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REPORT AND RECOMMENDATIONS ON THE TAXATION OF COOPERATIVES IN UGANDA

for:

Uganda Cooperative Alliance Ltd.

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List of Acronyms

MCM	-	Ministry of Cooperatives and Marketing
DCU	-	District Cooperative Union
UCA	-	Uganda Cooperative Alliance
WG(s)	-	Working Group (s)
BOU	-	Bank of Uganda
AS	-	Agricultural Secretariat
MOF	-	Ministry of Finance
USAID	-	United States Agency for International Development
UNDP	-	United Nations Development Project
WB	-	World Bank
SSA	-	Sub-Saharan Africa
CMB	-	Coffee Marketing Board

DRAFT

TERMS OF REFERENCE

BACKGROUND:

1. Coffee, over the last few decades has been the primary export crop of Uganda, earning well over 90% of the country's foreign exchange. Even though the recent collapse of world market prices has effectively taken most of the profitability out of its export, it remains the dominant crop for foreign exchange earnings and government revenue.

2. With the return of political stability, the government's next set of priorities includes diversification of the economy. It is not clear, however, if this should be accomplished with or without a de-emphasis on coffee exports. For the most part, it will be government's positive programs and policies or conversely, government inaction that will make coffee a future viable crop or one that is abandoned.

3. It is in this context that this study of the taxation system was undertaken, with particular emphasis on the effects of taxation on the activities surrounding coffee and its export.

OBJECTIVES:

4. The government has recently granted permission to four (4) national unions to export coffee directly. This new system effectively by-passes CMB and results in the exporter (unions) controlling the size of net sales proceeds that CMB previously controlled.

5. It is these residuals (net of producer's cost, handling and transport costs, marketing margins, etc.) on which a new tax policy needs to be formulated. Formulation of such a policy could necessarily include a package comprised of taxes as well as tax incentives. Alternatively, various subsidies can be built into the coffee export system if government deems it appropriate.

6. Additionally, as the coffee producers do not fall under the Export Retention Scheme, the government pays them in Uganda Shilling at the official rate. Payments in this manner result in a tax (implicit) being imposed on them. This hidden tax is to be studied with a view toward reducing or eliminating it.

7. The corporate tax has been assessed on the union cooperatives in the same manner as with corporations. Cooperatives are clearly different types of entities, and as such should be taxed according to the nature of functions and structure.

TASKS

8. The specific tasks are as follows:

   A. Develop a working document which UCA can use in their endeavors to convince government to change their cooperative tax policy.

   B. Assess the question of government export tax policies and the effect this policy would have on the planned cooperative coffee export program.

   C. Research into the tax structure from the farmer to the export tax level to:

      i) determine how much of farmers income is going into taxes;

      ii) determine the proportion of tax revenue that is contributed by cooperatives in the form of corporate/profit taxes;

   D. Evaluate the appropriateness of tax assessment on income or properties of cooperatives.

   E. Show alternative ways of reducing the tax burden on the export and corporate taxes.

F. Show the impact of item "E" above on revenue to the government.

G. Indicate what alternative sources of revenue or taxation method could be used to off-set any loss of revenue to government as a result of the suggested taxation changes under item "E" above.

H. Review taxation measures related to asset revaluation and capital gains.

I. Prepare and submit a report to UCA which addresses the above issues.

SCOPE AND TIME OF ASSIGNMENT

It should be noted that the time frame involved in this assignment on cooperative taxation included three (3) weeks to both make the study and submit a final draft. In such a short time span, it is not possible to progress beyond conceptual recommendations. Detailed tax incentive plans with the various incentive mechanisms, rates of application and comprehensive coverages worked out and ready for installation in the tax system requires a 2nd phase. It should be stressed therefore that this study (phase 1) is largely conceptual, and primarily sets out various suggested tax incentive proposals that would have to be developed into functional models.

I. EXECUTIVE SUMMARY

A. FOREWORD

This is the first formal study on the Ugandan system of taxation which has been conducted primarily from the perspective of the cooperative sector. Motivated apparently by the heavy tax burden that coffee has traditionally carried, the study became more of a necessity as coffee's fortunes declined in the last year or so without a corresponding decline in coffee's tax burden.

While it is not at all unusual and in fact quite human to depend on institutions, people, economic sectors, etc. which are strong, efficient and reliable, over-reliance can subtly enter the relationship because of those positive attributes that make things work. When over-dependency develops, gentle reminders have to be presented to the imposer.

To grow and remain viable, the coffee industry must be permitted to earn profits and reinvest. In this new era where cooperative unions can now export directly, the potential producer profits remain under the cloud of possible excessive taxation.

However, irrespective of surface appearances, the taxation of coffee cannot be reviewed in isolation. It fits into the overall revenue structure of Uganda and as such a review must also be made of those other components.

B. SUMMARY OF FINDINGS

1. The coffee industry in Uganda has been adversely affected by governmental export policies which include extraordinarily high taxes. These taxes are the following:

   a) Residual Tax (Explicit in Application): This tax is the end result of the government price fixing scheme for producers. It is derived after netting out against the world market price, the government fixed price payment to producers and the processing and marketing margins. The tax ranges between 30% to 40%, depending on the price fixing.

   b) Sales in Shillings at Official Rate (Implicit in Application): This tax results when the exporter (producer) does not receive his payment for coffee sales in foreign exchange. Instead, his payment is made in Uganda Shilling at the official rate of exchange. The effective tax (termed implicit) is the differential between the official rate and parallel market rate of exchange. It ranges currently between 40% and 60%, but has increased in excess of 80% at various times.

   c) Corporate Tax: This tax is levied against all corporate entities. The Ministry of Finance has elected to treat the union cooperatives as corporations. The tax rate is applied at 45% on the surplus of the cooperative if a surplus results. The income tax is computed <u>before</u> distribution of surplus, and the surplus statutory reserve at 25% must also be deducted before any distribution to members are made. However, due to the mechanism for distributing bonuses, a legal tax avoidance (i.e. tax reduction) device does appear to be available.

   d) Poll Tax: The farmers are subject to this universal per capita tax. It is applied to the individual's personal assets, whatever they might be. In the case of coffee farmers, the number of trees is the basis of valuation.

e) Individual Tax for Farmers: Farmers are to report all forms of income on an individual basis. The individual tax rates will apply to total taxable income.

2. The new direct export system recently approved by government, which permits four national unions to export directly to world markets, will not eliminate any of the taxes in (1) above. The only net advantages in the new system involve the possibility of receiving better world market prices and reducing Coffee Marketing Board's marketing margins and other related service costs.

3. An informal forecast and analysis of the world market demand for coffee indicates that Eastern Europe's adoption of western style capitalism and democracy will raise the per capita income and living standards. As a consequence, coffee (like many other products) will experience a higher level of world wide demand, along with higher world prices. There does not appear to be on the part of the government, a recognition of the future export potential these recent developments hold for coffee.

4. The government's tax collection system appears extremely weak, particular in those areas (direct taxes) where developing countries collect a large percentage of their tax revenue. These direct taxes include individual income tax and corporate taxes. Uganda's tax revenue from these taxes amounted to 11% of total tax revenue as compared to an average of 30% in SSA. Thus Uganda is ranking last in Sub-Sahara Africa (SSA) in this category, according to a recent UNDP/World Bank Study. The coffee sector contributed approximately 14% of total tax revenues in 1988/89.

   The tax revenue from direct taxes is unusually low for a country of Uganda's size as the result of the following:

   a) The threshold salary level for individuals is set exceptionally high for taxation to apply. Thus, most individual salaries fall under that minimum "salary threshold" of U. Shs 240,000.

   b) It appears that most of the "magendo" and small scale type of operations are not paying taxes of any kind.

The indirect tax revenues are also weak and unreliable in that 95% of the excise tax and 80% of sales tax revenue came from domestic production of 3 items: beer, soft drinks and cigarettes.

5. There is no urban property tax in Uganda. Thus, no tax revenue is earned from the very common and universally applied <u>urban</u> property tax. This tax is generally applied on buildings under lease, vacant land, and commercial buildings in urban areas.

6. Official written documents explaining current taxation codes and provisions were never made available. Such documents are necessary for tax payers to review and study in order to understand what their tax obligations are. Ministry of Finance officials only have a 1984 tax codification manual with revisions and additions to the tax laws individually hand-written and individually maintained.

7. The level of industrialization is exceptionally low in Uganda. As such, a common and universal tax revenue base is also weak in this country.

8. The revaluation of cooperatives' assets is necessary in order to account for the devaluations and inflation occurring over several years; i.e. in order to reflect current market values. Taxable income, moreover, should not be derived without accounting for the replacement cost of fixed assets.

9. The import tax on the farmer's agricultural inputs is applied or waived, on a case by case basis. No documentation was available to indicate official exemptions.

10. A new and comprehensive tax law is presently being drafted by the government. This Consultant was advised that now is the proper time to submit requests for Unions and Societies' exemptions and privileges.

C. SUMMARY OF RECOMMENDATIONS

1. The ultimate purpose of this study is to develop a sound foundation for intelligently approaching government and communicating the problems arising out of their coffee export policies. The limited scope and time-frame do not lend themselves to formulation of detailed comprehensive tax incentive proposals that could be placed on government desks.

   Therefore, the follow-up exercise to this conceptual study should be a detailed and highly focused tax formulation that accomplishes the following:

   i) The development of several alternative tax incentive plans - based on the general framework outlined in this study. These plans should be detailed and comprehensive to the point where it is possible to forecast results and outcomes for any given scenario. All possible contingencies should be addressed.

   ii) A comprehensive examination and analysis should be made to determine exactly what tax collections are possible for the other tax sectors to legimately contribute to total tax revenue. That is, an assessment of all possible revenues available for collection in Uganda.

   iii) A review or survey should be made of a fair, equitable and well balanced tax system which is working well in a coffee producing, or commodity exporting country. Use should be made of whatever attributes are transferable to Uganda.

2. The implications for the coffee sector arising out of the political and economic changes in Eastern Europe are extremely positive and significant. Coffee, among several other universal foods, will experience an early increase in demand from this previously depressed section of the world. From another perspective, the world coffee exporters in the last 50 years have not dealt with the type and level of Eastern European demand they will deal with in the next 5 years.

UCA should, in order to capitalize on this unique historical situation, have a well researched and documented report prepared that forecasts the effects Eastern Europe will have on growth in World market demand and prices in 3 to 5 years. Presentation of such a report to government, along with a well orchestrated publicity campaign, can provide the leverage needed for government to grant the tax incentives (i.e. government investment) required for revitalization and expansion of the coffee industry.

3. As pointed out above, there is an urgent need for the GOU to make an investment in its coffee industry. This can best be accomplished by setting up a tax incentive plan that first, keeps the present coffee industry a viable sector of the economy. Secondly, and most importantly, Uganda needs to position itself for what will be record high world market demand and prices in 4 to 5 years.

   The essence of this incentive plan should be in the expansion of production through:

   i. development of new farms;
   ii. expansion of existing farms;
   iii. rehabilitation of existing farms.

   The tax incentive mechanism that can most efficiently accomplish the task of reinvestment of coffee earnings is the investment credit. This approach is recommended for the following reasons:

   a) The government is most likely to agree to a tax incentive plan that does not require dismantling its existing tax structure and procedures.

   b) The investment credit is straight-forward and simple since it is simply a matter of netting the tax credit against taxes (residual payments) due government. A verification procedure through the Ministry of Agriculture would be set up to allow or disallow the credit based on verification of new investment.

   c) The rate of investment credit allowed can be reliably established by analyzing the relationships between required investments and tax liabilities. The various ratios obtained would be the basis for establishing the investment credit rate or rates.

4. A second alternative is a tax holiday. Even though the chances of a positive response from government appear remote, a request could be made for a tax-free holiday. The same rationale used in the above recommendation (# 3) would be the basis of this request.

The tax-free period would be variable (as specified by a schedule) depending on how much verifiable investment was put into the three categories of coffee investments outlined above. On the other hand, a fixed minimum investment could be the basis for a tax holiday of a fixed period of say, 3 years.

The incentive for reinvestment under a tax holiday scheme is strong since the farmer will have no illusion about enjoying such special privileges after enduring the present high taxes.

5. A third alternative for a tax incentive proposal to government involves the following:

   a) The government would set a price for farmers that guarantees a minimum profit. Even if the market is below a profitable point, the farmers would receive their minimum profit. The government in effect yields a subsidy to the farmer that comes out of the union's gross.

   b) The various unions would take possession of the product and export directly, based on the world market price.

   c) No tax would be in effect on the unions unless the World Market price went above a certain threshold level.

   d) The unions would have the farmer's subsidy returned to them only after they become liable for the payment of taxes, as per "c" above. The subsidy would be deducted from their tax payment to government until fully recovered. Thus, the government ultimately pays the subsidy.

The incentive for reinvestment is also strong under this incentive plan because the farmer is guaranteed a certain minimum income, no matter how low the world market price falls.

A positive result from the perspective of the cooperative movement would be that the farmers would develop a closer attachment to the unions because of the guaranteed payment. (It is assumed that the government would only require unions to make guaranteed payments and not private exporters).

6. The 4th alternative for a tax incentive proposal looks at the basic principle of equity. Again, it must be addressed, irrespective of whether coffee prices are up or down, or whether the government needs coffee's foreign exchange earnings.

This alternative seeks to provide tax relief to coffee producers directly through manipulation of the explicit and implicit taxes. This is where the heaviest taxes occur.

As pointed out in the report, an implicit tax is imposed along with a residual tax. These two taxes can be used to bring relief in the following manner:

SAY:	official rate	=	370;
	parallel rate	=	660
	producer payment	=	$54,054
	implicit tax	=	44%
	explicit tax	=	34%

The following steps explain the procedures:

1. Payment for sale of coffee is made at the official exchange rate amounting to Ug. Shs. 20,000,000.

2. Payment at the parallel rate would have been Ug. Shs. 35,675,640, for a loss (Tax) of Ug. Shs. 15,675,640.

3. The producer will have returned to him 34% (explicit rate) of differential of Shs. 15,675,640; the amount of Shs. 5,329,718 would be returned as Foreign Exchange Retention.

Comments

a) The implicit tax would be reduced by the refund while gaining some foreign exchange.

b) The refund would be made based on the rule that reduction of the implicit tax would be made as long as the implicit tax rate exceeded 15%.

c) If the explicit tax increases, the rate of refund increases.

d) A major consideration here is that this still works within the present system's framework.

e) The corporate tax could also be included as a deduction or credit against the Implicit Tax balance not absorbed.

7. The reforms UCA is in the process of carrying out should be given high profile publicity. This is necessary because:

   a) Most persons interviewed by the writer had criticism for past union mismanagement, and displayed little sympathy for the cooperative movement.

   b) It will be vitally necessary to demonstrate to government that if it grants tax incentives to cooperatives, the government taxes waived will be used productively.

8. In conjunction with requesting tax incentives, UCA should point out how the loss of coffee's taxes can be replaced. Fortunately, there are several areas where substantial tax revenues are being lost in Uganda. Therefore, it will not be difficult to identify alternative sources for government. These are as follows:

   a) Custom Import Duties
   b) Excise Taxes on local manufacturing
   c) Sales Tax on the excise tax.
   d) Sales Tax on the custom import duties
   e) The non existence of an urban property tax.

9. The cooperatives are being most heavily taxed through the implicit taxation which occurs when payment for coffee sales are made to the producer in shillings at the official rate. The discount between the official and parallel rates averaging 30 to 40%, determines the amount of discount or tax on the producer's sale.

   The implicit tax, based on my limited taxation review in Uganda appears virtually impossible to eliminate, given Uganda's dependency on coffee's foreign exchange earnings. However, it can and should be used as a bargaining chip when the government is approached on tax incentives.

10. The corporate tax, as it presently is applied treats cooperatives as corporations. However, there is one concession that is made: distribution of a "bonus" can come out of a statutory reserve, (retained earnings) or out of taxable income before determination of taxes.

   The option is not open to distribution of surplus to members. The surplus can only be distributed after determination of taxes and after setting aside 25% of after-tax surplus as a statutory reserve..

   As there are no restrictions on the amount or size or frequency of bonus distributions, there appears to be an opportunity for legal tax avoidance (i.e. reductions). In other words, the bonuses can be paid several times a year out of reserves but charged against taxable income. (See details worked out at II. 4a)

11. There is a need for an <u>urban</u> property tax in Uganda, both

in terms of the needs for tax revenue as well as to spur or provide impetus for development of idle, vacant urban land. Uganda is the first country encountered by the writer which does not have an urban property tax.

Therefore, to make the acceptance of this tax more palpable (i.e. reducing the resistance), the initial rates set should be low and minimally progressive. The approach for developing the program should be set out in the following framework:

a) A survey by the lands bureau or ministry should be responsible for identifying and up-dating all urban maps on property.

b) An appraisal value (cost and market) must be done by same ministry.

c) Forecasts of several levels of assessments, both by classes of property and by individual properties, need to be determined in order to develop appropriate assessment rates.

d) The billing and collection mechanism is then established.

Obviously, at this point, there is not enough data in hand to predict the magnitude of tax revenue possible.

12. There are several financial and tax considerations requiring the revaluation of fixed assets. These include:

a) properly accounting for the replacement cost of fixed assets;

b) properly and accurately accounting for and determining taxable income;

c) properly reflecting current market values in the balance sheet.

In order to set uniform standards and a structured procedure, the revaluation process should be established along the following guidelines:

i) Develop a standardized list or schedule of fixed assets to be considered as the basic core assets for revaluation.

ii) Get proforma invoices from 3 to 4 difference supply sources.

iii) A current composite price should be developed for each item.

iv) Convert with exchange rate formula to be worked out with (approved by) government. The base could be the official rate plus an add-on factor for inflation and future devaluations.

v) Deductions for age, current condition, wear and tear etc. should be performed based on a standardized schedule.

13. The level of industrialization is low in Uganda. As such, a strong potential tax base or sector is missing. Although this is far removed from coffee, it is in the best interest of UCA to actively support government efforts to broaden its tax base.

Many industrial vacuums exist in Uganda which require only low to medium level technological inputs. The government should identify those imported items that import - substitute factories can manufacture. Successful efforts in this area result in foreign exchange savings as well as the generation of tax revenue. Both of these factors help to reduce Uganda's dependency on coffee.

14. The payment of import duties on farmers' inputs should logically be dealt with under any tax incentive package negotiated. However, since the present tax regime is presently being reviewed and revised, now is the most opportune time for UCA to appeal for duty-free privileges on farmers' inputs. The comprehensive investment incentive tax package will likely take longer to negotiate.

15. The audit of all taxable revenues in Uganda should be performed by a single and consolidate tax audit department. Presently, with each tax department having its own self-contained audit section, no autonomy or independence exists from the heads of tax revenue departments. Thus, the audit department head should be autonomous of individual tax department commissioners and report directly to the Deputy Minister of finance.

II. REVIEW OF UGANDA'S SYSTEM OF TAXATION

A. INTRODUCTION

The tax structure in Uganda is typical of the tax and tariff regime found in many developing countries. Indirect taxes (import duties, excise, sales, etc.) as opposed to direct taxes (income tax, poll tax, etc.) tend to provide most tax revenue, except where there is a single dominating export. In Uganda, that dominating export is coffee.

However, even in a mono-export economy, there has to be a reasonable balance struck between or among the various taxes. To do otherwise not only places an extremely risky reliance on coffee, the prime foreign exchange earner, but it also imposes a constraint on Uganda's ability to formulate and execute long range development programs.

Thus, it is under these precise circumstances that this study has been undertaken; i.e. with a view toward identifying an approach that answers or addresses two pressing issues. The first issue involves the survival of coffee as a viable export crop, while the second issue deals with the GOU's ability to substitute for the temporary loss of coffee's dwindling revenues.

Indeed, it can be boiled down to whether these two objectives are mutually exclusive or in fact, does accomplishment of one enhance the achievement of the other issue. The writer believes the latter applies.

Finally, while there is no intent to set tax policy, the importance of coffee to the long-term well being of Uganda's economy requires an extensive, perceptive and in depth evaluation of the taxation system.

B. AN OVERVIEW OF THE TAX SYSTEM

1. Principles of Tax Design

There are three (3) major principles of tax design: equity, economic efficiency and administration. The principle of equity requires that taxation conform to the country's sense of fairness. Economic efficiency means that taxation should not interfere with the prime economic objectives of:

i) growth;
ii) stability
iii) equitable distribution
iv) independence.

Administration implies that tax revenue is efficiently collected without excessive costs for government or for tax payers.

A review of Uganda's application of these principles was an additional objective of this taxation study.

2. Taxation's Regressive Trend

As stated above, Uganda derives tax revenue from taxes that are applied directly to income as well as revenue from indirect taxes.

In recent years revenues from taxes have been falling. Revenue from tax declined from 12.6% of GDP in 1970-71 to 5.2% in 1988-89. This is due in part to low collections, inefficient and unstable tax administration, falling coffee prices and a tax system which has too many exemptions.

A review of Table 1 will show all of the major taxes in effect in Uganda and gives a trend dating back to the 1970-71 year.

TABLE 1: TAX COLLECTION AND TAX STRUCTURE
1970/71 - 1988/89
(% OF GDP mp)

Fiscal Year	Total Tax	Income Tax	Tax on Imports: Custom Duty	Tax on Imports: Sales Tax	Tax on Exports: Total	Tax on Exports: Coffee	Sales Tax and Excise Duty on Domestic Production
1970/71	12.6	2.25	2.72	0.93	2.59	2.23	3.02
1971/72	12.8	3.08	2.57	1.14	2.47	2.03	3.23
1972/73	10.0	2.03	1.35	0.93	2.75	2.61	2.69
1973/74	7.8	1.35	1.20	0.59	2.24	2.11	1.93
1974/75	10.2	0.93	1.41	1.55	3.64	3.53	2.42
1975/76	9.0	0.78	1.31	1.25	3.63	3.62	1.86
1976/77	7.9	0.71	0.54	1.16	3.84	3.84	1.54
1977/78	9.7	0.73	0.75	1.00	5.81	5.76	1.23
1978/79	3.4	0.41	0.39	0.50	1.33	1.33	0.70
1979/80	3.5	0.42	0.35	0.52	1.22	1.22	0.60
1980/81	1.6	0.28	0.32	0.29	0.07	0.07	0.02
1981/82	7.9	0.74	1.69	1.61	2.21	2.21	1.43
1982/83	10.3	0.49	1.27	1.28	3.18	3.18	1.38
1983/84	11.2	0.79	1.18	1.48	5.20	5.20	1.19
1984/85	9.3	0.56	0.82	1.28	5.48	5.37	0.85
1985/86	6.5	0.36	0.40	0.57	4.39	4.34	0.62
1986/87	4.5	0.51	0.53	0.57	1.81	1.81	0.88
1987/88	5.6	0.47	0.55	0.58	1.62	1.62	1.85
1988/89	5.2	0.57	0.93	0.63	0.70	0.69	2.03

Source: Ministry of Finance; Government Financial Statistics, IMF; Background to Budget, 1989/90, Ministry of Economic Planning, UNDP, World Bank Trade Expansion Program, Country Report, (1990).

3. Indirect Taxes

Among the two major categories of taxes (direct and indirect), we find that the largest is indirect taxes and include the following:

i. Import duties: Taxes on international trade and transactions are generally the largest single source of revenue in developing countries. This tax is simple to administer and when high rates are applied to luxuries, these duties generally are more effective in reaching high income groups than poorly enforced direct income taxes. Import duties also protect domestic producers from foreign competition. (Significant inadequacies with Uganda's custom tariff system will be covered in detail in section II C, 4c).

ii. Excise Taxes: Specific taxes on domestic manufactured goods, with either specific rates or ad-valorem rates. Here in Uganda, the rates range from 5% to 90% in the form of ad-valorem. Although these taxes come out of the income of manufacturers, they ultimately are passed on to consumers. Some examples of the products being levied with excise taxes are soft drinks, beer and cigarettes.

iii. Sales Taxes: These taxes in many countries take many forms; such as a turnover tax, wholesale tax, retail tax, value added tax, etc. Here in Uganda the sales tax is first applied as a sales tax on imports. Effectively, this entails taxing wholesalers and retailers in the form of a turnover tax. Additionally, the sales tax at various rates are applied to domestically produced goods. The ad-valorem rates range from 10% to 120%.

iv. Export Tax: This tax, primarily on coffee, is made up of an explicit tax that manifests itself in the form of a residual balance after all crop costs and all other charges associated with selling the coffee are deducted. There is also what is termed an "implicit tax"; (both of these taxes will be covered in detail in this report).

v. Commercial Transaction Levy (CTL): These are minor charges on commercial services. A comparative analysis of these indirect taxes are shown in Table 2 for the 1987/88 and 1988/89 periods.

vi) Miscellaneous taxes such as vehicle registration, airport taxes, hotel occupancy taxes, etc. are minor and thus do not significantly affect total tax revenue collections.

TABLE 2: STRUCTURE OF INDIRECT TAXATION
(1987/88 - 1988/89)

	Millions of New Ugandan Shillings		Percent Share of Total Tax Revenue	
Type of Taxes	1987/88	1988/89	1987/88	1988/89
Total Tax Revenue	18,320	43,885	100.0	100.0
Tax Indirect Taxes	16,016	38,096	87.4	86.8
Taxes on Domestic Production	6,524	19,211	35.6	43.8
Sales Tax	4,301	12,211	23.5	27.9
Executive Duty	1,711	4,786	9.3	10.9
Commercial Transactions Levy	375	942	2.0	2.2
Other Minor Taxes	138	1,219	0.8	2.8
Taxes on International Trade	9,492	18,885	51.8	43.0
On Imports:				
Customs Duty	1,866	7,775	10.2	17.7
Sales Tax	2,351	5,271	12.8	12.0
On Exports:				
Export Tax	5,275	5,839	28.8	13.3

Source: Ministry of Finance, Uganda.

UNDP - World Bank Trade Expansion Program - country Report. (Table 8) (1990)

4. Direct Taxes

Direct taxes in Uganda are minor in comparison to indirect taxes and account for an exceptionally low 11% of total revenue collected. According to an UNDP/World Bank study, the low collection on the income tax and corporate tax placed Uganda at the lowest ranking as far as direct tax collection, in Sub-Saharan Africa (SSA). This appears to be both a bane as well as an opportunity for Uganda, if the government quickly seizes the initiative to stop the tax leakage in these sectors. Obviously, significant revenues exists here that can be collected. (Recommendations on this are covered in another part of this report at II - C, 4 c).

If one examines the reasons why Uganda is only collecting an average of 11% of its direct taxes as compared to an average of 30% in Sub-Sahara Africa (SSA), three factors can be identified:

i. Although Uganda has an income tax system of high and progressive rates, ranging from 10% to 60%, the system does not "capture "a majority of the taxable entities in its network. Thus, the "tax base" is narrow since most of the "magendo" and small scale activities go untaxed.

ii. Secondly, Uganda having a very high threshold level of personal income on which a tax can be applied, permits the majority of incomes to go tax free. This is simply because most incomes fall below that minimum level, thereby, resulting in an exemption for personal income taxes.

iii. Finally, the tax administration (i.e., the tax collection effort) has significant weaknesses.

To measure or compare the 11% collection of direct tax in Uganda to other SSA countries, a review should be made of Table 3 below:

Table 3: Tax Collection and Tax Shares in Low-Income Sub-Saharan African countries in 1987

Country	GNP Per Capita	Direct Taxes	Tax on Domestic Transactions	Tax on International Trade	Tax Effort (% GDP)
		-- Percentage of Total Tax Revenue --			
SSA Countries a/	252	29.8	35.2	36.4	17.5
Zaire	150	36.3	24.4	39.4	13.9
Malawi	160	43.3	36.0	20.5	18.5
Tanzania	180	27.2	63.8	9.1	15.5
Burkina Faso	190	27.9	32.9	43.9	13.7
Mali	210	14.2	54.6	31.3	13.6
Zambia	250	24.2	41.9	33.9	23.7
Togo	290	54.0	13.7	41.5	24.7
Kenya	330	34.1	44.3	21.5	18.5
Lethoso	370	12.4	11.7	75.8	19.7
Ghana	390	24.0	28.4	47.5	13.0

a/ Other low income sub-Saharan African countries were excluded due to lack of data for 1987.

Source: Table 1 and World Development Report 1989, pp. 164 and 1986

UNDP - world Bank Trade Expansion Program - Country Report (Table 7) (1990)

C. MACROECONOMIC FACTORS AFFECTING THE TAXATION OF COFFEE

It has been generally agreed - in previous studies by the World Bank and UNDP - that one of the major problems confronting the coffee sector involve macroeconomic disequilibrium. This condition is primarily brought on by:

i) overvalued exchange rates;

ii) import, export and exchange controls;

iii) official vs parallel foreign exchange markets.

While government taxation policies appear to be an additional factor or burden, these tax policies in fact grew out of or resulted from the disequilibrium.

Thus, the taxation of coffee cannot be reviewed in isolation. In order to fully appreciate the position of all parties concerned, all major taxes must be reviewed within the context of relevant socio-economic programs, policies and priorities.

Taxes also invariably become political since taxes essentially are compulsory contributions made to government, without a particular or immediate benefit received by the taxpayer.

1. Coffee's Central Role in Economy

There is not an awful lot that can be said about coffee's pivotal role in the Ugandan economy, which has not already been widely documented. However, for the record, a description of the pertinent macro-economic factors and conditions need to be reiterated, with particular emphasis on their effect on taxation policies.

a) Pivotal Sector

Any sector in an economy which is pivotal must, by its very nature affect tax revenues, foreign exchange earnings, employment, consumer spending, per capita income, politics, etc. Coffee appears to play such a role in Uganda.

Presently, the world market price of coffee is down to a historical low. In this type of severe economic downturn - no matter what the industry or sector might be -governments around the world would hope and seek to prevent two events from occurring.

These would include, first preventing the disintegration of the industry or sector, and having achieved that, would attempt to minimize the resulting inevitable unemployment. Moreover, in such difficult circumstances, it is clearly understood that it is not possible to extract taxes out of that sector without effectively draining out its viability. Finally, the government would take measures to help revive the sector as early as possible.

b) Foreign Exchange Earnings.

More foreign exchange needs to be earned by Uganda. Coffee still remains the most likely way to earn it, and is also the fastest way in the short term. Presently, coffee ranks second to loans and grants, in terms of foreign exchange inflows. Since Uganda obviously cannot always depend on or continue to survive off loans and grants, it should consider giving priority to coffee for expansion of production through tax incentives.

Even in the face of declining prices and without a foreign exchange retention scheme, tax incentives combined with improved tax administration on other taxes would expand coffee production and foreign exchange earnings. Equally important, however, is the near certainty that with this approach, Uganda's coffee industry would be perfectly positioned in 4 to 5 years to capitalize on the expanded world coffee market. (See section C-3 for details on coffee's forecasted recovery).

Thus, from a macro-economic perspective, it could be a severe mistake to permit coffee production to regress, atrophy or even remain at the present level.

2. Factors in Coffee's Decline

a) Explicit Tax

Coffee's decline in Uganda, excluding world market forces, can primarily be attributed to the government's system of setting prices. The tax, while not in the form of a pro rata tax, is applied as a residual after fixed prices are paid to producers and other marketing and processing expenses are deducted. This tax is considered an explicit tax. The amount of taxes taken out of coffee's earnings over the last few years, are shown in Table 4 below:

Table 4:

Taxation on Coffee - Explicit Taxes
(in millions of dollars)

Year	Coffee Earnings ($)	Coffee Tax ($)	% of Coffee Revenue	% of Total Tax Rev.
1986/87	307.5	99.8	33.5%	39.9%
1987/88	265.3	87.7	33.1%	28.7%
1988/89	262.8	39.3	15.0%	13.5%

Note: Coffee tax in dollars converted at average exchange rate for each year.

Source: Key Economic Indicator (Table 8) (1990) Background to the Budget (Tables 8 and 9) (1988/89)

The taxation effects as shown above are extremely harsh and damaging to almost any commercial enterprise. Moreover, the taxation computation also has a distortion on coffee price as they are formulated by the price fixing committee. That is prices fixed by the agricultural policy committee have always been extremely low, resulting in inadequate revenue to adequately cover producer's costs. Inadequate adjustments for inflation have further compounded the pricing problems.

b) Implicit Tax

The second biggest factor in the decline of coffee again excluding world market forces - is the continued application of the implicit tax. As the difference between the official rate of exchange and the parallel rate become larger, the implicit tax also grows.
This situation occurs because coffee exporters surrender their foreign currency earnings at the official exchange rate. Coffee is the only export not permitted to retain foreign exchange through Uganda's Export Retention Scheme. Reference again to Table 5 will demonstrate the effect of the implicit tax on coffee's well being.

Table 5: Coffee Taxation - Implicit

Year	Total Exported $	Total to Producers $	Official Ave. Rate (UShs. to $1.00) Rate	AMT	Parallel Rate (Avg) (USHS) Rate	AMT	% Diff. Brential or Disc.	Implicit Tax or Loss UShs.	US$
1986/87	307.5	141.5	20	2,830.0	110	15,565.0	81.8%	12,735.0	115.8
1987/88	265.3	122.0	60	7,320.0	285	34,770.0	78.9%	27,450.0	96.2
1988/89	262.3	120.8	169	20,415.2	471	56.896.8	64.1%	36.481.6	76.9

Source: Bank of Uganda data; Key Economic Indicators; Background to the Budget

Note: 1. Exchange rate averaged for each year.

2. Column 3 includes Farmers, Primary Societies and Processors to total 46% to this group.

c) War Damage

Significant destruction of cooperatives' assets occurred during Uganda's war of liberation (1985/86). The loss of coffee, cotton, motor vehicles, inventories and various operational material had a crippling effect on their operations. Full recovery has yet to be made from this destruction.

It is estimated by the Ministry of Cooperatives and Marketing that 25 million US$ was lost. During 1987 documented claims were submitted to government for reparation of losses. No action has yet been taken on these claims.

While it is easy to understand why the government, with its limited and scarce resources, has not been able to pay compensation, the government should be supportive by aiding them with tax incentives.

d) World Wide Supply

There is currently an exceptionally large supply of coffee on the internationally market; the culmination of several years of excessive production. From the writers vantage point, it appears to be a situation where a realignment of market forces will occur in the medium term, thereby leading to coffee's recovery. This is primarily true because of unprecedented political and economic reforms currently taking place in both the industrialized and third world. For the moment, however, the glut of coffee world-wide has contributed to coffee's present economic decline.

3. Prospects for Coffee's Recovery

a) World Market Expansion and Price increases.

In the last several months, socio-economic events unprecedented in the last half century have occurred in Eastern Europe. Although captioned under the general description of freedom, these events also include or will include:

i) the introduction of western style capitalism,

ii) political and economic realignment;

iii) a significant increase in the standard of living and per capita income;

iv) an increasing demand for western products as well as higher quality of product, among others.

A cursory examination of the key statistics - such as number of countries, collective population, projected rates of growth, per capita income, etc. surrounding Eastern Europe, in addition to consumer tastes and preferences indicate that the probabilities are extremely high for a tremendous surge in demand for coffee in 3 to 5 years.

Considering only the population factor of the several countries in that region (excluding Russia), there are approximately 200 million people. Russia also is liberalizing its economy and moving away from central control; thus its 300 million plus population should also be considered. In short, the world market, in 3 to 5 years, will definitely be affected by this new segment.

This is simply because demand for coffee from some percentage of this one-half billion people will drive the price of coffee up to unprecedented levels.

b) Marginal Increase in Investments vs Initial Investment.

Even without the events of Eastern Europe, Uganda would have had a sound and rational basis for putting additional investment into the coffee sector. Whether for renewal or expansion of production, additional investment would be in order. This is true because the bulk of the investment is already in place. As such, any additional costs incurred at this time are marginal costs and thus are supplemental rather than primary.

Therefore, the Eastern Europe events merely increase the probabilities to overwhelming odds that the world market price increase will occur. In other words, the bulk of Uganda's investment is already in place, and it should not be abandoned simply because there has been a cyclical downturn in the industry.

For the considerations discussed here, as well as in (a) above, there is an obvious response needed from the Government of Uganda. This response should be the immediate formulation of a package of tax incentives, which would serve to expand, rehabilitate, and upgrade coffee production.

This type of program would do more than provide farmers with a tax incentive program for coffee; it in fact would guarantee a sound economic future for all Ugandans.

4. <u>Other Macroeconomic Issues Central to Coffee, Taxation and the Economy</u>.

a) Corporate Taxes

The corporate tax at 45% is a tax applicable to all businesses and/or commercial operations which are legally registered as being separate and distinct from the owners. The owners interest in the entity is represented by shares of stock or equity participation.

As it has not been possible to obtain written tax codes or written documentation on the tax laws, it is not possible to quote the definition of a corporation as Uganda interprets a legal entity. However, the Commissioner of Income Tax made it clear that the government views union cooperatives as corporations.

Additionally, he acknowledged that union cooperatives do function somewhat differently in that cooperatives tend to distribute a large portion of their surplus. But, by law they first must pay income tax at the 45% rate before any distributions are made. Moreover, with respect to distributions to the primary societies, the unions are required to keep 25% of their surplus profits <u>after</u> taxation as a statutory reserve. Therefore, in order of priority, the following example applies:

	Ug.Shs.
Taxable Income	300,000,000
Tax at 45% rate	(135,000,000)
Net Income After Tax	165,000,000
Statutory Reserve at 25%	(41,250,000)
Net Surplus distributible to members	123,750,000

Taking the above example one step further, the Commissioner for Income Tax indicates it is possible for unions to deduct against taxable income bonuses paid to primary societies. A choice is given (though not stated) between charging the bonus against statutory reserves (retained earnings) or against taxable income. Here is where knowledge of tax laws permit legal tax avoidance, resulting in an effective lower tax rate. The following illustrate these points:

<u>CASE I</u>: If a bonus of Ug. Shs.130,000,000 is charged against the statutory reserve;

	<u>P. & L. EFFECT</u>
	Ug.Shs
Taxable Income Before Bonus	300,000,000
Bonus (changed to reserve)	0
Taxable Income After Bonus	300,000,000
Tax at 45%	(135,000,000)
Net Income After Tax*	165,000,000

<u>CASE II</u>: If a bonus of UShs. 130,000,000 is charged as current expense;

	Ug. Shs.
Taxable Income Before Bonus	300,000,000
Bonus (Charged to expenses)	(130,000,000)
Taxable Income After Bonus	170,000,000
Tax at 45%	(76,500,000)
Net Income After Tax *	93,500,000

* 25% statutory reserve would be based on this figure.

There are three points to be derived from the exercises:

i) There is a tax reduction of UShs. 58,500,000 when the bonus is charged against taxable income instead of the reserve;

ii) knowledge of tax laws are necessary to legally avoid or reduce taxation;

iii) exercising one's legal right to call the annual distribution (at year-end or mid-year) a bonus or either a surplus distribution. That is, the option is made available to the unions, and with knowledge of the options, they can choose to use it.

b) Primary societies

The Commissioner of Income Tax also stated that since partnerships are not liable for income taxes, the total income is passed to the partners or society members. In this manner, the individuals thus are liable for payment of taxes on their total income under the tax regulation covering individuals.(See Appendix - 1)

However, because of the high taxable income threshold level for individuals, the individuals who form primary societies never earn enough income for taxes to apply.

c) Fair and Comprehensive Taxation of All Sectors.

As pointed out earlier in this report, the taxation effort in Uganda is not sufficiently strong and comprehensive for a country of approximately 16 million people. That is, from a macroeconomic standpoint, all of the various sectors in the economy are not carrying their fair share of the tax burden.

The result of such a situation is presently being manifested in the scope and source of government's revenues. Coffee is presently only accounting for approximately 13 to 14% of government revenues, while donor and loan funding is dominating with 63% of foreign exchange. Because of historically inadequate taxation of the various tax bases, and the non-taxation of other potential tax bases, it has not been possible to tap into them.

Clearly with coffee caught in its present downturn, government had no other alternatives to turn to for support. Therefore, the only alternative has been to secure loans and grants while the over-burdened coffee sector goes through its recovery cycle. Such levels of aid would not have been necessary if all sectors of the economy had been carrying their fair share of the tax burden.

Examination of these alternative tax bases revealed that an inadequate level of tax revenue was extracted from the following bases:

Import Tax (Duties)

Only 14% of total revenue has been realized from customs duties during the last two years. This does not compare favorably with other Sub-Saharan African (SSA) countries in both the size and scope of such collections. The distribution of the collections was made up of:

- Motor vehicles - 20%
- Petroleum Products - 48%
- Other - 32%

Even though Uganda has high rates of duty in its tariff schedule, very little duty is being earned by these high rates. For duty rates exceeding 50%, only 2.5 percent of total duties came from that category. Tariff rates of 5 and 10% account for 30% of such collections and rates of 20, 30 and 40% make up more than 60% of import duty revenue. (See Table 6) As the average duty rate (i.e. collection/import value) on all imports is approximately 6%, it is obvious that the high rates of duty are being evaded. Thus, in addition to more effective enforcement of tariff collections, a review and elimination of the large number of exemptions is needed. Note in Table 6 that the duty tariff band of zero percent had the highest imported value (48.5%).

Table 6: Duty Collections by Tariff Rates

Tariff Band	Import Value (% of total)	Duty Collection (% of total)
0	48.5	0.0
5	10.4	8.6
10	12.5	21.0
15	0.7	1.7
20	13.8	37.9
25	0.2	0.3
30	9.0	19.0
40	3.0	7.0
50	0.5	1.8
60	0.0	0.0
70	0.2	1.0
80	0.0	0.0
100	0.02	0.3
150	0.04	0.7
200	0.02	0.5

Source: Customs and Excise Department, Ministry of Finance, Uganda.

UNDP - World Bank Trade Expansion Program - Country Report. (Table 9) (1990)

Excise Taxes

These taxes are levied on the ex-factory price of manufactured or processed goods where the process takes place in Uganda, and are collected on a monthly basis by the Customs and Excise Department. Again, there are high rates of duties, ranging from 5% to 90%, but effective collection is extremely weak.

The weakness stems, in part from the method of tax liability calculation and in part from poor auditing or tax administration. In fact, the method of calculation negatively affects two related taxes: sales taxes and income taxes. Thus, three taxes are underpaid due to the fact that the cost of production is used as a basis for determining these taxes; i.e., the cost of production plus a 10 to 20 mark-up to arrive at ex-factory. Manipulation of the production cost in common in the industries, and so far the audit functions has had difficulties in uncovering it.

The effect of production cost manipulation on 3 different taxes are shown in the following example on a unit basis:

Table 7: Tax Effect on Cost Manipulation

	Actual (Ushs.)	Manipulated
Production cost per unit	100,000	40,000
Profit margin 20%	20,000	8,000
Ex-factory	120,000	48,000
Add: Excise Tax at 5%	6,000	2,400
Sales Tax at 3%	3,780	1,512
Sales Price	129,780	51,912
Loss: Total costs (Admin. 8,000)	(117,780)	(51,912)
Net Income	12,000	0

Tax Effect:

	Actual	Manipulated	Tax Loss
Excise Tax 5%	6,000	2,400	3,600
Sales Tax at 3%	3,780	1,512	2,268
Income Tax at 45%	5,400	0	5,400

Where:

Excess Tax = (Prod. Cost + margin) x Excise Tax rate
Sales Tax = (Ex-Factory + Excise Tax) x Sales Tax rate
Income Tax = Net Income x 45%

Sales Tax

The sales tax is used as a tax on top of a tax as shown in above example, both for the imported products and locally manufactured products. It is applied as a sort of surcharge on:

i) duties determined on imported goods

ii) excise tax determined on local goods.

Thus again, when the initial taxes are understated, this tax, as a function of the prime taxes, is also understated.

d. Substitute for Coffee Taxes during Tax Holiday Period

Two considerations are involved here. First, the amount of taxes (Table 8) coffee producers are paying is determined. Secondly, the total coffee taxes are assumed to be waived by government under a tax holiday or similar tax incentive scheme, with other taxes substituted for the uncollected coffee tax. This situation is shown in the following tables where it is assumed that the low tax collection (tax administration) of Uganda can be easily improved by 100%. To forecast, however, on the side of conservatism, a 50% increase in taxes was used rather than 100%.

Table 8: Summary of Coffee Tax
(In US.$; millions)

Year	Explicit Tax	Implicit Tax *	Other **	Total
1986/87	99.8	115.8	1.3	216.9
1987/88	87.7	96.2	2.4	186.3
1988/89	39.3	76.9	3.9	120.1

* Implicit Tax not actual paid in cash
** Estimated for corporate and Poll Tax

Source: Background To The Budget (July 1989)

The table above shows first what would be lost if tax incentives are given, and the table below shows where the tax revenue is most likely to be recovered. Given the low rate of tax collection here in Uganda, these sectors will easily yield the shortfall from the coffee sector.

Table 9

Substitute Taxes for Coffee Tax Waived

1988/1989

Type of Tax	Waived Tax (US.$ in millions)	Substitute Tax (US.$ in millions)	
Coffee Taxes	ACTUAL	ACTUAL	FORECASTED
Explicit Tax	39.3		
*Implicit Tax	76.9		
Corporate Tax (Est.)	3.5		
Poll Tax	0		
1. Direct Tax:		40.2	60.3
Income Tax - Individuals			
Income Tax - Corporations			
Income Tax - Unofficial Co.'s			
2. Indirect Taxes:			
Excise Taxes		28.3	42.4
Sales Taxes		103.4	155.1
Custom Import Duties		46.0	69.0
	119.7		326.8
EXCESS OF SUBSTITUTE TAXES OVER COFFEE TAX waived			207.1

* Memo only since not actually counted by government.

1. Based on 30% average collection rate of total tax revenue in Sub-Saharan African countries: thus 30% of 1988/89 total Ugandan tax revenue was used for all direct taxes.

2. Estimates based on a gross-up of 1988/89 collections by 50%, due to very significant "slack" in tax collection effort. This rate of forecasted increase is considered conservative since 100% increase is possible.

D. MICROECONOMIC FACTORS AFFECTING TAXATION OF COFFEE

When giving consideration to the individual production unit, one must look at - from the cost perspective - such factors as development costs, capital costs, and operational costs. Proper identification and analysis of these costs will determine if the production unit is viable, or which constraints must be removed (if feasible) to render viability to it.

Although marketing, pricing and distribution channels particularly with respect to coffee, do not enter on a daily basis into most production units' decision making, these factors cannot be ignored - even on a microeconomic level.

With respect to the imposition of taxation, the economic unit finds that taxation is an extraneous factor largely outside of its control. Thus, it is incumbent upon the taxing authority to be fair, equitable and sensitive to the economic unit's ability to meet its demands for taxes.

1. Outline of the New Coffee Export System

The Government of Uganda has agreed to permit the export of coffee by two other categories of exporters - Cooperative Unions and Private Exporters in addition to CMB. These cooperative unions and private exporters will now have the advantage of selling directly to international markets at the best available price. The primary elements and factors involved in the coffee exporting process under this new scheme are the following:

i) Government tax:

World Market Price
Less: Government fixed price to producer
Exporter's Margins
Exporter's processing
Exporter's transport

Government Net Guaranteed

ii) Exporter Pricing and Net Profit

World Market Price
Less: Government fixed price to producer
Government tax - guaranteed

Exporter's costs

Net to Exporter

iii) Farmer's Price and Net

Government Fixed Price
Less: Farmers cost

Farmer's Net

iv) Export Payment: in local currency converted at official rate of exchange.

v) Input Purchases: by OGL and import license

Close scrutiny of the above export system will reveal that the unions are only gaining very limited additional benefits under the new export scheme. In-as-much as the government will continue to fix prices and make payments in shilling, the explicit and implicit taxes still remain excessive. Thus, the minimal gains to the producers only involve the opportunity to get slightly better world market prices, and to reduce service charges previously charged by CMB.

2. <u>Coffee's Profitability and Cost Structure (Rubosta)</u>

Examination of coffee's profitability is important for several reasons:

i) to determine if it is a viable export crop;

ii) to evaluate the effects of taxation;

iii) to evaluate the appropriateness of taxation;

iv) to aid government in formulating policies and programs for it;

v) to forecast its impact on the economy.

Review of a recent USAID cost analysis indicate that Uganda's coffee is clearly competitive on the World Market. (See Appendix 2 and 3) Specifically, the USAID cost study on rubosta coffee set certain criteria. These criteria, if satisfied, indicated that the coffee was competitive. The "what if" type of question was used as follows:

i) it is competitive if the average variable cost of producing, processing and marketing (internal and external) that commodity is equal to or less than the world price;

ii) it is competitive if its competitive coefficient is less or equal to the official exchange rate;

iii) it is competitive if its index of competitiveness is greater or equal to one.

A contrast should be drawn between the USAID study and recent UCA cost studies on coffee. These in-house UCA studies appear to determine if the production cost of coffee is being adequately covered by the price fixing mechanism government is imposing; whereas the USAID study does not appear to try to determine if the local government policies toward coffee are either good or bad, but rather is Uganda's coffee competitive vis a vis the world market forces. Having determined that it is competitive, then it is left to government to formulate policies for its production and export that will maximize its profitability. Consequently, there does not appear to be any inherent conflict between the results of the two studies.

3. <u>Government Policies to Determine Coffee's Growth or Demise</u>

The economic implications from these analyses (see Appendix 2 and 3) are significant when viewed with respect to a mono - export economy. These are as follows:

a) If a commodity is competitive when the world market price is at a historical low, it must have tremendous profitability at a higher volume with higher prices that are sure to increase. As such, the government would be well advised to provide tax incentives to expand the crop system.

b) At the current reduced level of production, combined with low market prices, the availability of legitimate tax revenues are minimal (past year coffee tax revenues are 13 to 14% only). Under such circumstances the government would not forfeit much revenue if a tax holiday or tax incentive scheme, with certain government pre-conditions, were worked out and installed. This would immediately bring most previously abandoned farms back into production.

A primary condition to be set by government could be that the farmer must install " x" new acres per quarter to qualify for the tax concessions. A verification mechanism would be set up by government for verification and monitoring.

c) So far, no other export commodity has been identified for Uganda that could be installed in the short to medium term (3 to 5 years) and do as well as coffee. Simply stated, no other crop has the obvious advantages of coffee:

i) it is a well known crop to Ugandan farmers;

ii) it has been proven to do well in Uganda;

iii) it's profitability has been proven;

iv) the Eastern Europe market segment will increase World demand in 3 to 5 years.

The obvious conclusions to be drawn is that the GOU should review its present policies, with respect to coffee. If its view is to ensure the continued viability of coffee, then taxation and pricing policies should be liberalized.

III. CONCLUSIONS

A. GENERAL

Taxation in all parts of the world, although preceived as being necessary, is never totally understood and welcomed. In the developing world, to an even greater extent exists the notion that taxation is really the problem of "others". The others invariable feel the same way, leaving the taxing authorities with little choice but to impose or levy taxes on the most convenient and accessible targets.

After a limited review of Uganda's system of taxation, this scenario to an appreciable extent appears to be applicable. In this case, the obvious target was the coffee industry. Moreover, since it had to export its product to overseas markets, government had no difficulties in imposing its levies as the product crossed Uganda's borders.

Technically, there is not a lot one can find wrong with this as long as:

i) the government is fair and reasonable in its application of taxes;

ii) the government does not forget about or ignore applying the tax to other sectors;

iii) there is a built-in mechanism in the system that restrains the application of taxation when a heavily taxed sector is ailing.

Having reviewed Uganda's system of taxation, the writer is inclined to conclude that none of the above criteria has been satisfied. Thus, in such a situation, the overburdened taxee is left with no other choice but to make an appeal for relief and adjustments in the system.

This review is therefore timely and appropriate as a first step, but the limited scope of review can only, for the most part, provide confirmation of what was intuitively known. However, as a necessary first step, it was incumbent upon UCA to identify and quantify the problems in the tax system.

At this point, the tax system in Uganda is very similar to the typical developing country's tax system. That is, the following characteristics apply:

i) it is basic in application and approach;

ii) it is rigid in its structure;

iii) it does not present or permit any alternatives or"loop holes";

iv) it does not have a highly efficiency audit, monitoring and follow-up function (tax administration) in place.

Therefore, getting relief within the framework of the system is difficult, if not impossible. There is simply very little margin for adjustments.

However, the present time is the most appropriate time to speak up and put forth proposals on alternative taxing approaches, tax incentive plans and general revisions in the structure of taxes in Uganda.

Such is the case because the government is presently gearing up to work out or develop a new system of taxation. It should be structured along lines that reflect the new realities, particularly with respect to coffee, in Uganda. UCA is the logical body to be in the forefront of a lobbying effort in order to ensure that the government speaks appropriately to these new realities concerning coffee.

1. Coffee's Need for a Dispensation

The survival of coffee as a viable industry is being threatened by World economic forces and government tax policies that have traditionally been harsh; and currently are not being adjusted for the new economic realities. Thus, two issues which are involved here includes survival of coffee as a viable export crop, and secondly involves the government needs to continue sound fiscal management of the economy without accumulating large deficits.

Indeed, it is a very important dichotomy which exists here: on one hand, there would be a temporary loss of coffee tax revenue under a GOU coffee recovery program; while without formal government intervention the revenue from coffee will continue to dwindle until it is permanently lost. Consequently, it would be a severe mistake to permit coffee production to regress, atrophy or even remain at present level. It clearly should be supported for future growth in world demand.

On the other hand, it has been well documented in this report that there is an ample pool of uncollected taxes. The efficient collection of these taxes would appear to adequately cover any government deficit potentially arising from a tax incentive program for coffee. (see Table 9 for data)

2 U.S. Cooperatives as a Taxation Model

The US cooperative model has been briefly discussed in a context where attempts were made to draw parallels between the U.S. and Ugandan models. Although the U.S. version of the cooperative has many similarities as well as differences, the environment surrounding taxation is the one primary factor which sets the U.S.A cooperative apart from what one finds in most of the third World.

Consider by comparing the two environments surrounding taxation in Uganda and the U.S.:

i) Most individuals in Uganda are exempt from taxation because of the high level of income required to fall into a taxable category. The vast majority of individuals are liable for payment of tax in the US.

ii) The Ugandan government depends on the export tax revenue and thus the explicit or "up-front tax" in Uganda. There is no export tax levied in the U.S.

iii) Cooperatives constitute the sector which is the primary foreign exchange earner in Uganda. As such, they are hit with the implicit tax on receipt of payments. In the U.S., cooperatives comprise a very tiny and insignificant part of their economic sector.

iv) No one in the U.S.A. private business sector expects or receives exclusive special tax privileges, in-as-much as everyone carries an equal tax burden. In Uganda, the coffee producers have been shouldering the bulk of the tax burden, and now deserve some relief as their industry attempts to recover.

These differences were pointed out to emphasize that it is largely futile to attempt to use U.S. cooperatives as a model when looking at taxation. They for the most part are taxed just as every other entity or individual,a s long as they are a for-profit organization. Only non-profit organizations get special tax treatment.

Only the distribution of their surplus differs to some extent from most entities, but the application of tax rates, allowances, deductions, special tax credits, etc. essentially follow the principle of payment of fair share.

The cooperatives in Uganda have paid more than their fair share of taxes and must look beyond U.S. cooperatives to gain some relief. However, some tax data on U.S. cooperatives can be found in the appendix of this report.

Finally, if we were to look at an optimal model of cooperative taxation, it would by necessity be in a developing country with economic conditions paralleling those in Uganda. It might not even be coffee that is the primary export commodity, but it would have to be a country which has only 1 or 2 primary export crops. Obviously, the prime criterion of equity in the tax system must be satisfied if it qualifies as a model.

IV. FINAL REMARKS

The taxation question is very important to the future of the coffee industry. In fact, it is just as important as many other aspects currently being reviewed, studied and developed. Such is the case because taxes represent a cost, and if any cost gets out of control in a commercial operation, the entire entity will eventually suffer.

Therefore, if tax relief is not achieved through a combination of tax incentives and a better distribution of the tax burden, decline and abandonment can likely occur. People will not continue to work at endeavors where they cannot see a definite minimal gain.

List of Individuals Interviewed

1. Charles Kabuga
   General Secretary
   Uganda Cooperative Alliance

2. Pius Batarinyebwa
   Commissioner for Cooperative
   Development
   Ministry of Cooperatives and Marketing.

3. Working Group No.3 on Taxation

4. M/s Evelyn Kamagaju
   Michael Cornelius
   UCA Statutory Services

5. Dr. M. Serunjogi
   Deputy Director - Research
   Bank of Uganda

6. Mr. Lars O. Wicknertz
   Consultant, Coffee Export
   Swed Farm

7. Prof. F. Banugire
   Director General - Taxation
   Ministry of Finance

8. Mr. Zake
   Head Economic Abalysis UN
   Ministry of Finance

9. Mr. Isanga Musumba
   Legal Officer
   Ministry of Finance

10. Mr. Lubega
    Commissioner , Income Tax
    Ministry of Finance

11. Prof. S. Karugire
    Director General - Customs
    Ministry of Finance

12. Mr. Ssemakula
    Customs Officer
    Ministry of Finance

13. Mr. Kyamanywa
    Senior Financial Analyst
    Agricultural Secretariat
    Bank of Uganda.

14. Mr. Fred Winch

Deputy Director
USAID

15. Mr. Bagugira
Head, Audit Department
Ministry of Cooperatives and Marketing

16. Mr. Olle Otteby
Director - UNEX
UCA.

List of Reference Report and Publications:

A: Background to the Budget, 1989/90
Ministry of Planning and Economic Development
The Republic of Uganda

B: UNDP-World Bank Trade Expansion Program
Country Report
Uganda, An Agenda for Trade Reform
Trade Policy Division
The World Bank

C: Report on and Recommendations for
The Rehabilitation of the District Cooperative Unions;
By
Gus W. Carlson, Jr. ; Assisted by
Gordon Kunde
Olle Otteby

D: Key Economic Indicators, April 1990
Statistics Department
Ministry of Planning and Economic Development
The Republic of Uganda.

APPENDIX

TAXATION OF CO-OPERATIVE UNIONS

Co-operative unions are made up of groups of small primary societies scattered within the districts throughout the country. The Primary Societies are made up of individuals. For tax purposes, unions are treated as corporations while primary societies are treated as partnerships.

Co-operative unions are chargable to tax in the ordinary way on their total income like any other corporations and the rate of tax is 45% on their total income. By Law, the unions are required to keep 25% of their surplus profits after taxation under a statutory reserve. Any balance of profits can then be distributed to the primary societies.

In Uganda, partnerships are not assessable to tax, but the individuals who make up the partnerships are. Therefore any profits distributed by unions to primary societies are not taxed on the primary societies. This is income of the individuals who form the primary societies. When the income is paid to the individuals who form the society, they are supposed to pay tax on that income. However, the individuals who form up these primary societies are so many that none is liable to pay tax because the personal reliefs they are entitled to are much higher than the income they earn.

Unions normally pay bonuses to the primary societies when substantial profits have been made. These bonuses are paid out of the accumulated reserves. For tax purposes, when such bonuses are paid, they are an allowable expense to the union though paid out of the balance disposable account.

Co-operative unions are entitled to the following allowances:-

1) Wear and Tear on Plant and Machinery at the following rates:-

   a) Class one - Heavy self propelling Earth Moving equipment 37½% of written down value.

   b) Class two - Light self propelling earth moving equipment 25% of written down value.

   c) Class three - Other plant 12½% of written down value.

2) Industrial building allowance at a rate of 4% on straight line for 25 years.

3) Investment allowance of 20% of cost of constructing industrial building plus of Machinery installed in an approved business. That is granted once at the beginning of production.

4) Farm works allowance at a rate of 20% on straight line for 5 years.

SOURCE: MINISTRY OF FINANCE

APPENDIX 2

TITLE: COST STRUCTURE AND EXPORT COMPETITIVENESS FOR UGANDA ROBUSTA COFFEE DURING 1989/90

ROBUSTA COFFEE

TABLE I: PRODUCTION AND MARKETING COSTS PER HECTARE 1989/1990

COST COMPONENTS	PHYSICAL		FINANCIAL (DOMESTIC) %	FINANCIAL (DOMESTIC) USHS	FINANCIAL (FOREIGN) %	FINANCIAL (FOREIGN) USHS	TOTAL USHS
A: INPUTS	Hired						
Seeds							
Fertilizers	250Kgs						37,500
Manure	2Tons						10,000
Pesticides/Insecticides	2Lts						3,000
Gunny Bags	25						12,500
Herbicides							
Depreciation-Equipment							16,500
Transport/Marketing							5,000
SUB TOTAL			43	36335	57	48165	84,500
B: LABOUR (MANDAYS)	Family	Hired					
Weeding/Intercultivation	100	40					27,000
Pruning	20	40					15,000
Application of Fertilize	5	5					2,250
Mulching/Manuring	20						3,000
Spraying		10					3,000
Drying/Pulping/Sorting	50						7,500
Harvesting/Plucking	80	40					24,000
Post Harvesting Operations							
SUB-TOTAL	130	60					81,750
C: ANNUITY OF ESTABLISHMENT							7,500
D: REHABILITATION COST							2,250
E: PRICE/PHYSICAL CONTIGENCY (15%)							23,250
F: TOTAL COST OF PRODUCTION (SHS/HA)							189,500
G: YIELD PER HECTARE IN KGS							1,500
H: COST OF PRODUCING 1KG							126
I: PRODUCER PRICE ADJUSTED (SHS/KG)							130
J: PRODUCER PRICE WITH VARIABLE COSTS							87
K: PRODUCER PRICE WITH POSITIVE RETURNS TO FAMILY LABOUR							130
L: MARKETING AND PROCESSING COST			77	43760	23	13071	56,831
M: TOTAL COST							256,081
N: COST OF PRODUCING, PROCESSING & MARKETING 1KG							171

SOURCE: US AID

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TITLE: COST STRUCTURE AND EXPORT COMPETITIVNESS FOR UGANDAN ROBUSTA COFFEE DURING 1989/90

APPENDIX 3

ROBUSTA COFFEE

TABLE II: COST STRUCTURE, EXPORT COMPETITIVENESS AND RETURNS TO FARMERS 1989/90

A: GIVEN			
1. World Price in Kg (May 1990)			2.01
2. Official Exchange Rate Ushs			379
3. World Price in Ush Per Kg (1*2)			761.8
4. Yield in Kg/HA			1500
5. Conversion Factor			0.54
6. Tax Value			0.331
	Ushs	Ushs	Ushs
B: EXPORT VALUE (3*4*5)			617,058
C: INPUT COST (Per Hectare)			232,831
1. Imported Inputs		63486	
a. Cost Of Farm Inputs	48165		
b. Marketing Costs	13071		
c. Annuity of Est./Reh.	2250		
2. Domestic Inputs		87595	
a) Cost of Farm Inputs	36335		
b. Marketing Costs	43760		
c. Annuity of Est./Reh.	7500		
3. Factor Renumeration		81750	
a) Family Labour			
b) Hired Labour			
D: DOMESTIC RESOURCE COST (C.2+C.3)			169,345
E: EXCESS PROFIT (B-C)			384,227
F: INTERNATIONAL VALUE ADDED (B-C.1)			
1. IN USHS			553,572
2. IN US$			1,461
G: DRC+TAX (=C.2+C.3+A.6*E)			296,524
H: COMPETITIVE COEFFICIENT			
1. BEFORE TAX (D/F.2)			116
2. AFTER TAX (G/F.2)			203
I: INDEX OF COMPETITIVENESS (EXCHANGE RATE/G)			
1. BEFORE TAX (EX. RATE/H.1)			3.27
2. AFTER TAX (EX.RATE/H.2)			1.87

SOURCE: US AID

APPENDIX 4

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OFFICIAL AND PARALLEL MARKET EXCHANGE RATES
(SHILLINGS PER US DOLLAR; PERIOD AVERAGES)

	1983		1984		1985		1986		1987		1988		1989		
	official	parallel	official	parallel	official	parallel	official	parallel	official	parallel	official	parallel	official	parallel	off[illegible]
January			3.00	4.22	5.20	9.70	14.53	20.59	14.00	116.92	60.00	280.00	150.00	396.00	[illegible]
February			3.02	4.16	5.50	10.56	14.70	22.75	14.00	153.33	60.00	337.00	165.00	406.00	[illegible]
March			3.18	4.42	5.80	12.25	14.70	33.30	14.00	173.05	60.00	390.00	200.00	460.00	[illegible]
April			3.23	4.69	5.90	14.16	14.70	35.49	14.00	147.93	60.00	370.00	200.00	520.00	[illegible]
May			3.20	4.66	6.00	14.31	14.70	51.52	..	..	60.00	437.00	200.00	566.00	
June			3.24	4.80	6.00	14.97	14.00a 50.00b	54.33	..	..	60.00	451.00	200.00	612.00	
July			3.33	5.00	6.00	16.89	14.00a 50.00b	76.86	60.00	106.00	150.00	480.00 400.00 SIP	200.00	613.00	
August			3.65	5.87	6.00	16.21	14.00 50.00	76.95	60.00	156.00	150.00	416.00 400.00 SIP	200.00	592.00	
September			4.00	6.45	6.00	17.95	14.00	78.75	60.00	187.00	150.00	445.00	200.00	610.00	
October	2.80	4.25	4.38	7.26	6.00	19.28	14.00	87.55	60.00	205.00	150.00	447.00	340.00	633.00	
November	3.23	4.13	5.32	8.98	10.42	26.49	14.00	85.75	60.00	234.00	150.00	456.00	340.00	714.00	
December	3.08	4.13	5.42	9.48	12.75	31.15	14.00	100.43	60.00	258.00	165.00	447.00	370.00	751.00	
Annual Average	1.60.c	4.17c	3.75	5.83	6.86	16.99	23.28	61.05	14.00d 60.00e	176.55d 171.00e	106.25	414.00	230.42	572.75	

a. Priority rate (Government imports, drugs, agricultural inputs)

b. Market rate (Other imports)

c. Average for October - December

d. Average for January - April

e. Average for May - December

SOURCE: BANK OF UGANDA

Table 13: Domestic Sales Tax Base, Revenue and Rate by Commodity Categories (millions of U.Sh., 1988/1989)

Commodity	Tax Base	Tax Yield	E.T.R	Commodity	Tax Base	Tax Yield	E.T.R
Beer	4098.0	3907.9	95	Water Tanks	10.11	1.72	17
Cigarettes	5332.6	3539.9	66	Pencils	4.69	1.61	34
Soft Drink	3819.1	2027.2	53	Barbed Wire	6.06	1.55	26
Wheat Flour	1831.5	1199.4	65	Coffee	6.86	1.22	18
Textiles	1802.9	502.4	28	En-Ware	7.61	1.18	15
Mattresses	453.4	132.9	29	Biscuits	3.53	1.02	29
Timber	353.3	132.6	38	Boxes & Bags	10.31	0.97	9
Soap	5395.7	111.8	2	Brushes	3.80	0.52	14
Iron Sheets	513.7	102.7	20	Polythene	3.86	0.39	10
Uganda Waragi	265.2	98.2	37	Chalk	1.43	0.34	24
Plastics	223.2	73.1	33	Welding Rod	2.96	0.30	10
Cement	223.8	69.0	31	Cables	2.45	0.24	10
Paper	156.0	62.2	40	Steel Wire	2.40	0.24	10
Paints	135.5	49.7	37	M.S. Plates	2.40	0.23	10
Batteries	159.0	39.9	25	Feeds	1.96	0.20	10
Hessian Bags	136.9	35.2	26	Maize Mill	1.88	0.19	10
Jaggery	95.9	30.9	32	Ugma (Hardware)	1.69	0.17	10
Tea	216.5	28.1	13	Wiring Rod	0.87	0.16	19
Nails	85.1	25.5	30	Rice	0.40	0.16	40
Chain Links	58.0	17.4	30	Matches	0.50	0.12	25
Molasses	75.1	15.0	20	Manhole Covers	0.94	0.09	10
Tubes & Tires	36.3	13.1	36	Fencing Posts	2.18	0.09	4
Toothpaste	74.4	7.4	10	Curry Powder	0.62	0.06	10
Detergents	17.9	6.2	35	Steel Bars	0.56	0.06	10
Sufurias	13.9	5.2	37	Horch Covers	0.48	0.05	10
Karais	12.4	4.9	40	Bronze Bars	0.36	0.04	10
Welded Mesh	22.0	3.3	15	Wine	0.04	0.03	80
Leather	24.6	3.2	13	Pulleys	0.19	0.02	10
Edible Oil	7.0	2.7	38	Pangas	0.07	0.02	30
Shoes	8.7	2.6	30	Maize Huller	0.08	0.01	9
Sweets	6.0	2.1	35	Weights	0.04	0.004	9

* "0.0" means that the number is small.
Source: Inland Department, Ministry of Finance.

SOURCE: UNDP - WORLD BANK TRADE EXPANSION PROGRAM - COUNTRY REPORT (1990).

Table : Sales Tax Rates on the Local Products (1988/89)

Descriptions	Sales Tax Rates	Descriptions	Sales Tax Rates
Soap	10%	Edible Oil*	20%
Horch Covers	10%	Jaggery	20%
Coffee	10%	Molasses	20%
Tea	10%	Iron Sheets	20%
Fencing Posts	10%	Batteries	20%
Curry Powder	10%	Matches	25%
Feeds	10%	Cement	25%
Toothpaste	10%	Biscuits	30%
Polythene	10%	Shoes*	30%
Tubes & Tires*	10%	Pangas	30%
Leather	10%	Sweets	30%
Textiles*	10%	Uganda Waragi	30%
Hessian Bags	10%	Paints	30%
Welding Rod	10%	Detergents	30%
Bronze Bars	10%	Plastics	30%
Steel Bars	10%	Timber	30%
Welded Mesh	10%	Boxes & Bags	30%
Wiring Rod	10%	Karais	30%
Water Tanks	10%	En-Ware	30%
Barbed Wire	10%	Nails	30%
Steel Wire	10%	Mattresses	30%
Chain Links	10%	Pencils	30%
M.S. Plates	10%	Chalk	30%
Mannole Covers	10%	Rice	40%
Maize Mill	10%	Paper	40%
Maize Huller	10%	Soft Drink	50%
Weignts	10%	Sufurias	50%
Pulleys	10%	Wheat Flour*	60%
Cables	10%	Wine	80%
Brusnes	10%	Cigarettes	35%-90%
		Beer	90%

*Import sales tax rate on these products were higher in 1988/89.
Source: Inland Department, Ministry of Finance.

SOURCE: UNDP - WORLD BANK TRADE EXPANSION PROGRAM - COURTRY REPORT (1990)

Table : Sales Tax Rates on Major Imported Goods (1988/89)

Descriptions	Sales Tax Rates	Descriptions	Sales Tax Rates
Citrus fruits,....	Free	Butter	30
Medicaments,..	Free	Vanilla	30
Fertilizers,...	Free	Vegetable oils,...	30
Electric rails locom	Free	other sugars.....	30
Live horses, asses,	10	cocoa paste	30
Meat and edible affa	10	lubricating preparat	30
Fish	10	plywood,....	30
Guts, bladders and s	10	agglomerated cork	30
Other live plants	10	excise books,...	30
Manioc, arrowroot,..	10	articles of plasteri	30
Flours or meals of o	10	bolts and nuts....	30
Vegetable saps....	10	locks...	30
Vegetable products	10	radiotelegraphic....	30
beet-pulp,.....	10	mattress supports...	30
manufactured tobacco	10	equipment for parlou	30
clays...	10	pencils...	30
slag, dross,....	10	Buckwheat, millet, s	40
chemical products	10	Meat extracts and me	40
organic	10	prepared foods	40
prepared glues	10	fruit....	40
composite solvents..	10	sauces.....	40
artificial resins, .	10	perfumery, cosmetics	40
raw hides, skins,...	10	silk	40
basketwork....	10	woven fabrics of met	40
waste paper....	10	woven fabrics or fla	40
picture books,....	10	hemp...	40
woven fabrics of cot	10	woven pile fabrics..	40
coin	10	rubberised textiles.	40
tubes and pipes....	10	gloves,....	40
nickel....	10	rags,..	40
magnesium	10	footwear	40
lead	10	head bands,....	40
zinc	10	parts, fittings, tri	40
tin	10	sinks,....	40
tugsten	10	safety glass....	40
swas...	10	travel goods	50
flying machines..	10	articles of furskin	50
ships,....	10	woven fabrics of man	50
side-arms...	10	woven fabrics of she	50
worked animals...	10	woven fabrics of man	50
hand sieves....	10	garments	50
paintings,.....	10	bed-linen,....	50
petroleum oils......	20	wigs, false beards,.	50
glaziers' putty	20	pearls, stones,...	50
other combustible...	20	motor vehicles...	50
chemincal products	20	other clocks....	50
rubber tyres,...	20	gramophones...	50
tubes and pipes of a	20	Cereal flours:Wheat	80
centriguges	20	wine	80
lenses,...	20		

*The highest within the category.

Source: Custom and Excise Department, Ministry of Finance.

SOURCE: UNDP - WORLD BANK TRADE EXPANSION PROGRAM. - COUNTRY REPORT (1990)

ROBUSTA COFFEE PRICE STRUCTURE

		Estab. Price Ex. Rate 340	Estab. Percent	World Mkt. Price Govt.rate 395	World Mkt. Price Mkt. Rate 630	World Pr[illegible]
Average export price $US/Kg.		1.14	100%	0.80	0.80	
Average export price Shs/Kg.		387.6	100%	316	504	
Taxes		132	34%	108	172	
Coffee Marketing Board		78	20%	64	101	
Processors: Union & Private		52	13%	42	68	
Primary Societies		15	4%	12	20	
Farmer		111	29%	90	144	
Kiboko at a yield of..... i.e. it takes 2 sacks of [illegible] Coffee to equal 1 sack of [illegible] exportable Coffee	0.54	60	15.5%	49	78	

PRICE - PRODUCTION FORCAST FOR 10 YEARS

Year		1	2	3	4	5	6	7	8	9	
MINIMUN PRICE SHS [illegible]ed on est price plus an [illegible]crease of 2% share each yr. [illegible]rcent total price to farmer:		60 15.0%	66 2% 17.0%	74 2% 19.0%	81 2% 21.0%	89 2% 23.0%	97 2% 25.0%	105 2% 27.0%	112 2% 29.0%	120 2% 31.0%	1[illegible] 3[illegible]
MAXIMUM PRICE SHS [illegible]sed on official exchange [illegible]ate at 22/3/90 + 5%/yr.	1.05	144	151	159	167	175	184	193	203	213	
PRODUCTION IN 000 TONS Based on assumptions below		160	160	178	196	214	214	214	225	236	

SOURCE: THE SECOND AGRICULTURAL REHABILITATION PROJECT

1989 Department of the Treasury
Internal Revenue Service

Instructions for Form 990-C

Farmers' Cooperative Association Income Tax Return

(Section references are to the Internal Revenue Code unless otherwise noted.)

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	75 hrs., 34 min.
Learning about the law or the form	23 hrs., 4 min.
Preparing the form	40 hrs., 13 min.
Copying, assembling, and sending the form to IRS	4 hrs., 17 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form more simple, we would be happy to hear from you. You can write to the **Internal Revenue Service**, Washington, DC 20224, Attention: IRS Reports Clearance Officer, T:FP; or the **Office of Management and Budget**, Paperwork Reduction Project (1545-0051), Washington, DC 20503.

General Instructions

A. Purpose of Form

Form 990-C, Farmers' Cooperative Association Income Tax Return, is used to report income, gains, losses, and deductions of farmers' cooperative associations.

B. Filing Form 990-C

Who Must File.—Every farmers' cooperative association must file Form 990-C whether or not the association has taxable income (Regulations section 1.6012-2(f)).

Generally, a farmers' cooperative is a farmers', fruit growers', or like association organized and operated on a cooperative basis to:

(1) Market the products of members or other producers and turn back to them the proceeds of sales, minus the necessary marketing expenses, on the basis of either the quantity or the value of their products; OR

(2) Purchase supplies and equipment for the use of members or other persons and turn over the supplies and equipment to them at actual cost, plus necessary expenses.

A producer is a person who, as owner or tenant, bears the risk of production and receives income based on farm production rather than fixed compensation. For example, if a corporation leases its land to a tenant farmer who agrees to pay a rental fee based on a percentage of the farm crops produced, both the landowner and the tenant farmer qualify as producers.

When To File.—File your return by the 15th day of the 9th month after the end of your tax year.

Extension.—File Form 7004, Application for Automatic Extension of Time To File Corporation Income Tax Return, to request an automatic 6-month extension of time to file Form 990-C.

Period Covered.— File the 1989 return for the calendar year 1989 and fiscal years beginning in 1989. If the return is for a fiscal year, fill in the tax year space in the form heading.

Where To File.—

If the principal office of the organization is located in ▼	Use the following Internal Revenue Service Center address ▼
Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee	Atlanta, GA 39901
Arizona, Colorado, Kansas, New Mexico, Oklahoma, Texas, Utah, Wyoming	Austin, TX 73301
Indiana, Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Alaska, California, Hawaii, Idaho, Nevada, Oregon, Washington	Fresno, CA 93888
Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania (ZIP codes beginning with 169–171 and 173–196 only), Rhode Island, Vermont	Holtsville, NY 00501
Illinois, Iowa, Minnesota, Missouri, Montana, Nebraska, North Dakota, South Dakota, Wisconsin	Kansas City, MO 64999
District of Columbia, Maryland, Pennsylvania (ZIP codes beginning with 150–168 and 172 only), Virginia, any U S. possession, or foreign country	Philadelphia, PA 19255

Signature.—The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other officer (such as tax officer) authorized to sign. A receiver, trustee, or assignee must sign and date any return required to be filed on behalf of a cooperative.

If a cooperative officer filled in Form 990-C, the Paid Preparer's space under "Signature of officer" should remain blank. If someone prepares Form 990-C and does not charge the cooperative, that person should not sign the return. Certain others who prepare Form 990-C should not sign. For example, a regular full-time employee of the cooperative such as a clerk, secretary, etc., does not have to sign.

Generally, anyone who is paid to prepare Form 990-C must sign the return and fill in the other blanks in the Paid Preparer's Use Only area of the return.

The preparer required to sign the return **MUST** complete the required preparer information and:

- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give a copy of Form 990-C to the taxpayer in addition to the copy filed with IRS.

Tax return preparers should be familiar with their responsibilities. See **Pub. 1045**, Information for Tax Practitioners, for details.

C. Figuring and Paying the Tax

1. Accounting

Accounting Methods.—Taxable income must be figured using the method of accounting regularly used in keeping the cooperative's books and records. In all cases the method used must clearly reflect taxable income. See section 446.

Cooperatives are generally required to use the accrual method of accounting if their average annual gross receipts are more than $5,000,000. Cooperatives changing to the accrual method because of this provision must complete **Form 3115**, Application for Change in Accounting Method, and attach it to Form 990-C. The cooperative must also show on a statement accompanying Form 3115 the period over which the section 481(a) adjustment will be taken into account and the basis for the conclusion. See section 448 and Regulations sections 1.448-1T(g) and 1.448-1T(h) for more information. Include the amount reportable as income in 1989 under section 481(a) on line 10, page 1.

See Section 460; Notice 87-61, 1987-2 C.B. 370; and Notice 88-66, 1988-1 C.B. 552.

Unless the law specifically permits otherwise, the cooperative may change the method of accounting used to report taxable income in earlier years (for income as a whole or for any material item) only by first getting consent on Form 3115. Also see **Pub. 538**, Accounting Periods and Methods.

Completed crop pool method of accounting.—Cooperatives may use the completed crop pool method of accounting for crop pools open before March 1, 1978. This provision is limited to cooperatives which have been using this method of accounting for at least 10 tax years ending with the first tax year beginning after December 31, 1976, and who enter into an agreement with the U S. Government for a loan using the pool as collateral and make

SOURCE: DEPT. OF TREASURY INTERNAL REVENUE SERVICE price support advances to eligible producers in amounts equal to the proceeds of the loan. See section 1382(g).

Change in Accounting Period.—Generally, before changing an accounting period, the Commissioner's approval must be obtained (Regulations section 1.442-1) by filing **Form 1128**, Application for Change in Accounting Period. Also see Pub. 538.

2. Rounding Off to Whole-Dollar Amounts

Money items may be shown on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

3. Depositary Method of Tax Payment

Deposit cooperative income tax payments (and estimated tax payments) with a Federal Tax Deposit Coupon (**Form 8109**). Make these tax deposits with either a financial institution qualified as a depositary for Federal taxes or the Federal Reserve bank or branch servicing the geographic area where the cooperative is located. Do not submit deposits directly to an IRS office; otherwise, the cooperative may be subject to a failure to deposit penalty. Records of deposits will be sent to the IRS for crediting to the cooperative's account. See the instructions contained in the coupon book for more information. To get more deposit forms, use the reorder form (**Form 8109A**) provided in the coupon book.

To help ensure proper crediting to your account, write your employer identification number, "Form 990-C," and the tax period to which the deposit applies on your check or money order.

For more information concerning deposits, see **Pub. 583**, Taxpayers Starting a Business.

4. Estimated Tax

Generally, a cooperative must make estimated tax payments if it can expect its estimated tax (income tax minus credits) to be $500 or more. Use **Form 1120-W**, Corporation Estimated Tax, as a worksheet to compute estimated tax. Use the Payment coupons (Forms 8109) in making deposits of estimated tax.

If the cooperative overpaid estimated tax, it may be able to get a "quick refund" by filing **Form 4466**, Corporation Application for Quick Refund of Overpayment of Estimated Tax. The overpayment must be both: (1) at least 10% of expected income tax liability, and (2) at least $500. To apply, file Form 4466 after the end of the tax year, but before the 16th day of the third month thereafter, and before the cooperative files its tax retun.

5. Timing Change in Deducting Accrued Expenses

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year that all events have occurred that determine the liability, and the amount of the liability can be figured with reasonable accuracy. However, generally all the events that establish liability for the amount are treated as occurring only when economic performance takes place. There are exceptions for recurring items. See section 461(h).

6. Rule of 78's Not an Acceptable Method of Figuring Interest

Taxpayers are reminded that, generally, the Rule of 78's is not an acceptable method for computing interest income and expense. Anyone using the Rule of 78's should see Revenue Procedures 84-27, 84-28, 84-29, and 84-30, (which are in Cumulative Bulletin 1984-1) to change their method.

D. Interest and Penalties

Avoid interest and penalties by correctly filing and paying the tax when due. The cooperative may have to pay the following penalties unless it can show that failure to file or to pay was due to reasonable cause and not willful neglect.

1. Interest.—Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, gross valuation overstatements, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

2. Late Filing of Return.—A cooperative that fails to file its tax return when due (including extensions of time for filing) may be subject to a penalty of 5% a month or fraction of a month, up to a maximum of 25%, for each month the return is not filed. The penalty is imposed on the net amount due. The minimum penalty for failure to file a tax return within 60 days of the due date for filing (including extensions) is the lesser of the underpayment or $100.

3. Late Payment of Tax.—Generally, the penalty for not paying tax when due is ½ of 1% of the unpaid amount, up to a maximum of 25%, for each month or fraction of a month the tax remains unpaid. The penalty is imposed on the net amount due.

4. Underpayment of Estimated Tax.—A cooperative that fails to make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. In general, to avoid the estimated tax penalty, the cooperative must make estimated tax payments of at least 90% of the tax shown on the return or 100% of its prior year's tax. See section 6655 for details and exceptions. **Form 2220**, Underpayment of Estimated Tax by Corporations, is used to see if the cooperative owes a penalty and to figure the amount of the penalty. You may be required to complete and attach Form 2220 if no penalty is due. See Form 2220 for details. Also be sure to check the box on line 33, page 1, Form 990-C. If the cooperative owes a penalty, enter the amount of the penalty on this line.

5. Overstated Tax Deposits.—If the cooperative overstated its deposits, it may be subject to a 25% penalty of the overstated amount. See section 6656(b).

6. Other Penalties.—There are also penalties that can be imposed for negligence, substantial understatement of tax, and fraud. See sections 6653 and 6661.

E. Other Forms, Returns, Schedules, and Statements That May Be Required

1. Forms

The cooperative may have to file any of the following:

Forms W-2 and **W-3.** Wage and Tax Statement; and Transmittal of Income and Tax Statements.

Form W-2P. Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments.

Form 966. Corporate Dissolution or Liquidation.

Forms 1042 and **1042S.** Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; and Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent such payments or distributions constitute gross income from sources within the U.S. (see sections 861 through 865). For more information, see sections 1441 and 1442, and **Pub. 515**, Withholding of Tax on Nonresident Aliens and Foreign Corporations.

Form 1096. Annual Summary and Transmittal of U.S. Information Returns.

Form 1098. Mortgage Interest Statement. This form is used to report the receipt from any individual of $600 or more of mortgage interest in the course of the cooperative's trade or business for any calendar year.

Forms 1099-A, B, DIV, INT, MISC, OID, PATR, R, and **S.** Information returns for reporting abandonments, acquisitions through foreclosure, proceeds from broker and barter exchange transactions, certain dividends and distributions, interest payments, payments for certain fishing boat crew members, medical and dental health care payments, direct sales of consumer goods for resale, miscellaneous income payments, nonemployee compensation, original issue discount, patronage dividends, total distributions from profit-sharing plans, retirement plans, individual retirement arrangements, insurance contracts, etc., and proceeds from real estate transactions. Also use these returns to report amounts that were received as a nominee on behalf of another person. For more information see **Pub. 937**, Business Reporting.

Note: *Every cooperative must file information returns if, in the course of its trade or business, it makes payments of rents, commissions, or other fixed or determinable income (see section 6041) totaling $600 or more to any one person during the calendar year.*

Form 5452. Corporate Report of Nondividend Distributions.

Form 5498. Individual Retirement Arrangement Information. Use this form to report contributions (including rollover contributions) to an individual retirement arrangement (IRA) and the value of an IRA or simplified employee pension account.

SOURCE: DEPT. OF TREASURY INTERNAL REVENUE SERVICE