Tax Justice Network-Africa & ActionAid International

Tax competition in East Africa: A race to the bottom?

Tax incentives and revenue losses in Uganda

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About TJN-A

Tax Justice Network-Africa (TJN-A) is a Pan-African initiative established in 2007 and a member of the global Tax Justice Network. TJN-A seeks to promote socially just, democratic and progressive taxation systems in Africa. TJN-A advocates pro-poor taxation and the strengthening of tax regimes to promote domestic resource mobilization. TJN-A aims to challenge harmful tax policies and practices that favor the wealthy and aggravate and perpetuate inequality.

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The government of Uganda is providing a wide range of tax incentives to businesses to attract greater levels of foreign direct investment (FDI) into the country. Yet this study shows that such tax incentives are leading to very large revenue losses and are not needed to attract FDI.

Estimating the revenue loss from tax incentives in Uganda is difficult since there are different estimates available in the public domain and there is a lack of government transparency in this area. The African Development Bank (AfDB) estimates that losses from tax incentives and exemptions are "at least 2%" of GDP. This amounts to around UShs 690 billion (US$272 million) in 2009/10. The country is therefore being deprived of badly-needed resources to reduce poverty and improve the general welfare of the population. These revenue losses amount to nearly twice Uganda's entire health budget in 2008/09 – a serious situation when average per capita incomes are just US$500 and a quarter of the country's 34 million population lives in poverty (less than US$1.25 a day).

Uganda's provision of tax incentives is part of the tax competition among the members of the East African Community (EAC). Following the EAC's re-establishment in 1999, Kenya, Tanzania and Uganda created a customs union (a duty-free trade area with a common external tariff) in 2005, and were joined by Rwanda and Burundi in 2009. This has created a larger regional market, and means that firms can be located in any EAC country to service this market. At the same time, however, countries are being tempted to increase tax incentives in order to attract FDI and, they believe, increase jobs and exports. Our analysis suggests that the provision of tax incentives across the East Africa region represents harmful tax competition and may be leading to a "race to the bottom".

Uganda provides a range of tax incentives for companies exporting – such as import duty and stamp duty exemptions – and offers corporate income tax holidays for certain categories of businesses, such as companies engaged in agro-processing and those exporting finished consumer and capital goods. The Free Zones Bill of 2002, which is

still awaiting final Cabinet approval, intends to create free trade areas and offer a range of generous tax incentives.

Analysis suggests that the primary beneficiaries of Uganda's tax exemptions and incentives are large domestic firms and foreign multinational companies. Yet a 2006 report by the African department of the International Monetary Fund (IMF), focusing on East Africa, notes that "investment incentives – particularly tax incentives – are not an important factor in attracting foreign investment". More important factors are good quality infrastructure, low administrative costs of setting up and running businesses, political stability and predictable macro-economic policy. It is unlikely that Uganda's attraction of more FDI than its neighbours, Kenya and Tanzania, is due to its use of tax incentives. Kenya and Tanzania provide greater tax incentives than Uganda, but receive less FDI.

The government is formally committed to reducing tax incentives and exemptions, which is certainly welcome. However, it is moving slowly and the extent to which this commitment will actually be implemented is questionable.

In our view, the government should:

- Remove tax incentives granted to attract FDI, especially tax holidays.
- In the oil sector, make public all the production sharing agreements (PSAs) and subject these to public review, with a view to eliminating the fiscal incentives provided, and to ensure that all future PSAs are shared and debated publicly.
- Undertake the promised review, which should be made public, of all tax incentives with a view to reducing or removing many of them, especially those that involve the exercise of discretionary powers by ministers.
- Provide on an annual basis, during the budget process, a publicly available tax expenditure analysis, showing annual figures on the cost to the government of tax incentives, and showing who the beneficiaries of such tax expenditure are.
- Take greater steps to promote coordination in the EAC to address harmful tax competition.

Abbreviations

AfDB	African Development Bank
AU	African Union
EAC	East African Community
EPZ	Export processing zone
FDI	Foreign direct investment
FTA	Free trade area
GDP	Gross domestic product
IMF	International Monetary Fund
PSA	Production sharing agreement
UNCTAD	United Nations Conference on Trade and Development
URA	Uganda Revenue Authority
VAT	Value added tax

Introduction

The government of Uganda is providing a wide range of tax incentives to businesses to attract greater levels of foreign direct investment (FDI) into the country. Yet this study shows that such tax incentives are leading to very large revenue losses and are at any rate not needed to attract FDI.

Estimating the revenue loss from tax incentives in Uganda is difficult since there are different estimates available in the public domain and there is a lack of government transparency in this area. The African Development Bank (AfDB) estimates that losses from tax incentives and exemptions are "at least 2%" of GDP.[1] This amounts to around UShs 690 billion (US$272 million) in 2009/10.[2] The country is therefore being deprived of badly-needed resources to reduce poverty and improve the general welfare of the population. This is critical when average per capita incomes are just US$ 500 and when a quarter of the country's 34 million population lives in poverty (less than US$ 1.25 a day).[3]

The report also shows that it is unlikely that Uganda's attraction of more FDI than its neighbours, Kenya and Tanzania, is due to its use of tax incentives. Kenya and Tanzania provide greater tax incentives than Uganda, but receive less FDI.

In 2009/10, Uganda collected UShs 4.07 trillion (US$1.6 billion) in tax revenues, mainly from income taxes, VAT and excise taxes, which amounted to 11.8% of GDP.[4] However, estimates suggest that collections could increase to 16% if tax collection were improved and if some of the revenue-negating measures, such as tax incentives, were removed.[5] The gap between current and potential collections is enormous, amounting to UShs 1.46 trillion (US$582 million).[6]

Uganda's provision of tax incentives is part of the tax competition among the members of the East African Community (EAC). Following the EAC's re-establishment in 1999, Kenya, Tanzania and Uganda created a customs union (a duty-free trade area with a common external tariff) in 2005, and were joined by Rwanda and Burundi in 2009. This has created a larger regional market, and means that firms can be located in any EAC country to service this market. At the same time, however, countries are being tempted to increase investment incentives in order to attract FDI and, they believe, increase jobs and exports. As a 2006 IMF report notes:

> *"Increased competition over FDI and growing pressure to provide tax holidays and other investment incentives to attract investors could result in a 'race-to-the-bottom' that would eventually hurt all three [ie Kenya, Uganda and Tanzania] EAC members. Left unchecked, the contest could result in revenue loss, especially in Tanzania and Uganda, and threaten the objective of improving revenue collection."*[7]

Our analysis suggests that this is indeed happening and that the wide range of tax incentives provided by Uganda and its fellow member states in the EAC are indeed leading to a "race to the bottom".

Tax incentives

A tax incentive is defined as "a deduction, exclusion or exemption from a tax liability, offered as an enticement to engage in a specified activity such as investment in capital goods for a certain period".[8] Tax incentives are the fiscal form of investment incentives and include corporate income tax holidays and reductions in tax rates. Non-fiscal or non-tax incentives include direct subsidies like government grants, loans and guarantees for target projects. Tax incentives are granted to attract FDI and/or to promote specific economic policies, such as to encourage investment in certain sectors.

Investment incentives[9]

Corporate income tax incentives

- Tax holidays or reduced tax rates
- Tax credits
- Investment allowances
- Accelerated depreciation
- Reinvestment or expansion allowances

Other tax incentives

- Exemption from or reduction of withholding taxes
- Exemption from import tariffs
- Exemption from export duties
- Exemption from sales, wage income or property taxes
- Reduction of social security contributions

Financial and regulatory incentives

- Subsidised financing
- Grants or loan guarantees
- Provision of infrastructure, training
- Preferential access to government contracts
- Protection from import competition
- Subsidised delivery of goods and services
- Derogation from regulatory rules and standards

1. Tax incentives in Uganda

Tax incentives and exemptions are mainly provided for under the Investment Code, 1991, the Income Tax Act and the Value Added Tax Act.[10] **All investors** with a licence from the Uganda Investment Authority:

- are exempt from import duties and VAT on imports of any plant, machinery, equipment, vehicles or construction materials for an investment project
- receive a VAT refund on building materials for industrial/commercial buildings
- are given "first arrival privileges" in the form of duty exemptions for personal effects and a motor vehicle (previously owned for at least 12 months).[11]

Incentives granted to **companies exporting** include:

- import duty exemption on plant and machinery and other inputs
- stamp duty exemption
- duty draw back – which allows a refund of all or part of any duty paid on materials and inputs imported to produce for export
- withholding tax exemptions on plant and machinery, scholastic materials, human and animal drugs, and raw materials.[12]

The Income Tax Act (ITA) specifies businesses and individuals that are exempt from **corporate income tax** and withholding tax.[13] Most significantly:

- Businesses engaged in agro-processing or managing or running an educational institution are exempt from corporate income tax with no time limit.
- Companies exporting finished consumer and capital goods – when exports account for at least 80% of production – are exempt from corporate income tax for ten years.[14]

The **Free Zones Bill** of 2002, which will authorise the creation of free trade areas (FTAs) is still awaiting final Cabinet approval.[15] Businesses operating in these zones will be entitled to a range of tax incentives such as:

- a 10-year corporate income tax holiday

- duty exemption on the import of raw materials, plant and machinery, and other inputs
- stamp duty exemption
- duty drawback to apply on import of goods from the domestic tariff area
- no export tax on exported goods
- exemption of withholding tax on external loans
- the ability to repatriate dividends to get relief from double taxation.[16]

At least 35 goods and services – including petrol, diesel, gas, computers and software – are **VAT exempt**.[17] The standard rate of VAT on taxable supplies is 18%.

Uganda offers further incentives to companies operating in specific sectors (see box below).

Some sector-specific tax incentives in Uganda

Mining[18]

- Mining companies are given special consideration through a variable rate income tax (VRIT). A minimum of 25% and a maximum 45% VRIT have been put in place depending on the level of profitability.
- Duty free import of mining plant and equipment with VAT deferment facilities.
- Mineral exploration expenditures are expensed 100%.
- Import taxes such as customs duty for all mining equipment are zero-rated.
- Depreciation allowance for all depreciable mining assets is 30%.

Forestry[19]

- The Income Tax Act exempts interest earned by a financial institution on a loan granted to any person for the purpose of forestry from withholding tax.

Floriculture[20]

- There is 0% import duty and VAT deferral on import of a complete unit of a green house.
- Flower exporters get a 10-year tax holiday (awaiting approval of relevant regulations).
- Tourism[21]
- The supply of accommodation in tourist lodges and hotels outside Kampala district is exempt from VAT.
- Equipment imported for use in licensed hotels is exempt from customs duties.
- Large-scale enterprises receive a tax waiver on fuel used in the generation of power for business operations.

Uganda's oil tax regime

Exploration activities led to major oil discoveries in the Lake Albert basin in western Uganda in 2006, following which proven reserves of 2 billion barrels have been identified. Uganda's nascent oil and mineral resources were previously governed by the Petroleum Exploration and Production Act 1985,[22] Petroleum (Exploration and Production) Regulations 2003, and the Uganda Mining Act 2003 (referred to below as the former framework). Oil operations are now governed by the Income Tax (Amendment) Act 2010 and the National Oil and Gas Policy, approved by the Ugandan Cabinet in 2008.[23] A draft

Petroleum (Exploration, Development, Production, and Value Addition) Bill 2010 is also pending enactment.

Exploration for oil was undertaken by, among other companies, the London-listed Heritage Oil which, upon discovery of oil reserves, sold all its Ugandan assets to another company, Tullow Oil, for US$1.45 billion.[24] The Ugandan government has consistently held that the transaction was incomplete until Heritage paid capital gains tax on the sale, while the company argued that it was not subject to this tax in Uganda. Uganda'senergy minister, Hilary Onek, was reported as protesting that "these guys are making super-normal profits. They just invested a tiny little figure of US$150 million and now they are going to earn US$1.5 billion. Why don't they want to pay taxes on that money?"[25] The resolution to this dispute has been the main reason for the delay in oil production in Uganda. In November 2011, Uganda won the first round of a legal case at the the Tax Appeals Tribunal, which agreed with the government that the US$435 million oil deal between Heritage and Tullow was indeed taxable.[26]

The capital gains tax dispute provoked some amendments to the ITA in October 2010.[27] The ITA now compels firms discovering oil in Uganda to pay capital gains tax on the sale of exploration rights (although the new Act will not be applied retrospectively).[28] The ITA also defines the deductible tax categories, including exploration, development and production expenditure.[29] It empowers the Commissioner General of the Uganda Revenue Authority to conduct impromptu special audits on any petroleum company for verifying tax compliance.[30] The law also requires companies to file quarterly, annual and in some cases monthly reports on production and revenue, prescribes penalties for breach of those obligations, and prescribes a formula for calculating withholding tax for various activities and also for the valuation of crude output for customs purposes.[31]

However, a full picture of the tax incentives offered in the oil sector is not known since the government has hitherto refused to make public the production sharing agreements (PSAs) it has signed with the oil companies, which include Heritage, Tullow, Dominion and Tower Resources. That said, some parts of some existing PSAs have been leaked, and are seen to include sweeping "stabilisation clauses" that protect companies from increases in taxes for the 20 years duration of the agreements.[32] Some estimates are that the government will earn large revenues from oil – perhaps around US$2 billion a year.[33] However, analysis by NGOs is that these earnings will not be as much as the government claims, that the principal beneficiaries will be the companies, and that the government could earn much more by improving the fiscal terms of the agreements.[34]

2. Winners and losers from tax incentives

A lack of transparency has long prevented the public scrutinising the extent of tax incentives. It is unclear precisely who the principal beneficiaries are, since there have been no official studies. Yet analysis suggests that the main winners are likely to be large domestic firms and foreign multinationals benefiting from the export-oriented incentives, and that the losers – due to revenue losses – are the general population and the country as a whole.

The winners

In September 2010, the Uganda Investment Authority (UIA) released a list of 300 investors who had benefited from government tax holidays and incentives. Dr Maggie Kigozi, the UIA executive director, forwarded the list to Parliament's Committee on Commissions, Statutory Authorities and State Enterprises as evidence in investigations into the circumstances under which the Uganda Revenue Authority (URA) had rejected incentives given to some investors. Dr Kigozi noted that the companies were officially given tax holidays even after the tax incentives were formally abolished in 1997.[35] The companies on the list included Roko Construction, Meera Investments, Alcon International, Cairo International Bank, Crane Bank, BMK Industries, Ankole UNGA, former Celtel Uganda and Hima Cement.[36]

Large firms as beneficiaries

A 2001 study looked at the impacts of Uganda's tax reforms in the mid-1990s on the prevalence of tax evasion and exemptions among firms, and their effects on the distribution of tax burdens. Based on data collected from 243 firms, the authors observed that evasion and exemptions were widespread and that exemptions benefited large businesses to a disproportionate degree, while evasion is more common among small businesses. This created a situation where medium-sized firms bore a disproportionate tax burden. The study argued that the smaller tax base resulting from these exemptions meant higher tax rates and, consequently, a stronger incentive to evade them.

The study also noted that large firms were often in a stronger bargaining position with politicians and bureaucrats who granted the exemptions. As the tax bill of a large firm is bigger, the incentive to seek exemption is greater. Large firms are also unlikely to escape the attention of the tax authorities and thus also have a higher incentive to seek tax exemptions. Conversely, small firms will ordinarily not qualify for tax exemptions and are able to slip out of the tax collector's net; even when detected by the tax authority, enforcement costs for small firms can easily exceed the potential tax revenue collected.[37]

The losers

There are different estimates available in the public domain on the extent of revenue losses from Uganda's tax incentives and exemptions:

- The government admits to providing tax *waivers* amounting to US$6.5 million in 2010/11; these relate to exemptions granted to the payment of income tax and VAT.
- The EAC estimates losses from *import duty exemptions* to be around US$56.2 million in 2008, amounting to 0.4% of GDP.
- The AfDB gives a much higher estimate for losses from *tax incentives and exemptions* together – of "at least 2%" of GDP, or around US$272 million (see box).

Revenue loss estimates: different sources

Government

Budget speeches indicate that the government provided tax waivers worth UShs 18.7 billion (US$7.3 million) in 2011/12[38] and UShs 16.7 billion (US$ 6.5 million) in 2010/11.[39]

East African Community

The EAC provides figures on revenue losses from import duty exemptions, noting that Uganda lost revenues of US$56 million in 2008 and US$142 million in the three years 2006–08. The figure of US$56.2 million is equivalent to around 0.4% of Uganda's GDP.[40]

Import duty exemptions granted by Uganda 2005–08 (US$ millions)[41]

	2005	2006	2007	2008
Value of exemptions	178.8	174.0	217.5	211.4
Revenue foregone	33.1	36.4	49.4	56.2
Total trade taxes	586.0	682.1	919.1	1102.0
Percentage foregone	5.3	5.1	5.1	4.9

African Development Bank

According to a 2010 AfDB report, Uganda could be foregoing revenues of "at least 2%" of GDP as a result of tax incentives and exemptions.[42] This would amount to around UShs 690 billion (US$272 million) in 2009/10.[43]

3. Problems with Uganda's tax incentives

International organisations such as the African Development Bank (AfDB) and the IMF have joined with NGOs and others in criticising Uganda's tax incentives, calling for them to be reviewed and reduced. The IMF says that incentives have been granted "in an ad hoc fashion to individual sectors and firms".[45] The AfDB notes that tax exemptions have been granted in Uganda "with no specific deadline or details about who they apply to".[46] For our analysis, the key point is that tax incentives are not necessary to attract foreign investment.[47]

Why tax incentives are not necessary

Proponents of tax incentives often argue that lower tax burdens give investors a higher net rate of return and therefore free up additional income for re-investment. The host country thus attracts increased FDI, raises its income and also benefits from the transfer of technology. A further argument, particularly in relation to the less developed countries, is that it is imperative to provide incentives to investors given the otherwise poor investment climate: the volatility in politics, dilapidated infrastructure, the high cost of doing business, the macroeconomic instability, corruption and an inefficient judiciary. Revenue losses are rationalised by arguing that the capital and jobs created will improve the welfare of citizens and expand the economy.

However, the list of the disadvantages of tax incentives is long, as outlined in a recent IMF report. It argues that they:

- result in a loss of current and future tax revenue
- create differences in effective tax rates and thus distortions between activities that are subsidised and those that are not

- could require large administrative resources
- could result in rent-seeking and other undesirable activities
- could, in the case of income tax holidays, be a particularly ineffective way of promoting investment. Companies that are not profitable in the early years of operation, or companies from countries that apply a foreign tax credit to reduce the home country's tax on the foreign source income, would not benefit from income tax holidays. In contrast, such holidays would be of less importance to companies that are profitable from the start of their operation
- could attract mainly footloose firms
- can be outside the budget and non-transparent[48]

Tax incentives tend to reduce government revenues by 1–2% of GDP, according to the Organisation for Economic Co-operation and Development (OECD.[49] The IMF notes that investment incentives, if they are to be of benefit, should be well-targeted and focused narrowly on the activities they seek to promote but that "the corporate income tax holiday usually does not meet the criterion of a well-targeted incentive."[50] Tax holidays strongly favour transitory rather than sustainable investments and create glaring opportunities for aggressive tax avoidance.[51] A joint report by the IMF, OECD, UN and World Bank comes to the same conclusion, noting that, where governance is poor, corporate income tax exemptions "may do little to attract investment" and when they do, "this may well be at the expense of domestic investment".[52]

The application of different rules and procedures complicates tax administration and increases costs. Where the administration of tax incentives is abused, as is often the case, there are also social costs caused by corruption and rent -seeking.[53] Tax incentives are also prone to abuse when the incentive is exhausted and the promoters of the business fraudulently wind it down and simultaneously establish another entity to be accorded the same tax incentives. Tax incentives also tend to favour elite private investors who have adequate capital of their own.[54] In addition, once incentives have been selectively granted, sectors that consider themselves excluded will agitate for inclusion, widening the incentives still further. Once incentives are provided, they are politically difficult to remove. In some cases, incentives are a further waste of resources in that many companies would invest anyway, without the incentive. Generally, investment incentives are recommended when the business is in the nature of a public good, such as with projects for encouraging green technologies, primary health care and disease prevention, upgrading skills of workers and research and development.[55]

Attracting FDI in Uganda

> *"Studies... suggest that tax-driven investment does not provide a stable source of investment in the recipient country."*
>
> Joint IMF, OECD, UN and World Bank report for the G20, 2011 [56]

Evidence suggests that tax incentives are not needed to attract FDI. A 2006 report by the African department of the IMF, focusing on tax incentives in East Africa, notes that the above-mentioned list of disadvantages of tax incentives is:

> *"...supported by available empirical evidence which mostly confirms that investment incentives – particularly tax incentives – are not an important factor in attracting foreign investment".*[57]

The IMF report argues that countries that have been most successful in attracting foreign investors have not offered large tax or other incentives and that providing such incentives was not sufficient to attract large foreign investment if other conditions were not in place. The report also notes that in "specific circumstances, well-targeted investment incentives could be a factor affecting investment decisions" but that "in the end, investment incentives seldom appear to be the most important factor in investment decisions".[58] More important factors in attracting FDI are good-quality infrastructure, low administrative costs of setting up and running businesses, political stability and predictable macroeconomic policy.[59] A US State Department report notes that Uganda's potential for attracting larger amounts of FDI is hindered by weak infrastructure, a largely poorly-trained workforce, political interference, and high levels of corruption.[60]

Recent FDI in Uganda has been primarily drawn to the telecommunications, manufacturing, finance and energy sectors.[61] Besides attracting investments from European countries, Uganda is witnessing an increase in investments from China and India. This is attributed to the government's reducing of bureaucracy, streamlining the legal framework, addressing corruption and stabilizing the economy. Uganda has achieved higher inflows of FDI than its fellow EAC members, Tanzania and Kenya, in recent years, as shown in the table below. It is, however, unlikely that this is due to its provision of tax incentives. Both Kenya and Tanzania offer more generous tax incentives than Uganda, notably with regard to their EPZs. Indeed, this reasoning partly explains why the IMF, and other international organisations such as the AfDB, has been pressing

Uganda and other governments in East Africa to radically reduce their tax exemptions (see section 4).

FDI flows (US$ million)

	2006	2007	2008	2009	2010
Kenya	51	729	96	141	133
Tanzania	597	647	679	645	700
Uganda	644	792	729	816	848

Source: UNCTAD, *World Investment Report 2011*, Annex Table 1.1

The "race to the bottom"

Fiscal incentives imposed in one country can lead to tax competition among countries and a "race to the bottom", a process we are witnessing in East Africa. Tax competition can occur when firms are able to locate where tax rates are lowest, thereby encouraging other countries to lower their tax rates in order to retain and attract dynamic firms and able workers.[62] Tax competition can make it difficult for countries to maintain desired tax rates, leading to ever-declining tax rates and revenues. In both Kenya and Tanzania, for example, the governments are also granting massive tax incentives, partly in a competition to attract FDI, resulting in significant revenue losses for the government, as in Uganda. Tax rate disparities in the EAC have also encouraged illicit trade, complicated operational systems for companies wishing to carry on business throughout the EAC and slowed down the integration process.

Economic and finance ministers in the European Union have defined harmful tax competition as including factors such as: an effective level of taxation which is significantly lower than the general level of taxation in the country concerned; the presence of tax benefit categories reserved for non-residents; and tax incentives for activities that are isolated from the domestic economy and therefore have no impact on the national tax base.[63]

The EAC has taken some concrete steps to widen and deepen economic cooperation among its members, and Article 83 of the treaty establishing the EAC provides for monetary and fiscal harmonisation, including the removal of tax distortions. Tariff barriers between Kenya, Uganda and Tanzania, the original member countries, were removed in 1999, and

Rwanda and Burundi became members in 2007.[64] Yet Uganda, along with the other EAC members, is taking only limited steps to promote such fiscal coordination.

Uganda's narrow tax base

Reducing tax incentives would expand Uganda's narrow tax base. It is estimated that the 35 highest tax payers in Uganda account for around 50% of all tax revenue.[65] A large section of the economy is untaxed, especially the informal and commercial agricultural sectors. Uganda's revenue collection in the 2007/08 fiscal year was among the lowest in the East Africa region.[66] Actual VAT collections, for instance, are far less than what would be expected with statutory rates as high as 18%.[67] Moreover, it is estimated that only 5% of the VAT on domestic commodities is actually collected.[68]

Similar to its EAC partners, the Ugandan government is undertaking measures to widen the tax base by including the informal sector. This is part of its National Development Plan for 2010/11– 2014/15.[69] With the recent discovery of oil, Uganda's tax revenues can also be expected to increase dramatically, highlighting the importance of both fair taxation and transparency. A more simplified tax regime, together with better use and visible benefits of taxes collected, could encourage greater formalisation and thus widen the tax net. A larger tax base would in turn reduce some tax rates and help discourage tax evasion.

4. Government policy on tax incentives

The government is formally committed to reducing tax incentives and exemptions, which is certainly welcome. However, it is moving slowly and the extent to which this commitment will actually be implemented is questionable.

In 2009, for example, the government agreed, according to the IMF, to undertake a comprehensive review of existing tax exemptions with a view to eliminating them in the 2010/11 budget. However, this did not happen.[70] In November 2009, the Commissioner General of the URA, Ms Allen Kagina, called for a proper evaluation and management of tax incentives provided to investors to ensure they were not misused. After the investors had been given incentives, the URA should have the mandate "to go in and audit" the incentives.[71] More recently, the government has formally agreed to review and reduce its tax exemptions. Following an IMF mission to Kampala in October 2011, an IMF report notes that the Ugandan government agreed that "all tax exemptions are to be reviewed, costed in terms of lost revenue and assessed on "value-for-money" grounds".[72] According to the IMF, the Ugandan government has agreed:

> *"on the importance of eliminating additional tax exemptions and incentives in FY 2012/13 and beyond, recognising the importance of avoiding a tax competition 'race to the bottom' within the EAC Common Market".*[73]

The IMF notes that exemptions on corporate income tax, which provide a 10-year tax holiday for export businesses and for agro-processing firms, are being "streamlined" in 2011/12. This requires the URA to recertify on an annual basis the eligibility of each taxpayer to benefit from the exemptions and to narrow the scope of the eligibility criteria, particularly for agro-processing firms.[74]

> *"Eliminating tax exemptions and incentives is the right way to address Uganda's revenue gap. Many exemptions in the VAT are on goods that are mainly used as intermediate inputs rather than for final consumption thus undermining the logic of the VAT. These statutory exemptions – like the myriad investment incentives under the corporate income tax and those that ad hoc tax breaks granted by government directly – vastly complicate the work of the URA, provide scope for abuse and tax evasion, and contribute to an uneven playing field within the EAC Common Market. Importantly, the effectiveness of such exemptions in achieving investment or other social objectives is never carefully assessed, highlighting the need to establish a formal "tax expenditure" budget process." (IMF [75])*

The government has committed to the following list of measures to reduce tax incentives:

Uganda: Measures to Enhance Revenue Performance
Revenue measures to become effective from the start of FY 2011/12:
Eliminate VAT exemption on supply of motor vehicles or trailers of a carrying capacity of 3.5 tons or more designed for the transport of goods; Streamline agricultural processing exemptions and 10-year export holiday under the CIT; Eliminate government incentives for construction materials for hotels; Eliminate investment trader regime under the VAT; URA to issue and begin to enforce proposed transfer pricing guidelines; and Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures.
Revenue measures to become effective in FY 2012/13:
Introduce a capital gains tax on non-business assets of individuals; Eliminate VAT exemptions on the following intermediate products: ► Supply of petroleum fuels subject to excise duty, except for kerosene (motor spirit, gas oil, spirit type jet fuel, kerosene type jet fuel, as well as residual oils for use in thermal power generation to the national grid); ► Supply of any goods and services to the contractor and subcontractors of hydro-electric power projects; ► Supply of specialized vehicles, plant and machinery, feasibility studies, engineering designs, consultancy services and civil works related to hydro-electric power, roads and bridges construction, public water works, agriculture, education and health sectors; and ► Supply of computers, computer parts and accessories, computer software and software licenses, printers and accessories. URA to begin to pay VAT refunds directly, rather than through budgetary appropriation.
Revenue measures to become effective in FY 2013/14:
Eliminate the following VAT exemptions: ► Supply of machinery used for the processing of agricultural or dairy products; ► Supply of packaging material exclusively used by the milling industry for packing milled products or used by the dairy industry for packing milk; and ► Supply of feeds for poultry and livestock.

Source: IMF, *Uganda: Second Review under the Policy Support Instrument and Request for Waiver of Assessment Criteria, Country Report No.11*, October 2011, p.15

Recommendations

In our view, the government should:

Remove tax incentives granted to attract FDI, especially tax holidays.

In the oil sector, make public all the production sharing agreements (PSAs) and subject these to public review, with a view to eliminating the fiscal incentives provided, and to ensure that all future PSAs are shared and debated publicly.

Undertake the promised review, which should be made public, of all tax incentives with a view to reducing or removing many of them, especially those that involve the exercise of discretionary powers by ministers. Those incentives that remain must be simple to administer and shown by the government to be economically beneficial.

Provide on an annual basis, during the budget process, a publicly available tax expenditure analysis, showing annual figures on the cost to the government of tax incentives, and showing who the beneficiaries of such tax expenditure are.

Promote coordination in the EAC to address harmful tax competition. This means agreeing on the removal of all FDI-related tax incentives. It does not mean achieving full tax *harmonisation* in the EAC but increasing tax *coordination*, allowing individual countries fiscal flexibility. In turn, this principally means improving the existing draft code of conduct on tax competition in the EAC, and agreeing:

- on *minimum* rates on certain taxes to avoid harmful tax competition
- to provide a mandatory, regular exchange of information to other states concerning proposed tax rate changes
- to adhere to high transparency standards, such as the IMF Code of Good Practices on Fiscal Transparency
- to establish a robust dispute settlement mechanism
- to conduct annual, comparable and publicly available, tax expenditure analyses.

Endnotes

1 African Development Bank, *Domestic Resource Mobilisation for Poverty Reduction in East Africa: Uganda Case Study*, November 2010, p.20
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6 Based on figures in IMF, *Uganda: Second Review under the Policy Support Instrument and Request for Waiver of Assessment Criteria, Country Report No.11*, October 2011, p.24. Nominal GDP in 2009/10 of UShs 34,530
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10 Chapters 340 and 349 respectively of the Laws of Uganda
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13 The Income Tax Act, 1997 (as amended) section 21 (1) and 'Uganda Investment Incentive Regime 2010/2011', http://ura.go.ug/header/headerMain.jsp?viewPageNo=7#
14 Those exempt from income tax also include: listed institutions, local authorities, members of the armed forces, the Uganda Police Force and the Uganda Prisons Service and employees of the East African Development Bank; companies operating or leasing aircraft in domestic and international traffic; interest earned by a financial institution on a loan granted to companies for the purpose of farming, forestry, fish farming, bee keeping, animal and poultry husbandry or similar operations.
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22 Chapter 150 of the Laws of Uganda.

23 Uganda Oil and Gas Information Limited, http://ugandapetroleum.com/ugandaoilandgas_004.htm

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35 She wrote: 'We stopped issuing incentives in 1997 following the enactment of the Income Tax Act. However, the incentives issued to investors at the time continued to be valid until their expiry.' Cited in Yasin Mugerwa, 'List of tax holiday beneficiaries sent to parliament', *The Monitor*, 29 September 2010

36 Yasin Mugerwa, 'List of tax holiday beneficiaries sent to parliament', *The Monitor*, 29 September 2010

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of a large tax payer, a blue chip company in Kenya which increased the level of investment considerably within months of KRA's withdrawal of some previously enjoyed incentive. Apparently, certain categories of taxpayers, mostly, large, were allowed to offset VAT refunds against other tax liabilities, a facility which was withdrawn due to challenges in managing the same.

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