UNIVERSITY OF NAIROBI
PARKLANDS CAMPUS
FACULTY OF LAW
OCTOBER
2008

CHALLENGES IN HARMONIZING TAX LAW (AND POLICY)
UNDER EAST AFRICAN COOPERATION: HOW FEASIBLE?

By

MWOK-HANDA EKATERINA

G62/71082/07

Dissertation Submitted In Partial Fulfillment Of The Requirements For The Award
Of The Degree - Master Of Laws (LL.M) - University Of Nairobi

Supervisor:

ARTHUR ESHIWANI – Professor of Public Law University of Nairobi
DECLARATION

I, HANDA E., do hereby declare that this dissertation is my original work and has not been submitted and is not currently being submitted for a Degree of any University.

Signature:

HANDA E:

This dissertation has been submitted for examination with my approval as the University supervisor.

Signature:

ARTHUR ESHIWANI – Professor of Public Law
Public Law Department
University of Nairobi
# TABLE OF CONTENTS

DECLARATION........................................................................................................... ii

TABLE OF CONTENTS ........................................................................................... iii

ACKNOWLEDGEMENTS ....................................................................................... vi

DEDICATION........................................................................................................... vii

ABBREVIATIONS ................................................................................................. viii

ABSTRACT ............................................................................................................. ix

TABLE OF STATUTES ......................................................................................... xi

TABLE OF REFERRED CASES .............................................................................. xiv

CHAPTER ONE ........................................................................................................ 1

1. INTRODUCTION ................................................................................................. 1

1.2. STATEMENT OF THE PROBLEM .................................................................. 3

1.3. RATIONALE AND JUSTIFICATION OF THE STUDY .................................. 5

1.4. THEORETICAL AND CONCEPTUAL FRAMEWORK .................................... 8

1.4.1. Defining Regional Integration ................................................................. 8

1.4.2. Defining Harmonization ......................................................................... 13

1.5. METHODOLOGY ............................................................................................ 16

1.6. HYPOTHESIS ................................................................................................ 17

1.7. OBJECTIVES OF THE STUDY .................................................................... 17

1.8. LIMITATIONS OF THE STUDY .................................................................. 18

1.9. PROFILE OF THE STUDY ............................................................................. 19

CHAPTER TWO ...................................................................................................... 21

REGIONAL INTEGRATION AND TAXATION HARMONIZATION: EAC CUSTOMS UNION EXPERIENCE .................................................. 21

2.1. INTRODUCTION ............................................................................................. 21
2.2. IMPLICATIONS, CHALLENGES AND BENEFITS OF EAC CUSTOMS UNION

2.2.1. Historical Background Of EAC Cooperation ........................................ 24
2.2.2. New Development Visions For Kenya, Uganda And Tanzania ............. 30

2.3. CURRENT INTEGRATION AND TAX HARMONIZATION EFFORTS UNDER EAC CUSTOMS UNION ................................................................. 35

2.3.1. Benefits From Establishment Of CET In RIAs .................................... 41
  2.3.1.1. Economic Benefits of EAC Customs Union ..................................... 41
2.3.2. Political Implications of Regional Integration ..................................... 46
2.3.3. Political Implications of EAC Customs Union ..................................... 48
2.3.4. Compensation Mechanisms Under EAC Customs Union ................... 50

2.4. ROLE OF TAXATION IN EAC INTEGRATION ....................................... 51

2.4.1. Taxation – An Instrument Of Revenue Generation ............................ 51
2.4.2. Funding And Maintenance Of EAC Structures And Institutions .......... 52
2.4.3. Poverty Reduction And Distribution Of Social Justice ...................... 53
2.4.4. Correction Of Market Failures ......................................................... 56
2.4.5. Stabilization Of EAC Economies ..................................................... 58
2.4.6. Resource, Income And Wealth Redistribution ................................... 59
2.4.7. Stabilization Of EAC Economies ..................................................... 58
2.4.8. Social Protection ........................................................................ 60

2.5. REASONS FOR HARMONIZATION OF TAX LAW UNDER EAC CUSTOMS UNION ......................................................................................... 61

2.5.1. Reduction Of Harmful Tax Competition ............................................ 62
2.5.2. Prevention Of Revenue Losses ........................................................... 63
2.5.3. Reduction Of Consequences Of Several Tax Reforms ....................... 63
  2.5.3.1. Reduction Of Impact Of Economic Integration On Taxation .......... 64
  2.5.3.2. Reduction Of Effects Of Trade Liberalization On Taxation .......... 65
  2.5.3.3. Reduction Of Effects Of Financial Liberalization On Taxation ...... 69
  2.5.2.4. Improvement Of Coordination Of Trade And Tax Policy .............. 70
CHAPTER THREE ............................................................................................................ 73
GOALS, CHALLENGES AND IMPLICATIONS OF TAX LAW HARMONIZATION UNDER EAC CO-OPERATION ............................................................................... 73

3.1. INTRODUCTION ........................................................................................................... 73
3.2. GOALS OF TAX LAW HARMONIZATION UNDER EAC CO-OPERATION ... 73

3.3. BENEFITS FOR HARMONIZATION OF TAXATION .............................................. 74
   3.3.1. Reduction Of Consumer Mobility And Protection Of Investment ................. 74
   3.3.2. Reduction Of Operational Costs, Costs Of Tax Compliance And Enforcement .................................................................................................................... 76
   3.3.3. Reduction Of Effects Arising From Heterogenous Economies .................... 77

3.4. CHALLENGES AND IMPLICATIONS OF TAX HARMONIZATION UNDER EAC ......................................................................................................................... 77
   3.4.1. Prevention Of Revenue Losses ........................................................................ 78
   3.4.2. Reaching Equilibrium Between Economic Integration And Tax Policies...... 79
   3.4.3. Need To Achieve National Budgetary Targets .............................................. 79
   3.4.4. Escalating Use Of Regressive Consumption Taxes ...................................... 80
   3.4.5. Need To Reduce The Reliance On Consumption Taxes And Better Use Of Income Taxes ........................................................................................................ 84
   3.4.6. Improvement Tax Administration And Exchange Information .................. 86
   3.4.7. Administrative Coordination For Equitable Distribution Of Tax Bases ...... 89
   3.4.8. Need For A Suitable Institutional Framework For Dispute Resolution ...... 92
   3.4.9. Taxation Of E- Commerce .............................................................................. 93
   3.4.10. Threat Of Double Taxation ........................................................................... 96
   3.4.11. Growth of Financial Institutions .................................................................. 101
      3.4.12.1. Property Rating In EAC: Historical Overview ....................................... 101
      3.4.12.2. Differentials In Property Tax Systems In EAC Region ......................... 108
ACKNOWLEDGMENTS

In most of mankind gratitude is merely a secret hope for greater favors.

Duc De La Rochefoucauld

TO GOD BE THE GLORY.

For support, love, encouragement and trust in me I am indebted to my family – my husband Dr. George S. Adari and my daughter Kristina – without whom this course and the project just as my life would make little sense.

This thesis would not have been possible without invaluable counsel and guidance of my supervisor, Professor Arthur Eshiwani, from whom I have learnt a lot and developed keen interest in taxation law. I am humbled, honored and privileged to have worked under his supervision.

I am also grateful to the University of Nairobi through whose generosity a full-time scholarship was awarded to me. This enabled me to undertake my Postgraduate Programme leading to the award of the Degree of Master of Laws (LL.M.) at the School of Law during the 2007/2008 Academic year.

My sincere thanks go to Professor Albert Mumma for discussions of the topic and valuable comments in the course of the preparation of this study.

I am grateful to Mr. Vyas Yash and Ms. Pamela Ager for thoughtful advice and acceptance to read this work without sufficient notice and oversee its completion.

In this paper, I have cited the sources of materials borrowed from the published literature and ideas that I have picked up from discussions with colleagues. I thank everyone for their contribution. Special thanks go to my classmates Ann Mwangi and David Malakwen.

Finally, I am grateful to all my friends who offered their support and do sincerely thank Raydon Busisa for spending long hours typing this work and Jane Khabombi for taking over my house chores and burdens during challenging time of my studies.

vii
I dedicate this dissertation to my mother – Zadorozhnaya Mariya.

Everything I am – you and your unrelenting support made me.
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGOA</td>
<td>African Growth and Opportunity Act</td>
</tr>
<tr>
<td>AIDS/HIV</td>
<td>Acquired Immunodeficiency Syndrome/ Human Immunodeficiency Virus</td>
</tr>
<tr>
<td>BAFICAA</td>
<td>Business Action for Improving Customs Administration in Africa</td>
</tr>
<tr>
<td>CBI</td>
<td>Cross-Border Initiative</td>
</tr>
<tr>
<td>CET</td>
<td>Common External Tariff</td>
</tr>
<tr>
<td>CHOGM</td>
<td>Commonwealth Heads of Government Meeting</td>
</tr>
<tr>
<td>COMESA</td>
<td>Common Market for East and Southern Africa</td>
</tr>
<tr>
<td>EAC</td>
<td>East African Community</td>
</tr>
<tr>
<td>EACCU</td>
<td>East African Community Customs Union</td>
</tr>
<tr>
<td>EACSO</td>
<td>East African Common Services Organization</td>
</tr>
<tr>
<td>EADB</td>
<td>East African Development Bank</td>
</tr>
<tr>
<td>EAF</td>
<td>East African Federation</td>
</tr>
<tr>
<td>EALA</td>
<td>East African Legislative Assembly</td>
</tr>
<tr>
<td>EAPMP</td>
<td>East Africa Power Master Plan</td>
</tr>
<tr>
<td>ECJ</td>
<td>European Court of Justice</td>
</tr>
<tr>
<td>EPPO</td>
<td>Export Promotion Programmes Office</td>
</tr>
<tr>
<td>EPZs</td>
<td>Export Processing Zones</td>
</tr>
<tr>
<td>ERP</td>
<td>Economic Recovery Program</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FTA</td>
<td>Free Trade Area</td>
</tr>
<tr>
<td>GDP</td>
<td>Growth Domestic Product</td>
</tr>
<tr>
<td>HIPC</td>
<td>Highly Indebted Poor Countries</td>
</tr>
<tr>
<td>IGAD</td>
<td>Inter-governamental Authority on Development</td>
</tr>
<tr>
<td>IGADD</td>
<td>Inter Governmental Authority on Drought and Development</td>
</tr>
<tr>
<td>Acronym</td>
<td>Description</td>
</tr>
<tr>
<td>---------</td>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IUCEA</td>
<td>Inter-University Council for East Africa</td>
</tr>
<tr>
<td>KIPPRA</td>
<td>Kenya Institute for Public Policy Research and Analysis</td>
</tr>
<tr>
<td>KRA</td>
<td>Kenya Revenue Authority</td>
</tr>
<tr>
<td>LVFO</td>
<td>Lake Victoria Fisheries Organization</td>
</tr>
<tr>
<td>MDGs</td>
<td>Millennium Development Goals</td>
</tr>
<tr>
<td>MUB</td>
<td>Manufacturing Under Bond</td>
</tr>
<tr>
<td>NAFTA</td>
<td>Northern American Freed Trade Agreement</td>
</tr>
<tr>
<td>NIC</td>
<td>Newly Industrialized Country</td>
</tr>
<tr>
<td>NPV</td>
<td>Net Present Value</td>
</tr>
<tr>
<td>NTB</td>
<td>Non-Trade Barriers</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>PIT</td>
<td>Personal Income Tax</td>
</tr>
<tr>
<td>PTA</td>
<td>Preferential Trade Area</td>
</tr>
<tr>
<td>QR</td>
<td>Quantitative Restrictions</td>
</tr>
<tr>
<td>RIAs</td>
<td>Regional Integration Arrangements</td>
</tr>
<tr>
<td>RI</td>
<td>Regional Integration</td>
</tr>
<tr>
<td>ROW</td>
<td>Rest of the World</td>
</tr>
<tr>
<td>SACU</td>
<td>South Africa Customs Union</td>
</tr>
<tr>
<td>SADC</td>
<td>Southern Africa Development Community</td>
</tr>
<tr>
<td>SAPs</td>
<td>Structural Adjustment Programs</td>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>VAT</td>
<td>Value Added Tax</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>WCO</td>
<td>World Customs Organization</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
</tbody>
</table>
ABSTRACT

This Dissertation focuses on the problem of tax law (and policy) harmonization in the East African Community.

We set out to prove that it is difficult to bargain for tax law and policy harmonization in the context of regional integration and EAC co-operation in particular.

This Dissertation starts by providing a general historical background of East African Cooperation from pre-independence period, outlining reasons for past failures, to the time when the new East African Community Customs Union comes into existence. The dissertation offers a different dimension to the existent explanations as to why the 1967 East African Community did not survive and argues that polarized developmental visions of the three East African countries were partly to blame for unsuccessful integration experience. The paper goes further to explore the new circumstances under which current cooperation efforts are being conducted and emphasize the instrumental role of taxation in the process of regional integration in terms of facilitating the achievement of EAC CU goals and objectives. The study identifies challenges, benefits and implications of the EAC Customs Union but at the same time pinpoints that without tax law and policy harmonization meaningful economic integration is not viable.

We observe that economic regional integration with the attendant consequences such as revenue losses, trade and financial liberalization has had an impact on taxation systems of the integrating countries producing a number of departures in municipal tax laws, which have not been synchronized despite years of cooperation. It is with this observation in mind that the paper appraises the process of tax harmonization and illustrates on the example of property taxation the disparities present in the municipal tax laws of three countries and the difficulties involved in harmonizing them.

The dissertation finds that due to the diversity of the opinions that exist on the type of tax harmonization, method of determination of appropriate rates and tax bases as well as relatively low cost of maintaining the status quo harmonization of tax law is difficult to achieve. Other factors that complicate successful bargaining on common taxation law and
policy in EAC are issues of state sovereignty, diversity of jurisdictional interests and preferences, countries’ divergent and at time conflicting obligations under various regional arrangements as well as institutional framework of EAC, among other reasons.

An overview of European Union experience with tax law and policy harmonization is offered so as to gain insights into the dynamics of the process and borrow some of the time-tested approaches.

Despite our finding that harmonization of tax law (and policy) in the context of EAC regional integration is an arena where change is slow as governments do not want to take risks with policy and promulgate laws that might change or influence their political, economic or social positions, we are of the opinion that on the balance, tax harmonization under EAC integration is viable but the political, social and economic challenges elaborated in this study have to be addressed.
TABLE OF STATUTES

East African Tax Management Act of 1952;
East African Tax Management Act No.10 of 1958;
East African Income Tax (Management) Act of 1970;
East African Customs Management Act of 1984;
East African Community Customs Management Act, 2004;
The East African Community Mediation Agreement, 1987;

REPUBLIC OF KENYA

The Air Passenger Service Charge Act (Cap.475 Laws of Kenya);
The Customs and Excise Act (Cap. 474 Laws of Kenya);
The Betting, Lotteries and Gaming Act (Cap.131 Laws of Kenya);
The Directorate of Civil Aviation Act (Cap.394 Laws of Kenya);
The Entertainment Tax Act (Cap.479 Laws of Kenya);
The Income Tax Act (Cap.470 Laws of Kenya);
Local Government Act (Cap. Laws of Kenya);
The Parliamentary Pension Act (Cap.196 Laws of Kenya);
The Rating Act (Cap. 267 Laws of Kenya);
The Road Maintenance Levy Fund Act (Act No 9 of 1993 Laws of Kenya);
The Second Hand Motor Vehicles Purchase Tax Act (Cap.484 Laws of Kenya);
The Stamp Duty Act (Cap.480 Laws of Kenya);
The Traffic Act (Cap.483 Laws of Kenya);
The Transport Licensing Act (Cap.484 Laws of Kenya);
The Value Added Tax Act (Cap.476 Laws of Kenya);
The Valuation for Rating Act (Cap.266 Laws of Kenya),
The Widows and Children’s Pension Act (Cap.195 Laws of Kenya);

xiii
UNITED REPUBLIC OF TANZANIA

The Airport Service Charges Act, 1992;
The Car Benefit Tax Act, 1991;
The Customs and Excise Management Act, 1977;
The Customs Tariff Act, 1976;
The Excise Tariff Ordinance (Cap. 332);
The Foreign Commercial Vehicles Licensing Act, 1970;
The Income Tax Act, 1973;
The Local Government (District Authorities) Act of 1982;
The Local Government Finance Act of 1982;
The Local Government (Urban Authorities) Act of 1982;
The Land Ordinance (Cap. 113);
The Land Rent and Service Charge Act of 1974;
The Motor Vehicle (Tax Registration and Transfer) Act, 1972;
The Pools and Lotteries Act, 1967;
The Port Service Charges Act, 1973;
The Road and Fuel Toll Act, 1985;
The Stamp Duty Act, 1972;
The Traffic (Foreign Vehicle Routes) Act, 1973;
The Urban Authorities (Rating) Act of 1983;
The Value Added Tax Act, 1997;
The Vocational Education and Training Act 1994;

REPUBLIC OF UGANDA

The Arrangements of EAC Customs Regulations 02 August 2006;
The Buganda Local Authorities Rating Act, 1963;
The Customs Tariff Act, 1970 (Act No. 17 of 1970 Statutes of Uganda);
The East African Excise Regulations 1970;
The East African Excise Spirits Regulations;
The East African Excise Management Act (EAC Cap. 26 Statutes of Uganda);
The Excise Tariff Act (Cap. 174 Statutes of Uganda);
The Finance Statute 1998 (statute No. 4 of 1998 Statutes of Uganda);
The Gaming and Pool Betting (Cap. 292 Statutes of Uganda);
The Income Tax Act, 1997;
The In-house EAC CM Regulations;
The Local Government (Rating) Act, 1964;
The Local Government (Rating) Decree of 1979;
The Local Government (Rating) Ordinance of 1948;
The Stamps Act (Cap.342 Statutes of Uganda);
The Stamp Duty Act (Cap.172 Statutes of Uganda);
The Traffic and Road Safety Act (Cap.361 Statutes of Uganda);
The Traffic and Road Safety Act and Regulations, 1998 (Act No.15 of 1998 Statutes of Uganda);
The Urban Authorities Act, 1964;
The Urban Authorities Ordinance (Fifth and Sixth Schedules) of 1958;
The Value Added Tax Act, 1996;

CASES REFERRED

Halsey (HM Inspector of Taxes) v. Marks & Spencer Plc 2007 EWCA Civ.117;