Towards Sustainable Development

POLICY BRIEF

Why informal sector enterprises in Uganda do not want to register

Executive Statement

This brief presents the nature, extent, and reasons why Micro, Small and Medium enterprises remain informal in Uganda. The findings reveal that Uganda has two types of informality, namely legal and fiscal, characterized by absence of a trading license due to non-registration by the Uganda Registration Services Bureau and Local Governments. Besides legal informality, businesses in Uganda can also be fiscally informal, meaning that they are not registered with Uganda Revenue Authority and hence do not pay taxes. In this regard, the evidence reveals that 30.1 percent of informal businesses are not registered with Local Authorities, 91.7 percent are not registered with URSB, 99.2 percent are not registered with URA and 26.3 percent do not have a trading license. The reasons businesses put forward for non-registration include; perceived high cost of business registration with authorities; lack of incentives to attract business to register; poor service delivery within Local Governments and absence of a supportive policy and legal framework for reducing informality in the country. Given the above reasons, there is a need to increase business awareness about the benefits of registration through mass media campaigns. In addition, Government needs to deepen coordination and institutional funding to enable URSB, URA and Local Governments to widen the scope of business registration.

Introduction

Micro, Small and Medium Enterprise (MSMEs) play a crucial role in the Ugandan economy, constituting 90 percent of private sector production and employing over 2.5 million people. Furthermore, MSMEs play a critical role in knowledge transfer, industrialisation, export promotion and domestic resource mobilisation. Despite their importance, most operate in the informal sector. According to the World Bank (2020), the informal sector encompasses businesses, workers and activities operating outside the legal and regulatory systems or frameworks of the laws of the land. The informal sector in developing countries comprises more than unregistered street vendors and tiny businesses; it includes several established businesses employing hundreds of people across a diverse range of sectors while going untaxed. In essence, these businesses or activities have not been registered by regulatory institutions like the Uganda Revenue Authority (URA), Uganda Registration Services Bureau (URSB), and Uganda National Bureau of Standards (UNBS), just to mention a few. The informal sector contributes about 49 percent to the country’s GDP, however, less than 1 percent is collected as taxes from the sector. Therefore, the government loses a significant amount of tax revenue. Furthermore, it is estimated that 80 percent of the economy is informal. Thus, the tax burden falls on the remaining 20 percent. Therefore, there is a huge benefit to the current taxpayers and the tax collector.
in the formalisation of the informal sector.

There are several benefits that businesses can gain from registration. The first relates to access to capital and investment funding from financial institutions and donors. This is because the registration of a business establishes it as a separate legal entity from the owner; thus, the individual’s liability is limited. Secondly, registered businesses attract business entities because they feel more secure when dealing with legally registered entities. In addition, registered businesses can bid for different contracts from the Government and Private sector. Finally, there is easy access to an investment licence and other incentives.

There have been previous attempts by the Government and development partners to formalize MSMEs. The most notable effort has been the Tax Register Expansion Program (TREP), which enabled a collaboration of three Government entities (URSB, URA, Kampala Capital City Authority (KCCA), and the Ministry of Local Government (MoLG)). A key shortcoming of this programme is its failure to reach rural businesses in the informal sector.

This policy brief is based on a 2021 study conducted by the Economic Policy Research Centre (EPRC) titled “Assessment of Informal Businesses in Uganda.” See details about the study at eprcug.org/publication/assessment-of-informal-businesses-in-uganda/?wpdm dl=15332&refresh=65b752bb2e5921706513083. The objective of this policy brief is to highlight the key reasons why Ugandan business owners choose not to register their businesses.

Extent of Informality

Before exploring why business owners in Uganda do not register their businesses with local responsible authorities, this brief examines the extent and types of informality in Uganda. Uganda has two kinds of informality, namely legal and fiscal; where legal informality refers to a business that is not registered with URSB and Local Governments and does not have a trading licence, and fiscal informality refers to a business that is not registered with URA and does not fulfil its tax obligations. Businesses may cycle in and out of informality. Businesses may be informal across any or both dimensions.

Indeed, the evidence presented in Figure 1 suggests that 30.1 percent of informal businesses are not registered with Local Authorities, 91.7 percent are not registered with URSB, 99.2 percent are not registered with URA and 26.3 percent do not have a trading licence.

The URSB Act Cap 210 mandates the Bureau to register all business entities in Uganda that are required by law to be registered; this has not been the case. According to Figure 2, 7.2 percent of the informal businesses have been registered by both Local authorities and URSB, 62.7 percent have been registered by Local Authority but not URSB, 1.1 percent have been registered by URSB but not the Local Authority, and 29 percent have been registered by neither. It is important to note that the Local Authorities have formed a strong platform for registration, this may be because they are relatively closer and accessible to businesses. There is also a perception that URSB is expensive and caters only for a specific group of businesses. Furthermore, Local Authorities enjoy a high degree of trust and legitimacy among the population.
Figure 3 suggests that 71 percent of the informal businesses are only fiscally informal, 0.8 percent are only legally informal, and 28.2 percent are both fiscally and legally informal. There is a high incidence of fiscal informality meaning that very few businesses are registered with URA. The reason for this may partly lie in business owners not feeling they are getting value for money in service delivery. The Government can sensitise business owners with justification of the tax expenditures. The messaging should improve.

### Reasons for non-registration

Despite the benefits of business registration pointed out earlier, several businesses still prefer not to register their business for several reasons.

#### A. Poor perceptions on the cost of business registration

(i) Perceptions about registration fees

Findings showed that, non-registered businesses believe registration fees are most costly at URA (UGX 224,967), followed by URSB (UGX 168,238) and least costly at the local authorities (UGX 50,113). Interestingly, registration for a TIN at URA is free, and registration costs at URSB do not exceed UGX 24,000 for a sole proprietorship and UGX 60,000 for a limited company.

(ii) Perceptions about annual tax payment by already registered businesses

The mandatory requirement to pay taxes upon registration has been documented in literature as a hindrance to registration by non-registered businesses (Suresh et al., 2013). According to Figure 4, non-registered businesses perceive that registered businesses pay an annual average of UGX 357,019 in taxes. However, this is not the case; presumptive tax in Uganda may range from UGX 16,448 to UGX 40,640, depending on the sales turnover. This points to the fact that there is a tax education gap in informal businesses.

(iii) Perceptions about compliance costs

There is also evidence that the perceptions of non-registered businesses about how much they think the registered businesses incur to comply with payment obligations at the different agencies affects business registration. According to Figure 4, perceptions about compliance costs for URA averaged UGX 91,454, while compliance costs for Local Authorities averaged UGX 47,108. One possible reason for this, is that URA offices tend to be located in urban areas,

![Figure 3: Fiscal and legal informality, %](source: Informal Business Survey 2021)

![Figure 4: Business owners’ perceptions of registration costs](source: Informal Business Survey 2021)
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far from non-registered businesses, while Local Authorities have their offices much closer to the businesses; thus, there is an information gap.

(v) Perceptions about distance to registration points

Figure 6 shows that non-registered business owners may need to move an average of 16.6 km to access URA services. The fact that URA registration is done online exacerbates the situation, as informal business owners may not have access to smartphones and internet services, which are expensive. On the contrary, the average distance to the nearest Local Authority is only about 2.7 km.

There is a need for more sensitisation/outreach programmes from URSB, mainly to explain their mandate to the business communities. The programmes should not be selective but rather engage the entire business community. Additionally, there is a need for at least one URA and URSB office at district and local governments to make it easy for business owners to register their businesses with these two entities. (Extract from MoFPED, 2022)

B. Expected benefits that come with remaining informal

Flexibility and independence, especially for self-employed individuals, may constitute some of the reasons why businesses do not register. According to (OECD, 2007), regulatory, administrative, fees, and financial requirements are the major hindrances to small business formalisation in developing countries. Figure 4 suggests that businesses that remain informal in some way benefit from being outside of the regulatory and administrative reach of local authorities. In detail, Figure 4 shows that 22 percent of the informal businesses that are fiscally or legally informal benefit from low operating costs, 19 percent of
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the businesses that are fiscally and legally informal benefit from flexibility in the working environment, 58 percent of the businesses that practice all forms of informality benefit from the fact that their businesses will not be exposed to third parties.

Figure 8 shows that of the businesses included in the study, 35 percent offer prices lower than registered firms. This is partly because informal businesses incur lower operating costs than registered firms. Thus, they can afford to charge a lower price. Indeed, unregistered business owners stated as below;

*When you register, you are exposed to high taxes, and in the process, you lose customers to competitors because you have to put your prices higher to meet the tax requirement. When a business has a small capital, it prefers to stay hiding than being exposed and forced to pay taxes.*

(Extract from MoFPED, 2022)

C. Business environment incentives

The pre-existing constraints in the business environment also incentivise informality in Uganda. A review of the EPRC quarterly Business Climate Index (BCI) reports undertaken between 2012 to-date reveals that, over the past 9 years, Uganda’s business environment has remained constrained by high electricity costs and outages, unfavourable tax policy, high cost of credit, increasing competition from substandard products as well as corruption and bribery.

Previous efforts to register businesses have also been uncoordinated and required business owners to visit multiple registration centres, resulting in valuable work time and money losses. Regarding the high cost of credit, evidence suggests that only 14 percent of business firms have ever listed on the stock market to raise working capital (EPRC, 2019). The remaining 86 percent have never used this channel to raise capital, primarily due to a lack of knowledge of how the stock market works.

D. Absence of supportive policies and laws for reducing informality

Uganda currently lacks a clear national policy on the informal sector (Muwonge et al., 2007). Due to a lack of this framework, limited information dissemination exists on the legal and regulatory practices, including registration procedures for the informal sector businesses. Besides lacking a regulatory and institutional framework to address informality, abrupt changes in the business regulatory environment have resulted in informality. UNCDF (2018) reported that introducing an excise duty on mobile money transactions comprising receipts, payments, and withdrawals at a rate of 1 percent of the transaction value in 2018 reversed gains made in formalising the agriculture, education and rural finance and energy sectors. Introducing
this tax increased the operating costs of 71 percent of businesses (EPRC, 2017). A Key informant Interview also suggested that the legal provisions such as “confidentiality of financial details of eligible taxpayers, e.g. bank details”, have shielded several potential taxpayers” (KIlIs, Monday, February 14th, 2022).

4. Conclusion and Policy Recommendations

This brief highlights why business owners prefer not to register their businesses. We recommend the following policy actions to facilitate business registration.

a) Raise awareness; sensitise the business communities about the benefits of registration, the costs, and the procedures involved. This can be done through radio programmes, meetings and workshops, and announcements through public speakers mounted on vehicles and motorcycles. Sensitisation will also help business owners bypass several hidden costs at the registration stage and improve perceptions of the cost of doing business.

b) Reduce the paperwork involved in the registration process and avoid requests for unnecessary information asked at the point of registration. Several Government agencies usually ask for similar information, which frustrates business owners. The government should take advantage of advancements in technology to enhance registration. This will also reduce the paperwork involved during registration and enable data sharing among different agencies.

c) Stronger collaborations between registration institutions like URSB, URA, and Local Governments. Since local authorities are closer to the local population, URA and URSB could locate their offices within Local Government offices to bring services closer to the people.

Endnotes

2 https://globaldev.blog/taxation-and-informality-gap-uganda/
4 https://www.independent.co.ug/uganda/80-of-economy-is-informal-only-20-of-businesses-pay-taxes/
5 https://www.standardbank.co.ug/uganda/business/business-info-hub/insights-for-business/Ursee%20whether-to-register-your-business%20%27s
6 https://web.ura.go.ug/Pages/Home%20page%20services/How%20to%20get%20a%20TIN%20%20Taxpayer%20Identification%20Number%20(TIN).aspx
7 https://ursb.go.ug/tins