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TAX COMPLIANCE REVIEW

CASE STUDY: SSEKYALI & ASSOCIATES

A dissertation presented to

FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT

in partial fulfillment of the requirements for the award of the degree

Master of Arts in Microfinance Management

UGANDA MARTYRS UNIVERSITY

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I acknowledge that this work has been under my supervision and is ready for submission for the award of a Master Degree in Business Administration of Uganda Martyrs University .

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Signature

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Definitions, Abbreviations and Glossary of Terms

Abbreviation	Meaning
ICPAU	Institute of Certified Public Accountants of Uganda

IT	Income Tax
ITA	Income Tax Act
KCCA	Kampala Capital City Authority
LGA	Local Government Act
LST	Local Service Tax
PAYE	Pay As You Earn
The Firm	Ssekyali & Associates
TPCA	Tax Procedures Code Act, 2014
URA	Uganda Revenue Authority
UShs/UGX	Uganda Shillings
VAT	Value Added Tax
VAT Act	The Value Added Tax Act, cap 349
WHT	Withholding Tax

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1. EXECUTIVE SUMMARY

Ssekyali & Associates is a small sized local audit firm established in January 2019. It provides audit, management consultancy and accountancy services to small sized businesses. The Firm engaged services of a tax expert to assess its overall tax compliance status in line with the existing tax laws and legislation of Uganda. The tax review assessed compliance with Pay As

You Earn (PAYE), Withholding Tax (WHT), Income Tax, Value Added Tax (VAT) administered by the Uganda Revenue Authority (“URA”) and Local Service Tax (LST) administered by local authorities for the period January 2019 to June 2023.

The tax consultant was tasked with undertaking a tax compliance review of the Firm’s past transactions to evaluate the extent to which it fulfills its tax obligations in compliance with the laws governing tax and other statutory compliance administration requirements in Uganda. The tax compliance review analyzed the level of accuracy, timeliness, and completeness in tax compliance of the past business transaction to assess whether the taxes due were accounted for in full and in a timely manner for the period January 2019 to June 2023.

The consultant reviewed the Firm’s internal periodic tax calculations, tax declarations and corresponding payments, the cash inflow and outflow transactions, contracts, invoices, payment vouchers, observed the tax compliance environment to assess and identify potential tax risks, opportunities and exposures arising. The data collection tools used to execute the assignment included document review checklists and/or guides, review of the URA website declarations, and key informants’ interview guides.

The Firm duly is registered with the URA for tax purposes. However, WHT, PAYE and LST were not accounted for during the review period in contravention of the tax legislation. The non-compliance is mainly attributed to the limited tax knowledge and awareness at the Firm. In addition, sales transactions were under declared for Valued Added Tax and Income Tax purposes leading to a variance in sales declared to the URA versus the company records.

The non-compliance has resulted into outstanding principal tax and interest exposures totaling to UGX 39,194,144. Management is encouraged to sensitize its staff through tax trainings to develop tax awareness to ensure accurate and timely declaration of taxes to the URA.

2. CHAPTER ONE INTRODUCTION

2.1. Introduction

This consultancy report was prepared as a partial fulfilment of the requirements for award of a Master of Business Administration Degree of Uganda Martyrs University – Nkozi to Mr Muyanja Ronald Wasswa registration number 2021-M102-20880 (hereafter “*The Consultant*”).

This tax compliance¹ review report documents the detailed findings from examination of the tax compliance aspects of Ssekyaali & Associates (“*The Firm*” herein after). The report documents a brief background to the report, findings, and recommendations among others.

The report was authored to identify areas of potential non-compliance with the existing tax laws and regulations and to provide recommendations for addressing the existing inherent tax risks both in the past and in the future. The review period covers January 2019 to June 2023.

This report examines the tax compliance status of The Firm’s operations to confirm whether or not taxes were accounted for accurately and in a timely manner for the review period.

2.2. Background to the organisation

Ssekyaali & Associates is a small sized local audit firm established in January 2019 by CPA Nicolas Ssekyaali. It is located at Plot 21 Kisota Road, Kampala, Uganda. The Firm is regulated by the Institute of Certified Public Accountants of Uganda “ICPAU”. It has four full-time employees and a few consultants who are engaged whenever the need arises. It specializes in the provision of audit, management consultancy and accountancy services.

The organization does not have a structured tax compliance framework or strategy to guide management on the timelines, completeness, accuracy, and general direction in regard to processes and procedures to ensure overall tax compliance. There is also an internal tax knowledge gap due to the absence of tax experts in the current staff pool which has resulted into unintended omissions and/or commissions thus exposing the Firm to tax risks².

2.3. Objectives of the review

The report sets out to examine the following aspects;

- conduct a thorough examination of all company’s cash generating and cash outflow activities to assess whether the applicable taxes were duly accounted for or not in accordance with the existing laws and legislations to identify the potential tax risks and opportunities. The business cash outflow and inflow activities like expenses, incomes and assets have inherent tax implications which must be considered by management.

¹ Tax Compliance refers to adhering to tax laws and regulations by correctly reporting income, expenses, and other financial details to the relevant tax authorities. It involves timely filing of tax returns and paying the correct amount of taxes

² Tax risk is the risk that a company may be paying or accounting for an incorrect amount of tax (including both income and indirect taxes), or that the tax positions a company adopts are out of step with the tax risk appetite that the directors have authorized or believe is prudent.

- Identify and quantify the potential tax exposures arising from non-compliance with the laws. Tax exposure represents the additional principal tax, interest and penalties arising from failure to account for any tax liability correctly in a timely manner.
- assess whether the reported taxes are accurate and complete as per the tax laws and regulations.

2.4. Rationale for the tax compliance review

The tax compliance review sets out to identify potential tax compliance gaps/issues, explore resolutions, and increase corporate value by effectively dealing with uncertainty in business management and limiting future tax liability exposures.

The review is also intended to develop appropriate solutions to minimize possible tax exposures and risks based on in-depth review of issue-specific laws and regulations and the quantification of potential tax effect.

The recent aggressiveness of the Uganda Revenue Authority “URA” has stimulated the Firm to assess its tax compliance environment, existing tax risks and identify potential tax risk mitigation mechanisms to avert adverse URA tax recovery measures like issuing assessments, demand notices, agency notices, and the closure of premises.

3. CHAPTER TWO LITERATURE REVIEW

3.1. Introduction

This chapter provides a comprehensive review of existing literature related to tax compliance. The review covers aspects of tax compliance which encompasses tax filing, payment, and reporting.

The literature review is a vital component of any study as it helps to establish the foundation and context for the entire review. It allows the reviewer to identify gaps in the existing knowledge and literature, understand the current state of the study topic, build on previous studies and

theories, and justify the need for the current study. By reviewing and synthesizing relevant literature, the reviewer can position their study within the broader academic discourse and demonstrate how it contributes to the field.

The chapter is structured as follows: an introduction that provides an overview of the chapter, the importance of the literature review, and the structure of the chapter; a discussion on the Economic Deterrence Theory and its relevance on tax compliance; a definition, overview and evolution of tax compliance practice; an analysis of the tax compliance dimensions; an examination of tax compliance parameters such tax filings, payments and reporting; a discussion on the importance of tax compliance.

3.2. Theoretical Framework

3.2.1 Economic Deterrent Theory

The economic deterrent theory was introduced by Allingham and Sandmo in 1972. The theory contends that a variety of factors, including tax rates, the benefits of tax evasion, the likelihood of fraud being detected, and the severity of penalties for doing so can influence taxpayers' behavior. Consequently, rational decisions are made by taxpayers amidst uncertainty, where tax evasion can lead to tax savings or penalties (Fjeldstad et al., 2012).

The theory is based on the idea that tax compliance levels are high where tax evasion is likely to be detected and punished more severely, as fewer people will engage in it. Conversely, when the likelihood of tax audits by tax authorities is low and fines are minimal, the expected return from evasion is high. The model advocates for stricter audit and heavy penalties for offenders as a basis for reducing non-compliance. Tax compliance refers to the willingness of taxpayers to comply with tax laws to achieve an economic balance in a country. It is the process and procedure of convincing taxpayers to comply with the relevant tax laws (Oladipo et al., 2022). On the other hand, tax non-compliance poses a major challenge for many tax authorities, and convincing taxpayers to comply is difficult (James and Alley, 2002).

Theory assumes that the fear of being discovered or caught as a noncompliant taxpayer can serve as an effective deterrent to encourage honest behaviour to improve overall tax compliance levels. The fear of being identified and penalized is an effective strategy for encouraging truthful behavior. The theory is criticized for emphasizing considering the coercive side of compliance at the expense of consensus. Tax administrations, influenced by the concepts of economic deterrence, have developed enforcement strategies that primarily focus on penalties and fear of detection, as well as the associated time and financial cost, including the burden of the tax payment itself.

Taxpayer noncompliance is the main cause of developing countries' difficulties in collecting tax revenues efficiently (Okpeyo et al., 2019b). Tax evasion and avoidance are characteristics of tax violations, defined as the inability to file tax returns, report income, accurately calculate deductions, and make timely payments (Jenkins and Forlemu, 1993). Both tax avoidance and evasion pose substantial economic challenges for a nation.

Tax compliance is affected by taxpayers' ability to understand tax laws and their willingness to comply with them. Tax compliance is determined by how effective the tax laws and regulations are complied with, through timely declaration and payment of the relevant taxes as stipulated by the tax laws. The tax authorities are crucial in ensuring that taxpayers comply with their tax obligations. Despite the enormous efforts of the government and the Uganda Revenue Authority in taxpayer education campaigns and amendments to the law so as to encourage voluntary tax compliance, the rates of tax noncompliance are significant.

3.2.2 Critique of the Economic Deterrent Theory

The economic deterrent theory is criticized for the inconsistent results generated by the application of coercion to enhance compliance because imposing penalties does not impact the moral behavior of taxpayers towards tax compliance. There is a qualitative difference between enforced and voluntary compliance

The theory assumes a high probability of tax audits by the tax authority, when there are low audit probabilities and low penalties, the tendency for evasion will be higher, while if there is a high tendency for detection and penalties are severe, fewer people will evade taxes (Fjeldstad, Schulz-Herzenberg and Sjursen, 2012). The theory ignores the fact that tax audits are done on a sample basis on a risk-based approach due to resource constraints faced by tax authorities of developing countries, so not all taxpayers can be audited by the tax authority at the same period.

Some critics argue that, beyond coercive threats and punishments, tax incentives like tax waivers should instead be designed to reward or encourage certain compliant behaviours among taxpayers.

The deterrence model is also criticized for failure to consider behavioral factors such as attitudes, perceptions, and moral judgments (Lewis, 1982). It neglects the presence of codes of conducts, such as moral and ethical constraints that have potentials to prevent people from cheating taxes (Sour, 2004). The aggregation of the above criticisms has led to incorporation of diverse perspectives/fields –especially behavioral-into the study of tax compliance behavior, and subsequently, development of broad-based factors that affect taxpayers' (non)compliance behavior. Tax (non) compliance is manifested in a variety of ways with varying consequences.

4. CHAPTER THREE METHODOLOGY

4.1. Introduction

This section covers the approach and tools used to plan, execute, and complete the assignment. Both qualitative and quantitative methods of data collection were used in data collection since monetary values from historic financial transactions and human interaction behavioral actions were observed during the fieldwork.

4.2. Data collection tools

The data collection methods and tools deployed to gather the report findings include the following:

- **Document review** of the financial records including the filed tax returns, supplier contracts, sales & purchase documents, payment vouchers, accounting records among others, as generated and kept by the firm since inception for the period January 2019 to June 2023. Documents review checklists and guides were used as tools in the data collection process.
- **Review of the Uganda Revenue Authority³ website** for the filed returns, system tax ledgers, payments, registration, and taxpayer profile for the period January 2019 to June 2023. Information submitted to the URA website is third party data to confirm whether the internally generated reports and records mirror the submissions to the URA to minimize errors and omissions.
- The Managing Partner and the Finance head were interviewed as **Key Informants** to provide high-level insights on the tax compliance strategy, practices, and environment of The Firm. The Key Informants Interview guide was used as a tool for the interviews.

4.3. Applicable Tax Laws

The tax laws of Uganda based on in deriving the report findings, recommendations and conclusions are listed below.

- The Value Added Tax Act, Cap 349;
- The Income Tax Act, Cap 340;
- Tax Procedures Code Act, 2014
- Local Governments Act, 2008

5. CHAPTER FOUR TAX COMPLIANCE REVIEW FINDINGS

5.1. Introduction

This section of the report covers the key findings pertaining to the tax compliance status of The Firm. The findings are documented in terms of the observations, possible explanation, and implications.

³ <https://ura.go.ug/en/>

5.2. Summary of findings

The table below summarises the principal tax liability, penalties, and interest arising from the tax non-compliance identified during the tax compliance review exercise.

Table 1: Summary of identified liabilities.

#	Tax Head	Description	App	Principal	Interest/Penalties	Total Liability
1	WHT	Freelance consultants	I	1,464,216	686,988	2,151,204
2	VAT	Undeclared sales	II	5,859,000	1,619,795	7,478,795
		Late filing penalty		N/A	553,545	553,545
3	PAYE	Undeclared PAYE	III	4,077,000	2,808,600	6,885,600
4	LST	Undeclared LST	IV	350,000	175,000	525,000
5	IT	Income tax		N/A	21,600,000	21,600,000
		Total		11,750,216	27,443,928	39,194,144

Waiver of interest

Section 40C of the Tax Procedures Code Act (TPCA), 2014, waived any interest and penalty outstanding as of 30th June 2020. The Consultant has therefore computed estimated penalties and interest on the outstanding tax liabilities commencing on 01st July 2020.

5.3. Detailed findings

5.3.1 Withholding Tax (WHT) Compliance

Introduction

WHT is a form of income tax that is withheld at source by one person (withholding agent) upon making payment to another person (payee). This tax is deducted at source and remitted to URA in advance by the withholding agent⁴. WHT on payments to local service providers is charged at 6%.

The Firm is obliged to withhold 6% on **ALL** payments for local management or professional fees unless the supplier is WHT exempt. The Firm is required to file monthly WHT returns and remit the tax deducted for professional service payments by the 15th of the following month⁵. The Firm did not declare any WHT returns or payments to the URA for the period under review.

⁴ <https://ura.go.ug/en/domestic-taxes/tax-exemption/withholding-tax/>

⁵ Section 123(1) of the Income Tax Act

5.3.1.1 Failure to deduct and declare WHT on payments to local freelance professional service providers

The Firm utilizes the services of freelance local accountants on a needs basis to bridge the resource gap in execution of client assignments. It was noted that WHT was not accounted for on payments to the service providers as mandated by the Income Tax Law Cap 349.

The identified total WHT liability is UGX 2,151,204 comprised of principal tax of UGX 1,464,216 and interest of UGX 686,988.

Table 2: WHT liability arising from failure to deduct from professional service providers.

Period	Consultants	Gross payment	WHT 6%	Interest 2%	Total Liability
Jan 2019 to June 2023	Consultant I	11,887,000	713,220	311,274	1,024,494
	Consultant II	2,953,000	177,180	75,812	252,992
	Consultant III	6,810,000	408,600	198,036	606,636
	Consultant IV	2,753,600	165,216	101,866	267,082
		24,403,600	1,464,216	686,988	2,151,204

The revelation presented in table 2 could be explained by management's inadequate tax knowledge of the mandatory legal requirement to withhold and account for WHT on any payments made to local professional service providers. The identified liability is therefore payable.

The Firm is therefore 100% non-compliant with its WHT obligation since no WHT has been accounted for the entire review period.

5.3.2 Value Added Tax (VAT) Compliance

VAT is an indirect tax on consumption charged on value-added to taxable supplies at different stages in the chain of distribution. In Uganda, VAT is imposed on the supply of goods and services (taxable supplies) made by a taxable person, other than exempt supplies and imports other than exempt imports⁶. The current VAT rate is 18%.

5.3.2.1 Non declaration of sales revenue for VAT purposes

The Firm was registered for VAT effective 01st July 2022. It was observed that all filed VAT returns from July 2022 to June 2023 have no sales revenue declared except for the return of April 2023 where only sales to one customer worth UGX 350,000 are declared. It was also noted that the declared tax liability was not remitted to the URA to date, and it is accumulating interest at 2% per month compounded.

Table 3 VAT liability arising from non-declaration of sales in the monthly VAT returns

⁶ <https://thetaxman.ura.go.ug/?p=1175>

Period	Turnover	VAT Liability	Interest 2%	Total Liability
July 2022 to Jun-23	32,550,000	5,859,000	1,619,795	7,478,795

Details are contained in **Appendix II**.

The revelation presented in Table 3 could be explained by the fact that management is aware of the requirement to account for VAT on The Firm's sales revenue because they voluntarily registered for VAT with the URA to access business opportunities from reputable organizations which mainly deal with VAT registered suppliers.

The deliberate under declaration of revenue also reveals that the 18% VAT rate is too high to part away with for remittance to the URA for this small business operator. The Firm is usually cashflow constrained due to delays in customer payment of the billed fees, high operational costs like rent, internet, fieldwork costs, staff welfare, stationery, payroll among others.

Management opted to ignore declaring any sales in the VAT returns to retain the 18% VAT to finance operational costs at the expense of potential future principal tax, interest, and penalties exposures.

This finding implies that the Firm intentionally dodges declaring VAT to the URA on sales transactions to its customers leading to loss of government revenue amounting to the undeclared VAT.

Management also stated that the 18% VAT rate is high for small businesses to ably remit sales tax to the URA and also to retain sufficient cashflows to finance their business operations. Policy makers may explore the option of lowering the VAT rate specifically for the small business operators to enable them to willingly comply with their numerous tax obligations.

The Firm voluntarily registered for VAT⁷ since it has never met the annual compulsory VAT registration threshold of UGX 150 million⁸ therefore it is mandated to comply with the VAT laws.

5.3.2.2 Late filing of some VAT returns

Finding

It was noted that some VAT returns were filed past the statutory due dates by the 15th of the following month resulting into late filing penalties. The penalties were already assessed by the URA as evidenced by the URA taxpayer ledger, but the amounts are yet to be paid and accruing interest as computed below;

Table 4 VAT return late filing liability

Return	Return due	Return filing	Penalty	Payment	Interest	Total
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⁷ Voluntary VAT registration refers to registering for VAT with the tax authorities even if you don't meet the threshold level for compulsory registration.

⁸ <https://thetaxman.ura.go.ug/?p=1175>

period	date	date			Months Due	2%	Liability
Apr-23	15/05/2023	16/05/2023	200,000	(200,000)	1	4,000	4,000
Jan-23	15/02/2023	16/02/2023	200,000	-	14	63,896	263,896
Sep-22	15/10/2022	17/10/2023	200,000	-	18	85,649	285,649
Total			600,000	(200,000)		153,545	553,545

This reveals that the internal tax compliance structure is weak in terms of timely submission of returns and payment of the tax due. It was noted that The Firm does not have an end of month compliance checklist or procedures to ensure that all actions are concluded as stipulated in the month end tax compliance checklist.

The late filing of returns implies that the overall tax compliance environment is weak due to absence of systems, tax compliance checklists, manuals, and documented guidelines to strictly control and monitor compliance with the existing laws and regulations.

5.3.3 Pay As You Earn (PAYE) Compliance

Introduction

PAYE is tax imposed on the total monthly income (salary and other payments) of an employee (totalling above UGX 235,000)⁹. It is paid to URA by the employer on behalf of the employee.

The Firm is not registered for PAYE since registration as an audit firm by the URA and the ICPAU, yet it has employees who are paid salaries and wages thus contravention of the law related to PAYE compliance. PAYE returns and associated payments are due by the 15th of the month following.

5.3.3.1 Non declaration of PAYE on employee salaries and wages

Finding

The Firm has four full-time employees who are paid salaries and wages on a monthly basis, but PAYE is not accounted for on the employee emoluments. The non-declaration of PAYE on employee emoluments has resulted into principal tax and interest exposure as computed below.

Table 5 Non declaration of PAYE on employee salaries and wages

Period	PAYE Liability	Interest	Total Liability
July 18 to Jun-19	453,000	453,000	906,000
July 19 to Jun-20	906,000	915,060	1,821,060
July 20 to Jun-21	906,000	697,620	1,603,620

⁹ <https://ura.go.ug/en/domestic-taxes/payee-rates/>

July 21 to Jun-22	906,000	480,180	1,386,180
July 22 to Jun-23	906,000	262,740	1,168,740
Total	4,077,000	2,808,600	6,885,600

Details are contained in **Appendix III**.

It was revealed that management assumes that PAYE is only accounted for by PAYE registered companies. The Firm is not registered for PAYE with the URA which made management believe that it is not required to account for the tax. However, the law requires that all employers are mandated to register for all applicable tax heads, deduct and remit PAYE from the employees' emoluments on a monthly basis as stipulated by the law.

This implies that management is not cognizant of the Firms PAYE obligations. The Firm is mandated to register and account for PAYE since failure to do so shifts the tax burden to the employer since PAYE ought to have been deducted from the employees.

5.3.4 Local Service Tax (LST) Compliance

Introduction

LST is an annual tax assessed and collected by the local authorities under the Local Governments Act, 2008 in the month of July of each fiscal year and paid in four equal monthly instalments in the months of July, August, September, and October of the fiscal year¹⁰.

5.3.4.1 Non declaration of LST to the local authority

The Firm did not account for LST for the period under review. LST should be deducted by employers from employees from July to October of each year and remitted to the local authorities of employees' residence by the 15th of November of each year. The identified liability is as per the table below. Details are contained in **Appendix V**.

Table 6 Non declaration of LST on employee salaries and wages

Period	LST Liability	Surcharge 50%	Total Liability
July 18 to Jun-19	70,000	35,000	105,000
July 19 to Jun-20	70,000	35,000	105,000
July 20 to Jun-21	70,000	35,000	105,000
July 21 to Jun-22	70,000	35,000	105,000
July 22 to Jun-23	70,000	35,000	105,000
Total	350,000	175,000	525,000

¹⁰ https://www.kcca.go.ug/uDocs/Local_Service_Tax_FAQs.pdf

Table 6 represents the noncompliance obligation as a result of LST outstanding totaling to UGX 525,000 comprised of UGX 350,000 as principal and UGX 175,000 as 50% surcharge.

This reveals the tax knowledge gap as management is not aware of its obligation to account for LST from employee emoluments. Management attributes the non-compliance to ignorance of the compliance requirement due to lack of sensitization and awareness by the local authorities of this obligation.

This implies that the Local authorities are losing a lot of vital LST collections on account of limited public awareness of their obligations. The tax is crucial in supporting local community infrastructure maintenance and social services delivery for community welfare improvement.

5.3.5 Income Tax Compliance¹¹

5.3.5.1 Provisional tax compliance

The Firm is required to submit provisional income tax returns within six months into the year of income and a revised provisional return before the end of the twelfth month of the tax year. Provisional income tax returns for the review period were filed as per the table below. The provisional returns for the period ended June 2022 and June 2023 have never been filed to date.

Table 7 Provisional tax compliance

Period	Return due date	Return filing date	Taxable income	Tax Liability
July 18 to Jun-19	31/12/2018	25/01/2019	-	-
July 19 to Jun-20	31/12/2019	10/12/2019	-	-
July 20 to Jun-21	31/12/2020	29/10/2020	4,500,000	216,000
July 21 to Jun-22	31/12/2022	No return filed	-	-
July 22 to Jun-23	31/12/2023	No return filed	-	-

This finding revealed in the table 7 is explained by management’s unfamiliarity of the rationale, timelines, and obligation of timely filing of annual provisional tax returns which exposes The Firm to non-compliance penalties.

It is implied that the non-filing of provisional tax returns confirms non-compliance with tax laws mandating taxpayers to file provisional returns by the statutory due dates which exposes the Firm to non-compliance fines and penalties.

¹¹ Section 4 of the Income Tax Act defines income tax as a tax charged for each year of income and is imposed on every person who has taxable income for the year of income.

5.3.5.2 Final income tax compliance

Finding

The Firm did not file final tax returns for the period under review except for the period ended June 2022 where a tax liability of UGX 472,535 was declared to the URA. The tax return for the period ended June 2022 which was due by 31st December 2022 was filed very early on the 24th of January 2022 before the return due date thus only financial information for six months was declared to the URA instead of financial information for 12 months as required by law. This leads to a high likelihood of under declaration of the annual revenue and the resultant tax liability for the period.

This revealed that management is not conversant with the tax filing requirements and timelines for final tax returns to declare the business incomes earned in the year as obliged by the law.

This implies that there is a notable knowledge gap regarding the obligation to file final income tax returns to declare the business income earned annually plus the potential penalties in case of late or non-filing of the returns.

5.3.6 Other compliance observations

5.3.6.1 Record keeping

Finding

We noted that The Firm's transactions for the period January 2019 to June 2023 are inadequately documented due to absence of vital records like contracts, sales invoices, purchases invoices, payment vouchers, bank reconciliations and a reliable accounting system to record business transactions for future reference purpose and for verification by third parties.

The poor record keeping as identified above is attributed to the ancient business mindset of storing vital business information in small business proprietor's minds other than in record form, failure to appreciate the value of accurate record keeping towards long-term business survival, inadequate internal systems, practices, and control environment to ensure integrity in business operations, limited financial resources to sustain sufficient recommended business standards and practices.

This implies that the Firm lacks an established management information system, software, manual, documented procedures, and processes to facilitate the collection, storage, organization, and distribution of information to the relevant stakeholders. Management is reluctant to design and implement industry best practices in records management which is vital in the modern business environment.

5.3.6.2 Revenue variances in company records

Finding

The review of the company revenue figures indicated a significant variance in the revenues in varying reports internally generated from The Firm's operations as summarized below.

Table 8 Revenue variances in company records

Period Ended	Sales per VAT returns	Sales per annual returns	Sales per sales records
Jun-19	-	-	9,870,500
Jun-20	-	-	12,456,000
Jun-21	-	-	34,000,000
Jun-22	-	73,915,000	22,340,000
Jun-23	350,000	-	32,550,000

Table 8 findings reveal that the cashflow constraints faced by small businesses entice them to conceal or under declare business transactions to dodge taxes due to a general low morale of the public to pay taxes in developing countries due to the apparent limited benefits from tax payments.

This finding highlights the ever-dwindling ethics in the business environment which has exacerbated the practice of tax evasion through sales non declaration leading to intentional nonpayment or underpayment of taxes due by use of fraudulent techniques which is illegal and a criminal offence. Tax evasion may potentially result into reputation damage for the perpetrators, criminal prosecution, penalties, and jail time.

The Firm is advised to carryout detailed reconciliations of the revenue figures as declared in the VAT returns, annual tax returns and company sales records for timely rectification of the glaring inconsistencies before discovery of the same by the URA which will result into assessments, fines, and penalties.

6. CHAPTER FIVE SUMMARY OF KEY FINDINGS, DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

6.1. Introduction

This chapter provides a summary of the key findings from the tax compliance review process, discussions of the findings, conclusions, and recommendations to management to address the identified non-compliance and also guide on future compliance actions.

6.1.1 Failure to account for WHT on payments to local freelance professional service providers

The Firm is exposed to a WHT liability arising from failure to deduct and remit WHT from payments to freelance service providers as mandated by the Income Tax Law Cap 349.

Legal Provision

Section 118A of the Income Tax Act (ITA) provides that a resident person who pays management or professional fees to a resident person shall withhold tax on the gross amount of the payment at 6%. A payment is defined to include any amount *paid* or *payable* in cash or kind, and any other means of conferring value or benefit on a person¹².

WHT agents who fail to withhold tax become personally liable to pay the WHT which was not withheld in accordance with Section 124 of the ITA. Section 136 1(c) of the ITA imposes interest of 2% per month on a person who fails to pay to the Commissioner, any tax withheld or required to be withheld by the person from payment to another person.

Recommendation

The Firms internal payment process should be reinforced by developing a WHT compliance checklist to ensure WHT is correctly deducted and accounted for before any professional service supplier payment is approved and effected. The WHT compliance checklist should be duly signed off by the Finance Head and Managing Partner before any payment is approved.

The identified WHT exposure should be settled at the earliest to mitigate accumulation of 2% monthly interest. Going forward, management should deduct and remit WHT on payments to professional service providers for onward declaration to the URA within 15 days after the month of payment to the supplier.

6.1.2 Non declaration of monthly VAT on company sales revenue

The Firm perpetually files VAT returns with NIL sales declaration yet it has sales transactions leading to concealment of business sales transactions, it only declared VAT sales in April 2023 to one customer, yet it voluntarily registered for VAT in July 2022. It was thus expected to declare VAT sales since the date of VAT registration, but we noted the contrary.

Legal Provision

¹² Section 2(z)xx of the Income Tax Act

Section 65(3) of the VAT Act provides that a person who fails to pay tax imposed on or before the due date is liable to pay a penal tax on the unpaid tax at 2% per month compounded.

Section 50 of the TPCA provides that where a person knowingly or recklessly— makes a statement to an officer of the Uganda Revenue Authority that is false or misleading in a material particular; or - omits from a statement made to an officer of the Uganda Revenue Authority any matter or thing without which the statement is misleading in a material particular, and the tax properly payable by the person exceeds the tax that was assessed as payable based on the false or misleading statement or omission, that person is liable to pay a penal tax equal to double the amount of the excess.

Implication

The Firm is exposed backward taxes, penalties, and interest for non-declaration of sales in the submitted monthly VAT returns. The compliance with EFRIS would alleviate the risky practice of non-declaring business transactions.

Recommendation

The Firm should develop a tax compliance checklist for all applicable taxes on the sales revenue to ensure that the taxes are accounted for correctly and in a timely manner.

Management should review the previous period declarations, amend the returns to declare the undeclared revenue and pay the outstanding taxes to curb accumulation of penal interest.

The Firm should adopt the use of Electronic Fiscal Receipting and Invoice Solution “EFRIS” introduced by the URA to manage the issuance of e-receipts and e-invoices in accordance with the Tax Procedures Code Act 2014 to curb sales suppression and tax evasion. EFRIS will be key in helping the Firm with timely and accurate recording management.

6.1.3 Late filing of some VAT returns

Some VAT returns were filed past the statutory due dates of 15th of the following month resulting in penalties and interest for late filing.

Legal Provision

Section 65(2) of the VAT Act provides that a person who fails to lodge a return within the required time is liable to pay a penal tax amounting to whichever is the greater of - two hundred thousand shillings; or - an interest of 2% for the period the return is outstanding.

Section 65(3) of the VAT Act provides that a person who fails to pay tax imposed on or before the due date is liable to pay a penal tax on the unpaid tax at 2% per month compounded.

Recommendation

Management should set an internal deadline of the 10th of the following month as the due date for filing tax returns to avoid late filing penalties. The tax filing responsibility and accountability should be given to a specific staff or external party whose performance indicators are tagged to accurate declarations, timely tax filing and payment, avoidance of non-compliance penalties and interest among others.

6.1.4 Non declaration of PAYE on employee salaries and wages

Finding

The Firm has four full-time employees who are paid salaries and wages on a periodic basis, but PAYE is not accounted for on the employee emoluments.

Legal Provision

Section 19(1)a of the ITA, states that employment income means any income derived by an employee from any employment and includes any amount of a capital or revenue nature – any wages, salary, leave pay, payment in lieu of leave, overtime pay, fees, commission, gratuity, bonus, or the amount of any travelling, entertainment, utilities, cost of living, housing, medical or other allowance.

According to Section 2(z) (iii) of the ITA, employment means a position entitling the holder to a fixed or ascertainable remuneration.

Section 116 of ITA provides for the employer's obligation to withhold tax from a payment of employment income to an employee at source.

Section 124 of the ITA provides that a withholding agent who fails to withhold tax in accordance with this Act is personally liable to pay to the Commissioner the amount of tax which has not been withheld, but the withholding agent is entitled to recover this amount from the payee.

Section 136(1) and Section 48 of the TPCA provide that a person who fails to pay any tax on or before the due date for payment is liable for interest at a rate equal to two per cent per month on the amount unpaid calculated from the date on which the payment was due until the date on which payment is made.

Section 136(7) of the ITA provides that the interest due and payable which exceeds the aggregate of the principal tax and penal tax shall be waived.

Section 40C of the TPCA provides that any interest and penalty outstanding as at 30th June, 2020 is waived.

Recommendation

The Firm should register for PAYE to ensure compliance with the tax laws on taxation of employee taxation.

Conclusion

Failure to deduct PAYE on employee emoluments is a serious tax non-compliance signal which has exposed the Firm to fines and penalties from the tax authorities.

6.1.5 Non filing of final income tax returns as required by the law.

Finding

The final income tax returns for the years ended 2019, 2020, 2021 and 2023 have never been filed to date.

Legal Provision

Section 48 of the TPCA provides that a person who fails to furnish a tax return by the due date, or within a further time allowed by the Commissioner is liable to pay a penal tax equal to 2% of the tax payable or UGX 200,000 per month, whichever is higher, for the period the return is outstanding.

Section 21 of the TPCA states that where a taxpayer fails to furnish a self-assessment return for a tax period as required under a tax law, the Commissioner may, at any time, make an assessment of the tax payable by the taxpayer for the tax period.

Recommendation

The Firm should ensure that final tax returns and their respect payments are submitted to the URA by the sixth month after the end of the tax period to avoid penalties for non-filing.

Management should schedule regular tax trainings facilitated by the URA or prominent tax professionals to create tax awareness amongst the company staff specifically the finance team to equip them with sufficient tax knowledge to bridge the identified tax knowledge deficiencies.

6.1.6 Provisional tax compliance

The Firm is required to submit provisional income tax returns within six months into the year of income and a revised provisional return before the end of the twelfth. The provisional tax returns for 2022 and 2023 were not filed at all.

Legal Provision

Section 48 of the TPCA provides that a person who fails to furnish a tax return by the due date, or within a further time allowed by the Commissioner is liable to pay a penal tax equal to 2% of the tax payable or UGX 200,000 per month, whichever is higher, for the period the return is outstanding. The likely penalty for non-filing of the provisional has not been computed.

Recommendation

The Firm should ensure that provisional returns and their respect payments are submitted to the URA by the sixth and twelfth month of each tax period to avoid penalties for under or non-filing.

6.1.7 Non declaration of LST to the local authority

Finding

LST was not accounted for on employee emoluments for the period under review as required by law. LST is an annual tax assessed in the month of July of each fiscal year and paid in four equal monthly instalments in the months of July, August, September, and October of the fiscal year.

Legal Provision

The Local Governments Act imposes a Local Service Tax (LST) on all persons in gainful employment payable to Local Government Authorities in which the persons are residents. All employers are required under the Local Government Act (LGA) to withhold LST from all employees earning Ushs 100,000 or more per month and remit it to the respective LGA.

Section 50 of the Kampala Capital City Act, 2010 mandates KCCA to levy LST in accordance with the provisions under the local Governments Act.

Item 9 under part 3 of the fifth schedule to the local Governments Act stipulates, among others that

- Salaried employees shall pay LST in four equal instalments during the financial year.
- Payment of LST shall be completed within the first four months of the financial year

Paragraph 15 of the Fourth Schedule of the LGA as amended by the Local Governments (Amendment)(No.2) Act, 2008 imposes a 50 percent surcharge on the amount that remains unpaid at the end of the first for four months of the financial year.

LST is determined by applying to the LST bands on the basis of their take home salary. A “take home salary” is defined by Section 3(2) of the LGA as the gross salary after deducting income tax in the form of PAYE. LST is an allowable deduction in the computation of PAYE (Section 22(1)(d) of the ITA), inaccurate determination of LST results in inaccurate determination of PAYE, over and under payment of employees.

Recommendation

The Firm employees should be declared for LST purposes. The identified liability may be declared for tax compliance purposes.

The Firm should engage the local authorities for sensitization about the LST compliance obligations.

6.1.8 Record keeping

Finding

We noted that The Firm's transactions are inadequately documented due to absence of vital records like contracts, sales invoices, purchases invoices, payment vouchers and a reliable accounting system to record business transactions.

Legislative provision

Section 15 of the TPCA provides that every taxpayer shall for the purposes of a tax obligation –

- a) Maintain, in English language, records including in electronic format, as may be required to determine the taxpayer's tax liability
- b) Maintain the record so as to enable the taxpayer's tax liability under the tax law to be readily ascertained.
- c) Retain the record for five years after the end of the tax period to which it relates.

Section 49 of the TPCA provides that a person who deliberately fails to maintain proper records for a tax period is liable to pay a penal tax equal to double the amount of tax payable by the person for the period to which the failure relates.

In addition, a person who fails to provide information to the URA upon request is liable to an express penal tax of twenty million shillings.

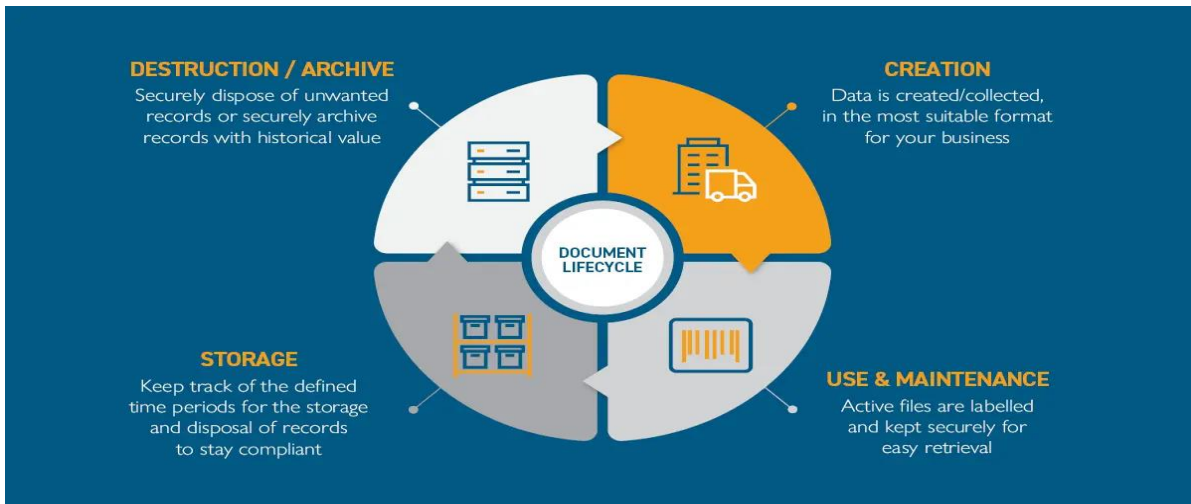
Implication

The Firm's business transactions should be adequately supported to avert the risk of additional assessments due to under or non-declaration of transactions to the URA.

Recommendation

The Firm should ensure that all business transactions are appropriately documented, and the support documents should be easily accessible to avoid assessment and penalties due to unsatisfactory record keeping. There should be an information officer, or a record keeping focal person to efficiently control and monitor the company's record keeping function.

Management should adopt a suitable records management framework which addresses key business concerns as illustrated below:



6.1.9 Revenue variances in company records

Finding

A variance was noted between the revenue figures indicated in company records versus declarations to the URA.

Implication

The inconsistencies in revenue figures in the different company records and declarations to the URA implies deliberate management efforts to conceal transactions to dodge or under declare tax payable which is a criminal offence.

Recommendation

The Firm should carry out detailed reconciliations of the revenue figures as declared in the VAT returns, annual tax returns and company sales records for timely rectification of the glaring inconsistencies.

7. CONCLUSION

Based on the report findings, The Firm has significant tax compliance gaps which require deliberate efforts by management to address so as to avert the risk of URA assessments and the associated penalties. The Firm may explore the following proposals to aid in addressing the tax compliance gaps;

- Establish an internal audit function with tax knowledge to ensure company transactions are periodically reviewed for accuracy and completeness
- Establish a suitable information management system for proper record management
- Hire a tax consultant to train the internal staff and also to handle the tax compliance needs until internal capacity is fully developed and capable of executing the tasks.
- Document tax compliance checklists, manuals, and procedures
- Ensure timely filing and payment of taxes
- Identify internal tax knowledge gaps and develop a tax training calendar to ensure tax sensitization and awareness

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