

Streamlining and Harmonising The Tax System Remains A Priority

Earlier this year journalists from Nation Media Group travelled by road from Uganda to Tanzania and then to Kenya. At the outset, they had the Uganda Shilling equivalent of \$500, which they never spent but just changed to the relevant local currency each time they crossed a border. In Kenya they converted their currency (now Kenya Shillings) back to dollars. The outcome was that their \$500 had reduced to \$224 simply as a consequence of the differential in exchange rates and commissions paid to foreign exchange bureaus. This experience in relation to foreign currency transactions is just one practical illustration of the many real impediments to East Africa operating as one business region.

Businesses operating across East Africa face similar challenges to these journalists in terms of the taxation of cross border activities. Yes, the East African Community trade protocol, once signed, will result in tax free movement of most goods within East Africa, but there remains a pressing need for the review of the tax treatment of services where supplied cross-border.

An increasing proportion of a modern economy comprises the supply of services – witness, the move of many service jobs that have been outsourced to India from the US. And yet if services are supplied from one East African country to another, the result is a significant withholding tax cost - 15% on payments from Tanzania or Uganda, and 20% on payments from Kenya - which makes the process uneconomic. Taking the Indian example where call centres are mushrooming, one could imagine that personal service oriented businesses, such as banks, might wish to consider establishing one call centre for operations within East Africa. However, even if the regulatory issues in the region for telecoms could be resolved, withholding taxes would still present a practical difficulty.

One of the major objectives of reviving the East African Community is to create an enlarged regional market in order to attract trade and investment. In this context, withholding tax costs are of particular concern to the increasing number of businesses who treat East Africa as one market and who are therefore looking to centralise their management operations for East Africa within one regional head office, often with a shared service centre in that country.

In due course, a further aspect of East African integration will be the free movement of people within the region. However, without the ratification of the East African Double Tax Treaty (signed in 1997), tax will remain a major impediment as a number of individuals are likely to find themselves “tax resident” in more than one country, with the consequent risk that more than one Revenue Authority will seek to tax the same income.

Another fundamental cross-border tax concern is VAT. For financial institutions the economics of a regional head office or shared services centre can be adversely affected by an irrecoverable VAT cost. More generally, although exports of goods and services are in principle subject to VAT at the zero rate, the reality is often different. In particular, the burden put in terms of evidencing the export of goods can cause real difficulty. In addition, the VAT treatment of cross-border services is one of complexity and can result in unintentional double taxation. Indeed following a legislative change in Tanzania in 2003, it is more or less impossible for services to be treated as exported from Tanzania

with the result that Tanzania is an unattractive location for the provision of services to the rest of the region.

The good news is that many of the issues outlined above can be solved relatively easily provided there is sufficient commitment. Domestic ratification of the East African tax treaty in all three countries is required in order to resolve the double taxation of individuals. Prior to such ratification one would also wish the treaty to be amended so as to abolish withholding tax on services charged between the East African countries – alternatively, the Income Tax Acts in each of the three countries could be amended in the 2005 Budget so as to eliminate such withholding tax. So far as VAT is concerned one would want to see the three countries take a co-ordinated approach to the VAT treatment of cross border services so as to avoid unintentional double taxation.

As part of this year's East Africa's Most Respected Companies Survey CEOs in East Africa were asked to state which actions they think their governments should take to significantly improve the business environment. The improvement of taxation by streamlining and harmonising the tax system was the third overall reason that they gave. Taking some of the measures outlined in this article will certainly go some way to harmonisation of the regional tax environment. Nevertheless, equally important are additional measures to streamline the domestic tax environment in all three countries. Although tax rates are generally not unreasonable, tax administration and red tape remain an impediment to the efficiency of business.

A workshop convened in Dar es Salaam in June by the Commonwealth Secretariat, the Commonwealth Business Council and the World Bank discussed the Investment Climate in Africa, and in particular the results of diagnostic studies of the investment climate conditions in five countries, including Kenya, Tanzania, and Uganda. Amongst the tax constraints identified were the significant costs associated with delays in the refunds of value added tax and other trade-related taxes, as well as the proportion of management time (up to 15%) spent in dealing with regulatory matters (including tax). Indeed only last month the Kenyan horticulture industry cited the delay in VAT refund payments and the time spent in following up such refunds as adversely affecting their competitiveness. This concern is common to exporters across East Africa and especially those in the key agricultural sector.

Ultimately, if we are serious about driving economic growth and therefore poverty reduction, there is a need to improve the investment climate so as to reduce the costs and risks that firms and entrepreneurs face. A critical element of any such improvement is a more cohesive and business friendly tax environment.

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