmonisation within the EAC is necessary and badly missing. But the coordination problem is a very uneasy one, because the EAC Partner States do have several obligations in other economic communities of the region, which might create conflicts within the multiple membership interests.

However, tax advantages are very closely linked to government aid and subsidisation. Therefore, in 1998 the EU also implemented a commitment in the code of conduct on business taxation (cf. paragraph J of the Code[45]). The commission published guidelines on the application of the state aid rules to measures relating to direct business taxation. The latest report on these matters is from early 2004.[46] Any aid granted by a member state or through state resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between member states, be incompatible with the common market. Additionally any kind of tax relief can constitute state aid. Therefore the relations between any tax benefits and aid have to be taken into consideration.

III.2. Indirect and Direct Tax Harmonisation

III.2.1. Excise Taxes

As already mentioned above, excise taxes are levied on single commodities for revenue purposes or often additionally justified by health hazards (tobacco and alcohol) or ecological reasons (external effects on the environment, e.g. gasoline tax and motor vehicle tax). In a closed economy, excise taxes drive wedges between producer and consumer prices, create a substitution effect or deadweight loss (welfare loss), which beside the revenue aspect might also be politically justified to steer the demerit preferences of the consumers. In a cross-country perspective differences in consumer marginal rates of substitution (and, therefore, international welfare losses) arise if the destination principle is applied and the countries levy different tax rates on the internally consumed goods. Cross-country differences in producer marginal rates of transformation (resulting in an inefficient allocation of world production) arise when countries levy taxes on goods and services produced within their borders (if the origin principle is applied). For this result the standard neoclassical assumptions apply (equilibrium approach) and the preferences are equal in all countries. Then tax harmonisation would be welfare increasing. If the preferences are not equal, perhaps due to different cultural backgrounds,,[47] harmonisation would increase internal distortions and reduce welfare.

“Tax rate uniformity does not appear to be the right way to maximize welfare if integrating countries are different. Some flexibility should be maintained”.[48]

[45] See the Commission Notice on the application of the State aid rules to measures relating to direct business taxation, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998Y1210(01):en:HTML.

[46] See Commission (2004), http://ec.europa.eu/competition/state_aid/studies_reports/rapportaidesfiscales_en.pdf. See also Fuest (2009, pp. 97).

[47] The enormous differences in tax rates on alcoholic beverages between North Europe and Middle and South Europe are the result of extremely consumer habits within the single countries. See Graf (2001).

[48] De Bonis (1997, p. 2).

But especially tax rate differences (including a zero tax rate) can also be used as a strategic variable in attracting demand from the neighbouring countries. Such strategies correspond to beggar-my-neighbour-policies and have to be avoided within common markets or economic unions. However, preference differences and strategic behaviour are difficult to define so that harmonisation is always a process of negotiations between the members, clearly dependent on the negotiation power of the different members, who can also form “strategic alliances” as the EU approach above has demonstrated.

International historical developments and experiences show some fundamental characteristics of excise tax systems can be found:

(1) Regarding the revenue impacts, excises play an important role in developing countries and are still relevant also in the developed countries. Since the eco-tax movement has gained relevance, especially excise taxes on polluting goods have been implemented because in a short- and mid-term perspective the intended substitution effects are comparatively small (because of the lack of existing technical alternatives[49]); at least for an intermediate period such taxes often yield high revenue thus increasing their relevance for the budgets.

(2) Whereas in former times there was a large number of excise taxes, nowadays those taxes are concentrated on the most important commodities, which additionally have the external impacts as described above. Such commodities are tobacco, alcoholic beverages, crude oil products, gas, coal, electricity etc. Also so-called luxury taxes (on cars, furs, jewellery, etc.) have been or are still raised. In some countries luxuries were taxed by an increased rate within the VAT system.

(3) While excises on mass consumption goods deliver high and sustainable tax revenue, bagatelle taxes, often yielding more administrative and compliance costs, have to be abolished.

(4) The motor vehicle tax and the licence fees (or vehicle registration fees) are implemented especially in those countries, which have no own car production. Then both of the taxes yield considerable revenue without endangering the national employment situation.[50] Like excises on crude oil products such taxes and fees do have features as import duties have.

(5) The motor vehicle tax and fees have similarities with the luxury tax because only well-to-do people are able to buy cars in developing countries. This would reduce the regressive impacts of the excises, where the average tax burden related to the income is higher for the lower income groups due to a low propensity to save.[51]

(6) With the reduction and abolition of import duties, revenue has been decreased or transferred to a new jurisdictional level (in the EU from the member states to the European budget); for compensating such losses, excise taxes are an appropriate substitute especially if the demand for the taxed commodities is price inelastic.

(7) In the modern excise tax systems most of the excises are levied as specific taxes on units or other technical measures. Such taxes are neutral regarding the product quality.

(8) Specific taxes are more transparent than ad valorem taxes, where the tax burden can only be determined if the commodity price is known. Therefore, they can be compared and coordinated more easily in case of tax harmonisation activities.

[49] See Petersen/Müller/Nagel (1997).

[50] Car producing countries do have much lower tax or fee rates because they would jeopardize the employment situation within this sector; see for more details Keser (2003).

[51] See Cnossen (2008, p. 14).

(9) Specific taxes can be much better controlled in cross-border transactions, and are therefore connected with less tax evasion.

(10) In developing countries other mass commodities have to be taken into consideration, which also could yield sustainable revenue and diminish the regression impact of the system.

(11) The tax bases and the tax rates within the EAC Partner States have to be coordinated and the tax rates adjusted. Otherwise zero taxation in some or high rate differences between member countries would give incentive for purely tax induced cross-border shopping and smuggling.

The EU has a similar set of excise taxes as the EAC. Commonly applied are excise taxes on

- alcoholic beverages,
- manufactured tobacco products and
- energy products (motor fuels and heating fuels, such as petrol and gasoline, electricity, natural gas, coal and coke).

The revenue is allotted to the member states' budgets. The EU legislation in this area was mainly adopted in the context of the establishment of the single market on 1 January 1993, which involved the abolition of controls of a fiscal nature at internal borders between member states. The legislation developed further on can be divided into three main categories:

- The structure of the tax to be applied to a particular commodity. The structure of taxation means the definition of the product categories, the way in which the excise duty is calculated (e.g. per hl; per degree alcohol; per 1000 pieces, etc.), the scope of possible exemptions, etc.
- The minimum tax rates that member states have to respect for each type of product. Above those minimum rates, member states can freely fix their own rate levels.
- General provisions that apply across the product categories. These provisions concern in particular the production, storage and movement between member states of excise products.[52]

The border equalisation system was replaced by a paper-based document – the Accompanying Administrative Document (AAD) – which was developed for the control of intra-community movements of excise goods, while tax-suspension can only take place between authorised economic operators, guaranteeing financial security for the movement, both of which can only be discharged when the goods arrive at their destination. The system was put in place to monitor intra-community movements of excise goods in order to ensure payment of duty in the member state where they are released for consumption, whilst at the same time respecting the principle of free movement of goods within the internal market.[53] Meanwhile the Excise Movement and Control System (EMCS) has been implemented, which is a computerized system for monitoring movements of excise goods between EU member states under duty suspension. It will replace the paper document that currently must accompany such movements. EMCS will mean simplification of procedures, paperless administration,

[52] For more details see European Commission: Taxation and Customs Union; http://ec.europa.eu/taxation_customs/taxation/excise_duties/gen_overview/index_en.htm.

[53] For more details see the warehouse concept, European Commission: Taxation and Customs Union; http://ec.europa.eu/taxation_customs/taxation/excise_duties/common_provisions/ index_en.htm

and effective use of modern IT tools and amounts to an important evolution for those who trade in alcohol, tobacco or oil products.[54]

The charts in Appendix 4 provide three examples of excise goods demonstrating that excise tax rates are still quite different. Regarding ethyl alcohol the islands (Ireland and the United Kingdom) as well as Finland have considerably higher rates, only topped by Sweden with the highest burden on these products (see figure A1 in the appendix 4). The Central European states have much lower rates, and Denmark was forced by the geographical vicinity to Germany and the open borders with many opportunities for cross-border trade to reduce its tax rates on alcoholic beverages, so that they are now closer to the standards in the neighbouring countries. Sweden recently started an initiative to increase the tax rate, but did not find support for such strategy.

The differences of tax burdens regarding gasoline tax (unleaded petrol) are even less than in case of alcoholic beverages because cross-border selling also plays an important role, pressing the states to have not too large burden differentials (see figure A2 in Appendix 4). Therefore in case of internationally tradable goods there is a competitive pressure due to a certain degree of equalisation within the national tax burdens. In case of non-tradable goods like heating gas and oil as well as electricity the consumers are bound to the national suppliers so that tax avoidance by consuming abroad is impossible. Consequently such goods are extremely burdened in single countries and used as an important source of revenue financing (see the figure A3 in the appendix 4). Therefore, many other factors like geographical location, characteristics of goods, cultural differences etc. have to be taken into consideration and explain at least partly the burden differences even in a highly developed single market and currency union like the EU.

III.2.2. Value Added Tax (VAT)

Compared to the excise tax, a VAT system is internally neutral regarding the consumption structures. In an international context similar problems as in the case of excises arise, depending on the principles which are applied (origin or destination principle). In three EAC Partner States – Kenya, Tanzania and Uganda – the VAT plays at least an equal or more important role than the excises.[55] In Rwanda and Burundi the VAT system has very recently been implemented or implementation is still ongoing. Internationally relevant competitive advantages or disadvantages may arise from differently defined tax bases or remarkable tax rate differences especially regarding tradable goods. As VAT is regarded as “optimal” if it has a broad tax base without any exclusion of specific goods and services and a uniform proportional tax rate. It should comprise all companies producing or trading in the goods and service markets. As more goods and services are exempt from the tax base (zero rates) or preferentially taxed (with lower than the standard rate), as more the general neutrality diminishes and substitution effects gain relevance. The differentiations within the tax base and the rate systems then cause the need within common markets and economic unions to coordinate the VAT system so that just acceptable differentiations remain, which do not impair the fair rules of systems’ competition.

[54] For details see http://ec.europa.eu/taxation_customs/taxation/excise_duties/circulation_control/index_en.htm.

[55] See Cnossen (2008, p. 6).

Usually the VAT systems have the following characteristics, which have to be checked in case of harmonizing activities:

(1) Exemptions are made for specific goods and services so that the buyer (usually the final consumer) gets the purchase without any VAT being applied to the sale. Exemptions from tax include for example, certain activities in the public interest (medical care, school education etc.) or certain insurance and financial services. This is the case because reasons other than tax policy (social and health policy, education policy etc.) justify this relief. However, as the supply is exempt from VAT, deduction of the VAT paid on the inputs is not possible. In other cases sectors may be exempt from VAT if other (similar) taxes are paid.

(2) Zero rating happens in case of exemptions, whereby the supplier is allowed to deduct his input VAT. These exemptions are used for instance for the exports of goods from a community to third countries and also for intra-community supplies of goods dispatched from one member state to a taxable person (or identified trader) in another. Sometimes these exemptions are called zero-rate supplies as the result is that there is no residual VAT in the final price.

(3) Zero-rating also takes place especially for non-tradable goods like land sale, housing sale, renting and leasing etc. In the first two examples specific national acquisition taxes exist, in the other social justifications apply.

(4) Some VAT systems are close to an ideal one and have only one proportional tax rate. Most of the systems have more than one rate but usually a standard rate.

(5) Other systems have also a number of reduced rates (often including the zero rate mentioned above, which corresponds to the exemption method).

(6) Reduced rates may also apply for labour intensive goods.

(7) Often special schemes exist, e.g. for travel agents (because tax yield from different member countries might be included in one deal) and the taxation of gold (especially old gold coins).

(8) The supply of services is in principle taxable at the supplier's place of establishment. However, in order to ensure that VAT receipts accrue to the member state of consumption, several exceptions to this general rule are often made.

(9) Often insurances and financial services are tax exempt (because of national taxes like the insurance tax; these exemptions are currently under inspection in the EU).

(10) The VAT arrangements applicable to second hand goods (including, for example, used cars and works of art) can either be the normal VAT arrangements or the special arrangements applicable to second-hand goods, works of art, collectors' items and antiques (the "margin scheme", difference taxation). Private sales of non-taxable persons are usually tax exempt but limited in number per year.

(11) Distance selling means that a supplier sells goods to private individuals or customers established in another member state which does not apply VAT to his intra-community acquisitions of goods. The supplier takes care of the transport of the goods to the customers. Typical examples are mail-order companies.

(12) Electronic service taxation is highly complex and requires a complex network of internal (applied within the community) and external (for the exchange with third countries) regulations.[56]

Naturally, in the EU very complex rules have been implemented over the course of time so that nowadays the VAT system is as complex as the income and profit taxation.[57] Here just the basic rules for the differentiation of the VAT tax rates are mentioned, which are quite simple:

- Supplies of goods and services subject to VAT are normally subject to a standard rate of at least 15% (minimum standard rate), the maximum standard rate is 25%;
- member states may apply one or two reduced rates of not less than 5% on goods and services enumerated in a restricted list;
- they may also, under certain conditions, apply a reduced rate to certain labour intensive services.

The producers or traders under a VAT regime have several obligations: (a) Declaration: Information to the fiscal administration on commencement, change and cessation of business, submit periodical tax declarations, conduct bookkeeping, pay the resulting tax yield in a proper way. (b) VAT invoice rules. (c) Intra-community information system use for the control of intra-community trade in case of an economic union. (d) Right to deduct input VAT and VAT refunds. Regarding the consumers in a union without border controls the origin principle applies to cross-border shopping; exceptions are the above mentioned new car sales, the mail-orders and distance purchases as well as e-commerce. Combating tax fraud is always highly on the agenda.

For small businesses (manufacturers or self-employed persons) usually certain lower turnover limits exist. Below such limits the firms do not have to register for VAT, but are also not eligible for input tax deduction.[58] However, they may register voluntarily, if the respective entity expects to exceed the limit in the near future or to profit from input tax deduction.

EU the member states fully use the rate limits set by the directives. Appendix 4 (see table A1) shows that the standard tax rate is in fact between 15 % (Luxembourg and the United Kingdom) and 25 % (Denmark and Sweden). Reduced rates range from 5 % to 17 % and the super reduced rate (below the minimum rate) from 3 % to 4.8 %. Again these differences are quite remarkable and leave a certain space for national policies as well as systems competition.

III.2.3. Income, Corporate and Capital Gains Tax

While the definition of the tax base is already complicated for a VAT system, in case of income and corporation tax the task is even more complex. Regarding direct taxation the view

[56] The OECD has formulated principles on the taxation of e-commerce, which were agreed at a 1998 conference in Ottawa. These principles establish that the rules for consumption taxes (such as VAT) should result in taxation in the jurisdiction where consumption takes place. The OECD also agreed that a simplified online registration scheme, as now adopted by the Council, is the only viable option today for applying taxes to e-commerce sales by non-resident traders. See, e.g. Chetcuti (2002).

[57] For more details see http://ec.europa.eu/taxation_customs/taxation/gen_info/tax_policy/index_en.htm.

[58] It should be mentioned that small businesses often have tight connections to the shadow economy so that incentives should be set to also get them registered.

is dominating that the subsidiarity principle has to be applied, because differences in direct taxation are very strongly determined by national attitudes, preferences and cultures. Therefore, even in an integrated union such as the EU, the harmonisation measures have been limited to eliminating discrimination and double taxation, preventing zero taxation and fraudulent usage of tax regulations as well as decreasing the compliance costs for taxpayers being taxable in more than one member country. Therefore, double taxation agreements form an integral part of member states' tax rules, and the personal tax rules included in these agreements have to remain within the boundaries set by the EU treaty, just like any other national laws.[59] However, as already mentioned above, international tax evasion is under specific scrutiny.

Personal income taxation needs a clear definition of the taxable person, the tax base as well as the schedule. Regarding the tax base, the income definition, the sources of income and the tax period are of specific interest. Within the tax schedules marginal rates are important because these directly influence tax avoidance, evasion, the supply of effort and the mobility of production factors (labour and capital, where capital without doubt has the highest mobility). For wage taxes the withholding procedure (pay-as-you-earn) is of utmost relevance.

Insofar the EU has been involved in direct taxation it mainly pertains to capital income and corporate taxes because in this field mobility of the tax base plays the most important role.[60] Regarding capital income many sources belong to the personal income tax base (dividends, income from renting and leasing, interest, capital gains). Because of a remarkable mobility of private capital partly due to evading reasons, the EU has adopted a saving tax directive in June 2003. It has been applicable since 1 July 2005. The directive applies to interest paid to individuals resident in an EU member state other than the one where the interest is paid. Member states had to transpose its provisions into national legislation. The European Commission on 13 November 2008 adopted an amending proposal to the savings taxation directive, with a view to closing existing loopholes and better preventing tax evasion.[61] The most important component is the information exchange, which has already been addressed above.[62] During a transitional period some member states, not taking part in the information exchange, have to apply a withholding tax, which has to be partly transferred to the residents' countries. Similar agreements have been made with third party countries.

Regarding companies taxation the coordination problems are almost innumerable. Therefore, one has to concentrate on the most important issues. If the definition of the tax base is taken into consideration, accrual as well as cash basis accounting methods are used. For different sectors (e.g. agriculture) specific tax rates often apply. Generally the question arises, which business expenses are deductible. And additional different depreciation, provisions and evaluation methods can be applied. Because of this complex only some core elements are named, which have to be taken into consideration for the necessary coordination processes within a common market:

[59] The European Court of Justice (ECJ) is a driving force in the field of direct tax harmonisation. See Lang/Pistone/Schuch (2008).

[60] See van der Hoek (2003) and Mitu (2008).

[61] For details see http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/index_en.htm.

[62] Fore more details see the recent publication of the OECD (2009b).

(1) Differences in the definition of the tax bases lead to differences between the statutory tax rates expressed in the law and the effective tax rates really applied. Therefore, a certain coordination of tax rates seems to be necessary.[63]

(2) Transfer prices can be used as a vehicle to shift the company tax base into low tax member states or third party countries. The deepening of the internal market and the growing number of new technologies and business structures at national and international level aggravate these problems. There is convincing evidence that applying transfer prices for tax purposes is complicated and a serious problem in practice.

(3) Between parent companies and subsidiaries conditions for exempting dividends from withholding taxes have to be relaxed and double taxation for subsidiaries of subsidiary companies eliminated.

(4) On the other hand the profit shifting between affiliated companies by internal credit operations (shareholder borrowing) has to be controlled (earnings stripping rule in the US, interest deduction limit in Germany).

(5) Operating rules for mergers of companies located in different member countries.

(6) Coordinating the taxation of interest and royalty payments made between companies of different member states.

(7) Permanently update of the DTA between the member states.

A short view on the top statutory personal income tax rates (see figure A4 in Appendix 4) demonstrates the enormous differences in the top marginal tax rates within the EU27. Romania has the lowest top marginal rate with 16 %, while the rate in Denmark of 59 % is 3.7 times higher.[64] Regarding corporate income tax the tax rates are substantially lower (see figure A5 in the appendix 4) but also range between 10 % in Cyprus and 35 % in Malta. Since 1995 a strong decline can be observed. Much more informative are effective tax rates, which are heavily influenced by the above mentioned differences in the definitions of the tax bases. Devereux/Griffith (1999) developed a method to calculate effective rates for standardized investments, which are often used in the literature.[65]

IV. Administration, Application of Tax Law and Tax Practice, Law Abidance of Taxpayers

Mutual assistance between the member states in the tax field has to be established. Directives have to complement the existing provisions on mutual assistance in bilateral tax treaties concluded between the member states. When an internal market is created and physical border controls are abolished, it is necessary to set up a control system to manage the VAT control of intra-community trade. Mutual assistance in recovery of taxes, customs and certain fees has to be established in a community. Such directive has to be extended to VAT, excise taxes, and taxes on income, capital and insurance premiums.

The creation of an internal market with no physical borders leads to increased cross border trade, increased mobility as well as the feature of e-business. This makes it necessary to

[63] For this purpose the European Commission has implemented the so-called Common Consolidated Corporate Tax Base Working Group, for details see http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm.

[64] See European Commission: eurostat (2008, p. 8).

[65] For more details see Elschner/Vanborren (2009). For a comparison of effective corporate tax rates in Europe see Rose/Schmidt/Petersen/Kambeck (2006).

continuously modernise the legal instruments for mutual assistance and make cooperation between tax administrations more efficient. Risk management has to be designed to improve the tax administration's effectiveness in dealing with risks. This may result in measures aimed at avoiding non-compliance of taxpayers, or the better targeting of corrective action.

Most tax claims (or debts) due to national treasuries in modern tax systems are collected promptly through spontaneous payment by the debtor. When the claims are not settled promptly, national tax administrations must have a range of powers to recover the claim. At the limit, the claim can be recovered through the seizure and sale of the debtor's property by the tax administration ("enforcement"). Because it is likely that the debtor (or recoverable assets belonging to the debtor) is (are) within the jurisdiction of another member state, arrangements at community level are necessary to ensure that taxpayers cannot successfully evade their obligations in this way.

The aim of mutual assistance is to improve administrative cooperation between member states. Administrative cooperation concerns the tax and customs administrations of member states to cooperate with each other to share information. Close cooperation between these bodies is vital to detect and reduce tax fraud. This type of fraud costs the member states millions of currency units annually. In addition, it distorts competition for honest traders and undermines confidence in the communities’ taxation systems. Hence, intelligent and effective provisions against tax fraud have to be implemented. Therefore, it is necessary

- to lay down clearer and more binding rules governing the exchange of information;
- to provide for more direct contacts between national anti-fraud agencies;
- to facilitate more extensive exchange of information;
- to implement an option for member states to introduce a general reverse charge system.[66]

Regarding savings taxation each member state should provide information to other member states on interest paid from that member state to individual savers resident in those other member states. This procedure is the more necessary the larger the tax rate differences are between the member states.

[66] Reverse charge means that the tax liability is carried forward from the deliverer to the recipient of an invoice. See, e.g., http://www.bundesfinanzministerium.de/nn_39846/DE/BMF__Startseite/Service/Glossar/R/007__Reverse-Charge.html and below.

Part B: Structure of the Tax Systems in the EAC

V. Main Macroeconomic Variables and Important Economic Indicators for the EAC Partner States – Status of Internal and External Integration

Before the tax systems of the Partner States are described in more detail and comparisons of the statutory tax bases and rates are made, important macroeconomic data have to be analysed to shed some more light on the necessary integration and harmonisation activities. Due to limitations in data availability and the tight time schedule for the project, the following analyses predominately try to use the most recent EAC data[67] and additional information from international sources.[68] Table 6 combines the EAC data with data from the CIA World Factbook and the figures on the shadow economies estimated by Schneider (2007). In 2007 the population of the EAC region was 122,1 mill. [69]The three biggest are Tanzania (32.3%), Kenya (30.5%) and Uganda (23.1%), the smaller two are Burundi (6.5%) and Rwanda (7.6%). All the macroeconomic variables have been transformed by a current exchange rate into US dollars.[70]

The trends described above are at least partly reflected in the size of the shadow economy. All estimations of the informal sector are burdened with serious methodological problems, but nevertheless provide additional information on revenue reserves, which can be channelled into the official labour and goods markets in a mid-term perspective by appropriate control strategies. The size of the shadow economy as estimated by Schneider (2007) is lowest in Kenya (34.8 % of the GDP in 2004/05, rank 7 within 37 African countries) and highest in Tanzania (58.2%, respectively, rank 35 of 37). This points to possible structural problems within the Tanzanian service and industry sector, which might also be closely linked to informal sector activities.

[67] See East African Community (2008).

[68] See also OECD (2009a).

[69] The population size of the EU-27 is about 497,5 mill. The population of the EEC-6 (France, Germany without GDR, Italy, Benelux) was about 216 mill.

[70] The following USD exchange rates have been used: Burundi 0.84, Kenya 12.75, Rwanda 1.77, Tanzania 0.75, Uganda 0.45 (for 1000 currency units). Question marks are put if the values could not be verified. Here further clarifications have to be made in future project missions.

Table 6: Macroeconomic Data for the EAC Member Countries and Shadow Economy

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Population, mill. (mid-2007)	8,0	37,2	9,3	39,4	28,2
Population growth rate (2007)	2,7%	2,7%	2,6%	2,9%	3,2%
Real GDP, mill. $US (2007)	864	19842	1973	10154	9123[a]
GDP at market prices, mill $US (2007)	936	26950	3411	15412[b]	13782
GDP per capita, market prices, $US (2007)	118,5	724,5	365,0	440,0	472,8
GDP per capita, PPP, $US (2007, est.)	400	1600	900	1300	1100
GDP by sector (2008[1], est.), agriculture	32,9%	23,8%	35,0%	27,0%	29,0%
---,,--- , industry	21,3%	16,7%	22,1%	22,7%	24,8%
---,,--- , services	45,8%	59,5%	42,9%	50,3%	46,2%
Labor Force, mill. (various years[2], est.)	2,99	17,37	4,60	20,38	14,48
Labor Force, % of population (various years[2], est.)	43%	47%	60%	50%	50%
Labor Force by sector (various years[3], est.), agriculture	93,6%	75%	90%	80%	82%
---,,--- , industry	2,3%	25%	10%	20%	5%
---,,--- , services	4,1%				13%
Gross Nat'l Income, mill. $US (2007)	850	26759	3395	n/a	n/a
Gross Nat'l Disposable Income, mill. $US (2007)	1091	28885	3863	n/a	n/a
Gross Nat'l Disposable Income p. cap., $US (2007)	136,4	776,5	415,4	n/a	n/a
Gov't final consumption, mill. $US (2007)	287	4623	387	2972	1641
Priv. final consumption, mill. $US (2007)	796	20586	1535	10470	11085
Gross capital formation, mill. $US (2007)	109	5261	277	67	3118
Government revenue, mill. $US (2007/08)	336	7199	864	2895	4186
Tax	172	6113	435	1973	3076
Non-Tax	15	619	26	163	114
Grants	149	467	403	758	996
Gov't expenditure (re-current), mill. $US (2007/08)	245	7812	573	2448	1991
Gov't expenditure (development), mill. $US (2007/08)	118	3075	341	-	1907
est. size of shadow economy, % of off. GDP (2004/05)	39,7%	34,8%	41,6%	58,2%	44,9%
---,,--- , rank within Africa (37 countries)	13	7	16	35	26

Budget year: July-June (Kenya, Uganda, Tanzania), January-December (Burundi, Rwanda)

Source for all unless noted further below:
EAC, East African Community Facts & Figures - 2008

GDP (PPP), GDP by sector, Labor Force:
CIA World Factbook

Shadow economy:
Schneider, "Shadow Economies and Corruption All Over the World: New Estimates for 145 Countries"

Notes:

[1] except Kenya: 2007

[2] Burundi 2002, Kenya 2007, Rwanda 2000, Tanzania 2008, Uganda 2008

[3] Burundi 2002, Kenya 2003, Rwanda 2000, Tanzania 2002, Uganda 1999

Implausible values in source:

[a] exactly identical to 2006

[b] inconsistent with GDP per capita given in same source; implied actual value approx. 17,400

Table 7 summarizes the results of the best-known global economic indicators for the quality of the economic and political system: (1) the Index of Economic Freedom by the Heritage

Foundation,[71] (2) the Economic Freedom Index by the Fraser Institute,[72] and (3) the Corruption Perception Index by Transparency International.[73] Like in the case of the estimations of the shadow economy one has to be fully aware about the methodological shortcomings of such indicators of qualitative aspects but at least some trends can be found.

Table 7: Important Qualitative Indicators for the EAC Partner States

Country	CPI2008			EFW2008			IEF2009		
	Score	Rank (World)	Rank (SSA)	Score	Rank (World)	Rank (SSA)	Score	Rank (World)	Rank (SSA)
	Overall								
Burundi				5,23	131	27	48,8	153	32
Kenya				6,96	60	4	58,7	90	10
Rwanda				5,23	131	27	54,2	124	22
Tanzania				6,47	79	9	58,3	93	11
Uganda				6,78	69	7	63,5	63	4
	Government Size								
Burundi				4,68	118	27	55,8	131	39
Kenya				7,85	15	2	81,5	55	21
Rwanda				4,87	117	26	76,8	71	27
Tanzania				5,20	107	24	83,4	49	18
Uganda				7,23	38	6	86,9	36	10
	Corruption								
Burundi	1,9	158	36				25	133	28
Kenya	2,1	147	33				21	152	36
Rwanda	3,0	102	16				28	113	16
Tanzania	3,0	102	16				32	95	12
Uganda	2,6	126	26				28	113	16

CPI2008:
Transparency International, 2008 Corruption Perceptions Index
180 countries surveyed, including 48 in Sub-Saharan Africa
scale: 0 (worst) to 10 (best)

EFW2008:
Economic Freedom Network, Economic Freedom of the World - 2008 Annual Report
141 countries surveyed, including 35 in Sub-Saharan Africa
scale: 0 (worst) to 10 (best)

IEF2009:
The Heritage Foundation, 2009 Index of Economic Freedom
179 countries surveyed, including 46 in Sub-Saharan Africa
scale: 0 (worst) to 100 (best)

The Index of Economic Freedom by the Heritage Foundation consists of ten components for each country: Business Freedom, Trade Freedom, Fiscal Freedom, Government Size, Monetary Freedom, Investment Freedom, Financial Freedom, Property rights, Freedom from Corruption, Labour Freedom. Table 7 shows the overall index as well as the figures for Government Size and Freedom from Corruption which are of specific interest in this context. The overall index – as well as the single components – scale from 0 to 100, where 100 repre-

[71] Heritage Foundation (2009), see http://www.heritage.org/index/Default.aspx.

[72] Fraser Institute (2008), see http://www.freetheworld.com/release.html.

[73] Transparency International (2008), see http://www.transparency.org/policy_research/surveys_indices/cpi/2008.

sents the maximum freedom. Uganda, with a score of 63.5, has the highest rating of the EAC Partner States (rank 63 of 180 evaluated countries. For comparisons: the United Kingdom has rank 10 and Germany rank 25. Ratings between 69.9 to 60 are denoted as “moderately free”, while ratings between 59.9 and 50 are identified as mostly not free (below 50 as repressed). Burundi has with 48.8 shows lowest rating and the rank 153. Regarding Government Size Uganda with 86.9 again has the best rating and is ranked 36th. Considering Freedom from Corruption all Partner States are rated as “repressed” (below 32, where Tanzania with a rank of 95 is the best), while Burundi (rank 133) and Kenya (rank 152) have the worst positions. It has to be added that the ratings for the Partner States since 2000 are more or less stable, while Burundi and especially Rwanda have considerably improved their positions.

The Economic Freedom of the World index of the Fraser Institute in Vancouver/Canada consists of eight components: Size of Government, Legal System and Property Rights, Sound Money, Freedom to Trade Internationally, Regulations, Credit Market Regulations, Labour Market Regulations, Business Regulations. The rating for the Government Size as well as the summary rating principally shows a similar sequencing as the investigations of the Heritage Foundation. Table 6 also represents the figures for the Corruption Perception Index (CPI) of Transparency International. Rwanda and Tanzania score best with 3.0, a rank of 102 out 180 countries evaluated and rank 16 out of the 48 Sub-Sahara countries. The sequence for the other Partner States is similar to that of the Heritage Foundation. With regard to such indices, the EAC Partner States still have to improve the conditions for economic freedom and the compliance regarding a strict code of conduct for the public administration including the tax authorities.

For the evaluation of the volume of the cross-border transactions between the Partner States the export and/or the import volumes are of utmost relevance. Because the analysis of the export flows has rendered some problems and implausible results, in the following the stress has been put on the import flows. Table 8 represents the import and export matrix between the EAC Partner States. For example, Burundi has a total import volume of 60,9 mill USD in 2006, the bulk stemming from Kenya (35,4 mill. USD) and Uganda (16,9 mill. USD). Burundi’s exports to the other Partner States are 9,9 USD so that the internal trade balance deficit to the EAC Partner States is 51,0 mill. USD. The largest exporter within the internal EAC market is Kenya with a volume of 674,9 mill. USD, which is 75.5% of the total import volume within the EAC (894,2 mill. USD).

Table 8: Import and Export Matrix of the EAC Partner States

Imports To\From	Burundi	Kenya	Rwanda	Tanzania	Uganda	
Burundi	---	35,4	1,0	7,6	16,9	60,9
Kenya	4,7	---	2,9	62,6	13,9	84,1
Rwanda	4,0	69,4	---	8,3	61,6	143,3
Tanzania	1,0	169,1	0,1	---	5,3	175,5
Uganda	0,2	401,0	0,5	28,7	---	430,4
	9,9	674,9	4,5	107,2	97,7	894,2

Exports To\From	Burundi	Kenya	Rwanda	Tanzania	Uganda	
Burundi	---	30,3	0,4	31,0	20,6	82,3
Kenya	1,2	---	29,9	97,2	88,0	216,3
Rwanda	3,1	66,1	---	9,1	30,5	108,8
Tanzania	0,0	253,6	0,9	---	13,2	267,7
Uganda	1,2	385,7	1,9	20,5	---	409,3
	5,5	735,7	33,1	157,8	152,3	1084,4

Source:
EAC, East African Community Facts & Figures - 2008
in mill. $US (2006)

the import volumes reflect the economic strength of each member country, which is also expressed by the differences in the GDP per capita mentioned in Table 5. Therefore, Kenya has a trade balance surplus with each member country and a total surplus of 590,5 mill. USD. It is the only Partner State with a trade balance surplus while all the others have more or less high deficits, which are largest in case of Rwanda and Uganda.

The import flows determine the distribution of the indirect tax revenue to the member countries depending on the tax principle (destination or origin principle) applied in the common or single market. If the destination principle is applied, which efficiently functions in case of existing border controls, imports are taxed with the national excise and VAT rates and the revenue is with the importing country. If border controls are to be abolished to implement a single market as a pre-stage of a currency union then the origin principle is much more efficient than the destination principle (or any other mix of principles like applied in the EU, see above). The consequence would be a shift of indirect tax revenue in favour of the net-exporters, meaning more or less serious revenue losses for the usually smaller net-importing member countries. Such revenue shifts can be estimated if the single tax bases are statistically available. Then at least temporarily compensation payments via a clearance office have to be taken into consideration.

While the internal export/import relations are a measure of the status and the development (in case of available time series data) of the integration process within the common market, the trade with third party countries gives an impression of the integration into the larger regional markets or even into the global economy. Therefore the investigations should be extended to the trade with third party countries with the purpose to identify possible partners for further integration perspectives. The relatively small number of existing double taxation agreements (DTA) with third party countries[74] as well as the certain delay in the negotiations

[74] For more information see Tarimo (2009) and the table on p. 16 of that paper.

of the DTA for the EAC Partner States[75] points to the fact that in the past such arrangements had only limited relevance. With the ongoing integration processes in the direction of a common market and the integration in a broader international economic community, such treaties gain importance and have to be negotiated in due time.

VI. Overview on the National Tax Systems

VI.1. General Structure of the Tax Systems and Composition of Tax Revenue

This report concentrates on the tax systems and the analysis of the different taxes within the EAC member countries. The report mentions only the most important elements. More details can be found in the overviews in Appendix 4 (see tables A3 to A5). Import duties are not under consideration.[76] With the implementation of the Customs Union on 1 January 2005, a five-year phase-out of internal custom duties was decided, which will be finished on 1 January 2010.[77] From then on, only common external custom duties will apply. The revenues of the common external tariff (CET) are still directed to the national budgets.[78] The multiple memberships of EAC countries in other regional blocks are also not under consideration.[79] The general patterns discussed here apply to all regional integration processes, so that even competition with other blocs or a further enlargement of the EAC have to be borne in mind.

Modern tax systems consist of a limited number of indirect and direct taxes, the former bound to income use, the latter related to income formation. The main components of indirect taxes are the excise taxes (and similar taxes) levied on consumption goods and the VAT as a general consumption tax. Direct taxes are income and profit taxes (on labour and capital income) often accompanied by property taxes. In the industrial countries the relevance of direct taxation for the total tax revenue is substantially higher than in the developing countries due to a higher share of official market income. All Partner States of the EAC have quite a similar tax structure regarding the main components. The above mentioned main excise taxes are implemented (in partly different definitions of tax bases and composition as well as on a specific or ad valorem tax base), a VAT system is existing (or on the way to be introduced), and personal income (at least payroll taxes) as well as profit taxes (corporation taxes) are traditionally implemented. The structures of the personal income (PIT) and corporation tax (CIT) are quite different; especially the definitions of the tax bases are extremely heterogeneously composed and a mixture out of the enumeration of taxable and (partly) non-taxable components (for example in Rwanda) often connected with specific tax schedules for

[75] The DTA has been in the focus of the Fiscal Affairs Committee meeting in January 2009; see EAC Secretariat (2009).

[76] For the relevance and problems of import duties see Cnossen (2008).

[77] For more details see M.A. Consulting Group (2007).

[78] In the EU the returns from the external custom duties are revenue of the European budget.

[79] Burundi is also member in the CEPGL (Economic Community of the Great Lakes Countries), the ECCAS (Economic Community of Central African States)), and the COMESA (Common Market for Eastern and Southern Africa). Kenya is also member of the COMESA and the IGAD (Inter-Governmental Authority on Development). Rwanda is member of the CEPLG and the SADC (Southern African Development Community). Tanzania is also member of the SADC and Uganda of the COMESA and IGAD.

specific kinds of income (for example in Uganda). Such systems are not neutral on the national economy and create even more problems in common markets.

Due to the very tight time schedule of the mission, the following analyses are limited to the main excise taxes, the VAT system, the corporate taxation, the tax procedures and the practical implementation and administrative practice. The focus is laid upon the basic differences within the tax base definitions and the tax schedules applied. Concerning problems of tax incentives and harmful tax competition the expert group also refers to the results of the 2003 IMF mission. The problem of the relation between tax expenditures and state aid has also to be mentioned and was tackled again at least partly in the EAC Common Market Study.[80]

In spite of the fact that there are still considerable differences in the definitions of the tax bases, the rates as well as the schedules, the EAC has already passed through a process of harmonisation,[81] which is quite remarkable if the results are, compared to the long lasting developments within the EU (see the figures A1 to A5 and the table A1 in the appendix 4). Regarding the tax rates, the VAT rates have been harmonised on a range between 16% (Kenya) and 20% (Tanzania). The other Partner States apply (or will apply) a rate of 18%, while the systems are predominantly single rated.[82] At least in four member countries the CIT rates are 30% and even the highest marginal rate of the PIT has been fixed on the same level, while Burundi has a progressive tax schedule for rental income and wages starting with 20% resp. 27% and ending with 60%. Beside the rate harmonisation many elements of double taxation still exist especially connected with the different withholding taxes especially on dividends applied within the Partner States. Therefore, the negotiations on the avoidance of double taxation in the EAC are of utmost relevance.[83]

Table 9 delivers an overview on the current structure of the tax revenue for the Partner States of the EAC.[84] Unfortunately for Burundi no revenue data was available. In the other four Partner States the VAT constitutes the tax with the highest revenue between 32% in Tanzania and 36% of total tax revenue in Kenya. The second position is taken by the pay-as-you-earn taxation (wage tax) between 14% in Uganda and 26% in Kenya (neglecting the taxes on external trade, which are very important in Uganda and Tanzania, having the highest import values). The third position is taken by business income tax, which is between 7 % in Uganda and 23% in Kenya. Much less significant are the excise taxes, which deliver between 6% (Kenya) and 8% (Tanzania) for the three biggest, while only Rwanda is more dependent (13%) on this revenue source.

[80] See M.A. Consulting Group (2007); here especially the remarks on customs harmonisation (pp. 18), harmonisation of CIT (pp. 22) and on state aid (pp. 56) including the problem of Export Processing Zones (EPZ) are important.

[81] See IMF (2003, p. 8).

[82] See also the achievements mentioned on the EAC homepage, http://www.eac.int/about-eac/achievements.html?start=1.

[83] See Tarimo (2009) and Kamulegeya (2009).

[84] Question marks are put if the values were not available or could not be verified. Here further clarifications have to be done in future project missions. Regarding the tax revenue of the single taxes under consideration, the ArUGXa office of the GTZ project has made inquiries to the national tax authorities but predominantly got no answers.

Table 9: Tax Revenue Comparison in the EAC Partner States

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Total Tax Revenue[1]	**n/a**	**4822,4**	**603,6**	**2532,2**	**1525,7**
Indirect Taxes					
Excise Taxes					
Beer	25,8	145,4	31,5	69,3	106,5
Wine, Liquor, Spirits, etc.	n/a	12,7	1,3	1,4	
Bottled Water	1,5	18,5	9,1	-	
Soft Drinks		15,3		13,1	
Juices	n/a	n/a		-	
Cigarettes	2,1	86,7	6,0	41,0	
Fuel	n/a	59,0	11,5	7,0	
Motor Vehicles	n/a	n/a	3,1	39,6	
Cellular Phone Services	n/a	84,0	3,1	30,4	
Other Excises[2]	0,4	32,0	13,2	4,8	
VAT - Domestic + Import	n/a	1745,8	205,6	832,8	549,8
Taxes on External Trade	n/a	462,1	102,7	730,7	472,0
Direct Taxes					
Business Income Tax	n/a	1095,9	99,4	311,1	111,5
Wage Income Tax (PAYE)	n/a	1237,8	111,5	387,7	212,9
Withholding Taxes	n/a	n/a	n/a	58,1	60,8
Other Direct Taxes[3]	n/a	n/a	5,6	80,2	31
Other Taxes	n/a	n/a	n/a	16,4	29,6
Tax Refunds	n/a	-172,8	n/a	-91,4	-48,4
Tax Revenue Composition[4]					
Excise Taxes	n/a	6%	13%	8%	7%
VAT	n/a	36%	34%	32%	35%
Taxes on External Trade	n/a	10%	17%	28%	30%
Business Income Tax	n/a	23%	16%	12%	7%
PAYE	n/a	26%	19%	15%	14%
all others	n/a	n/a	1%	5%	7%
Population (million)[5]	8,7	37,7	9,5	40,0	28,6
Wage taxpayers	n/a	n/a	103033	n/a	n/a
GDP (2008)	1116	41896	3816	18346	16611
VAT Rate	18%[6]	16%	18%	18%[7]	18%
VAT Base (estimated)	n/a	10911	1142	4164	3054
VAT Base / capita (USD)	n/a	289	120	104	107
VAT Base / GDP	n/a	26%	30%	23%	18%
PAYE / taxpayer (USD)	n/a	n/a	1082	n/a	n/a

Sources:
Kenya Ministry of Finance, Budget Outlook Paper 2009/10 - 2011/12
Rwanda Revenue Authority, Annual Report for 2008
Tanzania Revenue Authority, TRA Quarterly Tax Revenue Collections 2007-08
Uganda Ministry of Finance, Planning and Economic Development, Background to the Budget 2008/09 Fiscal Year
Additional data supplied by project partners

all monetary figures in million USD unless noted

Revenue years: Burundi 2008, Kenya 2007/08, Rwanda 2008, Tanzania 2007/08, Uganda 2007/08

Exchange rates (July 1, 2009):
Burundi: 1000 BIF = 0.840 USD
Kenya: 1000 KES = $13.123 USD
Rwanda: 1000 RWF = $1.759 USD
Tanzania: 1000 TZS = $0.757 USD
Uganda: 1000 UGX = $0.483 USD

Notes:
[1] accounts for tax refunds if known; Kenyan tax revenue may be understated due to missing figures
[2] may include excises listed above but marked unknown
[3] may include direct taxes listed above but marked unknown
[4] excludes tax refunds; may not sum to 100% due to rounding
[5] at mid-point of revenue period, estimated
[6] 18% VAT rate introduced July 1, 2009; no VAT prior to this date
[7] VAT rate reduced to 18% July 1, 2009; previous rate 20%

The per capita tax bases and the relation of tax basis to the GDP are another good indicator for the development of tax systems. For this analysis the VAT base has been roughly estimated and the per capita amount determined. Compared to the GDP per capita (see table 6 above) the VAT base is smaller: in Kenya (289/724.5) 39.9%, in Rwanda (120/365) 32.8%, in Tanzania (104/440) 23.6%, and in Uganda (107/472.8) 22.6 %. These relations point to the fact that the share of household consumption or local production in the overall consumption is still comparatively low; in other words the shadow economy is still dominating within the Partner States, although to varying degrees.

If the VAT tax base is set in relation to GDP, the different percentages also point into the direction of the differences within the definition of the tax bases. Here Rwanda has the highest relation of 30%, which also points to the fact that still products from the shadow economy play an important role. Kenya (28%), Tanzania (23%) and Uganda (18%) have lower figures, which may at least partly be caused by the differences in tax exemptions and zero rated goods and services.

Only for Rwanda the share of PAYE among taxpayers is available. This figure demonstrates that the average wage earned (1082) is almost three times as high as the per capita GDP (365.0) in Rwanda.

All these figures are important indicators for the development process and should be determined by the national statistical offices and the EAC.

VI.2. Value Added Tax (VAT)

Within the EAC especially the three older Partner States have long lasting experiences with VAT systems. Kenya implemented the VAT in 1990, Tanzania in 1996 and Uganda in 1998, while the recently acceded members Rwanda and Burundi introduced VAT and the “taxe sur la valeur ajoutée” in 2001 and 1 July 2009 respectively.

The VAT systems are principally in accordance with international standards, e.g. the right to deduct the input tax, to exempt exports, to burden the consumer instead of the corporation and to avoid the cumulative impacts of gross turnover taxes. The following the description of the different country systems follows the structure (general aspects, output tax, input tax, procedures, special schemes) given in the Table A3 in Appendix 4. Due to limited space, only the main elements have been considered. The general features are described in detail only for one country; for the other countries only the most important divergences are mentioned.

VI.2.1. Kenya

VAT in Kenya is regulated by the Value Added Tax Act CAP 476 and the Subsidiary Legislations (Revised Edition, 2004).[85] The taxpayer is defined as a taxable person being liable to apply for registration. Registration can be mandatory or on a voluntary basis. The threshold for registration is 5 mill. KES/year (66,000 USD). Taxable transactions are the supply of goods and services as well as imports. The time of supply for goods and services is the date of delivery or invoice, or the time of part or full payment. In the construction industry the certificate of completion may be decisive – whichever date is earlier. In case of taxable imported services the time of supply is the date when the service, the invoice, or the part or full payment has been received – again whichever date is earlier. The place of supply is where goods and services are a taxable supply.

Exemptions are regulated in the 3rd schedule and comprise financial and insurance services, education and training services, health and sanitary services, agricultural services, social welfare services, burial services, transportation services, renting and leasing of land and residential buildings, postal services, tour operations and travel agencies, entertainment services, accommodation and restaurant services, conference services, car park services and transportation of tourists – this is the longest list of all member countries. Tax relieves are specified in schedule 8 (president, armed forces, other government, diplomats, aid agencies, charitable institutions, disabled persons, police) and zero rated supplies in schedule 5 (an extremely long list consisting of agricultural inputs and products, foodstuff, pharmaceutical products, medical equipment, educational equipment, etc.).[86]

The tax base of the VAT is the price for which the supply is provided (dealing at arm’s length) and the customs value for imports. Regulations for tax yield adjustments do not seem to exist. The standard tax rate is 16% and a reduced rate of 12% exists for the supply and import of electricity and fuel. The input tax is paid on the supply or import to a registered person for the use in the business. The input tax is fully credited, unless the input refers to exempt supplies; it is partially credited if input refers to both, taxable and exempt supplies. Regarding the

[85] For more details see Kenya Revenue Authority (2006/2007).

[86] See for more details the Value Added Tax Act (CAP.476), pp. 74-89.

tax procedures, self-assessment is possible.[87] Return and payment has to be done monthly, within 20 days after the tax period. An office assessment is done if no return has been made, failures to apply for registration have happened or failures in book keeping are observed. An interest payment for late payment does exist (not for refund) and penalties and enforcement measures are implemented. Taxpayers can appeal to the Tribunal, and in such cases the full amount of the tax in dispute has to be deposited. As special schemes a reverse charge for imported taxable services is applied and a withholding tax implemented.

VI.2.2. Uganda

The Value Added Tax Act of 1996 defines the taxpayer as a person (individual, partnership, trust, government, authority) who provides or expects to provide taxable supplies. The threshold for registration is 50 mill. UGX/year (24000 USD/year). Voluntary registration is possible. Taxable transactions are the supply of goods and services as well as imports. The time of supply is when goods are made available to the recipient or services are performed; an earlier point of time has to be taken into consideration if invoice or payment has been received before. The place of supply for goods is where goods are delivered or made available; the place of supply for services is where services are rendered.

Tax exempt goods and services are listed in schedule 2 and comprise unprocessed agricultural products and food, financial and insurance services, health supplies, educational and social welfare services, veterinary equipment, passenger transport services, supply of unimproved land, lease of immovable residential property, transfer of business as a going concern, supply of petroleum fuels subject to excise taxation, computers and software, and funeral services.[88] Zero rated supplies (schedule 3) are exports, international transport, drugs and medicines, educational materials, pesticides, fertilizers etc., cereals produced in Uganda, machinery for agriculture and milk products. The tax base is the total consideration or fair market value, in case of imports the customs value. Tax adjustments are possible if the supply is cancelled, consideration altered, goods and services returned or if the supply has not been paid for. The standard tax rate is 18% and a reduced rate of 5% exists for the sale of residential apartments.

The input tax is levied on taxable supplies or imports for the use in the business sector and has to be stated in a tax invoice. A credit of the input tax is granted fully unless the input refers to exempt supplies or partially if the input refers to both, taxable and exempt supplies. The credit arises – provided the invoice is issued – on the date the supply is carried out or in case of cash accounting on the date the tax has been paid. The credit normally results into an offset against future liabilities refund; if output is mainly zero-rated, in case of investment traders and if the credited amount exceeds 2500 USD the refund takes place within one month. Regarding the tax procedures a tax identification number (TIN) is existing, self-assessment is applied and the return and payment has to be done monthly 15 days after the tax period. An office assessment is done if no returns (or estimates) are submitted and after a tax audit. Interest payments for late refunds do exist as well as penalties for failures to submit returns etc. In case of no tax payment specific enforcement procedures are applied and audits are done depending on risk management considerations. Taxpayer appeals within

[87] The existence of a TIN could not yet been clarified.

[88] Only examples but not the full catalogues are presented here. For more details see the tables in the appendix 4 below.

30 days to the tax administration and subsequently an appeal to the Tax Appeals Tribunal are possible. In case of imported services a reverse charge also can be applied.

VI.2.3. Tanzania

The Value Added Tax Act of 1997 does not define the taxpayer. The threshold for registration is 40 mill. TZS/year (30000 USD/year). The place of supply for goods is outside Tanzania if it is installed or assembled there, inside Tanzania if the supplier has a place of business there. The exemptions are similar as in Uganda, however, machinery used for processing of agricultural products, computers and software are not tax exempt. Water except drinking water, is tax exempt. Military, railway, mining, religious institutions, water authorities, public infrastructure projects, diplomats etc. are VAT exempt. Only exports are zero-rated. The tax base is the amount of net consideration, at least the market value and the customs value of imports. The adjustment of the tax yield remains questionable, while the standard tax rate is 20% and was reduced to 18% in the Budget Speech 2009. The tax credit only arises on the date the supply is carried out; there is no regulation like cash basis accounting. A refund only happens if an offset is not possible within six month after the due date for lodging the return and a monthly refunds takes place in case of a continuous excess of input tax. Regarding the procedures, return and payment has to take place monthly, 30 days after the tax period. There is an interest payment for late payment and refund. Appeals to the board are possible within 30 days, followed by an appeal option to the Tax Revenue Appeals Tribunal (provided 50% of the disputed amount has been paid). There seem to be no special schemes.

VI.2.4. Burundi

The «Loi portant institution de la taxe sur la valeur ajoutée 'TVA'», has been implemented on 1 July 2009. The taxpayer is legally defined as everyone who carries out taxable supplies that exceed a certain turnover (determined by the Minister of Finance) or issues an invoice disclosing a certain amount of VAT. The threshold is 100 mill. FBU (82,000 USD). Taxable Transactions are the supply of goods and services, imports and in addition the withdrawal of business assets. Suppliers of services are entitled to opt for taxation from the beginning of an accounting year.[89] The option has to be announced at least two months in advance and entails a binding period of four years. If the amount of a taxpayers' annual turnover remains below the threshold in two succeeding accounting years, taxation comes to an end from the beginning of the following year. The place of supply of goods is not clearly determined in the law in cases of trans-border transactions. Since the exportations are taxed with zero-rate, the conclusion can be drawn that the place of supply is Burundi if the merchandise is sent from Burundi (principle of origin). Deviating from this principle the place of supply of electricity, gas and heat will be Burundi whenever the final consumption takes place in Burundi (principle of destination).

The place of supply of services is determined by where the service has been carried out or used.[90] The seat or residence of the supplier is not relevant in this context. This regulation is not in compliance with worldwide accepted principles (e.g. in the European Union). Double

[89] There is also a right for option for importing enterprises (Art. 36 of the law).

[90] The regulation in detail (Art. 5 lit. b and c of the law): Taxation in Burundi if "il s'agit de travaux immobiliers, lorsque ces travaux sont effectués au Burundi" or "il s'agit de toute autre operation, lorsque le service rendu, le droit cédé ou concédé , l'objet ou le matériel loué est utilisé, initié ou exploité au Burundi".

taxation effects might arise in trans-border activities if the other EAC countries have arranged this item in different ways. The law has not provided for a reverse-charge system with trans-border activities in case the place of supply is Burundi and therefore the foreign supplier is subject to taxation in Burundi. On the other hand Burundi regards supply of energy (electricity, gas, heating) and water as “goods” (place of supply is the place of consumption), which is not in accordance with the other Partner States.

The date of origin (fait générateur) of the VAT is the moment when the supply of the merchandise or the service has been carried out. The tax for the supply of goods is payable (eligible) in the same period of taxation. The tax for the supply of services falls due when the supplier has received the payment. The list of exemptions is much shorter than those ones of Uganda, Tanzania and Rwanda. Tax relief is possible for diplomats and international organizations. The taxable value of the supply – as the tax base – is determined as follows: The consideration paid in money or kind by all persons for that supply. All additional costs like transportation costs, insurance and others that are included in the invoice of the supplier are to be taken into account as well as price reductions and other sorts of discounts granted by the supplier. In case of the withdrawal of business assets the regular price or the replacement value is relevant.

The law allows for adjustments with later events like impairment of performance and rescission of the contract. The deduction of the input tax has to be rectified, if the purchased merchandise has disappeared (“ont disparu”). On condition that a tax fraud can be ruled out, this regulation is obviously not in line with the VAT system. The case of insolvency of the recipient (irrecoverable debts) is not regulated expressively. Thus, it remains unclear whether or not the supplier is entitled to get a reduction of his tax burden. The tax rate is 18% of the tax base.

The deduction of input-tax is principally guaranteed. However, the law provides for an important restriction: The input tax related to investments and connecting costs is deductible only up to 50%. This is contradictory to the general principles of the VAT system. Officials of the tax authority have justified this regulation indicating the difficult budget situation in Burundi and the uncertainty of tax revenues in the wake of the new tax.

A deduction of input tax is not allowed if this tax is attributable to the own tax-exempt activities of the taxpayer. This is absolutely in compliance with the VAT system. Other restrictions on input deduction, e.g. in connection with costs of accommodation, restaurant visits and others are common and generally accepted in other countries. Moreover, certain products of oil or petroleum are excluded from the input deduction system.[91] There is no regulation that input tax can only be deducted partly (proportionally) if the merchandise is attributable as well to taxable as to tax exempted activities.

If the amount of VAT on own activities is exceeded by the amount of input tax, the taxpayer is entitled to claim a refund. Regularly the claim is supposed to be set off with the tax liabilities resulting from taxpayer’s succeeding tax declarations. If the taxpayer terminates his business activities, he can claim a refund as well as the taxpayer who permanently records a claim of refund in a period of a trimester (like exporters). The refund has to be paid within a period of three months. If this fails the taxpayer can claim an additional interest of 1% per month. The responsible official of the tax authority is to be charged with this amount. The

[91] Art. 39 of the law.

refund is only to be paid if the amount exceeds 15 million FBU per trimester or 10 million FBU in the accounting year[92]. The tax authority can carry out audits in order to scrutinize the claimed refund.

The law does not provide for special regulations for certain businesses or professions (like farmers). Also a special difference-taxation system (like in the European Union) is not applicable.

VI.2.5. Rwanda

As mentioned before the VAT was introduced in Rwanda in 2001.[93] The law has been supplemented by a ministerial order of 2003[94] and some rules issued by the General Commissioner.[95] A larger part of the law (Art. 52 – 78) was repealed by the law on tax procedures in 2005[96], which now contains special procedural regulations devoted to the VAT. Like in the case of Tanzania the taxpayer is not legally defined within the Rwanda VAT law. The threshold for registration is 20 mill. FRW/year (35000 USD) or 5 mill. FRW (8750 USD) for the last three months. It is fixed by the Law on Tax Procedures.[97] Voluntary registration is possible. The taxable transactions are the same as in Burundi but the transfer of a whole business is not liable to VAT.

The determination of the place of supply of goods or services is crucial for Rwanda's right to levy the VAT. If the place of supply is located abroad, Rwanda is not entitled to tax this transaction. The place of supply of goods is in Rwanda if they are removed from a place in Rwanda in order to be used or processed in Rwanda or if they are exported or temporarily exported from Rwanda (principle of origin). In cases of uncertainties of the application of the law the Minister is empowered to make provisions by order in relation to a case or a class of cases with respect to the proper determination of the place of supply. Such an order is binding for the courts of justice.[98]

Services are regarded as supplied in Rwanda if the supplier of the service a) has a place of business in Rwanda and no place elsewhere; b) has no place of business in Rwanda or elsewhere but his usual place of residence is in Rwanda; c) has places of business in Rwanda and elsewhere but the place of business most directly concerned with the supply of services in question is the one in Rwanda; or d) has no place of business in Rwanda, has a place of business elsewhere but the recipient of the service uses or obtains the benefit of the service in Rwanda.[99] In this last case, the recipient is liable to tax on condition that he runs a business. He withholds the tax and pays it to the tax authority (reverse charge method).[100]

[92] Order by the ministry, legal basis in Art. 20 of the law.

[93] Law No. 06/2001 of 20/01/2001 on the Code of value added tax. This law repealed the ICHA (Impôt sur les chiffres d'affaires), which was a tax on turnover (sales tax).

[94] Ministerial Order No. 001 of 13/01/2003 Providing for Value Added Tax Rules and Taxation Procedure.

[95] Commissioner General's Rules No. 01/2001 of 01/08/2001 Governing VAT; No. 02/2002 of 30/12/2002 and No. 04 of 02/06/2005.

[96] Law No. 25/2005 of 4/12/2005 on tax procedures.

[97] Art. 10 Law on tax procedures.

[98] Information from the Tax authority in Rwanda.

[99] Art. 9 of the law.

[100] Art. 29 (2) of the law.

The Minister is entitled to issue regulations related to the application of the law whenever difficulties arise about interpretation of the law. Effects of double taxation or non-taxation in cases of cross-border supply of services may happen. If for instance a supplier with a residence in Rwanda carries out a service that is used in Burundi, Rwanda as well as Burundi can claim the right of taxation.[101]

Rwanda has a long list of tax exemptions which encompasses almost all items mentioned earlier for the other Partner States. In addition a long list of zero rated supplies does exist (see table A3 in the appendix 4). The taxable value of a taxable supply is the consideration paid in money or in kind by all persons for that supply. Price reductions and discounts for prompt payment reduce the basis of taxation correspondingly. This does not apply to payment by instalment.

Deviating from this principle the taxable value of the taxable supply is the open market value of the supply exclusive of the VAT, where goods or services are supplied: for non-monetary consideration, or for both a monetary and non-monetary consideration, or for a consideration that is lower than the open market value of the goods or services.[102]

This exception is obviously not in line with the generally applied VAT principles because the tax law regularly has to follow the contracts concluded under civil law on condition that tax evasion can be ruled out. The tax authority in Rwanda has commented on this observation that this regulation does not play any role in practice. Nevertheless this item should be kept in mind for further attempts to harmonize VAT in the EAC region.

The law provides for regulations concerning the adjustment of tax in case of succeeding events which have impact on the basis of taxation[103]. In cases of bad debts the tax administration can grant a tax relief in favour of the taxpayer.[104]

The standard tax rate for supply of goods or services or importations is 18%. The input tax is deductible when the recipient has acquired the goods or services for the purpose of his business. The amount of the tax – alongside other formal requirements – must have been disclosed in the invoice of the supplier. Payment is not required for deduction, except for deduction of VAT on importation. Condition for deduction of the whole of input tax is the tax liability related to the own business activities of the recipient. If these activities are tax exempted or partly tax exempted the deductible amount of input tax has to be reduced proportionally. The law has empowered the Minister to determine areas where a deduction of input tax is not allowed.[105] The corresponding order[106] provides for exclusion of deduction as follows: input tax on motor cars (with some exceptions); input tax on business entertainment; input tax on telephone, fuel and power services (on particular conditions),

[101] If the supplier has no place of business in Rwanda, the place of supply is supposed to be in Rwanda in case the service is received there. In the reverse case a service might be taxed in Rwanda as well due to the principle of origin. Double taxation effects will occur. These examples demonstrate that the definition of the place of supply in case of services is decisive for the avoidance of double taxation.

[102] Art. 16, 17 of the law.

[103] Art. 20 Ministerial Order of 13/01/2003.

[104] Art. 80 lit. f of the law, Art. 67, 68 of the Ministerial Order of 13/01/2003.

[105] Art. 44 of the law.

[106] Ministerial Order of 13/01/2003, Art. 26 – 29.

The deduction of input tax on goods that are used for export is linked with the condition that the proceeds of this export are repatriated into Rwanda. The same order excludes the deductibility of input tax in cases of "imported services" under the regime of reverse charge (see above). This interdiction has been alleviated by a rule of the Commissioner General[107]:

"Consumers of services which are not available on the local market can be allowed to deduct VAT reverse charge. Services are deemed not to be available in the local market if there is no single firm producing similar or identical services in the local market."

The last two exceptions from deductibility of input tax are aiming at protecting and strengthening the internal market in Rwanda. However, they are contradictory to the idea of the VAT system (of neutrality) and the free movement of capital within the EAC.

If the amount of deductible input tax exceeds the VAT on taxpayer's taxable activities, he is entitled to get a refund. The corresponding amount has to be remitted to the taxpayer within 30 days after the end of the prescribed period for filing return or the receipt of the last outstanding tax return due, respectively. If there are any reasonable doubts on the authenticity of the claim, verification can be carried out prior to payment. In any such case, the period for the response to be communicated shall not exceed three months from the date when the claim was lodged.[108]

VI.3. Excise Taxes

The EAC Partner States are charging the consumption on the basis of quite different legal constructions. Uganda and Tanzania are still using the old Management and Tariff Act of the former Community; this act dates back from 1954. Kenya and Rwanda have implemented a new law, which is structured quite differently. Burundi has up to now no separate law for the implemented excise taxes. A set of the most important excise taxes and their tax rates are presented in table 10 below.

VI.3.1. Kenya

Excise taxes in Kenya are based on the Customs and Excise Act. Chapter 472 of 1977 in the revised edition of 2000. The most important excises are – following international standards – charged on beer, wines, spirits, soft drinks (like mineral water and juices), cigarettes, and fuel. Beside these excises the taxation of motor vehicles and airtime (service fees on cellular telephones[109]) exists. Almost all excise taxes are levied on a specific rate base. Table 11 below shows the rates applied until 15 June 2009. The motor vehicle tax has a uniform rate of 20% while the cellular phone services are charged with 10%.

[107] Rule of 02/06/2005 governing VAT.

[108] Art. 49 of the law, additional provisions in the Commissioner General's rule of 01/08/2001, Art. 29 – 37 including a regulation of interest of 1.5% per month in favour of the taxpayer in case of delayed refund.

[109] Between the MoF of Kenya, Tanzania and Uganda in 2005 an agreement has been made to unify the tax rates on „mobile and other wireless telephone services". The current rates are 10% in Kenya, 7% in Tanzania and 12% in Uganda. Until today this accord has not been implemented. An exchange of experiences on the auditing process respecting the telecommunication companies perhaps might be helpful, which is seen „a very, very big challenge" by the KRA.

Kenya is the only Partner State of the EAC to have implemented a special task force "Domestic Excise" within the Kenya Revenue Authority (KRA).[110] In view of the EAC customs union implemented in 2005, the hitherto existing law on excises was regarded as outdated and separated from the customs area as a specific "Excise Act". This bill is currently in the parliamentary consultation procedure. How far the current shortcomings ("bad legislation, thousands of loopholes") will be abolished in that new draft is currently unclear. However, with the abolishment of some ad valorem tax rates in the past and the introduction of specific tax rates, Kenya has already contributed to more transparency within the excises.

The Budget Speech of 14 June 2009 (Budget Day) announced new tax rates for some of the excise taxes to be implemented starting from 15 June 2009. These rates are shown in the following Table 10.

Table 10: New Excise Tax Rates in Kenya

	Rates Removed	Rates in use
Soft carbonated drinks and juices	7% per litre	10 % per litre
Mineral waters	KES 6.00 or 10 % per litre	KES 3.00 or 5 % per litre
Sparkling wines and fortified wines	KES 7 per 1% per alcohol per litre	KES 70 or 50% per litre
Un-denatured ethyl alcohol	KES 200 or 65 % per litre	KES 120 or 65 % per litre
Compounded spirits	KES 7 per 1 % alcohol per litre	KES 120 or 65 % per litre

Source: KRA (2009). Provisional Collection Order.

Again the tax rates are a mixture of specific and ad valorem rates, which does not contribute to the simplicity and administrative efficiency of consumption taxation.

VI.3.2. Uganda

Uganda is levying excise taxes based on the above mentioned Management and Tariff Act. Chapter 338 ("The Excise Tariff Act", commenced on 1. November, 1954) regulates the details of the excise taxes. Like in Kenya excises are charged on beer, wines, spirits, soft drinks (like mineral water and juices), cigarettes, and fuel. Also taxes on motor vehicles and airtime (service fees on cellular telephones) are raised. Any person manufacturing excisable goods must be licensed by the Commissioner-General of the Uganda Revenue Authority. The license is renewable on an annual basis. The applicant is further required to attach a plan of the factory in which it is proposed to manufacture excisable goods. The excise is accountable by way of a stock book (Form E6) that contains details of the daily receipts into

[110] The personal interviews have shown that this has substantially contributed to enormous gains in efficiency within the administration. Anonymous citation: "Before this there was no documentation, no system, no processing, no procedures".

and delivers from the stock room. Excise taxes are payable when the goods are delivered from the stock room or an invoice is raised.

The tax rates are specified and determined in the Finance Act and have been often adapted in the past. The rates are fixed on an ad valorem base for beer, wine, spirits, carbonated drinks and cellular phone services. In case of the first three items the excise tax rates are substantially higher for imported than local products, which might be interpreted as a discrimination of foreign producers. Cigarettes and fuels are burdened by a specific tax rates levied on production units (pieces or litre).

VI.3.3. Tanzania

The excise tax system in Tanzania is based on the same legal root as in Uganda but obviously has been a bit more modernized in the course of time. Chapter 147 of the Excise (Management) and Tariff Act of Tanzania regulate the details of the excise taxes. Remarkable is the glossary (Part I.2.) in which the relevant terms area defined in more detail. The provisions regarding the taxpayer and the tax liability as well as the procedures are quite similar as in Uganda.

All excises in Tanzania are levied in the form of specific taxes on litres for liquids or pieces for cigarettes. The motor vehicle tax as well as the cellular phone tax is levied in the form of an ad valorem tax, which makes sense because these taxes are similar to a partial sales (or service) tax on these two items. Because of the different rate structures in Uganda, Rwanda, and Burundi (ad valorem base) a cross country comparison of the tax burdens is not possible, which causes in-transparency within the community.

VI.3.4. Burundi

Until very recently the law on Transactions of Burundi from 1989[111] provided the legal base for the excise taxation in Burundi. The ad valorem rates for beer and non- as well as carbonated drinks were 17%; those for wines and other drinks, imported cigarettes and deluxe vehicles were fixed on 20%. These rates were substantially lower than in the other Partner States of the EAC. This law was repealed on 1 July 2009. The legal base for excise taxation (taxe de consommation) is now the Budget Law for 2009[112]. In Art. 24 of the law the tax rates are defined for the first two items on an ad valorem and the others on a specific base as follows:

- For imported wine and liquors: 50% of the customs value[113],
- for tobacco (imported or domestic): 100%,
- sugar (imported or domestic): 400 FBU per kilogram,
- carbonated drinks and beer (imported or domestic): 50 FBU per bottle.

The excise taxes for all goods are levied by the customs authority.

VI.3.5. Rwanda

The excise taxes in Rwanda are charged in accordance with Law N° 75/2008 modifying and completing law No. 26/2006 determining and establishing consumption tax on some im-

[111] Décret-Loi no. 1/04 du 31 janvier 1989 portant réforme de la taxe sur les transactions.

[112] Loi No. 1/36 du 31 décembre 2008 portant fixation du budget general de la République du Burundi pour l'exercice 2009.

[113] To determine by application of the Customs law (Code des douanes)

ported and locally manufactured products. All items are burdened with an ad valorem tax rate. On beer 60% and on wine as well as spirits (brandies, liquors and whiskey) 70% are levied. Fruit juices are taxed with 5%, powdered milk and mineral water have a rate of 10%, lemonade, soda and other juices of 39%, cigarettes have a 150% rate, while all forms of fuel are charged with 76%. For motor vehicles up to 1500cc the rate is 5%, up to 2500cc 10% and above 15%. Telephone communication is burdened with 5%. The taxable value on imported products is calculated to cost, insurance and freight upon arrival in Kigali. On locally manufactured products it is calculated according to the selling price exclusive of taxes.

VI.4. Income and Profit Taxation

The income and profit taxes in the EAC member countries have their roots in quite different tax approaches. While the direct tax systems of the old Partner States were under British influence, the systems in Rwanda and Burundi were much closer to French traditions. In Kenya, Tanzania, Uganda, and Rwanda personal income tax (PIT) and corporate income tax (CIT) are regulated within the income tax act or law, while Burundi disposes of a general tax code. In the following the focus is laid on the CIT because the profit taxation is the most important tax component for the development of a common or single market. However, the structures of the income taxes (IT) are so different and – compared to modern and much simpler systems of income and profit taxation – at least partly outdated, that any fundamental reform process in the direction of neutrality and efficiency within the member countries would create an enormous potential for future welfare gains.

In the following, like in the case of the VAT systems and excises, the description of the single country systems follows a schematic overview (taxation of residents and non-residents as well as the most important elements) as given in Table A4 in Appendix 4. The general features are again described in detail for the first country, and for the other countries only the most important divergences are mentioned.

VI.4.1. Kenya

The income tax in Kenya is regulated by the Income Tax Act, Chapter 470, which came into force on 1 January 1974 after the dissolution of the former East African Community Management Act. The taxpayer is defined as a body being a company incorporated under the law of Kenya, or that the management and control of the affairs of the body was exercised in Kenya in the particular tax period, or that the body has been declared by the minister of finance by notice in the gazette to be resident in Kenya for any year of income. Regarding the scope of income and the personal tax liability the residence principle applies, while the worldwide income principle is implemented regarding the factual tax liability (the income of Kenyan residents in foreign countries is taxed in Kenya, the world-income principle does not apply). The threshold for taxation (that is to say the basic exemption for individuals within the tax schedule) is about 1600 USD/year (see table 11 below).

The tax base under consideration is the business profit, following the International Financial Reporting Standards (IFRS) or comprehensive domestic rules. Revenue expenditures are in general deductible including interest payments. A variety of depreciation rates on capital expenditures exist, amounting to 100% for roads and infrastructure, 12.5% to 37.5% for plants and machinery, and 2.5% and 5% for buildings (see table A4). Capital gains remain untaxed, since the capital gains tax was suspended in 1985. A long list of incomes is exempt from income taxation, e.g., for many boards in the agricultural sector, irrigation sector, the post, some registered pension schemes, specific banks, some advisory activities of international experts, some sort of interests from savings, interests from government securities, etc.[114] In the past losses could be carried forward indefinitely; in the Budget Speech of 11 June 2009 it was announced that losses can be carried forward the year of loss and the next four succeeding years of income. Losses from abroad are not deductible.

The individual (marginal) tax rates are between 10% and 30%; the profits are taxed with the highest individual tax rate (30%). Reduced rates are applicable for companies having been part of an export processing zone (EPZ);[115] after ten years they are taxed by a 25% rate. Newly listed companies with issued shares (20% to 40% hold in the public) are taxed with a rate ranging from 27% to 20%. Dividends are burdened by a withholding tax related to the voting power, and for interest payments not only the above mentioned exemptions exist, but some preferential rates also apply (between 10% and 25%). Royalties and fees are taxed with 5%. Regarding taxation of multinationals, transfer pricing rules apply since 1 July 2006 but thin capitalisation rules and measures against dividend stripping have not been implemented. Regarding tax incentives the above mentioned EPZ allow their companies for a 10 years tax holiday, and initial capital allowances are given in respect to the capital expenditures to the hotel sector, the manufacturing, and the shipping sector.

Regarding the procedures every person with chargeable income in the income tax is required to obtain a personal identification number (PIN); the tax period is the calendar year. Self-assessment based on a return is possible and the return should be submitted until 30 June of the following year. The payment has to be done within four months of the following year. Prepayments have to be made in form of four instalments based on the previous year's income. Audits, penalties and enforcement envisaged and executed.

The taxation of non-residents follows the source principle (see table 2 above) without any specifications. The withholding tax rates are the same as for residents with the exception of qualifying interest payments. Royalties and service fees are taxed with 20%, immovable property with 30% and other property with 15%.

VI.4.2. Uganda

In Uganda the income tax is levied following the Income Tax Act 1997, CAP. 340. The taxpayer is defined as a company which is incorporated under the Uganda law or undertakes the majority of its operations in Uganda. The scope of income follows the residence principle and the world-wide income principle (see table 3 above). The threshold for taxation of individuals is about 690 USD/year. The tax base under consideration is the business income which includes components listed in Part IV of the Income Tax Act (Chargeable Income, 18. Business Income: some capital gains, income from stock trading, some forms of interest and rents). The profit is defined following generally accepted accounting principles and special statutory rules. Expenditures are generally deductible, including interest payments and expenditures for research and development. Depreciation rates on capital expenditures are between 20% to 40%. Non-deductible are the income tax itself and distributed profits. In contrast to Kenya, capital gains are taxable at the same rate as other profits and no relief is allowed for inflation or reinvestment. Dividends from controlled companies are exempt if the

[114] The so-called First Schedule is part of the Income Tax Act, pp. 157-165.

[115] For more details see http://www.epzakenya.com/.

recipient holds at least 25%. Losses can be carried forward indefinitely. Losses abroad can only be offset against foreign profits.

The individual marginal tax rates range between 10% and 30%. Profits are normally taxed with 30%. For mining companies rates between 25% and 45% are applied. A tax credit for the withholding tax on earned income is generally allowed as well as a foreign tax credit. The rates of the withholding taxes on distributed income are 15% for dividends and interest payments. If interest payments are paid by listed companies to individuals, a 10% rate applies. Royalties, fees and rents remain untaxed. With regard to profit shifting in case of transfer pricing the arm's-length principle applies, but guidelines do not exist. In case of thin capitalisation a limited deduction of interest payments has been established and a general anti-avoidance rule is directed against dividend stripping. In Uganda no tax free zones are established but initial capital allowances are made for mining (100%), business buildings (20%), urban (50%) and rural plants and machinery (75%).

Regarding the tax procedures the registration is done manually and a tax identification number (TIN) does exist. The tax period is the calendar year and self-assessment is possible. The return has to be presented 4 months after the end of the year of income. Payments have to be done via bank accounts and prepayments are to be made in two instalments; every member of a partnership has to complete a separate return. Audits are stipulated and additional assessments possible within three years (in case of suspected fraud at any time). Penalties and interest payments for late payments are installed and enforcement is assured. Taxpayer's appeals are possible first to the commissioner general (CG) within 45 days, then to the High Court or Tax Tribunal (again within 45 days). The CG may waive or accept a lesser amount to be paid if an objection has reasonably made against an assessment.

In case of the taxation of non-residents the tax base is the source income in Uganda without any specifications. Withholdings taxes apply with a 15% rate on dividends, interest payments, royalties, service fees, rents and remittances from branches to their head offices.

VI.4.3. Tanzania

In Tanzania the income and profit taxation is based on the Income Tax Act 2004, which came in force in July 2004. The basic definition of the taxpayer is consistent with the Uganda formulation, but supplemented by a numeration of sole proprietor, partnership, trust, cooperative, and branch of foreign company. The scope of income is the same as in Uganda. The threshold of taxation for individuals is about 900 USD/year. The tax base consists of business profits and gains. As accounting standards the IFRS and comprehensive domestic rules are used. Depreciation rates on capital expenditures are 5% for buildings, 12.5%for machinery, furniture and fixtures, and 25% to 37.5% for vehicles and other items. Bribes and fines are not deductible. Capital gains, exempt income and losses are again treated like in Uganda.

The individual marginal tax rates are between 15% and 30% and the standard company tax rate is 30%. Reduced rates exist for companies in EPZ after ten years (25%) and for newly listed companies with at least 35% of equity capital issued to the public (for three years). 0.3% of the turnover have to be paid in case of losses in three consecutive years due to incentives. The withholding tax on earned income is in Tanzania generally a final one if the taxpayer is a resident. The rates of withholding taxes on dividends are 5% for income from listed companies and 15% from others, respectively. Interest payments are burdened with 10% and royalties with 15%. Regarding transfer pricing in Tanzania guidelines are currently being drafted. Tanzania has EPZ as well as Special Economic Zones (SEZ) with 10 years tax holidays. Initial capital allowances are allowed for mining (exploration and development: 100%), plant, machinery in manufacturing and tourism (50%) and business buildings and hotels (20%).

Registration is IT supported in Tanzania and the prepayment is allowed in four instalments per year. All the other measures are the same as in Uganda.

VI.4.4. Burundi

The PIT and CIT are laid down in Part Two of the General Tax Code (Code Général des Impôts) under the headline “Income Tax (Impôt sur les revenus)”. This code was announced in 1963 and has been amended numerous times. For the purpose of applying the code additional laws as well as orders by the Ministry (ordonnances ministerielles) and rules have been issued. Concerning tax incentives the Investment Code of 2008[116] is providing different kinds of tax relief, but mainly takes reference to special legislation in this field.[117] The definition of the taxpayer depends on the kind of income. There is no distinction made between personal income tax and corporate income tax. Basis of taxation are rather three types of income: rental income[118], investment income[119], and business income[120].

Rental income taxation is based on a tax schedule with progressive tax brackets ranging from 20% to 60%. The highest rate is applicable to income that exceeds the amount of 3.8 mill. FBU[121].The total amount of tax paid must not exceed 35% of income. Rental income means all net-revenue derived from rent of buildings and land in Burundi irrespective of owner’s residence in Burundi or elsewhere. The law provides for a 40% deduction of the gross revenue as compensation for possible expenses.

Investment income means income derived from corporate entities in Burundi such as dividends, interests and similar distributed profits. The taxable amount also comprises the capital gain in the share property or participation as well as hidden reserves on condition that these gains have been realized.[122] Moreover all liquidation proceeds are subject to taxation as well as hidden profit distribution.[123] The tax rate amounts to 15% and is levied from the distributing entity as a withholding tax.

In case the investment income is distributed to another business entity, irrespective of its legal status, half of the distributed amount (50%) is treated (by operation of law) as acquired within professional activity and taxed as business income. This regulation is not applicable in case of reinvestment of the profit. No tax will be levied whenever dividends are distributed by corporate entities that are registered as “Exempted Enterprises” (“Régime de Zone franche”).

[116] Loi No. 1/24 du 10 Septembre 2008 portant Code des Investissements du Burundi.

[117] See Loi No. 1/015 from July 31, 2001 and ministerial order (décret-loi) 1/30 from August 31, 2002.

[118] Impôt sur les revenus locatifs.

[119] Impôt sur les revenus de capitaux mobiliers investi au Burundi.

[120] Impôt sur les revenus professionnels ou impôt professionnel.

[121] 1 EURO = 1648 FBU (Burundi Francs)

[122] Art. 14 of the Law on Income Tax: „Les revenus des actions ou des parts y assimilées … comprennent … les remboursements totaux ou partiels du capital social, dans la mesure où ils comprennent des benefices, des plus-values ou des reserves incorporés antérieurement au capital social”.

[123] Art. 25 Income Tax Act.

Pursuant to statutory provisions enterprises are eligible for such registration in case they deal with exports of certain non-traditional goods (like coffee and tee) or with special services like developing software products.[124]

Business income (impôt professionnel) appears in three types: Income by business enterprises and others[125], wages[126], and income by self-employed and freelance persons[127]. A threshold for taxation does only exist in case of wages; the amount is 480000 FBU (400 USD). Income gained by business enterprises is taxable whenever the activities are exerted in Burundi. If the enterprise has no business seat or permanent establishment in Burundi, it is submitted to taxation on payments for supply of services and royalties. The paying enterprise in Burundi must withhold the tax and transfer it to the tax authorities.

Regularly the taxable profit is calculated with the income resulting from all activities including capital gains, which are realized or at least disclosed in the accountancy. Three forms of ascertaining the taxable amount do exist: a) The "real profit"[128], exactly deduced from the bookkeeping system and in compliance with the generally accepted accounting principles[129]; b) a simplified method[130] with a receipt and expenditure accounting and c) a lump sum system[131] with smaller enterprises consisting of elements of appraisal of profit carried out by the tax authority. The regular tax rate is 35%. Enterprises which deal with exports of non-traditional merchandise (like coffee and tee) are subject to a reduced tax rate of 50% of the general rate (that means 17.5%). The minimum rate of taxation is 1% of the annual turnover, even when the business has suffered losses in that year.[132]

Enterprises registered as "Exempted enterprises" ("Régime de Zone franche", see above) take advantage of a total exemption during the first ten years of existence. Afterwards the tax rate will amount to 15%[133] without any time limitation. Within this system a further reduction is granted to enterprises that employ more than 100 Burundian persons. Then the tax rate will be 10%. The law offers additional reductions in case of re-investment of at least 25% of the profits gained during the first ten years. Leasing and hire-purchases of enterprises[134] are totally tax-exempt during the first three years of activity, while the profits of the next four years

[124] The law enumerates four types of enterprises eligible for registration: "Les entreprises franches industrielle, commercial, agricole et de service". For this reason the term "régime de zone franche" has no reference to a geographical surface and cannot be translated as "free zone".

[125] Bénéfices des entreprises industrielles, commerciales, artisanales, ou immobilières, exploitées en sociétés ou autrement.

[126] Rémunérations.

[127] Profits des professions libérals et autres occupations lucratives.

[128] Le régime réel d'imposition d'après le bénéfice ou le chiffre d'affaires. This type is applicable when the turnover figures exceed the amount of 40 million (service and accommodation fees) respectively 50 million Burundi Francs.

[129] The law does not provide for special methods of making up the balance-sheet. A carry-forward of losses to the following four accounting periods is possible.

[130] Le régime simplifié d'imposition, applicable for a turnover between 15 and 40 million Burundi Francs (services and accommodation) respectively between 20 and 50 million Burundi Francs derived from other income sources.

[131] Le régime du forfait.

[132] Special regulation for enterprises exporting of coffee: Minimum rate is 0,5 % of the annual turnover.

[133] Special regulation for „entreprises franches commerciales" (rate is 1 % of annual turnover or 0,8 % if more than 20 Burundians are employed permanently, applicable for the whole period of existence).

[134] Les sociétés de crédit-bail et de location-vente.

are taxed with a reduced tax rate of 20%. Generally exempt is income that is re-invested in vocational information and teaching. Also certain profits gained by agricultural enterprises and in connection with cattle breeding are tax exempt.

A Burundian enterprise is not entitled to deduct losses of permanent establishments or subsidiary companies in foreign countries. Foreign enterprises have to tax their profit gained by establishments in the territory of Burundi. Expenditures connected with business abroad (overhead expenses) are not deductible, even if they can be attributed to the activities in Burundi. The same applies to costs paid abroad that are attributable to the establishment in Burundi. Consequently the law does not provide for any regulations on allocated costs and transfer pricing.

Wages (rémunérations) are taxed due to a progressive tax schedule. The marginal tax rates are between 27% and 60%.[135] An upper ceiling of 35% for the average tax rate is implemented. Profits of self-employed and freelance persons are also taxed at a rate of 35%. A cash based accounting is applicable to determine the profit. There are no unilateral regulations related to avoidance of double taxation in connection with cross-border activities to be found in the law. The law only refers to international conventions into which Burundi has not entered up to now.

VI.4.5. Rwanda

The PIT and CIT in Rwanda are laid down in Law No. 16/2005 on Direct Taxes on Income. Moreover Law No. 26/2005 Relating to Investment and Export Promotion and Facilitation comprises additional tax provisions. Partly these regulations have already been transferred into the Law on Income tax. Further basis for taxation are constituted by the Ministerial Order No. 004/07 and Commissioner General Rules No. 001/2007, both governing the implementation of the Law on Direct Taxes on Income.

In addition to income taxation there are decentralized taxes levied by districts in line with the decentralization policy directed towards the promotion of economic development in districts. Within this context, the collection of property tax (on houses and land), trading licenses and rental income has been transferred to local authorities (provinces and districts). Special fees and taxes are levied in connection with motor vehicles, particularly a property tax on vehicles and a profit tax on the vehicle's ownership transfer. All these taxes are not considered in this report.

An individual who earns income from domestic and foreign sources as well as a non-resident person who has income that has a source in Rwanda is liable to personal income tax. Income subject to personal income tax includes employment income, business profits as well as investment income. The threshold is 360000 RWF (640 USD) and the marginal tax rates are 20% and 30% (for an annual taxable income of above 1,2 mill. RWF, 2185 USD). Intermediate business owners pay a lump sum tax of 4 % on the annual turnover not exceeding 20 mill. RWF (36400 USD).

A withholding tax of 15% is levied on dividends, interest payments, royalties, service fees including management and technical service fees, performance payments to artists, musicians and others made by resident individuals or entities including tax-exempted entities. An important withholding tax is the pay-as-you-earn-system, where the employer has to withhold

[135] This highest rate is applicable to income over 3,98 mill. FBU (3275 USD).

the tax on employment income. The withholding agent is required to file a tax declaration and transmit the tax withhold to the Rwanda Revenue Authority (RRA) within fifteen working days. A recipient who has exclusively derived income that is subject to withholding tax is exempt from submitting an annual tax declaration.

A withholding tax of 5% of the CIF (cost, insurance and freight) value of goods imported for commercial use is to be paid at Customs before the goods are released from the bonded warehouse. This is a regulation of great importance to Rwanda since transportation cost account for a great portion of the final price. A withholding tax of 3% of the invoice is retained on payments by public institutions to suppliers of goods and services based on public tenders.

Employment income includes all payments made to an employee in cash or in kind such as: wages, salary, leave and sick pay, medical allowances, commissions, bonuses including gratuity and incentives; allowances, including any cost of living, subsistence, rent, and entertainment or travel allowances; pension payments (if not paid under the state social security system); other payments made in respect of current, previous or future employment. The following payments are excluded from income taxation: retirement contributions made by the employer on behalf of the employee to the state social security system; retirement contributions (made by the employer or the employee) to special qualified pension funds; employment income received from an employer who is not a resident in Rwanda by a non-resident individual for the performance of services in Rwanda, unless such services are related to a permanent establishment of the employer in Rwanda; payments related to services for international organizations on basis of International agreements and payments to diplomatic personnel.

The business profit is determined as the income from all business activities (reduced by all business expenses) that also includes proceeds of sale of business assets and liquidation proceeds. The business profit is calculated for the tax period on the basis of the profit or loss account drawn up in accordance with the National Accounting Plan. The tax authority (Commissioner General) may use any other accounting method or other source of information in accordance with the law to assure the accuracy of the taxpayer’s profit.

Income derived from agricultural activities is exempt, if the proceeds do not exceed 12 mill. RWF in the tax period. Investment income includes all payments in cash or in kind by an individual in the form of interest, dividend, royalty or rent which has not been taxed as business income. If the payment of interest, dividend and royalty was subject to withholding taxation (see above), the taxpayer does not pay any tax on this kind of income. If such income has not been burdened by the withholding tax, this income has to be declared in the annual tax return and is subject to taxation with a flat rate of 15%.

All income derived from rent of machinery and other equipment and land including livestock in Rwanda are to be included in the taxable base. Depreciation expenses, interest payments on loans, and a lump sum of 10% of the gross revenue, which has to compensate for the expenses, are deductible. A capital gains tax does not exist in Rwanda. As far as cross-border activities are concerned the law includes a unilateral regulation to avoid double taxation effects. For this purpose the tax credit method is applicable as stated in Art. 6 Income Tax Act.[136]

The CIT in Rwanda is levied on business profits received by entities. Addressed are companies established in accordance with Rwandan law or foreign law, cooperative societies and their branches, public business enterprises, partnerships, entities established by districts, towns and municipalities and the City of Kigali, to the extent that these entities conduct business, other entities that perform business activities and are established to realize profits. Exempted from corporate income tax are public and not-for-profit organisations.[137]

Resident entities are liable to corporate income tax on business profit per tax period whether from domestic or foreign operations. Non-resident entities are liable to tax on business profit derived through a permanent establishment in Rwanda. The business profit is taxable at a rate of 30%.[138] However, a registered investment entity that operates in a Free Trade Zone[139] and foreign companies that have their headquarters in Rwanda that satisfy the requirements stipulated in the Rwandan law on Investment Promotion are entitled to pay corporate income tax at the rate of 0% without time limitation, exemption from certain withholding taxes, and tax free repatriation of profits. A registered investor (not operating in a free zone) is entitled to a profit tax discount of 2% if the investor employs between 100 and 200 Rwandans, 5% if the investor employs between 101 and 400 Rwandans, 6% if the investor employs between 401 and 900 Rwandans, 7% if the investor employs more than 900 Rwandans.

This tax discount is granted only if the investor maintains the employees for a period of at least six month during the tax period. The conditions for registration are laid down in the law on Investment Promotion. If in a tax period a taxpayer exports commodities or services of a volume between 3 and 5 mill. USD, he is entitled to a tax discount of 3%. If the amount exceeds 5 mill. USD, the tax discount will be 5%. Companies that carry out micro finance activities approved by the competent authorities pay corporate income tax at a rate of 0% for a period of five years (renewable by the order of the Minister). There are (unspecified) additional incentives provided for investors which are in the discretion of the Government.[140]

Important principles for determining the business profit are the following elements: Non-deductible expenses are bonuses, attendance fees and similar other payments made to the

[136] Art. 6 Income Tax Act: "If during a tax period a resident in Rwanda generates income derived from taxable activities performed abroad, the income tax payable by that resident in respect of that income is reduced by the amount of foreign tax payable on such income in accordance with articles ... of this law. The amount of foreign tax payable shall be substantiated by appropriate evidence such as tax declaration, a withholding tax certificate or any other similar acceptable document. The reduction of the income tax provided for by paragraph one of this Article does not exceed the tax payable in Rwanda on income from abroad."

[137] E.g., the National Bank of Rwanda and the Rwanda Development Bank, entities that carry out only activities of religious, humanitarian, scientific, charitable or educational character, international organizations, agencies of technical cooperation and their representatives, if such exemption is provided for by international agreements, qualified pension funds, the Rwandan Social Security Fund.

[138] The tax rate had been reduced from 35 % to 30 % to harmonize it with that of the other States of the EAC.

[139] Free zones are planned in Rwanda but not yet in operation.

[140] Law on Investment Promotion, Art. 19: "Upon request by the board of Directors of the agency, and depending on the nature of projects and the importance they have to the nation, their location or the capital invested, Cabinet may put in place additional incentives and facilities to investors."

members of the Board of Directors, dividends declared and paid-out profit shares, fines and similar penalties, donations and gifts exceeding 1 % of turnover as well as donations given to profit making persons, personal consumption and entertainment expenses, depreciation rates for computers, communication systems, software products and data equipment (50%), depreciation of goodwill that is purchased from a third party (10%), investment allowance of 40% of the invested amount in new or used assets may be depreciated in the first year excluding (small) motor vehicles.[141] full deductibility of training and research expenses. Losses can be carried forward to the next five tax periods; a carry back for losses is only provided for cases of long-term contracts[142], foreign sourced losses can neither reduce domestic sourced business profits nor can they reduce future domestic sourced business profits. There are special provision on thin capitalization (not applicable to commercial banks and insurance companies)[143] and transfer pricing rules[144]. Inter-company dividends and profit shares with partnerships received from a resident entity are not taxable. Special regulations with corporate reorganization (merger, acquisition and splitting of resident companies: transfer of the book values to avoid tax burdens) apply.

VI.5. Procedure Law and Tax Administration

The countries in the British tradition usually do not have a general procedure law, which summarizes the rights and obligations of the taxpayer. Such rules are embodied in the single laws (like IT act, VAT act, excise act, etc.). But the development within the EAC area is slowly moving towards the implementation of a separate procedure law and a law on tax or finance courts. Up to now Rwanda is the only country having adopted a distinct and separate law on tax procedures. In Kenya such regulations are discussed since 2006, in Tanzania and Uganda the acts are in the state of a draft law. Burundi still has the tax procedures within the single laws. Again the description follows a schematic overview (see table A5 in the appendix 4), which is structured into the statutory basis, organisational form, tax procedures and tax tribunals.

VI.5.1. Kenya

A new law which encompasses the tax procedures of the three existing single tax laws is considered as very urgent in the tax administration. Already in 2006 the draft version of the Tax Procedure Code (TPC) has been brought into the parliamentarian discussion. The Ministry of Finance (MoF) expects the enacting in the coming months. A tax revenue appeals tribunal act has not been discussed. Kenya has an independent revenue authority, the KRA already mentioned above. A PIN system and a large taxpayer unit (LTU) are implemented but a special unit for international taxation does neither exist in the MoF nor in the KRA. No information could be obtained regarding the Information Technology (IT) and its coverage. The cooperation between the EAC member countries is organized within the East African

[141] Conditions: the amount of business assets is equal to 30 mill. RWF and the assets are held at the establishment for at least three years. The investment allowance becomes 50 % if the registered business is located outside Kigali or falls within the priority sectors determined in the Investment Code of Rwanda.

[142] Details in Art. 20, last paragraph, of the law on direct income.

[143] See Art. 22, last paragraph, of the law on direct income.

[144] Art. 30 law on direct income, Art. 8 – 13 of Ministerial Order 004/07.

Revenue Authority (EARA).[145] The effectiveness of administration is impeded by the high share of informal sector activities and too much bureaucracy; a reduction in the corruption level seems to be necessary. A special anticorruption unit exists. These impressions were expressed within almost all the interviews made by the project collaborators within the Partner States.

Regarding the tax procedures the rights and obligations of the taxpayers are at least partly defined. Adjustments of the tax yield after audit are often made and estimates are possible. Referring to the audit details the existence of an electronic risk filter (screening) could not be clarified, office audits, field audits and cumbersome procedures do not exist. Information on the possibility for advanced rulings through the revenue authorities could not been generated. Taxpayer’s appeals are possible in administrative and judiciary form. Regarding the work of the tribunals the lawsuits were evaluated as time consuming.

VI.5.2. Uganda

Uganda also intends to introduce a procedure law in the near future. A draft version obviously exists. Like in the case of Kenya, a tax revenue appeals tribunal act does not yet exist but seems to be intended. The Uganda Revenue Authority is again an independent institution.[146] A TIN system as well as LTU have been implemented, an IT system (ITAS) with a partly coverage also exists. Uganda is a member of the EARA and the effectiveness of the administration is evaluated like in Kenya. The existence of an anticorruption unit could not be verified. The tax procedures are identical to Kenya, while time limits for adjustments do exist, except in fraud cases.

Regarding the audits a risk filter has not yet been implemented; office and field audits as well as cumbersome procedures are undertaken. Advanced rulings of the revenue authorities are allowed, but – with long delays – only rarely happening. Administrative and judiciary appeals of the taxpayers are usual and a deposit of the tax amount is necessary unless the commissioner general (CG) renounces. The procedure of the tax tribunals is time consuming and the quality of the decisions poorly evaluated.

VI.5.3. Tanzania

A tax administration procedure act is currently discussed in Tanzania and will presumably be enacted by the end of 2009. A law on the implementation of a tax and finance court already exists since 2006 (Tax Revenue Appeals Act). This implementation has been done independently from the existing law so that currently the regulations regarding a lawsuit before the Tax Tribunal collides with the regulations of the income tax law.

Most of the details described above for Uganda are concordant with Tanzania so that just the differences are mentioned. Tanzania has an information technology system (ITAX) with partial coverage. A special anti corruption unit exists and regarding the audits an electronic risk filter has been implemented. The length of the procedure in before the Tax tribunal has also been evaluated as time consuming.

[145] The revenue authorities of Kenya, Uganda, Tanzania and Rwanda have signed a Memorandum of Understanding (MoU) on exchange of information on tax and other related matters following the conclusion of negotiations over the last two years. For more details see KRA - http://www.kra.go.ke/news/newsearaaccord.html.

[146] For the organisational structure see URA - http://www.ugrevenue.com/departments/.

VI.5.4. Burundi

As mentioned above, the legal basis of tax procedures is not laid down in a separate law but in each of the special tax laws. The main principles are the following: the local jurisdiction for income taxation is determined by the seat or the permanent establishment of the enterprise or the place of residence of the individual. Regarding rental income foreign taxpayers with no residence in Burundi are taxed in the region where the real estate is located. The tax declaration has to be submitted until the end of March respectively three months after the expiration of the accounting year. The tax has to be calculated by the taxpayer and is due and payable simultaneously.

Companies deriving income from "activité professionnelle" are obliged to submit all important records like balance sheets, profit and losses statement, inventories and others to be examined by a tax investigator. Moreover the tax authority is entitled to carry out a tax audit within the premises of the taxpayer. The audit has to be announced in advance and the notification must indicate exactly the accounting years to be examined and the date of the beginning of the audit. The auditor notifies his observations to the taxpayer who has the right to comment on it within 20 days. Whenever the taxpayer omits to submit the relevant documents, the auditor is entitled to estimate the base of taxation.

If the taxpayer does not agree with the results of the audit and the changed tax assessment, he can present the case to a special commission (commission de conciliation), consisting of representatives of taxpayers and of tax administration. This procedure aims at settling the dispute without further litigation. However, the statement of the commission is neither binding for the taxpayer nor for the tax authority. There is a statutory time limitation for changing the tax as well in favour of the taxpayer as to his disadvantage (droit de rappel). The regular time limit is four years after the end of the accounting year. If the taxpayer wants to contest a tax assessment, he has the right to bring forward a motion (réclamation) within a time limit of three months. The decision is made by the Minister of Finance and can be contested with a lawsuit (recours) in front of the administrative courts.[147]

In case of the VAT the taxpayer is obliged to inform the tax authorities of the commencement of his business within 30 days. If he has no seat or residence in Burundi, he has to determine a representative in Burundi. The tax period is the month. The tax is due and payable at the same time when the tax declaration has to be submitted. The time limit is 15 days after the previous month. Concerning tax audits, the time limits for tax adjustments, and the taxpayer's right of appeal, the same regulations are applicable as in the income tax law.

In the interviews the experts gained the impression that the population in Burundi is not sufficiently prepared for the implementation of the new VAT. The campaign launched by the Minister of Finance and the issued leaflet on the TVA can only be regarded as a first attempt to meet the requirements in this field. The parliament in Burundi has just enacted a law to concentrate and strengthen the tax administration. For this purpose an autonomous revenue authority is supposed to be established by the end of 2009.

[147] La Cour Administrative, la Cour d'Appel.

VI.5.5. Rwanda

Up to now Rwanda is the only country in the EAC to adopt a distinct and separate law on tax procedures. In 2005 this law was enacted[148] and Ministerial Orders and Commissioner General Rules[149] are providing more detailed regulations in this field. The law is valid for matters of personal and corporate income tax, withholding taxes, VAT, and property tax on vehicles and boats. Nevertheless the special tax laws also contain procedural provisions which have to be taken into account. The Law on Tax Procedures provides regulations affecting the relation between tax administration and taxpayers but also addresses questions of the organization of the tax administration.

The law contains instructions on the methods of communication supplemented by a Ministerial Order for the use of electronic messages and the submission of electronic evidence.

Apart from cases of statutory representation every individual or legal entity is entitled to choose a representative to comply with all the obligations required for the taxpayer.

The following legislations have to be published in the Official Gazette of the Republic of Rwanda: Laws, decrees laws, ministerial orders, and Commissioner General's rules. Special administrative instructions and public rulings issued by the Commissioner General have to be published in a nationwide newspaper and made available to the taxpayers in a public place or at the offices of the tax administration. The following taxpayers are required to keep account books and records: All companies operating in Rwanda established in accordance with domestic or foreign law, and all persons engaged in business activities, professional or vocational occupation, except when such taxpayers have an annual turnover not exceeding 1,2 mill. RWF (2180 USD).

Any person who is required to keep books and records is obliged to prepare, establish and keep all books and records of transactions which show the tax liability, the obligation to withhold taxes, and to file a declaration of a tax withhold. Any person who has an annual turnover exceeding 20 mill. RWF (36400 USD) is obliged to keep the following additional documents: a record showing business assets and liabilities, records showing daily income and expenses, records showing purchases and sales of goods and services, records showing trading stock at the end of the tax period. All documents must be preserved at least in a period of ten years and are required to be kept in the premises of the taxpayer or any other place located within Rwanda.[150]

The taxpayer may apply to the Commissioner General for an extension of the deadline for filing the tax declaration if sufficient proof of the reasons and difficulties faced in filing the tax declaration on time is given. A notice of assessment is issued when the taxpayer has not paid the tax on time, the amount of the tax has to be changed after investigations and audit, serious indications exist that the possibilities for effective tax collection are in jeopardy, due to the financial position of the taxpayer or due to the taxpayer's intention to evade taxation. The notice of assessment constitutes the full legal basis for the recovery of the tax, interest, penalties and all costs incurred collection.[151] The law stipulates the conditions of auditing and

[148] Law No. 25/2005 of 04/12/2005 on tax Procedures

[149] Ministerial Order No. 002/07/ of 09/05/2007 and Commissioner General Rules No. 002/2007 of 15/06/2007.

[150] Art. 12, 13, 15 of the law.

[151] Art. 18, 19 of the law.

investigation procedures and to what extent the taxpayer and third parties are obliged to give information to the tax authority (problem of professional secrecy).[152]

The law lists the cases where an assessment procedure can be started without notice, e.g. when no tax declaration has been made or there are serious indications of tax fraud. When a taxpayer shows signs and indications of prosperity in a certain fiscal year, and the taxpayer cannot give an explanation for this apparent prosperity, the tax administration may add the value of these signs and indications to the taxable income and use this as a method of proof. Very important are the regulations on the "contradictory procedure". When the tax administration discovers a miscalculation, an omission, an understatement of income or any other error in the tax declaration or an assessment, it has the right to issue an adjusted assessment. The taxpayer has the right to give his opinion prior to the intended adjustment within 30 days after he had been notified. If the assessment is incorrect, the taxpayer himself may transmit additional evidence or information to indicate that the adjusted assessment is incorrect. The rectification note may be issued in a period of three years, starting from the day of the filing of the tax declaration.

The regulations related to administrative appeal are determined.[153] The taxpayer who is not satisfied with the contents of the tax assessment notice may appeal to the Commissioner General within 30 days after receipt of the assessment notice. The decision on the appeal is supposed to be taken within a period of 30 days (but not more than 60 days). When no decision is taken within this period, the appeal is assumed to have a basis. The taxpayer who is not satisfied with the decision of the Commissioner General may appeal to the Appeals Commission within 30 days. This Commission takes a decision within 60 days. Then the taxpayer can make a judicial appeal. The appeal must be brought before the tribunal within 30 days.

Moreover the area of tax recovery is regulated in the law including the procedure of attachment of the taxpayer's property.[154] The right of tax secrecy is guaranteed. The administration is not entitled to disclose any information about the taxpayer if not expressively allowed in the law. The law provides also for regulations on interests, fines and penalties. In case the taxpayer has committed a tax fraud, he is subject to an administrative fine of 200% of the evaded tax – apart from a conviction in a criminal procedure.[155] The taxpayer can apply for a waiver of tax liability, interest on late payment and administration fines in case of substantial hardships indicating no ability to clear the tax liability. A waiver cannot be granted to persons proved to commit offences of understating or evading taxes.

The administration and accountability of taxes and duties in Rwanda was initially under the Ministry of Finance and Economic Planning. This was later vested into an independent body – the Rwanda Revenue Authority (RRA)[156] – that was established in 1997.[157] The RRA has ambitious strategic plans for the next years: the main areas of focus are effective resource

[152] Art. 23, 24 of the law.

[153] Art. 30 – 38 of the law.

[154] Art. 46 – 56.

[155] Art. 64.

[156] www.rra.gov.rw .

[157] The main departments within RRA are the Domestic Tax Department (DTD is comprised of two offices: Large Taxpayer's Office (LTO)157 and Small and Medium Taxpayers Office (SMTO)), the Customs & Excise Department, the Revenue Protection Department, the Planning and Research Department, the Taxpayers Service Department, and the IT Department.

mobilization, enhancement of taxpayer's compliance levels, building a capable and effective organization, and continuous business process re-engineering. In spite of critical remarks made by external observers concerning red tape problems and lack of proficiency and knowledge with the lower ranks of tax officials (particularly with audit procedures), the experts got the impression that RRA tackles these shortcomings with intelligence and energy including combating corruption ("zero tolerance"). Thus, positive prospects for the further development of the tax administration can be expected.

VI.6. Summaries for the Partner States

As already mentioned above, a considerable level of harmonisation has already been achieved regarding VAT rates as well as in the CIT systems (see table 11). With Tanzania reducing its VAT rate to 18%, four of five Partner States have the same rate; only Kenya has a lower standard rate of 16% and a reduced rate of 12% just on electricity and fuel.[158] The variety of tax rates within the EU (see table A1 in the appendix 4) is much larger. The same trends are to be observed regarding the CIT rates. Within the EAC there is a uniform standard corporate tax rate of 30% for residents with the exception of Burundi (35%) and only Kenya taxes non-residential companies with 37.5%.

[158] Question marks are put if the values were not available or could not be verified. Here further clarifications have to be done in future project missions.

Table 11: Comparison on Tax Rates within the EAC Partner States

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Corporate Tax:					
Standard Corporate Rate, resident	35%	30%	30%	30%	30%
Standard Corporate Rate, non-res.	35%	37,5%	30%	30%	30%
Personal Income Tax:					
Tax-free income threshold ($US, approx.)	400	1700	-	-	-
Tax rates on taxable income ($US, approx.)	27%	-1600: 10%	-640: 0%	-900: 0%	-750: 0%[1]
	to	-3110: 15%	-2120: 20%	-3250: 15%	-1350: 10%
	60%	-4620: 20%	>2120: 30%	-4870: 20%	-2380: 20%
		-6130: 25%		-6490: 25%	>2380: 30%
		>6130: 30%		>6490: 30%	
Value Added Tax:					
Supply and Import of Goods & Services	18%[2]	16%[3]	18%	18%[4]	18%
Export of Goods & Services	0%[2]	0%	0%	0%	0%
Excise Duty:					
Beer, malted	$0.04 per bottle	$0.71 / litre	60%	$0.25 / litre	60% (imp.), 20% (local)
Beer, unmalted		$0.47 / litre		$0.15 / litre	
Wine	50%	$0.09 / proof litre	70%	$0.79 / litre[5]	70% (imp.), 20% (local)
Spirits, Liquor, etc.	50%	$0.09 / proof litre	70%	$1.17 / litre	70% (imp.), 45% (local)
Cigarettes	100%	$9.20 - 32.90 / mile	150%	$4.00 - 17.20 per 1000	$9.60 - 24.10 per 1000
Carbonated Drinks	$0.04 per bottle	10%	39%	$0.04 / litre	13%
Juices	n/a	10%	5%	-	10%
Bottled Water	$0.04	Max of: 10% or $0.08 / litre	10%	-	10%
Motor Vehicles	20%	20%	5% / 10% / 15%[7]	5% / 10%[6]	n/a
Cellular Phone Services	n/a	10%	5%	10%	12%
Gasoline	n/a	$0.38 / litre	76%	$0.26 / litre[8]	$0.41 / litre
Diesel (automotive)	n/a	$0.26 / litre		$0.24 / litre[8]	$0.89 / litre
Diesel (industrial)	n/a	$0.05 / litre		$0.29 / litre	$0.89 / litre
Kerosene	n/a	$0.10 / litre		$0.04 / litre	$0.10 / litre

Sources:
PriceWaterhouseCoopers, East African Tax Reference Guide 2008/09
Rwanda Revenue Authority, Domestic taxes and rates
Additional data supplied by project partners

Exchange rates (July 1, 2009):
Burundi: 1000 BIF = 0.840 USD
Kenya: 1000 KES = $13.123 USD
Rwanda: 1000 RWF = $1.759 USD
Tanzania: 1000 TZS = $0.757 USD
Uganda: 1000 UGX = $0.483 USD

Notes:

[1] residents only; non-residents taxed 10% on entire first $1250

[2] VAT rates introduced July 1, 2009; no VAT prior to this date

[3] VAT rate 12% on electricity and fuel oils

[4] VAT rate reduced to 18% July 1, 2009; previous rate

20%

[5] for wines made of >25% imported grapes; 0% tax
otherwise

[6] for engines up to and over 2000 cc, respectively

[7] for engines below 1500 cc, between 1500 and 2500 cc, and above 2500 cc,
respectively

[8] plus Road Toll, $0.15 / litre

Regarding the excise tax rates the structure is much more complex.[159] Almost in every country there is a mixture of specific tax rates and ad valorem tax rates. Tanzania is the only Partner State with purely specific rates for beer, wine, cigarettes, soft drinks and fuel. Kenya has at least partly for soft drinks ad valorem rates, while Uganda and Burundi predominantly have ad valorem rate with the exception for cigarettes in Uganda and sugar in Burundi. Rwanda applies only ad valorem rates in case of the excises. The motor vehicle tax (not to be verified in Burundi and Uganda) as well as the tax on cellular phone services (not to be verified in Burundi) are also fixed on an ad valorem basis. The mixture of specific and ad valorem bases within and between member countries is a basic obstacle for the comparison of the tax burdens on the different goods being taxed. For a detailed and exact comparison the basic prices as well as the quality (e.g., for the taxation of spirits the alcoholic content) has to be identified so that the tax amount per unit of the consumption good in consideration can be estimated. Then a cross-country comparison based on USD would allow for a clarification. Due to time restrictions such comparison could not be done; however, the differences in the tax burdens are quite remarkable and are even more substantiated if the different treatment of the single goods within the VAT systems is taken into consideration. Therefore, a detailed analysis should be carried out how strong the excise taxes and the VAT are burdening the goods under consideration so that the cumulative burdens of both are clarified in a cross country comparison.

[159] Additionally the excise tax on plastic bags might play a more or less important role, which has not been analysed because of lacking data.

Part C: Harmonisation Issues in the EAC

VII. Problem Areas of Harmonisation

The brief summary of the last chapter has demonstrated that there are still huge differences, especially regarding excise taxation; the same holds true for the definitions of tax bases within the EAC member countries. Especially the long catalogues of tax exempt or zero rated items within the VAT and CIT systems demand specific attention if unfair tax competition is to be avoided within a common market. As pointed out before, tax harmonisation is an important prerequisite for the formation of a common market because the equal treatment of taxpayers, goods and services as well as kinds of income is the fundamental target of an efficient and just tax policy. Therefore, double taxation has to be avoided, tax evasion as well as corruption combated and the rights and liabilities of the taxpayers strengthened in tax procedure law.

VII.1. Harmonisation Requirements for the VAT Systems

All VAT laws within the EAC Partner States contain the necessary legal elements determining modern net-turnover tax systems. Additionally they often include procedural regulations which are not specific for VAT but of general relevance for the taxpayer's right of appeal, the enforcement of tax liabilities, and fines in case of illegal behaviour and tax evasion. These structures are the result of different cultures and traditions, which are no core components for harmonisation processes. Hence, the provisions regarding the assessment of the output tax and the input tax are highly relevant for harmonisation. In these areas there is a huge accord in the single country laws. All laws contain the basic items like registration of taxpayers,[160] kinds of turnovers, time and place of supply, tax base and tax rate. All laws also contain the basic regulations for the deductible input VAT, and the offset or refund of an overshooting input tax.

Compared to the harmonized VAT systems of the EU laws in all of the EAC partner states lack specific regulations on the place of turnover, own consumption, adjustment of tax assessment in case of return of goods or the change in the consideration, treatment of prepayments, subsequent change of input tax on investment goods in case of a tax relevant change in use. These weaknesses are shortcomings in the national laws and should be abolished in the harmonisation process. **Therefore, a common EAC VAT Model should be developed.** Such binding model, as it is used in the EU,[161] is suggested as a medium-term target in the harmonisation process.

However, high harmonisation priorities are to be determined in the areas of tax schedules (rates), tax exemptions and zero rated turnovers, tax bases as well as input tax refund. Highly different *tax rates* are not beneficial for a common market. But in contrast to the EU, the EAC has already reached a comparatively high level of integration and harmonisation. Tanzania has announced to reduce its rate from 20% to 18% while in Kenya there are dis-

[160] In Tanzania and Rwanda a definition of the taxpayer is missing in the VAT laws.

[161] See VAT Directive 2006/112/EC.

cussions to increase the standard rate from 16% to 18% so that in the near future a uniform standard VAT rate seems to be possible. Another advantage is to be seen in the fact that reduced tax rates exist only for Kenya (12% on electricity and fuel) and Uganda (5% for sale of residential apartments). Such structures reduce the threat of manipulation and simplify administration.

As already mentioned above, the catalogue of tax *exemptions and zero rated goods* is considerable in all countries. Such regulations render the administration much more difficult and increase the threat of tax fraud. Such catalogues tend to be continuously extended, leading to the erosion of the tax base and serious revenue losses. Kenya with its different schedules has obviously the longest list of tax exempt items; Uganda defines many goods and services as zero rated and allows for the input tax deduction, while Tanzania has put similar goods and services tax exempt without the possibility to subtract the input tax. As long as such goods belong to the so-called non-tradables, they are not relevant for cross-border transactions and the differences can be neglected within a common market. Important products, e.g. agricultural products and foodstuff, but also international transport services should be taxed similarly. In such cases harmonisation has to be recommended because discrimination between the Partner States is likely. Furthermore the countries with long lists of zero rate supplies should become aware of the revenue losses, which are necessarily connected with such questionable regulations.[162] **Therefore, the expert group strongly recommends the restriction of the zero-rated items exclusively to the export flows.**

VAT systems in the EAC member countries are following the destination principle. *Cross-border transactions* (exports) are zero-rated, but input tax deduction is allowed. This system requires border controls so that the export can be checked and controlled at the borders (the above mentioned border equalisation). The import has to be evaluated by the customs clearance at the border so that the import VAT can be charged. Such border control and clearance systems are a substantial disruptive factor within a common market or economic union and create lots of problems: delays in trade movements at the borders, administration costs, errors in the evaluation of goods, comprehensive documentary obligations, proof of the paid import VAT, fake of documents and corruption are the most frequent examples. The abolishment of border controls would have enormous efficiency gains for a community and for the corporate identity within a common market – the EU is a convincing example. But many prerequisites have to be fulfilled before border controls and border lines can be abolished. The EU system as discussed above is a very complex one and surely not a best practice example. The switch over to the origin principle also demands precautions regarding the distribution of the VAT revenue to the member countries, which – as the preliminary EU system – demands high IT input on the side of the administration as well as the taxpayers, a high degree of trustworthiness of all involved persons, and a broad consensus within all Partner States. Attaining such a consensus needs a long and successful experience with the integration process, which even in the EU is not yet in sight. Currently there are many other reasons not to abandon the border controls: for the controls of the customs, the excise taxes (still after the realisation of the common market), for the controls of the motor vehicles and the surveillance of persons border controls are still decisive.

[162] In some countries the revenue losses have already influenced the public debate, especially since the international financial and economic crisis has substantially reduced the tax bases and the future tax revenue; see, e.g., Policy Forum (2009).

Therefore the expert group recommends maintaining the border control system at least for a longer transitional period until all necessary adaptations are analysed and implemented within the national systems.

The taxable value of a taxable supply is in principle the consideration paid (or payable) by the recipient. The VAT law in Rwanda stipulates that the open market value shall be the taxable value if the consideration is less than the open market value of the good or service. Good economic reasons may occur for a businessman to offer goods or services at a lower price than the market price. The tax law has to follow these arrangements if tax fraud is excluded. Thus, it is not in compliance with the VAT system to alter the taxable value in deviation of taxpayer's contracts. Difficulties will arise in all cross-border activities when the other state – like, e.g., Burundi – does not give precedence to the market value. **Therefore, a harmonisation of the bases of taxation is recommendable.** The treatment of bad debts should also be considered under the aspect of harmonisation. If the claim of the supplier is definitively not recoverable the taxation has to be adjusted correspondingly – this would at least be in compliance with the VAT system (not burden the entrepreneur with VAT). Burundi has no regulation in this respect while Rwanda – by ministerial order – paves the way to a tax relief for the supplier.

VAT Systems Harmonisation

Develop a common EAC VAT Model

Reduce zero-rated transactions to exports only

Harmonise and reduce exempt transactions

Maintain the border controls in a mid-term perspective

Harmonise the tax bases

Define the place of services in every detail (EU model)

Apply harmonised rules and practices for VAT refunds

Equalise administration and tax procedures in all Partner States

The *export and import of services* cause serious problems and are frequently discussed in the affected public. Services are not subject to border controls. The strict compliance with the destination principle is not practicable. In the national VAT laws clear definitions of the place of supply for cross-border services are badly missing. Following the approach to avoid collision and double taxation (see table 4 above) goods and services are only neutrally treated if they are taxed once and only once in case of indirect taxation. Since most of the involved staff of the revenue authorities just follows pure revenue interests, double taxation is likely but also zero taxation might appear. The only efficient solution can be seen in a catalogue describing in detail the possible services and allocates them to the origin or destination country. Such a resort has been developed in the process of learning by doing in the EU. A best practice example is the "Directive 2008/8/EC of 12 February 2008".[163]

The expert group strongly recommends the implementation of a similar regulation for the EAC member countries.

The regulations for the *refund of excess input taxes* is of utmost relevance for companies. Such payments heavily influence the financial basis of a company. As international experiences have shown, companies have often been driven into insolvency because of delayed payments. This happens especially where companies have high needs for investment. The same holds true for companies in the start-up period. Again this topic plays an important role in the public discussions. For instance in Kenya long waiting times are to be observed in contrast to the legal statement that tax refund has to be carried out within 60 days, while an entitlement for interest payments does not exist. In its "Tax Matters" PWC had a headline: "VAT refunds – Taxpayer paying through the nose". Citation: "Businesses in a VAT refund position find themselves having to borrow money from financial institutions at high interest rates and then 'lending' it to the Government for free".[164]

Even Kenya's President Kibaki was engaged in the discussions. PWC: "The President instructed recently the KRA to make outstanding VAT refunds within 60 days of the date of his pronouncement" – 6 October 2008. In almost all member countries the refund period is too long. The law in Tanzania mentions a period of six months. Exceptions apply to companies having regular excess input tax, like exporters. Uganda has usually an immediate refund for such companies. Nonrecurring excess input tax is only refunded if the amount exceeds 2500 USD. Risk filters within the IT system might put things right. The harmonisation need lies not so much in the legal area as in the administrative procedures. The refunds are often delayed by bureaucratic barriers. That happens due to high requirements for proof, delayed or long lasting auditing, or just cumbersome procedures – often accompanied by an imperfect IT support. The examples of Kenya and Tanzania should be taken into consideration where refund applications testified by certified public accountants are processed much faster. But even such a good idea has not contributed to a certain automatism regarding the refunds.

Rwanda as well as Burundi have provided particular exceptions from deductibility. In Rwanda in case of "importation of services" the reverse charge method is applicable (Art. 29 VAT law). The recipient has to pay the tax, but he is not entitled to deduct the tax as input tax (ministerial order of 13/01/2003, Art. 29). This is contradictory to other foreign VAT systems. A rule by the Commissioner General of 02/06/2005 provides for an exception from this inter-

[163] For details see http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:044:0011:0022:EN:PDF.

[164] PWC (2008).

diction: If the recipient gets a service that is not available on a local market, he has the right to deduct the input tax. This regulation is discriminating and constitutes a distortion of the competition within EAC. Additionally in Rwanda an exporting enterprise cannot deduct input tax related to his own purchases of the merchandise if it does not repatriate the proceeds from his activities into Rwanda (ministerial order, see above). This also is contradictory to the VAT system and violates the EAC-principle of free movement of capital. In Burundi the principle of deduction of input tax is not fully satisfied since only 50% of input tax (related to investment) is generally eligible for deduction. When deduction of input tax has been claimed for an acquisition of goods, the deduction has to be reversed. This regulation is not in line with VAT principles and should be subject to harmonisation efforts. Generally the deduction of input tax is of crucial importance to the VAT system. **Therefore, the expert group recommends to harmonise the legal bases and the administrative processes regarding VAT input tax deduction.**

A specific problem for most of the member countries is the low rate of compliance; for example in Uganda about 60% of the registered companies do not file their VAT declarations and 30% of the VAT yield is not or only paid with large delays,[165] intolerable competitive distortions are created on the national but possibly also the community level. The strengthening of the national tax administrations is one of the most important prerequisites for a functioning common market. Additionally at least the basic tax procedures have to be adapted to a community standard so that misbehaviour and harmful tax practices are avoided.

Therefore, the expert group recommends to convey the idea of such harmonisation necessities into the consciousness of the staff of the MoF as well as the revenue authorities by adequate training methods.

VII.2. Harmonisation Requirements for the Excise Taxes

As mentioned above the excises levied on excisable goods have different steering purposes (demand-steering impacts for health and ecological purposes) but are also contributing to the total tax revenue within the EAC member countries (see table 9 above).[166] The substantial differences within the tax rates have been discussed in chapter VI.6. Together with the VAT burden a double taxation in case of such taxable goods arises as far as they are not expressively exempt from VAT.[167] The border equalisation system guarantees that such goods are taxed in accordance with the destination principle. The exporting state relieves the goods from the national tax burden and the import state charges them with its own tax rates. Then the private consumption in the destination country is burdened with the same tax rates on domestically manufactured as well as imported goods. The same rules are applied within the EU. As the EU example mentioned above has demonstrated, there is no need for total harmonisation. Especially differences in tax rates may remain due to the stage of development and national cultural traditions. **The administration and the tax procedures should be the same in all member countries**; the procedures must not impose a disproportionate burden

[165] These figures have been presented by the URA at a VAT Harmonisation Workshop organised by the GTZ in Hotel Club du Lac, Bujumbura, Burundi, 12-13 March 2009.

[166] There revenue capacity is less than described by Cnossen (2008) but regarding cross border transactions they play a very important role.

[167] In some member countries of the EAC also local excise taxes exist, which due to time limitations have been neglected in this report.

in costs and time on the involved persons and a competent and upright staff has to execute the tax procedures in an absolutely reliable, consistent, and correct manner.

As the analyses above have demonstrated the EAC member countries are still charging the excise taxes on highly different legal bases. The enormous differences in the definitions of the tax bases and the quality of the taxed goods impede any detailed comparison regarding the tax burdens. Detailed studies have to be made to give an impression on the supposed large differences. High burden differences induce cross border shopping and smuggling activities; thus the only outcome often is tax evasion and criminal behaviour including corruption. In the interviews many experts complained that for instance cross border deals with fuel between Kenya and Tanzania play an important role just for tax saving reasons, which obviously is not welfare creating.

Excise Taxes Harmonisation

Develop a harmonised legal basis for excise taxation:

- define the exclusive categories of taxable goods
- define the particular taxable items in a uniform way
- replace the ad valorem rates by specific rates
- define lower and upper ceilings for the national tax rates

Determine the specific tax rates in the national excise tax laws

Abolish discriminatory rates for imported goods

Harmonise tax bases for levying excise taxes

Harmonise excise tax rates

Besides the excise taxes there is a number of other tax laws charging various goods and services (motor vehicle acts, cellular phones fees, road and fuel tolls, hotel levy, airport service charge – all examples from Tanzania) which should also be taken into consideration. Because some partner countries are currently aiming at a reform of the excises,[168] the EAC should promote such initiatives. **Therefore, the experts recommend the establishment of a general law providing guidelines for the single national laws in defining uniform tax bases and more harmonized legal structures.** The single national tax laws then have to

[168] Uganda for instance is discussing a reform; see letter of intend to the IMF of 20 June 2008.

determine the tax bases and rates in more detail. The focus has to be set on the taxable goods and the tax bases, where uniform definitions have to be applied.

It is not necessary in a common market for all taxable goods to be identically (especially not for non-tradables) defined, but a certain harmonisation especially of the tradables is recommendable. The above mentioned catalogue (see chapter II.3.1.) is internationally not under dispute because with these categories of consumption goods not only the fiscal revenue but also health and environmental reasons are convincing arguments. Indirect taxes levied only in one member country (e.g., sugar in Kenya, cement in Uganda) or bagatelle taxes like the matches tax with negligible revenue should be abolished.[169] Generally the tax basis of the specific indirect taxes – as already mentioned above – should be defined in specific units of measurement, which allow for clear definitions of the product quality. In case of ad valorem taxes often questionable bases (like producers costs) are used, which allow for interpretations and corruption. The only argument that ad valorem taxes are automatically inflation adjusted is true but inflation adjustments can easily be made on an annual base even for specific rates. **Therefore, the expert group recommends the introduction of specific tax rates within the national excise tax laws.**

Tax rates can remain different as long as trade steering impacts are weak and no discrimination is involved. Recommendable is the introduction of lower and upper ceilings so that compared to the current stand of the art a stronger harmonisation is assured. However, the coexistence of **different rates for nationally manufactured goods and imported goods** is a clear violation of common market principles. **Therefore, such discrimination has to be abolished.**

VII.3. Harmonisation Requirements for the Income and Profit Taxation

As already mentioned above the focus is laid on the analyses of company taxation; the CIT is a tax directed to production and trade activities, which substantially contributes to the GNP. Additionally at least medium-size and larger companies are usually involved in international competition so that a neutral CIT is the best prerequisite to prevent competitive distortions or to avoid harmful tax competition. The PIT is much more orientated to the individual sphere of the taxpayer, following other societal aims like family, educational or social policy strategies. Here the different cultures and traditions play a decisive role, so that harmonisation activities in these fields are much less suitable. Therefore, the EU is following the subsidiarity principle regarding the PIT so that the design of personal taxation is under the exclusive legislation of the member countries.

All EAC member countries have implemented an integrated income and profit tax system, which principally corresponds to the modern forms of income taxation proposed in the international sphere.[170] The laws apply to single proprietors, business partnerships and corporate bodies. The complexity of tax laws and the many different specific schedules and exemptions

[169] The taxation of certain services like the hotel levy and airport charge in Tanzania are also questionable taxes due to the negative impacts such taxes can have on the employment situation.

[170] The structures and single elements are, however, far away from being modern and efficient. For a simple and efficient income and profit tax model see Petersen (2004) and Petersen/Rose (2004), which in the meantime has been implemented in a district of Bosnia and Herzegovina in connection with a GTZ advisory mission. A similar approach has been developed for Liechtenstein where the draft law is currently in parliamentary discussion.

are a clear indication that these laws are presumably not neutral regarding the legal status, investment, financing, profit distribution, and inflation.[171] Therefore, national tax reforms have to be discussed to liberate the PIT and CIT from steering mechanisms, which very likely have created or will create massive competitive distortion within the planned common market. The national PIT and CIT systems should guarantee equity and equality also regarding cross border transactions, but this process is clearly beyond the harmonisation perspective. As long as such fundamental reforms are not carried out, the most serious elements of harmful tax competition have to be abolished.

The collisions within the income tax systems are caused by the intentions of the single member countries to broaden their national tax bases. The dominating method for national states is to define their national income and profit tax base in applying the residence principle regarding the personal tax liability and the world-wide income principle for the factual tax liability (income generated in other countries, see table 3 above). If the source countries also tax the same base, double taxation takes place. Now three collision avoidance methods can be implemented: In case of unilateral measures the nation state can implement the tax credit method so that in case the income is taxed in the source state the tax is to offset the national tax liability. If the national tax rate applied is higher than the foreign tax rate, an additional tax burden results. In the opposite example a tax refund would be necessary. With this method the source state gets the revenue partly or even totally. A refund would reduce the tax revenue in the residence state, which makes the implementation of such a method politically less attractive. The other two collision avoiding methods (tax exemption in the source state: source principle for personal and territoriality principle for the factual tax liability; exemption in the source state: residence principle in the source state for personal and territoriality principle for the factual tax liability; see table 3 above) are also possible but breach with the intention especially of synthetically orientated income tax systems to tax the total income of national taxpayers. The intention to tax the total income (inland and world-wide) was closely connected with the directly progressive tax schedules (with increasing marginal rates) due to equity argumentations. Because progression (via increasing marginal tax rates) is losing relevance especially regarding companies taxation, in the meantime many national tax laws have moved from a synthetic to a dual or even more scheduled system. Thus, today such arguments are less important. But still the existing DTA are prevailing with their traditions of international taxation so that not one of the three approaches is chosen but instead double taxation avoiding details are negotiated as presented in table 4 above.[172]

The EAC Partner States have applied the residence principle and the world-wide income principle with the exception of Kenya where the source principle is combined with the territoriality principle. The mix and the missing systematic provisions within the national tax laws against double taxation create many practical problems because in no member country the assignment of the income elements to domestic and foreign income is sufficiently done. Consequently the assignment to the own or foreign fiscal sovereignty is more or less arbitrary.

As already mentioned above the tax rates regarding company taxation are almost harmonised on a 30% tax rate with the exception of Burundi, which applies a 35% tax rate. Again

[171] For more details on an efficient PIT and CIT system see Petersen (2004).

[172] The costs and benefits (in form of national revenue losses or gains) of the different methods can be estimated in simulation approaches if the necessary information is raised.

with the exception of Burundi the company tax rates correspond to the highest marginal rates in PIT so that at least a certain equal treatment of companies with different legal status seems to be guaranteed. The determination of profitable income is partly based on the IFRS or on comprehensive national accounting standards. In the big business the profit definitions are following the International Accounting Standards (IAS). These standards are supplemented by national regulations especially in case of depreciation rules. Usually the tax authorities accept the profit as testified by a certified public accountant (CPA). Obviously there are differences in the depreciation standards within the EAC member countries, but these are not so serious that a harmonisation would be necessary. Business expenses (operating expenditures) like financing costs, maintenance expenses, and advertising costs should generally be fully deductible. In almost each CIT cost components can be found, which are not deductible (e.g. gifts to business associates, bribes, income taxes, and fines). Large differences might also cause competitive disadvantages but such are not observable within the EAC.

Much more problems are involved with the tax incentives set by the single member laws. Tax incentives and state aid (see above under III.1. and several times later) are often connected with discrimination of foreign suppliers and have to be critically analysed regarding harmonisation necessities. Here the export processing zones (EPZ), high special depreciations, and additional initial capital allowances have to be taken into consideration. Kenya and Tanzania (Tanzania only in few cases) have implemented EPZ, in Rwanda EPZ are not yet operating, but important tax exemptions are granted, and in Burundi "Zone franche" according to the Investment Code are existing. Uganda abolished such incentives in 1997 but the IMF[173] noticed that efforts are made to reintroduce such incentives to compensate the competitive advantages of the neighbouring countries. However, when all Partner States have introduced such questionable measures, such incentives and the competitive advantage will disappear so that the only (negative) impact of such construction is the existence of privileges for some companies and substantial revenue losses. **Therefore, it is much better to implement efficient PIT and CIT systems without specific incentives for a few, but with simplicity, transparency, fair rules and adequate tax rates for all, the employees as well as the companies.**

Due to statements of the MoF in Kenya the relevance of EPZ is declining ("appetite for EPZs is going down"). The regulation that 80% of the products have to be exported and 20% should be supplied in the domestic markets has become more and more difficult to achieve, especially since China and Korea have entered the textile markets in the former importing countries. The time horizon is another problem: In EPZ the tax-free status is guaranteed for 10 years, afterwards a reduced tax rate has to be paid. Now many companies expect the government to extend the tax holidays and they threaten to move out of the country – the usual attempted extortion as a consequence of misguided incentives. The MoF now considers to introduce Special Economic Zones (SEZ) following the example of Singapore – and for sure will come out of the frying pan and into the fire!

EPZs and other special incentives distort fair competition in a common market extensively. They are contradictory to economic integration and cause unfair tax and state aid competition – with the only result that all are losers in a footrace for ever increasing incentives and decreasing tax revenue.

[173] See the IMF Country Report 06/353, 1. December 2006.

Therefore, the group of experts very strongly recommends to review and harmonise the incentive schemes and, in a medium-term perspective, the abolishment of all EPZ, SEZ and similar arrangements in the transitional phase of the establishment of a common market.

The same is true regarding special depreciations and initial capital allowances. The high depreciation rates for mining in Tanzania (100%), Uganda (75%), and Kenya (40%) are very questionable. Beyond that in Kenya special depreciations exist for machinery and hotels (100%) whereas in Tanzania and Uganda the rates are between 20% and 50%. However, almost all depreciation allowances exceeding 50% in the first year have elements of tax incentives, which should be abolished instead of harmonising them on a comparatively high level. The latter would lead to a further eroded company tax base with all the negative impacts for the future tax revenue. The other depreciation rates are in accordance with the standards and a certain deviation from country to country does not play a decisive role but allows the Partner State to have a certain margin for the internal tax policy without distorting the common market interests.

Another important aspect is the treatment of **capital gains**, which play an important role in case of dissolving hidden reserves. Then often a large tax yield may result. At least partially the capital gains are taxed within the CIT and burdened with the standard tax rate. The different treatment within the Partner States again may cause competitive disadvantages so that generally a harmonisation need has to be taken into consideration, which should be directed to the tax rate as well as to the estimation of the capital gain. The problem arises because profits are determined by subtracting the acquisition or manufacturing costs from the realized sales prices. These variables influence the volume of the profit in a crucial way. Hence, this variable has to be adjusted to inflation to avoid a pure paper profit. Beyond that the fact has to be taken into consideration that capital gains taxation can be avoided by reinvestment. **Such alternatives exist and have to be included in harmonising activities.**

The treatment of losses is also important, especially in a dynamic analysis.[174] Because of the principle of annual taxation, losses would only be taken into consideration in the year of appearance, which is perceived as unfair in a long-term or even life-time perspective. Therefore, most of the CIT systems have established carry forward (or backward) rules so that losses usually are transferred into future tax periods. Restrictions of volumes or time limits might cause serious excess burdens for the companies under consideration. **Therefore the carry forward methods should also be included in the harmonising activities as well as the acceptance of foreign losses** (depending on the method to avoid double taxation as discussed above).[175]

It has already been mentioned above that the **withholding taxes** within the EAC create enormous problems. Such taxes are withheld at the source for payment; they include dividends, remunerations for particular benefits being taxable such as interest payments, royalties and management services. Table 12 shows the items are under consideration and how they are taxed in Kenya, Tanzania, and Uganda.

[174] For more details see Petersen (2004).

[175] In the EU there is a vivid discussion on this problem since the ECJ has decided a case in favour of concerned companies with reference to the free movement of capital within the EU.

Table 12: Withholding Tax Rates to Non-residents

	Kenya	Tanzania	Uganda	Rwanda	EAC double tax treaty maximum rates (proposed)*
	%	%	%	%	%
Dividends	10	10	15	15	10
Dividends – listed	10	5	15		10
Insurance commission	20	n/a	n/a		
Insurance premium	n/a	5	n/a		
Interest**	15, 25	10	15	15	15
Natural resource payment	n/a	15	15		
Rent***	0, 15, 30	0, 15,	15	n/a	15
Royalties	20	15	15	15	15
Services****	20	15	15	15	15

* The EAC double tax treaty is not yet in force; the maximum rates shown above are per the latest draft of the treaty.

** Higher 25% rate in Kenya applies in the case of "bearer instruments".

*** Kenya: 0% equipment, 30% immoveable property, 15% other; Tanzania: 0% aircraft, 15% other.

**** Application in Kenya is to management and professional fees, training, contractual fees.

Source: Price Waterhouse Coopers East Africa Tax Reference Guide 2008 / 2009. The figures for Rwanda are added.

In accordance with the source or territoriality principle, the taxation in the source state is generally justified for non-residents, even if the burden is a flat-rate. Usually the tax liability of the foreign taxpayer is satisfied with that procedure in the source state. The income is then part of the income tax base in his residence state. Now the treatment in the residence state is of utmost relevance as it has already been discussed above. As far as no compensating measures are implemented in the national tax laws, double taxation might be a very frequent fact. Such problems will lose relevance if the drafted DTA for the EAC will be implemented. **However, the field of withholding taxation has to be considered seriously within the harmonisation activities.**[176]

[176] In the meeting held 5th November 2009 the EAC Ministers of Finance adopted fixed rates for withholding tax at 5% on dividends, and 10% on interest, royalties, management and professional fees under the DTA

PIT and CIT Systems Harmonisation

Review and harmonise all tax incentive schemes in the CIT system, especially EPZs and SEZs

Harmonise initial capital allowances of more than 50%

Treat capital gains from asset sales as normal profit but allow for inflation adjustment

Harmonise the treatment of losses (carry forward) including foreign losses

Harmonize the withholding taxes on dividends, interest payments, royalties and service fees

Enact national laws and harmonise rules on transfer pricing and thin capitalisation in addition to general anti-avoiding clauses regarding profit shifting

Develop an EAC Model Convention for DTAs with third party countries

Create special units for international taxation and tax harmonisation in the RAs

Multinational or international groups (consolidated companies) act in the markets of several countries. The structures of parent companies with their subsidiaries (permanent establishments) are often less determined by market factors than by entrepreneurial decisions in which tax planning plays an important role. Via specific price formation profit shifting between the countries where the head office and the subsidiaries are located is a very frequent fact. The outcome is a shift of the taxable base into the countries with the lower tax rates (tax systems competition). The high-tax states (see the discussions in chapter III.1 above) have developed counter measures such as the arm’s length principle, which is applied in case of “unacceptable” **transfer prices**. The prices must not deviate from those which are agreed between non-affiliated companies. These principles were fixed by the OECD and published for the first time in 1979.[177] Closely connected are interest payments between parent compa-

[177] See OECD (2001).

nies and their subsidiaries, which made their way into the tax evasion literature as the problem of **"thin capitalisation"**.[178]

In Kenya transfer pricing has become a big topic; after the Budget Speech 2009 it was extensively discussed in the newspapers. "Transfer Pricing Rules" exist since 1 July 2006, but obviously many questions have remained open as the following citations demonstrate:

"KRA … starts its audit activities by challenging the soft underbelly of transfer pricing-services … The make up and allocation of the costs may result in a complex exercise where multiple jurisdictions are involved to ensure that no party to the transaction is inappropriately charged for the services received… KRA is actively looking for easy pickings" (PWC). And Deloitte (The Financial Journal, 16 June 2009) states: "One of the most glaring and disturbing omissions from the current regulation is the manner in which the KRA or Minister would go about adjusting the taxable income of a taxpayer whose pricing they determine does not meet the arm's length rules. It would be useful if KRA would have very narrow and clear guidelines and defer the methodologies to the most recent OECD Guidelines. The ambiguities and gaps in the current rule might lead to the extraneous and mischievous interpretation and application of the law by the KRA and taxpayers, which would in turn lead to the wastage of time and resources".[179]

A common market should develop solutions for such problems; currently the Partner States of the EAC have quite diverging approaches. At least partly the legal rules correspond to the OECD principles, other rules consist of vague general clauses, which allow for the CG to decide in single cases. In Uganda there is a draft version of a directive for the treatment of transfer pricing, in other countries such problems are under discussion but still unsolved. Because of possible arbitrary decisions on single cases, there exists a serious threat that within the EAC similar cases are treated quite differently. **Therefore profit shifting has to be a core element within the harmonisation activities to avoid harmful tax competition.**

The unilateral avoidance of double taxation has already been discussed above. In practical tax cases these national regulations have to be applied prior to international law set in DTA. Only if double taxation cannot be avoided nationally, the DTA rules apply. In combination with national and DTA rules double taxation problems can be solved sufficiently. Therefore, the expert group urgently recommends the implementation of the drafted EAC DTA. The harmonisation of this DTA wit the DTA between third party countries should be another common goal. **For new negotiations a model convention for the EAC member countries should be developed.** The existing DTA with third party countries are listed in table 13.

[178] See OECD (1998).

[179] And in addition Deloitte states: "The Kenayan transfer pricing rules became operational on July 1, 2006. These rules require certain taxpayers to develop and document their transfer pricing policies. There appears to be some confusion as to what 'transfer pricing documentation' includes."

Table 13: Double Tax Treaties in EAC Member Countries

	Kenya	Rwanda	Tanzania	Uganda	Burundi
Belgium		*		Yes	
Canada	Yes		Yes		
China				*	
Denmark	Yes		Yes	Yes	
Finland			Yes		
France	*				
Egypt				*	
Germany	Yes				
India	Yes		Yes	Yes	
Italy	Yes		Yes	Yes	
Mauritius		Yes		Yes	
Netherlands				Yes	
Norway	Yes		Yes	Yes	
South Africa		Yes	Yes	Yes	
Sweden	Yes		Yes		
Switzerland	Yes				
United Kingdom	Yes			Yes	
Zambia	Yes		Yes	Yes	

* Pending Treaties (signed but not yet in force)

Source: www.taxanalysts.com

The problem of double taxation agreements has not been seen as urgent, which explains why the already long existing draft DTA for the EAC has not yet been finally approved. Additionally, the number of DTA with third party countries is comparatively low, which might be taken as a proxy that all member countries are not sufficiently included into the international markets. But beyond that the insight seems to be lacking within the Partner States that double taxation has enormous negative impacts on intra-community trade and the economic integration process. The threat of possible tax revenue losses is evaluated higher than future growth enhancing community advantages, which will also lead to revenue increases in the Partner States, respectively. The often mentioned accession of Rwanda and Burundi as reason for the delay is utilized more as a welcome excuse for the delays than a rational justification. **Regarding tax incentives and EPZ the political will to follow new concepts is necessary for a successful harmonisation process.**

VII.4 Harmonisation Requirements for Procedure Law and Tax Administration

As already mentioned in chapter VI.5, most of the member countries have started activities to reform the procedure law as well as the administrative structures. It is surprising that these activities are more or less uncoordinated among the Partner States. The threat of the isolated implementation of legal systems exists, which might provoke a new field of conflicts between the Partner States.

Therefore information and staff exchange between the Partner States is recommendable to secure a certain degree of harmonisation in legislative procedures from the very beginning.

In Kenya, Tanzania, Uganda and Rwanda, semi-autonomous revenue authorities (RA) have been established. Burundi will follow with the implementation of such an authority by the end of 2009. These structures are based on reforms dating from a decade earlier; in practice they have stood the test of time.[180] These authorities are less hierarchically structured than other governmental institutions, semi-autonomous and structured similar to private offices. They normally recruit their staff themselves, have a better salary structure, and are independent of instructions of the MoF. Their budget is supposed to be directly financed from the tax revenue they collect. This RA model is convincing and should be further developed. Deficiencies have been observed e.g. in the recruiting process: not always the best candidates have been selected, but often the candidates with the best connections.

Equally successful have been the LTU, which are centrally responsible for the taxation of large taxpayers. These units have substantially improved the quality and effectiveness of the tax administration and are usually characterized by a high professional competence.[181] They exist in Kenya, Tanzania, Uganda and Rwanda. Problems remain with the smaller revenue offices, which often have less staff and material resources.

A large backlog exists within the tax administration regarding hard- and software for information technology (IT) services, which is the backbone for information exchange (see VIII. below). The development within the single member countries is quite diverging. While some countries already have the possibility to file electronic tax forms does exist and electronic risk filters are implemented (Kenya, Tanzania), in others neither electronic register nor corresponding TIN systems have been implemented (Uganda). Besides the backlog, there is an enormous need for harmonisation, because integration processes are strongly accompanied by an ever increasing information exchange. **The keywords for the harmonisation activities are a uniform TIN system, registration of taxpayers, data banks for the basic tax data** (residence/place of business, kind of business, relevant tax data, etc.), **and data exchange with important partner administrations.** The compatibility of the software used within the EAC member countries is of utmost importance. Isolated applications such as ITAX (Tanzania) and ITAS (Uganda), which are without any doubt very useful on the national level, can create serious obstacles for a successful harmonisation process.

[180] See Taliercio (2004). See also IMF Publication 2009:"The Story of an African Transition"; http://www-wds.worldbank.org/external/default/main?pagePK=64193027&piPK=64187937&theSitePK=523679&menuPK=64187510&searchMenuPK=64187283&siteName=WDS&entityID=000160016_20041027132024.

[181] See Baer/Bennon/Toro (2002). See also http://www.imf.org/external/pubs/cat/longres.cfm?sk=15674.0.

Administration and Procedures Harmonisation

Exchange national administrative staff between the Partner States to create a “spirit of harmonisation”

Develop and enact a harmonised Tax Procedure Act:

- describing taxpayers rights and obligations
- defining rules for adjustments of tax assessments, types of adjustments and time frames
- defining common sanctions for non-compliance
- defining the procedures of appeal
- defining the procedures of enforced collection

Develop an indicator system to evaluate the RAs performance and efficiency

Develop and apply a harmonised field audit manual

Develop a code of conduct for all RAs

The quality of tax governance (administrative quality) might be determined with the help of some soft indicators. These include professional competence of the staff, motivation, duration of proceedings, bureaucratic obstacles (e.g. the number of forms to be filed, submission of documents and evidence, unclear competences), number of faulty services, correction of faulty services, and influence of personal relations and corruption within the administrative procedures. Such indicators determine the effectiveness and efficiency of public administrations, but are difficult to be collect and evaluate. Therefore, the results of such attempts have to be used with caution. This also holds true for a study generated by PWC from the Paying Taxes 2009 report.[182] The Paying Taxes study, carried out by a joint venture of PWC and the World Bank, highlights how businesses are affected not only by corporate income taxes, but also by many other taxes. In addition, it shows how the procedural burden of tax compliance affects companies (payment numbers, time used for tax purposes, etc.). Such indicators touch sensitive core areas of tax administrative behaviour. An improvement of the administrative quality is in the very first instance an important national task. But steps in the direction of more fundamental reforms should be discussed and coordinated within the EAC.

Another important field is the question of taxpayers’ compliance; as long as citizens and taxpayers have a deep-seated mistrust in governmental institutions, law-abiding behaviour is jeopardized. The willingness to register, to file forms and to pay taxes is heavily dependent on how the citizens perceive the fairness of the tax system and the administrations involved.

[182] See www.doingbusiness.org/taxes and www.pwc.com/payingtaxes.

Compliance with the tax systems can be improved if the rights and obligations of the taxpayer are expressly and clearly regulated in the tax code or the different laws (especially the law on tax procedures). Modern tax laws stipulate the interference rights of the administration and the rights of the taxpayers regarding binding information, confidentiality, refusal of information, etc. However, most of these regulation are missing in the laws of the EAC Partner States, although the right of appeal against tax assessments is regulated properly. All encompassing tax administration laws could put things right and contribute to a harmonisation within the EAC area.

Provisions on tax assessments as well as time limitations for adjustments exist only rarely. This is very important for the taxpayer because it impedes on their confidence that tax assessments can only be adapted under very specific conditions. However, legal certainty is the prerequisite for economic action, especially for long-term investment.

The effective collection of tax claims is an indicator for the quality of administration. Both the normal collection procedure and the enforced collection practices tend to be weak points. Shortcomings have been observed in the legal field as well as in practical execution. The assessment statistics of the revenue authorities are often presented as success stories. But the actually collected amounts differ from those, which have been assessed before. Finally a rather high percentage has to be written off.[183] The field of enforcement is so important for the effective tax burden in the Partner States that in a common market, uniform rules and practices should be implemented.

The possibility of legal remedies against tax assessments is generally implemented within the laws of the Partner States. Usually an administrative appeal forms the first step before a tribunal is involved. An assessment of the quality of the administrative and judicial rulings was not possible. Statistical documents on the number of appeals, the quota of successful appeals, information about the length and the costs of appeal procedures were not available. Tax tribunals exist in some Partner States; such courts substantially improve the legal protection for the taxpayers because special and experienced judges are more able to pass efficient and just decisions. **The expert group recommends the harmonisation of taxpayer's legal protection as an important cornerstone for the development of a common market. This includes the development of a "code of conduct" for the revenue authorities for all Partner States, which should guarantee the commitment of all levels of the tax administration and stimulate the spirit of partnership within the EAC.**[184]

VIII. Transparency and Information Exchange

The most important prerequisite for integration policies is the trust between the partner states that correct information is provided on the main economic indicators, the budgetary situation regarding expenditures (especially state aid) and revenues (tax revenue as well as all other components) so that administrations, economic research institutes, the media, and the public are well informed about the current status and development trends over time. Only if all stakeholders have sufficient information about the challenges and future perspectives, a

[183] Uganda, Letter of Intent to IMF, 20/06/08.

[184] Such code has also been mentioned by members of the Kenyan MoF. But it was added that such a code of conduct would only have chances in the parliament if derogation rules would be included, too.

spirit of partnership within a common market and economic union can be gradually developed.

Carrying out this study and collecting the necessary information has shown that much still needs to be done. The information policies and strategies are quite heterogeneous and far from being perfect. Reliable statistics are often missing, and statistics published suffer from serious inaccuracy.[185] This holds true for most of the figures cited in this report. With good figures on the composition of tax revenue, national accounts statistics and additional information on the output of the different sectors, reliable indicators for the relevance of the shadow economy can be developed, which also deliver important information for the future tax trends. **Therefore, more efforts have to be made as fast as possible to improve the information base and the statistics in the EAC member countries, but also in the EAC Secretariat, before the harmonisation details mentioned above can be realised.** Only correct diagnosis can lead to an adequate therapy.

The quality of the statistical base also depends on the readiness of the national authorities – the MoF, the RA, and the statistics agency – to cooperate rationally and efficiently. Naturally, the tax data have to be prepared in an anonymous format; but with modern statistical procedures all necessary information for the analyses of effective tax burdens and the distribution of tax burdens can be delivered even on an individual basis. An effective, equal, and fair tax assessment is heavily dependent on the information base and the analyses of tax data.

The RA must be in the position to exchange data nationwide and comprehensively between their own offices. They are also dependent on external information from other bureaus; cross-linking with municipal administrations and the registration offices is necessary (personal residence, business residence, kind of business etc.). The RA only performs sufficiently if they are efficiently linked with the banking system, especially those banks which are involved in transferring tax payments. Reminders, offsets, and enforcement measures are not possible without corresponding information exchange. For this purpose IT support is indispensable. Only in the second rate taxation of capital income has to be mentioned in this context, which implies that capital income is reported to the fiscal administration. If tax evasion regarding capital income is a frequent behaviour then the fairness of taxation has to be discussed in relation to the banking secrecy, which has played an important role in the past but has almost been abolished by the initiatives of the OECD and some EU partner states (especially France and Germany) very recently (see the discussion in III.1. above).

The RA also has to develop a network with the social insurance institutions (information on pension payments and sickness benefits) as well as with the social aid institutions, which are paying transfers. Cross cheques may detect tax evasion as well as transfer fraud. The most important fact is the immediate control if taxes and social security contributions have not been correctly paid (pay-as you-earn).

Regarding the aspects of inner-community and international taxation, unilaterally set national rules or DTA rules like presented in table 4 above have to be applied. Because the distribu-

[185] Obviously such information is also spreading within the member countries. Therefore, Article 50 of the EAC Protocol mentions the cooperation in statistics: "1. Partner States shall cooperate to ensure the availability of relevant statistical data for describing, monitoring and evaluating all aspects of the Common Market. 2. The objective of cooperation in paragraph 1 of this Article shall be to make available relevant, timely and reliable statistical data for sound decision making and effective service delivery in the Community".

tion of the tax revenue heavily depends on the location of the incomes under consideration within the different member countries and the kind of method applied to avoid double taxation (but also to secure that every income component is taxed once), also information exchange between the revenue authorities of the member countries is necessary. For cross border transactions information on the persons and the connected payments have to be delivered. Otherwise mutual reproaches are induced, which create serious resentments between the partner states and a threat for the community's spirit. With the cancellation of DTA between old partners of the EU such controversies have recently reached a new but questionable quality. **This implies the development of a "code of conduct" for all Partner States, which should guarantee the commitment of all levels of the tax administration and stimulates the spirit of partnership within the EAC.**[186]

IX. Strategic Recommendations for Tax Harmonisation in the EAC

The details of harmonisation needs and the process of harmonisation have been described in the two previous chapters. This chapter focuses on the general experiences from the field studies carried out within the five Partner States. Due to the very tight time frame, such remarks are of course only first impressions and have to be taken with much reservation. Interviews have been organised with representatives of the management of the private sector, politicians, and of the tax administration within the single member countries and carried out from 2 to 19 June 2009. The German interviewers were accompanied by two experts from Uganda and Burundi and three experts from the EAC Secretariat. The team would like to thank all those who supported the field studies by taking part in the interviews and through their enlightening remarks and statements, which have substantially improved the quality of the present study (see appendix 1).[187]

In the interviews almost all partners supported the idea to harmonise the tax systems within the EAC.[188] A common market is the commonly agreed overall target. Tax harmonisation is regarded as a practicable project and the proponents point to the successful implementation of the customs union, which will be completed until the beginning of the coming year. However, the interviewers gained the impression that in their immediate positive response the interview partners were often not fully aware about the fact that tax harmonisation is a much more demanding project than a customs union. In spite of their ostensible support of harmonisation, occasionally objections were expressed. Hence, fears were mentioned that the own position might be worsened within the harmonisation process, especially the loss of a more or less part of the national tax revenue. Others expressed doubts on their competitive situation and fears that one partner might dominate the whole community.

Because such fears have also determined the discussions in the EU whenever new states were considering accession, some illuminating remarks and information shall be added. At the time of accession, considerable differences in the economic performance of the different

[186] Such code has also been mentioned by members of the Kenyan MoF. But it was added that such a code of conduct would only have chances in the parliament if derogation rules would be included, too.

[187] A list of the interview partners is printed above.

[188] For the interview questions see appendix 3.

countries certainly exist. In the first year following the accession, even losses in tax revenue and decreases in per capita income are to be observed. But sooner or later, the accession of new states into the community produces integration profits, so that especially the poorest accession states increase their per capita income considerably and the income gap closes and even smaller countries catch up, sometimes even surpassing former high income countries (see figures A6 in the appendix 4). Even the Eastern European countries have caught up in the meantime so that for instance Poland and the Czech Republic have now reached between 80% and 90 % of the average per capita income in the EU. And also those with comparative losses in this process – like Germany – have had enormous advantages because the opening of the European markets for their products has secured their high income position. **Therefore, all Partner States are winners of the integration process. If such message is spread to the public, doubts and fears will be overcome and the perception of integration and harmonisation become much more optimistic.**

It has to be stressed in public discussions that harmonisation does not mean total equalisation and egalitarianism (like in socialism). The nations shall keep their particularities in culture and tax culture. Therefore, adaptations have to be made only regarding cross border activities. All other tax components can remain different, while the states should bear in mind that overburdening of single tax bases might have disadvantages for the own competitive situation within the common market or the global market. Because in many states the citizens have a preference for lower taxation, high tax countries will run into problems and have to reform their tax and partly expenditure systems. That is a healthy competition because the Leviathan state is then under pressure and vanishing from the world map.

But tax harmonisation will be a complex and difficult endeavour, which may take much longer than some regional experts think (see the EU example above). The national tax laws are not in the focus of this report but having the complex constructions of the tax systems in mind, **reforms on a national basis will not only be inevitable but necessary and even recommendable.** For the harmonisation process priorities and posteriorities have to be set. Preference should be given to those elements that are indispensable for a common market and are comparatively easy to be implemented. The experts agree that the avoidance of double taxation in the area of income taxation has the first priority, followed by the harmonisation of the VAT, the excise taxes, the profit taxes and the tax procedures; the last resort might be the abolishment of the border controls and the shift to the origin principle in taxation. Then an inter-community equalisation system would have to be implemented to guarantee for a fair distribution of the VAT, which might be steered by a regional fund[189] perhaps due to the per capita income volumes. This would be the next step of integration from the common to the single market or an economic union (see table 1 above).

Double taxation has been set first because in this field the bulk of work has already been done. The draft version of the DTA for the EAC is existent since 1997 and just waiting for the ratification. The recent objections of Uganda can easily be incorporated. The completion of this agreement would not only avoid double taxation but also be taken as a clear signal in the direction of a common market. **Therefore the expert group emphatically supports the completion of the multilateral DTA as soon as possible.**

[189] Such regional fund has been proposed in M.A. Consulting Group (2007, pp. 4).

VAT is the second important component; and here especially the legal structures have to be harmonised. The most difficult tasks are seen in harmonising tax exemptions (including zero rated goods) and cross border services. Also the procedures for input tax deduction have to be harmonised, which again is an ambitious and time-consuming endeavour.

Excise taxes, as the third complex, also demand fundamental adaptations in the tax laws of those member countries, which have predominantly ad valorem rates. The profit tax as well as the tax procedures are also connected with substantial national adaptations and inner-community harmonisation.

Strategic Recommendations

- Improve and harmonise information base and statistics in the Partner States and the EAC Secretariat
- Convey the spirit of harmonisation into the consciousness of administrations and citizens
- Create a more optimistic perception of integration and harmonisation
- Reforms within the national tax laws are necessary and recommendable
- Strengthen and modernise national tax authorities

Who are the stakeholders in the harmonisation process? The EAC Secretariat is supposed to take centre stage in the harmonisation endeavours and activities. The partner countries have agreed that the EAC as a supra-national organisation is responsible for the initiative and the steering of the harmonisation process. Thus, the position of the Secretariat is comparable to that of the EU Commission. The implementation of the reform measures is the responsibility of the Partner States. However, the EAC Secretariat has no power to decree binding directives for the partner states, a fact that puts it in a much weaker position than the EU Commission.[190] the further harmonisation process is much encumbered by the fact that up to now the staff of the EAC Secretariat and the technical equipment is very limited. In the taxation field there is almost no professional competence implemented, being able to promote the

[190] Interestingly with regard to the harmonisation of labour laws the Article 10 of the EAC Protocol states: “For purposes of this Article, the Council shall issue directives and make regulations on its implementation”. The Council is the Council of Ministers and not the Secretariat. Article 37 on the harmonisation of tax policies and laws does not mention any directives at all.

complex harmonisation process. The EAC Secretariat has no special tax department and the lack of revenue has counterproductive consequences.[191]

Addressees of the EAC initiatives are the responsible ministries in the member countries. But as the EU experiences have shown, the driving forces have mostly been the ministers of finance and the tax authorities within the partner states. In order to ensure smooth coordination, both the Ministers of Finance and the Ministers for EAC Affairs must participate in the harmonisation process. Additional channels for cooperation should also be used. An important role might be played by the East African Revenue Authorities (EARA); the periodical meetings of the CG could be an appropriate platform for professional discussions. The national tax authorities have to become aware that a double tracked strategy can be successful, which not only leaves the initiatives with the EAC but incorporates also national initiatives as momentum for the harmonisation process. **The governments of the partner states must come to the conclusion that strengthening and modernising the national tax authorities is a further prerequisite for a successful tax harmonisation strategy.**

Some critical remarks close this chapter. The experts gained the impression that at least in some areas the political will to fully support integrative processes was missing and that there are also deficits in implementation, for example in the case of the multilateral DTA, which has been pending since 1997. Furthermore, there is an ongoing process of developing the tax system as well as the implementation of a newly structured tax authority in Burundi. The Partner States should support Burundi through technical assistance, which perhaps would be a first initiative in the direction of a regional fund being implemented for the economically weaker regions of the community.

Regarding the double and multi-membership in regional African organisations this might create coordination problems, which have recently been pointed out by the IMF. However, the Partner States have to ponder the future strategy and development of the EAC, which sooner or later will become a serious competitor for other regional organisations as the integration process gains momentum. Here again, the example of the EU shows that by now, it has almost totally replaced the EFTA. A long-term strategy addressing countries interested in joining the community has to be developed. Up to now the dimension of the community is far from the optimal size required for further increasing economies of scale.

X. Summary

Economic integration for using the economies of scale is a powerful instrument in the development process. The connected tax harmonisation might have some revenue-reducing impacts in the short run, but increasing intra-community and international trade as well as economies of scale induce economic growth and benefit all partners of a community in the

[191] The above mentioned Study on the Establishment of an East African Community Common Market (M.A. Consulting Group (2007), p. 5) proposes two sources of funding: “The first extends the current mode of direct contributions by the Partner States by recommending that the contribution be assed at a 0.5% level of the previous year’s Gross Domestic Product. Funds from this source are to be used specially to finance the Community’s recurrent expenditure (operations and programs). The second source is a charge of 1.5% on total customs revenue of the Community. Resources from this source are to be deposited in a special development fund and will be used to finance social and economic infrastructure and to promote the development of disadvantaged areas of the Community. The level of contributions shall be reviewed every three years.”

long run. Such a process is much more rational than to set national tax incentives and state aid, which usually ends in an accelerating spiral of harmful tax competition, destroying the revenue powers of the states involved.

Chapter II of this report gives the necessary definitions of the basic terms and methods, guaranteeing that in direct as well as indirect taxation the problems of double and zero taxation can be avoided, so that all incomes, goods and services within a common market are taxed strictly once only. Chapter III describes in more detail the possible range of harmonisation based on the experiences made within the EU and the very recent international developments in combating harmful tax competition. Then the details of harmonisation are discussed for the main taxes in the focus of this report: excise taxation, VAT and CIT. Chapter IV briefly summarizes the problems of tax administration, procedures and taxpayers behaviour before the main macroeconomic variables are presented, concisely analysed and illuminated against the background of internal and external integration in chapter V..

Chapter VI contributes a general analysis of the structure of the tax systems in the five Partner States. Subsequently, the VAT, excise tax, and income tax systems and the tax procedures of the Partner States are confronted, supplemented by a more detailed overview in Appendix 4 (see tables A3 to A5). Chapter VII describes the harmonisation requirements and the recommendations of the expert group, which are briefly summarised in the Executive Summary at the beginning of this report. The enormous relevance of transparency and information exchange is accentuated again in chapter VIII, while chapter IX contains the long-term strategic recommendations of the expert group. Finally the expert team would like to thank once more all the people involved, who have substantially contributed to the realisation of this study. We hope it will have a fruitful impact on the further integration process in East Africa and on the development of its member countries.

Appendices

Appendix 1: List of Interview Partners and Meetings

Rwanda

Date	Meeting partner	Function	Organisation
01.06.2009	Pierre Célestin Bumbakare	Commissioner for Domestic Taxes Department	Rwanda Revenue Authority (RRA)
	Charles Kagame	Head of Legal Department	RRA
	Ben Kagarama	Deputy Commissioner LTO	RRA
02.06.2009	Prosper Musafiri	Director General Economic Planning	Ministry of Finance
	Thomas Bedenbecker	Coordinator Economy and Employment	GTZ
03.06.2009	Dmitry Gershenson	Resident Representative	IMF
	Kiran Holmes	RRA Project Manager	DFID
04.06.2009	Rosemary Mbabazi Mugisha	Acting Director General	Investment Promotion, Rwanda Development Board
	Gerald Mpysi	Chairman	Inspire Management Institute
05.06.2009	Herbert Gatsinzi	Senior Manager	Tax Advisory Service, Ernst & Young
	Mary BAINE	Commissioner General	RRA
	Rainer Krischel	Country Director Rwanda/Burundi	GTZ

Burundi

Date	Meeting partner	Function	Organisation
08.06.2009 and **11.06.2009**	Pascal Kirahagazwe	Inspecteur des impôts, Coordinateur (Etudes et Réformes au Département des Impôts)	Ministère des Finances
	Patrick Ndayishmiye	Juriste-Fiscaliste, Coordinateur de la Cellule chargées des Etudes et des Réformes	Département des Impôts
	Gaspard Rucunga	Vérificateur au Département des Impôts	Ministère des Finances
09.06.2009	Henri Bukumbanya	Chef de Service	Département des Impôts
	Donatien Bihute	Directeur Général, CDE	Bureau Technique d'intervention (BTI) au Burundi
	Kiran Holmes	DFID	RRA Project Manager

10.06.2009	Aloys Ntakirutimana	Directeur des Impôts	Ministère des Finances
11.06.2009	Parfait Ndonkeye	Inspecteur des Douanes, Chef de Service Informatique, Direction des Douanes	Ministère des Finances
	Sue Hogwood	Head of Office	DFID, Bujumbura

Tanzania

Date	Meeting partner	Function	Organisation
02.06.2009	Richard Marshall	Partner Tax Services	Price Waterhouse Coopers
	Dr. Axel Doerken	Head of Country Bureau Tanzania	GTZ
03.06.2009	Patrick N. Kassera	Commissioner Large Taxpayer Department	Tanzania Revenue Authority
04.06.2009	Hussein Kamote		Confederation of Tanzania Industries (CTI)
	Andrew Okello	Revenue Policy and Administration Advisor	IMF
	Mario de Zamaróczy	Coordinator	IMF East Africa Regional Technical Assistance Centre (Afritac)
	Joannes N.A.Mally	Commissioner for Domestic Revenue Department	TRA
	Harry M. Kitillya	Commissioner General	TRA
05.06.2009	Edward Mwachinga	Senior Manager Taxation Services	Deloitte & Touche
	James Kirimi	Manger Tax	

Uganda

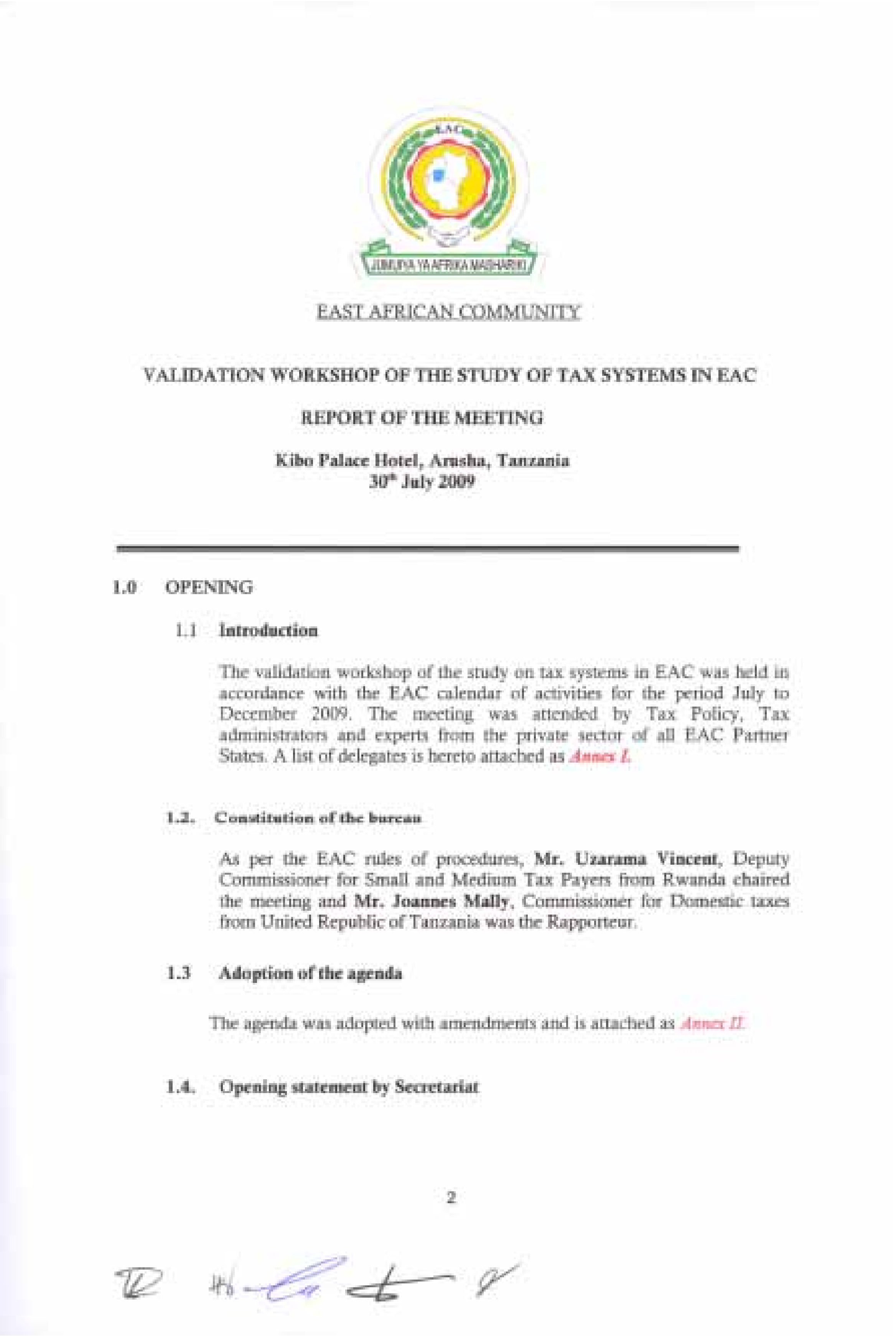
Date	Meeting partner	Function	Organisation
08.06.2009	Francis Onapito	Corporate Affairs Director	Nile Breweries Ltd.
	Lawrence K Kiiza	Director Economic Affairs	Ministry of Finance Planning and Economic Development
09.06.2009	**Public Holiday**		
10.06.2009	Godfrey Ayebale Steven Kabagambe Janepher Sambaga Ronald Kazibwe	Head Business Division Mobilization/Education Head of Lobby & Advocacy Research Officer	Uganda National Chamber of Commerce & Industry
	Peter Kayambadde Albert Beine	Senior Managers Tax Services	KPMG

	Obua Joel	Tax Department	Deloitte & Touche
	Mrs. Jacqueline Kobusingye Opondo Mrs. Patience Rubagumbya Mrs. Atukunda Allen Mrs. Berna Arinaitwe	Commisioner Internal Audit&Comliance Manager of Policy and Rulings Arrears&Objections Human Resource Develp	Uganda Revenue Authority

Kenya

Date	Meeting partner	Function	Organisation
15.06.2009	Rosalyn Amati	Deputy Chief Council	Treaty Department, Tax Law Office.
	Linda Murila		Tax Law Office
16.06.2009	Martin Gumo	Deputy Director Economic Affairs	Ministry of Finance
	Mary Nguli	Economist	Ministry of Finance
17.06.2009	John K. Nijirani	Commissioner of Domestic Taxes, Large Taxpayer Office	KRA
	Alice A. Owuor	Senior Deputy Commissioner, Domestic Taxes Department	KRA
	Catherine W. Bwire	Senior Deputy Commissioner, Head Policy Unit-Technical DTD	KRA
	Ephraim Munene	Domestic Taxes Department	KRA
	Edward Mbugua	Domestic Excise, Large Taxpayer Office	KRA
18.06.2009	Dickson Hainga	Head of Macro Economics Department	The KENYA INSTITUTE for PUBLIC POLICY RESEARCH and ANALYSIS (KIPPRA)
	Benson Kirya	Macro Economic Department	The KENYA INSTITUTE for PUBLIC POLICY RESEARCH and ANALYSIS (KIPPRA)
	Gedfrey Karibuki	Macro Economic Department	The KENYA INSTITUTE for PUBLIC POLICY RESEARCH and ANALYSIS (KIPPRA)
19.06.2009	Dickson Poloji		Kenyas Association of Manufacrurers (KAM)

Appendix 2: Report of the Meeting



EAST AFRICAN COMMUNITY

VALIDATION WORKSHOP OF THE STUDY OF TAX SYSTEMS IN EAC

REPORT OF THE MEETING

Kibo Palace Hotel, Arusha, Tanzania
30th July 2009

1.0 OPENING

1.1 Introduction

The validation workshop of the study on tax systems in EAC was held in accordance with the EAC calendar of activities for the period July to December 2009. The meeting was attended by Tax Policy, Tax administrators and experts from the private sector of all EAC Partner States. A list of delegates is hereto attached as *Annex I.*

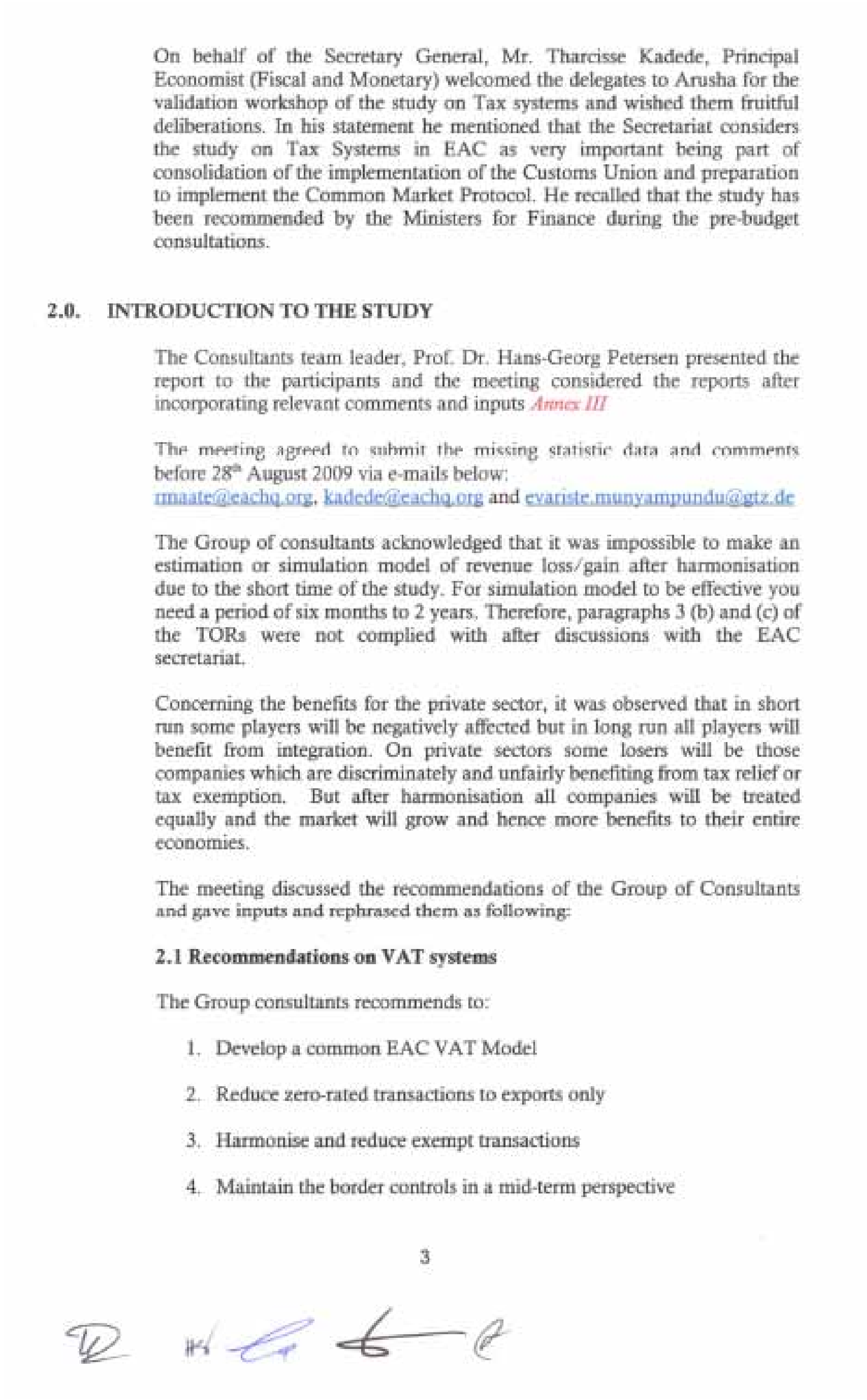
1.2. Constitution of the bureau

As per the EAC rules of procedures, **Mr. Uzarama Vincent**, Deputy Commissioner for Small and Medium Tax Payers from Rwanda chaired the meeting and **Mr. Joannes Mally**, Commissioner for Domestic taxes from United Republic of Tanzania was the Rapporteur.

1.3 Adoption of the agenda

The agenda was adopted with amendments and is attached as *Annex II.*

1.4. Opening statement by Secretariat



On behalf of the Secretary General, Mr. Tharcisse Kadede, Principal Economist (Fiscal and Monetary) welcomed the delegates to Arusha for the validation workshop of the study on Tax systems and wished them fruitful deliberations. In his statement he mentioned that the Secretariat considers the study on Tax Systems in EAC as very important being part of consolidation of the implementation of the Customs Union and preparation to implement the Common Market Protocol. He recalled that the study has been recommended by the Ministers for Finance during the pre-budget consultations.

2.0. INTRODUCTION TO THE STUDY

The Consultants team leader, Prof. Dr. Hans-Georg Petersen presented the report to the participants and the meeting considered the reports after incorporating relevant comments and inputs *Annex III*

The meeting agreed to submit the missing statistic data and comments before 28th August 2009 via e-mails below:
rmaate@eachq.org, kadede@eachq.org and evariste.munyampundu@gtz.de

The Group of consultants acknowledged that it was impossible to make an estimation or simulation model of revenue loss/gain after harmonisation due to the short time of the study. For simulation model to be effective you need a period of six months to 2 years. Therefore, paragraphs 3 (b) and (c) of the TORs were not complied with after discussions with the EAC secretariat.

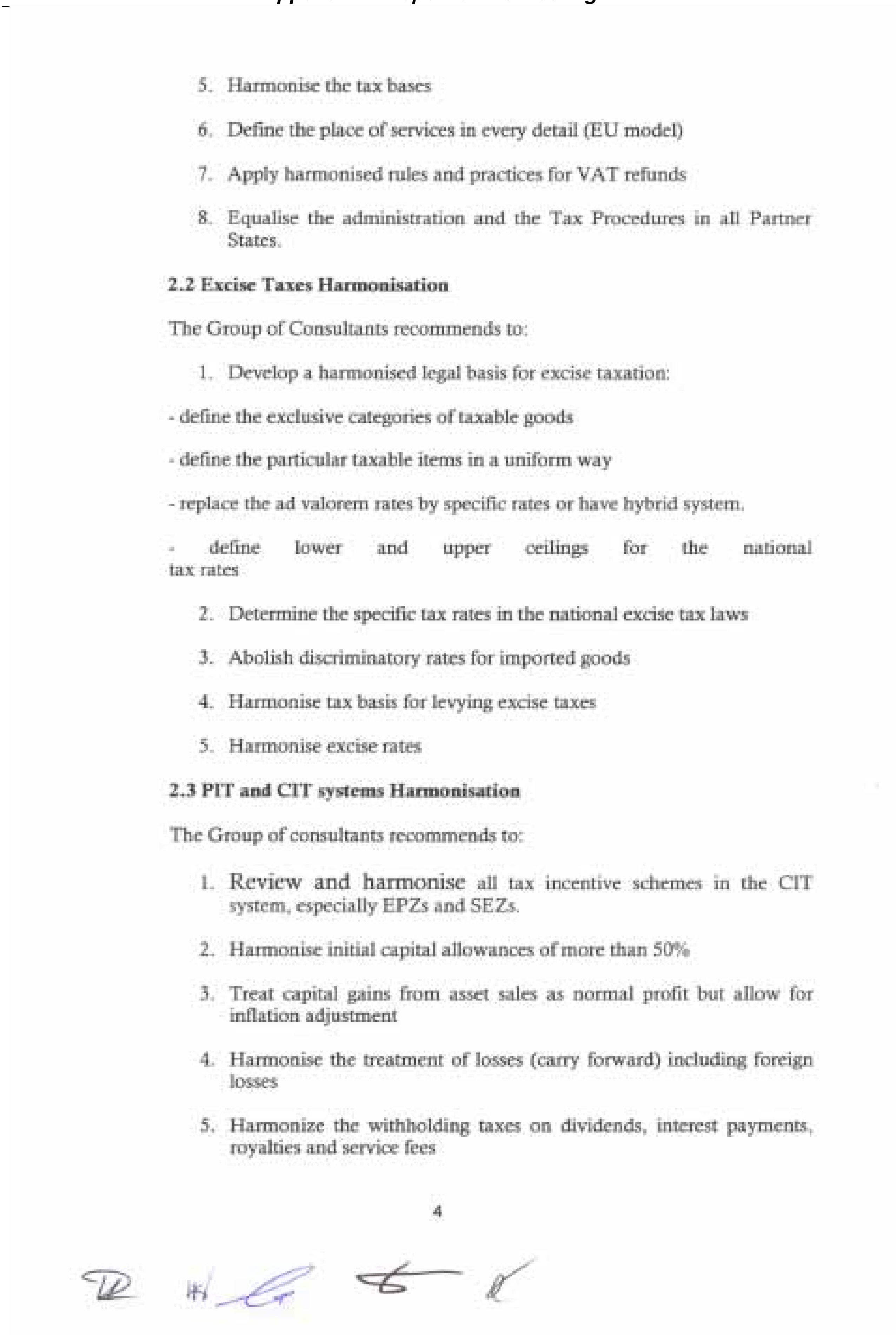
Concerning the benefits for the private sector, it was observed that in short run some players will be negatively affected but in long run all players will benefit from integration. On private sectors some losers will be those companies which are discriminately and unfairly benefiting from tax relief or tax exemption. But after harmonisation all companies will be treated equally and the market will grow and hence more benefits to their entire economies.

The meeting discussed the recommendations of the Group of Consultants and gave inputs and rephrased them as following:

2.1 Recommendations on VAT systems

The Group consultants recommends to:

1. Develop a common EAC VAT Model
2. Reduce zero-rated transactions to exports only
3. Harmonise and reduce exempt transactions
4. Maintain the border controls in a mid-term perspective



5. Harmonise the tax bases

6. Define the place of services in every detail (EU model)

7. Apply harmonised rules and practices for VAT refunds

8. Equalise the administration and the Tax Procedures in all Partner States.

2.2 Excise Taxes Harmonisation

The Group of Consultants recommends to:

1. Develop a harmonised legal basis for excise taxation:

- define the exclusive categories of taxable goods

- define the particular taxable items in a uniform way

- replace the ad valorem rates by specific rates or have hybrid system.

- define lower and upper ceilings for the national tax rates

2. Determine the specific tax rates in the national excise tax laws

3. Abolish discriminatory rates for imported goods

4. Harmonise tax basis for levying excise taxes

5. Harmonise excise rates

2.3 PIT and CIT systems Harmonisation

The Group of consultants recommends to:

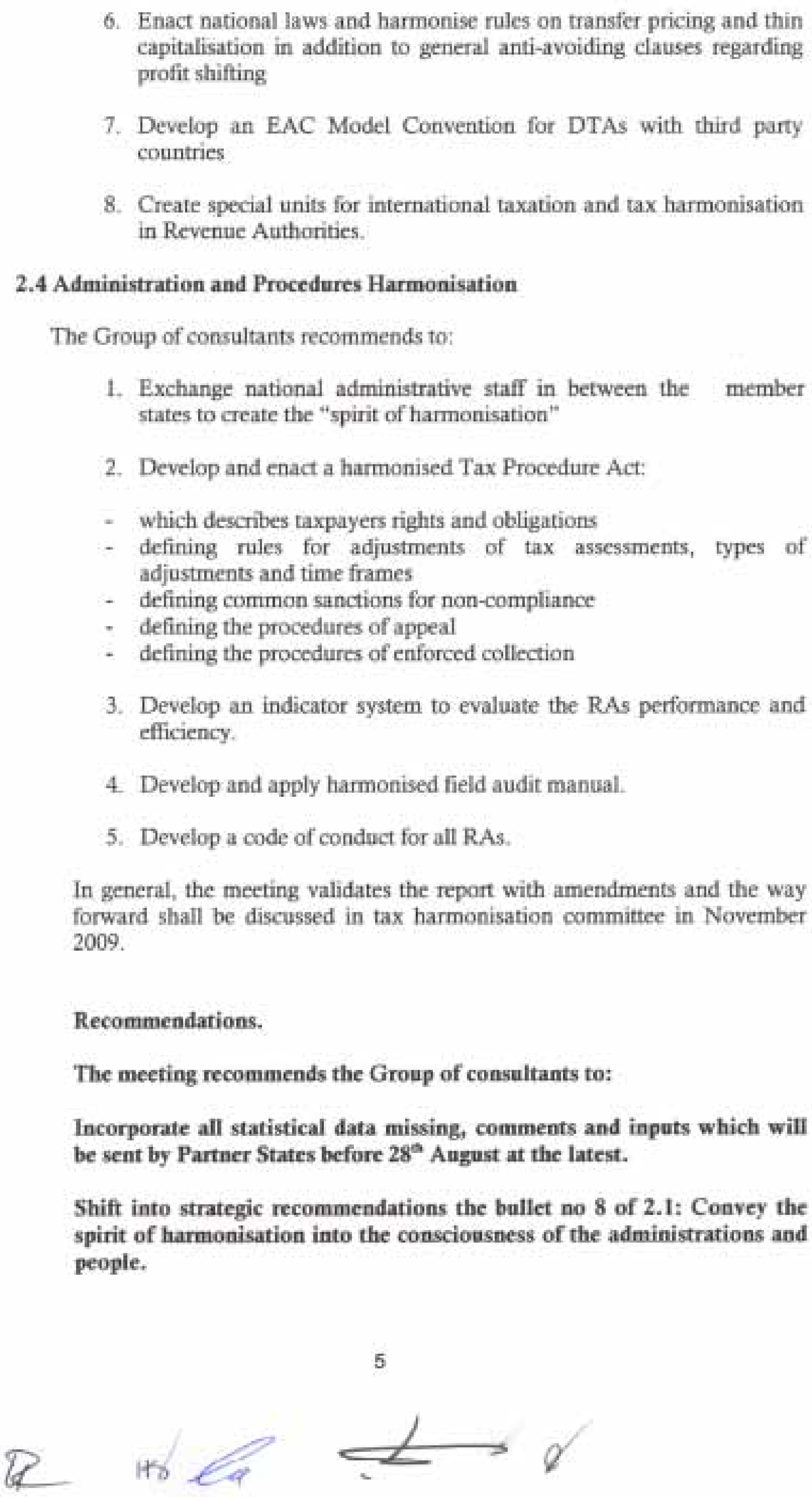
1. Review and harmonise all tax incentive schemes in the CIT system, especially EPZs and SEZs.

2. Harmonise initial capital allowances of more than 50%

3. Treat capital gains from asset sales as normal profit but allow for inflation adjustment

4. Harmonise the treatment of losses (carry forward) including foreign losses

5. Harmonize the withholding taxes on dividends, interest payments, royalties and service fees



6. Enact national laws and harmonise rules on transfer pricing and thin capitalisation in addition to general anti-avoiding clauses regarding profit shifting

7. Develop an EAC Model Convention for DTAs with third party countries

8. Create special units for international taxation and tax harmonisation in Revenue Authorities.

2.4 Administration and Procedures Harmonisation

The Group of consultants recommends to:

1. Exchange national administrative staff in between the member states to create the "spirit of harmonisation"

2. Develop and enact a harmonised Tax Procedure Act:

- which describes taxpayers rights and obligations
- defining rules for adjustments of tax assessments, types of adjustments and time frames
- defining common sanctions for non-compliance
- defining the procedures of appeal
- defining the procedures of enforced collection

3. Develop an indicator system to evaluate the RAs performance and efficiency.

4. Develop and apply harmonised field audit manual.

5. Develop a code of conduct for all RAs.

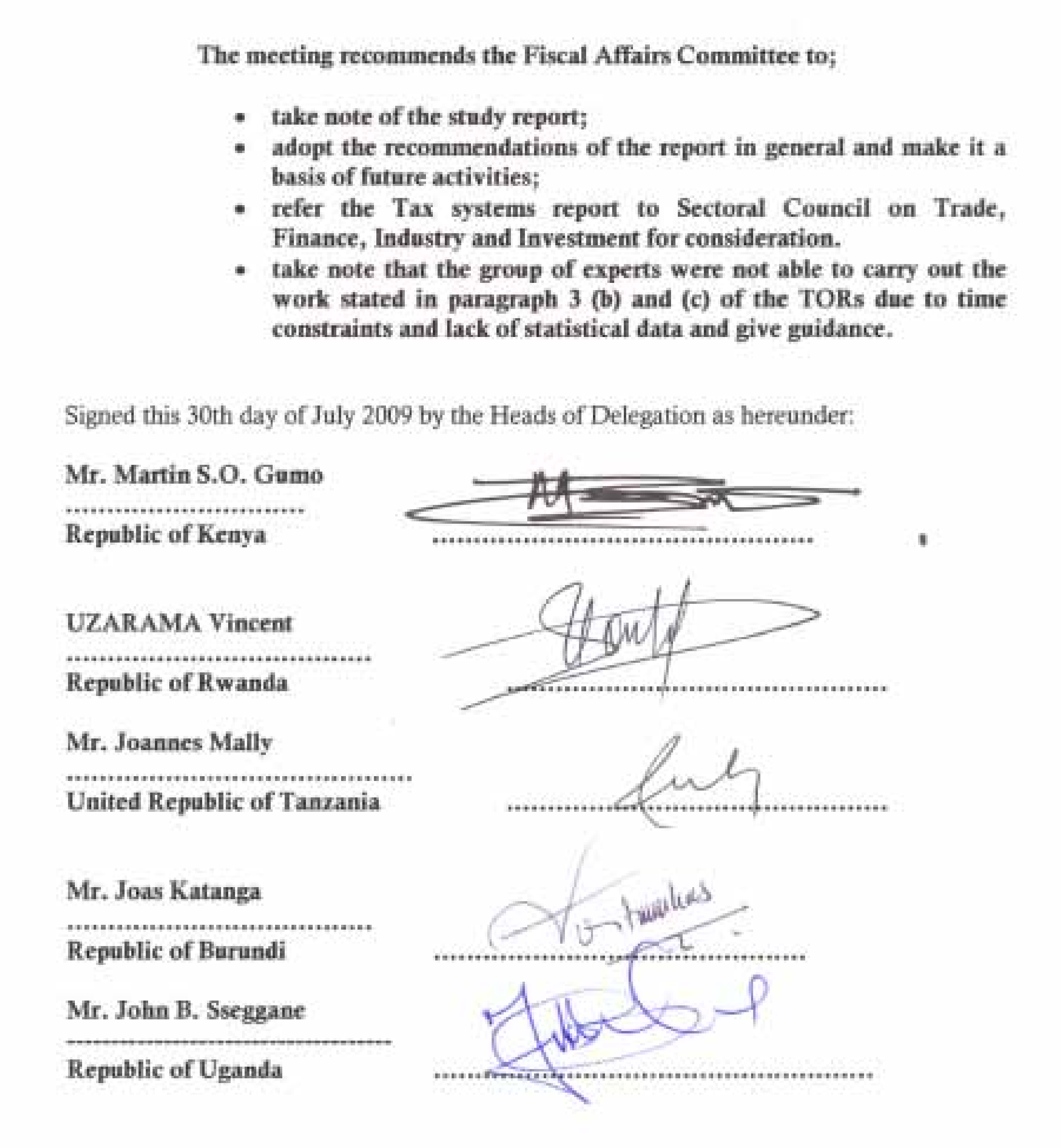
In general, the meeting validates the report with amendments and the way forward shall be discussed in tax harmonisation committee in November 2009.

Recommendations.

The meeting recommends the Group of consultants to:

Incorporate all statistical data missing, comments and inputs which will be sent by Partner States before 28th August at the latest.

Shift into strategic recommendations the bullet no 8 of 2.1: Convey the spirit of harmonisation into the consciousness of the administrations and people.



The meeting recommends the Fiscal Affairs Committee to;

- **take note of the study report;**
- **adopt the recommendations of the report in general and make it a basis of future activities;**
- **refer the Tax systems report to Sectoral Council on Trade, Finance, Industry and Investment for consideration.**
- **take note that the group of experts were not able to carry out the work stated in paragraph 3 (b) and (c) of the TORs due to time constraints and lack of statistical data and give guidance.**

Signed this 30th day of July 2009 by the Heads of Delegation as hereunder:

Mr. Martin S.O. Gumo
....
Republic of Kenya ....

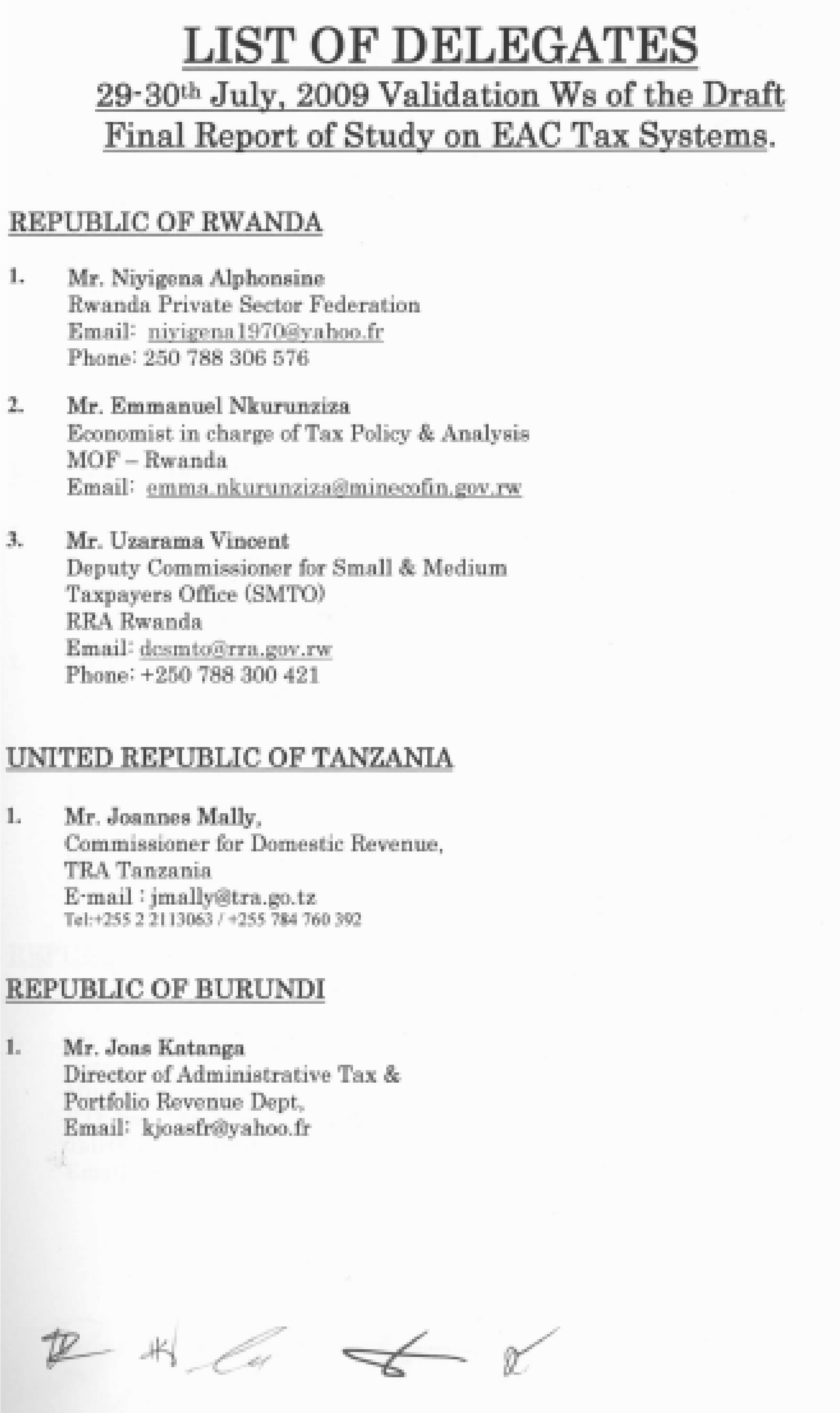
UZARAMA Vincent
....
Republic of Rwanda ....

Mr. Joannes Mally
....
United Republic of Tanzania ....

Mr. Joas Katanga
....
Republic of Burundi ....

Mr. John B. Sseggane

Republic of Uganda ....



LIST OF DELEGATES

29-30th July, 2009 Validation Ws of the Draft Final Report of Study on EAC Tax Systems.

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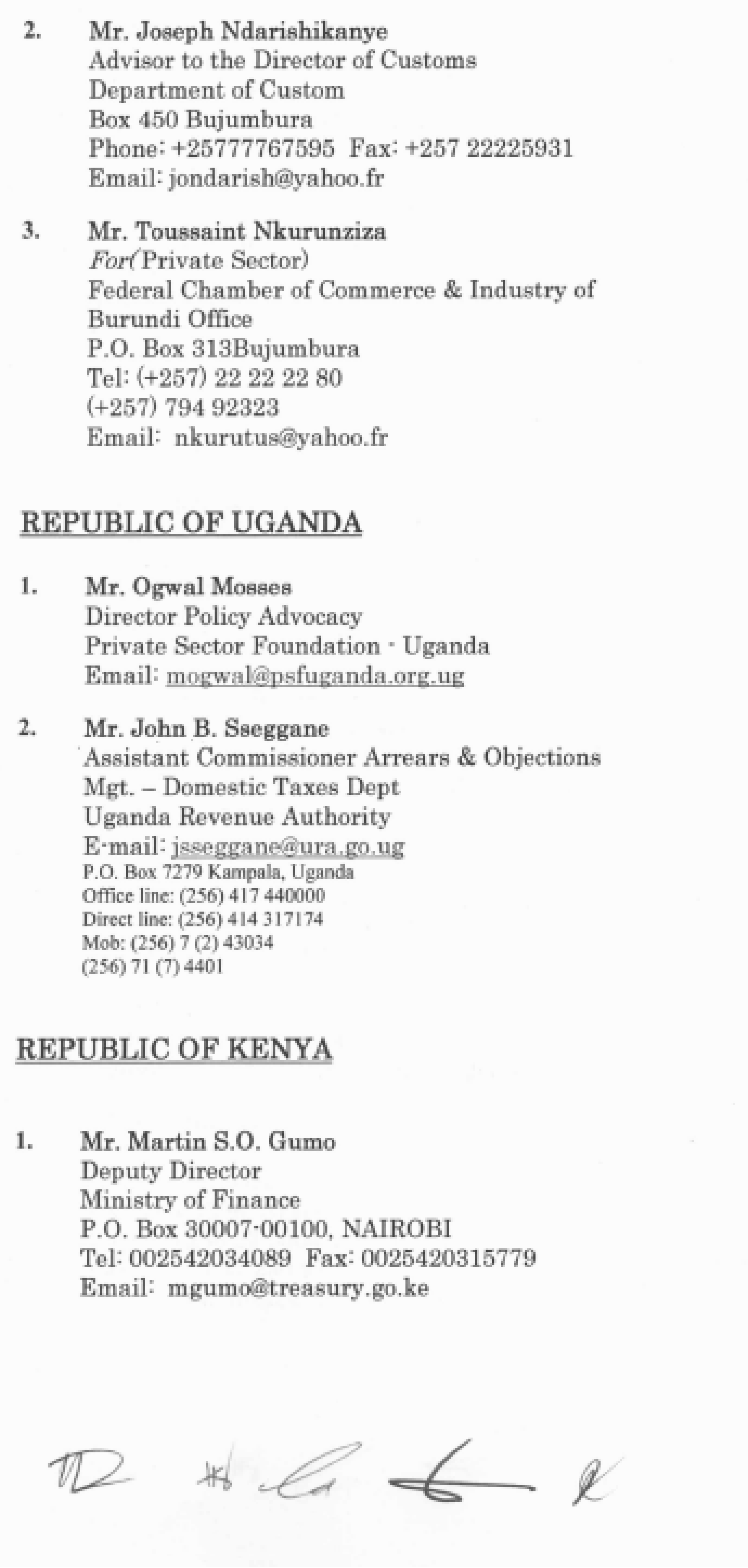

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Appendix 3: Questionnaire

EAC Tax Harmonisation: Interview Questions

A. Key Aspects

- Avoidance of Double Taxation
- Harmonisation of tax law and taxation procedures
- Reduction of both tax fraud on the side of taxpayers and unacceptable behaviour on the side of tax officials in the region

B. List of Priority for Prospective Activities of EAC towards Tax Harmonisation

(1) Double Taxation Agreements

(2) VAT

(3) Excise Taxes

(4) Corporate Income Tax

(5) Tax Administration and Procedures

C. Questionnaire

1. Double Taxation Agreements

(1) Does domestic legislation provide any rules about unilateral avoidance of double taxation?

(2) Which DTAs are in force, are in preparation at present
-within the EAC,
-with non-member countries?

(3) Which DTA model is being applied (OECD, UN)?

(4) What are the reasons for the small number of DTAs agreed upon in the past?

(5) Are there winners and losers of DTAs among the member countries in case of a uniform multilateral DTA within the EAC?

(6) Are there specialised departments in the Revenue Authorities to deal with this field of taxation?

(7) What about mutual agreement procedures and the exchange of information between the contracting states?

(8) What about simultaneous and joint field audits of international taxpayers?

2. VAT

(1) What does the term “taxpayer” mean in your VAT-law? Is there an exact definition? Does the application of the law raise any problems in practice.

(2) What about the threshold to be a non taxable small business enterprise? Is it possible to exert an option for taxation and are there any binding periods to be observed?

(3) Does the law contain any provisions to determine the place of supply of goods and services? Does the reverse charge method come into operation (e.g.: recipient has his place of residence or registered seat within the country)?

(4) When does taxpayer’s obligation for VAT exactly arise (end of transaction, issue of invoice, payment)?

(5) What does the base of taxation comprise (consideration and other remunerations, market price)? How to deal with changes of the tax base (e.g. price-reduction, canceling of the agreement, sales price is not paid due to insolvency of the contracting partner or for other reasons)? Can the tax assessment be adjusted?

(6) Deduction of input-tax: What are the conditions? Adjustment of the deductible amount by a succeeding change of usage (time limit?)? How to cope with deduction in cases of “mixed” usage, partly for taxable activities, partly for non taxable purposes.

(7) How is the procedure of tax refund regulated and what are the problems in practice. Are refunds delayed due to audits and other reasons? Scrutiny with doubtful tax declarations?

(8) Are there any areas where the regime of difference taxation is applicable (e.g. sale of second-hand goods, travel-agencies)?

(9) Are there special provisions related to the taxation of farmers, fishermen and other entrepreneurs?

(10) Could you outline the main points of the procedure of VAT taxation referring to taxation period, time limit for submitting the tax declaration, time for payment, principle of self-assessment respectively assessment by the tax authorities.

3. Excise Taxes

(1) What kind of excise taxes are charged here (including motor vehicle taxes)? Which ones are imperative for the national and local budgets?

(2) Where do excise duties result into double taxation referring to VAT and customs duties?

(3) Which excise taxes distort international trade within the EAC?

(4) Is there a discrimination effect towards producers and distributors of neighbouring countries?

4. Corporate Income Tax (CIT)

(1) Are the international accounting standards applied and controlled equally in the member countries? Which discrepancies are there in this field (e.g. concerning the valuation of business assets, tax law and commercial law)?

(2) Is the tax base of CIT comparable within EAC (e.g. deductible and non-deductible expenditure, tax relief for new investors)?

(3) What kind of incentives are provided for new investors (e.g. tax free zones, special depreciation rates)

(4) Are there any withholding taxes on dividends, interest payments and royalties?

(5) What about losses? Are they carried forward, are there any time limits?

(6) What happens in case of profits and losses abroad? Are they set off against domestic results?

(7) Which rules are there concerning transfer pricing, thin capitalisation and other typical problems of international activities of affiliated enterprises?

(8) What about discrimination of non-resident taxpayers (higher tax rates, non-deductible expenses, impediments of profit transfer..)?

(9) Do the tax rates on corporate profits differ in the EAC? Are there reduced tax rates for specific activities and situations?

5. Tax Administration and Procedures

(1) How is the allotment of rights and obligations with tax administration and taxpayers regulated. Does a special law on tax procedures exist? What are the main principles? Right to submit legal remedies against tax assessment and other administrative acts? Is there a legal way for appeal to the courts in fiscal matters?

(2) How can the tax administration enforce taxpayer’s obligations? Is tax enforcement “over the border” possible and are there any agreements between member states?

(3) Conditions for a tax audit.

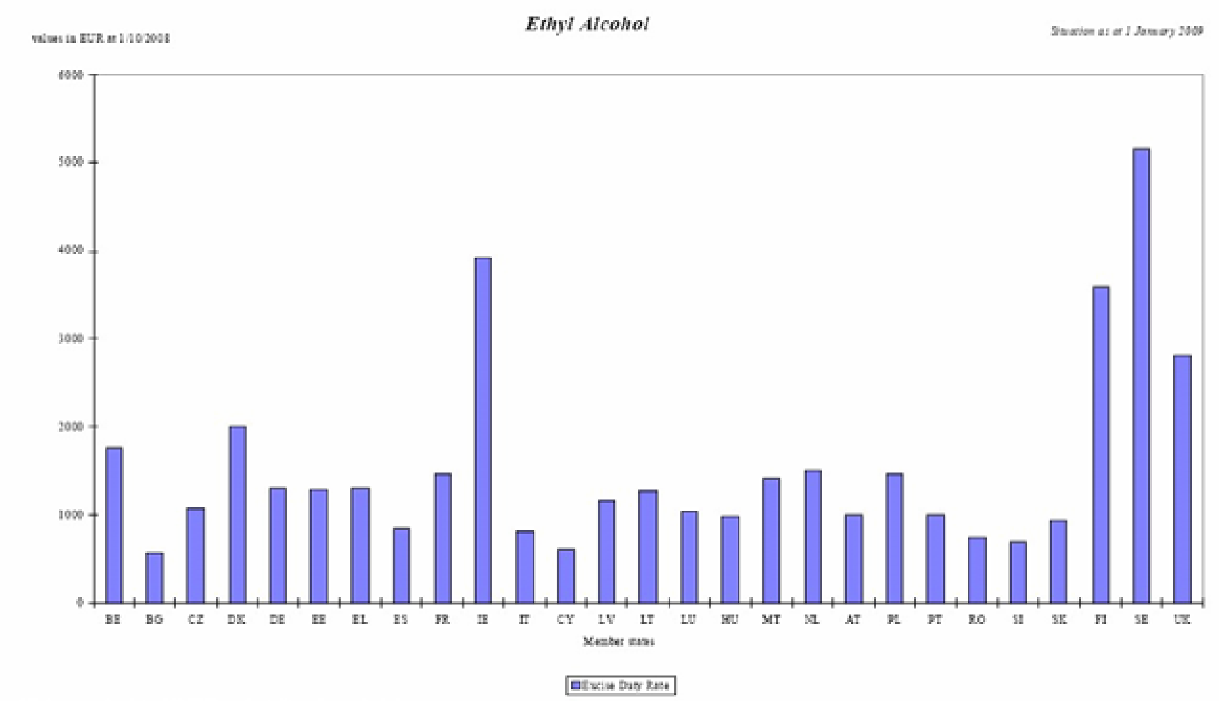
(4) How to cope with the problem of corruption within the administration? Has there a special anti-corruption unit been established? What are the results or experiences?

(5) How to combat tax fraud and tax evasion? Is tax fraud a criminal offence or is it treated as a mere administrative offence? How does tax fraud affect tax liabilities (extension of due time, interest payments etc.)?

(6) Statutory provisions on exchange of data in the field of taxation? How is the cooperation with other member states of EAC supported by IT equipment?

Appendix 4: Figures and Tables

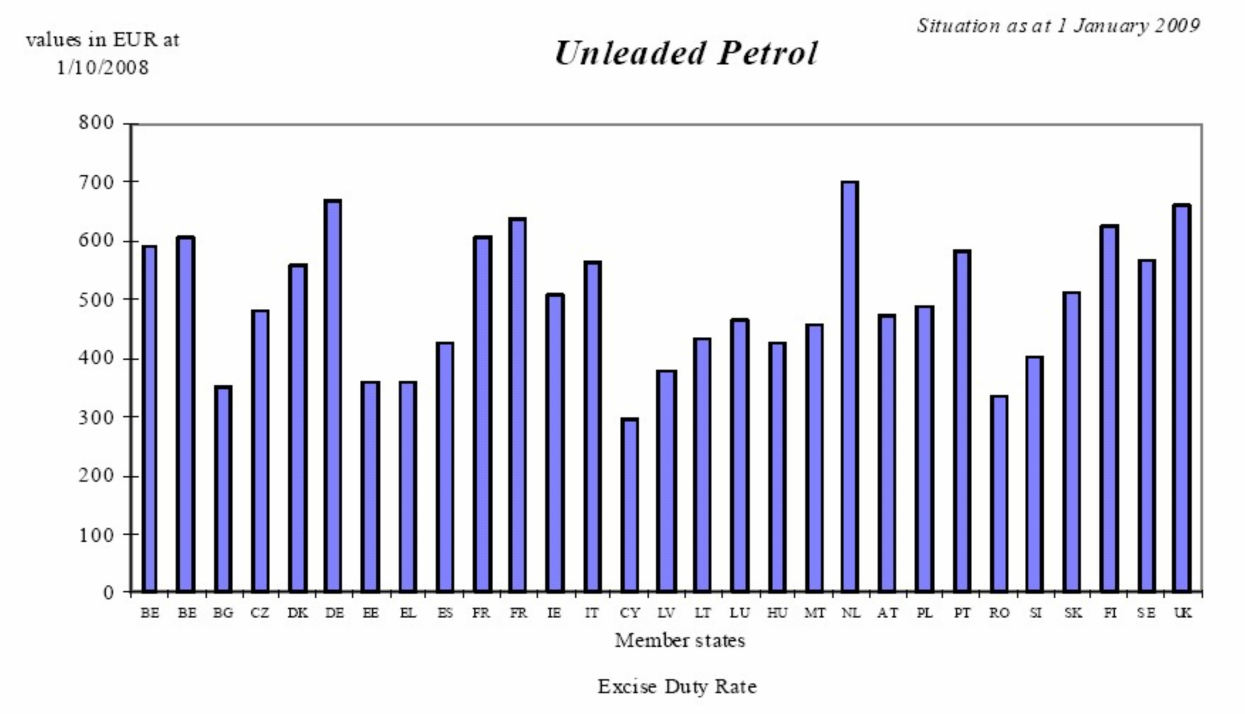
Figure A1: Ethyl Alcohol Taxation in the EU



Minimum excise duty: 550 EUR per hectolitre of pure alcohol

Source: European Commission (2008).

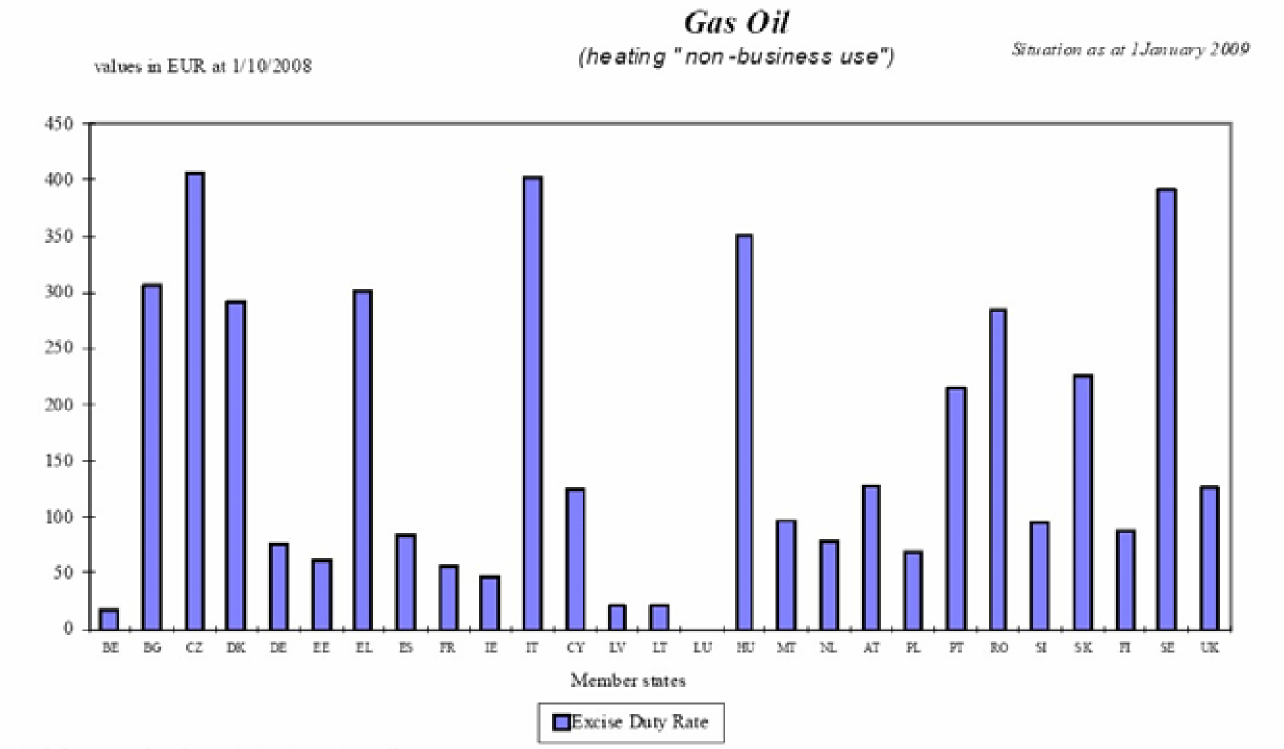
Figure A2: Unleaded Petrol Taxation in the EU



Minimum excise duty: 359 EUR per 1000 litres

Source: European Commission (2008).

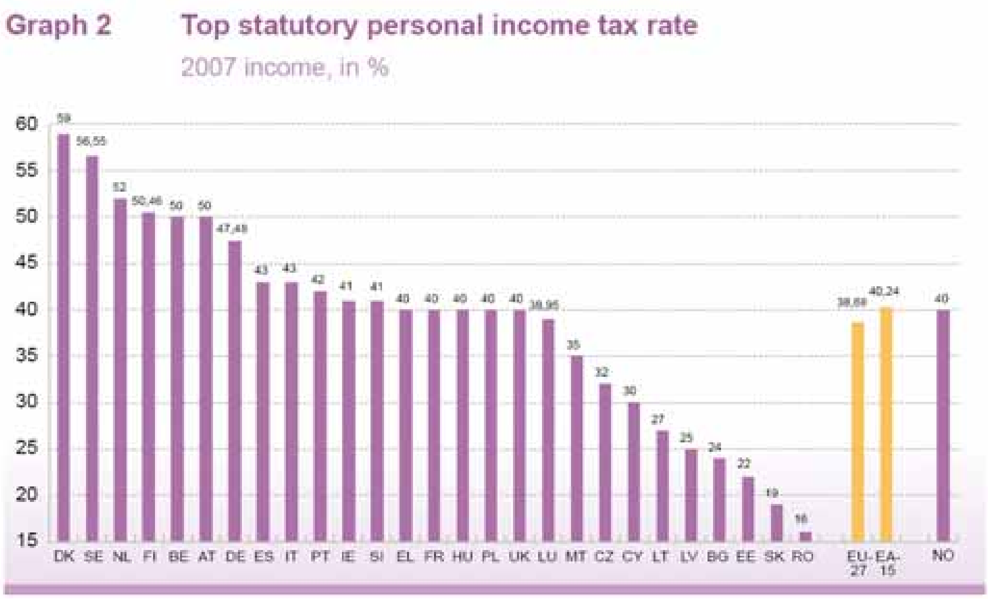
Figure A3: Heating Gas Oil Taxation (Non-tradable) in the EU



Minimum excise duty: 21 EUR per 1000 litres

Source: European Commission (2008).

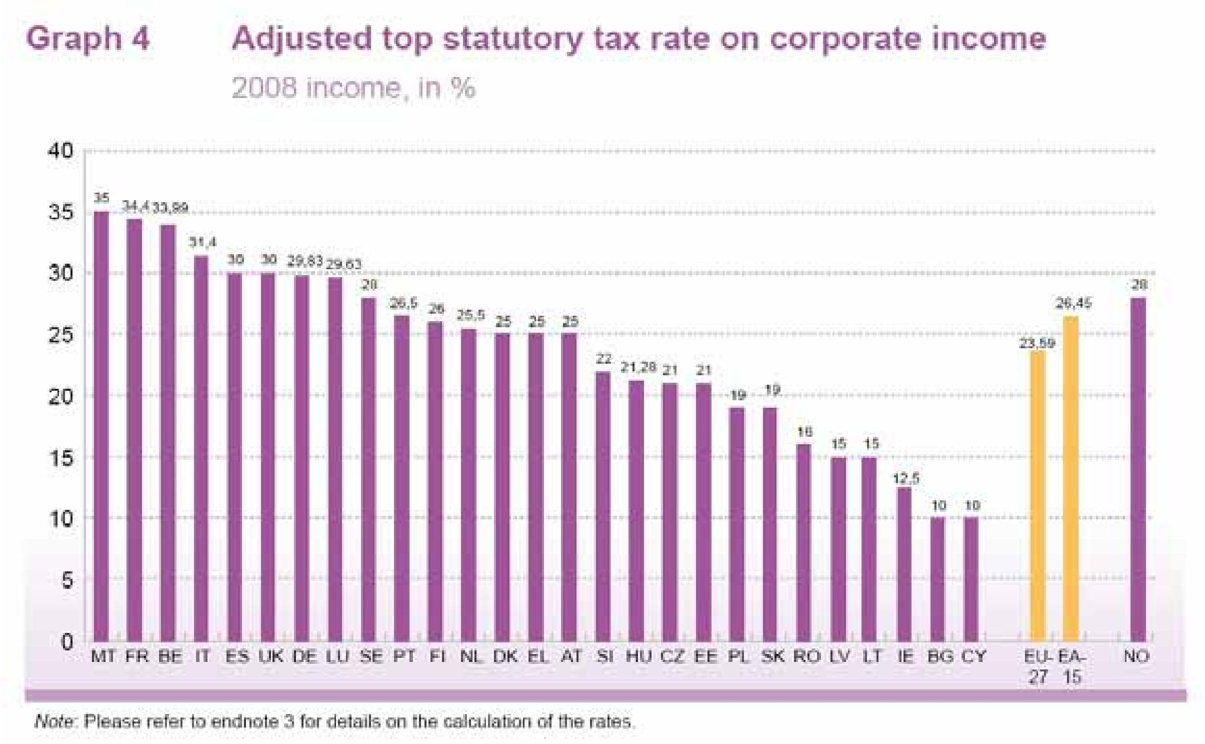
Figure A4: Personal Income Tax Rates in the EU



Note: Please refer to endnote 2 for details on the calculation of the rates.

Source: European Commission. eurostat (2008).

Figure A5: Corporate Tax Rates in the EU



Graph 4 Adjusted top statutory tax rate on corporate income

2008 income, in %

Note: Please refer to endnote 3 for details on the calculation of the rates.

Source: European Commission. eurostat (2008).

Table A1: VAT Tax Rates in the EU

Member States	Code	Super Reduced Rate	Reduced Rate	Standard Rate	Parking Rate
Belgium	BE	-	6 / 12	21	12
Bulgaria	BG		7	20	
Czech Republic	CZ	-	9	19	-
Denmark	DK	-	-	25	-
Germany	DE	-	7	19	-
Estonia	EE	-	5	18	-
Greece	EL	4,5	9	19	-
Spain	ES	4	7	16	-
France	FR	2,1	5,5	19,6	-
Ireland	IE	4,8	13,5	21,5	13,5
Italy	IT	4	10	20	
Cyprus	CY	-	5 / 8	15	-
Latvia	LV	-	10	21	-
Lithuania	LT	-	5 / 9	19	-
Luxembourg	LU	3	6 / 12	15	12
Hungary	HU	-	5	20	-
Malta	MT	-	5	18	-
Netherlands	NL	-	6	19	-
Austria	AT	-	10	20	12
Poland	PL	3	7	22	-
Portugal	PT	-	5 / 12	20	12
Romania	RO		9	19	
Slovenia	SI	-	8,5	20	-
Slovakia	SK	-	10	19	-
Finland	FI	-	8 / 17	22	-
Sweden	SE	-	6 / 12	25	-
United Kingdom	UK	-	5	15	-

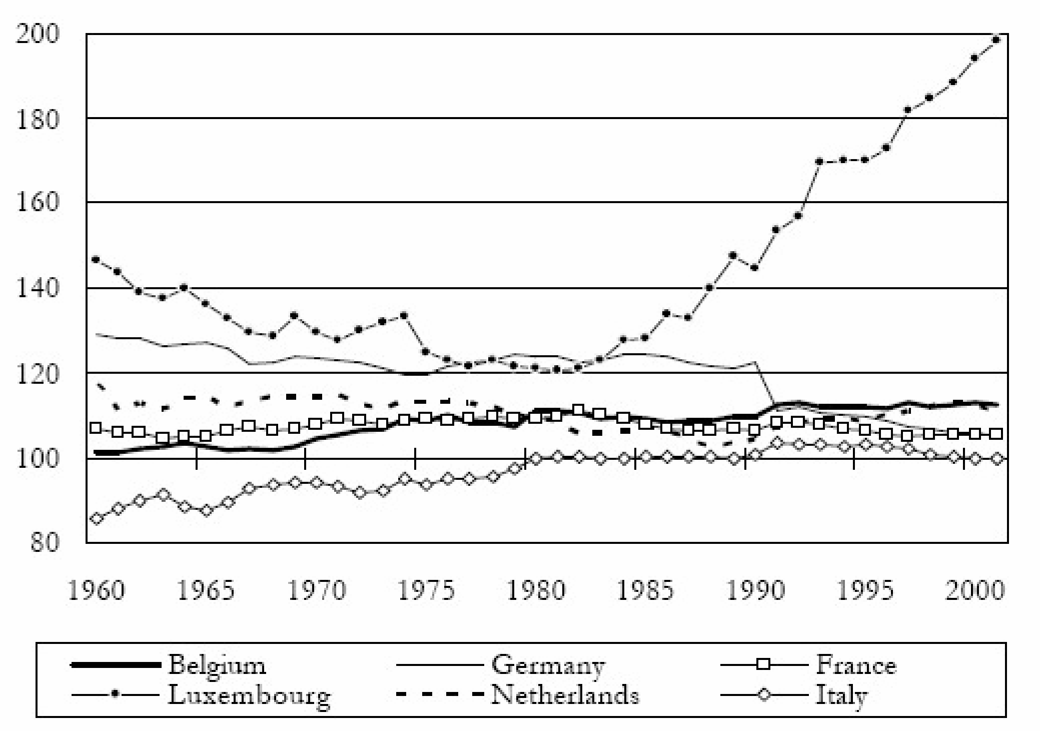
Source: European Commission. Taxation and Customs Union (2009)

Table A2: Macroeconomic Indicators for the EAC Member Countries

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Real GDP Growth (%)	3,2	2,6	8,5	6,8	7,0
GDP (mill. $US, current prices)	1116	41896	3816	18346	16611
GDP per capita ($US, current)	126	1087	381	442	521
GDP per capita ($US PPP)	338	2123	883	1163	1371
Total Final Consumption (% GDP)	115,9	93,9	98,5	88,9	93,3
Private Consumption (% GDP)	82,8	78,3	88,1	69,4	81,5
Public Consumption (% GDP)	33,1	15,7	10,4	19,5	11,7
Total Gross Capital Formation (% GDP)	11,1	19,3	21,0	32,4	24,2
Private Capital Formation (% GDP)	2,2	14,8	11,6	23,1	18,7
Public Capital Formation (% GDP)	8,9	4,5	9,4	9,3	5,4
Trade Balance (% GDP)	-21,9	-16,2	-12,8	-19,2	-11,9
Exports (f.o.b., % GDP)	5,5	13,1	5,1	12,2	11,1
Imports (f.o.b., % GDP)	27,4	29,4	17,8	31,4	23,0
Total revenue and grants (% GDP)	31,1	25,4	26,9	23,2	18,3
Tax revenue (% GDP)	17,7	21,9	12,8	15,0	12,8
Grants (% GDP)	11,8	1,7	13,3	7,0	5,1
Total expenditure and net lending (% GDP)	40,0	31,5	27,2	23,3	20,5
Total expenditure and net lending (mill. $US)	446	13197	1039	4266	3408
Current expenditure (% GDP)	27,9	22,5	16,6	15,1	12,7
Wages and salaries (% GDP)	10,1	7,7	3,5	5,1	4,5
Interest on public debt (% GDP)	1,5	2,6	0,6	1,2	1,3
Capital expenditure (% total exp. & net lending)	0,3	0,3	0,4	0,3	0,4
Primary balance (% GDP)	-7,4	-3,5	0,2	1,2	-0,9
Overall balance (% GDP)	-8,9	-6,1	-0,3	0,0	-2,2
Fiscal balance (% GDP)	-8,9	-6,1	-0,3	0,0	-2,2
Fiscal balance (mill. $US)	-100	-2571	-12	-2	-369
Current account balance (% GDP)	-16,6	-4,2	-7,9	-14,8	-9,8
Current account balance (mill. $US)	-185	-1750	-303	-2713	-1633

http://www.africaneconomicoutlook.org/en/countries
all data 2008

Figure A6: GDP Per Capita Catch-up and Convergence in the EU-15



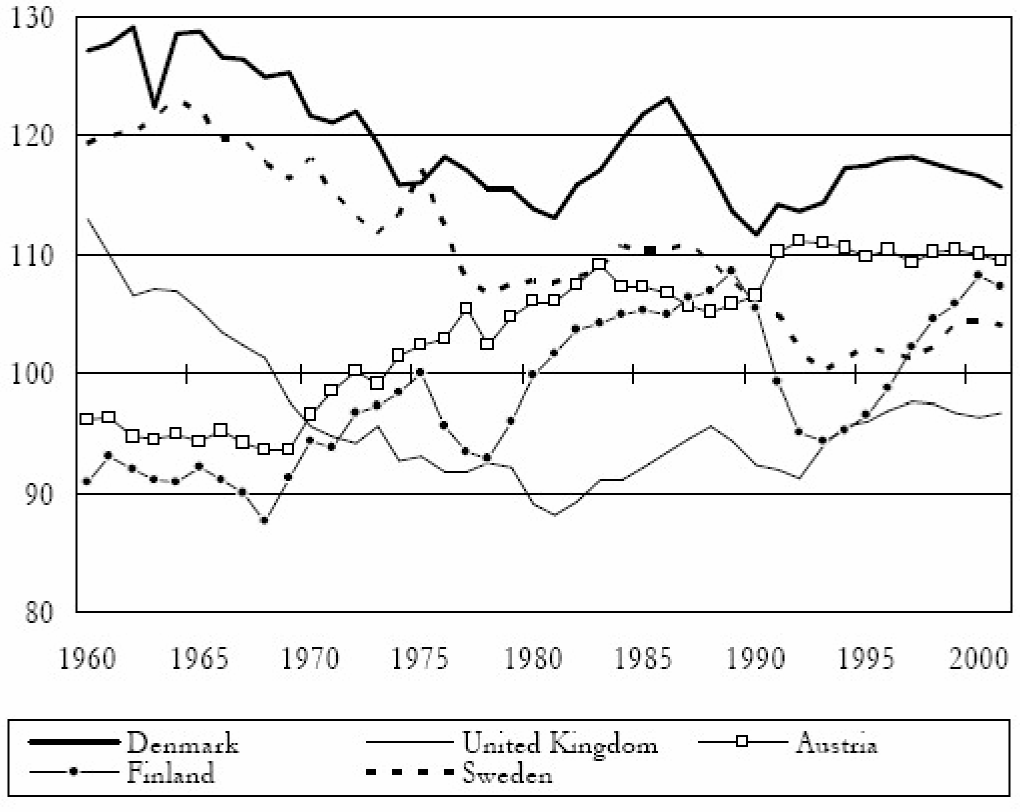
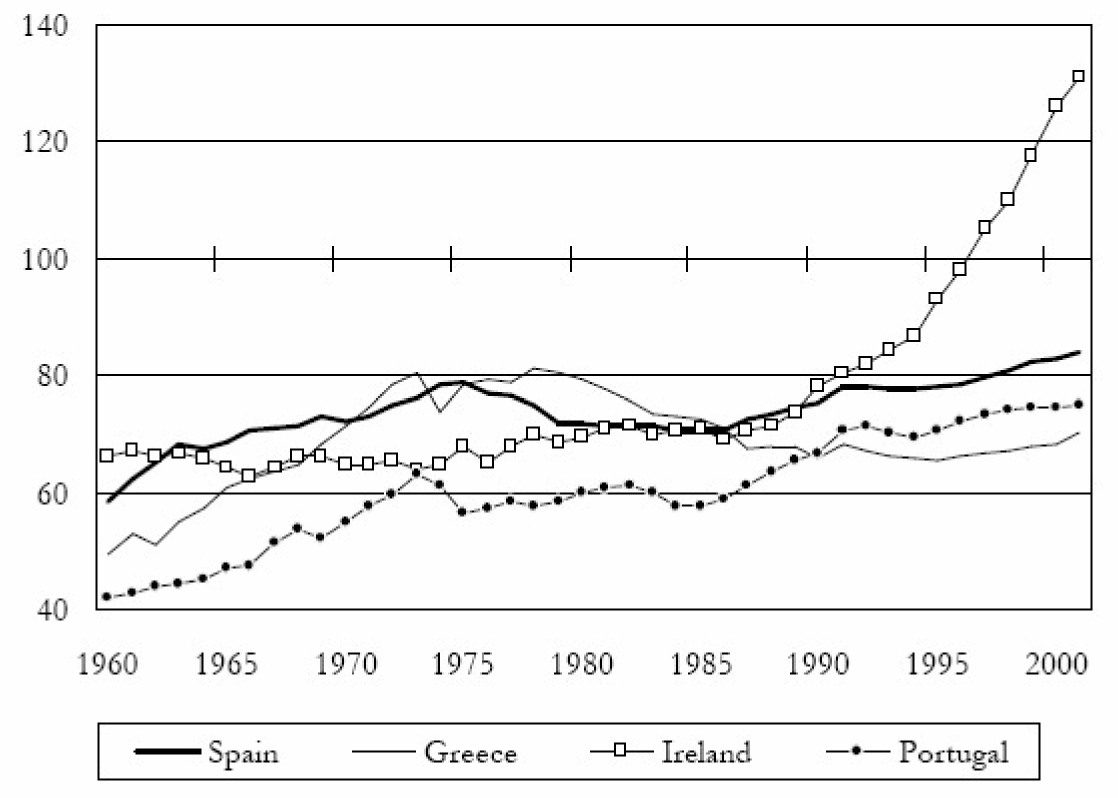


Figure A6: Continuation



New EU Member States (Membership in 2004)

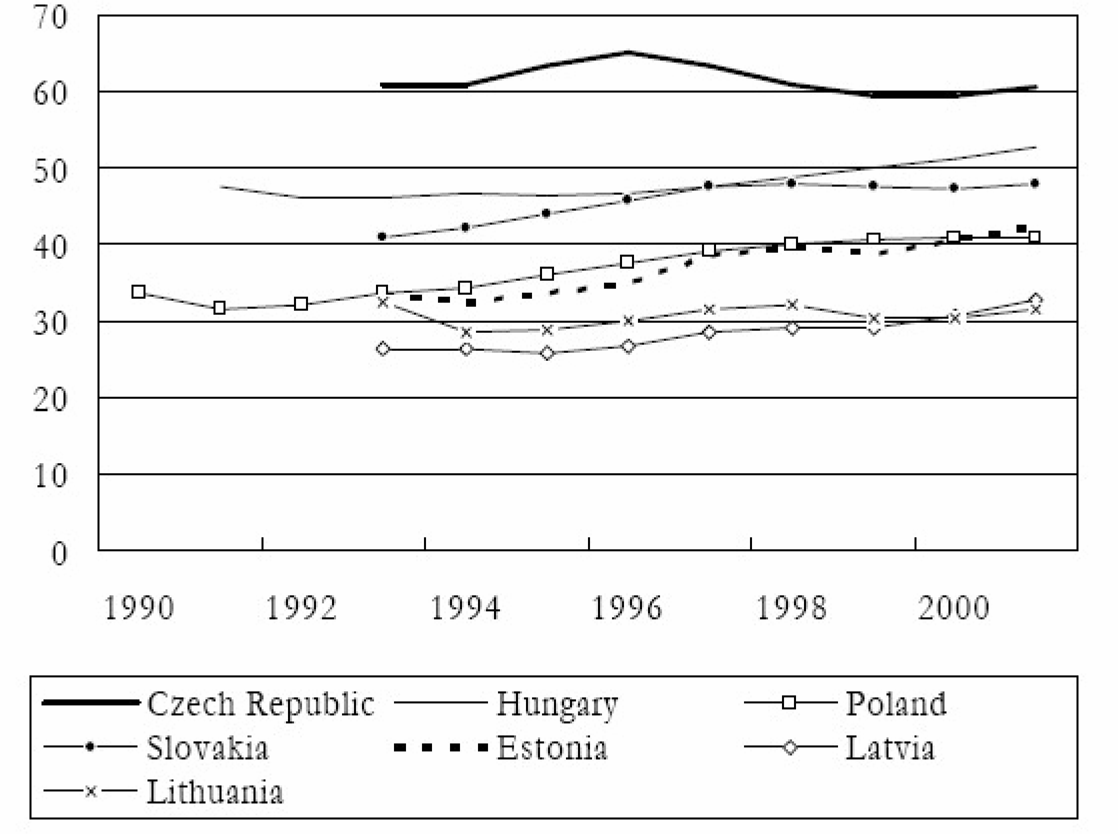


Table A3: Overview on the VAT Systems in the EAC

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Law	Loi portant institution de la taxe sur la valeur ajoutée "TVA" 2009	Value Added Tax Act 2008	Code of Value added Tax 2001	The Value Added Tax Act 1997	The Value Added Tax Act 1996
General Aspects					
Taxpayer	Everyone who carries out taxable supplies that exceed a certain turnover (determined by the Minister of Finance) or issues an invoice disclosing a certain amount of VAT	Taxable person, liable to apply for registration	No legal definition	No legal definition	Person (individual, partnership, company, trust, government, authorities) who makes or expects to make taxable supplies
Threshold for registration (Turnover)	100 million FBu/year (82,000 USD)	5 million KES/year (66,000 USD)	20 million FRw/year (35,000 USD) or 5 million FRw last 3 months	40 million TZS/year (30,000 USD)	50 million UGX/year (24,000 USD)
Voluntary registration	Possible for suppliers of services and importers	Mandatory	possible	Commissioner General may agree	Commissioner General may agree
Output Tax					
Taxable transactions	Supply of goods and services, withdrawal of business assets, importation	Supply of goods and services, importation	Supply of goods and services, withdrawal of business assets, importation (transfer of a whole business is not taxable)	Supply of goods and services, importation	Supply of goods and services, importation
Time of supply, goods	When goods are made available to the recipient	Whichever comes earliest: - date of supply/delivery, or - date of invoice, or - part or full payment for supply, or - certificate of completion in case of construction industry	When goods are made available to the recipient; in case of transport: when the goods are removed from the premises of the supplier	Whichever is the earliest - goods are removed from the premises of the supplier or made available to the recipient or services are performed; - a tax invoice is issued; - a payment is received	Whichever is the earliest - goods are delivered or made available or the performance of the service is completed - payment is made - a tax invoice is issued
Time of supply, services	When supply is performed, earlier if invoice has been issued or payment received	For an *imported* taxable service, whichever comes earliest: - date the imported service is received, or - date the invoice is received, or - part or full payment is made	When supply is performed; earlier if invoice has been issued or payment received	When supply is performed; earlier if invoice has been issued or payment received	When supply is performed; earlier if invoice has been issued or payment received
Place of supply, goods	In Burundi, when: - transfer carried out according to sales conditions valid in Burundi - supply of electricity, water, gas, heat and others - consumption is in Burundi	Where it is a taxable supply	Seat, permanent establishment or residence of the supplier (principle of origin)	In Tanzania if their supply doesn't involve a removal from Tanzania; outside Tanzania if their supply involves installation or assembly outside Tanzania	Where goods are delivered or made available
Place of supply, services	In Burundi, when: - service is used or received in Burundi - service is linked to real estate - service is carried out in Burundi		Seat, permanent establishment or residence of the supplier; Rwanda is place of supply if the supplier has no place of business in Rwanda and recipient has residence in Rwanda and obtains or uses the benefit of the service in it	In Tanzania if the supplier has a place of business and this place is most concerned with the supply	Where services are rendered except in certain cases

Table A3: Overview on the VAT Systems in the EAC (Continuation)

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Exemptions*	- financial services - supply of agricultural products (if not processed) - medical treatment and supply of medicines - educational services - supply of social performance - services with international travel - sale of residential buildings - sale of certain non built-up real estate - lease and rent of special sorts of immobile property (other than hotel business and use for commercial purposes) - certain imported goods that are exempted from customs duties	- financial services - insurance services - agricultural services - health services - education and training services - sanitary services - social welfare services - postal services - community services - funeral services - transportation services - tour operations and travel agencies - transportation of tourists - entertainment services - accommodation and restaurant services - conference services - car park services - renting, leasing, hiring of land and residential buildings - services rendered by certain associations	- financial services - supply of gold to a bank - all agricultural and livestock products, except for those processed (excludes milk which is processed in local industries) - agricultural inputs/equipment - water supply services - health supplies - educational services - books, newspapers, journals, cassettes and diskettes used as educational materials - funeral services - passenger transport services - transfer of special kinds of property , e.g. buildings for residential purposes - several goods and services imported by persons with "investment certificate" pursuant to the Investment Code	- financial services - insurance services - unprocessed agricultural products/food - pesticides, fertilizers, etc. - veterinary supplies - water except drinking water - health supplies - educational supplies - social welfare services - books and newspapers - funeral services - passenger transport services - supply of land - sale/lease of residential buildings - supply of petroleum fuels subject to excise	- financial services - insurance services - unprocessed agricultural products/food - machinery used for processing of dairy products - veterinary equipment - health supplies - educational services - social welfare services - funeral services - computers and software - passenger transport services - supply of unimproved land - lease of immovable residential property - supply of petroleum fuels subject to excise - transfer of business as a going concern
Tax relief for certain persons	Diplomats, International Organizations	President, Armed Forces, Other Governments, Diplomats, Aid Agencies, Charitable Institutions, Disabled Persons, Police	Diplomats (on condition of reciprocity)	Military, Railway, Mining, Religious Institutions, Water Authorities, Public Infrastructure Projects, Diplomats	Diplomats, Public International Organisations, Certain Road Construction projects
Zero rated supplies*	Exportations and connected services	- Exportation of goods and services - detailed list of zero-rated supplies and goods: see 5th Schedule	- export of goods from Rwanda and linked services - supply of freight transport services from or to Rwanda and ancillary services - supply of goods by duty free shops - supply of goods for use in aircraft stores on flights to destinations outside Rwanda - supply of aviation fuel - supply of services which are physically rendered outside Rwanda - supply by certain tour operators or travel agents - supplies made under agreement between the government of Rwanda and donors	Exportation of goods and services	- exportation of goods and services - international transport - drugs and medicines - educational material - pesticides, fertilizers, etc. - cereals produced in Uganda - machinery for agriculture - milk products
Tax base	Amount of net consideration (plus third party subventions if applicable); withdrawal of business assets: market price	Price for which the supply is provided (dealing at arm's length); customs value if imported	Amount of net consideration, at least "open market value"; customs value if imported	Amount of net consideration, at least market value; customs value if imported	Total consideration or fair market value; customs value if imported

Table A3: Overview on the VAT Systems in the EAC (Continuation)

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Adjustment of tax	When later events like impairment of performance or rescission of the contract alter the base of taxation	?	When the amount of consideration has changed later; in cases of “bad debts” a tax relief can be granted by the tax administration	?	When supply is cancelled, goods or services returned, consideration altered, or supply not been paid for
Tax rate, standard	18 %	16 %	18 %	20 % (being reduced to 18 %)	18 %
Tax rate, reduced	n/a	12 % (supply and import of electricity and fuel oil)	n/a	n/a	5 % (sale of residential apartments)
Input tax					
Definition	VAT that is included in the price for a taxable supply	Tax paid on the supply/importation to a registered person for use in the business	Tax payable in respect of the supply of taxable goods or services supplied to a registered supplier during a prescribed accounting period for the purpose of a business carried on or to be carried on by him; tax paid on the importation of any taxable goods	Tax on taxable supplies/imports to a registered person for use in the business, stated in a tax invoice	Tax paid or payable in respect of a taxable supply to or import of goods or services by a taxable person, stated in a tax invoice
Credit of input tax	- full, unless input refers to exempt supplies - partial if input refers to both taxable and exempt supplies - exception for investment goods: only 50% of input tax deductible	- full, unless input refers to exempt supplies - partial if input refers to both taxable and exempt supplies	- full unless input refers to exempt supplies - partial if input refers to both taxable and exempt supplies - deductibility excluded for certain imported services or in certain cases of exports	- full unless input refers to exempt supplies - partial if input refers to both taxable and exempt supplies	- full unless input refers to exempt supplies - partial if input refers to both taxable and exempt supplies
Credit arises	provided the invoice is issued, on the date the supply is carried out	?	provided the invoice is issued, on the date the supply is carried out	provided the invoice is issued, on the date the supply is carried out	provided the invoice is issued: - on the date supply is carried out - in case of cash basis accounting, on the date the tax is paid - on the date of registration
Credit results in offset against future liabilities or in refund	- refund only if offset is not possible; - time limit for refund: three months, earlier refund possible with termination of the business or in cases when a taxpayer can claim a refund permanently (such as exporters) - refund is only paid out if the amount exceeds 15 million FBu per trimester or 10 million FBu in the accounting year.	?	- refund only if offset is not possible - monthly refund if continuous excess of input tax	- refund only if offset is not possible within 6 months after due date for lodging the return - monthly refund if continuous excess of input tax	- normally offset refund within 1 month only if: - output is mainly zero-rated - in case of an investment trader - credited amount over 2,500 USD
Procedures					
TIN	Yes	?	Yes	Yes	Yes
Self-assessment	Yes	Yes	Yes	Yes	Yes
Return and payment	monthly/15 days after tax period	monthly/20 days after tax period	monthly/30 days after tax period	monthly/30 days after tax period	monthly/15 days after tax period
Office assessment	- if no return submitted (estimate) - after audit	- failure to make any return required - failure to apply for registration - failure to keep proper books	- if no return submitted (estimate) - after audit	- if no return submitted (estimate) - after audit	- if no return submitted (estimate) - after audit

Table A3: Overview on the VAT Systems in the EAC (Continuation)

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Interest for late payment/refund	Yes / Yes	Yes / No	Yes / Yes	Yes / Yes	Yes / Yes
Penalty for failure to submit return, etc.	Yes	Yes	Yes	Yes	Yes
Enforcement if no payment	Yes: attachment of debts and other measures	Yes	Yes: attachment of debts and other measures	Yes: attachment of debts and other measures	Yes: attachment of debts and other measures
Audits	Yes (on risk management considerations)	Yes	Yes (on risk management considerations)	Yes (on risk management considerations)	Yes (on risk management considerations)
Appeals	- appeal to a special commission, consisting of representatives of the taxpayers and of the tax administration; decision is not binding - Appeal to the Minister of Finance within three months; decision can be contested with a lawsuit with the administrative courts	appeal to Tribunal (with deposit of the full amount of the tax disputed)	- within 30 days to the Commissioner General - after decision, within further 30 days to the Appeals Commission - after decision, again within further 30 days to Tribunal	Provided 50 % of the disputed amount is paid**: - within 30 days to the Board - after decision, within further 30 days to Tax Revenue Appeals Tribunal	Provided 100 % of the disputed amount is paid (unless extension is given by Commissioner General): - within 30 days - after decision, further appeal to the Tax Appeals Tribunal
Special schemes					
reverse charge	No	in case of imported services	in case of imported services	?	in case of imported services
taxation on difference	n/a	n/a	n/a	n/a	n/a

* The findings are based on the respective VAT Act. Other regulations have not been taken into account. The raster doesn't mirror each particular detail of the law.

** VAT Act states appeals procedures which differ from those shown in the Tax Revenue Appeals Act 2006

Table A4: Overview on the Income Tax Systems in the EAC

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Law	Law on Income Tax (Code Général des Impôts et Taxes, Livre II) 2005	Income Tax Act 2008	Law on Direct Taxes on Income 2005	The Income Tax Act 2004	The Income Tax Act 1997
A. Taxation of Residents					
Taxpayer	Dependent upon sort of income: - rental income: owner or possessor of real estate - investment income and business income: companies, partnerships and individuals	- companies incorporated under the laws of Kenya - bodies whose management and control of the affairs was exercised in Kenya in the particular year of income under consideration bodies that have been declared by the Minister by Notice in the Gazette to be resident in Kenya for any year of income	- personal income tax: resident individuals in Rwanda - corporate income tax: companies, cooperative societies, public business enterprises, partnerships, entities established by districts and towns to the extent that they conduct business	- companies incorporated under Tanzanian law - management/control in Tanzania - sole proprietor, partnership, trust, cooperative, branch of foreign company	- companies incorporated under Ugandan law - management/control in Uganda - sole proprietor, partnership, trust, cooperative, branch of foreign company - companies undertaking the majority of their operations in Uganda
Scope of Income	Worldwide income	Income in Kenya (residence principle)	Worldwide income	Worldwide income	Worldwide income
Threshold for taxation	- rental income: no threshold; - wages (= business income): 480,000 FBu (390 USD); - other income: no threshold	?	360,000 RWA (630 USD) for individuals	For individuals lower presumptive tax possible if business income does not exceed 20,000,000 TZS (15000 USD)	1,560,000 UGX (750 USD) for individuals
Tax Base	Business profit and gains	Business profit	Business profits and gains	Business profits and gains	Business profit
Accounting standards	Three forms of ascertaining the profit: - the "real profit", deduced from bookkeeping in accordance with the generally accepted accounting principles (no method prescribed) - simplified method with a receipt and expenditure accounting (for medium size businesses) - lump sum system for smaller enterprises consisting of elements of appraisal	IFRS and comprehensive domestic rules	Special rules in the "National Accounting Plan", Transfer Pricing Rules, simplified rules for small businesses	IFRS and comprehensive domestic rules	Generally accepted accounting principles and special statutory rules
Revenue expenditures deductible	In general deductible	In general deductible including interest payments	In general deductible if incurred for the direct purpose of and in the normal course of the business	In general deductible including interest, research and development	In general deductible including interest, research and development

Table A4: Overview on the Income Tax Systems in the EAC (Continuation)

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Depreciation on capital expenditures	No special regulations in the law	- Industrial Buildings 2,5% - Rental resid. Buildings 5 % - Hotel buildings 4 % - Roads or similar Infrastructure 100 % - Plant and Machinery Class 1 37,5 % Class 2 30 % Class 3 25 % Class 4 12,5 % - Farm works 33,3 %	- Land, fine arts, antiquities: not subject to depreciation - buildings, equipment, Plants 5 % - purchased good will, cost of reconstruction of intangible assets 10 % - computers, software, communication systems 50 % - other business assets 25 % - investments on special conditions (smaller 40 or vehicles excluded) 50 %	- machinery/vehicles/ other 25 to 37,5 % - furniture, fixtures 12,5 % - buildings 5 %	- machinery/equipment 20 % - cars, small buses 35 % - large trucks 30 % - computers 40 %
Non-deductible expenditures	- income tax - profit distribution - fines and penalties - all expenses not necessary to run the business - certain expenses of the supervisory board (costs of meetings)	?	- income tax - fines and penalties - profit distribution - entertainment expenses - donations exceeding one per cent of turnover - restrictions due to thin capitalization rules	- income tax - bribes - fines - profit distribution	- income tax - profit distribution
Capital gains	Taxable at the same rate as other profit	Capital gains tax was suspended in Kenya in 1985	Businesses: taxable at the same rate as other profit; no capital gains tax on the sale of private property	Taxable at the same rate as other profit, no inflation relief, no reinvestment relief	Taxable at the same rate as other profit, no inflation relief, no reinvestment relief
Exempt income: Dividends from controlled companies	No regulation	?	No regulation	Exempt if recipient holds at least 25 %	Exempt if recipient holds at least 25 %
Other exemptions	Income that is designed to be re-invested in vocational information and education; certain profit gained by agricultural enterprises (including cattle breeding)	?	Profit shares with partnerships	Exemptions granted by the minister	Income of - listed institutions or - diplomatic organisations or - local authorities
Losses	Can be carried forward (4 years); losses suffered abroad cannot be offset	Can be carried forward indefinitely (to be changed to: into the next 4 years of income); losses abroad: n/a, due to residence principle	Can be carried forward into next 5 years; losses suffered abroad cannot be offset	Can be carried forward indefinitely; losses suffered abroad can be offset against foreign profits only	Can be carried forward indefinitely; losses suffered abroad can be offset against foreign profits only
Tax rates					
Standard	35 % business income (excluding wages); progressive table for rental income	30 %	30 % (corporate income tax)	30 %	30 %

Table A4: Overview on the Income Tax Systems in the EAC (Continuation)

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Reduced	- enterprises exporting non-traditio nal merchandise (such as coffee and tee) 17,5 % - minimum rate of taxation is 1 % of the turnover figures (in case of losses) - certain enterprises, registered as “exempted” according to the In vestment Code of 2008 are exempted for the first ten years of existence. As of the eleventh year the tax rate will be 15 % without time limitation. - within this system further reduc tion is granted to enterprises em ploying more than 100 Burundian persons: 10 % - leasing and hire-purchase enter prises are fully exempted for three years, and taxed at 20 % for the next four years (more cases of reduction are stipulated in the law)	EPZs after 10 years: 25 % Newly listed companies approved under the Capital Markets Act: - with 20 % issued shares listed, first 3 years 27 % - with 30 % issued shares Listed, first 5 years 25 % - with 40 % issued shares listed, first 5 years 20 % Non-resident shipping operators: 2,5 % of gross Non-residents telecommunication operators: 5 %	- Tax reductions from 2 to 7 % depending on the number of Rwandan employees - export businesses get a tax discount of 3 or 5 % depending on the turnover; - businesses operating in a Free Trade Zone are taxed with 0 % without time limitation.	- 25 % after 10 years in EPZ - 25 % newly listed company with at least 35% of equity issued to the public (for 3 years) - 0.3 % of turnover in case of losses in 3 consecutive years due to incentives	mining companies 25 -45 %
Withholding Tax on earned income					
Tax credit	No (withholding tax is definitive)	?	Yes	In specific cases	In general
Final tax	If companies derive investment income (e.g. dividends), 50 % of this yield is regarded as derived from business and taxed as business income with the regular rate of 35 %; regulation not valid when the yield is re-invested	?	Withholding tax reduces the payable amount and can lead to a refund if offset is not possible	In most cases if recipient is a resident individual not in business	In case of - interest paid by a financial institution to a resident individual - dividends paid to a resident individual
Foreign tax credit	?	?	Yes	Yes	Yes
Rates of withholding taxes on distributed income					
Dividends	15 %	> 12,5 % voting power: Exempt < 12,5 % voting power: 5 %	15 %	Standard rate 15 % if paid by listed company to individuals 10 % if paid to company controlling at least 25 % 0 %	Standard rate 15 % if paid by listed company to individuals 10 % if paid to company controlling at least 25 % 0 %
Interest	15 %	bearer instruments 25 % government bearer bonds 15 % other 15 % Qualifying interest: - housing bonds 10 % - bearer instruments 20 % - other 15 %	15 %	10 %	Standard rate 15 % if paid to individuals, associated companies, financial institutions 0 %
Royalties	15 %	5 %	15 %	15 %	0 %
Service fees	15 %	5 %	15 %	0 %	0 %
Rents	15 %	n/a	0 %	10 % if for land and buildings, otherwise 0 %	0 %

Table A4: Overview on the Income Tax Systems in the EAC (Continuation)

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Profit shifting					
Transfer pricing rules	No guidelines	Income Tax Rules on Transfer Pricing w. e. f. July 1st 2006	Arm's length principle to be applied; all methods of determination (e.g. resale price method or cost plus method) are acknowledged	Arm's length price to be applied; guidelines being drafted	Arm's length price; no guidelines in force
Thin capitalization rules	No regulation	?	Limited deduction of interest (if loan exceeds four times the amount of equity)	Limited deduction of interest	Limited deduction of interest
Dividend stripping	No regulation	?	No special regulation	General anti-avoidance rule	General anti-avoidance rule
Tax Incentives					
Tax free zones	No tax free zones – as a geographical term – but "Zone franche" according to the Investment Code (tax relief on certain conditions)	Export Processing Zones (EPZ): 10 years tax holidays	Not yet operating, but important tax exemptions or reductions are granted by the law	Export Processing Zones (EPZ): 10 years tax holidays Special Economic Zones (SEZ): 10 years tax holidays	None
Initial capital allowances	see above under "Tax rates, reduced"	(once only at a given percentage) in respect of capital expenditure: - hotel sector: on buildings that are certified as industrial buildings - ordinary manufacturing sector: on both machinery and buildings - manufacture under bond sector: on both machinery and buildings - shipping sector for resident ship owners on ships more than 495 tons	see above under "Tax base, depreciation" and "Tax rates, reduced"	- mining: exploration and development 100 % - agriculture: plant and machinery 100 % - Business buildings, hotels 20 % - manufacturing/tourism: plant and machinery 50 %	- mining 100 % - business buildings 20 % - plant, machinery: urban 50 % rural 75 %
Procedures					
Registration	Yes	Every person with chargeable income is required to obtain PIN	Yes	Yes (IT supported)	Yes (manually)
TIN	Yes	?	Yes	Yes	Yes
Tax period	Tax year	Tax year	Tax year	Tax year	Tax year
Self-assessment	Yes; return no later than 3 months after the end of the year of income	Return of income and accounts no later than June 30 of the following year	Yes; return no later than 6 months after the end of the accounting period	Yes; return no later than 6 months after the end of the accounting period	Yes; return no later than 4 months after the end of the year of income
Payment	Through banks	?	Through banks	Through banks	Through banks
Prepayments	Yes	4 instalments based on previous year's income	4 instalments	4 instalments	2 instalments
Returns of group members	Separate return for each member	?	Separate return for each member	Separate return for each member	Separate return for each member
Audits	Yes	Yes	Yes	Yes	Yes
Adjustments/time limits	Additional assessments possible within 4 years	No	Additional assessments possible within 3 years	Additional assessments possible within 3 years (in case of fraud any time)	Additional assessments possible within 3 years (in case of fraud any time)
Penalties	Yes	Yes	Yes	Yes	Yes
Interest for late payments	Yes	?	Yes	Yes	Yes
Enforcement	Yes	Yes	Yes	Yes	Yes

Table A4: Overview on the IncomeTax Systems in the EAC (Continuation)

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Appeals	- appeal to a special commission, consisting of representatives of the taxpayers and of the tax administration; decision is not binding - Appeal to the Minister of Finance within three months; decision can be contested with a lawsuit with the administrative courts	?	- within 30 days to the Commissioner General - after decision, within further 30 days to the Appeals Commission - after decision, again within further 30 days to Tribunal	Provided the amount of the undisputed tax or 33 % of the assessed amount (whichever is higher) is paid: - within 30 days to the Board - after decision, within further 30 days to Tax Revenue Appeals Tribunal	- within 45 days to Commissioner General - after decision, within 45 days to High Court or Tax Tribunal - CG may waive the amount or accept a lesser amount to be paid in case where an objection has reasonably been made to an assessment
B. Taxation of Non-Residents					
Scope of income	Source in Burundi (no specification)	Source in Kenya (no specification)	Source in Rwanda (no specification)	Source in Tanzania (no specification)	Source in Uganda (no specification)
Withholding tax rates	Identical to residents	Different to residents	Identical to residents	In general identical to residents	Different to residents
Dividends	15 %	> 12,5 % voting power: Exempt < 12,5 % voting power: 5 %	15 %	- if paid by listed company 5 % - if paid by others 10 %	15 %
Interest	15 %	bearer instruments 25 % government bearer bonds 15 % other 15 % Qualifying interest: - housing bonds n/a - bearer instruments n/a - other n/a	15 %	10 %	15 %
Royalties	15 %	20 %	15 %	15 %	15 %
Service fees	15 %	20 %	15 %	15 %	15 %
Rents	15 %	- immovable property 30 % - other property 15 %	0 %	15 %; for leased aircraft 0 %	15 %
Remittances of branches to head offices	0 %	?	0 %	10 %	15 % of repatriated income (special formula for this income)
Assessment of non-residents	No special regulations	n/a	No special regulations	n/a	n/a

Table A5: Overview on Administration and Tax Procedures in the EAC

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Statutory Basis					
Tax Administrative Procedures Act	No	Being enacted by 2010	Law on Tax Procedures 2005	Being enacted by the end of 2009	In state of draft
Tax Revenue Appeals Tribunal Act	No	No	Basic rules in the Law on Tax procedures	Act in force since 2006	No
Procedures stated in specific Tax Acts	Income Tax, VAT, Excise Taxes	Income Tax, VAT, Excise Taxes	Income Tax, VAT, Excise Taxes	Income Tax, VAT, Excise Taxes	Income Tax, VAT, Excise Taxes
Organisation					
Independent Revenue Authority	No (will be established by end of 2009)	Yes	Yes (since 1997)	Yes	Yes
Taxpayer Identification Number	Yes	Yes	Yes	Yes	Yes
Large Taxpayer Unit	Yes	Yes	Yes	Yes	Yes
Special units for int'l taxation					
Ministry of Finance	No	No	No	No	No
Revenue Authority	No	No	No	No	No
Information Technology (IT)					
System	For budget administration: SIGEFI (Sistema de gestion financiera)	?	Standard Integrated Government Tax Administration System (SIGTAS), For Customs: ASYCUDA	ITAX	ITAS
Coverage		?		Partly	Partly
Cooperation within EAC	EARA*	EARA*	EARA*	EARA*	EARA*
Effectiveness of administration					
Informal sector	Too high				
Bureaucracy	Too high	Too high	Too high	Too high	Too high
Corruption	To be reduced	Too high	Too high	Too high	Too high
Special anti-corruption unit	Internal Inspection and Control Unit in the Ministry of Finance	To be reduced Yes	To be reduced Yes	To be reduced Yes	To be reduced ?
Taxation Procedures					
Rights and obligations defined	Partly	Partly	Partly	Partly	Partly
Assessments					
Adjustment after audit	Yes	In many cases	Yes	In many cases	In many cases
Time limits for adjustments	4 years	No	3 years	3 years unless fraud	3 years unless fraud
Estimates possible	Yes	Yes	Yes	Yes	Yes
Audits					
Electronic risk filter	No	No (?)	Yes	Yes	No
Office audits	Yes	Yes	Yes	Yes	Yes
Field audits	Yes	Yes	Yes	Yes	Yes
Cumbersome procedure	Yes	Yes	Yes	Yes	Yes
Advanced rulings					
Allowable		?	No records available	Yes	Yes
Receivable	No records available	?		Rare, delayed	Rare, delayed
Appeals					
Administrative appeals					
Judiciary appeals	Yes	Yes	Yes	Yes	Yes
Deposit of tax while appealing	Yes	Yes	Yes	Yes	Yes
(suspension effect)	?	Yes	?	Yes, unless CG renounces	Yes, unless CG renounces
Tax Tribunals					
Costly procedure	No records available (judgments not published, therefore no impact on taxation in general)	?	No records available (judgments not generally published, therefore no impact on taxation in general)	?	?
Time-consuming		Yes		Yes	Yes
Quality of decision		?		?	poor

*East African Revenue Authorities - regular meetings of Commissioner Generals and special committees

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