

## CASE STUDY

# Efficient and effective municipal tax administration: a case study of the Kampala Capital City Authority

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The literature on improving tax revenue focuses on five particular characteristics of what an effective tax system should incorporate, namely; economic efficiency, administrative simplicity, flexibility, transparency and fairness (Stiglitz and Rosengard 2015). To achieve this, many governments and local authorities focus on trying to affect larger policy and legislative changes to reform the tax system.

However, effective initial modifications can be made through relatively simple and in some cases low-cost alterations to administration structures. This is particularly the case in places where there is low compliance from existing tax bases, a feature that currently describes many developing countries. A further benefit from initially focusing on tax administration, is that many of the potential administrative modifications can be introduced at any level of government that handles any type of tax collection. This is in contrast to policy and legislation changes that may sit solely under the purview of one sole national authority. Finally, alterations to tax administration can be quicker, less tedious and therefore show results in a relatively short term.

**Effective initial modifications can be made through relatively simple and in some cases low-cost alterations to administration structures**

To illustrate the potential impact of tax administration reforms, this policy note focuses on the case study of the Kampala Capital City Authority (KCCA). Until 2011, there were significant impediments to administration of municipal revenues in Kampala, including unreliable manual databases, poor technologies, unclear procedures, a narrow tax base and poor collection procedures. This resulted in extremely low revenue collections and poor tax morale. Like most local authorities, the KCCA faces a number of constraints in undertaking large-scale legislative reform to support its effort in raising more own-source revenue, since much of the reform has to be managed at a national level and can be a long and cumbersome process. Therefore, the KCCA, from its inception, decided to start by focusing on the areas that it could influence and that could bring short term results. Through such reforms, the KCCA managed to increase its own-source revenue by more than 100% in four years. These reforms, centred around the four main areas of effective tax administration (Bird 2010, Freire and Garzon 2014):

- 1 Better identification of taxpayers;
- 2 Transparent process in assessing their liabilities;
- 3 Effective billing and collection;
- 4 Facilitating and monitoring compliance as well as dealing with non-compliance.

**Through reforms to revenue administration, the KCCA managed to increase its own-source revenue by more than 100% in four years**

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## **An effective enabling environment for reform**

From the outset, implementing any reform will require sufficient political buy-in. With improvements to tax administration, it is particularly important that such reforms are acknowledged as a central component to tax reform and is actively pushed from the highest political levels, as otherwise it is a commonly neglected area of reform (Bird 2010).



For the KCCA, an Act of Parliament in 2010, which replaced the Kampala City Council (KCC) with the current Kampala Capital City Authority (KCCA) and resulted in a number of further associated governance changes, provided this necessary enabling environment for reform. In particular:

- The position of the Executive Director (ED), who is appointed directly by the President, was created as part of the legislation. The appointed ED, Dr Jennifer Musisi, had previously been working as part of senior management in the Uganda Revenue Authority (URA), the national tax body. Therefore, she brought with her a solid understanding of tax administration and its necessity for supporting revenue collection efforts in the city.
- As part of the initial re-organisation from the KCC to the KCCA, a further decision was made to create an independent Directorate of Revenue Collection (DRC). In most cities and local authorities, this function is merged with expenditure, where the latter function is often given priority over the former. By splitting the functions within the KCCA, this Directorate could concentrate solely on its mandate of revenue collection and further supported the enabling environment for reform.

Reforms to address key challenges to revenue administration focused on four key areas:

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## Internal staffing and skills

For the DRC to operate effectively, it had to be staffed with a critical mass of qualified staff (Kopanyi 2015). When the KCCA was initially founded, the ED was given the opportunity to recruit a number of staff to build the foundation of the organisation. Given her previous work in the URA, she appointed a number of staff who had worked with her in the same agency. Other staff were recruited from a number of technical directorates in other ministries, departments and agencies. The Directorate is currently staffed with more than 100 contract and permanent staff, working across three departments of the Directorate, namely Audit and Compliance, Research and Analysis and Revenue Collection.

Currently, all the Directorate's staff receive monthly training and refresher courses on tax and operational guidelines. Furthermore, there is the assurance that the staff have the basic on-the-job training in tax law, and changes in tax laws are subsequently incorporated as part of the training. This structural re-alignment and allocation of a cadre of competent and skilled staff thus provided the groundwork to introduce further reforms in the municipal tax administration.

Providing an adequate cadre of qualified staff to the Directorate as well as re-organizing its functions and providing on-going skills training, has been key in ensuring that administration reforms are sustainable over time.

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## Key Stages of Reform

Following the creation of the KCCA there were a number of reforms that were undertaken in a phased approach, as illustrated by Table 1. Each of the important stages are further elaborated as part of this brief.

Year	Major Milestone	Rationale
2011	Restructuring of the Kampala City Council to the Kampala Capital City Authority. Established a Directorate of Revenue Collection. Evaluated the performance of outsourced revenue contracts	Separate out and streamline the structure of the revenue collection for the city.
2012	Conducted an assessment of revenue administration. Undertook mass taxpayer identification	To identify efficient performing revenue lines and contracts. Introduced a massive taxpayer education and sensitisation programme.
2013	Procured an electronic revenue management system (e-Citie) Introduced mobile money payments for tax. Introduced a debt collection strategy	To ameliorate the negative consequences of having manual systems.
2015	Established a large taxpayer office with an audit function. Institutionalised debt collection.	Re-establishing a focus on the five main revenue sources and the top tax payers.
2016	Embarking on a computer based mass registration and valuation of properties in Kampala. Start exploring alternative financing mechanisms.	To replace old expired valuation rolls (the last full valuation was carried out in 2005).

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## Digitised databases

Where administration reforms have been effective in other contexts, there has been a number of disadvantages in manual tax administration, such as delays in reconciliation of client ledgers, error-prone billing systems, and overall poor service delivery for the client (Sserunkuuma, 2016). The KCCA, therefore, decided to introduce digitisation alongside an overall effort to improve service delivery through automation of revenue collection. To do this, they implemented an electronic revenue management system, eCitie, that allowed for automatic billing, reconciliation, and generation of receipts, and that sent

**An electronic revenue management system, eCitie, allowed for automatic billing, reconciliation, and generation of receipts, and sent out a reminder to taxpayers when they needed to pay their bills**

<sup>1</sup> Adapted from Musoke, P. (2017) *Kampala Financial Recovery Journey*. Presentation given in Hargeisa, Somaliland – October 2017.

out a reminder to taxpayers when they needed to pay their bills. At the back-end, the system generated management reports for the Directorate and could automatically flag which taxpayers were in arrears.

As part of the system, the city rolled out its own taxpayer identification numbers. Although there is already an existing system of national tax identification numbers in Uganda, there is a very low registration rate. The KCCA noted that if they relied on this, they may be restricting their tax base. Therefore, the online system allowed for an automatic generation of a number as soon as any client registered with the system. This number gives the taxpayers access to their accounts which they can recall to understand which payments they need to make and when. Furthermore, given that in a developing country city like Kampala, there is no guarantee that people will be able to access the internet, the account can be accessed via mobile phone through sending an SMS. All this information feeds into an overall revenue database that has replaced manual record keeping. The KCCA estimates that through this reform alone, it was able to double its revenues from Commercial road user fees from 800 million UGX (over 222,000 USD) to over 1.6 billion UGX (over 444,000 USD)

This system itself required an upfront capital investment of about USD 2.75 Million (approximately UGX 9.9 billion). However, it is important to highlight that in procuring the system, the KCCA opted for one with open source code. This way an in-house technical team could operate, fix and further develop the system according to the KCCA's future needs. This has reduced the overall future cost as it has meant they are not tied to any specific supplier's services and eliminated the need for annual subscription fees.

It is important to note that simply digitising payment systems will not automatically make the tax administration more effective. On the contrary, if it is too complex and not appropriate for the existing organisational structures, it can actually have adverse effects on collection. There is therefore need to continuously review and streamline the relevant forms that are required to ensure they remain appropriate for the new systems.

Finally, it is critical that those who are meant to use the system are trained to use the technology in the most optimal way possible, ensuring that it becomes a support rather than a burden to the overall system. This is a core part of the KCCA's training programme.

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## In-house revenue collection

With well-trained and qualified staff, revenue collection was brought in-house, having previously been outsourced to individual contracting firms. To effect this from the outset, the Directorate decided to cancel all existing out-sourced contracts (Kopanyi 2015). However, the applicability of this reform in other contexts may vary. Research has clearly shown the benefits of separating the function of any entity that is collecting taxes, so that there is as much autonomy as possible between officials dealing with the revenue and those who are spending the taxes (Bird 2010). However, there is debate in the literature

on whether outsourcing or conducting revenue collection as part of a local authorities' primary function is preferable.

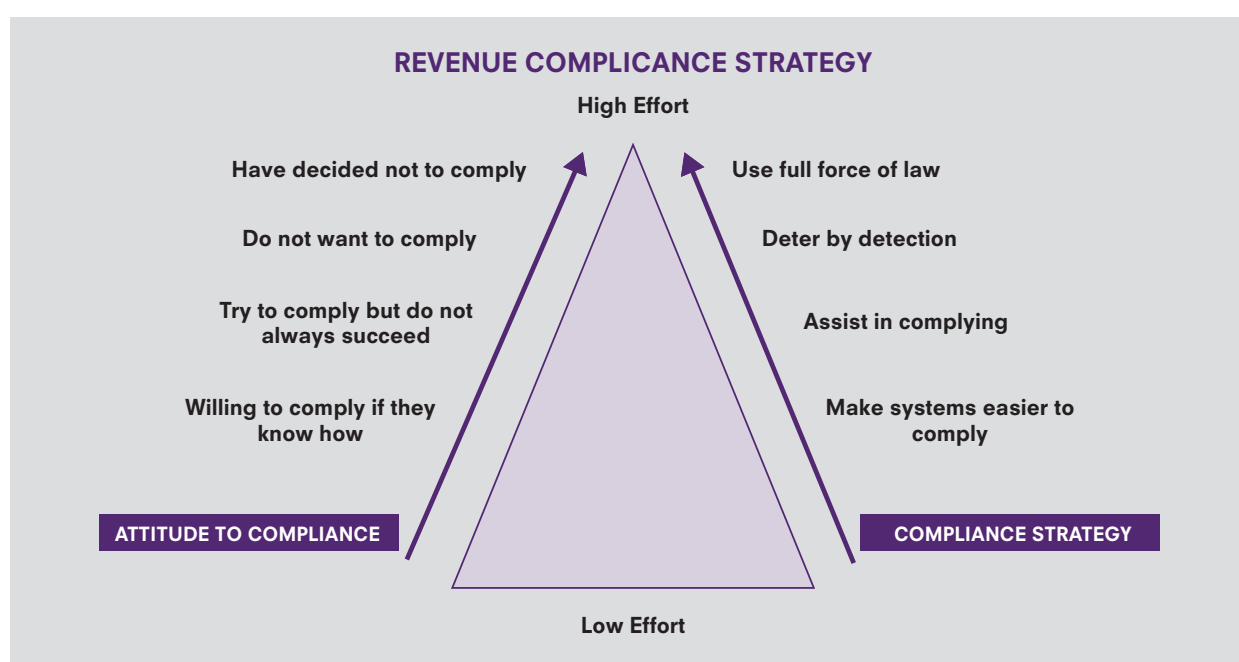
In Kampala, the lack of oversight of the outsourced contractors was a major source of leakage in revenue, coupled with weak contracts. This led to the decision to carry out collection in-house.

## The taxpayer as the client

One of the biggest challenges that the KCCA faced in tax administration reform, aside from re-equipping the staff with the appropriate skills and the up-front capital investment, was re-engaging taxpayers and getting them to use the system. Tax morale was low in the city due to the years of corruption and the overall efforts that were needed to meet their tax obligations.

Where administration reforms have been effective in other contexts, there has been a shift in organisational focus towards viewing the taxpayer as a client who requires good services (Bird 2010). The better the service provision, in the form of simple and transparent payment mechanisms, the more likely taxpayers are to comply, as it becomes more convenient for them to do so.

This view has been adopted by the KCCA as well. From the outset, they carried out extensive evaluations to understand what influenced tax payer behaviours, such as economic factors, which businesses they worked for and their level of education. Then they worked on segmenting taxpayers by their attitudes to compliance and using this to assess what interventions would be required to ensure compliance. The more taxpayers willingly comply with the system, the less effort and cost will be needed for enforcing compliance (see diagram 1). The KCCA's strategy was to focus on meeting the needs of the widest base of those who were willing to comply and then progressively work towards the more difficult strata.



For example, the Directorate implemented services that included being able to pay taxes through instalments, which made it more affordable to some of their clients. Through a review of their data, they noted that approximately 70% of their revenue was actually being generated by 20% of their clients. Therefore, to support them, they set up a dedicated office for large taxpayers that provide premium services. This office provides dedicated relationship managers for each of the payers.

To widen their tax base, the Directorate of Revenue Collection has also instituted a number of communication campaigns. These focus on helping the taxpayer understand why paying taxes is important to the city and how their taxes are being spent. After seeing an increase in voluntary compliance, these targeted communications and overall taxpayer engagement have been streamlined within the Directorate's annual plans.

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## Underlying conditions for success

Underlying the success of these reforms were three key enabling conditions:

- 1 An enabling environment for reform**, with the necessary understanding of the importance of revenue administration reform and how this could be achieved, and the needed political backing to achieve these.
- 2 Adequate resources for cost-effective administrative reform.**

Substantial investments have been required in Kampala to raise administrative capacity, bring collection in-house and invest in new systems. However, these up-front capital investments to increase collection have been largely recovered through higher revenues within one year (Kopanyi 2015).

At the same time, the DRC's costs of operation increased from 1.1% in 2011 to 11.21% of collection by 2014 (Kopanyi 2015). Though this is an extremely large increase in costs, and further reforms are still needed to reduce costs of collection, resultant improvements in revenue collection mean that the KCCA has now moved from a low cost but unsustainable revenue collection to a higher cost sustainable system.

- 3 Realistic reforms: a focus on main revenue sources and incremental reforms**

Simplification and streamlining of procedures is a key component of improving tax administration and thus increasing revenues collected. They started by identifying their top major sources of revenue and those which were more efficient in terms of cost of collection. They termed this their 80:20 strategy, i.e. identifying the top sources that were generating 80% of their revenue. They decided to focus on enhancing these at the same time as reducing the overall number of taxes they were collecting, which at the time was more than 20 different ones.

**Up-front capital investments to increase collection have been largely recovered through higher revenues within one year**

**The KCCA started by identifying the major sources of revenue. They termed this their 80:20 strategy, - identifying the top sources that were generating 80% of their revenue**



Having a large number of small taxes is often a defining characteristic of developing country municipal systems. This is done with little consideration that the costs of collecting each of these taxes both for the authority and the tax payer are relatively high and the efficiency relatively low. Furthermore, the larger number of taxes are collected, the increased nuisance these may be to the tax payer and may reduce their willingness to comply overall. When implementing modifications to tax administration, it is important to ensure that all costs are taken into account: both the cost for the entity administering the tax as well as the cost of compliance for the taxpayer. Additionally, all reforms will have to adequately acknowledge the fact that tax administration in itself represents a complex interaction between public and private actors (Bird 2013). Therefore, just implementing new taxes does not mean that automatically revenue will increase. Therefore, the strategy to focus on the top yielding revenue source was to benefit both the authorities, reducing their costs of collection, and the tax payers, to reduce their costs of compliance.

Additionally, in order to sensitise the staff and ensure the reform was successful and any glitches could be handled effectively, the eCitie platform was rolled out incrementally. The platform was purchased in 2012, and it took a year to fully be implemented. Following this, the KCCA progressively rolled it out for different payments, prioritizing those that had the highest revenue potential and where they had noted there were the most arrears. Therefore, they started with digitising the commercial road user fees, followed by trading licenses and one time payments. The current stage, expected to be completed by the in 2017, includes local hotel fees, local service tax and outdoor advertising.

## Future Reforms

The outlined reforms helped KCCA to increase its own-source revenue by over 100% from less than 40 billion UGX (approximately 11 million USD) in 2011/12 to 85 billion UGX (approximately 23.5 million USD) in 2014/15 (Kopanyi 2015). By comparison, most local authorities in developing countries would look at a 10% increase per year, (or 46% compounded increase over four years) as a success (Kopanyi 2015). This impressive growth was achieved without changing any legislation or policy; rather the focus of the KCCA's initial reforms were solely in the realm of tax administration. Although the KCCA went through a series of reforms, each of these individually contributed to the increase in revenue and can be used as an example by other cities on how tax administration can be reformed. Therefore, it offers an example of how a developing country municipal authority can shift to adopting administration and procedures comparative to most developed countries and through this be able to sustainably increase its revenues.

The KCCA is continuing to implement administrative reforms for enhancing revenue collection. Some of these improvements, such as establishing a computerised fiscal cadastre, are to support larger reforms that are taking place within land and property tax systems. Others, such as the current rollout of a street addressing system, will be an important component in expanding in the city's tax base (Freire and Garzon 2014)

## In Summary

The case study of the KCCA underscores the importance of improvements in administration efforts to increasing overall revenue. Furthermore, such reforms are in general easier for authorities to implement and can usually be done even when they may not have the power to influence policy and legislation.

Reforms in any area, including tax administration, will require an enabling political environment to implement. Furthermore, such reforms are one-off measures and therefore will not provide continued increases in revenue over time. Therefore, in the medium to long run, local authorities will also have to engage with reforming tax policy as well as addressing institutional and legal constraints to their efforts in order to ensure continued increases in municipal revenues.

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