

# Small Business Taxation in Uganda

Tax Compliance and Tax Culture among  
Small and Medium-Sized Enterprises in Kampala



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# **Small Business Taxation in Uganda**

Tax Compliance and Tax Culture among  
Small and Medium-Sized Enterprises in Kampala

by

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## **Abstract**

*This research is a study of tax compliance among small and medium-sized enterprises (SMEs) in Kampala, Uganda. A top down approach towards taxing these businesses aims to increase the total revenue collected. However, the potential revenue from SMEs is quite small relative to the total revenue collected and administrative costs of ensuring compliance. What is then the purpose of taxing these businesses? The aim of this thesis is to explore if and why a bottom up approach towards taxation, focused on the development of the sector and the creation of a tax culture, is a more sustainable solution for domestic resource development regarding SMEs in Kampala. With the help of a two month qualitative fieldwork research among people working at or owning SMEs, I answer the main question of this research: Which factors influence tax compliance among SMEs in Kampala, Uganda? Using the "slippery slope" framework for tax compliance, I explain how these factors influence the dimensions of power and trust which are respectively related to enforced and voluntary compliance. Trust in the authorities among SMEs in Kampala is very low. The existing level of compliance is based on the power of the authorities, which is also relatively low because SMEs seek and find diverse ways to evade taxation. At the moment, tax compliance among these businesses is enforced rather than voluntary. The bottom up approach aims to build and sustain trust between SMEs and the government which leads to voluntary compliance. Voluntary compliance is a more sustainable solution for domestic revenue collection. It aims to increase tax morale, facilitating long term compliance.*

**Keywords:** Taxation, Tax Compliance, The "Slippery Slope" Framework, Enforced vs. Voluntary Compliance, Tax Culture, SMEs, Informal Sector, Kampala, Uganda

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## List of Abbreviations

CG	Commissioner General
COIN	City Operator Identification Number
CSO	Civil Society Organization
EAC	East African Community
GDP	Gross Domestic Product
GoU	Government of Uganda
GPT	Graduated Poll Tax
IGO	Inter-Governmental Organization
IMF	International Monetary Fund
KCCA	Kampala Capital City Authority
NGO	Non-Governmental Organization
NRM	National Resistance Movement
NTCA	Netherlands Tax and Customs Administration
OECD	Organisation for Economic Co-operation and Development
PAYE	Pay As You Earn
P.S.V.	Public Service Vehicle
SA	South Africa
SEATINI	Southern and East African Trade Information and Negotiation Institute
SDG	Sustainable Development Goals
Shs	Ugandan Shillings
SME	Small and/or Medium-Sized Enterprise
TIN	Tax Identification Number
TREP	Taxpayer Register Expansion Program
UGX	Ugandan shilling
URA	Uganda Revenue Authority
URSB	Uganda Registration Services Bureau
USD	United States Dollar
VAT	Value Added Tax

## Executive Summary

This research is a study of tax compliance among small and medium-sized enterprises (SMEs) in Kampala, Uganda. For the past decade, the tax-to-GDP ratio of Uganda has been stuck just below 13 percent. The pervasiveness of the informal sector is described as one of the reasons why the tax-to-GDP ratio is stuck in Uganda. Tapping into this informal sector with the primary aim to increase domestic revenue mobilization and close the tax-to-GDP gap can be described as a top down approach towards taxation. SMEs form a significant part of the informal sector and are inherently hard to tax. The presumptive income tax or small business tax targeting SMEs collects less than 4 billion Ugandan shillings yearly. The Uganda Revenue Authority (URA) estimated that the potential revenue from this tax could be about 83 billion shillings of which 24 in Kampala alone, this shows a significant tax compliance gap. Still, the potential revenue is relatively low compared to the total revenue and administrative costs of ensuring compliance. The total amount of revenue collected by the URA in the '15/'16 fiscal year was almost 13 trillion Ugandan shillings.

Is it reasonable to pursue a top down approach towards taxation of SMEs if it does not contribute to achieving the aim of this approach? What should be the goal of taxing these SMEs? Should these SMEs be taxed at all? A bottom up approach towards taxation aims to develop the sector that is taxed and at the same time create a *tax culture*. Where the top down approach mainly imposes taxes on these businesses and enforces them to comply, the bottom up approach starts from the perspective of the SMEs. What do they need to develop and grow? How can the state facilitate this? What is the role of taxation in this development? The aim of this thesis is to explore if and why the bottom up approach towards taxation is a more sustainable solution for domestic resource development regarding SMEs in Kampala.

A two-month qualitative fieldwork research among SMEs in Kampala, Uganda aims to clarify this issue. The main question asked in this research is: *Which factors influence tax compliance among small and medium-sized enterprises (SMEs) in Kampala, Uganda?* The methods of data collection were the unstructured interview, informal conversations, hanging out and participatory observation. I had dozens of informal conversations with people working at or owning SMEs, and carried out a total of 20 in-depth interviews of which 15 with SMEs and 5 with URA, KCCA & NGO staff working on taxation. The data is analyzed using the "slippery slope" framework (Kirchler, Hoelzl, & Wahl, 2008). This framework links the dimensions of power and trust to enforced and voluntary compliance. A top down approach is focused on increasing the (perceived) power of the authorities, enforcing compliance. A bottom up

approach builds on trust, and is therefore more likely to create voluntary compliance.

An important factor that helps to explain tax compliance is tax morale. Tax morale concerns the intrinsic motivation to pay taxes rather than the obligation to do so. Tax morale in Uganda is particularly low. People believe taxes are too high and the public services they receive in return are poor. Most studies on tax compliance and tax morale focus on middle or high income countries and/or are based on large quantitative surveys. For this research I use a socio-legal approach to taxation. This approach goes beyond the institutional perspective and looks at 'tax law in action' rather than 'tax law in the books'. By combining social scientific methods with an analysis of the tax law, this approach helps me to come as close to the lived reality of these SMEs as possible. The combination of the official story and the lived reality is crucial for this research because it determines the perceived power of and trust in the authorities.

The main taxes SMEs in Kampala are liable to pay are the KCCA trading license and the URA small business tax. A presumptive tax system is supposed to make it easier for the authorities to assess these businesses and support further formalization. Recent developments such as payment through mobile money and the concept of the 'one stop shop' significantly reduce the costs of compliance. As mentioned above, there is a lot of non-compliance in URA's small business tax. SMEs often find it easy to escape the attention of the URA or to hide a substantial part of their tax liability. This because of a lack of capacity at the URA and due to the location, size, and tax morale of these SMEs.

The URA and KCCA are responsible for taxing these small and medium-sized enterprises. The KCCA has more capacity to enforce compliance than the URA. Recently, both organizations started working together in the Taxpayer Register Expansion Program (TREP). TREP aims to expand the tax register, if someone wants to apply for a trading license, he or she first has to verify their Taxpayer Identification Number (TIN) and possibly pay outstanding taxes. The goal of TREP is to increase formalization and ultimately raise more revenue. In practice, it has not led to an increase in compliance regarding URA's small business tax.

Tax morale among small and medium-sized enterprises in Kampala is low. The people working at or owning SMEs do not like to or want to pay taxes. There is a lot of mistrust towards the authorities which are often perceived as corrupt. People do not know what their taxes are used for. According to some, the money collected through taxation either ends up in the hands of corrupt officials or politicians. People working at or owning SMEs in Kampala would like to see taxes used for the improvement of healthcare, infrastructure and education. However, they believe the roads are bad and the quality of the hospitals and schools is low. Knowledge about the tax system is also generally low. People do not understand



how their tax rate is established. To some these taxes are truly a burden as it is difficult to make ends meet, this forces them to evade taxation. Others deliberately evade or under declare, their tax morale is low and they do not feel compelled to pay (the right amount).

The main factors influencing tax compliance among SMEs in Kampala are subjective tax knowledge, attitudes towards taxes, personal, social and national norms, perceived fairness of the tax system and its implementation, compliance costs and political interference. These factors influence the dimensions of power and trust in the "slippery slope" framework. I explained that the trust in the authorities is very low. The (perceived) power of the authorities is also relatively low as SMEs find several ways to evade taxation. The existent level of tax compliance is mainly based on the perceived power of the authorities. Subsequently, compliance is enforced rather than voluntary.

The potential revenue from SMEs in Kampala is relatively low compared to the total revenue and the administrative costs of enforcing compliance. Pursuing a top down approach, which is mainly aimed at increasing the total revenue collected and closing the tax-to-GDP gap, is less reasonable because efficiently taxing these SMEs will not contribute to achieving these goals. However, exempting all SMEs from paying taxes is also problematic. As these enterprises grow they might still be inclined not to pay taxes, because they never did before. A bottom up approach aims to develop the sector that is taxed and at the same time create a tax culture. Where the top down approach mainly imposes taxes on businesses and enforces compliance, the bottom up approach starts from the perspective of the SMEs and tends to generate voluntary compliance. Creating a tax culture and voluntary compliance are more sustainable solutions for domestic resource development, because as these businesses grow with the help of the state they will feel more inclined to pay their taxes. Therefore, the bottom up approach towards taxation is a more sustainable solution for domestic resource development regarding SMEs in Kampala.

The above implies that it is important to build a relationship of trust rather than increase the power of the tax authorities regarding taxation of SMEs in Kampala. How to build this relation of trust? This could be done by looking at the needs of these businesses and using taxation to develop the sector. SMEs in Kampala lack security and have trouble finding financial capital, and personal or business insurance. If the government wants to build a relation of trust, it could be useful to use taxation to help these businesses fulfil their individual needs. In the discussion of this thesis I elaborate on the practical opportunities and challenges regarding a bottom up approach towards taxation among SMEs in Kampala. This is a governance question, however the perspectives of the people working at and owning SMEs remains important as they shape the foundation for such an approach.

## 1. Introduction

Taxation is often seen as the most healthy form of state revenue collection (Gobena & Van Dijke, 2015). If a state depends on broad taxation of society for its revenue, it is likely that it will develop policies favoring those paying taxes (Moore, 2008). Domestic resource mobilization through taxation has become an exceedingly important subject within international development for the past decades.<sup>1</sup> Developing countries collect taxes between 10 and 20 percent of the Gross Domestic Product (GDP) while among high-income countries the average is about 40 percent. Closing this *tax-to-GDP gap* could generate more revenue for the state and decrease dependence on foreign loans, aid, and rents on natural resources. The collected revenue could support state capacity and domestically funded development. In practice many developing countries have been struggling to close their tax-to-GDP gap the past decade.

Why do developing countries tax relatively little? The economic structure, the complexity of the tax law for taxpayers and tax professionals, political aspects, culture, norms and identity are some of the factors that explain a relatively low tax-to-GDP ratio (Besley & Persson, 2014). Developing countries often have a large informal sector, it is not an exception when this sector covers over half of the country's economy. A significant part of the informal sector consists of small and medium-sized enterprises (SMEs), which are inherently hard to tax. Tapping into this informal sector is often seen as a way to increase domestic revenue mobilization and close the tax-to-GDP gap. Governments and tax authorities struggle to get businesses in this sector to register, file and pay their taxes. This top down approach towards taxation is aimed at enhancing tax compliance and increasing the total amount of revenue collected. Yet, because it often concerns SMEs the potential revenue is relatively low compared to the total revenue and administrative costs of ensuring compliance.

### *Taxation and Tax Compliance in Uganda*

The focus of this study is on Uganda. About a year ago, President Museveni asked the Uganda Revenue Authority (URA) to increase the tax-to-GDP ratio to 20 percent in 2020.<sup>2</sup> For the past decade, the tax-to-GDP ratio of Uganda has been stuck just below 13 percent (Ssewanyana, Matovu, & Timukye, 2011). The pervasiveness of the informal sector is described as one of the reasons why the

tax-to-GDP ratio is stuck in Uganda (Mawejje & Okumu, 2016). The past couple of years, the URA and Kampala Capital City Authority (KCCA) have been working together in the Taxpayer Register Expansion Program (TREP). This project aims to expand the taxpayer register to increase efficiency in revenue collection. The program has not yet led to an increase in revenue collected from SMEs. The presumptive income tax or small business tax targeting SMEs collects less than 4 billion Ugandan shillings yearly. The URA estimated that the potential revenue from this tax could be about 83 billion shillings of which 24 in Kampala alone, this shows a significant tax compliance gap (Nanziri, Atukunda, & Lumal, 2016). This is still close to nothing compared to the total collected revenue of almost 13 trillion Ugandan shillings in the '15/'16 fiscal year (Ministry of Finance, 2016).

An important factor that helps to explain tax compliance is tax morale. Tax morale concerns the intrinsic motivation to pay taxes rather than the obligation to do so. A study, comparing tax compliant attitudes in four countries in Sub-Saharan Africa, showed that tax morale in Uganda is particularly low. People in Uganda believe taxes are too high and the public services they receive in return are poor (Ali, Fjeldstad, & Sjørnsen, 2013). The latter determinant of tax morale is closely related to the *fiscal exchange theory* that suggests that compliance is influenced by (perceptions of) the availability of public goods and services provided by the government (Timmons, 2005). Compliance costs and the complexity of tax laws, are also often important determinants of tax morale.<sup>3</sup>

### *Objective of the Thesis*

The potential revenue from SMEs is relatively low compared to the total revenue and the administrative costs of enforcing compliance. It is therefore less reasonable to pursue a top down approach which is mainly aimed at increasing the total collected revenue and closing the tax-to-GDP gap. What should then be the goal of taxing these SMEs? Should these SMEs be taxed at all? A bottom up approach to tax compliance might provide an interesting answer to these questions. The goal of the bottom up approach is to develop the sector that is taxed and at the same time create a *tax culture*. Where the top down approach mainly imposes taxes on these businesses and enforces them to comply, the bottom up approach starts from the perspective of the SMEs. What do they need to develop and grow? How can the state facilitate this? What is the role of

taxation in this development? The tax morale of these businesses is targeted rather than their tax compliance.

The aim of this thesis is to explore if and why the bottom up approach towards taxation might be a more sustainable solution for domestic resource development regarding SMEs in Kampala. Both approaches lead to different outcomes. A top down approach is more likely to create enforced compliance and a bottom up approach tends to generate voluntary compliance. I illustrate this with data collected during a two-month qualitative fieldwork research among SMEs in Kampala, Uganda. I analyze this data using the “slippery slope” framework (Kirchler, Hoelzl, & Wahl, 2008). This framework links the dimensions of ‘power of the authorities’ and ‘trust in the authorities’ to enforced and voluntary compliance. A top down approach is more focused on increasing the power of the authorities, enforcing compliance. A bottom up approach builds on trust, and is therefore more likely to create voluntary compliance.

### *Main, Sub- and Research Questions*

To understand if and why a bottom up approach towards taxation might be a more sustainable solution for domestic resource development regarding SMEs in Kampala. It is important to understand which factors influence tax compliance among these businesses. Therefore, the main question of this research is:

*Which factors influence tax compliance among small and medium-sized enterprises (SMEs) in Kampala, Uganda?*

Three sub-questions aim to answer the main question and are accompanied by several research questions:

1. *What is the official relation between small and medium-sized enterprises and the government regarding taxation?*
  - 1.1 What taxes should these SMEs be paying according to Ugandan tax law?
  - 1.2 What are the costs of compliance related to these taxes?
  - 1.3 Relative to the taxes that should be paid, to what extent are these compliant costs problematic?

The purpose of the first sub- and research questions is to map the official relation between SMEs and the URA. What are the tax obligations of the enterprises in this sector? What are their costs of compliance? The latter is difficult to measure because compliance does not always involve only money or time. Part of this first

sub-question will be answered in chapter four, where I discuss the context of this research and therefore the current tax regime in Uganda.

2. *What are the roles of the Uganda Revenue Authority (URA) and Kampala Capital City Authority (KCCA) when it comes to the taxation of small and medium-sized enterprises?*
  - 2.1 How are the URA and KCCA involved in ensuring compliance in this sector?
  - 2.2 What measures do the URA and KCCA take to decrease compliance costs?
  - 2.3 To what extent are the URA and KCCA successful in moving SMEs from the informal to the formal sector?

The Ugandan Revenue Authority and Kampala Capital City Authority are responsible for the collection of tax revenue in Kampala. Because they have the authority to enforce compliance, it is important to understand their role. Sub-question two focuses on how these organizations interact with SMEs.

3. *How do small and medium-sized enterprises relate to the taxes imposed on them by the Government, URA and KCCA?*
  - 3.1 What do the people who work at or own SMEs know already about the tax law and the tax authorities?
  - 3.2 To what extent do they trust the tax authorities?
  - 3.3 Where do they think tax revenue is spend on and what is their opinion about these expenditures?
  - 3.4 What reasons do they give themselves for why people do not pay taxes?

The third and final sub-question aims to illustrate how taxation is perceived by the people working at or owning small and medium-sized enterprises. It is important to understand what people already know about the tax laws and authorities. I want to find out how trust influences tax compliant attitudes and it is interesting to explore where they believe tax revenue is spend on and their opinion about these expenditures. Finally, I like to illustrate what explanations people give themselves why people would evade taxation.

### *A Socio-Legal Approach to Studying Taxation*

In the 2030 Sustainable Development Goals (SDGs), target 17.1 calls for 'Strengthen[ing] domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection'.<sup>4</sup> To 'strengthen domestic resource mobilization' it is very important to not only look at the 'rule of law' but also at 'the role of law'. If we

do not, the policies designed might fail to generate development outcomes aimed to produce such as 'security, growth and equity' (The World Bank, 2017). Regarding taxation, it is important that the focus is not only on increasing domestic revenue collection, but that the consequences of taxation are also considered. It is important that taxation is sustainable and this requires paying attention to the creation of a tax culture and a healthy relation between the taxpayer and the state.

Most studies on tax compliance and tax morale focus on middle or high income countries and/or are based on large quantitative surveys. For this research I use a socio-legal approach to taxation. This approach goes beyond the institutional perspective and looks at 'tax law in action' rather than 'tax law in the books'. By combining social scientific methods with an analysis of the tax law, this approach helps me to come as close to the lived reality of these SMEs as possible. The combination of the official story and lived reality is crucial for this research because it determines the perceived power of and trust in the authorities among SMEs in Kampala. I use the socio-legal approach to critically review the formal/informal duality which is often used by the government institutions to define the status of these businesses. In practice, it is more like a continuum ranging from informal subsistence economy to completely formal enterprises (Joshi et al., 2014; see [Appendix A](#)). The bottom up approach towards taxation aims to assist rather than enforce SMEs towards the formal side of this continuum. In this way, the continuum could be used as a model for a path of development.

### *Overview of the Thesis*

Before I move on, I provide a brief overview of this thesis. This introduction is followed by a literature review, starting with a section on the influence of taxation on state-society relations in developing countries. Furthermore, I look at tax compliance, tax morale and tax compliant attitudes, specifically in Sub-Saharan Africa. The literature review is concluded with a section on the socio-legal approach to taxation. The third chapter focuses on the analytical framework and methodology of this research. First, I explore the analytical framework used in this study. Introducing the "slippery slope" framework (Kirchler, Hoelzl, & Wahl, 2008). Then, I describe my research population, draft the methods used

for data collection and conclude with a brief overview of the data analysis, reliability and validity of the research.

In chapter 4, I explore the context of this research, taxation in Uganda. I start with a brief explanation of the development of taxation in Uganda. This is followed by a section on the current national tax regime and on the national and local taxes SMEs in Uganda are officially liable to pay. Concluding the fourth chapter, I take a first look at what is known about tax morale and tax compliant attitudes in Uganda. Chapter 5 considers the findings of the research. Using the data collected during the fieldwork research, I illustrate several profiles of SMEs in Kampala to demonstrate how their day-to-day business life is influenced by taxation. In the following section, I analyze the roles of the URA and KCCA. Specifically the influence of TREP on tax compliance and tax morale. I present the conclusions of this research in chapter 6, answering the main, sub- and research questions. Linking the findings of the research to the “slippery slope” framework to understand which factors influence tax compliance. In the final chapter, I discuss the objective of this thesis, reflect on the socio-legal approach and the limitations of this study, and consider opportunities for future research.

## **2. Literature Review**

The aim of this literature review is to explore what is known about taxation, tax compliance and tax morale in developing countries. The chapter is divided into three sections. I begin with a section on the role of taxation in state-building and the influence of tax on state-society relations. First related to events in early modern Europe, then to taxation in the today's Sub-Saharan Africa. Although today's Sub-Saharan Africa is different in many ways, the distinction made between coercive taxation and revenue bargaining to analyze the events in early modern Europe is instrumental for understanding how taxation influences state-society relations in these developing countries. In the second section of this chapter the focus is on taxpayers and those liable to pay taxes. Why do people pay or evade taxes? I explore the literature on tax compliance and tax morale in Sub-Saharan Africa. In the concluding section of this chapter, I discuss the socio-legal approach to taxation. This perspective forms an important link between the theoretical and analytical framework of this thesis. It helps to better understand the lived reality of SMEs in Kampala. I argue that the formal/informal duality is fabricated and in reality the status of small and medium sized enterprises is more fluid.

### **2.1 Taxation and State-Society Relations**

Taxation is generally thought to be one of the most healthy types of domestic resource mobilization (Gobena & Van Dijke, 2015). Resource mobilization is important for the development of state capacity and increasing the capacity of the state to govern is in its turn an important part of state-building. In this way, taxation is closely related to state-building. According to Margaret Levi (1988) 'The history of state revenue production is the history of the state'. Deborah Bräutigam (2008) agrees and adds that 'taxation may play the central role in building and sustaining the power of states'. She argues that taxes 'form one of the central arenas for the conduct of state-society relations, and they shape the balance between accumulation and redistribution that gives states their social character'. Another landmark study on how revenue production and state-building are intertwined is Charles Tilly's (1992) *Coercion, Capital, and European States: AD 990 -1992*. Which brings me to early modern Europe and the distinction between *coercive taxation* and *constructive revenue bargaining*.



## *Coercive Taxation and Revenue Bargaining in Early Modern Europe*

The studies mentioned above argue that taxation has played a central role in state-building during the formation of the modern state in early modern Europe and the accumulation of its power. Following the work of Charles Tilly (1992) and exploring the relation between taxation and governance in developing countries, Mick Moore (2008) explains that there are essentially two competing narratives of taxation each valid in some contexts. These narratives illustrate how taxation influences state-society relations. The first relates to *coercive taxation* and the second to *constructive revenue bargaining*. Moore (2008) demonstrates this distinction with a situation as it could have existed in early modern Europe:

*"Think first of a rather sluggish tax collector lumbering after a number of nimble citizens. Much of the time he cannot catch them. When he does, he treats them brutally and manages to squeeze out some cash. At the end of the day, he trudges back wearily to show an angry king how little money he has to show for his efforts. Meanwhile, the citizens gather in the tavern, commiserating with those of their number who are bruised and taxed, and lamenting, as always, how tomorrow their business and pleasure will be interrupted by the constant need to keep an eye out for the tax man."*

This is a story of coercive taxation. A lose-lose situation wherein the king does not succeed in effectively collecting revenue and citizens have to keep an eye out for the tax man. It is a top down approach to taxation, the citizens are compelled to pay these taxes and collection is done coercively. However, this might change as Moore (2008) continues:

*"Then, someone has an idea: could they not reach an agreement with the king about how much they would pay, and what the king would do for them in return, that would leave everyone better off? Conversation might turn to how they would select representatives to negotiate with the king. There might even be in the room a proto social scientist who would declare this the positive sum option, contrasting it with the existing negative sum situation, in which more for the state is less for the citizen, and everyone suffers indirectly from such a clumsy way of financing government."*

Similar to coercive taxation, revenue bargaining begins with a 'greedy state' that threatens to tax citizens who would rather not pay taxes. However, their negotiations about taxes with the king engages the taxpaying citizens in the political process. 'Taxation becomes a source of healthy conflict between them and the state' (Moore, 2008). Governments become dependent on the revenue from taxes which encourages revenue bargaining with the taxpayers. Influence in decision making over public policy is institutionalised in exchange of (quasi-) voluntary tax compliance. This narrative is comparable to a bottom up approach. Taxpayers are involved in the tax policy, which encourages them to voluntarily comply to their tax obligations.

Coercive taxation has three main characteristics. First of all, assessment is done arbitrary. Secondly, collection is carried out through coercion. Finally, taxpayers are not represented in tax policy decisions. Especially the third characteristic is central to the difference between coercive taxation and constructive revenue bargaining. Constructive revenue bargaining shapes the foundation for the fiscal contract theory, wherein the relation between society and the state is determined through taxation, creating a mutual dependence (Timmons, 2005). But why should the ruler consider revenue bargaining (the contractual solution) instead of coercive taxation? Why hand in power for revenue that could also be collected forcefully? Revenue bargaining has several advantages over coercive taxation, for both ruler and taxpayer. For example, it provides a more stable income of revenue for the state, tax payments become more predictable, and it institutionalizes influence of the taxpayer on public policy. In early modern Europe and in other Western countries the observation is that the situation generally developed from coercive taxation towards revenue bargaining. Some citizens gained influence on (tax) policy, which has been part of the democratization of the early modern European state. In this way, these two types of taxation shape different state-society relations.

### *Taxation and State-Society Relations in Developing Countries*

Rather recently an increased interest emerged in academic scholarship on the uses of tax law for 'the universal quest for human development' (Brauner & Stewart, 2013). As previously pointed out, domestic revenue mobilization increases state capacity which could benefit development. How does taxation

influence state-society relations in today's developing world? The situation in early modern Europe cannot be compared with that of today's developing countries. First, the concept of the state is different in today's Sub-Saharan Africa compared to the situation in early modern Europe. The administrative state was externally imposed in colonial and post-colonial times. Today, state law often exists besides other (more informal) bodies of values and rules (von Benda-Beckmann, von Benda-Beckmann, & Eckert, 2009). It is important to consider this, as it also might influence the influence of taxation on state-society relations in developing countries. Second, many governments in today's developing world do not rely on broad taxation for revenue collection. They often depend on revenue collected through for example foreign loans, aid or natural resource rents. This radically changes the way we are to understand the role of taxation in state-society relations. The geographical focus of these paragraphs is on Sub-Saharan Africa.

As pointed out previously, compared to high-income countries developing countries tax little. The economic structure, complexity of the tax law for taxpayers and tax professionals, political aspects, culture, norms and identity are according to Besley and Persson (2014) some of the factors contributing to a relatively low tax-to-GDP ratio.

Referring back to the two types of taxation mentioned in the previous section, Mick Moore (2008) observes a reversal of causality. Where revenue bargaining led to some democratization in early modern Europe, democratization caused tax reform in several developing countries. When several African countries started to organize multiparty elections in the early nineties, Jane Guyer (1992) observed that in rural Nigeria there was a call for 'representation without taxation'.<sup>5</sup> This has also been the case in Tanzania and Uganda, political pressure emerged from the introduction of a multi-party system and led to the abolishment of the unpopular poll taxes and the tax system was reformed (Fjeldstad & Therkildsen, 2008). More on taxation in Uganda in chapter 4. According to Fjeldstad & Therkildsen (2008), African leadership today has to 'seek consent first' and can only 'enforce taxation afterwards'. This in combination with the fact that revenue today can be collected elsewhere could help to explain why the tax-to-GDP ratio in developing countries is relatively low.

In today's globalizing world it is important to consider international influence on taxation in developing countries. Taxation is not only a domestic issue. Multinational enterprises around the world operate in several countries and bilateral tax treaties ensure that these enterprises are not taxed twice over one economic activity. Recently these treaties have been the focus of discussion as some multinationals use this system of treaties cleverly to avoid paying taxes. As a result, developing countries miss out on much needed revenue. The IMF, World Bank and other IGOs or NGOs have been increasingly involved in tax reforms in developing countries. National governments still play a central role in tax policy. For example, tax reform requires laws, bureaucratic implementation, and 'a level of acceptance by the taxpayers' (Brauner & Stewart, 2013). However, Odd-Helge Fjeldstad and Mick Moore (2008) argue that tax policy is now globalised. According to them there is a 'powerful orthodoxy' which is promoted in particular by the IMF and other transnational taxation professionals. This orthodoxy has produced a far-reaching process of tax reform virtually throughout the world. It is driven by economic and fiscal considerations and can therefore be described as a top down approach to taxation. According to Odd-Helge Fjeldstad and Mick Moore (2008), 'A reform agenda focused on issues of state-building in the poorer countries would look substantially different'. I believe, this agenda would be more closely related to the bottom up approach. Including the perspective and the need of the taxpayer rather than focusing on increasing the total revenue.

## **2.2 Why do People Pay or Evade Taxes?**

In the previous section I explored the influence of taxation on state-society relations. This relation forms the foundation of understanding why people pay or do not pay taxes in developing countries. The level of tax compliance explains whether people comply to their obligation to pay taxes. Tax compliance has become an important determinant of the efficiency of tax systems. However, when we want to understand *why* people pay or do not pay taxes we have to look at *tax morale*. In this section I take a closer look at tax morale and tax compliant attitudes. How can we use these concepts to better understand why people pay or do not pay their taxes? In addition, I look at the literature on tax morale in developing countries, specifically focused on Sub-Saharan Africa.

## *Tax Compliance and Tax Morale*

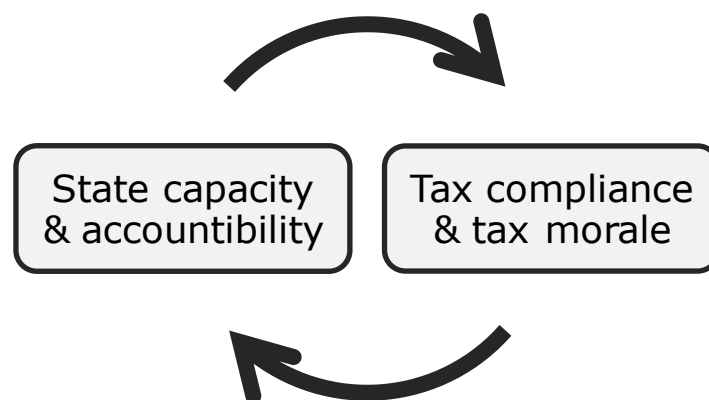
Ali, Fjeldstad and Sjørnsen (2013) argue that if we want to deal with the problem of tax evasion an understanding of the factors underlying taxpayers' decisions about whether to pay or evade taxes is required. Therefore, I take a brief look at the main theories that try to explain why people pay or do not pay their taxes. Five can be distinguished, I briefly introduce the core argument of each theory. (1) *Economic deterrence*: taxpayer behavior is determined by an analysis of the costs and benefits of evading taxes. (2) *Fiscal Exchange*: the presence of public services, government providing goods to taxpayers, can increase compliance.<sup>6</sup> (3) *Social Influences*: taxpayer behavior is influenced by the norms and values of an individual's reference group. (4) *Comparative treatment*: the addressing of inequities through taxation can influence taxpayer behavior. (5) *Political legitimacy*: behavior is influenced by the extent to which taxpayers trust their government (Ali, Fjeldstad, & Sjørnsen, 2013).

Tax morale, or the intrinsic motivation to fulfill tax duties, has been and is an important determinant for tax compliance in Western countries such as the Netherlands. Tax morale is about citizens' actual motivation to pay their taxes and not just about their obligation to do so. Studies have shown that tax morale is crucial to a functioning tax system – without a positive tax morale, no efficient system.<sup>7</sup> In the past decades several studies used quantitative research to find determinants of tax morale, often large cross-country analysis of what factors might explain a low or a high tax morale.

To study tax morale, especially among those evading taxes, can be challenging. Ali, Fjeldstad and Sjørnsen (2013) mention that individuals are often reluctant when it comes to revealing their non-compliance. That is why a lot of research studying the determinants of tax compliance looks at attitudes towards evasion rather than someone's actual non-compliance. Looking at perceptions and attitudes instead of actual non-compliance is a way of understanding behavior related to tax compliance. Attitudes can certainly not predict behavior. However, research from social psychology states that it can actually have a strong influence on behavior (Ajzen & Fishbein, 1977). Therefore, research aims to find which factors are correlated with tax compliant attitudes and revenue

administrations try to use this knowledge to improve compliance (Ali, Fjeldstad, & Sjørnsen, 2013).

Taxation activates a stronger fairness norm, leading citizens to demand more from their leaders. Because of a loss-aversion mechanism, taxation increases citizens' willingness to punish corrupt leaders or other officials. Taxation can initiate a self-enforcing mechanism; tax morale and compliance increases state capacity and accountability which in turn increases tax morale and compliance (see Figure 1 below). In this way, tax morale plays a central role in building and sustaining the power of the state, and shaping state-society relations (Bräutigam, 2008). Therefore, regarding the legitimacy of the state, this might also be an interesting incentive to increase domestic resource mobilization (from the perspective of the state).



*Figure 1: Taxation's self-enforcing mechanism. tax morale and compliance increases state capacity and accountability which in turn increases tax morale and compliance.*

### *Tax Compliant Attitudes in Developing Countries*

To enhance tax compliance in developing countries it is important to understand the determinants of tax morale in these countries. Several studies combine international surveys with other data to find these determinants.<sup>8</sup> These studies indicate that various concepts have an influence on tax morale in developing countries. To name a few: trust in government, accountability, public goods and services, efficient and transparent legal structures, support for democratic governance, gender, age, education, and religion. These determinants are closely related to the theories mentioned above. Experience with paying taxes also seems to be an important determinant of tax morale (Moore, 2014).

Tax morale concerns an intrinsic motivation and is thereby also likely to be linked to local context and cultural values. Cross-societal experiments and data on corruption, tax evasion and fraudulent politics show that weak institutions and cultural legacies, that generate rule violations, might impair individual intrinsic honesty (Gächter & Schluz, 2016). However, it is important to understand that this could be related to the fact that different cultural values and meanings shape different ideas about intrinsic honesty. Different cultural values and meanings might also explain different shapes and levels of tax morale.

The literature on tax morale and tax compliant attitudes in developing countries is growing but still relatively small today. A lot of the studies on tax behavior build on the work of Kirchler (2007): *The Economic Psychology of Tax Behaviour*. Regarding compliance, Kirchler, Hoelzl and Wahl (2008) demonstrate that tax authorities in developing countries often show little trust in taxpayers and seem to believe that deterrent actions can solve all problems related to tax compliance. Therefore, tax environments in developing countries often feature so called 'cops and robbers' relationships between taxpayers and the tax authority. I elaborate on the work of Kirchler, Hoelzl and Wahl in [section 3.1](#), where I illustrate the analytical framework of this research. Regarding tax morale, Asaminew (2010) argues that in developing countries paying taxes is not seen as contributing to public goods. He states that is rather seen as a burden imposed by government. According to Gobena and van Dijk (2015) taxpaying behavior has been studied using two main approaches. The first study's compliance using an economic model or in other words the deterrence approach. The second consists of socio psychological perspectives and looks at non-economic perspectives. The five theories mentioned above include both perspectives.

Abdul-Raza and Adafula (2013) look at taxpayers' attitude and its influence on tax compliance decisions among SMEs in Tamale, Ghana. They found that: 'the burden of taxes paid affects the attitudes of individuals and this informs how they evaluate the tax system and consequently their compliance decisions'. Interestingly, in this study, factors such as accountability and transparency did not significantly impact taxpayers' attitudes. This trust in government could be explained by the high perceived level of benefits derived from the provision of public goods and services. Still, individuals did not clearly understand the tax

laws and the researchers found a positive relationship between levels of understanding and tax compliance decisions.<sup>9</sup>

### **2.3 A Socio-Legal Approach to Taxation**

As I explained in the introduction, it is important to value the lived reality of small and medium-sized enterprises in Kampala to understand their relation with taxation and the authorities. I need to go beyond the institutional perspective, and therefore I use a socio-legal approach to taxation.

The roots of the socio-legal approach are found in legal anthropology. One of its pioneers, Bronislaw Malinowski (1926), concluded in his landmark fieldwork study 'Crime and Custom in Savage Society' that all societies have some form of law or other mechanism to maintain social order. This mechanism can exist in the shape of formal laws or as an informal body of norms and rules. According to von Benda-Beckmann et al. (2009) law, 'constitutes, organizes and legitimizes positions of authority of governing agents and governance activities'. Regardless whether these governing agents belong to the state or any other politico-legal authority such as a traditional power holder. This forms the foundation for legal pluralism, which can be defined as: 'the theoretical possibility of more than one legal order or mechanism within one socio-political space, based on different sources of ultimate validity and maintained by forms of organization other than the state' (von Benda-Beckmann, 2003). Especially in today's developing world, where the state is often a colonial legacy, different legal orders exist within the socio-political space of the state. This is where the socio-legal approach distinguishes itself from other disciplines such as economics, political and legal sciences, where law is often perceived as only a matter of the state. The socio-legal approach is analytical rather than instrumental, studying what law does instead of what it could or should do. Thereby it looks at *law in action* rather than *law in the books*, or in the case of this study: *tax law in action*.

Tax law in today's society is a way of maintaining order through fiscal efforts, ensuring stability in revenue collection for the state which is crucial for its functioning. Moreover, the fiscal contract theory suggests that taxation is a crucial link in the relation between society and the state (Timmons, 2005). The socio-legal approach changes the way we perceive tax law. It becomes a



instrument of governance rather than a natural part of society. In the context of this research tax law in Uganda attempts to formalize SMEs and thereby bring order to this sector and increase revenue collection. It is a fiscal instrument that used to increase the control of the state. In the previous two sections I explored the influence of taxation on state-society relations and tax compliant attitudes / tax morale in developing countries. These theories might help to explain why SMEs in Kampala, Uganda pay or evade taxes. To fully comprehend the situation I need to fully understand the status of these small and medium-sized enterprises. Are they formal or informal? The socio-legal approach helps me to better understand the lived reality of small and medium-sized enterprises in Kampala. This will explain why specifically these businesses are interesting for this study and it brings me to question the formal/informal duality.

### *The Formal/Informal Duality*

Joshi, Prichard and Heady (2014) state that enterprises are in the informal sector because: 'they contravene – or are not subject to – some of a variety of rules and regulations, including labor laws, environmental laws, registration, and taxation'. They emphasize that the duality of formal and informal businesses does not really exist. It is more like a continuum ranging from informal subsistence economy to completely formal enterprises (see [Appendix A](#)). According to Joshi et al. (2014), an enterprise might for example escape national taxation, but is often burdened by several types of fees, charges, and licensing costs imposed on them by local governments. In addition, informal and formal businesses are often linked in their economic activities. The distinction between formal and informal businesses is problematic because it is a fabricated duality facilitating an institutional perspective. Whether a small or medium-sized business is formal or informal depends if it is on the radar of the state. Even within a state the distinction is problematic because for different government institutions the determinants of informality differ. Especially when the systems these institutions use are disintegrated. For example, the tax authorities might define informality based on whether a SME is paying (the right) taxes. For a municipality it might be related to whether this same business has a (or the correct) trading license.

Because of this problematic duality, it is difficult to establish beforehand if a SME is (more) formal or informal. Therefore, instead of categorizing SMEs as either formal or informal, I find that these businesses 'generate enough income to warrant taxation but find it easy to escape the attention of the tax administration or to conceal a substantial part of their tax liability, because of their location, size, and/or nature of their businesses' (Joshi et al. 2014). This perspective on SMEs in developing countries such as Uganda is useful because it is not subject to problematic formal/informal or registered/non-registered dualities. This fluid perception of their status is closer to the reality of their practices. Informality and non-registered are negative terms that are used by the government to classify those paying taxes and those who do not. From a socio-legal perspective, these dualities favor the goals of the state. Which are to increase the revenue collected from taxation, their control on the sector and the legitimacy of their actions.

When following an institutional approach, the formal/informal duality is instrumental. It classifies which businesses are paying taxes and which are not. Subsequently, policy is to target those not paying taxes and successful policy will increase tax compliance and thereby the total amount of collected revenue. This is very much like a top down approach. However, as this duality is not a reality, it might be better to follow the bottom up approach. Assuming that the informal economy is like the continuum presented in [Appendix A](#), it is beneficial to focus on the needs of SMEs to develop them towards a more formalized enterprise. Subsequently, the deliverance of services and the construction of trust between the state and the sector could increase voluntary tax compliance, creating a tax culture, safeguarding long term compliance and decreasing the administrative costs of ensuring compliance. In [section 3.3](#), I elaborate on the characteristics of the small and medium-sized enterprises than shape the main research population of this study.

### **3. Analytical Framework and Methodology**

This chapter focuses on the analytical framework and methodology of the research and is divided into two main sections. In the first section I elaborate on the main analytical framework used in this study, Kirchler, Hoelzl and Wahl's (2008) "slippery slope" framework for tax compliance. In the second section of this chapter, I illustrate the research population and explain which methods and techniques I used to collect and analyse the data. Furthermore, I elaborate on the reliability and validity of the research. For this fieldwork research I had dozens of informal conversations with people working at or owning SMEs in Kampala. Furthermore, I carried out a total of 20 in-depth interviews of which 15 with SMEs and 5 with URA, KCCA & NGO staff working on revenue collection.

#### **3.1 The "Slippery Slope" Framework**

The analytical framework used in this thesis is based on the "slippery slope" framework for tax compliance, presented in an article of Erich Kirchler, Erik Hoelzl, and Ingrid Wahl (2008) titled, '*Enforced versus voluntary compliance: The "slippery slope" framework*'. The framework is based on the idea that the tax climate in a society varies on a continuum between antagonistic and synergistic. In the former, taxpayers and authorities work against each other and in the latter they work together. Kirchler, Hoelzl and Wahl (2008) explain:

*"The antagonistic climate can be characterized by a 'cops and robbers' – attitude on both sides: tax authorities perceive the taxpayers as 'robbers' who try to evade whenever they can and need to be held in check; taxpayers feel persecuted by the authorities ('cops') and feel it right to hide. [...] The synergistic climate can be characterized by the idea that tax authorities perform a service for the community, and are a part of the same community the individual taxpayers belong to."*

The distinction between the antagonistic and synergistic tax climate is similar to the difference between coercive taxation and constructive revenue bargaining discussed in [section 2.1](#). Moore's (2008) story of the tax collector scrambling after a number of nimble citizens resembles the 'cops and robbers' attitudes described above. A synergistic climate wherein the authorities perform a service

for the community, to which the authority itself also belongs to, is more closely related to the idea of constructive revenue bargaining.

The framework aims to illustrate that tax compliance is influenced by two main dimensions: 'the power of the authorities' and 'the trust in the authorities'. Both dimensions are determined by the perception of the taxpayer. The power of authorities, is related to the taxpayers' perception of the authorities competence to enforce compliance and punish evasion. The trust in authorities is influenced by the general opinion of individuals and social groups that taxation is used by the authorities for the common good. According to the framework, tax compliance will increase by raising either or both power and trust. The former will result in enforced compliance and the latter in voluntary compliance. This creates a three-dimensional framework, as shown below in the illustration of the "slippery slope" framework (Figure 2).

Kirchler, Hoelzl and Wahl (2008) use this framework in their study as a conceptual tool to look at factors that are considered to be important for explaining compliance such as: audit probabilities, fines, tax rate, subjective tax knowledge and participation, attitudes towards taxes, personal, social and national norms, and perceived fairness. Several of these factors are related to tax morale and tax compliant attitudes.

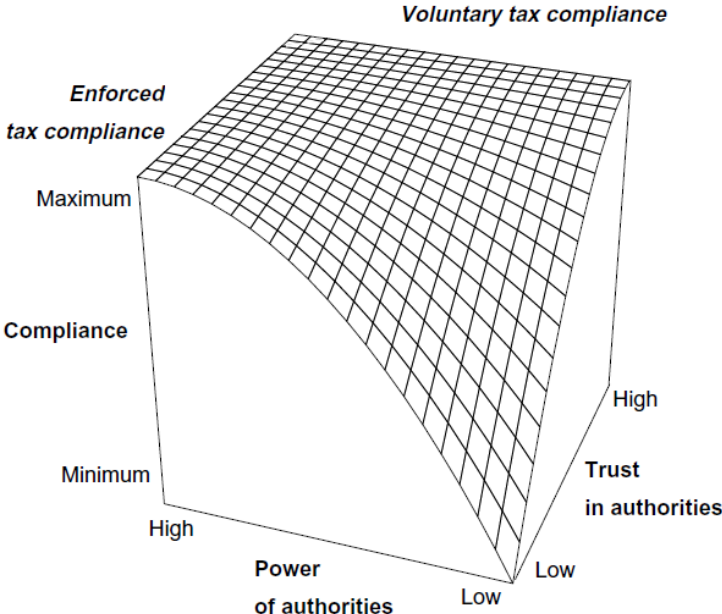


Figure 2: Kirchler, Hoelzl and Wahl (2008), 'The "slippery slope" framework'.<sup>10</sup>

The framework got its “slippery slope” character from the idea that changes in power also influences trust and vice versa. Kirchler, Hoelzl and Wahl (2008) explain that as the trust in the authorities decreases, it is likely that also the perceived power of the authorities will decrease. A decrease in power would also lead to a decrease in trust. Compliance could fall into a downward spiral, slipping down the slopes of power and trust. This self-enforcing mechanism could also create an upward movement. But, trust and power are more easily lost than gained. If trust in the tax authorities decreases, their actions will be interpreted as less legitimate than before. Which makes it more legitimate to seek opportunities to reduce payments and support for the authorities (Kirchler, Hoelzl, & Wahl, 2008). Thereby, the power of the authorities declines as well.

The factors that influence tax compliance according to Kirchler, Hoelzl and Wahl (2008) and which return in this research on are: subjective tax knowledge and participation, attitudes towards taxes, personal, social and national norms, and perceived fairness. In this paragraph I briefly explain how these factors influence the dimensions of power and trust in the “slippery slope” framework. First of all, ‘Subjective tax knowledge’ is positively correlated with trust, and poor understanding or misunderstanding are positively correlated with distrust. According to Kirchler, Hoelzl and Wahl (2008), ‘attitudes towards taxes’ influence both power and trust, and the relation between the two dimensions. Favourable attitudes could contribute to trust and consequently enhance voluntary compliance. Attitudes are also relevant for the interpretation of the use of power of the authorities. They explain why the use of power is perceived as generous or cruel. The use of power is more often perceived as cruel, when there is a negative attitude towards taxation. Subsequently, it is likely that trust in the authorities will further decline.

‘Norms’ also influence both power and trust. Kirchler, Hoelzl and Wahl (2008), differentiate three types of norms: national, social and individual. National norms are found in the tax laws and the role the tax authorities. They have a direct influence on power. Discrepancies in norms within government, can decrease the power of the tax authorities. If social norms, such as the belief that tax evasion is not a serious felony, are widespread the power of tax authorities declines. On an individual level, norms relate to moral reasoning and values. Norms can increase and decrease power of and trust in the authorities, as they

influence whether the tax authorities are seen as the legitimate actor to go after the people that are not paying taxes. Finally, 'perceived fairness' is also an important factor influencing tax compliance. If the tax system is perceived as unfair, trust in the authorities will decrease. Mistrust in the authorities, legitimizes actions to evade or under declare taxes. In this way, as the trust in the authorities declines so does tax compliance. People feel less inclined to voluntarily comply when they do not trust the authorities.

In this study I use the "slippery slope" framework to analyze tax compliance among SMEs in Kampala. The dimensions of power and trust are closely related to tax morale, since it concerns perceptions rather than objective measurements of tax compliance. A lot of what is known about tax morale in developing countries is based on secondary cross-societal survey data. As discussed in the literature review, local context and cultural values are also important determinants of tax morale. Tax morale seems to be motivated on a personal level, linked to individual and social ideas surrounding trust, accountability, transparency and public goods and services. Looking at these determinants of tax morale in the context of the "slippery slope" framework will help me to analyse the current relation between tax compliance, SMEs and the authorities in Kampala, Uganda.

### **3.2 Research Population, Methods and Analysis**

I begin this section with the research population, clarifying what businesses in Kampala I understand to be small or medium-sized enterprises. Additionally, I included the institutions responsible for collecting the taxes in Kampala in the research (URA & KCCA). Before I conclude this chapter with some paragraphs on the analysis, validity and reliability of this research, I elaborate on the methods used for data collection.

#### *Research Population*

The main research population of this study consists of people working at or owning small and medium-sized enterprises. These SMEs operate specifically in Kampala central division, an economic hotspot in the city, Uganda and East Africa. There is not one universal definition of a SME, it really depends on the

economic structure of a country.<sup>11</sup> Therefore, I use the characteristics found in column c and column b of the informal economy continuum mentioned in [section 2.3 \(Appendix A\)](#). The people owning these businesses are often non-poor, well educated and skilled. These businesses are mainly manufactures or service providers and the market is generally highly competitive. Some of their main problems include access to capital and personal or business insurance. These businesses are liable to pay taxes, however they under-report earnings, use loopholes and often escape formal tax assessments. If they have workers, they are commonly unregistered. In several developing countries, such as Uganda, they fall under a presumptive tax regime that is aimed at further formalization. Cash transactions are common among all small and medium-sized enterprises.

Smaller businesses that are also part of the presumptive tax regime generally have poorer owners, but they are still reasonably well educated and skilled. These businesses have even more problems in gaining access to capital, and are often difficult to assess because of poor or no recordkeeping. These enterprises 'generate enough income to warrant taxation but find it easy to escape the attention of the tax administration or to conceal a substantial part of their tax liability, because of the location, size, and/or nature of their businesses' (Joshi, Prichard, & Heady, 2014). In Uganda, SMEs are typically below the VAT threshold and within the presumptive / small business tax regime of the URA.

Besides the people working at or owning SMEs in Kampala, the Uganda Revenue Authority and Kampala Capital City Authority also play an important role in this research. They are responsible for collecting the taxes the SMEs are liable to pay. I sketch a brief profile of these institutions in the following chapter. During my time in Kampala, I collaborated closely with the Uganda Revenue Authority. This collaboration provided me with additional literature, up-to-date information on the domestic tax laws and research on the informal sector carried out by the Ugandan Revenue Authority.

### *Methods for Data Collection*

The data for this study was collected in May and June 2017, during a two month fieldwork research in Kampala using qualitative methods from anthropology and development sociology. The main method was the qualitative unstructured

interview. Using a topic list and a couple of pre-formulated questions, this type of interviewing tries to 'exert as little control over the interaction as possible' (DeWalt and DeWalt 2011). The advantage of this method is that respondents can put forth their own opinions about the topic. In this case, their perspective on and opinion about taxation and the (tax) authorities.

Other important methods used for this research include: hanging out and participatory observation. *Hanging out* mainly consists of 'being there'. It helps to establish contact with the research population and builds a relationship of trust. Hanging out is a way of collecting data outside of formal meetings with respondents. Naturally, this method leads to *informal conversations*, these are not official interviews, but the respondent is aware of the role of the researcher and knows that what they talk about could be used for the research. The focus is on the 'natural flow of conversation' which can be compared with conversations everywhere in daily life. *Participatory observation*, is described by DeWalt & DeWalt (2011) as taking 'part in the daily activities, rituals, interactions, and events of a group of people as one of the means of learning the explicit and tacit aspects of their life routines and their culture'. This is an excellent method to get as close to the lived reality of SMEs in Kampala as possible. Participatory observation helps to understand the differences between the official story and how things work out in practice. It reveals the differences between what people say and what they do.

### *Analysis, Validity and Reliability*

As mentioned in the beginning of this chapter, I had dozens of informal conversations with people working at or owning SMEs, and carried out a total of 20 in-depth interviews of which 15 with SMEs and 5 with URA, KCCA & NGO staff working on taxation. The data collected during this fieldwork was analysed using NVivo. Starting with open coding, I created codes purely based on the data collected. This gave a good overview of the possible answers for the sub-questions. Subsequently I used closed coding, codes related directly to the sub- and research questions. I provided an overview of these codes in [Appendix C](#). I also included an overview of what kind of and how many businesses were part of this research. In [section 5.1](#), I used the codes to create profiles that illustrate day-to-day business life of SMEs in Kampala in. They illustrate the main findings



of the two-month fieldwork research. Aggregating the results of this research into such profiles has its advantages and disadvantages. It helps to create a lively description of the relation between business and taxation among SMEs in Kampala. But, these profiles should be read with caution as it is important to understand that in a way they somewhat simplify reality. The profiles are built up from information provided by several informants, the names are pseudonyms.

Validity and reliability are two important indicators for the quality of research (Boeije, 2010). The reliability of this research is difficult to determine. Taxation of SMEs in Uganda, the 'phenomenon itself' studied in this research is currently changing. Therefore, conducting the same research after a certain amount of time would probably provide different answers. The instruments used might be reliable, but the circumstances and context has changed. Therefore it is difficult to measure reliability in qualitative research.

The internal validity of this research is threatened mainly by the fact that people are generally reluctant to talk about their unwanted behavior or non-compliance. That is why this research studies attitudes rather than actual (non-) compliance. As mentioned in [section 2.2](#), attitudes can certainly not predict behavior, but research has shown that it can actually have a strong influence on behavior (Ajzen & Fishbein, 1977). Because people might not want to partake in the research, a specific part of the 'story' could be missing. To mediate this, I aimed for a diverse sample regarding gender, location and trade. The use of a local research assistant to find respondents also helped because it lowered the threshold to partake in this research. However, the research subsequently depended partially on his sampling. The fact that I was a foreigner and clearly not a tax agent made people considerably more willing to talk with us.

External validity involves the generalizability of the research, whether the results of the study can be generalized 'beyond the specific research context' (Boeije, 2010). External validity is problematic in qualitative research, as it often involves specific people, organizations, events and places. This is also the case in this research. But, it can also be seen as a strength of qualitative research. A focus on 'understanding and illuminating important cases rather than generalizing from a sample to a population' (Boeije, 2010). Qualitative research might find a deeper understanding of relations revealed by quantitative research, or reveal relations overlooked.

## 4. Taxation in Uganda

In this chapter I focus on the context of this study. I start with a the development of tax in Uganda, this history is important because it influenced the way taxation is perceived today by Ugandan society and shows how the tax system evolved. In the second section, I look at the current tax regime in Uganda. First, I give an overview of the national system and its main sources of revenue. Then, I focus on what taxes small and medium-sized enterprises in Kampala are liable to pay. The concluding part of this chapter focuses on the behavioral aspects of taxation, a first look at tax morale in Uganda.

### 4.1 History of Taxation

To understand the context of taxation in Uganda it is important to note that 'taxation' as an individual offer for a collective purpose, existed in pre-colonial Ugandan society. This was known as 'luwalo', compulsory work obligations set out by native authorities such as chiefs. In colonial times under the indirect rule of the British Empire, native authorities were also allowed to commute these work obligations into cash payments, gaining their first taxing powers (Fjeldstad & Therkildsen, 2008). Taxation is not only a matter of the state or by definition a monetary commitment. It is basically an individual offer to a collective purpose. In the case of *coercive taxation* or a top down approach to taxation, it is imposed on society by those in power. Regarding *revenue bargaining* or the bottom up approach to taxation, it is an agreement between those in power and society.

#### *Poll Taxes in (Post-)Colonial Uganda*

Before 1962, when Uganda became an independent nation-state, the country was part of the British colonial administration as a protectorate. A monetary form of taxation was introduced in the beginning of the twentieth century. In 1905, the colonial administration introduced a poll tax, a fixed sum for every able bodied adult male. The purpose of this poll tax changed over the years. In the early colonial days, it was a way of forcing the peasantry to sell labor and/or produce cash crops for export. It was also used for British war efforts, especially during the Second World War. Eventually, the poll tax was used for self-financing the colony, reducing reliance on custom duties, and financing development activities and public administration (Fjeldstad & Therkildsen, 2008).

After independence, in the 1960s, the purpose of the poll tax was mainly 'development'. Under the regime of Idi Amin in the 1970s state-provided services collapsed throughout the country, additionally the revenue collected from poll taxes collapsed dramatically and never really recovered. The political and social impacts of these poll taxes were substantial, much higher than its yield in terms of revenue might indicate. Since 1986, president Museveni and the National Resistance Movement (NRM) have been in power. In the 90s the revenue collected from the poll tax was 'too small to cover the investment and recurrent costs of the expansion of service provision that took place' (Fjeldstad & Therkildsen, 2008). These expansions were funded by central government and aid donors. The poll tax changed during its existence of about a hundred years. It became a Graduated Poll Tax (GPT), with an adjustable tax rate to fit individual situations. The poll tax has always met a lot of resistance in Uganda until the abolishment of the GPT in 2005.

Daniel Bwanika remembers a time when the poll tax was operational.<sup>12</sup> He was a young boy in the village. The authorities would come and bind those that did not pay to a rope, dragging them through the village. They were jailed and released after a couple of days. The whole thing was repeated each year. Interestingly, this story sounds somewhat similar to the example of the tax man chasing after the citizens in early modern Europe ([section 2.1](#)).

The benefits a poll tax are that it is a uniform charge, it covers a large population category (e.g. adult able bodied males), and it is conceptually quite simple. In practice it had some serious negative outcomes. These taxes were often perceived as inequitable, regressive, and unfair by citizens. Therefore they were unpopular in Uganda. Collection was an issue and non-compliance was substantial because: local politics or conflict could obstruct collection and influence who had to pay, the 'ability to pay' was difficult to assess in the peasant economy, and who actually paid was 'fairly accidental' because the administrative effectiveness was generally low. Poll taxes have several characteristics of coercive taxation. Assessment whether someone has to pay is arbitrary, it is coercively collected, and taxpayers are often not represented in (tax) policy decisions. It was clearly a top down approach to towards taxation.

### *Reforms Towards Today's Tax System*

Following the Washington Consensus, the tax system in Uganda started to change in the 90s. At this time, the tax-to-GDP ratio of Uganda was below the seven percent. The first major overhaul of the Ugandan tax system was the establishment of a semi-autonomous revenue authority in 1991, the Uganda Revenue Authority (URA). Since 1991, the URA has undergone several major reforms. The main responsibility of this organization was and is the enforcement of the central government's tax regime. Although the URA is a semi-autonomous organization, it is also regarded as a department of the Ministry of Finance, Planning and Economic Development and thereby it is subject to their financial rules and regulations. The institution is led by the commissioner general who is appointed by the Minister of Finance, Planning and Economic Development. Since the foundation of the URA, the tax-to-GDP ratio grew to about thirteen percent. I elaborate on the current tax regime in the following section.

As mentioned above, the GPT (a more advanced version of the regular poll tax) was abolished in 2005. Fjeldstad and Therkildsen (2008) argue that increased political competition eventually 'raised the political cost of the coercive poll tax system'. Multi-party democracy returned to Uganda in 2005. Preparing for elections in 2006 the abolishment of the GPT prevented it becoming a national issue that could be used by other parties to bring the NRM in discredit. This is where Fjeldstad and Therkildsen (2008), observe a reversal of causality. According to them, where in early modern Europe tax reform and revenue bargaining led to some democratization, it is democratization through the reintroduction of a multi-party democracy that has resulted into tax reform. The role of IGOs such as the IMF in the tax reforms of Uganda the past decades should not be underestimated. The political climate might have paved the way for tax reform, organizations such as the IMF and World Bank have been actively involved in these reforms as well. There was a clear move away from a focus on taxes on international trade, towards income taxes and the Value Added Tax on goods and services, introduced in 1996.

How can we relate these developments to the distinction between a top down and a bottom up approach to taxation? As argued earlier, the (graduated) poll tax is a top down approach to taxation. It is interesting to see if the abolishment

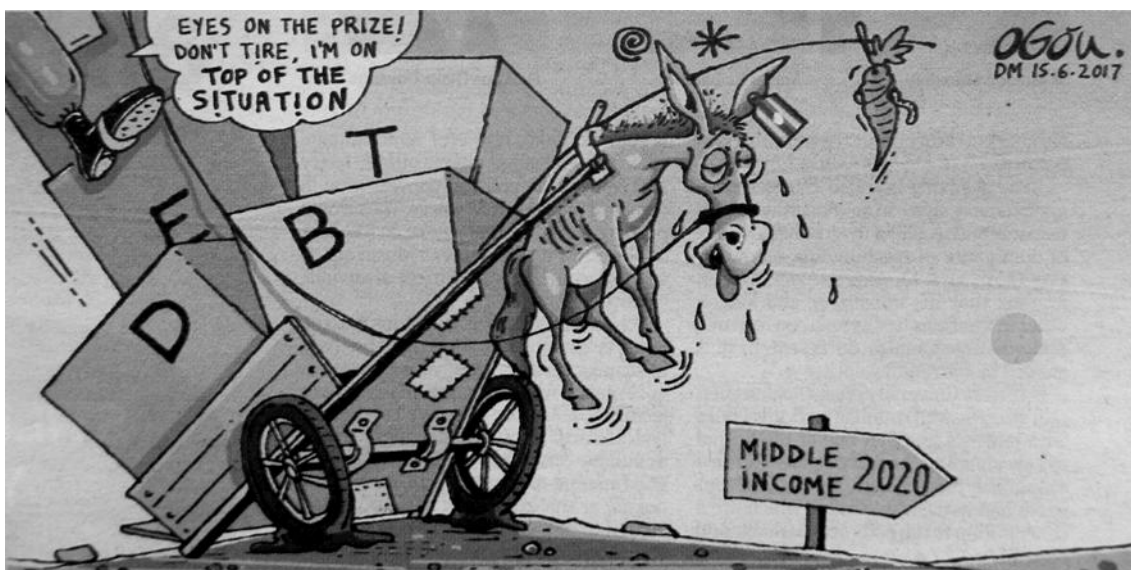
of this tax made room for a more bottom up approach towards taxation. To be able to say anything about this, it is important to take a closer look at the current tax regime. In the following chapter I analyze how this tax system works in practice, related to small and medium-sized enterprises in Kampala.

## 4.2 The Current Tax Regime

It is important to understand the current tax system in Uganda. What are its main features? What is the absolute tax revenue? Where does it come from? Where is it spend on? I conclude this section with a part where I focus on the tax system in relation to small and medium-sized enterprises in Kampala.

### *National Taxation in Uganda*

With a tax-to-GDP ratio of about 13 percent, Uganda has one of the lowest tax-to-GDP ratios of the East African Countries. But, the ratio doubled since '91/'92 when it was about 6.7 percent. Before I take a closer look at the national tax system, I give a brief overview of the Ugandan budget and main expenditures. Uganda has a large deficit in financing its budget. In the fiscal year '15/'16, the total revenue collected by the Ugandan Revenue Authority was more than 11 trillion Ugandan shillings (UGX), this was about 230 billion less than the target, and covered close to 70 percent of the budget. In the '17/'18 budget, only 15 of the almost 30 trillion budget is expected to be raised through revenue collection. Uganda's debt portfolio has reached 37 trillion Ugandan shillings.



*Illustration 1: 'Uganda's debt portfolio has reached a staggering Shs37 trillion.'*  
*Cartoon featured in the Daily Monitor, 15 June (2017b)*

<b>Income</b>	<b>15/16 Prel outturns</b>	<b>Expenditure</b>	<b>15/16 Prel outturns</b>
Recurrent revenue	11,498.5	Current Expenditures	9,185.0
<i>URA</i>	11,059.1	<i>Wages &amp; Salaries</i>	3,070.5
<i>Non-URA</i>	318.1	Interest Payments	1,688.2
<i>Oil Revenue</i>	121.2	Development Expenditures	5,823.2
Grants	1,146.4	Net Lending & Investment	1,532.5
<b>Total:</b>	<b>12,696.3</b>	<b>Total:</b>	<b>16,664.1</b>

Table 1: GoU 15/16 budget performance in billion shillings. Based on the Annual Budget Performance Report.

In the table above, I provided an overview of the preliminary budget performance in '15/'16. When government expenditures of the '15/'16 fiscal year are divided into sectors, the two on top of the list are 'Work & Transport' and 'Education' (both around 1,8 trillion shillings). After those two, 'Security' and 'Justice, Law and Order' follow at respectively 1,3 and 1,1 trillion shillings. Other big expenses are 'Health', 'Public Sector Management', 'Accountability' and 'Public Administration'. All around 800 billion shillings.

I explained that the semi-autonomous Uganda Revenue Authority (URA) is responsible for the enforcement of the central government's tax regime. Zooming in on the revenue collected in the fiscal year '15/'16 shows that most of the collected revenue comes from taxes on goods and services, close to 6 trillion Ugandan shillings. This includes excises, and the main contributors are the Value Added Tax and general taxes on goods and services. Other revenue come from taxes on income, profits, capital gains, international trade and transactions. An overview of the main categories is found in Table 2 below. In the following paragraphs I elaborate on the Ugandan national tax system and the main sources of revenue.

<b>Collected revenue</b>	<b>15/16 outturn</b>	<b>Collected revenue</b>	<b>15/16 outturn</b>
<b>Income, profits, capital gains</b>	<b>3,809.6</b>	<b>Goods and services</b>	<b>5,989.1</b>
<i>Individuals</i>	1,803.5	<i>General</i>	3,522.0
<i>Corporations and enterprises</i>	853,6	<i>Value added Tax (Gross)</i>	3,725.0
<i>Unallocable</i>	1,152.4	<i>Refunds</i>	(203.0)
<b>International trade, transactions</b>	<b>1,388.8</b>	<i>Excises</i>	2,299.8
<i>Customs and import duties</i>	1,372.9	<i>Specific services</i>	17.4
<i>Taxes on exports</i>	15.9	<i>Use of goods &amp; permission</i>	149.9
<i>Other taxes</i>	61.5		

Total collected revenue: 11.187,5 billion Ugandan shillings

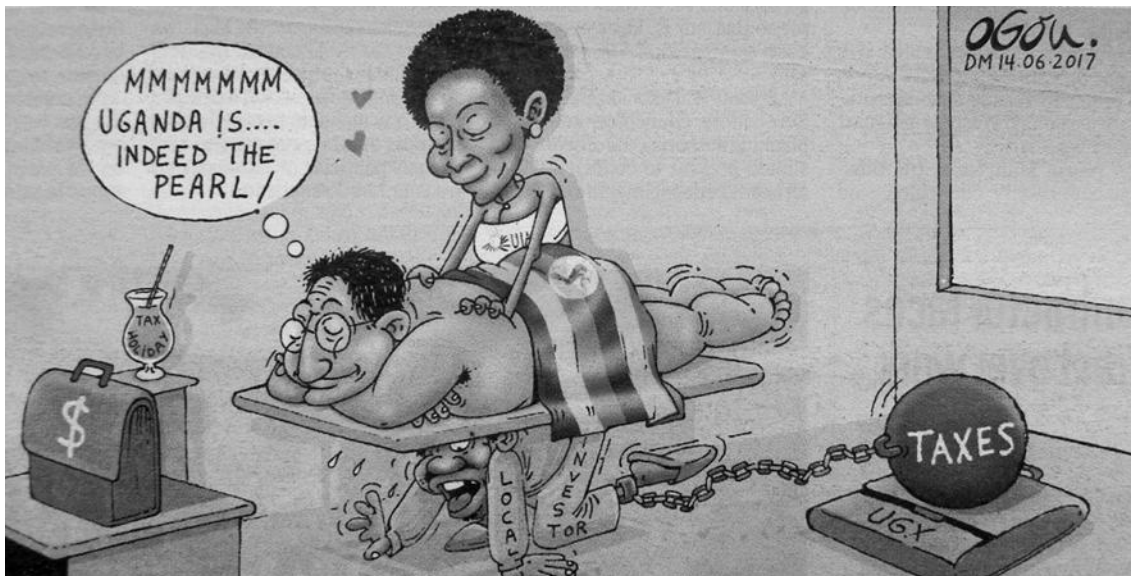
Table 2: URA 15/16 collected revenue in billion shillings. Based on the Annual Budget Performance Report.

Indirect taxes are the main contributors to the total collected revenue. The *Value Added Tax (VAT)* has existed in Uganda since 1996 and has grown to be the main source of revenue for the URA. Currently VAT is rated at 18% on most goods and services with some exemptions which are zero rated. In the '15/'16 fiscal year it raised about 3.5 billion Ugandan shillings (refunds subtracted). *Excises* form, with a 2.2 billion share in the total revenue, also an important part of the revenue collected by the URA. The aim of excises is to discourage unwanted behavior such as, smoking and drinking alcohol. *The past decades, Customs and import duties* and taxes on *exports* have become significantly less important for state revenue. The government regularly changes rates and exemptions regarding the taxes described above. They for example attempt to discourage import and promote domestically made products under the motto 'Buy Uganda, Build Uganda'. Although these actions are mainly build on good intentions, it also complicates the tax system.

The direct taxes in the Ugandan tax system are mainly part of the is the *Income Tax Act*. Withholding is the main source of revenue and can be divided into three main categories: employment income, gross payments/earnings other than employments, and imports. Regarding employment income, *Pay As You Earn (PAYE)* is the system used to tax employment income. PAYE is the main contributors to the revenue collected from the income tax. PAYE is collected at the employers rather than the employees, this increases compliance and efficiency. Monthly, the employer is required to deduct the tax from the employee's income. Because more than half of the Ugandan economy is part of the informal sector, and the people working in this sector pay no income tax, people paying taxes through PAYE feel that they are being treated unfairly and taxed disproportionately. In this research I mainly focused on income tax (a presumptive small business tax), and the local trading license. I elaborate on these taxes in the following part of this section.

An issue regarding the Ugandan tax system that has led to some controversy lately are tax exemptions. Several Ugandan politicians, such as President Museveni, are in favor of these exemptions. According to them these exemptions will increase investment and enhance long term economic growth. NGOs such as SEATINI have publically expressed their concerns regarding these exemptions

(Daily Monitor, 2016). Below, I included an illustration from the Daily Monitor, an independent newspaper in Uganda, on the issue. It illustrates how tax exemptions are experienced by at least a part of Ugandan Society.



*Illustration 2: 'Uganda has been voted best investment country at the Africa Energy Forum conference.'*  
*Cartoon featured in the Daily Monitor, 14 June (2017a)*

### *SMEs and Taxation in Kampala*

What about small and medium-sized businesses in Kampala? Which taxes are they obliged to pay? SMEs in Kampala are affected by both direct and indirect taxes. Direct taxes include trading licenses, income tax and rental income tax. Indirect taxes are the Value Added Tax, import and excise duties. Payments for services such as the collection of garbage and the supply of water or electricity are also often perceived as taxation. In the following paragraphs I discuss the taxes SMEs are obliged to pay or indirectly affected by. I start with the local trading license, this also calls for a brief profile of the Kampala Capital City Authority, the local government institution responsible for issuing this license.

In 2011, the Kampala Capital City Authority (KCCA) replaced the Kampala City Council, through an act of parliament known as the 2010 Kampala Capital City Act. Kampala is divided into five divisions: Kampala Central, Makindye, Nakawa, Kawempe and Lubaga. This research has focused mainly on Kampala Central Division. Besides the lord mayor, each division has a popularly elected mayor. KCCA also has an executive director who officially has to answer to the Minister of Kampala City Authority. The responsibilities of the (lord) mayor(s) are mainly



ceremonial. Regarding revenue collection, KCCA is responsible for executing the local tax regime within its administrative boundaries. The functions of the authority regarding taxation are: 'to determine taxation levels', 'to assist city division in mobilising the residents to pay local taxes', and 'to perform any other function given to the Authority by the central government' (GoU, 2010). Some of the main revenue responsibilities include the collection of: trading licences, property tax, the local service tax, hotel tax, and market fees. The focus of this research is mainly on trading licenses. SMEs in the central division often pay the KCCA for garbage collection, I elaborate briefly on this at the end of this section.

It is obligatory to have a *trading license* for anyone in Uganda who wants to run a business. In Kampala this policy is implemented by the KCCA under the mandate of the Ministry of Trade and Industry. The trading license is required for all companies, including service companies. The license has to be renewed each year which can be done at any KCCA division council, or at a so called 'one stop shop'. KCCA uses a system called COIN (City Operator Identification Number) to identify individual enterprises. The amount that has to be paid to receive the license depends on the location and nature of the business. The nature of the business is classified with a list of over a hundred types of businesses. Locations in the city are graded in four categories.<sup>13</sup> The size of the business or annual turnover is not relevant.

Regarding the national income tax collected by the URA, there is a so called 'small business tax' for SMEs. It is a presumptive tax for businesses with a turnover between 10 and 50 million Ugandan Shillings a year. The sum of the presumptive tax is determined by the location, nature and size of the business. This makes it much more complicated to assess what a business is liable to pay compared to the trading license issued by KCCA. In [Appendix B](#), I provided an overview of the schedule determining the rate of this tax. As explained in the introduction, the small business tax has a significant compliance gap. It was initiated about two decades ago and changed several times but never raised more than about 4 billion Ugandan Shillings. This is close to nothing compared to the total revenue of about 13 trillion collected in the '15/'16 fiscal year. In '15/'16 the URA estimated the potential revenue from the small business tax to be about 83 billion shillings, 24 billion in Kampala alone (Nanziri, Atukunda, & Lumal, 2016).

The *Rental income tax* does not impact SMEs directly. However, landlords proceed the burden of this tax onwards onto these businesses. The URA recently started to increase enforcement of this tax as it is one of the most evaded. Tenant contracts are often falsified, not written at all, or there are several of them. Therefore the rent paid by the tenants is often higher than the landlord's taxed rental income. Similar to the small business tax, the rental income tax only raised a couple of billion shillings in the past decades. However, past fiscal year a team was organized to focus on rental income tax compliance and almost 50 billion shillings was collected. This is quite a significant increase.

SMEs are not able or obliged to register for and pay the *Value Added Tax (VAT)*, because the threshold to register is an annual turnover of 150 million Ugandan Shillings. As most SMEs are within the presumptive tax regime having an annual turnover below 50 million, they do not have to and cannot register for VAT. Most SMEs do not import goods themselves, therefore they do not directly pay for any *Custom or Import duties*. They buy their goods at (other) wholesalers in town. However, the prices of goods are affected by these duties. *Garbage collection and other services* are provided by governmental and non-governmental institutions. Some business owners perceive paying for these services as also paying for taxes. VAT does influence the costs of some services. For example, water and electricity is rated at 18%.

### **4.3 Tax Morale and Tax Compliant Attitudes**

Before I move on to the next chapter and present the findings of this study, I take a look at what is already known about tax morale and tax compliant attitudes in Uganda. Tax morale in Uganda is particularly low, people believe taxes are too high and the public services they receive in return are poor (Ali, Fjeldstad, & Sjørnsen, 2013). As described in [section 2.2](#), tax morale concerns the intrinsic motivation to pay taxes and is an important part of tax compliance. In the following paragraphs I analyze why tax morale in Uganda is particularly low.

According to Ali, Fjeldstad and Sjørnsen (2013) this is mainly the case because taxes are perceived as too high and unaffordable. Moreover, people in Uganda believe that the tax system is unfair and public services are poor. Regarding the five theories mentioned in section 2.2, Ali, Fjeldstad and Sjørnsen

(2013) found evidence for the influence of the provision of public services (specifically education and health) on an individual's tax compliant attitude (fiscal exchange theory; Timmons, 2005). In addition, payment to non-state actors in return for protection is likely to significantly reduce an individual's tax compliant attitude. Especially interestingly for the focus of this research is that, compared to the national average of about 30 percent, tax compliant attitudes in Kampala are particularly low at 23 percent. The researchers used an indirectly phrased question and considered individuals as having a tax compliant attitude if they believe tax evasion is 'wrong and punishable' and a non-compliant attitude if their response to the question was 'not wrong at all' or 'wrong, but understandable'.

Ali, Fjeldstad and Sjørnsen (2013) based their research on data from the Afrobarometer.<sup>14</sup> The data used came from surveys held in the period '11/'12. Since then a new round of surveys was held in '14/'15 and the same questions about taxation were asked. From the results it can be concluded that tax morale is still quite low in Uganda. However, it seems like tax morale is not as low as it used to be. Significantly more respondents agree with the statement: 'Citizens must pay their taxes to the government in order for our country to develop'. Less respondents agreed with the statement: 'The government can find enough resources for development from other sources without having to tax the people'. More respondents were of the opinion that it is wrong to not pay taxes owed on income and find it more difficult to avoid paying tax over income and property (Afrobarometer, 2017). Noteworthy is that respondents find tax policy more complicated in 2015 compared to 2012.

In the table below, I compare some of the findings from the Afrobarometer to the neighboring countries Kenya and Tanzania, and to South Africa. It shows that similar to Uganda, people in Kenya find it more difficult to find out what taxes they are obliged to pay. In Tanzania and South Africa this number decreased. Regarding the question whether taxation should contribute to development or the government should find other resources, an opposite trend is happening in Kenya where more respondents agreed strongly with the statement that the government should find other resources to finance development. Remarkable is that in all four countries more respondents argued that it is wrong and punishable not to pay income taxes (comparing the '11/'12 and '14/'15

results). These results of the Afrobarometer are interesting indicators of tax morale in Uganda. They also help to compare the situation in Uganda to other Sub-Saharan African countries.

	<b>Q1: Tax law complicated? <sup>1</sup></b>		<b>Q2: Taxation for development? <sup>2</sup></b>		<b>Q3: Other resources? <sup>3</sup></b>		<b>Q4: Wrong not to pay taxes? <sup>4</sup></b>	
	'11/'12	'14/'15	'11/'12	'14/'15	'11/'12	'14/'15	'11/'12	'14/'15
Uganda	35.0%	41.9%	34.9%	41.6%	37.8%	28.2%	32.0%	44.0%
Kenya	32.3%	37.5%	45.4%	36.7%	14.9%	23.4%	51.2%	51.3%
Tanzania	38.6%	29.9%	38.5%	33.3%	29.8%	21.9%	45.4%	62.5%
SA	15.0%	9.1%	28.7%	32.8%	9.9%	17.1%	51.7%	60.1%

Table 3: Tax morale in Uganda, Kenya, Tanzania and South Africa. Based on the Afrobarometer (2011-2015)<sup>15</sup>

## **5. SMEs & Revenue Collection in Kampala**

In this chapter I present the findings of the fieldwork research among small and medium-sized enterprises in Kampala. The chapter is divided into two sections. I start with a section describing day-to-day business for the people working at or owning SMEs in Kampala. I explain in what ways taxation impacts their business and how they perceive these taxes and relate to the authorities. What influences their tax compliant attitudes? I use quotes from interviews, anecdotes, and observations from the field to exemplify the findings of this research. The second section describes the roles of the Ugandan Revenue Authority (URA) and the Kampala Capital City Authority (KCCA), the two main governmental institutions responsible for revenue collection in Kampala. I illustrate recent developments in policy and practice aimed at increasing compliance through the Taxpayer Register Expansion Program (TREP).

### **5.1 Small and Medium-Sized Enterprises in Kampala**

In [section 3.3](#), I distinguished the main characteristics of the small and medium sized enterprises I focused on in this research. Following the informal economy continuum ([Appendix A](#)), the focus is on businesses that can be described as small or medium-sized. The people owning these businesses are often non-poor, well educated and skilled. The market is generally highly competitive, and some of the main problems they encounter include access to capital and personal or business insurance. These businesses are liable to pay taxes, however they under-report earnings, use loopholes and often escape formal tax assessments. Employees are commonly unregistered. Smaller businesses generally have poorer owners, but they are still reasonably well educated and skilled. Smaller businesses have more problems in gaining access to capital, and are often difficult to assess because of poor or no recordkeeping. Cash transactions are a problem for the authorities common among small and medium-sized enterprises. These businesses typically fall under a presumptive tax regime that is aimed at further formalization. It is difficult for the tax authorities to target these businesses. They 'generate enough income to warrant taxation but find it easy to escape the attention of the tax administration or to conceal a substantial part of their tax liability, because of their location, size, and/or nature of their businesses' (Joshi et al. 2014).

In this section I illustrate what day-to-day business life looks like for SMEs in Kampala. What are the main characteristics of these businesses? What challenges do they face? I describe how taxation (national, local, direct and indirect) affects these businesses. In [section 4.2](#), I clarified which taxes these SMEs are liable to pay. In this section I demonstrate how these businesses go about paying these taxes, if they pay them at all. Furthermore, I elaborate on how the people working at or owning SMEs relate to the taxes imposed on them by the authorities. What influences their tax compliant attitudes? In the following paragraphs I describe a number of SMEs operating in various sectors in Kampala. The common denominator of these businesses is that they are all affected by taxes collected by the URA and/or the KCCA. These profiles are created to illustrate day-to-day business life of SMEs in Kampala, the information comes from several informants and the names used are pseudonyms. I use quotes from interviews, anecdotes, and general observations from data collected during fieldwork in May and July 2017. I conclude this section with a part that reflects on the main characteristics of taxation and SMEs in Kampala.

#### *Day-To-Day Business and Taxation in Kampala*

Lawrence works as a driver of a 'matatu' or P.S.V. (Public Service Vehicle). Since the 90s, when the governmental public transportation system collapsed, matatu's have been the main mode of transportation in Kampala, followed by Boda Boda (motorcycle taxis) and private vehicles. Typically a matatu is a Toyota van, painted with a line of blue squares on the side.<sup>16</sup> It employs two people, the driver and the conductor. The former is responsible for operating the vehicle, the latter spots potential passengers on the road and collects the fees. There are dozens of routes along the main roads in Kampala, mainly connecting different residential neighbourhoods with Kampala's Central Division (or city centre). The vans are quite small which makes them crowded even when the maximum number of 14 passengers is not exceeded. However, it is the cheapest way of travelling around Kampala. Lawrence, as most matatu drivers, does not own the vehicle himself. From the 220 thousand shillings (about 50 euro's) he makes each day, Lawrence has to deduct 80 thousand for the owner. On top of that he pays another 80 thousand for fuel. This leaves him with about 60 thousand

(about 15 euro's), which he still has to share with his conductor and use to pay for the KCCA license, parking fees, and vehicle maintenance.

Lawrence has to sustain himself and his family for about 300 thousand shillings each month (about 70 euro's). Although he does not earn enough to be liable to pay income tax to the URA, he pays the monthly KCCA transport license fee of 120 thousand shillings. Lawrence only completed primary school and does not know a lot about tax laws and tax authorities. What he does know is that if you do not pay for the license they will confiscate your vehicle until you pay. The system used by the KCCA is now digitalised and they can pay with mobile money. According to Lawrence, this has made it almost impossible to evade taxation. Because you can go on your mobile phone and check whether you have paid or not. There are some ways to avoid paying, but it mainly involves delaying payment and keeping away from KCCA officials or bribing them. Lawrence especially complains about the tax on fuel. According to him, he would make more money if these taxes were lower. He believes that he is not able to do a lot of trips because he can only put in a limited amount of fuel each time, as the price is high. So if the government could lower the tax on fuel, he might make a bit more money. Furthermore, Lawrence considers it unfair that the license fee is a fixed rate for a month. What happens if he falls ill and cannot operate the vehicle? He works almost every day from early morning until late in the evening, at times he gets tired and has to find somebody to replace him. But that means he is not going to earn anything that day. The one who is operating the vehicle will take home whatever is left.

*"The only thing you can do is to delay. To delay paying. But if they get you. If the KCCA people come here and find out you did not pay they will just impound your vehicle. They impound the vehicle [...] and you pay even a higher fee."*

*Lawrence, May 2017*

Second-hand clothing is a major business in Uganda and especially in Kampala's Central Division. Louisa sells second-hand clothing in her shop close to the biggest (second-hand clothing) market in Uganda, Owino market. Her shop is on one of the major routes leading to the market and thereby it is a prime location. Rent is expensive, people in that area pay from one million up to three million shillings a month. Because rent is expensive, Louisa has two sub-renters to ease

the burden of the rent. Apart from some basics, she does not keep records. Louisa pays the URA 250 thousand shillings a year and about 200 for the KCCA trading license. Compared to the rent, these costs are affordable for her.

Louisa, does not really understand where the money she pays for taxes is going. She does believe that the government should be using this money to build decent infrastructure and provide affordable education and health care. However, what the government is really doing with the money, she does not know. Louisa blames the politicians, they just do whatever they want and not what the citizens want. She is obliged to pay these taxes but she does not feel like she gets anything in return.

*"They are not doing anything. [I do] not know exactly where the money is going. The roads are bad. The filth in the city is quite a lot. If you go to KCC hospitals there are no medicine. The money is not doing anything. [...] Let them build good roads. Let them put drugs in the hospital. Let them clean the city so that the city everywhere is clean."*

*Louisa, May 2017*

Fred works in a bookshop close to Kampala Road. The street is crowded with other bookshops. Trades crowd together in Kampala in certain places or on certain floors of so called arcades, I explain more about these arcades below. Fred is not the only individual operating his business in this shop, four others have their collections of books (mainly educational) which they bought from importers who in their turn got them from Kenya or Tanzania. Together they operate under one enterprise, which is registered at both KCCA and URA. Together they share the costs of rent, URA's small business tax, the KCCA trading license, and pay for services such as garbage collection, water and electricity. For the URA, it is not easy to determine in which bracket they are because each person keeps their own records and some of them are very basic. According to Fred, even if he brings the combined books to the URA, they refuse to look at it and estimate the turnover of the business based on the size and location of the shop.

*"Even if you are starting a new business you have to pay income tax in advance. Before getting a license, doing business in Kampala. [...] They tell you go to URA. Pay URA charges or taxes. That is what they mean pay URA taxes. You are going to*



*pay income tax. Hidden! You haven't progressed. You haven't earned in a year. But you are paying it in advance. They just ask you: 'What are your projected turnover a year? What are you investing? How much money are you having for that business?' I have 5 million. 'What is your projected turnover for the year?' Could be 10. And then they calculate and put it in the computer. Everything is programmed. And then gets your bracket. Gets your bracket and then you pay. [...] No one is paying less than 200. So we are really puzzled, we are really tortured. You are paying that money when you haven't earned it."*

*Fred, June 2017*

Fred, is quite frustrated about taxation. First of all, he considers it unfair that they have to pay taxes in advance, before he has earned a single coin. Furthermore, Fred mistrusts the authorities and believes they are corrupt. According to him, part of the money does not even reach the government and is kept by some officials. Fred believes taxes are too high and that this is also a reason why people do not pay or try to evade paying taxes. If taxes would be affordable people would not try to evade. Finally, he does not perceive to receive any services in return for the taxes he pays, except for basic infrastructure, although the government also borrows a lot of money for these infrastructural projects. According to Fred, the government does not provide these services because they simply do not care.

*"The government doesn't care. You can take your mother to a hospital where they service and you have to pay. But if you are waiting for government to provide that. You will die. You will definitely die."*

*Fred, June 2017*

Arcades are found mainly in Kampala's Central Division. Its function is a bit like a shopping mall but with hundreds of small shops. The architecture seems to be designed to fit as many shops as possible on each floor. It has quite some open spaces and openings in the floors which makes them feel a bit less claustrophobic. However, this is probably also a practical solution to the fact that power black-outs are not uncommon. As mentioned previously, trades crowd together on certain floors. For example, one might find only phone shops on the ground floor, travel bag traders on the first, and hair saloons on the second floor.

According to several shop owners the reason why they crowd together is because in this way customers know where to go. However, competition is vicious.

Ethnic groups tend to crowd together as well. For example, most people doing business around Arua Park are from North-West Uganda. Arua Park used to be the place where the busses departed for Arua, a major city in the North-West of Uganda. This is not the only case, people from other regions also tend to crowd together in certain places, an explanation for this could be trust.

Susan trades in travel bags on the first floor of an arcade in Kampala Central Division. She employs two people and does not share the shop. She pays a small business tax of about 150 thousand and 250 thousand for the KCCA trading license. Rent is expensive in these arcades and is no less than 1 million shillings each month. Her other major costs besides employees are electricity, water and garbage collection. Susan's shop definitely turns over more than 20 million each year. However, she is still in the lowest bracket (See [Appendix B](#)). For her it is easy to under declare because the URA lacks capacity to thoroughly assess medium-sized businesses like her shop.

*"There is a day that they pass through and ask for receipts. If you don't have it they will tell you: 'please carry your things inside' and they close. If they have not paid they are closed [...] and everybody has to go and pay. [At this moment] there are some that have not yet paid. Because this year they have not yet come. They can come any day. Some pay before they come but then there are those one who pay after they have come."*

*Susan, June 2017*

Susan has to pay for a trading license and income tax, and believes this is double taxation on one activity. However, she has to pay because when you do not pay they will close your shop and you will have to go and pay anyway. Although she works mainly as a wholesaler she is registered as a retailer. Because she pays taxes herself she does believe other people should also pay taxes, even though she believes they do not receive any services in return and she also under declares herself. Susan is not sure about what happens to the money they pay.

*"I don't know even what the government is using that money I don't know. How it is using that money. I don't know whether it reaches the government I don't*

*know.[...] I don't know whether that money goes directly to the government. I am not sure.[...] Because I have never, I have never heard any like minister tell me. Explain for us about that money."*

*Susan, June 2017*

Ibrahim and Isaac are two young boys manufacturing mainly welding and popcorn machines in Katwe, an area known for its unlimited manufacturing capabilities. They dropped out of school to work in the business that was started by Ibrahim's brother. They share their shop with a boy selling second-hand carpets and a man cutting and selling glass and mirrors. Sharing the shop lowers the burden of rent (about 700 thousand a month). Together they also pay for the trading license which is about 200 thousand each year. These boys struggle to keep their business going. Sometimes it is hard to pay for rent, and it is quite a challenge to gather enough money each year for the trading license. Therefore, Ibrahim and Isaac wait until the KCCA comes knocking on doors and closes down the businesses without license, only then they will pay. If they are not able to gather enough money they are forced to move their business and start anew. Ibrahim and Isaac do not pay the URA small business tax, as URA officials less often visit this part of town. If they come and they can pay, they will pay. If they cannot, they have to move their business elsewhere.

*"If you don't have a license they close your shop. For us. You have to pay. [...] If they don't come, no pay. The problem is money. [...] If you get some money we are paying. If we don't have. We leave."*

*Ibrahim, June 2017*

To some extent they understand what the government uses the money collected through taxation for. Isaac believes the government is using this money to build roads, schools and hospitals. However, he does not believe that the government is doing a very good job.

*"The government uses these taxes to pay for services such as roads and keeping the city clean. However, the government is doing a 50/50 job at this. Services should be better."*

*Isaac, June 2017*

### *Characteristics of Business and Taxation in Kampala*

In the paragraphs above, I presented several profiles of SMEs in Kampala and discussed how these SMEs relate to taxation and the authorities. Before I move on, I reflect on the main characteristics. How and to what extent taxation influences day-to-day business of these SMEs varies from case to case. For some taxes are truly a burden, others manage to cope reasonably well. Sometimes by manoeuvring the law to avoid a substantial part of the taxes they supposed to be paying. The KCCA will go around town to check for licenses several times a year. The cost of the KCCA license is a fixed rate, not depending on the turnover of the business. This makes it more difficult to evade or under declare. It is easier to avoid or under declare taxes imposed by the URA. For the URA, it is difficult to establish the correct presumptive tax an enterprise is supposed to pay, because many of these business do not keep (proper) records or even several records. The URA lacks the capacity to systematically assess all businesses.

Compliance costs seem to be relatively low because of recent changes in ways of payment (URA & KCCA) and the simplified tax regime (URA). People can pay with mobile money or they can go to any bank to pay for the trading license and presumptive income tax. A complaint from several businesses is that the presumptive income tax has to be paid at the beginning of the year, before any profits were made. This significantly increases compliance costs and might especially be problematic when people want to formally start a business.

The level of knowledge of the tax system among the people working at or owning SMEs is generally low. It depends on the level of education, but most people do not know a lot about the tax law or the authorities responsible for executing these laws. They know that they have to pay KCCA and/or URA or they will come and close down their business or confiscate their property. Many taxes are perceived as double taxation. For example paying for the trading license and the presumptive income tax. Also paying for these taxes and services such as garbage collection. There is a lot of mistrust towards the tax authorities and the government in general. Tax administrators are often perceived as corrupt, sometimes collecting taxes twice or at a higher rate than believed they supposed to. Besides, people do not believe that (all) the money they pay even reaches the government and eventually ends up in some individuals pocket.

People do know what they would like to see done with the money they pay on taxes. Infrastructure, health care and education, were basically mentioned by almost all respondents. People working at or owning SMEs would like to see the money they pay to be put to good use. However, they believe that politicians just use the money to enrich themselves and their family. This also explains why people are not excited about paying taxes and the tax culture is poor. People believe that the government should support them in return for the taxes they pay. However, the government is perceived as corrupt and the conditions of the roads, hospitals and schools as poor. Still, evasion is not always seen as an option because their businesses might be closed down or property confiscated. Interesting is that if people pay taxes, they do believe other people should pay taxes too, even though the money is not spend right.

As highlighted in the literature review of this thesis, the formal/informal or registered/non-registered duality mainly facilitates the perspective of the state. Practice shows that it is difficult to establish whether a business is formal or informal. For example, SMEs in Kampala might be part formal and part informal. A matatu or P.S.V. (Public Transport Vehicle) might be registered with all taxes and licenses paid for (maybe not even all the time). However, the work of the driver and conductor is informal. Indirectly they do pay taxes and for the KCCA the business is formal, but not all rules and regulations are followed.

Another example comes from the shops in Kampala selling products such as second hand clothing, phones, books, electronics, and hardware. A person operating a shop might pay for the local government licenses but not the URA income tax. Sub-renting is another problem that complicates the issue. One person might be renting the shop and paying all taxes and licenses that need to be paid. However, because rent is expensive this person is sub-renting parts of the small shop to other people. Indirectly these people contribute to the taxes that are paid, however the work they do is informal. Sometimes groups of people rent a shop and pay for the taxes and licenses together under the name of one enterprise. People in Kampala do not like to pay taxes, the flexibility of the location, size, and nature of their businesses is used to decrease the burden of these taxes or to evade paying them at all. These businesses try to adapt to the increased efforts of the URA and KCCA to formalize them. I elaborate on the role of the URA and KCCA in the following section.

People working at or owning SMEs understand that taxation is needed for the development of Uganda. However, they do not believe that the taxes they do pay are being put to good use. Therefore, they also understand why people would under declare or evade taxation. Their tax compliant attitudes are influenced by issues related to their trust in the authorities, knowledge of the tax regime, perspectives on public goods and service delivery, ideas about fairness, other social norms and values, and the power of the authorities to enforce compliance. In this section I illustrated how the people working at and owning SMEs in Kampala relate to the taxes imposed on them by the authorities. In the following chapter I relate the findings to the analytical framework presented in [section 3.1](#).

## **5.2 The Tax Authorities in Kampala**

Responsible for revenue collection in Kampala are the Ugandan Revenue Authority (URA) and the Kampala Capital City Authority (KCCA). In this section, I elaborate on the role of these institutions regarding the taxation of SMEs. How are the URA and KCCA involved in ensuring compliance in this sector? What measures do the URA and KCCA take to decrease compliance costs? To what extent are the URA and KCCA successful in moving SMEs from the informal to the formal sector? I answer these questions mainly by illustrating some recent developments in the policy and practice of these organizations aimed at increasing tax compliance through the Taxpayer Register Expansion Program (TREP). In this program URA and KCCA work together with Uganda Registration Service Bureau (URSB). Before I conclude this section, I briefly discuss the role of politicians protecting informal businesses from paying taxes. This influences the position of government institutions such as the URA and KCCA responsible for revenue collection.

### *The Uganda Revenue Authority, Kampala Capital City Authority and TREP*

URA and KCCA are working together in TREP to increase taxpayer registration which is a first step towards increasing tax compliance. TREP started about four years ago and was evaluated and expended each year. The institutions involved in Kampala are the URA, KCCA and URSB. TREP started several 'one stop shops' across Kampala. People who go to these 'one stop shops' for a trading license are now obliged to verify their (URSB) business registration number and (URA) Tax

Identification Number (TIN). Also payment has to be made for any outstanding taxes, such as the presumptive income tax of the URA. An one stop shop has three stages through which a business has to go through to receive a trading license. First, it needs to register or verify a business registration number at the URSB officer. Second, it should apply for or verify a TIN and possibly pay a presumptive income tax at the URA official. Finally, with a verified business registration number and TIN, he or she can apply for the trading license at the KCCA official. In practice businesses often first go to the KCCA official because it is the trading license for which most businesses come to the one stop shop. This is related to the fact that the KCCA has the capacity to enforce compliance.

Collaboration between the different institutions in TREP increased each year. In theory, this made it increasingly difficult for SMEs to evade or under declare taxes. Different systems are integrated enhancing the level of information the government has on these businesses. It is the disintegration of different governmental systems which allows SMEs to for example escape national taxation but pay local governments for several types of fees, charges, and licensing costs. It might be easy for businesses to stay under the radar of the URA. However, it is more difficult to dodge local government in the shape of the KCCA. This because they have more capacity for enforcement than the URA and physically check for licenses throughout the city several times a year. Integrating systems makes it obligatory for businesses applying or paying for a trading license to also have a TIN. Thereby it becomes more difficult for SMEs to pay one tax and evade another.

The definition of an 'informal business' differs between KCCA, URA and URSB. For example, for the URA a business could be informal because it has no TIN, regardless of whether it has a trading license or business registration number. For KCCA a business could be informal if it has no trading license, regardless of whether it has a TIN or business registration number. Finally, for URSB a business could be informal if it has no registration number, regardless of whether it has a TIN or trading license. This shows how the formal/informal duality is fabricated and facilitates the different goals of government institutions. One could say that through TREP the systems are more and more integrated and thereby also the governmental definition of the 'informal sector'. I illustrated this development schematically in the figure below.

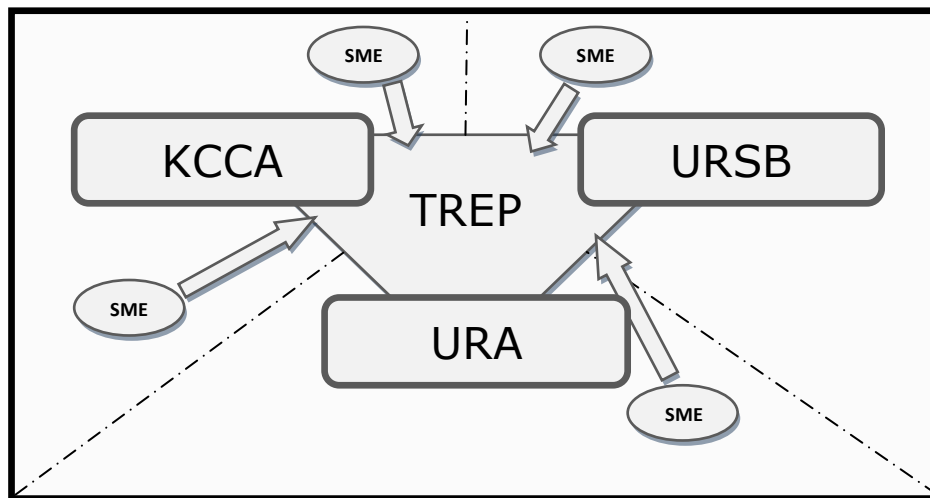


Figure 3: Schematic overview of influence TREP on SMEs in relation to KCCA, URA, and URSB

URA and KCCA attempt to decrease compliance costs by implementing simplified tax laws that are easier to understand, and by making use of technological developments to reduce the money and time it costs to comply. The fact that one still has to go to three different officials is one of the challenges TREP still faces today, the different officials are not allowed to access the systems of the other institutions. Even though some businesses complain they have to visit three desks instead of one, the one stop shop does significantly decrease compliance costs in terms of time. Initiatives such as payment through mobile money aim to further decrease compliance costs.

To what extent are the URA and KCCA successfully moving SMEs from the informal to the formal sector? It seems like the grip of URA and KCCA on these SMEs is growing. TREP introduces these businesses to the tax system. However, it seems like TREP has not led to an increase in the collection of revenue among SMEs by the URA. The total revenue collected through the URA small business tax has not significantly increased. The URA collected less than 10% of the target set for the '16/'17 fiscal year. It seems like the focus at URA is rather on other taxes such as the VAT and PAYE which contribute significantly more to the total revenue collected than the small business tax is even expected to raise if compliance would be at a hundred percent. Still, it will be interesting to see if and how the total revenue collected through this presumptive tax changes over the next couple of years, as TREP supposed to start paying off.



Although KCCA has more capacity to ensure compliance, the distinction between wholesale and retail in Kampala city centre is not very clear. Generally goods cross the border coming from Kenya or Tanzania. In Kampala many of these small shops sell relatively large quantities to retailers who take them upcountry, to the DRC, Rwanda or South Sudan. In addition, they also sell individual products as a retailer. Thereby, a business with a retail trading license might also be involved in wholesale activities and the other way around. Compliance is often also not even close to quasi-voluntary as the strategy of business owners differs, some will for example wait until KCCA comes before they will pay for the trading license or stay on the move to avoid paying.

In this section I examined the roles of the URA and KCCA when it comes to revenue collection among SMEs in Kampala. I explained how they are involved in ensuring compliance in this sector, what measures they take to decrease compliance costs, and to what extent they are successful in increasing tax compliance among SMEs. On paper both organizations aim to follow a 'service and client' model of interaction with taxpayers. For example, the culture statement of the URA is: 'We are a client focused & responsive organisation [...] to deliver a great client experience in an enjoyable environment'. Furthermore, the URA organizes a 'taxpayer appreciation day'.<sup>17</sup> In practice regarding SMEs in Kampala, the interaction is more like a 'cops and robbers' relation. I elaborate on this in the following section and the conclusion of this thesis.

Increasing taxpayer registration could result in a situation where the tax burden is not equally divided in society. This unfairness could influence compliance among other taxpayers. Therefore, revenue collection should not be the only purpose of taxing small and medium-sized businesses. Equally if not more important is the creation of a tax culture, the idea that everybody has to pay taxes. TREP has the potential to be a bottom up approach to taxation, unfortunately this is not yet the case. Before I move on to the next section, I would like to illustrate three cases of SMEs which are not paying any (direct) taxes at all, recognised and accepted by the authorities because they are protected by politicians. This also complicates the power of authorities such as the URA and KCCA to enforce taxation. These are the Nsambya carpenters and Boda Boda drivers. In the conclusion I elaborate on the political protection of these informal businesses and the significance of these cases.

### *Politicians Protecting the Informal Sector*

The carpenters in Nsambya, which is an area next to Kampala's Central Division, have been operating their business besides the main road since three years ago. They used to have a kind of market on a piece of land next to the road until the landlord wanted to redevelop the land and kicked them off. The carpenters moved to the road reserve. KCCA does not want them there, but cannot really do anything since several politicians and even President Museveni visited the carpenters and promised to arrange a piece of land where they could move their businesses. Three years have passed and the roadside market has grown and even got its own SACCO (Savings And Credit Corporation & Organization). These carpenters selling furniture do not have a trading license and pay no taxes at all. Nsambya is known for its furniture and if it was up to the people working there they would not move away from the roadside, because it is an excellent location.

Boda Boda are motorcycles of Chinese build which crowd the city streets. There are probably tens of thousands of them in the city and they act as an alternative public transport system for those who want to avoid getting stuck in the endless traffic jams of Kampala with a matatu or private vehicle. Hiring a Boda Boda is quite expensive relative to a matatu and mainly used by the growing middle class. Boda Boda drivers are exempted from paying taxes, pay no licenses and are not even obliged to pay for insurance. The Boda Boda transport system employs a significant part of the young adult male population and therefore also a significant part of the voting population. This might help to explain why Boda Boda are exempted from paying any taxes. In both cases mentioned, the URA and KCCA are not able to tax these small and medium-sized businesses because of the interference of politicians. The main reason why politicians interfere seem to be related to the fact that these sectors employ big parts of the voting population. Exempting them from paying taxes is likely to be a popular move. Government authorities such as the URA and KCCA might get cornered because of these moves, because politicians also demand from them to collect more revenue.

## 6. Conclusion

The main question asked in this thesis is: Which factors influence tax compliance among small and medium-sized enterprises (SMEs) in Kampala, Uganda? In this chapter I start with a section wherein I relate the findings of this study to the analytical framework introduced in [section 3.1](#). How does the situation in Kampala compare to the “slippery slope” framework? How are the dimensions of power and trust influencing compliance? Furthermore, how are power and trust influenced by recent developments in tax authority policy? This will reveal which factors influence tax compliance among SMEs in Kampala. In the following section, I present the conclusions of this research. I emphasize the most significant results, answer the main question and conclude with some unanswered questions and suggestions for follow-up research.

### 6.1 The Power of and Trust in the Authorities

In this section I relate the findings of this research to the “slippery slope” framework for tax compliance presented in [section 3.1](#). I included the three-dimensional framework to refresh the memory. The framework links the dimensions of power and trust to enforced and voluntary tax compliance. I start with power, then elaborate on trust and conclude with a part on the relation between both dimensions in the context of taxation, SMEs and the tax authorities in Kampala. Kirchler, Hoelzl and Wahl (2008), mention about eight factors explaining compliance. Several of these factors return in this study. I explain how subjective tax knowledge and participation, attitudes towards taxes, personal, social and national norms, and perceived fairness relate to the dimensions of power and trust. Additionally, I discuss how a few other factors fit within the framework such as compliance costs.

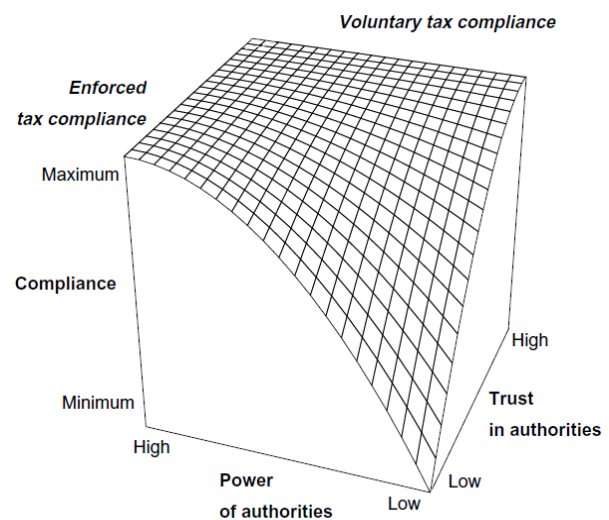


Figure 4: Kirchler, Hoelzl and Wahl (2008), The “slippery slope” framework.<sup>18</sup>

### *The Power of the Authorities*

As previously explained, the power of the authorities is related to the taxpayers' perception of the authorities competence to enforce compliance and punish evasion. According to the framework, a growth in the perceived power of the authorities will result in an increase of enforced compliance. A decline in the perceived power of the authorities will lead to a decrease in compliance (Kirchler, Hoelzl, & Wahl, 2008).

Subjective tax knowledge can influence the perceived power of the authorities. In Kampala, people know and fear that the URA and KCCA have the authority to close down their shop or confiscate their property if they do not pay their taxes. They do not want to pay these taxes, but if they do not the KCCA or URA might come and close down their shop. This knowledge of the consequences that are linked to a relatively high probability of detection increases compliance, enforced rather than voluntary. On the other hand, perceptions of ineffectiveness decreases the perceived power of the authorities. People know about and use possibilities to evade or under declare taxes. Examples are sub-renting, the sharing of a shop, moving business before the authorities come to check on licenses and other taxes, and poor or double bookkeeping. Bypassing the authority of these institutions is a clear sign of a lower perception of the power of these authorities, subsequently tax compliance declines.

The above shows how the perceived power of the authorities by the people working at or owning SMEs in Kampala relates to tax compliance. As power increases, enforced compliance grows. When power declines, so does compliance. This meets the expected relation between tax compliance and the perceived power of the authorities in the framework.

### *The Trust in the Authorities*

According to the framework, the trust in the authorities is influenced by the general opinion of individuals and social groups that taxation is used by the authorities for the common good. Thereby, an increase in trust will result in voluntary compliance, as people are willing to comply to contribute to the common good. On the other hand, mistrust leads to non-compliance (Kirchler, Hoelzl, & Wahl, 2008).

As mentioned before, people working at or owning SMEs in Kampala do not know a lot about the tax system. The low level of tax knowledge among SMEs in Kampala contributes to the mistrust in the authorities. People do not understand the tax system and believe they are taxed double or disproportionately. In this way, poor knowledge concerning taxation leads to non-compliance. Although the tax system is simplified, this has not led to an increase of tax knowledge among SMEs in Kampala. Spreading knowledge of the tax system among these businesses could build trust in the authorities and increase voluntary compliance. This corresponds to the findings of Kirchler, Hoelzl and Wahl (2008), who argue that subjective tax knowledge is positively correlated with trust, and poor understanding or misunderstanding are positively correlated with distrust.

Fairness is another important factor related to the dimension of trust. Trust in the authorities regarding the fairness of the tax system and its implementation among SMEs in Kampala is significantly low. As mentioned in [section 5.1](#), people believe the authorities are corrupt and they do not believe their taxes are used for the common good. People would like to see the money used for infrastructure, health care and education. However, according to them politicians just use the money to enrich themselves and their family. The conditions of the roads, hospitals and schools are perceived as poor. Mistrust in the authorities, legitimizes actions to evade or under declare taxes. In this way, as trust in the authorities declines, so does tax compliance. The framework supports this relation between trust and compliance. People feel less inclined to voluntary comply when they do not trust the authorities.

#### *Relations between Power and Trust*

As mentioned in the third chapter of this thesis, the "slippery slope" character of the framework comes from the idea that changes in power also influences trust and vice versa. Kirchler, Hoelzl and Wahl (2008) explain that as the trust in the authorities decreases, it is likely that also the perceived power of the authorities will decline. Furthermore, a decline in power would also lead to a decrease in trust. Compliance could fall into a downward spiral, slipping down the slopes of power and trust. How does this relate to the situation in Kampala?

As demonstrated above, the trust in the authorities is generally low. Therefore, people find it easier to legitimize tax evasion. Undermining the

legitimacy of the state decreases the perceived power of the authorities to enforce compliance. In this way, trust influences power. Tax enforcement in Kampala mainly comes down to physical controls and the closing down of shops, when taxes are not paid. This increases the power of the authorities. However, it also decreases trust, because trust is already low and these actions are perceived as cruel. I elaborate on this dynamic below.

As mentioned in [section 3.1](#), when people have a negative attitude towards taxation, the use of power is more often perceived as cruel. Subsequently, it is likely that trust in the authorities will further decline (Kirchler, Hoelzl, & Wahl, 2008). This also seems to be the case in Kampala. Actions by the tax authorities are often perceived as cruel (e.g. the closing down of shops or confiscation of property). Attitudes are also connected to knowledge, as they depend on the perceived use of the money collected. In the part on trust I explained how the perceived use of revenue relates to the framework.

According to Kirchler, Hoelzl and Wahl (2008), national, social and individual norms influence both power and trust. National norms are found in the tax laws and the role the tax authorities. They have a direct influence on power. Discrepancies in norms within government, see previous chapter and below, decrease the power of the tax authorities. If social norms, such as the belief that tax evasion is not a serious felony, are widespread the power of tax authorities declines. On an individual level, it is interesting to see that if people pay taxes, they believe others should comply as well. In this case norms increase the trust in and power of the authorities, as the tax authorities are seen as the legitimate actor to go after the people that are not paying taxes.

I mentioned in the introduction that compliance costs also influence tax compliance.<sup>19</sup> Kirchler, Hoelzl and Wahl (2008) did not explore how compliance costs fit within the “slippery slope” framework. I included compliance costs in this study, and will briefly explain how it fits within the framework related to taxation and SMEs in Kampala. As explained in [section 5.2](#), the URA and KCCA have attempted to significantly reduce the costs of compliance. License fees and taxes can be paid through mobile money and the one stop shop makes it possible to apply for and obtain a business registration number, TIN and trading license in one day and at one location.

I mentioned above that actions of the authorities might be seen as generous or cruel, depending on whether there is trust in the authorities. As there is a lot of mistrust in the authorities among SMEs, the reduction of compliance costs could cause a further decline in voluntary compliance. Paying through mobile money makes it easier to comply for the taxpayer. However, it also makes it easier for the authorities to check whether someone did pay or not. The 'one stop shop' is an easy place to go to for SMEs, it also makes it easier for the URA, KCCA and URSB to make sure everybody is registered and has paid their (correct amount of) taxes. Thereby, the reduction of compliance costs in the case of taxation in Kampala increases the power of the authorities and enforced compliance.

Before I conclude this section I would like to evaluate the impact of TREP and the role of politicians protecting the informal sector related to the framework. TREP focuses on the registration of businesses to increase formalization and eventually revenue collection. Ultimately, when the only purpose of formalization is revenue collection and there is no protection of the people working in the informal sector, the tax burden might become too heavy for them compared to the advantage of paying taxes. Formalization should go hand in hand with the establishment of rights for the people working in this sector. For example, without an effective minimum wage the workers of the informal sector will suffer from these taxes. Furthermore, no incentives are given to the businesses that choose to formalize except that they avoid being punished for tax evasion. Thereby, TREP increases the power of the authorities, but it is not building a relationship of trust with these businesses. Trust might even be damaged further, as they are increasingly controlled but still believe revenue is not used for the common good or their individual benefit.

As explained in [section 5.2](#), the role of politicians is also quite interesting. The 'informal sector' in Uganda is enormous and employs a large part of the population. I provided several examples of businesses not paying taxes because politicians intervened. For example, the Nsambya carpenters. KCCA does not want them there, but can't really do anything since even President Museveni supports them. Boda Boda drivers are also exempted from paying taxes, pay no licenses and are not even obliged to pay for insurance. This sector employs a lot

of young adult males in Kampala, which are a lot of votes and influence. This makes the relation between SMEs and the government more complex. As mentioned in the introduction, politicians demand more revenue from the Ugandan Revenue Authority, increasing the ratio from 13 to 20 percent in 2020. The URA attempts to increase the revenue collected through programs such as TREP, which also target SMEs. Several sectors which include SMEs are exempted from paying taxes under the influence of politicians because it employs a significant part of the voting population. This decreases the perceived power of the tax authorities. Their authority is undermined by the same politicians that demand from them to collect more taxes. On the other hand, it increases the trust in the government as the politicians protect these SMEs from what they believe to be unfair taxation.

*SMEs in Kampala and the "Slippery Slope" Framework*

According to the "slippery slope" framework, tax compliance is influenced by the power of and trust in the authorities. The power of the authorities is positively correlated with enforced compliance and the trust with voluntary compliance (Kirchler, Hoelzl, & Wahl, 2008). The dimensions of power and trust among small and medium-sized enterprises in Kampala are influenced by several factors. These are subjective tax knowledge, attitudes towards taxes, personal, social and national norms, perceived fairness of the tax system and its implementation, compliance costs and political interference.

The current situation in relation to SMEs and the government authorities in Kampala could best be positioned on the "slippery slope" framework within the circle drawn on the figure to the right. As explained, the trust in the authorities is very low. The power of the authorities is also relatively low as SMEs find several ways to evade taxation. The existing level of tax compliance is mainly based on the power of the authorities. Tax compliance among SMEs in Kampala is therefore enforced rather than voluntary.

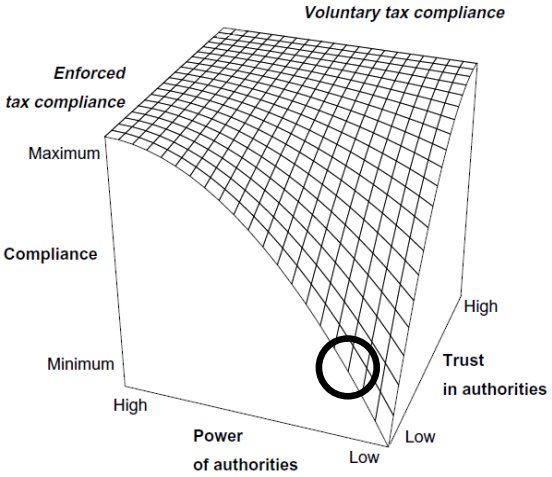


Figure 5: Kirchler, Hoelzl and Wahl (2008), The "slippery slope" framework.<sup>20</sup>



## **6.2 Tax Compliance among SMEs in Kampala**

The main taxes SMEs in Kampala are liable to pay are the Kampala Capital City Authority (KCCA) trading license and the Uganda Revenue Authority (URA) small business tax. Because of the size of these businesses they are not part of the regular national tax regime. The URA presumptive tax system is supposed to make it easier for the authorities to assess these businesses and support further formalization. In practice, there is a significant compliance gap in URA's small business tax. These businesses often find it easy to escape the attention of the URA or to hide a substantial part of their tax liability. This because of a lack of capacity at the URA and due to the location, size, and tax morale of these SMEs.

The URA and KCCA are responsible for taxing these small and medium-sized enterprises. The KCCA has more capacity to enforce compliance than the URA. Additionally, the focus at the URA is rather on taxes which yield more revenue such as the VAT and PAYE. Recently, both organizations started working together in the Taxpayer Register Expansion Program (TREP), in collaboration with the Uganda Registration Service Bureau (URSB). TREP aims to expand the tax register, this basically means that if someone wants to apply for a trading license, he or she first has to verify their Taxpayer Identification Number (TIN) and possibly pay for any outstanding taxes. This can be done at the 'one stop shop'. The goal of TREP is to increase formalization and ultimately raise more revenue. In practice, TREP has not yet led to an increase in compliance regarding URA's small business tax. It will be interesting to see if this changes in the following years when TREP is supposed to start paying off. Furthermore, recent developments such as payment through mobile money and the concept of the 'one stop shop' significantly reduce the costs of compliance. Relative to the amount of taxes to be paid, the compliance costs are not problematic. However, compliance has not yet increased significantly.

Tax morale among small and medium-sized enterprises in Kampala is low. The people working at or owning SMEs do not like to or want to pay taxes. There is a lot of mistrust towards the authorities which are often perceived as corrupt. Knowledge about the tax system is also generally low. People do not know what their taxes are used for. According to some, the money collected through taxation either ends up in the hands of corrupt officials or politicians and their

family. People working at or owning SMEs in Kampala would like to see taxes used for the improvement of healthcare, infrastructure and education. However, they believe the roads are bad and the quality of the hospitals and schools is low. To some these taxes are truly a burden as it is difficult to make ends meet, this forces them to evade taxation. Others deliberately evade or under declare, their tax morale is low and they do not feel compelled to pay (the right amount).

Factors influencing tax compliance among SMEs in Kampala are subjective tax knowledge, attitudes towards taxes, personal, social and national norms, perceived fairness of the tax system and its implementation, compliance costs and political interference. These influence the dimensions of power and trust which determine whether tax compliance is enforced or voluntary. At the moment there is mainly mistrust among SMEs towards the authorities. The existing level of compliance is based on the power of the authorities.

Taxation has a significant influence on state-society relations. In the literature review I illustrated two concepts: coercive taxation and revenue bargaining. These concepts are closely related to enforced and voluntary compliance. Coercive taxation is based on the power of the authorities and following the analytical framework this will lead to enforced compliance. Revenue bargaining is build on trust, therefore it is more likely to create voluntary compliance. Taxation in Uganda among SMEs in Kampala is mainly a coercive type of taxation. First of all, assessment is done arbitrary. Secondly, collection is carried out through coercion, shops are closed or property is confiscated if taxes are not paid. Finally, taxpayers are not represented in tax policy decisions. People working at or owning SMEs do not feel like they have a lot of influence on politics. In some cases politicians interfere in taxation as explained earlier in the examples of the Nsambya carpenters and Boda Boda drivers. In section 6.1, I mentioned that this further decreases the power of the tax authorities. This is an interesting dynamic that asks for follow-up research.

Constructive revenue bargaining shapes the foundation for the fiscal contract theory, wherein the relation between society and the state is determined through taxation, creating a mutual dependence (Timmons, 2005). This mutual dependence is missing in the relation between SMEs and the authorities in Kampala. The Ugandan government does not depend on small business taxation for its revenue and SMEs do not depend on the services of the

government. As I explained before, only a very small portion of the total revenue comes from this small business tax. Therefore the focus at the URA is on taxes which are easier to collect and which also produce more revenue, such as PAYE. In the short-term, this generates more revenue. Why should the Ugandan government consider revenue bargaining instead of coercive taxation? Why hand in power for revenue that could also be collected forcefully? As mentioned in the literature review, revenue bargaining has several advantages over coercive taxation. For example, it provides a more stable income of revenue, tax payments become more predictable for government and taxpayer, and it institutionalizes influence of the taxpayer on public policy. Furthermore, it could create a tax culture and increase tax morale, which is remarkably low in Uganda. This study focused on tax compliance among SMEs in Kampala, Uganda. In a follow-up research, it would be interesting to study which and in what way factors influence tax compliance in other sectors, regions and countries.

## 7. Discussion

*"Society is generally rebellious and I don't think it is limited to Kampala alone. [...] The human nature does not want, even animals do not want, regulation. That is why when they keep an animal in the zoo, and you give it all the food it needs, it will struggle to get out of the zoo. You get it? Regulation is a limitation of human nature. The human being wants to operate at its own terms."*

*Andema Fred, June 2017*

In the literature review of this thesis, I used an example of a tax man harassing citizens whilst collecting taxes for a king. Although taxation of small and medium-sized businesses in Uganda is based on a model of semi-voluntary compliance, from the perspective of those working at or owning these SMEs it is a comparable type of coercive taxation. Ultimately, because of the location, size, and/or nature of these businesses, enforcement comes down to physical controls and the closing down of shops when taxes are not paid. In TREP, local and national government (KCCA and URA) work together to increase the revenue collected from among others, these small and medium-sized businesses. This is not met with a lot of enthusiasm by the people working at or owning these SMEs, as explained in the quote above by the KCCA Deputy Director Revenue Collection. In this final chapter I discuss the conclusions and objective of this study and relate them to a broader context. I point out the limitations of the study and consider future directions for both research and policy.

### *Opportunities and Challenges regarding Bottom Up Taxation*

The aim of this thesis was to explore if and why a bottom up approach towards taxation is a more sustainable solution for domestic resource development in relation to revenue collection among small and medium-sized businesses in Kampala. I explained that the potential revenue from SMEs in Kampala is relatively low compared to the total revenue and the administrative costs of enforcing compliance. Pursuing a top down approach, which is mainly aimed at increasing the total revenue collected and closing the tax-to-GDP gap, is less reasonable because effectively taxing these SMEs will not significantly contribute to achieving these goals. However, exempting all SMEs from paying taxes is also problematic. As these enterprises grow they might still be inclined not to pay

taxes, because they never did before. A bottom up approach aims to develop the sector that is taxed and at the same time create a tax culture. Where the top down approach mainly imposes taxes on businesses and enforces compliance, the bottom up approach starts from the perspective of the SMEs. Thereby it tends to generate voluntary compliance. Creating this tax culture and voluntary compliance are more sustainable solutions for domestic resource development, because as these businesses grow with the help of the state they will feel more inclined to pay their taxes.

Factors influencing tax compliance among SMEs in Kampala are subjective tax knowledge, attitudes towards taxes, personal, social and national norms, perceived fairness of the tax system and its implementation, compliance costs and political interference. These influence the dimensions of power and trust which determine whether tax compliance is enforced or voluntary. At the moment there is mainly mistrust among SMEs towards the authorities. The level of compliance is based on the power of the authorities. The above implies that it is important to build a relationship of trust rather than increase the power of the tax authorities regarding taxation of SMEs in Kampala. How to build this relation of trust? It is important to look at the needs of these small and medium-sized enterprises and subsequently use taxation to provide services which fulfil these needs and further develop the sector.

This raises the following question: How to develop this sector and into which direction? This is a governance question, however the perspectives of the people working at and owning SMEs remain important as they shape the foundation for such an approach. The informal economy continuum, introduced in [section 2.3](#), might provide an initial answer (see [Appendix A](#)). First, it is important to realize that the informal/formal duality does not exist in practice. According to Joshi et al. (2014), it is more like a continuum ranging from informal subsistence economy to completely formal enterprises. An enterprise might for example escape national taxation, but is often burdened by several types of fees, charges, and licensing costs imposed on them by local governments. This is also often the case among SMEs in Kampala. The continuum could be used as a path of development. For example, SMEs have trouble finding financial capital and lack security, personal, and business insurance. If the government wants to build a relation of trust, it could be useful to use taxation to help these businesses fulfil

their individual needs. Other opportunities include improving literacy rates, building administrative capabilities, and spreading knowledge about taxation among the people working at and owning SMEs. In practice, a project could focus on bringing people and the tax authorities together to discuss the problems and needs of these SMEs. Such a program could well be connected to a project such as TREP. TREP now is mainly focused on registering these businesses and eventually increasing the collected revenue. However, TREP has the potential of a bottom up approach if it could include the perspective of SMEs in this process of formalization. Helping businesses to move forward on the continuum.

Challenges mainly involve capacity. The Uganda Revenue Authority already lacks the capacity to effectively collect revenue. Investing time and effort into a program that does not deliver immediate results seems irrational. I stressed the importance of a bottom up approach, but politicians put quite a lot of pressure on the URA to deliver quick results. This will definitely influence the willingness of the URA to choose a more bottom up approach towards the taxation of SMEs.

### *Socio-Legal Research on Taxation and Development*

Using the socio-legal approach when studying taxation provides an interesting dimension to the study of taxation in developing countries. In this research, it shaped the way I perceived these SMEs, helped me to go beyond the institutional approach used by government institutions to categorize these businesses, and broke down the formal/informal duality. With the help of the socio-legal approach I was able to show that in practice this duality does not really exist. I was able to look at 'tax law in action' rather than 'tax law in the books'. SMEs are often part formal and part informal. Even between different government institutions the definition of informality differs. This approach also helps to understand that taxation is not only a matter of the state or by definition a monetary commitment. It is basically an individual offer to a collective purpose. In the case of *coercive taxation* or a top down approach to taxation, it is imposed on society by those in power. Regarding *revenue bargaining* or the bottom up approach to taxation, it is an agreement between those in power and society.

In the current literature on tax evasion, there seem to be two main standpoints. Tax evasion is either a rational choice or it is the result of poverty and the result of an unfair system. In practice, it depends on the situation of

each individual business. For some it might be difficult to pay these taxes and others may consciously choose not to pay. This case study shows how 'the collection of revenue' should not always be the main or only sought after purpose of taxation. Especially regarding developing countries, that have a large informal sector consisting mainly of SMEs. Regarding long term development, it might be in their better interest to help develop the sector and create a tax culture.

### *Limitations of the Research*

One of the difficulties of studying taxation in developing countries is that the 'phenomenon itself' is constantly changing. Tax laws in developing countries are evolving and the nature of these SMEs is flexible. Because this study was part of a master thesis program and was therefore limited by time, the sample has been relatively small. A longer research would have resulted in a deeper and more comprehensive analysis of the situation and a larger number of respondents. Still, I believe the case study presented in this thesis provides an interesting analysis of which factors influence tax compliance among small and medium-sized enterprises in Kampala. People are generally reluctant to talk about their unwanted behavior or non-compliance. That is why this research studied attitudes rather than actual (non-)compliance (see [section 2.2](#)). Still, some people might not want to partake in the research and therefore a specific part of the 'story' could be missing. I aimed for a diverse sample regarding gender, location and trade, to mediate this issue. The use of a local research assistant to find respondents also helped because it lowered the threshold to partake in this research. However, the research did depend partially on his sampling.

The "slippery slope" framework enabled me to reveal which factors influence tax compliance through the dimensions of power and trust. Although these two elements prove to be important indicators, it also limits the analysis. In addition, because it considers perceptions it is difficult to objectively measure to what extent factors actually influence the power of and trust in the authorities.

### *Future Research Directions and Possibilities*

This study focused on factors influencing tax compliance among small and medium-sized enterprises in Kampala. It found that tax knowledge, personal, social and national norms, tax compliant attitudes, perceived fairness,

compliance costs and political legitimacy influence compliance. It would be interesting to study how other factors mentioned by Kirchler, Hoelzl and Wahl (2008) such as: audit probabilities, fines, and the tax rate influence the dimensions of power and trust among SMEs in Kampala. Furthermore, it is likely that there are more factors that Kirchler, Hoelzl and Wahl did not include in their study. For example, It would be interesting to further study the challenges and opportunities of using taxation for the development of small and medium-sized enterprises. This involves government support in overcoming obstacles such as illiteracy and administrative capabilities. This study showed the advantages of a bottom up approach, future research could focus on policy directions that could subsequently be used for the practical implementation of a bottom up approach.

Studying taxation and development in the Global South asks for a multi-level and interdisciplinary approach. Taxation is connected to both local and global issues, and involves challenges that raise governance, legal and social-scientific questions. The increased interest in taxation as a solution for domestic resource mobilization in the world of international development asks for a closer look at the social functioning of legal systems that are created and changed to increase tax revenue. Studying taxpayers and tax authorities, behaviour and governance, analysing current situations and looking for more sustainable alternatives. Considering the social impacts of increased domestic resource mobilization, and stressing the importance of balancing accumulation and redistribution. Yes, taxation could build the capacity of the state, but it should also contribute to a healthy state-society relationship. If it damages this relationship, it is likely that tax compliance and morale will decline even further.

At the moment, international and national institutions such as the IMF, World Bank, and tax authorities from the Global North are cooperating with countries in the Global South and sharing best practices. A research program studying global/local connections regarding taxation and development could well be connected to these collaborations. Finding answers to questions such as: How do global discourses in taxation influence local realities in countries in the Global South? What is the role of international organizations and collaborations? How can these organizations contribute to a sustainable development of domestic resource mobilization in these countries?



## Notes

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- 1 All major IGOs related to financial assistance work on the subject. Some examples of reports written on taxation are: African Development Bank (2011) Domestic Resource Mobilisation for Poverty Reduction in East Africa: Lessons for Tax Policy and Administration. IMF (2011) Revenue Mobilization in Developing Countries. OECD (2013) Building Tax Culture, Compliance and Citizenship. IMF & World Bank (2016) Domestic Resource Mobilization and Taxation.
- 2 Daily Monitor 7 October 2016. 'URA tasked to increase revenue to Shs34 trillion'. Last accessed 31 January 2017. <http://www.monitor.co.ug/Business/URA-increase-revenue-Shs34-trillion/>
- 3 Some interesting studies on tax compliance costs and the simplification of taxation for SMEs in developing countries include: Coolidge (2012) Findings of tax compliance cost surveys in developing countries. *eJournal of Tax Research* 10(2):250-287; Coolidge and Yilmaz (2016) Small Business Tax Regimes: What Surveys Reveal about Tax System Use and Abuse. The World Bank Group Trade and Competitiveness Global Practice. Note number 349. February 2016; Coolidge & Yilmaz (2015) Simplified Small Business Tax Regimes in Developing Countries: Empirical Evidence of Use and Abuse. In: *Tax Simplification*. Evans, Krever and Mellor (eds). Kluwer Law International.
- 4 United Nations Sustainable Development Goals: <https://sustainabledevelopment.un.org/sdg17>
- 5 Contrasting it to the popular slogan 'no taxation without representation'.
- 6 When non-state actors enter the arena of the provision of public services this can have a negative effect on compliance. This study did not specifically focus on this, but it would be an interesting subject to further explore in future research.
- 7 Belastingdienst (2016) PVA Burgerschap en belastingmoraal (Citizenship and tax morale)
- 8 International surveys used are for example the World Values Survey, the Afrobarometer and the Latinobarometre. Studies using this survey include: Torgler, B. (2005) Tax morale in Latin America. *Public Choice*, 122,133–157; Ali, Fjeldstad and Sjursen (2013) To pay or not to pay? Citizens' attitudes towards taxation in Kenya, Tanzania, Uganda and South Africa. Working Paper No. 143. Afrobarometer.
- 9 Other interesting examples are: Vadde and Gundarapu (2012) a study on factors influencing rental tax payers' compliance in Mekelle city, Ethiopia. Smulders and Naidoo (2013) addressing small business tax compliance burdens in South Africa and concluding that the revenue authority holds a key role in educating small business owners about the tax system.
- 10 The "slippery slope" framework: enforced tax compliance and voluntary tax compliance depending on the power of the authorities and trust in the authorities. Kirchler, Hoelzl and Wahl (2008) Enforced versus voluntary tax compliance: The "slippery slope" framework. *Journal of Economic Psychology*, 29:210–225.
- 11 The Ugandan Investment Authority uses the following categories: 'Micro Enterprise' is an enterprise employing up to four people, with an annual sales/revenue turnover or total assets not exceeding Uganda shillings 10 million. 'Small Enterprises' employ between 5 and 49 and have total assets between UGX: 10 million but not exceeding 100 million. The 'Medium Enterprise', employs between 50 and 100 with total assets more than 100 million but not exceeding 360 million. Information derived from the Authority's website: <http://www.ugandainvest.go.ug/sme/>. I choose not to use these categories because they come from an institutional perspective rather than an analytical perspective. Therefore, I went for the characteristics named in the informal continuum of Joshi, Prichard, & Heady (2014).

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- 12 Daniel Bwanika was my research assistant in Kampala during the fieldwork period.
  - 13 The costs or rates for the KCCA trading licence are found on the KCCA website: [https://www.kcca.go.ug/?jsp=trading\\_licence\\_rates](https://www.kcca.go.ug/?jsp=trading_licence_rates)
  - 14 Afrobarometer: 'An African-led series of national public attitude surveys on democracy and governance in Africa'. <http://www.afrobarometer.org/> Funded by: Mo Ibrahim Foundation, Swedish International Development Cooperation Agency, Department for International Development, United States Agency for International Development, World Bank, Institute for Security Studies (South Africa), United States Institute of Peace, Transparency International, Bill & Melinda Gates Foundation, Duke University China Research Center.
  - 15 Questions asked in Afrobarometer: (1) "Based on your experience, how easy or difficult is it to do each of the following: To find out what taxes and fees you are supposed to pay to the government?" Very Easy – Easy – Difficult – Very Difficult. %= Very Difficult. (2) "Which of the following statements is closest to your view?. Choose Statement 1 or Statement 2. Statement 1: Citizens must pay their taxes to the government in order for our country to develop. Statement 2: The government can find enough resources for development from other sources without having to tax the people." Agree very strongly with 1 or 2, Agree with 1 or 2, Agree with neither. % = Agree very strongly with 1. (3) Same as Q2. % = Agree very strongly with 2. (4) "I am now going to ask you about a range of different actions that some people take. For each of the following, please tell me whether you think the action is not wrong at all, wrong but understandable, or wrong and punishable: Not paying the taxes they owe on their income?". % = Wrong and punishable.
  - 16 These matatu's are also present on the picture used for the front page of this thesis, taken in Kampala's Central Division.
  - 17 Both the culture statement and the 'taxpayer appreciation day' can be found on the Uganda Revenue Authority's Facebook page, which is remarkably active: <https://www.facebook.com/URApge/>. Specifically the statement can be found here: [URA Culture Statement on Facebook](#)
  - 18 See 10
  - 19 See 3
  - 20 See 10

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# Appendixes

## Appendix A – The Informal Economy Continuum

Table 1. A typology of enterprise informality

Features	Informal economy				Formal economy
	A	B	C	D	
Degree of informality	Subsistence enterprises	Micro enterprises and small businesses	Small and medium businesses	Small, medium, and large businesses	
Type of activity	Totally informal Street traders, cottage/micro enterprises, subsistence farmers Labour intensive	High proportion of sales undeclared and workers not registered Small manufacturers, service providers, distributors, contractors Mostly labour intensive	Some proportion of sales undeclared and workers unregistered Small and medium manufacturers, service providers Mixed labour and capital intensive	Labour and firms registered and regulated Range of manufacturing and services Knowledge and capital intensive	
Technology					
Owner profile	Poor, low education, low level of skills Low barriers to entry, highly competitive, high product homogeneity Working capital	Poor and non-poor, likely educated, skilled Low barriers to entry, highly competitive, some product differentiation Working capital, some investment capital, supplier credit	Non-poor, well educated, high levels of skills Some barriers to entry, established markets Investment capital and working capital, letters of credit, supplier credit	Non-poor, highly educated, sophisticated level of skills Significant barriers to entry, established market/ product niche Investment capital and working capital, letters of credit, supplier credit	
Markets					
Finance needs					
Other needs	Personal insurance, social protection, security	Personal and business insurance and business support services, security	Personal and business insurance, business development services	Personal and business insurance, business development services Taxed under formal tax assessment	
Tax status	Earnings can be below minimum tax threshold, no recordkeeping, cash transactions	Liable for tax, difficult to identify and assess, poor or no recordkeeping, cash transactions	Liable for tax, under-report earnings, use loopholes, escape formal tax assessments	Liable for tax, under-report earnings, use loopholes, escape formal tax assessments	
Tax design desired features	No tax liabilities	Low rates to encourage registration, minimal compliance costs, low administration costs	Higher rates to encourage graduation into formal regime		

Notes: Greyscale text comprises features less relevant to taxation.

Source: Adapted from Zinnes' (2009, p. 8) adaptation of Djankov et al. (2002).

## Appendix B – Presumptive Taxes URA

Domestic Tax Laws 2016 – Income Tax Act (Part II Inserted by IT (Am) ACT 2015)

1. The amount of tax payable for purposes of section 4(5) where the gross turnover is less than fifty million shillings is –

(i) Kampala City and Divisions of Kampala

<b>BUSINESS TRADE</b>	With turnover between 35m - 50m	With turnover between 20m - 35m	With turnover between 10m - 20m
General Trade	500,000	400,000	250,000
Carpentry/ Metal	500,000	400,000	250,000
Garages (Motor Vehicle repair)	550,000	450,000	300,000
Hair and Beauty/ Salons	550,000	400,000	300,000
Restaurants or Bars	550,000	450,000	300,000
Clinics	550,000	450,000	300,000
Drug Shops	500,000	350,000	100,000
Others	450,000	300,000	200,000

## Appendix C – Overview of Coding

Businesses part of the research (*including interviews & informal conversations*)

<b>Business</b>	<b>#</b>	<b>Business</b>	<b>#</b>
General Trade	12	Restaurants or Bars	3
Carpentry / Metal	5	Clinics	1
Garages (Motor Vehicle repair)	2	Drug Shops	0
Hair and Beauty/ Salons	3	Others ( <i>Public transport</i> )	3

*Based on the URA presumptive tax system (see [Appendix B](#))*

I carried out a total of 20 in-depth interviews of which 15 with SMEs and 5 with URA, KCCA & NGO staff working on taxation. Overview of interviews:

<i>SMEs</i>		
<i>Date</i>	<i>Pseudonym</i>	<i>Function informant</i>
23.05	Lawrence	Driver of a matatu (P.S.V.)
30.05	Trisha	Selling shoes
30.05	Louisa	Selling second-hand clothing
24.05	Ivan	Selling second-hand clothing
09.06	John	Manufacturer
09.09	Ibrahim & Isaac	Manufacturers
13.06	Fred	Selling books
13.06	Olivia	Hairdresser
15.06	Emmanuel	Carpenter
20.06	Peter	Potato trader
20.06	Aunty Dorothy	Selling Tupperware
22.06	Isa	Taxi driver (private hire)
28.06	Nick	Hardware trader
29.06	Charles	Cutlery trader
29.06	Susan	Bag trader

<i>URA, KCCA &amp; NGO staff</i>		
<i>Date</i>	<i>Name informant</i>	<i>Function informant</i>
22.05	Nicholas	URA – Supervisor, Research & Revenue Modelling
25.05	Nelly & Grace	SEATINI – Finance for Development / Tax Justice
14.06	Andema Fred	KCCA Revenue Collection – Deputy Director Compliance
27.06	Michael 1	URA – Domestic Tax Department
27.06	Samuel & Michael 2	KCCA Revenue Collection – Central Division Supervisor URA – ‘one stop shop’ Supervisor



First round of coding (open coding):

<i>Name</i>	<i>Sources</i>	<i>References</i>	<i>Name</i>	<i>Sources</i>	<i>References</i>
Associational taxes	2	2	SME (Subletting)	8	15
Bad economy	3	4	SME (Unions)	5	6
Culture	2	4	TAX (Assessment)	2	2
Education	3	4	TAX (Closed down)	8	9
Ethnicity	2	3	TAX (Compliance costs)	3	4
Formal and informal	2	2	TAX (Evading)	9	12
Housing	1	3	TAX (Fuel)	3	6
Ignorance	4	9	TAX (Import)	3	5
Zoning	1	3	TAX (Infrastructure)	6	9
KCCA compliance programs	1	2	TAX (KCCA trading license)	17	32
Micro finance	1	2	TAX (Mobile money)	4	6
Owner vs worker	3	5	TAX (Opinion)	7	17
Perceived corruption	9	14	TAX (Record keeping)	3	4
Politics	13	26	TAX (Rental income)	3	6
Public goods and services	5	9	TAX (URA Presumptive small business)	9	14
Gov. doing with taxes	12	14	TAX (URA)	9	14
Gov. should do tiwh taxes	9	9	TAX (VAT)	2	4
Should people pay taxes?	9	11	Taxi sector	5	16
Significance Kampala (urban-rural)	1	2	Transport	3	3
SME (Electricity)	3	3	TREP	5	8
SME (Rent)	9	12	URA autonomy	2	2

Second round of coding (closed coding):

<i>Name</i>	<i>Sources</i>	<i>References</i>
<i>SUB-Q1 Official relation between SMEs and the government regarding taxation</i>		
Q1.1 What taxes should these SMEs pay according to the law	6	13
Q1.2 What are the costs of compliance related to these taxes	9	22
Q1.3 To what extent are these compliance costs problematic	7	18
<i>SUB-Q2 Roles of the Uganda Revenue Authority (URA) and Kampala City Council Authority (KCCA)</i>		
Q2.1 Involved in ensuring compliance in this sector	5	20
Q2.2 Measures to decrease compliance costs	5	21
Q2.3 Successful in moving SMEs from the informal to the formal sector	5	12
<i>SUB-Q3 SMEs relating to the taxes imposed on them by the Government, URA and KCCA</i>		
Q3.1 Knowledge about the tax law and the tax authorities	15	23
Q3.2 Trust in the tax authorities	15	33
Q3.3 Tax revenue and expenditures	15	29
Q3.4 Why would people evade taxes	15	32